GENERAL MILLS INC
Form 10-K
July 27, 2006
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE FISCAL YEAR ENDED MAY 28, 2006

Commission File Number 1-1185

GENERAL MILLS, INC.

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	**41-0274440** (IRS Employer Identification No.)
Number One General Mills Boulevard **Minneapolis, Minnesota** **(Mail: P.O. Box 1113)** (Address of principal executive offices)	**55426** **(Mail: 55440)** (Zip Code)

(763) 764-7600
(Registrant s telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, $.10 par value	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes x No o

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes o No x

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 x No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Act. (Check one)
Large accelerated filer x Accelerated filer o Non-accelerated filer o

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

Aggregate market value of Common Stock held by non-affiliates of the registrant, based on the closing price of $48.10 per share as reported on the New York Stock Exchange on November 25, 2005 (the last business day of the registrant s most recently completed second fiscal quarter): $17,078 million.

Number of shares of Common Stock outstanding as of July 14, 2006: 352,811,767 (excluding 149,494,897 shares held in the treasury).

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant s Proxy Statement for its 2006 Annual Meeting of Stockholders are incorporated by reference into Part III.

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Part I

ITEM 1 BUSINESS

COMPANY OVERVIEW

General Mills, Inc. was incorporated in Delaware in 1928. The terms General Mills, Company, Registrant, we, us our mean General Mills, Inc. and all subsidiaries included in the consolidated financial statements unless the context indicates otherwise.

We are a leading producer of packaged consumer foods and operate exclusively in the consumer foods industry. We have multiple operating segments organized generally by product categories. We aggregate our operating segments into three reportable segments by type of customer and geographic region as follows:

- U.S. Retail;
- International; and
- Bakeries and Foodservice.

U.S. Retail reflects business with a wide variety of grocery stores, mass merchandisers, club stores, specialty stores and drug, dollar and discount chains operating throughout the United States. Our major product categories in this business segment are: ready-to-eat cereals, meals, refrigerated and frozen dough products, baking products, snacks, yogurt and organic foods. Our International segment includes a retail business in Canada that largely mirrors our U.S. Retail product mix, along with retail and foodservice businesses competing in key markets in Europe, Latin America and the Asia/Pacific region. Our Bakeries and Foodservice segment consists of products marketed throughout the United States and Canada to retail and wholesale bakeries, commercial and noncommercial foodservice distributors and operators, restaurants, and convenience stores. A more detailed description of the product categories for each reportable segment appears below. For financial information by business segment and geographic area, refer to Note Sixteen to the Consolidated Financial Statements on pages 51 through 52 in Item Eight of this report.

REPORTABLE SEGMENTS

U.S. RETAIL In the United States, we market our retail products primarily through our own sales organization, supported by advertising and other promotional activities. Our products primarily are distributed directly to retail food chains, cooperatives, membership stores and wholesalers. Certain food products also are sold through distributors and brokers. Our principal product categories in the U.S. Retail segment are as follows:

Big G Cereals We produce and sell a number of ready-to-eat cereals, including such brands as: *Cheerios, Honey Nut Cheerios, Frosted Cheerios, Apple Cinnamon Cheerios, MultiGrain Cheerios, Berry Burst Cheerios, Yogurt Burst Cheerios, Wheaties, Lucky Charms, Total* with strawberries, Whole Grain *Total, Total* Raisin Bran, *Total Honey Clusters, Trix, Golden Grahams, Wheat Chex, Corn Chex, Rice Chex, Multi-Bran Chex, Honey Nut Chex, Kix, Berry Berry Kix, Fiber One, Reese s Puffs, Cocoa Puffs, Cookie Crisp, Cinnamon Toast Crunch, French Toast Crunch, Peanut Butter Toast Crunch, Clusters, Oatmeal Crisp, Basic 4* and Raisin Nut Bran.

Meals We manufacture and sell several lines of convenient dinner products, including *Betty Crocker* dry packaged dinner mixes under the *Hamburger Helper, Tuna Helper* and *Chicken Helper* trademarks; *Old El Paso* Mexican foods and dinner kits; *Progresso* soups and ingredients; and *Green Giant* canned and frozen vegetables and meal starters. Also under the *Betty Crocker* trademark, we sell dry packaged specialty potatoes, *Potato Buds* instant mashed potatoes, *Suddenly Salad* salad mix and *Bac*O s* salad topping. We manufacture and market shelf-stable microwave meals under the *Betty Crocker Bowl Appetit!* trademark and packaged meals under the *Betty Crocker Complete Meals* trademark.

Pillsbury USA We manufacture and sell refrigerated and frozen dough products, frozen breakfast products, and frozen pizza and snack products. Refrigerated dough products marketed under the *Pillsbury* brand include *Grands!* biscuits and sweet rolls, *Golden Layers* biscuits, *Perfect Portions* biscuits, *Pillsbury Ready To Bake!* and *Big Deluxe Classics* cookies, and *Pillsbury* cookies, crescent rolls, sweet rolls, breads, biscuits and pie crust. Frozen dough product offerings include Oven Baked biscuits, rolls and other bakery goods. Breakfast products sold under the *Pillsbury* trademark include *Toaster Strudel* pastries, *Toaster Scrambles* pastries and *Pillsbury* frozen pancakes, waffles and waffle sticks. All the breakfast and refrigerated and frozen dough products incorporate the well-known *Doughboy* logo. Frozen pizza and snack products are marketed under the *Totino s* and *Jeno s* trademarks.

Baking Products We make and sell a line of dessert mixes under the *Betty Crocker* trademark, including *SuperMoist* cake mixes, Rich & Creamy and Whipped ready-to-spread frostings, Supreme brownie and dessert bar mixes, muffin mixes, *Warm Delights* microwaveable desserts and other mixes used to prepare dessert and baking items. We market a variety of baking mixes under the *Bisquick* trademark, sell pouch mixes under the *Betty Crocker* name and produce family flour under the *Gold Medal* brand introduced in 1880.

Snacks We market and produce *Pop Secret* microwave popcorn; a line of grain snacks including *Nature Valley* granola bars and Milk n Cereal bars; a line of fruit snacks

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including *Fruit Roll-Ups, Fruit By The Foot* and *Gushers;* a line of snack mix products including *Chex Mix* and *Gardetto s;* and *Bugles* savory snacks.

Yoplait We manufacture and sell yogurt products, including *Yoplait* Original, *Yoplait* Light, *Yoplait* Thick and Creamy, *Trix, Yumsters, Go-GURT* - yogurt-in-a-tube, *Yoplait Whips!* - a mousse-like yogurt, *Yoplait Nouriche* - a meal replacement yogurt drink, *Go-GURT* Smoothie - a yogurt beverage for kids, and *Yoplait* Smoothie - an all-family snack size smoothie. We also manufacture and sell a variety of cup yogurt products under the *Colombo* brand name.

Organic We market organic frozen fruits and vegetables, a wide variety of canned tomato products including tomatoes and spaghetti sauce, salsa, ketchup, soup, frozen juice concentrates, pickles, fruit spreads, granola bars and cereal under our *Cascadian Farm* and *Muir Glen* trademarks.

INTERNATIONAL Our international businesses consist of operations and sales in Canada, Latin America, Europe and the Asia/Pacific region. Outside the United States, we manufacture our products in 17 countries and distribute them in over 100 countries. In Canada, we market products in many categories, including cereals, meals, refrigerated dough products, baking products and snacks. Outside of North America, we offer numerous local brands in addition to such internationally recognized brands as *Häagen-Dazs* ice cream, *Old El Paso* Mexican foods, *Green Giant* vegetables, *Pillsbury* dough products and mixes, *Betty Crocker* mixes, *Bugles* snacks and *Nature Valley* granola bars. We manufacture certain products in the United States for export internationally, primarily in Caribbean and Latin American markets. We also sell mixes and dough products to bakery and foodservice customers outside of the United States and Canada. These international businesses are managed through 34 sales and marketing offices.

BAKERIES AND FOODSERVICE We market mixes and unbaked, par-baked and fully baked frozen dough products to retail, supermarket and wholesale bakeries under the *Pillsbury* and *Gold Medal* trademarks. In addition, we sell flour to bakery, foodservice and manufacturing customers. We also market frozen dough products, branded baking mixes, cereals, snacks, dinner and side dish products, refrigerated and soft-serve frozen yogurt, and custom food items to quick service chains and other restaurants, business and school cafeterias, convenience stores and vending companies.

JOINT VENTURES

In addition to our consolidated operations, we manufacture and sell products through several joint ventures.

Domestic Joint Venture We have a 50 percent equity interest in 8th Continent, LLC, a joint venture formed with DuPont to develop and market soy-based products. This venture began marketing a line of *8th Continent* soymilk in July 2001.

International Joint Ventures We have a 50 percent equity interest in Cereal Partners Worldwide (CPW), a joint venture with Nestlé S.A. (Nestlé) that manufactures and markets ready-to-eat cereal products in more than 130 countries and republics outside the United States and Canada. The cereal products marketed by CPW under the umbrella *Nestlé* trademark in fiscal 2006 include: *Chocapic, Cini Minis, Cookie Crisp*, Corn Flakes, *Crunch, Fitness, Fitness and Fruit, Honey Nut Cheerios, Cheerios, Nesquik, Shredded Wheat* and *Shreddies.* CPW also markets cereal bars in several European countries and manufactures private label cereals for customers in the United Kingdom. On July 14, 2006, CPW acquired the Uncle Tobys cereal business in Australia for approximately $385 million. This business had revenues of approximately $100 million for the fiscal year ended June 30, 2006. We funded our 50 percent share of the purchase price by making an additional equity contribution in CPW from cash generated from our international operations, including our international joint ventures.

We have 50 percent equity interests in the following joint ventures for the manufacture, distribution and marketing of *Häagen-Dazs* frozen ice cream products and novelties: Häagen-Dazs Japan K.K., Häagen-Dazs Korea Company Limited and Häagen-Dazs Marketing & Distribution (Philippines) Inc. We have a 49 percent equity interest in Häagen-Dazs Distributors (Thailand) Company Limited. We also have a 50 percent equity interest in Seretram, a joint venture with Co-op de Pau for the production of *Green Giant* canned corn in France.

In May 2006, we acquired a controlling financial interest in our Häagen-Dazs joint venture in the Philippines for less than $1 million.

COMPETITION

The consumer foods market is highly competitive, with numerous manufacturers of varying sizes in the United States and throughout the world. The food categories in which we participate are very competitive. Our principal competitors in these categories all have substantial financial, marketing and other resources. We also compete with private label products offered by supermarkets, mass merchants and other retailers such as club stores. Competition in our product categories is based on product innovation, product quality, price, brand recognition and loyalty, effectiveness of marketing, promotional activity and the ability to identify and satisfy consumer preferences. Our principal strategies for competing in each of our segments include superior product quality, innovative advertising, product promotion, product innovation and price. In most product categories, we compete not only with other widely advertised branded products, but also with generic

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and private label products, which are generally sold at lower prices. Internationally, we compete with both multi-national and local manufacturers, and each country includes a unique group of competitors.

CUSTOMERS

During fiscal 2006, one customer, Wal-Mart Stores, Inc. (Wal-Mart), accounted for approximately 18 percent of our consolidated net sales and 24 percent of our sales in the U.S. Retail segment. No other customer accounted for 10 percent or more of our consolidated net sales. At May 28, 2006, Wal-Mart accounted for 17 percent of our trade receivables invoiced in the U.S. Retail segment. The top five customers in our U.S. Retail segment accounted for approximately 47 percent of its fiscal 2006 net sales, and the top five customers in our Bakeries and Foodservice segment accounted for approximately 36 percent of its fiscal 2006 net sales.

SEASONALITY

In general, demand for our products is evenly balanced throughout the year. However, within our U.S. Retail segment demand for refrigerated dough, frozen baked goods and baking products is stronger in the fourth calendar quarter. Demand for *Progresso* soup and *Green Giant* canned and frozen vegetables is higher during the fall and winter months.

Internationally, demand for *Häagen-Dazs* ice cream is higher during the summer months and demand for baking mix and dough products increases during winter months. Due to the offsetting impact of these demand trends, as well as the different seasons in the northern and southern hemispheres, our international net sales are generally evenly balanced throughout the year.

TRADEMARKS AND PATENTS

Trademarks and service marks are vital to our businesses. Our products are marketed under trademarks and service marks that are owned by or licensed to us. The most significant trademarks and service marks used in our businesses are set forth in *italics* in this report. These marks include the trademarks used in our international joint ventures that are owned by or licensed to the joint ventures. In addition, some of our products are marketed under or in combination with trademarks that have been licensed from others, including *Reese s Puffs* cereal, *Hershey s* chocolate included with a variety of products, *Dora the Explorer* for yogurt and cereal, and a variety of characters and brands used on fruit snacks, including *Sunkist, My Little Pony*, *Animal Planet*, *Care Bears* and various Warner Bros. characters. We use the *Yoplait* trademark in connection with our yogurt business in the United States under the terms of a license agreement with a third party licensor. U.S. trademark and service mark registrations are generally for a term of 10 years, renewable every 10 years as long as the trademark is used in the regular course of trade.

We own the *Häagen-Dazs* trademark and have the right to use the trademark outside of the United States and Canada. We use the trademark internationally through Company-owned operations, a franchise system and joint ventures in the Asia/Pacific region. Nestlé has an exclusive royalty-free license to use the trademark in the United States and Canada.

J. M. Smucker Company (Smucker) holds an exclusive royalty-free license to use the *Doughboy* trademark and *Pillsbury* brand in the dessert mix and baking mix categories. The license is renewable without cost in 20-year increments at Smucker s discretion.

Given our focus on developing and marketing innovative, proprietary products, we consider the collective rights under our various patents, which expire from time to time, a valuable asset, but we do not believe that our businesses are materially dependent upon any single patent or group of related patents.

BACKLOG

Orders are generally filled within a few days of receipt and are subject to cancellation at any time prior to shipment. The backlog of any unfilled orders at May 28, 2006, was not material.

RAW MATERIALS AND SUPPLIES

The principal raw materials that we use are cereal grains, sugar, dairy products, vegetables, fruits, meats, vegetable oils, and other agricultural products as well as paper and plastic packaging materials, operating supplies and energy. We have some long-term fixed price contracts, but the majority of our raw materials are purchased on the open market. We believe that we will be able to obtain an adequate supply of needed ingredients and packaging materials. Occasionally and where possible, we make advance purchases of items significant to our business in order to ensure continuity of operations. Our objective is to procure materials meeting both our quality standards and our production needs at price levels that allow a targeted profit margin. Since commodities generally represent the largest variable cost in manufacturing our products, to the extent possible, we hedge the risk associated with adverse price movements using exchange-traded futures and options, forward cash contracts and over-the-counter derivatives. See also Note Six to the Consolidated Financial Statements on pages 40 through 42 in Item Eight of this report and Item Seven A on page 27 of this report.

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CAPITAL EXPENDITURES

During the fiscal year ended May 28, 2006, our aggregate capital expenditures for land, buildings and equipment were $360 million. We expect to spend approximately $425 million for capital projects in fiscal 2007, primarily for fixed assets to support further growth and increase supply chain productivity.

RESEARCH AND DEVELOPMENT

Major research and development facilities are located at the Riverside Technical Center in Minneapolis, Minnesota and the James Ford Bell Technical Center in Golden Valley (suburban Minneapolis), Minnesota. Our research and development resources are focused on new product development, product improvement, process design and improvement, packaging and exploratory research in new business areas. Research and development expenditures amounted to $173 million in fiscal 2006, $168 million in fiscal 2005 and $158 million in fiscal 2004.

EMPLOYEES

At May 28, 2006, we had approximately 28,100 full- and part-time employees.

FOOD QUALITY AND SAFETY REGULATION

The manufacture and sale of consumer food products is highly regulated. In the United States, our activities are subject to regulation by various government agencies, including the Food and Drug Administration, Department of Agriculture, Federal Trade Commission, Department of Commerce and Environmental Protection Agency, as well as various state and local agencies. Our business is also regulated by similar agencies outside of the United States.

ENVIRONMENTAL MATTERS

As of July 27, 2006, we were involved with the following active cleanup sites associated with the alleged release or threatened release of hazardous substances or wastes:

Site	Chemical of Concern
Central Steel Drum, Newark, New Jersey	No single hazardous material specified
East Hennepin, Minneapolis, Minnesota	Trichloroethylene
Vallejo, California	Petroleum fuel products
King s Road Landfill, Toledo, Ohio	No single hazardous material specified
Kipp, Kansas	Carbon tetrachloride
Northside Sanitary Landfill, Zionsville, Indiana	No single hazardous material specified
Operating Industries, Los Angeles, California	No single hazardous material specified
Sauget Landfill, Sauget, Illinois	No single hazardous material specified
Safer Textiles, Moonachie, New Jersey	Tetrachloroethylene
Stuckey s, Doolittle, Missouri	Petroleum fuel products

Site	Chemical of Concern

These matters involve several different actions, including administrative proceedings commenced by regulatory agencies and demand letters by regulatory agencies and private parties.

We recognize that our potential exposure with respect to any of these sites may be joint and several, but have concluded that our probable aggregate exposure is not material. This conclusion is based upon, among other things: our payments and accruals with respect to each site; the number, ranking and financial strength of other potentially responsible parties identified at each of the sites; the status of the proceedings, including various settlement agreements, consent decrees or court orders; allocations of volumetric waste contributions and allocations of relative responsibility among potentially responsible parties developed by regulatory agencies and by private parties; remediation cost estimates prepared by governmental authorities or private technical consultants; and our historical experience in negotiating and settling disputes with respect to similar sites.

Our operations are subject to the Clean Air Act, Clean Water Act, Resource Conservation and Recovery Act, Comprehensive Environmental Response, Compensation and Liability Act, and the Federal Insecticide, Fungicide and Rodenticide Act, and all similar state environmental laws applicable to the jurisdictions in which we operate.

Based on current facts and circumstances, we believe that neither the results of our environmental proceedings

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nor our compliance in general with environmental laws or regulations will have a material adverse effect upon our capital expenditures, earnings or competitive position.

EXECUTIVE OFFICERS

The section below provides information regarding our executive officers, together with their ages and business experience as of July 14, 2006:

Y. Marc Belton, age 47, is Executive Vice President, Worldwide Health, Brand and New Business Development. Mr. Belton joined General Mills in 1983 and has held various positions throughout General Mills, including President of Snacks Unlimited from 1994 to 1997, New Ventures from 1997 to 1999 and Big G Cereals from 1999 to 2002. Mr. Belton had oversight responsibility for Yoplait, General Mills Canada and New Business Development from 2002 to May 2005, and has had oversight responsibility for Worldwide Health, Brand and New Business Development since May 2005. Mr. Belton was elected a Vice President of General Mills in 1991, a Senior Vice President in 1994 and an Executive Vice President in June 2006. Mr. Belton is a director of Navistar International Corporation.

Randy G. Darcy, age 55, is Executive Vice President, Worldwide Operations and Technology. Mr. Darcy joined General Mills in 1987, was named Vice President, Director of Manufacturing, Technology and Operations in 1989, served as Senior Vice President, Supply Chain from 1994 to 2003 and Senior Vice President, Chief Technical Officer with responsibilities for Supply Chain, Research and Development, and Quality and Regulatory Operations from 2003 to 2005. He was named to his present position in May 2005. Mr. Darcy was employed by The Procter & Gamble Company from 1973 to 1987, serving in a variety of management positions.

Rory A. M. Delaney, age 61, is Senior Vice President, Strategic Technology Development. Mr. Delaney joined General Mills in this position in 2001 from The Pillsbury Company (Pillsbury) where he spent a total of eight years, last serving as Senior Vice President of Technology, responsible for the development and application of food technologies for Pillsbury s global operations. Prior to joining Pillsbury, Mr. Delaney spent 18 years with PepsiCo, Inc., last serving as Senior Vice President of Technology for Frito-Lay North America.

Ian R. Friendly, age 46, is Executive Vice President and Chief Operating Officer, U.S. Retail. Mr. Friendly joined General Mills in 1983 and held various positions before becoming Vice President of Cereal Partners Worldwide in 1994, President of Yoplait in 1998, a Senior Vice President of General Mills in 2000 and President of the Big G Cereals division in 2002. In May 2004, Mr. Friendly was named Chief Executive Officer of Cereal Partners Worldwide. He was named to his present position in June 2006.

James A. Lawrence, age 53, is Vice Chairman and Chief Financial Officer. Mr. Lawrence joined General Mills as Chief Financial Officer in 1998 from Northwest Airlines where he was Executive Vice President, Chief Financial Officer. Prior to joining Northwest Airlines in 1996, he was at Pepsi-Cola International, serving as President and Chief Executive Officer for its operations in Asia, the Middle East and Africa. He was elected Vice Chairman of General Mills in June 2006. Mr. Lawrence is a director of Avnet, Inc.

Siri S. Marshall, age 58, is Senior Vice President, General Counsel, Chief Governance and Compliance Officer and Secretary. Ms. Marshall joined General Mills in 1994 as Senior Vice President, General Counsel and Secretary from Avon Products, Inc. where she spent 15 years, last serving as Senior Vice President, General Counsel and Secretary. Ms. Marshall was named Chief Governance and Compliance Officer in May 2005. Ms. Marshall is a director of Ameriprise Financial, Inc.

Christopher D. O Leary, age 47, is Executive Vice President and Chief Operating Officer, International. Mr. O Leary joined General Mills in 1997 as Vice President, Corporate Growth. He was elected a Senior Vice President in 1999 and President of the Meals division in 2001. Mr. O Leary was named to his present position in June 2006. Prior to joining General Mills, he spent 17 years at PepsiCo, Inc., last serving as President and Chief Executive Officer of the Hostess Frito-Lay business in Canada. Mr. O Leary is a director of Telephone & Data Systems, Inc.

Michael A. Peel, age 56, is Senior Vice President, Human Resources and Corporate Services. Mr. Peel joined General Mills in this position in 1991 from PepsiCo, Inc. where he spent 14 years, last serving as Senior Vice President, Human Resources, responsible for PepsiCo Worldwide Foods. Mr. Peel is a director of Select Comfort Corporation.

Kendall J. Powell, age 52, is President, Chief Operating Officer and a director of General Mills. Mr. Powell joined General Mills in 1979 and held various positions before becoming Vice President, Marketing Director of Cereal Partners Worldwide in 1990. He was named President of Yoplait in 1996, President of the Big G Cereals division in 1997 and Senior Vice President of General Mills in 1998. From 1999 to 2004, he was Chief Executive Officer of Cereal Partners Worldwide. He was elected Executive Vice President of General Mills in 2004 with responsibility for our Meals, Pillsbury USA, Baking Products and Bakeries and Foodservice divisions. Mr. Powell was named Executive Vice President and Chief Operating Officer, U.S. Retail in May 2005, and was named to his present position in June 2006.

Jeffrey J. Rotsch, age 55, is Executive Vice President, Worldwide Sales and Channel Development. Mr. Rotsch joined General Mills in 1974 and served as the President of several divisions, including Betty Crocker and Big G Cereals. He served as Senior Vice President from 1993 to 2005 and as

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President, Consumer Foods Sales, from 1997 to 2005. Mr. Rotsch was named to his present position in May 2005.

Stephen W. Sanger, age 60, has been Chairman of the Board and Chief Executive Officer of General Mills since 1995. Mr. Sanger joined General Mills in 1974 and served as the head of several business units, including Yoplait and Big G Cereals. He was elected a Senior Vice President in 1989, an Executive Vice President in 1991, Vice Chairman in 1992 and President in 1993. He is a director of Target Corporation and Wells Fargo & Company.

Christina L. Shea, age 53, is Senior Vice President, External Relations and President, General Mills Foundation. Ms. Shea joined General Mills in 1977 and has held various positions in the Big G Cereals, Yoplait, Gold Medal, Snacks and Betty Crocker divisions. From 1994 to 1999, she was President of the Betty Crocker division and was named a Senior Vice President of General Mills in 1998. She became President of General Mills Community Action and the General Mills Foundation in 2002 and was named to her current position in May 2005.

Kenneth L. Thome, age 58, is Senior Vice President, Financial Operations. Mr. Thome joined General Mills in 1969 and was named Vice President, Controller for the Convenience and International Foods Group in 1985, Vice President, Controller for International Foods in 1989, Vice President, Director of Information Systems in 1991 and was elected to his present position in 1993.

AVAILABLE INFORMATION

Availability of Reports We are a reporting company under the Securities Exchange Act of 1934, as amended (1934 Act), and file reports, proxy statements and other information with the Securities and Exchange Commission (SEC). The public may read and copy any of our filings at the SEC s Public Reference Room at 100 F Street N.E., Washington, D.C. 20549. You may obtain information on the operation of the Public Reference Room by calling the SEC at (800) 732-0330. Because we make filings to the SEC electronically, you may access this information at the SEC s internet website: *www.sec.gov.* This site contains reports, proxies and information statements and other information regarding issuers that file electronically with the SEC.

Website Access Our website is *www.generalmills.com.* We make available, free of charge at the Investors portion of this website, annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the 1934 Act as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC. Reports of beneficial ownership filed pursuant to Section 16(a) of the 1934 Act are also available on our website.

CAUTIONARY STATEMENT RELEVANT TO FORWARD-LOOKING INFORMATION FOR THE PURPOSE OF SAFE HARBOR PROVISIONS OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

This report contains or incorporates by reference forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 that are based on our management s current expectations and assumptions. We and our representatives also may from time to time make written or oral forward-looking statements, including statements contained in our filings with the SEC and in our reports to stockholders.

The words or phrases will likely result, are expected to, will continue, is anticipated, estimate, plan, proje
similar expressions identify forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Such statements are subject to certain risks and uncertainties that could cause actual results to differ materially from historical results and those currently anticipated or projected. We wish to caution you not to place undue reliance on any such forward-looking statements, which speak only as of the date made.

In connection with the safe harbor provisions of the Private Securities Litigation Reform Act of 1995, we are identifying important factors that could affect our financial performance and could cause our actual results for future periods to differ materially from any opinions or statements expressed with respect to future periods in any current statements.

Our future results could be affected by a variety of factors, such as: competitive dynamics in the consumer foods industry and the markets for our products, including new product introductions, advertising activities, pricing actions and promotional activities of our competitors; economic conditions, including changes in inflation rates, interest rates or tax rates; product development and innovation; consumer acceptance of new products and product improvements; consumer reaction to pricing actions and changes in promotion levels; acquisitions or dispositions of businesses or assets; changes in capital structure; changes in laws and regulations, including labeling and advertising regulations; changes in accounting standards and the impact of significant accounting estimates; product quality and safety issues, including recalls and product liability; changes in customer demand for our products; effectiveness of advertising, marketing and promotional programs; changes in consumer behavior, trends and preferences, including weight loss trends; consumer perception of health-related issues, including obesity; consolidation in the retail environment; changes in purchasing and inventory levels of significant customers; fluctuations in the cost and availability of supply chain resources, including raw materials, packaging and energy; disruptions or inefficiencies in the supply chain; benefit plan expenses due to changes in

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plan asset values and discount rates used to determine plan liabilities; resolution of uncertain income tax matters; foreign economic conditions, including currency rate fluctuations; and political unrest in foreign markets and economic uncertainty due to terrorism or war.

You should also consider the risk factors that we identify on pages 7 through 10 in Item One A of this report, which could also affect our future results.

We undertake no obligation to publicly revise any forward-looking statements to reflect future events or circumstances.

ITEM 1A RISK FACTORS

Various risks and uncertainties could affect our business. Any of the risks described below or elsewhere in this report or our other filings with the SEC could materially adversely affect our business, financial condition and results of operations. It is not possible to predict or identify all risk factors. Additional risks and uncertainties not presently known to us or that we currently believe to be immaterial also may adversely affect our business, financial condition and results of operations in the future. Therefore, the following is not intended to be a complete discussion of all potential risks or uncertainties.

The food categories in which we participate are very competitive, and if we are not able to compete effectively, our results of operations would be adversely affected.

The food categories in which we participate are very competitive. Our principal competitors in these categories all have substantial financial, marketing and other resources. We also compete with private label products offered by supermarkets, mass merchants and other retailers such as club stores. Competition in our product categories is based on product innovation, product quality, price, brand recognition and loyalty, effectiveness of marketing, promotional activity and the ability to identify and satisfy consumer preferences. If our large competitors were to decrease their pricing or were to increase their promotional spending, we could choose to do the same, which could adversely affect our margins and profitability. If we did not do the same, our revenues and market share could be adversely affected. Our market share and revenue growth could also be adversely impacted if we are not successful in introducing innovative products in response to changing consumer demands or by new product introductions of our competitors. If we are unable to build and sustain brand equity by offering recognizably superior product quality, we may be unable to maintain premium pricing over private label products.

We may be unable to maintain our profit margins in the face of a consolidating retail environment.

Our five largest customers in our U.S. Retail segment together accounted for approximately 47 percent of that segment s net sales for fiscal 2006. The loss of any large customer for an extended length of time could adversely affect our sales and profits. In addition, as the retail grocery trade continues to consolidate and mass market retailers become larger, our large retail customers may seek to use their position to improve their profitability through improved efficiency, lower pricing and increased promotional programs. If we are unable to use our scale, marketing expertise, product innovation and category leadership positions to respond to these demands, our profitability or volume growth could be negatively impacted.

Price changes for the commodities we depend on for raw materials and packaging may adversely affect our profitability.

The raw materials used in our business include cereal grains, sugar, dairy products, vegetables, fruits, meats, vegetable oils, and other agricultural products as well as paper and plastic packaging materials, operating supplies and energy. These items are largely commodities that experience price volatility caused by external conditions such as weather and product scarcity, commodity market fluctuations, currency fluctuations and changes in governmental agricultural programs. Commodity price changes may result in unexpected increases in raw material, packaging and energy costs. If we are unable to increase productivity to offset these increased costs or increase our prices as a result of consumer sensitivity to pricing or otherwise, we may experience reduced margins and profitability. We do not fully hedge against changes in commodity prices and the hedging procedures that we do use may not always work as we intend.

If we are not efficient in our production, our profitability could suffer as a result of the highly competitive environment in which we operate.

Our future success and earnings growth depends in part on our ability to be efficient in the production and manufacture of our products in highly competitive markets. Our ability to gain additional efficiencies may become more difficult over time as we take advantage of existing opportunities. Our failure to reduce costs through productivity gains or by eliminating redundant costs resulting from acquisitions could adversely affect our profitability and also weaken our competitive position. Further, many productivity initiatives involve complex reorganization of

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manufacturing facilities and production lines. Such manufacturing realignment may result in the interruption of production which may negatively impact product volume and margins.

Disruption of our supply chain could adversely affect our business.

Our ability to make, move and sell products is critical to our success. Damage or disruption to our manufacturing or distribution capabilities due to weather, natural disaster, fire, terrorism, pandemic, strikes or other reasons could impair our ability to manufacture or sell our products. Failure to take adequate steps to mitigate the likelihood or potential impact of such events, or to effectively manage such events if they occur, particularly when a product is sourced from a single location, could adversely affect our business and results of operations, as well as require additional resources to restore our supply chain.

We may be unable to anticipate changes in consumer preferences and trends, which may result in decreased demand for our products.

Our success depends in part on our ability to anticipate the tastes and eating habits of consumers and to offer products that appeal to their preferences. Consumer preferences change from time to time and can be affected by a number of different trends. Our failure to anticipate, identify or react to these changes and trends, and to introduce new and improved products on a timely basis, could result in reduced demand for our products, which would in turn cause our revenues and profitability to suffer. Similarly, demand for our products could be affected by consumer concerns regarding the health effects of ingredients such as trans fats, sugar, processed wheat or other product ingredients or attributes.

We may be unable to grow our market share or add products that are in faster growing and more profitable categories.

The food industry s growth potential is constrained by population growth. Our success depends in part on our ability to grow our business faster than populations are growing in the markets that we serve. One way to achieve that growth is to enhance our portfolio by adding innovative new products in faster growing and more profitable categories. Our future results will also depend on our ability to increase market share in our existing product categories. If we do not succeed in developing innovative products for new and existing categories, our growth may slow, which could adversely affect our profitability.

Customer demand for our products may be limited in future periods as a result of increased purchases in response to promotional activity.

Our unit volume in the last week of each quarter is consistently higher than the average for the preceding weeks of the quarter. In comparison to the average daily shipments in the first 12 weeks of a quarter, the final week of each quarter has approximately two to four days worth of incremental shipments (based on a five-day week), reflecting increased promotional activity at the end of the quarter. This increased activity includes promotions to assure that our customers have sufficient inventory on hand to support major marketing events or increased seasonal demand early in the next quarter, as well as promotions intended to help achieve interim unit volume targets. If, due to quarter-end promotions or other reasons, our customers purchase more product in any reporting period than end-consumer demand will require in future periods, our sales level in future reporting periods could be adversely affected.

Economic downturns could cause consumers to shift their food purchases from our higher priced premium products to lower priced items, which could adversely affect our results of operations.

The willingness of consumers to purchase premium branded food products depends in part on local economic conditions. In periods of economic uncertainty, consumers tend to purchase more private label or other economy brands. In those circumstances, we could experience a reduction in sales of higher margin products or a shift in our product mix to lower margin offerings. In addition, as a result of economic conditions or otherwise, we may be unable to raise our prices as a result of increased consumer sensitivity to pricing. Any of these events could have an adverse effect on our results of operations.

Our international operations are subject to political and economic risks.

In fiscal 2006, approximately 16 percent of our consolidated net sales were generated outside of the United States. We are accordingly subject to a number of risks relating to doing business internationally, any of which could significantly harm our business. These risks include:

political and economic instability;

exchange controls and currency exchange rates;

foreign tax treaties and policies; and

restrictions on the transfer of funds to and from foreign countries.

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Our financial performance on a U.S. dollar denominated basis is subject to fluctuations in currency exchange rates. These fluctuations could cause our results of operations to vary materially from period to period. From time to time, we enter into agreements that are intended to reduce the effects of our exposure to currency fluctuations, but these agreements may not be effective in significantly reducing our exposure.

Concerns with the safety and quality of food products could cause consumers to avoid our products.

We could be adversely affected if consumers in our principal markets lose confidence in the safety and quality of certain food products or ingredients. Adverse publicity about these types of concerns, whether or not valid, may discourage consumers from buying our products or cause production and delivery disruptions.

If our food products become adulterated or misbranded, we might need to recall those items and may experience product liability claims if consumers are injured.

We may need to recall some of our products if they become adulterated or misbranded. We may also be liable if the consumption of any of our products causes injury. A widespread product recall could result in significant losses due to the costs of a recall, the destruction of product inventory and lost sales due to the unavailability of product for a period of time. We could also suffer losses from a significant product liability judgment against us. A significant product recall or product liability case could also result in adverse publicity, damage to our reputation and a loss of consumer confidence in our food products, which could have a material adverse effect on our business results and the value of our brands.

New regulations or regulatory-based claims could adversely affect our business.

Food production and marketing are highly regulated by a variety of federal, state, local and foreign agencies. Changes in laws or regulations that impose additional regulatory requirements on us could increase our cost of doing business or restrict our actions, causing our results of operations to be adversely affected. In addition, we advertise our products and could be the target of claims relating to false or deceptive advertising under federal, state and foreign laws and regulations.

We have a substantial amount of indebtedness, which could limit financing and other options and in some cases adversely affect our ability to pay dividends.

As of May 28, 2006, we had total debt and minority interests of approximately $7.2 billion. The agreements under which we have issued indebtedness do not prevent us from incurring additional unsecured indebtedness in the future.

Our level of indebtedness may limit our:

- ability to obtain additional financing for working capital, capital expenditures or general corporate purposes, particularly if the ratings assigned to our debt securities by rating organizations were revised downward; and
- flexibility to adjust to changing business and market conditions and may make us more vulnerable to a downturn in general economic conditions.

There are various financial covenants and other restrictions in our debt instruments and minority interests. If we fail to comply with any of these requirements, the related indebtedness and minority interests (and other unrelated indebtedness) could become due and payable prior to its stated maturity. A default under our debt instruments and minority interests may also significantly affect our ability to obtain additional or alternative financing.

If our subsidiary General Mills Cereals, LLC (GMC) fails to make required distributions to the holders of the B-1 interests of GMC, we will be restricted from paying any dividends (other than dividends in the form of shares of common stock) or other distributions on shares of our common stock and may not repurchase or redeem shares of our common stock until such distributions are paid.

Our ability to make scheduled payments on or to refinance our debt and other obligations will depend on our operating and financial performance, which in turn is subject to prevailing economic conditions and to financial, business and other factors beyond our control.

Volatility in the securities markets, interest rates and other factors or changes in our employee base could substantially increase our pension and postretirement costs.

We sponsor a number of defined benefit plans for employees in the United States, Canada and various foreign locations, including pension, retiree health and welfare, severance and other post-employment plans. Our major pension plans are funded, with trust assets invested in a diversified portfolio. Changes in interest rates, mortality rates, health care costs, early retirement rates, investment returns and the market value of plan assets can affect the funded status of our pension and postretirement plans and cause volatility in the net periodic benefit cost and future funding requirements of the plans. Although the aggregate fair value of our pension and postretirement plan assets exceeded the aggregate pension and postretirement benefit obligations as of May 28, 2006, a significant increase in future funding requirements could have a negative impact on our results of operations or cash flows from operations.

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If other potentially responsible parties (PRPs) are unable to contribute to remediation costs at certain contaminated sites, our costs for remediation could be material.

We are subject to various federal, state, local and foreign environmental and health and safety laws and regulations. Under certain of these laws, namely the Comprehensive Environmental Response, Compensation and Liability Act and its state counterparts, liability for investigation and remediation of hazardous substance contamination at currently or formerly owned or operated facilities or at third-party waste disposal sites is joint and several. We currently are involved in active remediation efforts at certain sites where we have been named a PRP. If other PRPs at these sites are unable to contribute to remediation costs, we could be held responsible for all or their portion of the remediation costs, and those costs could be material. We cannot assure you that our costs in relation to these environmental matters or compliance with environmental laws in general will not exceed our reserves or otherwise have an adverse effect on our business and results of operations.

An impairment in the carrying value of goodwill or other intangibles could negatively affect our consolidated results of operations and net worth.

Goodwill represents the difference between the purchase prices of acquired companies and the related fair values of net assets acquired. Goodwill is not subject to amortization and is tested for impairment annually and whenever events or changes in circumstances indicate that an impairment may have occurred. Impairment testing is performed for each of our reporting units. We compare the carrying amount of goodwill for a reporting unit with its fair value and if the carrying amount of goodwill exceeds its fair value, an impairment has occurred.

The costs of patents, copyrights and other intangible assets with finite lives are amortized over their estimated useful lives. Intangibles with indefinite lives, principally brands, are carried at cost. Finite and indefinite-lived intangible assets are tested for impairment annually and whenever events or changes in circumstances indicate that their carrying value may not be recoverable. An impairment loss would be recognized when fair value is less than the carrying amount of the intangible.

Our estimates of fair value are determined based on a discounted cash flow model using inputs from our annual long-range planning process. We also make estimates of discount rates, perpetuity growth assumptions and other factors.

As of May 28, 2006, we had $10.3 billion of goodwill and other intangible assets. Events and conditions that could result in an impairment include changes in the industries in which we operate, including competition and advances in technology; a significant product liability or intellectual property claim; or other factors leading to reduction in expected sales or profitability. Should the value of goodwill or other intangible assets become impaired, our consolidated net earnings and net worth may be materially adversely affected by a non-cash charge.

Resolution of uncertain income tax matters could adversely affect our cash flows from operations.

We accrue income tax liabilities for potential assessments related to uncertain tax positions in a variety of taxing jurisdictions. An unfavorable resolution of these matters, including the accounting for losses recorded as part of the Pillsbury transaction, could have a material adverse effect on our cash flows from operations.

ITEM 1B UNRESOLVED STAFF COMMENTS

None.

ITEM 2 PROPERTIES

We own our principal executive offices and main research facilities, which are located in the Minneapolis, Minnesota metropolitan area. We operate numerous manufacturing facilities and maintain many sales and administrative offices and warehouses, mainly in the United States. Other facilities are operated in Canada and elsewhere around the world.

As of July 27, 2006, we operated 66 facilities for the production of a wide variety of food products. Of these plants, 34 are located in the United States (one of which is leased), 15 in the Asia/Pacific region (10 of which are leased), six in Canada (two of which are leased), five in Europe (one of which is leased), five in Latin America and Mexico, and one in South Africa. The following table lists the locations of our principal production facilities, all of which are owned by us, that principally support our U.S. Retail segment unless otherwise noted:

Arras, France	International segment
Irapuato, Mexico	
Trenton, Ontario	Bakeries & Foodservice segment
Carson, California	
Lodi, California	
Covington, Georgia	
Belvidere, Illinois	
West Chicago, Illinois	
New Albany, Indiana	
Cedar Rapids, Iowa	

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Reed City, Michigan	
Chanhassen, Minnesota	Bakeries & Foodservice segment
Hannibal, Missouri	
Joplin, Missouri	Bakeries & Foodservice segment
Vineland, New Jersey	
Albuquerque, New Mexico	
Buffalo, New York	
Martel, Ohio	Bakeries & Foodservice segment
Wellston, Ohio	
Murfreesboro, Tennessee	
Milwaukee, Wisconsin	

We own flour mills at eight locations: Vallejo, California (not currently operating); Vernon, California; Avon, Iowa; Minneapolis, Minnesota (2); Kansas City, Missouri; Great Falls, Montana; and Buffalo, New York. We also operate six terminal grain elevators (in Minnesota and Wisconsin, two of which are leased), and have country grain elevators in seven locations (primarily in Idaho), plus additional seasonal elevators (primarily in Idaho).

We also own or lease warehouse space aggregating approximately 12.2 million square feet, of which approximately 9.6 million square feet are leased. We lease a number of sales and administrative offices in the United States, Canada and elsewhere around the world, totaling approximately 2.8 million square feet.

ITEM 3 LEGAL PROCEEDINGS

We are the subject of various pending or threatened legal actions in the ordinary course of our business. All such matters are subject to many uncertainties and outcomes that are not predictable with assurance. In our management s opinion, there were no claims or litigation pending as of May 28, 2006, that are reasonably likely to have a material adverse effect on our consolidated financial position or results of operations.

ITEM 4 SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

Part II

ITEM 5 MARKET FOR REGISTRANT S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Our common stock is listed on the New York Stock Exchange. On July 14, 2006, there were approximately 34,675 record holders of our common stock. Information regarding the market prices for our common stock and dividend payments for the two most recent fiscal years is set forth in Note Eighteen to the Consolidated Financial Statements on page 53 in Item Eight of this report. Information regarding restrictions on our ability to pay dividends in certain situations is set forth in Note Eight to the Consolidated Financial Statements on pages 43 and 44 in Item Eight of this report.

The following table sets forth information with respect to shares of our common stock that we purchased during the three fiscal months ended May 28, 2006:

Issuer Purchases of Equity Securities

Period	Total Number of Shares Purchased[(a)]	Average Price Paid Per Share	Total Number of Shares Purchased as Part of a Publicly Announced Program	Maximum Number of Shares that may yet be Purchased Under the Program[(b)]
February 27, 2006 through April 2, 2006	111,772	$ 49.55		
April 3, 2006 through April 30, 2006	445,466	$ 49.06		
May 1, 2006 through May 28, 2006	1,182,100	$ 49.79		
Total	1,739,338	$ 49.59		

(a) The total number of shares purchased includes: (i) 231,500 shares purchased from the ESOP fund of our 401(k) savings plan; (ii) 8,338 shares of restricted stock withheld for the payment of withholding taxes upon vesting of restricted stock; and (iii) 1,499,500 shares purchased in the open market.

(b) On February 21, 2000, we announced that our Board of Directors authorized us to repurchase up to 170 million shares of our common stock to be held in our treasury. The Board did not specify a time period or an expiration date for the authorization.

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ITEM 6 SELECTED FINANCIAL DATA

The following table sets forth selected financial data for each of the fiscal years in the five-year period ended May 28, 2006:

In Millions, Except per Share Data Fiscal Year Ended	May 28, 2006	May 29, 2005	May 30, 2004	May 25, 2003	May 26, 2002
Operating data:					
Net sales	$ 11,640	$ 11,244	$ 11,070	$ 10,506	$ 7,949
Gross margin	4,674	4,410	4,486	4,397	3,287
Gross margin as a percentage of net sales	40.1%	39.2%	40.5%	41.9%	41.4%
Interest, net	399	455	508	547	416
Net earnings	1,090	1,240	1,055	917	458
Financial position at year-end:					
Land, buildings and equipment	2,997	3,111	3,197	3,087	2,842
Total assets	18,207	18,066	18,448	18,227	16,540
Long-term debt, excluding current portion	2,415	4,255	7,410	7,516	5,591
Stockholders equity	5,772	5,676	5,248	4,175	3,576
Average shares outstanding (diluted)	379	409	413	395	342
Cash flow data:					
Net cash provided by operating activities	1,771	1,711	1,461	1,631	913
Capital expenditures	360	434	653	750	540
Net cash provided (used) by investing activities	(292)	496	(470)	(1,018)	(3,271)
Net cash provided (used) by financing activities	(1,405)	(2,385)	(943)	(885)	3,269
Per share data:					
Net earnings basic	3.05	3.34	2.82	2.49	1.38
Net earnings diluted	2.90	3.08	2.60	2.35	1.34
Dividends	1.34	1.24	1.10	1.10	1.10

Gross margin is defined as net sales less cost of sales.

Fiscal 2004 was a 53-week year; all other fiscal years were 52 weeks.

Diluted earnings per share for fiscal 2004 and 2003 have been restated for the adoption of EITF Issue 04-8.

Our acquisition of Pillsbury on October 31, 2001, significantly affected our financial condition and results of operations beginning in fiscal 2002.

ITEM 7 MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

EXECUTIVE OVERVIEW

We are a global consumer foods company. We develop differentiated food products and market these value-added products under unique brand names. We work continuously on product innovation to improve our established brands and to create new products that meet consumers evolving needs and preferences. In addition, we build the equity of our brands over time with strong consumer-directed marketing and innovative merchandising. We believe our brand-building strategy is the key to winning and sustaining leading share positions in markets around the globe.

Our businesses are organized into three reportable segments. U.S. Retail reflects business with a wide variety of grocery stores, mass merchandisers, club stores, specialty stores and drug, dollar and discount chains operating throughout the United States. Our major product categories in this business segment are ready-to-eat cereals, meals, refrigerated and frozen dough products, baking products, snacks, yogurt and organic foods. Our International segment is made up of retail businesses outside of the United States, including a retail business in Canada that largely mirrors our U.S. Retail product mix, and foodservice businesses outside of the United States and Canada. Our Bakeries and Foodservice segment consists of products marketed throughout the United States and Canada to retail and wholesale bakeries, commercial and noncommercial foodservice distributors and operators, restaurants, and convenience stores.

Our fundamental business goal is to generate superior returns for our stockholders over the long term. In the most recent fiscal year, our total return to stockholders, including stock price appreciation and dividends, was 7.2 percent, while the S&P 500 Index returned 8.8 percent; from fiscal 2001 to 2006, our total return to stockholders averaged 6.8 percent per year while the S&P 500 Index posted a 1.8 percent average annual return over the same period.

Our long-term growth objectives are:

- low single-digit average annual growth in net sales;
- mid-single-digit average annual growth in total segment operating profit (see page 25 for our discussion of this measure not defined by generally accepted accounting principles (GAAP)); and
- high single-digit average annual growth in earnings per share (EPS).

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These measures, combined with an attractive dividend yield and improvement in return on capital, drive the management of our business.

For the fiscal year ended May 28, 2006, our net sales grew 4 percent and total segment operating profit grew 5 percent, in line with our long-term goals. Diluted EPS decreased 6 percent in fiscal 2006; however, excluding the EPS effects of our convertible debentures in both fiscal years and the fiscal 2005 net benefit of gains on divestitures and debt repurchase costs, our diluted EPS grew 8 percent, in line with our long-term goal (see page 24 for our discussion of this measure not defined by GAAP). Our net cash provided by operations increased to nearly $1.8 billion in 2006, enabling us to: increase our annual dividend payments by 8 percent from fiscal 2005; continue to return cash to stockholders via share repurchases, which totaled $885 million in fiscal 2006; and repay $189 million of debt. We continued to reinvest in the long-term growth in our brands, increasing advertising by 8 percent from fiscal 2005, and we also continued to make significant capital investments to support future growth and productivity, as we spent $360 million in capital expenditures in fiscal 2006. Finally, our return on average total capital improved by 60 basis points (see page 25 for our discussion of this measure not defined by GAAP).

Results for fiscal 2006 were negatively impacted by increased fuel and commodity costs and higher advertising spending. Details of our financial results are provided in the Fiscal 2006 Consolidated Results of Operations section below.

As we begin fiscal 2007, we have momentum in several of our key businesses. We must sustain that momentum and restore net sales growth in two operating units that did not grow in fiscal 2006 Big G cereals and Pillsbury USA. We plan to launch new products, achieve competitive levels of retailer merchandising activity and increase advertising in Big G cereals in fiscal 2007. In Pillsbury USA, we plan to launch new products and focus consumer marketing support to improve product mix. We expect our worldwide food business to achieve another year of good sales and operating profit growth. We also intend to deliver more growth from new products and accelerate our performance in fast-growing channels such as drug stores, dollar stores and club formats. Finally, we plan to expand our margins by focusing on realizing price increases, managing our input costs, and achieving productivity through supply chain and administrative cost-saving efforts. We expect our fiscal 2007 interest expense to be $40 million higher than in fiscal 2006, primarily due to higher interest rates. We also expect the impact of the adoption of a new accounting standard for stock-based compensation to reduce earnings by $0.11 to $0.12 per diluted share in fiscal 2007, and we expect our effective tax rate to increase 75 to 125 basis points over the fiscal 2006 effective rate of 34.5 percent.

FISCAL 2006 CONSOLIDATED RESULTS OF OPERATIONS

For fiscal 2006, we reported diluted EPS of $2.90, down 6 percent from $3.08 per share earned in fiscal 2005. Excluding the effects of our convertible debentures in both fiscal years and excluding the fiscal 2005 net benefit of gains on divestitures and debt repurchase costs, diluted EPS increased 8 percent from $2.75 in fiscal 2005 to $2.98 in fiscal 2006. Earnings after tax were $1,090 million in fiscal 2006, down 12 percent from $1,240 million in fiscal 2005, reflecting the net benefit of gains on divestitures and debt repurchase costs in fiscal 2005.

Net sales for fiscal 2006 grew 4 percent to $11.6 billion, driven by 2 percentage points of unit volume growth, primarily in U.S. Retail and International, and 1 percentage point of growth from pricing and product mix across many of our businesses. Promotional spending and foreign currency exchange effects were flat compared to fiscal 2005. The components of net sales growth are shown in the following table:

Components of Net Sales Growth

	Fiscal 2006 vs. 2005
Unit Volume Growth	+2 pts
Price/Product Mix/Foreign Currency Exchange	+1 pt
Trade and Coupon Promotion Expense	Flat
Net Sales Growth	+4%

Table does not add due to rounding.

Cost of sales was up $132 million in fiscal 2006 versus fiscal 2005, primarily due to unit volume increases, as manufacturing efficiencies largely offset cost increases due to inflation. Also, the year-over-year change in cost of sales was favorably impacted by the following costs incurred in fiscal 2005: $18 million in expense from accelerated depreciation associated with exit activities, as described below; and $5 million of product recall costs. Cost of sales as a percent of net sales decreased from 60.8 percent in fiscal 2005 to 59.9 percent in fiscal 2006.

Selling, general and administrative (SG&A) expense increased by $260 million in fiscal 2006 versus fiscal 2005. SG&A as a percent of net sales increased from 21.5 percent in fiscal 2005 to 23.0 percent in fiscal 2006. The increase in SG&A from fiscal 2005 was largely the result of a $97 million increase in domestic employee benefit costs, including incentives; an $86 million increase in customer freight expense, primarily due to increased fuel costs; a $46 million increase in consumer marketing spending; and $23 million of increases in our environmental reserves.

Net interest expense for fiscal 2006 totaled $399 million, lower than interest expense for fiscal 2005 of $455 million, primarily as the result of debt pay down and the maturation of interest rate swaps. Interest expense includes preferred

distributions paid on subsidiary minority interests. We have in place an amount of interest rate swaps that convert $500 million of fixed-rate debt to floating rates. Taking into account the effect of our interest rate swaps, the average interest rate on our total outstanding debt and subsidiary minority interests was 6.4 percent at May 28, 2006, compared to 5.4 percent at May 29, 2005.

In fiscal 2006, we recorded restructuring and other exit costs of $30 million, consisting of $13 million related to the closure of our Swedesboro, New Jersey frozen dough plant; $6 million primarily for severance costs associated with the restructuring of our frozen dough plant in Montreal, Quebec; $4 million of restructuring costs at our Allentown, Pennsylvania frozen waffle plant, primarily related to product and production realignment; $3 million associated with an asset impairment charge in one of our plants; and $4 million primarily associated with fiscal 2005 supply chain initiatives. In fiscal 2005, we recorded restructuring and other exit costs of $84 million, consisting of $44 million of charges associated with fiscal 2005 supply chain initiatives; $30 million of charges related to relocating our frozen baked goods line from our Boston plant; $3 million of charges primarily associated with Bakeries and Foodservice severance; and $7 million of charges associated with restructuring actions prior to fiscal 2005. The fiscal 2005 supply chain initiatives were undertaken to further increase asset utilization and reduce manufacturing and sourcing costs, resulting in decisions regarding plant closures and production realignment. The actions included decisions to: close our flour milling plant in Vallejo, California; close our par-baked bread plant in Medley, Florida; relocate bread production from our Swedesboro, New Jersey plant; relocate a portion of our cereal production from Cincinnati, Ohio; close our snacks foods plant in Iowa City, Iowa; and close our dry mix production at Trenton, Ontario.

The effective income tax rate was 34.5 percent for fiscal 2006, reflecting the benefit of $11 million of adjustments to deferred tax liabilities associated with our International segment s brand intangibles. In fiscal 2005 our effective income tax rate was 36.6 percent, driven primarily by the tax impacts of our fiscal 2005 divestitures.

Earnings after tax from joint ventures totaled $64 million in fiscal 2006, compared to $89 million in fiscal 2005. Earnings from joint ventures in fiscal 2005 included $28 million from our Snack Ventures Europe (SVE) joint venture with PepsiCo, Inc., which was divested on February 28, 2005. In fiscal 2006, unit volume for Cereal Partners Worldwide (CPW), our joint venture with Nestlé S.A., grew 6 percent and net sales were up 4 percent. In February 2006, CPW announced a restructuring of its manufacturing plants in the United Kingdom. Our after-tax earnings from joint ventures was reduced by $8 million for our share of the restructuring costs, primarily accelerated depreciation and severance, incurred in fiscal 2006. Our share of the remainder of CPW s restructuring costs is expected to affect our after-tax earnings from joint ventures in fiscal 2007 and fiscal 2008. Net sales for our Häagen-Dazs joint ventures in Asia declined 7 percent from fiscal 2005 due to an unseasonably cold winter and increased competitive pressure in Japan. 8th Continent, our joint venture with DuPont, achieved 14 percent net sales growth in fiscal 2006.

Average diluted shares outstanding decreased by 30 million from fiscal 2005. This was due primarily to the repurchase of a significant portion of our contingently convertible debentures in October 2005 and the completion of a consent solicitation related to the remaining convertible debentures in December 2005, actions that ended the dilutive accounting effect of these debentures in our EPS calculations. In addition, we repurchased 19 million shares of our stock during fiscal 2006, partially offset by the issuance of shares upon stock option exercises.

FISCAL 2005 CONSOLIDATED RESULTS OF OPERATIONS

Earnings per diluted share of $3.08 in fiscal 2005 were up 18 percent from $2.60 in fiscal 2004 primarily due to the gain from the redemption of our SVE interest and the reduction in interest expense. Earnings after tax increased to $1,240 million, up 18 percent from $1,055 million in fiscal 2004. Our cash flow in 2005 was strong, enabling us to increase our dividend payments, continue to make significant fixed asset investments to support future growth and productivity, and reduce our total debt (notes payable and long-term debt, including current portion) by $2.0 billion.

Our net sales for fiscal 2005 were $11.2 billion, an increase of 2 percent for the year compared to sales in fiscal 2004. Excluding the effect of the 53rd week in 2004, net sales increased 3 percent (see page 26 for our discussion of this measure not defined by GAAP). Net sales growth was primarily driven by 2 percentage points of unit volume growth on a 52 vs. 52-week basis, primarily in U.S. Retail and International. Pricing and product mix across many of our businesses contributed 3 percentage points of growth, however increases in promotional spending, primarily in U.S. Retail, offset that effect. Foreign currency exchange effects contributed 1 percentage point of growth. The components of net sales growth are shown in the following table.

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Components of Net Sales Growth

	Fiscal 2005 vs. 2004
Unit Volume Growth:	
52 vs. 52-week Basis (as if fiscal 2004 contained 52 weeks)	+2 pts
Absence of 53rd week	1 pt
Price/Product Mix/Foreign Currency Exchange	+4 pts
Trade and Coupon Promotion Expense	3 pts
Net Sales Growth	+2%

Cost of sales increased by $250 million to $6,834 million, primarily driven by unit volume increases and $170 million in commodity cost increases.

SG&A costs decreased by $25 million from fiscal 2004 to fiscal 2005, primarily driven by four factors: a $54 million decrease in consumer marketing expense; a $37 million increase in distribution costs; a $34 million decrease in merger-related costs for the planning and execution of the integration of Pillsbury; and a $32 million increase in unallocated corporate items.

As detailed above in Fiscal 2006 Consolidated Results of Operations, restructuring and other exit costs were $84 million in fiscal 2005, compared to $26 million in 2004.

On March 23, 2005, we commenced a cash tender offer for our outstanding 6 percent notes due in 2012. The tender offer resulted in the purchase of $500 million principal amount of the notes. Subsequent to the expiration of the tender offer, we purchased an additional $260 million principal amount of the notes in the open market. The aggregate purchases resulted in debt repurchase costs of $137 million, consisting of $73 million of non-cash interest rate swap losses reclassified from Accumulated Other Comprehensive Income, $59 million of purchase premium and $5 million of noncash unamortized cost of issuance expense.

On February 28, 2005, SVE was terminated and our 40.5 percent interest was redeemed. On April 4, 2005, we sold our Lloyd s barbecue business to Hormel Foods Corporation. We received $799 million in cash proceeds from these dispositions and recorded $499 million in gains in fiscal 2005.

Net interest expense decreased 10 percent from $508 million in fiscal 2004 to $455 million in fiscal 2005, primarily due to a reduction of our debt levels.

In fiscal 2005 our effective income tax rate increased to 36.6 percent, driven primarily by the tax impacts of our fiscal 2005 divestitures. The higher book tax expense related to the fiscal 2005 divestitures did not result in the payment of significant cash taxes. Our effective income tax rate was 35.0 percent in fiscal 2004.

After-tax earnings from joint venture operations grew 20 percent to reach $89 million in fiscal 2005, compared with $74 million reported a year earlier. This increase was primarily due to unit volume gains by our continuing joint ventures.

Average diluted shares outstanding were 409 million in fiscal 2005, down 1 percent from 413 million in fiscal 2004 as the repurchase of 17 million shares from Diageo was partially offset by stock option exercises.

RESULTS OF SEGMENT OPERATIONS

The following tables provide the dollar amount and percentage of net sales and operating profit from each reportable segment for fiscal 2006, 2005 and 2004:

Net Sales

In Millions, Fiscal Year	2006 Net Sales	2006 Percent of Net Sales	2005 Net Sales	2005 Percent of Net Sales	2004 Net Sales	2004 Percent of Net Sales
U.S. Retail	$ 8,024	69%	$ 7,779	69%	$ 7,763	70%
International	1,837	16	1,725	15	1,550	14
Bakeries and Foodservice	1,779	15	1,740	16	1,757	16
Total	$ 11,640	100%	$ 11,244	100%	$ 11,070	100%

Segment Operating Profit

In Millions, Fiscal Year	2006 Segment Operating Profit	2006 Percent of Segment Operating Profit	2005 Segment Operating Profit	2005 Percent of Segment Operating Profit	2004
					First

$12.43 $8.11 $.09 First $18.55 $14.51 $.08

	2006				2005			2004
Second	17.48	10.35	.09	Second	20.00	15.00	.08	
Third	18.42	15.30	.09	Third	16.10	13.10	.08	
Fourth	17.57	11.14	.09	Fourth	13.40	7.88	.09	

The Company increased the dividend rate by 12.5% in the fourth quarter of 2008. The Company expects to continue its policy of paying regular cash dividends, although there is no assurance as to future dividends because they are dependent on future earnings, capital requirements, and financial conditions. The payment of dividends is subject to the restrictions of the Company s loan agreement if such payment would result in an event of default. See Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations, and Note 5 to the Company s financial statements included at Item 8 of this Annual Report on Form 10-K.

The following table sets forth information regarding securities authorized for issuance under the Company s equity compensation plans as of January 2, 2010, including the Company s 1995 and 2000 plans.

Equity Compensation Plan Information

Plan category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity compensation plans approved by security holders	221,750[1]	$10.58	367,500[2]
Equity compensation plans not approved by security holders	-	-	-
Total	221,750	10.58	367,500

[1] Includes options outstanding under the 1995 and 2000 plans.

[2] Includes shares available for future issuance under the 2000 plan, which expires July 19, 2010 under the

terms of the plan.

Each director who is not an employee of the Company (Outside Director) is paid a director s fee for his services at the annual rate of $24,600. All annual fees paid to non-employee members of the Board of Directors of the Company are paid in common stock of the Company or cash, in accordance with the Directors Fee Program adopted by the shareholders on March 26, 1997 and amended on January 5, 2004. The directors make an annual election, within a reasonable time before their first quarterly payment, to receive their fees in the form of cash, stock or a combination thereof. The election remains in force for one year.

Issuer Purchases of Equity Securities

Period	(a) Total Number of Shares Purchased	(b) Average Price Paid per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	(d) Maximum Number that May Yet Be Purchased Under the Plans or Programs
October 4 October 31, 2009	-	-	-	-
November 1 November 28, 2009	12,422	$15.35	-	-
November 29, 2009 January 2, 2010	27,638	13.80	-	-
Total	40,060	$14.28	-	-

The Company does not have any share repurchase plans or programs. The figures shown in the table above are for shares delivered to the Company to exercise stock options.

Stock Performance Graph

The following graph sets forth the Company s cumulative total shareholder return based upon an initial $100 investment made on December 31, 2004 (i.e., stock appreciation plus dividends during the past five fiscal years) compared to the Wilshire 5000 Index and the S&P Industrial Machinery Index.

The Company manufactures and markets a broad range of locks, latches, fasteners and other security hardware that meets the diverse security and safety needs of industrial and commercial customers. Consequently, while the S&P Industrial Machinery Index being used for comparison is the standard index most closely related to the Company, it does not completely represent the Company s products or market applications. The Wilshire 5000 is a market index made up of 5,000 publicly-traded companies, including those having both large and small capitalization.

	Dec. 04	**Dec. 05**	**Dec. 06**	**Dec. 07**	**Dec. 08**	**Dec. 09**
The Eastern Company	$100	$99	$152	$145	$70	$112
Wilshire 5000	$100	$106	$123	$130	$82	$102
S&P Industrial Machinery	$100	$98	$112	$136	$81	$114

ITEM 6 SELECTED FINANCIAL DATA

		2009	2008	2007	2006	2005
INCOME STATEMENT ITEMS (in thousands)						
Net sales		**$ 112,665**	$ 135,878	$ 156,281	$ 138,465	$ 109,107
Cost of products sold		**92,031**	110,415	120,343	103,882	84,375
Depreciation and amortization		**4,103**	4,128	4,370	3,746	3,460
Interest expense		**1,728**	1,064	1,289	1,098	1,014
Income before income taxes		**1,902**	6,043	14,845	14,846	7,020
Income taxes		**865**	1,538	4,765	5,187	2,653
Net income		**1,036**	4,505	10,081	9,659	4,367
Dividends		**2,155**	1,938	1,802	1,715	1,600
BALANCE SHEET ITEMS (in thousands)						
Inventories		**$ 24,520**	$ 30,797	$ 30,491	$ 28,043	$ 20,768
Working capital		**44,280**	48,745	47,028	35,546	31,223
Property, plant and equipment, net		**22,974**	23,911	25,234	25,816	22,397
Total assets		**100,872**	106,017	108,352	103,485	81,622
Shareholders equity		**66,597**	62,482	70,817	54,391	46,172
Capital expenditures		**2,226**	2,331	2,868	6,722	1,750
Long-term obligations, less current portion		**4,286**	11,429	14,383	17,507	12,384
PER SHARE DATA						
Net income per share						
Basic		**$ .17**	$ .77	$ 1.79	$ 1.76	$ .80
Diluted		**.17**	.73	1.68	1.67	.75
Dividends		**.36**	.33	.32	.31	.29
Shareholders equity (Basic)		**11.13**	10.63	12.58	9.94	8.47
Average shares outstanding:	Basic	**5,985,640**	5,875,140	5,631,073	5,474,137	5,455,073
	Diluted	**6,241,780**	6,159,563	5,989,754	5,768,108	5,828,837

The information in the table above reflects a 3-for-2 stock split effective October 2006.

ITEM 7 MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Summary

Net sales for 2009 decreased 17% to $112.7 million from $135.9 million in 2008. Net income for 2009 decreased to $1.0 million, or $.17 per diluted share, from $4.5 million, or $.73 per diluted share in 2008. Net sales in the Industrial Hardware and Security Products segments decreased approximately 17% and 24%, respectively, in 2009, primarily resulting from the economic slowdown in the many markets we serve. The Metal Products segment sales were comparable in 2009 and 2008, resulting from continued demand for our mine roof support products.

The following table shows, for the fourth quarter of 2009 and 2008, selected line items from the consolidated statements of income as a percentage of net sales, by segment.

	2009 Fourth Quarter							
	Industrial Hardware		Security Products		Metal Products		Total	
Net sales	100.0	%	100.0	%	100.0	%	100.0	%
Cost of products sold	71.6	%	74.9	%	107.4	%	79.2	%
Gross margin	28.4	%	25.1	%	-7.4	%	20.8	%
Selling and administrative expense	14.9	%	18.3	%	8.6	%	15.0	%
Operating profit	13.5	%	6.8	%	-16.0	%	5.8	%

	2008 Fourth Quarter							
	Industrial Hardware		Security Products		Metal Products		Total	
Net sales	100.0	%	100.0	%	100.0	%	100.0	%
Cost of products sold	72.7	%	76.8	%	106.1	%	80.3	%
Gross margin	27.3	%	23.2	%	-6.1	%	19.7	%
Selling and administrative expense	14.8	%	18.2	%	8.9	%	14.9	%
Operating profit	12.5	%	5.0	%	-15.0	%	4.8	%

The following table shows the amount of change from the fourth quarter of 2008 to the fourth quarter of 2009 in sales, cost of products sold, gross margin, selling and administrative expenses and operating profit, by segment (dollars in thousands).

	Industrial Hardware			Security Products			Metal Products			Total		
Net sales	$	(1,706	)	$	(1,794	)	$	(796	)	$	(4,296	)
Volume		-20.1	%		-18.0	%		-16.2	%		-18.6	%
Prices		1.2	%		2.0	%		2.6	%		1.7	%
New Products		7.4	%		0.6	%		-	%		3.6	%
		-11.5	%		-15.4	%		-13.6	%		-13.3	%
Cost of products sold	$	(1,389	)	$	(1,563	)	$	(779	)	$	(3,731	)
		-12.9	%		-17.4	%		-12.5	%		-14.4	%
Gross margin	$	(317	)	$	(231	)	$	(17	)	$	(565	)
		-7.9	%		-8.5	%		-4.7	%		-8.9	%
Selling and administrative expenses	$	(235	)	$	(314	)	$	(84	)	$	(633	)
		-10.8	%		-14.8	%		-16.0	%		-13.1	%
Operating profit	$	(82	)	$	83		$	67		$	68	
		-4.5	%		14.3	%		7.6	%		4.4	%

Net sales in the fourth quarter of 2009 decreased 13% to $28.0 million from $32.3 million a year earlier. Net income for the quarter decreased 65% to $369,000 (or $.06 per diluted share) from $1.1 million (or $.17 per diluted share) a year earlier. The decrease in sales in the fourth quarter from 2008 to 2009 is primarily attributable to the continued economic slowdown in many of the markets served by our Industrial Hardware and Security Products segments and decreases in the contract casting business in the Metal Products segment. The decrease in sales volume of existing products in those segments was partially offset by the introduction of new products and price increases to customers. The decrease in profit in the fourth quarter from 2008 to 2009 is due to the termination of the interest rate swap contract in December 2009, which resulted in a charge to interest expense of $967,350. See Note 5 to the Company s financial statements included at Item 8 of this Annual Report on Form 10-K.

Gross margin for the fourth quarter of 2009 decreased 8.9% from the fourth quarter of 2008. The decrease is primarily the result of lower sales volume in the 2009 fourth quarter as a result of the continued economic slowdown which affected many of the markets we serve.

Selling and administrative expenses for the fourth quarter of 2009 decreased 13.1% compared to the prior year quarter. The overall decrease was due to lower payroll and payroll related charges, advertising expense, travel expense and reduced sales commissions as a result of lower sales volume.

Authoritative Accounting Guidance

In December 2007, Financial Accounting Standards Board (FASB) issued revised authoritative guidance on disclosures related to Business Combinations. This guidance significantly changed the principles and requirements for how the acquirer of a business recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any non-controlling interest in the acquiree. It also provided guidance for recognizing and measuring the goodwill acquired in the business combination and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. The Company adopted this guidance effective January 4, 2009. Since this guidance was effective prospectively, except for certain retrospective adjustments to deferred tax balances, its adoption had no impact on the consolidated financial statements of the Company.

In December 2007, the FASB issued authoritative guidance which clarified the classification of noncontrolling interests in consolidated balance sheets and reporting transactions between the reporting entity and holders of noncontrolling interests. Under this guidance, noncontrolling interests are considered equity and reported as an element of consolidated equity. Further, net income encompasses all consolidated subsidiaries with disclosure of the attribution of net income between controlling and noncontrolling interests. The Company adopted this guidance effective January 4, 2009. Since this guidance was effective prospectively, its adoption had no impact on the consolidated financial statements of the Company.

In March 2008, the FASB issued authoritative guidance relating to disclosures about derivative instruments and hedging activities which expanded the disclosure requirements about an entity s derivative instruments and hedging activities. The guidance expanded the disclosure provisions to apply to all entities with derivative instruments. The provisions also apply to related hedged items, bifurcated derivatives, and nonderivative instruments that are designated and qualify as hedging instruments. Entities with instruments must provide more robust qualitative disclosures and expanded quantitative disclosures. Such disclosures generally will need to be presented for every annual and interim reporting period. The Company adopted this guidance effective January 4, 2009. Since this guidance required additional disclosure only, its adoption had no material impact on the consolidated financial statements of the Company.

In April 2008, the FASB issued authoritative guidance relating to the determination of the useful life of intangible assets. This guidance amended the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset. The intent of this guidance was to improve the consistency between the useful life of a recognized intangible asset and the period of expected cash flows used to measure the fair value of the asset in other applicable accounting literature. The Company adopted this guidance effective January 4, 2009. Since this guidance must be applied prospectively, its adoption had no impact on the consolidated financial statements of the Company.

In December 2008, the FASB issued authoritative guidance on employer s disclosures about postretirement benefit plan assets, which requires additional disclosures for assets held by employer pension and other postretirement benefit plans. The required disclosures include information about fair value measurements of plan assets, including the investment policies and strategies for the major categories of plan assets, and significant concentrations of risk within plan assets. This guidance was effective for fiscal years ending after December 15, 2009. Since this guidance provides only disclosure requirements, it did not have a material impact on the consolidated financial statements of the Company.

In May 2009, the FASB issued authoritative guidance on subsequent events, which introduces the concept of financial statements being available to be issued. This guidance will require the disclosure of the date through which an entity has evaluated subsequent events and the basis for that date (that is, whether that date represents the date the financial statements were issued or were available to be issued). For SEC registrants, this date will continue to be the date on which financial statements are filed with the SEC. This guidance was effective for fiscal years and interim periods beginning after June 15, 2009. The adoption of this new guidance had no impact on the consolidated financial statements of the Company. In February 2010, this guidance was effectively reversed for SEC filers because of a potential conflict between the guidance and SEC requirements.

In June 2009, the FASB issued authoritative guidance on consolidation of variable interest entities. The new guidance is intended to improve financial reporting by requiring additional disclosures about a company s involvement in variable interest entities. This new guidance is effective for fiscal years and interim periods beginning after November 15, 2009. The Company has not determined the impact, if any, of the adoption of this guidance on the consolidated financial statements of the Company.

In June 2009, the FASB issued The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles (the Codification). The Codification is the source for authoritative U.S. Generally Accepted Accounting Principles recognized by the FASB to be applied by non-governmental entities. Rules and interpretive releases of the SEC under the authority of the federal securities laws are also sources of authoritative GAAP for SEC registrants. All other non-grandfathered non-SEC accounting literature not included in the Codification is non-authoritative. The Codification was effective for financial statements issued for interim and annual periods ending after September 15, 2009. The adoption of the Codification had no impact on the consolidated financial statements of the Company.

In August 2009, the FASB issued new accounting guidance to provide clarification on measuring liabilities at fair value when the quoted price in an active market for an identical liability is not available. The new guidance was effective for the first reporting period beginning after August 28, 2009. The adoption of this guidance had no impact on the consolidated financial statements of the Company.

In January 2010, the FASB issued new accounting guidance which requires new disclosures regarding transfers in and out of Level 1 and Level 2 fair value measurements, as well as requiring presentation on a gross basis of information about purchases, sales, issuances and settlements in Level 3 fair value measurements. The guidance also clarifies existing disclosures regarding level of disaggregation, inputs and valuation techniques. The new guidance is effective for interim and annual reporting periods beginning after December 15, 2009. Disclosures about purchases, sales, issuances and settlements in the roll forward of activity in Level 3 fair value measurements are effective for fiscal years beginning after December 15, 2010. As this guidance requires only additional disclosure, there should be no impact on the consolidated financial statements of the Company upon adoption.

Critical Accounting Policies and Estimates

The preparation of the financial statements in accordance with accounting principles generally accepted in the United States (U.S. GAAP) requires management to make judgments, estimates and assumptions regarding uncertainties that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, and the reported amounts of revenues and expenses. Areas of uncertainty that require judgments, estimates and assumptions include items such as the accounting for derivatives; environmental matters; the testing of goodwill and other intangible assets for impairment; proceeds on assets to be sold; pensions and other postretirement benefits; and tax matters. Management uses historical experience and all available information to make its estimates and assumptions, but actual results will inevitably differ from the estimates and assumptions that are used to prepare the Company s financial statements at any given time. Despite these inherent limitations, management believes that Management s Discussion and Analysis of Financial Condition and Results of Operations and the financial statements and related footnotes provide a meaningful and fair presentation of the Company.

Management believes that the application of these estimates and assumptions on a consistent basis enables the Company to provide the users of the financial statements with useful and reliable information about the Company s operating results and financial condition.

Allowance for Doubtful Accounts

The Company maintains an allowance for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments. The Company reviews the collectibility of its receivables on an ongoing basis taking into account a combination of factors. The Company reviews potential problems, such as past due accounts, a bankruptcy filing or deterioration in the customer s financial condition, to ensure the Company is adequately accrued for potential loss. Accounts are considered past due based on when payment was originally due. If a customer s situation changes, such as a bankruptcy or creditworthiness, or there is a change in the current economic climate, the Company may modify its estimate of the allowance for doubtful accounts. The Company will write off accounts receivable after reasonable collection efforts have been made and the accounts are deemed uncollectible.

Inventory Reserve

Inventories are valued at the lower of cost or market. Cost is determined by the last-in, first-out (LIFO) method at the Company s U.S. facilities. Accordingly, a LIFO valuation reserve is calculated using the dollar value link chain method.

We review the net realizable value of inventory in detail on an ongoing basis, giving consideration to deterioration, obsolescence and other factors. Based on these assessments, we provide for an inventory reserve in the period in which an impairment is identified. The reserve fluctuates with market conditions, design cycles and other economic factors.

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Goodwill and Other Intangible Assets

Intangible assets with finite useful lives are amortized generally on a straight-line basis over the periods benefited. Goodwill and other intangible assets with indefinite useful lives are not amortized. Each year during the second quarter, the carrying value of goodwill and other intangible assets with indefinite useful lives is tested for impairment. The Company uses the discounted cash flow method to calculate the fair value of goodwill associated with its reporting units. No impairments of goodwill were deemed to exist. The determination of discounted cash flows is based on the businesses strategic plans and long-range planning forecasts. The revenue growth rates included in the plans are management s best estimates based on current and forecasted market conditions. Profit margin assumptions are projected by each business based on the current cost structures and anticipated cost reductions. There can be no assurance that operations will achieve the future cash flows reflected in the projections. If different assumptions were used in these plans, the related discounted cash flows used in measuring impairment could be different and an impairment of assets might need to be recorded.

Pension and Other Postretirement Benefits

The amounts recognized in the consolidated financial statements related to pension and other postretirement benefits are determined from actuarial valuations. Inherent in these valuations are assumptions about such factors as expected return on plan assets, discount rates at which liabilities could be settled, rate of increase in future compensation levels, mortality rates, and trends in health insurance costs. These assumptions are reviewed annually and updated as required. In accordance with U.S. GAAP, actual results that differ from the assumptions are accumulated and amortized over future periods and, therefore, affect the expense recognized and obligations recorded in future periods.

The discount rate used is based on a single equivalent discount rate derived with the assistance of our actuaries by matching expected future benefit payments in each year to the corresponding spot rates from the Citigroup Pension Liability Yield Curve, comprised of high quality (rated AA or better) corporate bonds. The expected long-term rate of return on assets is also developed with input from the Company s actuarial firms. We consider the Company s historical experience with pension fund asset performance, the current and expected allocation of our plan assets, and expected long-term rates of return. The long-term rate-of-return assumption used for determining net periodic pension expense for 2009 was 8.5%. The Company reviews the long-term rate of return each year. Future actual pension income and expense will depend on future investment performance, changes in future discount rates, and various other factors related to the population of participants in the Company s pension plans.

The Company expects to make cash contributions of approximately $2.5 million and $141,000 to its pension plans and postretirement plan, respectively, in 2010.

RESULTS OF OPERATIONS

Fiscal 2009 Compared to Fiscal 2008

The following table shows, for 2009 and 2008, selected line items from the consolidated statements of income as a percentage of net sales, by segment.

	Industrial Hardware	**Security Products**	**Metal Products**	**Total**
	2009			

Net sales	100.0	%	100.0	%	100.0	%	100.0	%
Cost of products sold	75.6	%	78.2	%	103.7	%	81.7	%
Gross margin	24.4	%	21.8	%	-3.7	%	18.3	%
Selling and administrative expense	15.2	%	18.1	%	8.8	%	15.1	%
Operating profit	9.2	%	3.7	%	-12.5	%	3.2	%
	2008							
Net sales	100.0	%	100.0	%	100.0	%	100.0	%
Cost of products sold	77.8	%	77.0	%	102.7	%	81.3	%
Gross margin	22.2	%	23.0	%	-2.7	%	18.7	%
Selling and administrative expense	13.5	%	15.7	%	8.1	%	13.5	%
Operating profit	8.7	%	7.3	%	-10.8	%	5.2	%

The following table shows the amount of change from 2008 to 2009 in sales, cost of products sold, gross margin, selling and administrative expenses, and operating profit, by segment (dollars in thousands):

	Industrial Hardware	Security Products	Metal Products	Total
Net sales	$ (10,086)	$ (13,186)	$ 59	$ (23,213)
Volume	-29.8 %	-29.4 %	-4.9 %	-25.9 %
Prices	0.9 %	4.8 %	2.9 %	2.8 %
New Products	12.1 %	0.7 %	2.3 %	6.0 %
	-16.8 %	-23.9 %	0.3 %	-17.1 %
Cost of products sold	$ (8,979)	$ (9,661)	$ 256	$ (18,384)
	-19.2 %	-22.7 %	1.2 %	-16.7 %
Gross margin	$ (1,107)	$ (3,525)	$ (197)	$ (4,829)
	-8.3 %	-27.8 %	-34.6 %	-19.0 %
Selling and administrative expenses	$ (488)	$ (1,033)	$ 144	$ (1,377)
	-6.0 %	-11.9 %	8.6 %	-7.5 %
Operating profit	$ (619)	$ (2,492)	$ (341)	$ (3,452)
	-11.8 %	-61.8 %	-15.2 %	-49.1 %

Industrial Hardware Segment

Net sales in the Industrial Hardware segment decreased 17% in 2009 from the 2008 level. This decrease was primarily due to reduced sales of existing products to the vehicular markets in 2009 compared to the prior year, while smaller declines were experienced in many of the other markets that use our Industrial Hardware products. New product introductions offset part of the decrease in sales for this segment. All of the new products were internally developed and offered to the many markets we service, including: military, utility truck, vehicular accessories and buses. New products included a lever arm assembly for service bodies, a variety of lightweight composite panels for the marine, transportation, high tech and construction markets, including in the construction of local delivery vans in Mexico where the lighter weight of the vehicles reduces fuel consumption, several new products for the military market including a roof center case assembly, a turret latch and a variety of handles, as well as an assortment of handles and latches used in many of the markets to which we sell.

Cost of products sold for the Industrial Hardware segment decreased 19% from 2008 to 2009. The primary reason for this decrease was the lower sales volume in 2009 and lower payroll and payroll related charges compared to the prior year.

Gross margin as a percentage of net sales improved from 22% in 2008 to 25% in 2009. The improvement in gross margin was primarily the result of lower raw material costs in 2009 compared to the higher raw material costs in 2008 that the Company was unable to recover from its customers.

Selling and administrative expenses decreased 6% from 2008 levels due to decreases in payroll and payroll related charges and lower expenditures for travel.

Security Products Segment

Net sales in the Security Products segment decreased 24% from 2008 to 2009. The primary reason for the decrease was a decrease in sales volume resulting from the continued economic slowdown in many of the markets served by the Security Products segment, including the travel, coin-op and commercial laundry markets. New products were mainly lock related, such as: a double bitted non-reversible cam lock for the enclosure market and various parts used in the musical instrument accessory market, as well as a variety of other lock products for various markets.

Cost of products sold for the Security Products segment decreased 23% from 2008 to 2009. The decrease in cost of products sold was directly proportionate to the decrease in sales.

Gross margin for 2009 at 22% was comparable to the 2008 level of 23% as a percentage of net sales for the Security Products segment.

Selling and administrative expenses decreased 12% from the same period a year ago due to a reduction in payroll and payroll related charges and decreased expenses for advertising and sales commissions.

Metal Products Segment

Net sales in the Metal Products segment were comparable for 2009 and 2008. Sales of mine products increased 14% in 2009 compared to 2008. Sales of contract casting products decreased 35% from 2008 levels. In 2009, sales of mine roof supports increased in the U.S. markets, continuing the growth experienced in 2007 and 2008. Sales of new products in 2009 consisted of a crater head for use in underground mining applications.

Cost of products sold for the Metal Products segment increased 1% from 2008 to 2009. Cost increases were experienced for raw materials, outside parts and processing, and worker s compensation insurance.

Gross margin as a percentage of sales in the Metal Products segment decreased slightly from -3% in 2008 to -4% in 2009. The negative results were primarily caused by excessive scrap and down time due to equipment failures. These operational issues are being addressed through a $2.5 million capital expenditure program in 2010.

Selling and administrative expenses in the Metal Products segment increased 9% from 2008 to 2009, due to increased payroll and payroll related charges.

Other Items

The following table shows the amount of change from 2008 to 2009 in other items (dollars in thousands):

	Total
Interest expense	$ 664
	62.5 %
Other income	$ (25)

		-33.3 %
Income taxes	$ (673)	
		-43.8 %

Interest expense increased from 2008 to 2009 primarily due to the termination of the interest rate swap contract in December 2009. The increase was partially offset by lower interest paid throughout 2009 on the decreased level of debt compared to the prior year.

Other income decreased from 2008 to 2009 due to lower interest income earned on cash balances in the Company s cash management program in 2009.

Income taxes the effective tax rate increased in 2009 to 45% from the 25% rate in 2008. The increase is primarily the result of a discrete tax item and a change in the mix of U.S and foreign income, as well as a change in the mix of U.S. earnings in states with lower income tax rates.

Fiscal 2008 Compared to Fiscal 2007

The following table shows, for 2008 and 2007, selected line items from the consolidated statements of income as a percentage of net sales, by segment.

	2008 **Industrial Hardware**	**Security Products**	**Metal Products**	**Total**
Net sales	100.0 %	100.0 %	100.0 %	100.0 %
Cost of products sold	77.8 %	77.0 %	102.7 %	81.3 %
Gross margin	22.2 %	23.0 %	-2.7 %	18.7 %
Selling and administrative expense	13.5 %	15.7 %	8.1 %	13.5 %
Operating profit	8.7 %	7.3 %	-10.8 %	5.2 %

	2007 **Industrial Hardware**	**Security Products**	**Metal Products**	**Total**
Net sales	100.0 %	100.0 %	100.0 %	100.0 %
Cost of products sold	72.5 %	76.8 %	104.3 %	77.0 %
Gross margin	27.5 %	23.2 %	-4.3 %	23.0 %
Selling and administrative expense	11.6 %	14.6 %	12.0 %	12.8 %
Operating profit	15.9 %	8.6 %	-16.3 %	10.2 %

The following table shows the amount of change from 2007 to 2008 in sales, cost of products sold, gross margin, selling and administrative expenses, and operating profit, by segment (dollars in thousands):

	Industrial Hardware	Security Products	Metal Products	Total
Net sales	$ (21,561)	$ (5,560)	$ 6,718	$ (20,403)
Volume	-32.2 %	-12.0 %	29.4 %	-18.8 %
Prices	1.2 %	1.7 %	15.1 %	2.6 %
New Products	4.6 %	1.1 %	3.7 %	3.1 %
	-26.4 %	-9.2 %	48.2 %	-13.1 %
Cost of products sold	$ (12,426)	$ (4,185)	$ 6,683	$ (9,928)
	-21.0 %	-9.0 %	46.0 %	-8.2 %
Gross margin	$ (9,135)	$ (1,375)	$ 35	$ 10,475
	-40.7 %	-9.8 %	5.7 %	-29.1 %
Selling and administrative expenses	$ (1,377)	$ (201)	$ 2	$ (1,576)
	-14.5 %	-2.3 %	0.1 %	-7.9 %
Operating profit	$ (7,758)	$ (1,174)	$ 33	$ (8,899)
	-59.7 %	-22.6 %	1.5 %	-55.9 %

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Industrial Hardware Segment

Net sales in the Industrial Hardware segment decreased 26.4% in 2008 from the 2007 level. This decrease was primarily due to the 2007 period having benefited from the one-time limited contract to supply latching system components for use in the military s up-armored Humvee program which was completed in April 2007. New product introductions offset part of the decrease in sales for this segment. All of the new products were internally developed and offered to the many markets we service, including: military, utility truck, vehicular accessories and buses. New products included a rear door lock and an out door handle for the bus market, a variety of lightweight composite panels for the marine, transportation, high tech and construction markets, several new products for the military market including a center case kit and a variety of handles, as well as an assortment of handles and latches used in many of the markets to which we sell. Sales volume of existing products was comparable to the prior year in most of the markets serviced by the Industrial Hardware segment. However, decreases in sales volume occurred in the truck accessory, Class 8 truck, service body, and trailer markets, following the general economic decline in the heavy and light truck markets.

Cost of products sold for the Industrial Hardware segment decreased 21.0% from 2007 to 2008. The lower manufacturing costs associated with the lower volume of sales was unfavorably impacted by higher costs of raw materials, increases in payroll related charges, maintenance and repair and research and development.

Gross margin as a percentage of net sales decreased from 27.5% to 22.2%, driven by higher manufacturing costs which could not be fully recovered through selling price increases due to the competitive nature of many of the products we sell.

Selling and administrative expenses decreased 14.5% from 2007 levels due to decreases in payroll and payroll related charges.

Security Products Segment

Net sales in the Security Products segment decreased 9.2% from 2007 to 2008. The primary reason for the decrease was a decrease in sales volume resulting from the economic slowdown in many of the markets served by the Security Products segment, including the travel, coin-op and commercial laundry markets. New products were mainly lock related, such as: a wing knob lock with a flip-up cover used in the automotive accessory market and various parts used in the motorcycle market, as well as a variety of other lock products for various markets.

Cost of products sold for the Security Products segment decreased 9.0% from 2007 to 2008. The decrease in cost of products sold was directly proportionate to the decrease in sales.

Gross margin for 2008 at 23.0% was comparable to 2007 level of 23.2% as a percentage of net sales for the Security Products segment.

Selling and administrative expenses decreased 2.3% from the same period a year ago due to a reduction in payroll and payroll related charges.

Metal Products Segment

Net sales in the Metal Products segment increased 48.2% from 2007 to 2008. Sales of mine products increased 46% in 2008 compared to 2007. Sales of contract casting products increased 29% from 2007. In 2008, sales of mine roof supports increased in both the U.S. and Canadian markets, continuing the growth experienced in 2007. Shipments of ductile iron castings more than doubled to 2,284 tons in 2008 from 1,058 tons in 2007. Sales of new products in 2008 consisted of a crater head for use in underground mining applications.

Cost of products sold for the Metal Products segment increased 46.0% from 2007 to 2008. Cost increases were experienced for raw materials, payroll and payroll related charges, utilities, outside parts and processing, supplies and tools and equipment maintenance.

Gross margin in the Metal Products segment improved slightly from -4.3% to -2.8% from 2007 and 2008. The negative results were primarily caused by $1.5 million in excessive scrap due to equipment failures. Additionally, production down-time resulted in an estimated negative impact of approximately $500,000. These operational issues are being addressed.

Selling and administrative expenses in the Metal Products segment were comparable for 2007 and 2008.

Other Items

The following table shows the amount of change from 2007 to 2008 in other items (dollars in thousands):

	Total
Interest expense	$(225)
	-17.5 %
Other income	$(171)
	-83.1 %
Income taxes	$(3,227)
	-67.7 %

Interest expense decreased from 2007 to 2008 primarily due to the decreased level of debt.

Other income decreased from 2007 to 2008 due to lower interest income earned on cash balances in the Company s cash management program in 2008.

Income taxes the effective tax rate decreased in 2008 to 25% from the 32% rate in 2007. The decrease is the result of a change in the mix of U.S and foreign income, as well as a change in the mix of U.S. earnings in states with lower income tax rates.

Liquidity and Sources of Capital

The Company s financial position remained strong throughout 2009, despite a loss in the first quarter that caused the Company to fail its fixed coverage ratio covenant for the first, second and third quarters. The primary source of the Company s cash is earnings from operating activities adjusted for cash generated from or used for net working capital. The most significant recurring non-cash items included in income are depreciation and amortization expense. Changes in working capital fluctuate with the changes in operating activities. As sales increase, there generally is an increased need for working capital. Since increases in working capital reduce the Company s cash, management attempts to keep the Company s investment in net working capital at a reasonable level by closely monitoring inventory levels (by matching production to expected market demand), keeping tight control over the collection of receivables, and optimizing payment terms on its trade and other payables.

The Company is dependent on the continued demand for its products and subsequent collection of accounts receivable from its customers. The Company serves a broad base of customers and industries with a variety of products. As a result, any fluctuations in demand or payment from a particular industry or customer will not have a material impact on the Company s sales and collection of receivables. Management expects that the Company s foreseeable cash needs for operations, capital expenditures, debt service and dividend payments will continue to be met by the Company s operating cash flows and available credit facility.

	2009	**2008**	**2007**

Current ratio	3.9	4.8	3.9
Average days sales in accounts receivable	51	52	52
Inventory turnover	3.8	3.6	3.9
Ratio of working capital to sales	39.3 %	35.9 %	30.1 %
Total debt to shareholders equity	17.2 %	21.9 %	24.7 %

At January 2, 2010, January 3, 2009, and December 29, 2007, the Company had cash and cash equivalents of $16.7 million, $9.0 million and $8.2 million, respectively, and working capital of $44.3 million, $48.7 million and $47.0 million, respectively.

Net cash provided by operating activities was $13.3 million in 2009 compared to $7.6 million in 2008 and $8.8 million in 2007. The $5.7 million increase in 2009 is the result of improvements in working capital during the year offset by the lower profitability. The $1.2 million decrease from 2007 to 2008 was primarily related to the decline in profitability and changes in working capital. During 2009, working capital provided $7.6 million in cash, most related to a $6.7 million decline in inventory during the period. During 2008, working capital used $1.4 million in cash. In 2008, a $1.6 million decline in accounts receivable was offset by a $1.1 million increase in inventory and a $1.9 decrease in accounts payable, accrued compensation and other accrued expenses. During 2007, working capital used $5.5 million in cash. In 2007, changes in inventory, recoverable taxes, accounts payable and other accrued expenses accounted for $13.3 million of cash usage, while changes in accounts receivable and other long term liabilities provided $7.7 million in cash.

During 2009, 2008 and 2007 the Company used $2.2, $2.4 and $2.8 million of cash in investing activities, respectively. The entire amount in 2009 was for the purchase of fixed assets. In 2008, the Company made one small acquisition using approximately $128,000. The balance for 2008 and for 2007 related primarily to the purchase of fixed assets. The Company expects to begin a major equipment upgrade in the Metal Products Group during 2010 and as a result we expect capital expenditures for 2010 to be approximately $4 million to $5 million.

Net cash used by financing activities in 2009 totaled $3.4 million. This consisted of the payment of $2.2 million in dividends and $2.2 million of long-term debt. These amounts were offset by the receipt of approximately $1 million related to the exercise of stock options during the year ($1.6 million from the sales of common stock, $200,000 in tax benefits related to the options, and the purchase of approximately $800,000 in treasury shares). In 2009, 153,421 shares were issued as a result of options being exercised at an average price of approximately $10.32 per share, and 55,881 shares were purchased for the treasury at an average price of $14.27 per share. While there is no assurance that the Company will receive additional funds resulting from the exercise of options in 2010, options representing an additional 113,750 shares at an average price of $9.50 per share are due to expire during 2010 if they are not exercised. Net cash used by financing activities totaled $4.2 million in 2008, including $3.8 million paid to reduce the Company s debt, and $1.9 million paid out as dividends during the year. The Company also received approximately $1.6 million net related to the exercise of stock options during the year ($1.9 million from the sales of common stock, $400,000 in tax benefits related to the options, and the purchase of approximately $600,000 in treasury shares). In 2008, 196,606 shares were issued as a result of options being exercised at an average price of approximately $9.47 per share and 42,955 shares were purchased for the treasury at an average price of $14.21 per share. Net cash used by financing activities in 2007 totaled approximately $1.1 million. Payments of $3.1 million in debt and $1.8 million in dividends were offset by $2.6 million received from the exercise of stock options and an additional $1.6 million related to tax benefits derived from these same stock option transactions. In 2007, 339,749 shares were issued as a result of options being exercised at an average price of approximately $7.54 per share.

The Company leases certain equipment and buildings under cancelable and non-cancelable operating leases expiring at various dates up to five years. Rent expense amounted to approximately $759,000, $908,000 and $882,000 in 2009, 2008 and 2007, respectively.

On September 22, 2006 the Company signed an unsecured loan agreement (Loan Agreement), which included a $20,000,000 term loan and a revolving line of credit, with its lender, Bank of America, N.A. The term portion of the loan required quarterly payments of $714,286 for a period of seven (7) years, maturing on September 22, 2013. Prior to April 21, 2009, the revolving credit portion allowed the Company to borrow up to $12,000,000 with a maturity date of September 22, 2009. The revolving credit portion had a variable quarterly commitment fee ranging from 0.10% to 0.25% based on operating results. Effective April 21, 2009, the Company agreed to a reduction in the amount available on the revolving credit portion to $3,000,000. Effective June 19, 2009, the quarterly commitment fee was fixed at 0.5%. There were no outstanding balances under the revolving credit portion at January 2, 2010 or January 3, 2009.

The interest rates on the term and the revolving credit portions of the Loan Agreement vary. Prior to June 19, 2009, the interest rates varied based on the LIBOR rate plus a margin spread of 1.0% to 1.65% for the term portion and 1.0% to 1.6% for the revolving credit portion. The margin rate spread was based on operating results calculated on a rolling-four-quarter basis. Effective June 19, 2009, the margin spread was fixed at a rate of 2.25%. The Company may also borrow funds at the lender s prime rate. On January 2, 2010, the interest rate on the term portion of the Loan Agreement was approximately 2.54%.

On November 13, 2009, the Company amended its Loan Agreement with Bank of America, N.A. The amendment extended the term of the revolving credit portion of the Loan Agreement to May 31, 2010 and permanently reduced the amount available to borrow to $3,000,000. In addition, the margin rate spread was fixed at two and one quarter percent (2.25%); the unused line fee was increased to one half of one percent

(0.50%); and the fixed coverage ratio covenant was modified such that it will be calculated on a fiscal year to date basis (instead of a rolling four quarter basis) commencing with the second quarter of fiscal 2009, provided that if the Company fails to comply with such fixed coverage ratio covenant for any quarter, then such ratio will be re-calculated to add back the amount of permitted dividends declared and actually paid during the period to meet the required 1.1 to 1.0 ratio, so long as the payment of such dividends does not result in the amount of consolidated cash to be below $10,000,000 on the date of determination. The testing period will return to a rolling 4 quarter period effective with the end of the first quarter of 2010. The amendment also required the Company to secure all of the present and future indebtedness of the Company and its subsidiaries with a continuing first priority security interest in all present and future assets of the Company and its consolidated subsidiaries.

On November 2, 2006, the Company entered into an interest rate swap contract with the lender with an original notional amount of $20,000,000, which was equal to 100% of the outstanding balance of the term loan on that date. The notional amount began decreasing on a quarterly basis on January 2, 2007 following the principal repayment schedule of the term loan. The Company has a fixed interest rate of 5.25% on the swap contract and paid the difference between the fixed rate and LIBOR when LIBOR was below 5.25% and received interest when the LIBOR rate exceeded 5.25%. This remained in effect until December 22, 2009 when the Company terminated the interest rate swap contract at a cost of $967,350, which was accounted for as a charge to interest expense. After terminating the contract, the Company commenced a refinancing plan of the Company s outstanding debt.

Subsequent to January 2, 2010, the Company completed the refinancing of all of its debt. On January 29, 2010, the Company signed a new secured Loan Agreement (the New Loan Agreement) with People s United Bank (People s) which included a $5,000,000 term portion and a $10,000,000 revolving credit portion. The term portion of the loan requires quarterly payments of $178,571 for a period of seven (7) years, maturing on January 31, 2017. The revolving credit portion has a quarterly commitment fee of one quarter of one percent (0.25%). The proceeds of the term portion along with the Company s available cash were used to retire the remaining portion of the debt with Bank of America, N.A., which on January 29, 2010 totaled $10,714,286.

Interest on the term portion of the New Loan Agreement is fixed at 4.98%. The interest rate on the revolving credit portion of the New Loan Agreement varies based on the LIBOR rate or People s Prime rate plus a margin spread of 2.25%, with a floor rate of 4.0%.

The Company s loan covenants restrict it from incurring any indebtedness (from any person other than the lender) that exceeds the aggregate sum of $2.0 million, or that exceeds $1.0 million in any single transaction, without the express consent of the lender or until the full payment of the current obligation has been made. The loan covenants also prohibit the Company from paying any dividends in the event the payment would result in a default under the terms of the Loan Agreement.

Tabular Disclosure of Contractual Obligations

The Company s known contractual obligations as of January 2, 2010, are shown below (in thousands):

	Payment due by period				
	Total	**Less than 1 Year**	**1-3 Years**	**3-5 Years**	**More than 5 Years**
Long-term debt obligations	$ 11,429	$ 7,143	$ 1,429	$ 1,607	$ 1,250
Estimated interest on long-term debt	915	181	388	264	82
Operating lease obligations	1,788	592	1,070	126	--
Estimated contributions to pension plans	12,144	328	3,971	3,971	3,874
Estimated post retirement benefits other than pensions	1,341	141	298	329	573
Total	$ 27,617	$ 8,385	$ 7,156	$ 6,297	$ 5,779

The Company paid approximately $5.7 million of the $7.1 million of long-term debt obligations due in less than one year, shown in the table above, in connection with the refinancing of the Company s debt on January 29, 2010.

The amounts shown in the above table for estimated contributions to pension plans and estimated postretirement benefits other than pensions are based on the assumptions in Note 10 to the consolidated financial statements, as well as the assumption that participant counts will remain stable.

The Company does not have any non-cancelable open purchase orders.

During the fourth quarter of Fiscal 2008 a change in the general economy caused a significant tightening of credit by financial institutions. During Fiscal 2009, the Company increased its cash position by approximately $7.8 million. While the Company used approximately $5.7 million of this in January 2010 in order to refinance its outstanding debt, the Company believes it has sufficient cash on hand and credit resources available to it to sustain itself though these difficult economic times.

ITEM 7A QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company s foreign manufacturing facilities account for approximately 12% of total sales and 15% of total assets. Its U.S. operations buy from and sell to these foreign affiliates, and also make limited sales (approximately 11% of total sales) to nonaffiliated foreign customers. This trade activity could be affected by fluctuations in foreign currency exchange or by weak economic conditions. The Company s currency exposure is concentrated in the Canadian dollar, Mexican peso, New Taiwan dollar, Chinese RMB and Hong Kong dollar. Because of the Company s limited exposure to any single foreign market, any exchange gains or losses have not been material and are not expected to be material in the future. Had the exchange rate as of January 2, 2010 for all of the listed currencies changed by 1%, the total change in reported earnings would have been less than $5,000. As a result, the Company does not attempt to mitigate its foreign currency exposure through the acquisition of any speculative or leveraged financial instruments. In 2009, a 10% increase/decrease in exchange rates would have resulted in a translation increase/decrease to sales of approximately $1.2 million, and to equity of approximately $2.5 million.

On January 29, 2010, subsequent to the date of the financial statements included in Item 8 of this Form 10-K and prior to filing this Form 10-K, the Company eliminated its interest rate risk by refinancing its long-term debt at a fixed rate of 4.98%. See Note 5 to the Company s financial statements included at Item 8 of this Annual Report on Form 10-K.

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ITEM 8 FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The Eastern Company

Consolidated Balance Sheets

	January 2 2010	January 3 2009
ASSETS		
Current Assets		
Cash and cash equivalents	**$ 16,746,673**	$ 8,967,625
Accounts receivable, less allowances of $392,000 in 2009 and $328,000 in 2008	**15,326,416**	17,021,774
Inventories:		
Raw materials and component parts	**7,837,854**	7,719,540
Work in process	**4,367,851**	6,448,593
Finished goods	**12,314,584**	16,628,746
	24,520,289	30,796,879
Prepaid expenses and other assets	**2,037,745**	2,366,634
Recoverable income taxes receivable		1,313,628
Deferred income taxes	**1,129,898**	1,225,723
Total Current Assets	**59,761,021**	61,692,263
Property, Plant and Equipment		
Land	**1,134,743**	1,102,385
Buildings	**13,790,853**	13,751,059
Machinery and equipment	**35,413,406**	33,574,613
Accumulated depreciation	**(27,365,369)**	(24,517,348)
	22,973,633	23,910,709
Other Assets		
Goodwill	**13,869,005**	13,700,356
Trademarks	**151,341**	143,818
Patents, technology and other intangibles net of accumulated amortization	**2,796,698**	3,415,012
Deferred income taxes	**1,283,323**	3,154,810
Prepaid pension cost	**36,838**	
	18,137,205	20,413,996
	$ 100,871,859	$ 106,016,968

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Consolidated Balance Sheets

	January 2 2010	January 3 2009
LIABILITIES AND SHAREHOLDERS EQUITY		
Current Liabilities		
Accounts payable	**$ 5,335,317**	$ 7,081,303
Accrued compensation	**1,811,236**	1,919,322
Other accrued expenses	**1,191,360**	1,706,681
Current portion of long-term debt	**7,142,858**	2,240,202
Total Current Liabilities	**15,480,771**	12,947,508
Other long-term liabilities	**1,077,247**	1,614,833
Long-term debt, less current portion	**4,285,713**	11,428,571
Accrued postretirement benefits	**1,341,498**	1,062,719
Accrued pension cost	**12,089,326**	15,311,924
Interest rate swap obligation		1,169,848
Commitments and contingencies (See Note 4)		
Shareholders Equity		
Voting Preferred Stock, no par value:		
Authorized and unissued: 1,000,000 shares		
Nonvoting Preferred Stock, no par value:		
Authorized and unissued: 1,000,000 shares		
Common Stock, no par value:		
Authorized: 50,000,000 shares		
Issued: 8,709,384 shares in 2009 and 8,553,353 shares in 2008	**26,236,477**	24,418,916
Treasury Stock: 2,644,215 shares in 2009 and 2,588,334 shares in 2008	**(18,375,416)**	(17,578,088)
Retained earnings	**67,558,201**	68,676,943
Accumulated other comprehensive income (loss):		
Foreign currency translation	**1,696,013**	664,990
Unrecognized net pension and postretirement benefit costs, net of taxes	**(10,517,971)**	(12,944,539)
Derivative financial instruments, net of taxes		(756,657)
	(8,821,958)	(13,036,206)
Total Shareholders Equity	**66,597,304**	62,481,565
	$ 100,871,859	$ 106,016,968

See accompanying notes.

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Consolidated Statements of Income

	Year ended		
	January 2 2010	**January 3 2009**	**December 29 2007**
Net sales	**$112,665,464**	$ 135,878,490	$ 156,281,083
Cost of products sold	**(92,031,078)**	(110,415,392)	(120,343,196)
Gross margin	**20,634,386**	25,463,098	35,937,887
Selling and administrative expenses	**(17,055,610)**	(18,432,700)	(20,008,851)
Operating profit	**3,578,776**	7,030,398	15,929,036
Interest expense	**(1,727,980)**	(1,063,607)	(1,288,952)
Other income	**50,733**	76,057	205,379
Income before income taxes	**1,901,529**	6,042,848	14,845,463
Income taxes	**865,122**	1,538,225	4,764,770
Net income	**$1,036,407**	$ 4,504,623	$ 10,080,693
Earnings per Share:			
Basic	**$0.17**	$ 0.77	$ 1.79
Diluted	**$0.17**	$ 0.73	$ 1.68

See accompanying notes.

Consolidated Statements of Comprehensive Income (Loss)

	Year ended		
	January 2 2010	**January 3 2009**	**December 29 2007**
Net income	**$ 1,036,407**	$ 4,504,623	$ 10,080,693
Other comprehensive income/(loss) -			
Change in foreign currency translation	**1,031,023**	(1,735,278)	1,643,816
Change in fair value of derivative financial instruments, net of income tax (expense)/benefit of ($72,200) in 2009, $204,866 in 2008 and $158,343 in 2007	**130,298**	(387,041)	(281,185)
Reclassification adjustment for termination of derivative financial instrument, net of income tax expense of $340,991	**626,359**		
Change in pension and postretirement benefit costs, net of income taxes (expense)/benefit of ($1,341,658) in 2009, $5,581,644 in 2008 and ($1,808,898) in 2007	**2,426,568**	(10,306,221)	3,193,078
	4,214,248	(12,428,540)	4,555,709
Comprehensive income/(loss)	**$ 5,250,655**	$ (7,923,917)	$ 14,636,402

See accompanying notes.

Consolidated Statements of Shareholders Equity

	Common Shares	Common Stock	Treasury Shares	Treasury Stock	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Shareholders Equity
Balances at December 30, 2006	8,012,550	$ 17,974,115	(2,533,089)	$ (16,655,041)	$ 58,279,371	$ (5,207,240)	$ 54,391,205
Net income					10,080,693		10,080,693
Cash dividends declared, $.32 per share					(1,801,570)		(1,801,570)
Currency translation adjustment						1,643,816	1,643,816
Change in pension and postretirement benefit costs, net of tax						3,193,078	3,193,078
Change in derivative financial instrument, net of tax						(281,185)	(281,185)
Change in accounting for uncertain tax positions					(295,928)		(295,928)
Purchase of Common Stock for treasury			(12,290)	(312,521)			(312,521)
Issuance of Common Stock upon the exercise of stock options	339,749	2,562,997					2,562,997
Tax benefit from exercise of non-qualified stock options and disqualifying dispositions of incentive stock options		1,575,500					1,575,500
Cash payment for fractional shares resulting from exercise of stock options		(20)					(20)
Issuance of Common Stock for directors fees	2,679	61,203					61,203
Balances at December 29, 2007	8,354,978	22,173,795	(2,545,379)	(16,967,562)	66,262,566	(651,531)	70,817,268
Net income					4,504,623		4,504,623
Cash dividends declared, $.33 per share					(1,938,172)		(1,938,172)
Currency translation adjustment						(1,735,278)	(1,735,278)
Change in pension and postretirement benefit costs, net of tax						(10,306,221)	(10,306,221)
Change in derivative financial instrument, net of tax						(387,041)	(387,041)
Effects of changing pension plan measurement date pursuant to ASC 715, net of tax					(152,074)	43,865	(108,209)

Consolidated Statements of Shareholders Equity *(continued)*

	Common Shares	Common Stock	Treasury Shares	Treasury Stock	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Shareholders Equity
Purchase of Common Stock for treasury			(42,955)	(610,526)			(610,526)
Issuance of Common Stock upon the exercise of stock options	196,606	1,861,486					1,861,486
Tax benefit from exercise of non-qualified stock options and disqualifying dispositions of incentive stock options		355,799					355,799
Cash payment for fractional shares resulting from exercise of stock options		(4)					(4)
Issuance of Common Stock for directors fees	1,769	27,840					27,840
Balances at January 3, 2009	8,553,353	24,418,916	(2,588,334)	(17,578,088)	68,676,943	(13,036,206)	62,481,565
Net income					**1,036,407**		**1,036,407**
Cash dividends declared, $.36 per share					**(2,155,149)**		**(2,155,149)**
Currency translation adjustment						**1,031,023**	**1,031,023**
Change in pension and postretirement benefit costs, net of tax						**2,426,568**	**2,426,568**
Change in derivative financial instrument, net of tax						**130,298**	**130,298**
Termination of derivative financial instrument, net of tax						**626,359**	**626,359**
Purchase of Common Stock for treasury			**(55,881)**	**(797,328)**			**(797,328)**
Issuance of Common Stock upon the exercise of stock options	**153,421**	**1,584,042**					**1,584,042**
Tax benefit from exercise of non-qualified stock options and disqualifying dispositions of incentive stock options		**202,767**					**202,767**
Issuance of Common Stock for directors fees	**2,610**	**30,752**					**30,752**
Balances at January 2, 2010	**8,709,384**	**$ 26,236,477**	**(2,644,215)**	**$ (18,375,416)**	**$ 67,558,201**	**$ (8,821,958)**	**$ 66,597,304**

See accompanying notes.

Consolidated Statements of Cash Flows

	Year ended January 2 2010	January 3 2009	December 29 2007
Operating Activities			
Net income	**$ 1,036,407**	$ 4,504,623	$ 10,080,693
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	**4,103,317**	4,128,312	4,369,998
Loss on sale of equipment and other assets	**5,644**	7,003	65,182
Provision for doubtful accounts	**320,716**	132,988	45,740
Deferred income taxes	**235,788**	286,046	(404,618)
Issuance of Common Stock for directors fees	**30,752**	27,840	61,203
Changes in operating assets and liabilities:			
Accounts receivable	**1,573,393**	1,467,368	6,133,976
Inventories	**6,671,197**	(1,099,265)	(1,923,947)
Prepaid expenses and other	**361,028**	272,933	(462,604)
Prepaid pension cost	**791,059**	(130,905)	(684,514)
Recoverable taxes receivable	**1,313,628**	100,288	(1,411,477)
Other assets	**(15,847)**	(111,295)	(229,858)
Accounts payable	**(1,858,201)**	(911,386)	(5,190,868)
Accrued compensation	**(127,707)**	(634,707)	(549,639)
Other accrued expenses	**(1,097,616)**	(426,618)	(1,139,189)
Net cash provided by operating activities	**13,343,558**	7,613,225	8,760,078
Investing Activities			
Purchases of property, plant and equipment	**(2,226,025)**	(2,331,341)	(2,867,829)
Proceeds from sale of equipment and other assets		13,246	25,120
Business acquisitions		(128,325)	
Net cash used in investing activities	**(2,226,025)**	(2,446,420)	(2,842,709)
Financing Activities			
Principal payments on long-term debt	**(2,240,202)**	(3,838,029)	(3,111,907)
Proceeds from sales of Common Stock	**1,584,042**	1,861,486	2,562,997
Tax benefit from disqualifying disposition of incentive stock options and exercise of non-qualified stock options	**202,767**	355,799	1,575,500
Purchases of Common Stock for treasury	**(797,328)**	(610,526)	(312,521)
Cash payment for fractional shares resulting from exercise of stock options		(4)	(20)
Dividends paid	**(2,155,149)**	(1,938,172)	(1,801,570)
Net cash used in financing activities	**(3,405,870)**	(4,169,446)	(1,087,521)
Effect of exchange rate changes on cash	**67,385**	(239,456)	278,416
Net change in cash and cash equivalents	**7,779,048**	757,903	5,108,264
Cash and cash equivalents at beginning of year	**8,967,625**	8,209,722	3,101,458
Cash and cash equivalents at end of year	**$ 16,746,673**	$ 8,967,625	$ 8,209,722

See accompanying notes.

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The Eastern Company

Notes to Consolidated Financial Statements

1. DESCRIPTION OF BUSINESS

The operations of The Eastern Company (the Company) consist of three business segments: industrial hardware, security products, and metal products. The industrial hardware segment produces latching devices for use on industrial equipment and instrumentation as well as a broad line of proprietary hardware designed for truck bodies and other vehicular type equipment. The security products segment manufactures and markets a broad range of locks for traditional general purpose security applications as well as specialized locks for soft luggage, coin-operated vending and gaming equipment, and electric and computer peripheral components. This segment also manufactures and markets coin acceptors and metering systems to secure cash used in the commercial laundry industry and produces cashless payment systems utilizing advanced smart card technology. The metal products segment produces anchoring devices used in supporting the roofs of underground coal mines and specialty products, which serve the construction, automotive and electrical industries.

On August 13, 2008, the Company entered into a joint venture agreement to further develop existing technology for use in the Security Products segment. The joint venture is currently not material to the consolidated financial statements of the Company. The Company's 80% ownership of this joint venture has been consolidated into its financial statements with the remaining 20% ownership accounted for as a minority interest therein, and included in other accrued expenses.

Sales are made to customers primarily in North America.

The consolidated balance sheets reflect the reclassification of debt per the refinancing which occurred in January 2010. See Note 5 Debt.

2. ACCOUNTING POLICIES

Estimates and Assumptions

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements, as well as the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Fiscal Year

The Company s year ends on the Saturday nearest to December 31. Fiscal 2009 and 2007 were 52 weeks, 2008 was a 53 week year.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its subsidiaries, all of which are wholly-owned. All intercompany accounts and transactions are eliminated.

Cash Equivalents and Concentrations of Credit Risk

Highly liquid investments purchased with a maturity of three months or less are considered cash equivalents. The Company has deposits that exceed amounts insured by the Federal Deposit Insurance Corporation (FDIC) up to $250,000, but the Company does not consider this a significant concentration of credit risk based on the strength of the financial institution.

Reclassification

Certain prior period amounts have been reclassified to conform to the current period presentation. These reclassifications had no effect on previously reported net income.

The Eastern Company

Notes to Consolidated Financial Statements (continued)

2. ACCOUNTING POLICIES ***(continued)***

Foreign Currency Translation

For foreign operations, balance sheet accounts are translated at the current year-end exchange rate; income statement accounts are translated at the average exchange rate for the year. Resulting translation adjustments are made directly to a separate component of shareholders equity Accumulated other comprehensive income (loss) Foreign currency translation . Foreign currency exchange transaction gains and losses are not material in any year.

Recognition of Revenue and Accounts Receivable

Revenue and accounts receivable are recognized when persuasive evidence of an arrangement exists, the price is fixed and determinable, delivery has occurred, and there is a reasonable assurance of collection of the sales proceeds. The Company obtains written purchase authorizations from its customers for a specified amount of product at a specified price and delivery occurs at the time of shipment. Credit is extended based on an evaluation of each customer s financial condition; collateral is not required. Accounts receivable are recorded net of applicable allowances. No customers exceeded 10% of total accounts receivable at year end 2009 or 2008.

Allowance for Doubtful Accounts

The Company maintains an allowance for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments. The Company reviews the collectibility of its receivables on an ongoing basis taking into account a combination of factors. The Company reviews potential problems, such as past due accounts, a bankruptcy filing or deterioration in the customer s financial condition, to ensure the Company is adequately accrued for potential loss. Accounts are considered past due based on when payment was originally due. If a customer s situation changes, such as a bankruptcy or creditworthiness, or there is a change in the current economic climate, the Company may modify its estimate of the allowance for doubtful accounts. The Company will write off accounts receivable after reasonable collection efforts have been made and the accounts are deemed uncollectible. Write-offs have been within management s estimates.

Inventories

Inventories are valued at the lower of cost or market. Cost is determined by the last-in, first-out (LIFO) method in the U.S. ($17,924,698 for U.S. inventories at January 2, 2010) and by the first-in, first-out (FIFO) method for inventories outside the U.S. ($6,595,591 for inventories outside the U.S. at January 2, 2010). Current cost exceeds the LIFO carrying value by approximately $4,725,000 at January 2, 2010 and $6,212,000 at January 3, 2009. There was no material LIFO quantity liquidation in 2009, 2008 or 2007.

Property, Plant and Equipment and Related Depreciation

Property, plant and equipment (including equipment under capital lease) are stated at cost. Depreciation ($3,387,575 in 2009, $3,410,538 in 2008 and $3,770,280 in 2007) is computed generally using the straight-line method based on the following estimated useful lives of the assets: Buildings 10 to 39.5 years; Machinery and equipment 3 to 10 years.

Goodwill, Intangibles and Impairment of Long-Lived Assets

Patents are recorded at cost and are amortized using the straight-line method over the lives of the patents. Technology and licenses are recorded at cost and are generally amortized on a straight-line basis over periods ranging from 5 to 17 years. Non-compete agreements and customer relationships are being amortized using the straight-line method over a period of 5 years. Amortization expense in 2009, 2008 and 2007 was $715,742, $717,774 and $599,718, respectively. Total amortization expense for each of the next five years is estimated to be as follows: 2010 - $648,000; 2011 - $547,000; 2012 - $235,000; 2013 - $220,000; and 2014 - $220,000. Trademarks are not amortized as their lives are deemed to be indefinite.

The Eastern Company

Notes to Consolidated Financial Statements (continued)

2. ACCOUNTING POLICIES *(continued)*

The gross carrying amount and accumulated amortization of amortizable intangible assets:

	Industrial Hardware Segment	Security Products Segment	Metal Products Segment	Total	Weighted-Average Amortization Period (Years)
2009 Gross Amount:					
Patents and developed technology	$ 2,662,125	$ 995,778	$ 45,679	$ 3,703,582	**16.0**
Customer relationships	45,825	1,921,811		1,967,636	**5.0**
Non-compete agreements	30,000	90,735		120,735	**5.0**
Other		128,941		128,941	**1.0**
Total Gross Intangibles	$ 2,737,950	$ 3,137,265	$ 45,679	$ 5,920,894	**11.6**
2009 Accumulated Amortization:					
Patents and developed technology	$ 1,262,599	$ 342,109	$ 41,996	$ 1,646,704	
Customer relationships	18,330	1,246,219		1,264,549	
Non-compete agreements	12,000	75,943		87,943	
Other		125,000		125,000	
Total Gross Amortization	$ 1,292,929	$ 1,789,271	$ 41,996	$ 3,124,196	
Net 2009 per Balance Sheet	**$ 1,445,021**	**$ 1,347,994**	**$ 3,683**	**$ 2,796,698**	
2008 Gross Amount:					
Patents and developed technology	$ 2,508,494	$ 1,039,925	$ 60,354	$ 3,608,773	**15.8**
Customer relationships	45,825	1,921,811		1,967,636	**5.0**
Non-compete agreements	30,000	90,735		120,735	**5.0**
Other		128,941		128,941	**1.0**
Total Gross Intangibles	$ 2,584,319	$ 3,181,412	$ 60,354	$ 5,826,085	**11.3**
2008 Accumulated Amortization:					
Patents and developed technology	$ 1,098,787	$ 258,295	$ 53,680	$ 1,410,762	
Customer relationships	9,165	861,857		871,022	
Non-compete agreements	6,000	67,733		73,733	
Other		55,556		55,556	
Total Gross Amortization	$ 1,113,952	$ 1,243,441	$ 53,680	$ 2,411,073	
Net 2008 per Balance Sheet	**$ 1,470,367**	**$ 1,937,971**	**$ 6,674**	**$ 3,415,012**	

In the event that facts and circumstances indicate that the carrying value of long-lived assets, including definite life intangible assets, may be impaired, an evaluation is performed to determine if a write-down is required. No events or changes in circumstances have occurred to indicate that the carrying amount of such long-lived assets held and used may not be recovered.

The Eastern Company

Notes to Consolidated Financial Statements (continued)

2. ACCOUNTING POLICIES *(continued)*

The Company evaluates the carrying amount of goodwill and trademarks on our balance sheets for possible impairment annually during the second quarter of each year. Goodwill or trademarks would be considered impaired whenever our historical carrying amount exceeds the fair value. Goodwill and trademarks were not impaired in 2009, 2008 or 2007. Should we reach a different conclusion in the future, additional work would be performed to determine the amount of the non-cash impairment charge to be recognized. The maximum future impairment of goodwill or trademarks that could occur is the amount recognized on our balance sheet.

The following is a roll-forward of goodwill for 2009 and 2008:

	Industrial Hardware Segment	Security Products Segment	Metal Products Segment	Total
2009				
Beginning balance	**$ 1,866,540**	**$ 11,833,816**	**$**	**$ 13,700,356**
Foreign exchange	**168,649**			**168,649**
Ending balance	**$ 2,035,189**	**$ 11,833,816**	**$**	**$ 13,869,005**
2008				
Beginning balance	$ 2,121,792	$ 11,833,816	$	$ 13,955,608
Foreign exchange	(255,252)			(255,252)
Ending balance	$ 1,866,540	$ 11,833,816	$	$ 13,700,356

Cost of Products Sold

The Company includes the cost of inventory sold and related costs for the acquisition and distribution of its products in cost of products sold. These costs include inbound freight charges, receiving, inspection, purchasing and warehousing related costs.

Selling and Administrative Expenses

All advertising, selling, general consulting, executive salaries, regulatory compliance, audit, legal and professional fees are included in selling and administrative expenses.

Product Development Costs

Product development costs, charged to expense as incurred, were $1,330,729 in 2009, $1,293,167 in 2008 and $1,439,044 in 2007.

Advertising Costs

The Company expenses advertising costs as incurred. Advertising costs were $486,598 in 2009, $560,660 in 2008 and $540,499 in 2007.

Income Taxes

In the first quarter of 2007 the Company adopted provisions of The FASB Accounting Standards Codification (ASC) 740 which clarifies the accounting for uncertainty in income taxes recognized in a company s financial statements. These provisions detail how companies should recognize, measure, present and disclose uncertain tax positions that have or are expected to be taken. As such, the financial statements will reflect expected future tax consequences of uncertain tax positions presuming the taxing authorities full knowledge of the position and all relevant facts. See Note 8 Income Taxes.

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The Eastern Company

Notes to Consolidated Financial Statements (continued)

2. ACCOUNTING POLICIES ***(continued)***

The Company and its U.S. subsidiaries file a consolidated federal income tax return.

Deferred tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse.

Earnings per Share

The denominators used in the earnings per share computations follow:

	2009	**2008**	**2007**
Basic:			
Weighted average shares outstanding	**5,985,640**	5,875,140	5,631,073
Diluted:			
Weighted average shares outstanding	**5,985,640**	5,875,140	5,631,073
Dilutive stock options	**256,140**	284,423	358,681
Denominator for diluted earnings per share	**6,241,780**	6,159,563	5,989,754

There were no anti-dilutive stock options in 2009 or 2007. The Company has excluded the effect of 261,750 shares in 2008 from the above dilutive stock options, as their inclusion would be anti-dilutive.

Derivatives

The Company maintained an interest rate swap agreement until December 2009 to minimize the risk of fluctuations of interest rates on the Company s variable rate term debt. The agreement involved the exchange of amounts based on the London Interbank Offered Rate (LIBOR) for amounts based on a fixed interest rate over the life of the agreement, without an exchange of the notional amount upon which the payments are based.

The Company s interest rate swap agreement was accounted for as a cashflow hedge, and, as a result, changes in the fair value of the derivative are recorded as an asset or liability with the offset amount recorded to accumulated other comprehensive income (loss) in shareholders equity for

2008 and 2007. There have been no losses related to the ineffectiveness of the Company s cashflow hedge in any of the years presented. On December 22, 2009, the Company terminated the interest rate swap contract at a cost of $967,350 that was accounted for as a charge to interest expense. See Note 5 Debt.

Stock Based Compensation

The Company accounts for stock based compensation pursuant to the fair value recognition provisions of ASC 718. No stock options were granted in 2009, 2008 or 2007, and as all options granted prior to January 1, 2006 were fully vested, there was no impact on the financial statements for any year presented.

The Eastern Company

Notes to Consolidated Financial Statements (continued)

2. ACCOUNTING POLICIES *(continued)*

Fair Value of Financial Instruments

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. The company utilizes a fair value hierarchy, which maximizes the use of observable inputs and minimizes the use of unobservable inputs when measuring fair value. The fair value hierarchy has three levels of inputs that may be used to measure fair value:

Level 1 Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.

Level 2 Quoted prices in markets that are not active; or other inputs that are observable, either directly or indirectly, for substantially the full term of the asset or liability.

Level 3 Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable.

The carrying amounts of financial instruments (cash and cash equivalents, accounts receivable, accounts payable, the interest rate swap agreement, and debt) as of January 2, 2010 and January 3, 2009, approximate fair value. Fair value was based on expected cash flows and current market conditions.

3. BUSINESS ACQUISITIONS

Effective January 11, 2008 the Company acquired certain assets from Auto-Vehicle Parts Company that included a certain product line owned by one of its divisions, the F.A. Neider Company (Neider). Neider produces the footman loop products, or strap fasteners, which are used to fasten straps, traps, tools, and cargo to a vehicle, container, or trailer. Neider manufactures footman loops used in the following markets: military, aerospace, service body, and trailer. The footman loop product line was integrated into the Company s Industrial Hardware segment. The cost of the Neider acquisition was $128,325, inclusive of transaction costs.

The above acquisition has been accounted for using the purchase method. The acquired product line is included in the consolidated operating results of the Company from the date of acquisition. There was no goodwill attributable to the acquisition of Neider.

Neither the actual results nor the pro forma effects of the acquisition of the above product line are material to the Company s financial statements.

4. CONTINGENCIES

The Company is party to various legal proceedings and claims related to its normal business operations. In the opinion of management, the Company has substantial and meritorious defenses for these claims and proceedings in which it is a defendant, and believes these matters will be ultimately resolved without a material adverse effect on the consolidated financial position, results of operations or liquidity of the Company. The aggregate provision for losses related to contingencies arising in the ordinary course of business was not material to operating results for any year presented.

Reflected in the 2007 Consolidated Statements of Income in Selling and administrative expenses is a contingency reserve for $250,000 relating to environmental issues at the Frazer & Jones Division. Settlement payments and remediation costs approximated $250,000 in 2008.

Approximately 42% of the total workforce is subject to negotiated union contracts, and approximately 18% of the total workforce is covered by such agreements that expire during 2010.

The Eastern Company

Notes to Consolidated Financial Statements (continued)

5. DEBT

On September 22, 2006 the Company signed an unsecured loan agreement (Loan Agreement), which included a $20,000,000 term loan and a revolving line of credit, with its lender, Bank of America, N.A. The term portion of the loan required quarterly payments of $714,286 for a period of seven (7) years, maturing on September 22, 2013. Prior to April 21, 2009, the revolving credit portion allowed the Company to borrow up to $12,000,000 with a maturity date of September 22, 2009. The revolving credit portion had a variable quarterly commitment fee ranging from 0.10% to 0.25% based on operating results. Effective April 21, 2009, the Company agreed to a reduction in the amount available on the revolving credit portion to $3,000,000. Effective June 19, 2009, the quarterly commitment fee was fixed at 0.5%. There were no outstanding balances under the revolving credit portion at January 2, 2010 or January 3, 2009.

The interest rates on the term and the revolving credit portions of the Loan Agreement vary. Prior to June 19, 2009, the interest rates varied based on the LIBOR rate plus a margin spread of 1.0% to 1.65% for the term portion and 1.0% to 1.6% for the revolving credit portion. The margin rate spread was based on operating results calculated on a rolling-four-quarter basis. Effective June 19, 2009, the margin spread was fixed at a rate of 2.25%. The Company may also borrow funds at the lender s prime rate. On January 2, 2010, the interest rate on the term portion of the Loan Agreement was approximately 2.54%.

On November 13, 2009, the Company amended its Loan Agreement with Bank of America, N.A. The amendment extended the term of the revolving credit portion of the Loan Agreement to May 31, 2010 and permanently reduced the amount available to borrow to $3,000,000. In addition, the margin rate spread was fixed at two and one quarter percent (2.25%); the unused line fee was increased to one half of one percent (0.50%); and the fixed coverage ratio covenant was modified such that it will be calculated on a fiscal year to date basis (instead of a rolling four quarter basis) commencing with the second quarter of fiscal 2009, provided that if the Company fails to comply with such fixed coverage ratio covenant for any quarter, then such ratio will be re-calculated to add back the amount of permitted dividends declared and actually paid during the period to meet the required 1.1 to 1.0 ratio, so long as the payment of such dividends does not result in the amount of consolidated cash to be below $10,000,000 on the date of determination. The testing period will return to a rolling 4 quarter period effective with the end of the first quarter of 2010. The amendment also required the Company to secure all of the present and future indebtedness of the Company and its subsidiaries with a continuing first priority security interest in all present and future assets of the Company and its consolidated subsidiaries.

On November 2, 2006, the Company entered into an interest rate swap contract with the lender with an original notional amount of $20,000,000, which was equal to 100% of the outstanding balance of the term loan on that date. The notional amount began decreasing on a quarterly basis on January 2, 2007 following the principal repayment schedule of the term loan. The Company has a fixed interest rate of 5.25% on the swap contract and paid the difference between the fixed rate and LIBOR when LIBOR was below 5.25% and received interest when the LIBOR rate exceeded 5.25%. This remained in effect until December 22, 2009 when the Company terminated the interest rate swap contract at a cost of $967,350, which was accounted for as a charge to interest expense. After terminating the contract, the Company commenced a refinancing plan of the Company s outstanding debt.

Subsequent to January 2, 2010, the Company completed the refinancing of all of its debt. On January 29, 2010, the Company signed a new secured Loan Agreement (the New Loan Agreement) with People s United Bank (People s) which included a $5,000,000 term portion and a $10,000,000 revolving credit portion. The term portion of the loan requires quarterly payments of $178,571 for a period of seven (7) years, maturing on January 31, 2017. The revolving credit portion has a quarterly commitment fee of one quarter of one percent (0.25%). The proceeds of the term portion along with the Company s available cash were used to retire the remaining portion of the debt with Bank of America, N.A., which on January 29, 2010 totaled $10,714,286.

Interest on the term portion of the New Loan Agreement is fixed at 4.98%. The interest rate on the revolving credit portion of the New Loan Agreement varies based on the LIBOR rate or People s Prime rate plus a margin spread of 2.25%, with a floor rate of 4.0%.

The Eastern Company

Notes to Consolidated Financial Statements (continued)

5. DEBT ***(continued)***

As a result of the refinancing in January 2010, the Company reclassified a portion of its long-term debt to current. Debt consists of:

	2009	2008
Term loan	**$ 11,428,571**	$ 13,571,428
Capital lease obligation with interest at 4.99% and payable in monthly installments of $21,203 through April 2009		83,838
Capital lease obligation with interest at 0% and payable in monthly installments of $1,915 through July 2009		13,407
	11,428,571	13,668,773
Less current portion	**7,142,858**	2,240,202
	$ 4,285,713	$ 11,428,571

The Company paid interest of $1,649,607 in 2009, $1,318,371 in 2008 and $1,323,246 in 2007.

Collectively, under the covenants of the Loan Agreement and the New Loan Agreement, the Company is required to maintain specified financial ratios and amounts. In addition, the Company has restrictions on, among other things, new capital leases, purchases or redemptions of its capital stock, mergers and divestitures, and new borrowing.

As of January 2, 2010, scheduled annual principal maturities of long-term debt for each of the next five years follow:

2010	$ 7,142,858
2011	714,286
2012	714,286
2013	714,286
2014	892,857
Thereafter	1,249,998
	$ 11,428,571

The Company paid approximately $5.7 million of the $7.1 million of scheduled annual principal maturities for 2010, shown in the table above, in connection with the refinancing of the Company s debt on January 29, 2010.

All capital leases of the Company matured during Fiscal 2009. On January 3, 2009, building improvements and equipment, with a cost of approximately $2,069,000, were recorded under capital leases with accumulated amortization of approximately $978,000.

6. STOCK RIGHTS

On July 23, 2008, the Company adopted a new stock rights plan to replace the plan that expired on July 22, 2008. At January 2, 2010, there were 6,065,169 stock rights outstanding under the plan. Each right may be exercised to purchase one share of the Company s common stock at an exercise price of $80.00, subject to adjustment to prevent dilution.

The rights generally become exercisable ten days after an individual or group acquires 10% or more of the Company s outstanding common stock, or after the commencement or announcement of an offer to acquire 10% or more of the Company s common stock. The stock rights, which do not have voting privileges, expire on July 23, 2018, and may be redeemed by the Company at a price of $0.01 per right at any time prior to their expiration at the discretion of the Board of Directors. In the event that the Company were acquired in a merger or other business combination transaction, provision shall be made so that each holder of a right shall have the right to receive, upon exercise of the right at its then current exercise price, that number of shares of common stock of the surviving company which at the time of such transaction would have a market value of two times the exercise price of the right.

The Eastern Company

Notes to Consolidated Financial Statements (continued)

7. Stock Options and Awards

Stock Options

The Company has stock option plans for officers, other key employees, and non-employee directors. At the end of 2009 two plans have shares reserved for future issuance, the 1995 and 2000 plans. Incentive stock options granted under the 1995 and 2000 plans must have exercise prices that are not less than 100% of the fair market value of the stock on the dates the options are granted. Restricted stock awards may also be granted to participants under the 1995 and 2000 plans with restrictions determined by the Compensation Committee of the Company s Board of Directors. Under the 1995 and 2000 plans, non-qualified stock options granted to participants will have exercise prices determined by the Compensation Committee of the Company s Board of Directors. No options or restricted stock were granted in 2009, 2008 or 2007.

As of January 2, 2010, there were 367,500 shares available for future grant under the above noted 2000 plan and there were no shares available for grant under the 1995 plan. As of January 2, 2010, there were 589,250 shares of common stock reserved under all option plans for future issuance.

Information with respect to the Company s stock option plans is summarized below:

	Shares	**Weighted Average Exercise Price**
Outstanding at December 30, 2006	1,002,750	$ 9.233
Exercised	(339,750)	7.544
Outstanding at December 29, 2007	663,000	10.099
Exercised	(196,606)	9.468
Cancelled	(28,394)	9.330
Outstanding at January 3, 2009	438,000	10.432
Exercised	**(153,421)**	**10.325**
Cancelled	**(62,829)**	**10.170**
Outstanding at January 2, 2010	**221,750**	**10.581**

Options Outstanding and Exercisable

	Outstanding and Exercisable as of January 2, 2010	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price

Range of Exercise Prices			
$9.46 $10.20	166,250	1.0	$ 9.579
$13.58	55,500	5.0	13.580
	221,750	2.0	10.581

At January 2, 2010, outstanding and exercisable options had an intrinsic value of $640,163. The total intrinsic value of stock options exercised in 2009 was $683,754.

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The Eastern Company

Notes to Consolidated Financial Statements (continued)

8. INCOME TAXES

Deferred income taxes are provided on temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and those for income tax reporting purposes. Deferred income tax (assets) liabilities relate to:

	2009	2008	2007
Property, plant and equipment	**$ 3,984,625**	$ 3,775,424	$ 3,399,329
Intangible assets			
Pensions			240,511
Other			
Total deferred income tax liabilities	**3,984,625**	3,775,424	3,639,840
Other postretirement benefits	**(472,878)**	(375,028)	(400,555)
Inventories	**(688,253)**	(782,446)	(804,529)
Allowance for doubtful accounts	**(93,386)**	(79,714)	(81,352)
Intangible assets	**(409,233)**	(302,576)	(245,401)
Accrued compensation	**(294,464)**	(348,870)	(360,540)
Interest rate swap obligation		(413,190)	(208,325)
Pensions	**(4,248,502)**	(5,116,289)	
Tax credits		(557,354)	(318,176)
Environmental reserve			(77,679)
Other	**(191,130)**	(180,490)	(9,181)
Total deferred income tax assets	**(6,397,846)**	(8,155,957)	(2,505,738)
Net deferred income tax (assets) liabilities	**$ (2,413,221)**	$ (4,380,533)	$ 1,134,102

Income before income taxes consists of:

	2009	2008	2007
Domestic	**$ 2,274,641**	$ 4,901,283	$ 13,133,039
Foreign	**(373,112)**	1,141,565	1,712,424
	$ 1,901,529	$ 6,042,848	$ 14,845,463

The provision for income taxes follows:

	2009	2008	2007
Current:			
Federal	**$ 505,005**	$ 896,199	$ 4,537,394
Foreign	**(128,177)**	198,634	281,201

State	**252,506**	157,346	350,793
Deferred:			
Federal	**264,227**	352,450	(354,609)
Foreign			
State	**(28,439)**	(66,404)	(50,009)
	$ 865,122	$ 1,538,225	$ 4,764,770

The Eastern Company

Notes to Consolidated Financial Statements (continued)

8. INCOME TAXES *(continued)*

A reconciliation of income taxes computed using the U.S. federal statutory rate to that reflected in operations follows:

	2009 Amount	**Percent**	**2008 Amount**	**Percent**	**2007 Amount**	**Percent**
Income taxes using U.S. federal statutory rate	**$ 646,520**	**34 %**	$ 2,054,568	34 %	$ 5,047,457	34 %
State income taxes, net of federal benefit	**149,893**	**8**	53,898	1	178,834	1
Impact of foreign subsidiaries on effective tax rate	**173,415**	**9**	(379,009)	(6)	(558,068)	(4)
Impact of manufacturers deduction on effective tax rate	**(68,174)**	**(4)**	(95,620)	(2)	(149,950)	(1)
Other net	**(36,532)**	**(2)**	(95,612)	(2)	246,497	2
	$ 865,122	**45 %**	$ 1,538,225	25 %	$ 4,764,770	32 %

Total income taxes paid were $645,976 in 2009, $1,061,151 in 2008 and $7,008,300 in 2007.

United States income taxes have been provided on the undistributed earnings of foreign subsidiaries ($10,983,219 at January 2, 2010) only where necessary because such earnings are intended to be reinvested abroad indefinitely or repatriated only when substantially free of such taxes.

During 2009 and 2008, the Company received tax benefits of $203,000 and $356,000, respectively, as a result of the exercise and sale of qualified stock options that resulted in the disqualification of those incentive stock options, and the exercise of non-qualified stock options during the year. The tax benefit associated with the exercise of the qualified and non-qualified stock options has been recorded to common stock.

A reconciliation of the beginning and ending amount of unrecognized tax benefits are as follows:

	2009	**2008**	**2007**
Balance at beginning of year	**$ 1,316,240**	$ 1,527,813	$
Balance recorded at adoption			1,565,014
Increase (decrease) for tax positions taken during a prior period	**(3,651)**	(37,014)	47,161
Increases for positions taken during the current period	**118,786**	80,822	384,373
Decreases relating to settlements	**(408,000)**	(34,595)	(47,161)
Decreases resulting from the expiration of the statute of limitations	**(231,835)**	(220,786)	(421,574)
Balance at end of year	**$ 791,540**	$ 1,316,240	$ 1,527,813

The Company files income tax returns in the U.S. federal jurisdiction, and various states and foreign jurisdictions. With few exceptions, the Company is no longer subject to U.S. federal, state and local income tax examinations by tax authorities for years before 2006 and non-U.S. income tax examinations by tax authorities prior to 2003.

Included in the balance at January 2, 2010, are $488,317 of unrecognized tax benefits that would affect the annual effective tax rate. In 2009, the Company recognized accrued interest related to unrecognized tax benefits in income tax expense. The Company had approximately $251,000 of accrued interest at January 2, 2010.

The total amount of unrecognized tax benefits could increase or decrease within the next twelve months for a number of reasons, including the closure of federal, state and foreign tax years by expiration of the statute of limitations and the recognition and measurement considerations under ASC 740. The Company believes that it is reasonably possible that the total amount of unrecognized tax benefits will not increase significantly and will decrease by approximately $185,000 over the next twelve months related primarily to the earnings of its Hong Kong subsidiary.

The Eastern Company

Notes to Consolidated Financial Statements (continued)

9. LEASES

The Company leases certain equipment and buildings under operating lease arrangements. Most leases are for a fixed term and for a fixed amount; additionally, the Company leases certain buildings under operating leases on a month-to-month basis. The Company is not a party to any leases that have step rent provisions, escalation clauses, capital improvement funding or payment increases based on any index or rate.

Future minimum payments under non-cancelable operating leases with initial or remaining terms in excess of one year during each of the next five years follow:

2010	$ 592,247
2011	580,930
2012	489,175
2013	101,559
2014	24,164
	$ 1,788,075

Rent expense for all operating leases was $758,606 in 2009, $907,617 in 2008 and $882,162 in 2007. The Company expects future rent expense, including non-cancelable operating leases, leases that are expected to be renewed and buildings leased on a month-to-month basis, for each of the next five years to be in the range of $800,000 to $900,000.

10. RETIREMENT BENEFIT PLANS

The Company has non-contributory defined benefit pension plans covering most U.S. employees. Plan benefits are generally based upon age at retirement, years of service and, for its salaried plan, the level of compensation. The Company also sponsors unfunded non-qualified supplemental retirement plans that provide certain current and former officers with benefits in excess of limits imposed by federal tax law.

The Company also provides health care and life insurance for retired salaried employees in the United States who meet specific eligibility requirements.

Effective January 3, 2009, the Company adopted authoritative guidance issued by the Financial Accounting Standards Board (FASB) related to measurement of pension and other postretirement benefit plans which requires the Company to measure the assets and obligations of its pension and other postretirement benefit plans as of the balance sheet date. Accordingly, in 2008 the Company was required to record fifteen (15) months of net periodic pension benefit cost in order to adopt the measurement date provision. The total cost was split into two parts, a twelve (12) month portion that was recorded as expense on the income statement, and a three (3) month portion that was recorded as an adjustment to retained earnings.

Following is a summary of the net periodic benefit cost recorded in Fiscal 2008:

	15 Months	3 Months	12 Months
Service cost	$2,324,033	$446,701	$1,877,332
Interest cost	3,352,940	667,863	2,685,077
Expected return on plan assets	(4,740,175)	(948,035)	(3,792,140)
Amortization of prior service cost	260,052	52,010	208,042
Amortization of the net loss	82,890	16,578	66,312
Net periodic benefit cost	$1,279,740	$235,117	$1,044,623

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Notes to Consolidated Financial Statements (continued)

10. RETIREMENT BENEFIT PLANS *(continued)*

Components of the net periodic benefit cost of the Company s pension benefit plans were as follows:

	2009	2008	2007
Service cost	**$2,205,931**	$1,877,332	$1,758,564
Interest cost	**2,829,233**	2,685,077	2,481,996
Expected return on plan assets	**(4,054,864)**	(3,792,140)	(3,847,920)
Amortization of prior service cost	**208,043**	208,042	81,791
Amortization of the transition obligation			(11,847)
Amortization of the net loss	**2,523,903**	66,312	918,116
Net periodic benefit cost	**$3,712,246**	$1,044,623	$1,380,700

Assumptions used to determine net periodic benefit cost for the Company s pension benefit plans for the fiscal year indicated were as follows:

	2009	2008	2007
Discount rate	**5.85%**	6.25%	5.8%
Expected return on plan assets	**8.5%**	8.5%	8.5%
Rate of compensation increase	**4.25%**	4.25%	4.25%

Components of the net periodic benefit cost of the Company s postretirement benefit plan were as follows:

	2009	2008	2007
Service cost	**$ 135,963**	$127,470	$111,167
Interest cost	**132,513**	124,244	128,426
Expected return on plan assets	**(61,598)**	(90,203)	(88,847)
Amortization of prior service cost	**(23,889)**	(23,886)	(23,866)
Amortization of the net (gain) loss	**(52,568)**	(33,560)	(17,335)
Net periodic benefit cost	**$ 130,421**	$104,065	$109,545

Assumptions used to determine net periodic benefit cost for the Company s postretirement plan for the fiscal year indicated were as follows:

	2009	2008	2007
Discount rate	**5.85%**	6.25%	5.8%
Expected return on plan assets	**8.5%**	8.5%	8.5%

As of the measurement date, the status of the Company s pension benefit plans and postretirement benefit plan was as follows:

	Pension Benefit		Postretirement Benefit	
	2009	**2008**	**2009**	**2008**
Benefit obligation at beginning of year	**$ 47,154,975**	$ 44,707,016	**$ 2,190,254**	$ 2,245,344
Change due to availability of final actual assets and census data				(180,343)
Service cost	**2,205,931**	2,324,033	**135,963**	127,470
Interest cost	**2,828,090**	3,354,083	**132,513**	124,244
Actuarial (gain)/loss	**1,469,762**	(378,701)	**131,233**	(11,022)
Benefits paid	**(2,121,116)**	(2,851,456)	**(133,911)**	(115,439)
Benefit obligation at end of year	**$ 51,537,642**	$ 47,154,975	**$ 2,456,052**	$ 2,190,254

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Notes to Consolidated Financial Statements (continued)

10. RETIREMENT BENEFIT PLANS (*continued*)

	Pension Benefit		Postretirement Benefit	
	2009	**2008**	**2009**	**2008**
Fair value of plan assets at beginning of year	**$ 31,843,051**	$ 45,272,679	**$ 1,127,535**	$ 1,134,110
Change due to availability of final actual assets and census data			**(74,579)**	(72,901)
Actual return on plan assets	**6,843,175**	(11,837,886)	**61,598**	66,326
Employer contributions	**2,920,044**	1,259,714	**133,911**	115,439
Benefits paid	**(2,121,116)**	(2,851,456)	**(133,911)**	(115,439)
Fair value of plan assets at end of year	**$ 39,485,154**	$ 31,843,051	**$ 1,114,554**	$ 1,127,535

	Pension Benefits		Postretirement Benefits	
Funded Status	**2009**	**2008**	**2009**	**2008**
Prepaid benefit cost	**$ 36,838**	$	$	$
Accrued benefit liability	**(12,089,326)**	(15,311,924)	**(1,341,498)**	(1,062,719)
Net amount recognized in the balance sheet	**$ (12,052,488)**	$ (15,311,924)	**$ (1,341,498)**	$ (1,062,719)

Amounts recognized in accumulated other comprehensive income consist of:

	Pension Benefits		Postretirement Benefits	
	2009	**2008**	**2009**	**2008**
Net (loss) gain	**$ (14,698,133)**	$ (19,990,932)	**$ 405,110**	$ 663,490
Prior service (cost) credit	**(2,159,014)**	(916,710)	**207,061**	230,950
	$ (16,857,147)	$ (20,907,642)	**$ 612,171**	$ 894,440

Change in the components of accumulated other comprehensive income consist of:

	Pension Benefit		Postretirement Benefit	
	2009	**2008**	**2009**	**2008**
Balance at beginning of period	**$ (20,907,642)**	$ (5,051,224)	**$ 894,440**	$ 857,299
Change due to availability of final actual assets and census data			**(74,579)**	107,442
Charged to net periodic benefit cost				
Prior service cost	**208,043**	208,042	**(23,889)**	(23,886)
Net (gain) loss	**2,523,903**	66,312	**(52,568)**	(33,560)
Other changes				
Change in measurement date		68,588		
Liability (gains) losses	**1,318,549**	(16,199,360)	**(131,233)**	(12,855)
Balance at end of period	**$ (16,857,147)**	$ (20,907,642)	**$ 612,171**	$ 894,440

In 2010, the net periodic pension benefit cost will include $843,154 of net loss and $204,569 of prior service cost and the net periodic post retirement benefit cost will include $10,600 of net gain and $23,900 of prior service credit.

The Eastern Company

Notes to Consolidated Financial Statements (continued)

10. RETIREMENT BENEFIT PLANS (*continued*)

Assumptions used to determine the projected benefit obligations for the Company s pension benefit plans and postretirement benefit plan for the fiscal year indicated were as follows:

	2009		2008	
Discount rate	**5.85**	%	6.25	%
Expected return on plan assets	**8.5**	%	8.5	%
Rate of compensation increase	**4.25**	%	4.25	%

In 2009 and 2008, the accumulated benefit obligation for all qualified and nonqualified defined benefit pension plans was $50,818,048 and $44,589,783, respectively.

Information for the under-funded pension plans with a projected benefit obligation and an accumulated benefit obligation in excess of plan assets:

	2009	2008
Number of plans	**5**	6
Projected benefit obligation	**$ 49,640,510**	$ 47,154,975
Accumulated benefit obligation	**46,456,805**	44,589,783
Fair value of plan assets	**37,551,184**	31,843,051
Net amount recognized in accrued benefit liability	**(12,089,326)**	(15,311,924)

Estimated future benefit payments are $2.4 million in 2010, $2.5 million in 2011, $2.6 million in 2012, $2.6 million in 2013, $2.7 million in 2014 and a total of $15.5 million from 2015 through 2019.

Estimated future benefit payments to participants of the Company s postretirement plan are $141,000 in 2010, $147,000 in 2011, $151,000 in 2012, $160,000 in 2013, $169,000 in 2014 and a total of $944,000 from 2015 through 2019.

The Company expects to make cash contributions to its pension plans of approximately $2.5 million and to its postretirement plan of approximately $141,000 in 2010.

We consider a number of factors in determining and selecting assumptions for the overall expected long-term rate of return on plan assets. We consider the historical long-term return experience of our assets, the current and expected allocation of our plan assets, and expected long-term rates of return. We derive these expected long-term rates of return with the assistance of our investment advisors and generally base these rates on a 10-year horizon for various asset classes and consider the expected positive impact of active investment management. We base our expected allocation of plan assets on a diversified portfolio consisting of domestic and international equity securities and fixed income securities.

We consider a variety of factors in determining and selecting our assumptions for the discount rate at December 31. We develop a single equivalent discount rate derived with the assistance of our actuaries by matching expected future benefit payments in each year to the corresponding spot rates from the Citigroup Pension Liability Yield Curve, comprised of high quality (rated AA or better) corporate bonds.

The Eastern Company

Notes to Consolidated Financial Statements (continued)

10. RETIREMENT BENEFIT PLANS (*continued*)

The fair values of the company s pension plans assets at January 2, 2010, utilizing the fair value hierarchy discussed in Note 2, follow:

	Level 1	Level 2	Level 3	Total
Cash and Equivalents:				
Common/collective trust funds	$	$ 170,377	$	$ 170,377
Equities:				
The Eastern Company Common Stock	2,600,370			2,600,370
Common/collective trust funds		19,450,771		19,450,771
Fixed Income:				
Common/collective trust funds		15,524,546		15,524,546
Insurance contracts		1,739,090		1,739,090
Total	$ 2,600,370	$ 36,884,784	$	$ 39,485,154

The investment portfolio contains a diversified blend of common stocks, bonds, cash equivalents, and other investments, which may reflect varying rates of return. The investments are further diversified within each asset classification. The portfolio diversification provides protection against a single security or class of securities having a disproportionate impact on aggregate performance. The long-term target allocations for plan assets are 65% in equities and 35% in fixed income, although the actual plan asset allocations may be within a range around these targets. The actual asset allocations are reviewed and rebalanced on a periodic basis to maintain the target allocations.

The plans assets include 193,624 shares and 167,658 shares of the common stock of the Company having a market value of $2,600,370 and $1,492,156 at January 2, 2010 and January 3, 2009, respectively. The plans purchased 25,966 and 27,810 shares of common stock of the Company during 2009 and 2008, respectively. Dividends received during 2009 and 2008 on the common stock of the Company were $69,705 and $40,171 respectively.

The fair values of the Company s postretirement plan assets at January 2, 2010, utilizing the fair value hierarchy discussed in Note 2, follow:

	Level 1	Level 2	Level 3	Total
Fixed Income:				
Insurance contracts	$	$	$ 1,114,554	$ 1,114,554
Total	$	$	$ 1,114,554	$ 1,114,554

For measurement purposes relating to the postretirement benefit plan, the life insurance cost trend rate is 1%. The health care cost trend rate for participants retiring after January 1, 1991 is nil; no increase in that rate is expected because of caps placed on benefits. The health care cost trend rate is expected to remain at 4.5% for participants after the year 2000.

A one-percentage-point change in assumed health care cost trend rates would have the following effects on the postretirement benefit plan:

	1-Percentage Point Increase	Decrease
Effect on total of service and interest cost components	$ 33,950	$ (27,632)
Effect on postretirement benefit obligation	$ 214,494	$ (197,856)

The Eastern Company

Notes to Consolidated Financial Statements (continued)

10. RETIREMENT BENEFIT PLANS (*continued*)

U.S. salaried employees and most employees of the Company s Canadian subsidiaries are covered by defined contribution plans.

The Company has a contributory savings plan under Section 401(k) of the Internal Revenue Code covering substantially all U.S. non-union employees. The plan allows participants to make voluntary contributions of up to 100% of their annual compensation on a pretax basis, subject to IRS limitations. The plan provides for contributions by the Company at its discretion. The Company made contributions of $165,188 in 2009, $184,303 in 2008 and $172,889 in 2007.

11. REPORTABLE SEGMENTS

The accounting policies of the segments are the same as those described in Note 2. Operating profit is total revenue less operating expenses, excluding interest and miscellaneous non-operating income and expenses. Inter-segment revenue, which is eliminated, is recorded on the same basis as sales to unaffiliated customers. Identifiable assets by reportable segment consist of those directly identified with the segment s operations.

During 2007, one customer accounted for approximately 27% of the revenue of the Industrial Hardware segment and approximately 14% of total revenue. No other customers exceeded 10% of total revenue in 2009, 2008 or 2007.

	2009	**2008**	**2007**
Revenue:			
Sales to unaffiliated customers:			
Industrial Hardware	**$ 49,954,491**	$ 60,041,074	$ 81,601,557
Security Products	**41,997,872**	55,183,759	60,743,913
Metal Products	**20,713,101**	20,653,657	13,935,613
	$ 112,665,464	$ 135,878,490	$ 156,281,083
Inter-segment Revenue:			
Industrial Hardware	**$ 215,742**	$ 614,803	$ 893,752
Security Products	**1,327,968**	2,964,334	3,209,517
Metal Products	**800,477**	607,302	748,714
	$ 2,344,187	$ 4,186,439	$ 4,851,983
Income Before Income Taxes and Minority Interest:			
Industrial Hardware	**$ 4,618,072**	$ 5,236,924	$ 12,994,321
Security Products	**1,540,694**	4,032,771	5,207,005
Metal Products	**(2,579,990)**	(2,239,297)	(2,272,290)
Operating Profit	**3,578,776**	7,030,398	15,929,036

Interest expense	**(1,727,980)**	(1,063,607)	(1,288,952)
Other income	**50,733**	34,747	205,379
	$ 1,901,529	$ 6,001,538	$ 14,845,463
Geographic Information:			
Net Sales:			
United States	**$ 99,636,783**	$ 112,171,233	$ 127,783,200
Foreign	**13,028,681**	23,707,257	28,497,883
	$ 112,665,464	$ 135,878,490	$ 156,281,083

Foreign sales are primarily to customers in North America.

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Notes to Consolidated Financial Statements (continued)

11. REPORTABLE SEGMENTS (*continued*)

	2009	2008	2007
Identifiable Assets:			
United States	**$ 85,455,482**	$ 90,479,681	$ 90,899,082
Foreign	**15,416,377**	15,537,287	17,452,819
	$ 100,871,859	$ 106,016,968	$ 108,351,901
Industrial Hardware	**$ 25,000,814**	$ 27,744,552	$ 31,492,875
Security Products	**43,812,116**	48,155,676	45,783,598
Metal Products	**12,555,735**	16,185,279	16,586,339
	81,368,665	92,085,507	93,862,812
General corporate	**19,503,194**	13,931,461	14,489,089
	$ 100,871,859	$ 106,016,968	$ 108,351,901

	2009	**2008**	**2007**
Depreciation and Amortization:			
Industrial Hardware	**$ 1,763,500**	$ 1,786,227	$ 1,898,251
Security Products	**1,413,291**	1,418,508	1,546,825
Metal Products	**926,526**	923,577	924,922
	$ 4,103,317	$ 4,128,312	$ 4,369,998
Capital Expenditures:			
Industrial Hardware	**$ 1,307,927**	$ 1,174,762	$ 1,649,767
Security Products	**353,539**	406,113	526,710
Metal Products	**526,601**	633,525	682,810
	2,188,067	2,214,400	2,859,287
Currency translation adjustment	**(17,186)**	18,865	(28,941)
General corporate	**55,144**	98,076	37,483
	$ 2,226,025	$ 2,331,341	$ 2,867,829

12. RECENT ACCOUNTING PRONOUNCEMENTS

In December 2008, the FASB issued authoritative guidance on employer s disclosures about postretirement benefit plan assets, which requires additional disclosures for assets held by employer pension and other postretirement benefit plans. The required disclosures include information about fair value measurements of plan assets, including the investment policies and strategies for the major categories of plan assets, and significant concentrations of risk within plan assets. This guidance was effective for fiscal years ending after December 15, 2009 and provides only disclosure requirements and did not have a material impact on the consolidated financial statements of the Company.

In May 2009, the FASB issued authoritative guidance on subsequent events, which introduces the concept of financial statements being available to be issued. This guidance will require the disclosure of the date through which an entity has evaluated subsequent events and the basis for that date (that is, whether that date represents the date the financial statements were issued or were available to be issued). For SEC registrants, this date will continue to be the date on which financial statements are filed with the SEC. This guidance was effective for fiscal years and interim periods beginning after June 15, 2009. The adoption of this new guidance had no impact on the consolidated financial statements of the Company. In February 2010, this guidance was effectively reversed for SEC filers because of a potential conflict between the guidance and SEC requirements.

The Eastern Company

Notes to Consolidated Financial Statements (continued)

12. RECENT ACCOUNTING PRONOUNCEMENTS (*continued*)

In June 2009, the FASB issued authoritative guidance on consolidation of variable interest entities. The new guidance is intended to improve financial reporting by requiring additional disclosures about a company s involvement in variable interest entities. This new guidance is effective for fiscal years and interim periods beginning after November 15, 2009. The Company has not determined the impact, if any, of the adoption of this guidance on the consolidated financial statements of the Company.

In June 2009, the FASB issued, The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles (the Codification). The Codification is the source for authoritative U.S. Generally Accepted Accounting Principles recognized by the FASB to be applied by non-governmental entities. Rules and interpretive releases of the SEC under the authority of the federal securities laws are also sources of authoritative GAAP for SEC registrants. All other non-grandfathered non-SEC accounting literature not included in the Codification is non-authoritative. The Codification was effective for financial statements issued for interim and annual periods ending after September 15, 2009. The adoption of the Codification had no impact on the consolidated financial statements of the Company.

In August 2009, the FASB issued new accounting guidance to provide clarification on measuring liabilities at fair value when the quoted price in an active market for an identical liability is not available. The new guidance was effective for the first reporting period beginning after August 28, 2009. The adoption of this guidance had no impact on the consolidated financial statements of the Company.

In January 2010, the FASB issued new accounting guidance which requires new disclosures regarding transfers in and out of Level 1 and Level 2 fair value measurements, as well as requiring presentation on a gross basis of information about purchases, sales, issuances and settlements in Level 3 fair value measurements. The guidance also clarifies existing disclosures regarding level of disaggregation, inputs and valuation techniques. The new guidance is effective for interim and annual reporting periods beginning after December 15, 2009. Disclosures about purchases, sales, issuances and settlements in the roll forward of activity in Level 3 fair value measurements are effective for fiscal years beginning after December 15, 2010. As this guidance requires only additional disclosure, there should be no impact on the consolidated financial statements of the Company upon adoption.

13. FINANCIAL INSTRUMENTS AND FAIR VALUE MEASUREMENTS

Financial Risk Management Objectives and Policies

The Company is exposed primarily to credit, interest rate and currency exchange rate risks which arise in the normal course of business.

Credit Risk

Credit risk is the potential financial loss resulting from the failure of a customer or counterparty to settle its financial and contractual obligations to the Company, as and when they become due. The primary credit risk for the Company is its receivable accounts. The Company has established credit limits for customers and monitors their balances to mitigate its risk of loss. At January 2, 2010 and January 3, 2009, there were no significant concentrations of credit risk. No one customer represented more than 10% of the Company s net trade receivables at January 2, 2010 and January 3, 2009. The maximum exposure to credit risk is primarily represented by the carrying amount of the Company s accounts receivable.

Interest Rate Risk

Prior to the refinancing completed in January 2010, the Company s exposure to the risk of changes in market interest rates related primarily to the Company s debt which bore interest at variable rates, which approximates market interest rates. While the Company used an interest rate swap to convert all of its Term Loan from variable to fixed rates for most of fiscal 2009, it terminated the swap contract on December 22, 2009. See Note 5 - Debt for additional details concerning the swap contract. The valuation of this swap was determined using the three month LIBOR index.

The Eastern Company

Notes to Consolidated Financial Statements (continued)

13. FINANCIAL INSTRUMENTS AND FAIR VALUE MEASUREMENTS (*continued*)

Fair Value Measurements

Assets and liabilities that require fair value measurement are recorded at fair value using market and income valuation approaches and considering the Company s and counterparty s credit risk. The Company uses the market approach and the income approach to value assets and liabilities as appropriate. There are no assets or liabilities requiring fair value measurement on January 2, 2010.

14. SELECTED QUARTERLY FINANCIAL INFORMATION (UNAUDITED)

Selected quarterly financial information (unaudited) follows:

			2009		
	First	**Second**	**Third**	**Fourth**	**Year**
Net sales	$ 28,432,473	$ 28,087,629	$ 28,131,092	$ 28,014,270	$ 112,665,464
Gross margin	3,420,085	5,676,766	5,722,051	5,815,484	20,634,386
Selling and administrative expenses	4,388,863	4,103,087	4,371,875	4,191,785	17,055,610
Net (loss)/income	(1,082,530)	842,382	907,377	369,178	1,036,407
Net (loss)/income per share:					
Basic	$ (.18)	$ .14	$ .15	$ .06	$ .17
Diluted	$ (.18)	$ .13	$ .15	$ .06	$ .17
Weighted average shares outstanding:					
Basic	5,965,751	5,967,826	5,991,345	6,017,708	5,985,640
Diluted	5,965,751	6,268,805	6,206,823	6,177,192	6,241,780

			2008		
	First	**Second**	**Third**	**Fourth**	**Year**
Net sales	$ 32,918,911	$ 36,098,718	$ 34,550,899	$ 32,309,962	$ 135,878,490
Gross margin	6,764,101	6,871,581	5,446,670	6,380,746	25,463,098
Selling and administrative expenses	4,693,193	4,534,735	4,379,689	4,825,083	18,432,700
Net income	1,206,678	1,354,700	875,041	1,068,204	4,504,623
Net income per share:					
Basic	$ .21	$ .23	$ .15	$ .18	$ .77
Diluted	$ .20	$ .22	$ .14	$ .17	$ .73
Weighted average shares outstanding:					

Basic	5,811,962	5,835,601	5,881,284	5,964,813	5,875,140
Diluted	6,157,130	6,154,270	6,189,149	6,130,805	6,159,563

Fiscal 2009 consisted of four 13 week quarters totaling 52 weeks for the year. Fiscal 2008 consisted of 13 weeks for the first, second and third quarters, with the fourth quarter being 14 weeks, totaling 53 weeks for the year.

15. SUBSEQUENT EVENT

Subsequent to the date of these consolidated financial statements the Company refinanced its debt. See Note 5 Debt.

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Report of Fiondella, Milone and LaSaracina LLP, Independent Registered Public Accounting Firm

The Board of Directors

The Eastern Company

We have audited the accompanying consolidated balance sheet of The Eastern Company (the Company) as of January 2, 2010, and the related consolidated statements of income, comprehensive income (loss), shareholders equity, and cash flows for the year ended January 2, 2010. Our audit also included the financial statement schedule listed in the Index at Item 15(a)(2). The Company s management is responsible for these financial statements. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company as of January 2, 2010, and the consolidated results of its operations and its cash flows for the year ended January 2, 2010 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company s internal control over financial reporting as of January 2, 2010, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 11, 2010 expressed an unqualified opinion.

/s/ Fiondella, Milone & LaSaracina LLP

Glastonbury, Connecticut

March 11, 2010

Report of UHY LLP, Independent Registered Public Accounting Firm

The Board of Directors

The Eastern Company

We have audited the accompanying consolidated balance sheet of The Eastern Company (the Company) as of January 3, 2009, and the related consolidated statements of income, comprehensive (loss) income, shareholders' equity, and cash flows for each of the two years in the period ended January 3, 2009. Our audits also included the financial statement schedule listed in the Index at Item 15(a)(2). These financial statements and schedule are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company as of January 3, 2009, and the consolidated results of its operations and its cash flows for each of the two years in the period ended January 3, 2009, in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

As discussed in Note 10 to the consolidated financial statements, the Company changed the measurement date for its pension benefit plan liability effective January 3, 2009 and, as discussed in Note 8, the Company changed its accounting for uncertain income tax positions effective December 31, 2006, both as required by accounting principles generally accepted in the United States of America.

/s/ UHY LLP

Hartford, Connecticut

March 11, 2009

ITEM 9 CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

For information regarding the change in the Company s independent registered public accounting firm, see the Form 8-K filed on June 12, 2009 and Form 8-K/A filed on June 17, 2009.

ITEM 9A CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

As of the end of the fiscal year ended January 2, 2010, the Company carried out an evaluation, under the supervision and with the participation of the Company s management, including the Chief Executive Officer (the CEO) and Chief Financial Officer (the CFO), of the effectiveness of the design and operation of the Company s disclosure controls and procedures pursuant to Exchange Act Rule 240.13a-15. The term disclosure controls and procedures means controls and other procedures of a company that are designed to ensure that the information required to be disclosed by the company in the reports it files or submits under the Securities and Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the Commission s rules and forms. Based upon that evaluation, the CEO and CFO concluded that the Company s current disclosure controls and procedures are effective in timely alerting them to material information relating to the Company and its subsidiaries required to be included in the Company s periodic SEC filings.

The Company believes that a controls system, no matter how well designed and operated, cannot provide absolute assurance that the objectives of the controls system are met, and no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a company have been detected. The Company s disclosure controls and procedures are designed to provide reasonable assurance of achieving their objectives, and the CEO and CFO have concluded that these controls and procedures are effective at the reasonable assurance level.

Management s Report on Internal Control over Financial Reporting

The Company s management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rules 240.13a-15(f). Under the supervision and with the participation of our management, including the CEO and CFO, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on our evaluation under the framework in *Internal Control Integrated Framework,* our management concluded that our internal control over financial reporting was effective as of January 2, 2010.

The independent registered public accounting firm of the Company has issued a report on its assessment of the effectiveness of the Company s internal control over financial reporting as of January 2, 2010. Their report is included below in this Annual Report on Form 10-K.

Changes in Internal Control over Financial Reporting

There were no significant changes in the Company s internal control over financial reporting during the last fiscal quarter that materially affected, or are reasonably likely to materially affect, the Company s internal control over financial reporting.

Report of Fiondella, Milone & LaSaracina LLP, Independent Registered Public Accounting Firm

The Board of Directors

The Eastern Company

We have audited The Eastern Company s (the Company) internal control over financial reporting as of January 2, 2010, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting included in Management s Report on Internal Control over Financial Reporting under Item 9A. Our responsibility is to express an opinion on the company s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of January 2, 2010, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company s consolidated balance sheet and the related consolidated statements of income, comprehensive income (loss), shareholders equity, and cash flows for the year ended January 2, 2010 and our report dated March 11, 2010 expressed an unqualified opinion.

/s/ Fiondella, Milone & LaSaracina LLP

Glastonbury, Connecticut

March 11, 2010

ITEM 9B OTHER INFORMATION

None.

PART III

ITEM 10 DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The Registrant s definitive proxy statement (Proxy Statement) for the 2010 Annual Meeting of Shareholders which is incorporated herein by reference will be filed with the SEC pursuant to Regulation 14A not later than 120 days after January 2, 2010.

The information concerning directors is incorporated herein by reference to our Proxy Statement under the captions Item No. 1 Election of Director and Director Compensation in Fiscal 2009 .

The information concerning our executive officers is incorporated herein by reference to our Proxy Statement under the captions Compensation Discussion and Analysis , Compensation Committee Report , Compensation Committee Interlocks and Insider Participation , Executive Compensation , Stock Options , Options Exercised in Fiscal 2009 , Outstanding Equity Awards at Fiscal 2009 Year-End , and Termination of Employment and Change in Control Arrangements . The Registrant s only Executive Officers are Leonard F. Leganza, Chairman, President and Chief Executive Officer, and John L. Sullivan III, Vice President and Chief Financial Officer.

The information concerning our Audit Committee is incorporated herein by reference to our Proxy Statement under the captions Audit Committee Financial Expert , Report of the Audit Committee , The Board of Directors and Committees and Exhibit B The Eastern Company Audit Committee Charter . The Audit Committee Charter is also available on the Company s website at http://www.easterncompany.com by clicking on Corporate Governance.

The information concerning compliance with Section 16(a) of the Securities Exchange Act is incorporated herein by reference to our Proxy Statement under the caption Section 16(a) Beneficial Ownership Reporting Compliance .

The Company s Board of Directors has adopted a Code of Business Conduct and Ethics that applies to our Chief Executive Officer, Chief Financial Officer, Chief Accounting Officer and the Company s other financial professionals. The Code of Business Conduct and Ethics is available on the Company s website at http://www.easterncompany.com by clicking on Corporate Governance.

ITEM 11 EXECUTIVE COMPENSATION

Information concerning director and executive compensation is incorporated herein by reference to portions of the Company s Proxy Statement to be filed with the SEC pursuant to Regulation 14A not later than 120 days after January 2, 2010, under the captions Director Compensation in Fiscal 2009 , Compensation Discussion and Analysis , Compensation Committee Report , Compensation Committee Interlocks and Insider Participation , Executive Compensation , Stock Options , Options Exercised in Fiscal 2009 , Outstanding Equity Awards at Fiscal 2009 Year-End and Termination of Employment and Change in Control Arrangements . The Compensation Committee of the Board of Directors operates under the Compensation Committee Charter, which can be found on the Company s website at http://www.easterncompany.com by clicking on Corporate Governance.

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ITEM 12 SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

Security ownership of certain beneficial owners and management:

(a) Information concerning security ownership of certain beneficial owners is incorporated herein by reference to the Proxy Statement to be filed with the SEC pursuant to Regulation 14A not later than 120 days after January 2, 2010, under the caption Security Ownership of Certain Beneficial Shareholders .

(b) Information concerning security ownership of management is incorporated herein by reference to the Proxy Statement to be filed with the SEC pursuant to Regulation 14A not later than 120 days after January 2, 2010, under the captions Item No. 1 Election of Director , Security Ownership of Certain Beneficial Shareholders , Executive Compensation , Stock Options , Options Exercised in Fiscal 2009 , and Outstanding Equity Awards at Fiscal 2009 Year-End . See also the equity compensation plan information in Item 5 of this Annual Report on Form 10-K.

(c) Changes in Control

None.

ITEM 13 CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

Information regarding certain relationships and related transactions is incorporated herein by reference to our Proxy Statement to be filed with the SEC pursuant to Regulation 14A not later than 120 days after January 2, 2010 under the caption Policies and Procedures Concerning Related Persons Transactions .

Information regarding director independence is incorporated herein by reference to our Proxy Statement to be filed with the SEC pursuant to Regulation 14A not later than 120 days after January 2, 2010 under the captions Item No.1 Election of Director and The Board of Directors and Committees .

ITEM 14 PRINCIPAL ACCOUNTING FEES AND SERVICES

Information concerning principal accountant fees and services are incorporated herein by reference to our Proxy Statement to be filed with the SEC pursuant to Regulation 14A not later than 120 days after January 2, 2010 under the caption Item No. 3 Ratification of Appointment of Independent Registered Public Accounting Firm .

PART IV

ITEM 15 EXHIBITS, FINANCIAL STATEMENT SCHEDULE

(a) Documents filed as part of this report:

(1) Financial statements

Schedules other than that listed above have been omitted because the required information is contained in the financial statements and notes thereto, or because such schedules are not required or applicable.

(3) Exhibits
Exhibits are as set forth in the Exhibit Index which appears on pages 63 through 64.

(b) Exhibits Required by Item 601 of Regulation S-K
Exhibits are as set forth in the Exhibit Index which appears on pages 63 through 64. Also refer to the following Form 8-K s filed by the Company.

Form 8-K filed on March 11, 2009 setting forth the press release reporting the Company s engagement of Morgan Joseph & Co. Inc. as its financial advisor is incorporated herein by reference.

Form 8-K filed on April 22, 2009 setting forth the press release reporting the Company s earnings for the quarter ended April 4, 2009 is incorporated herein by reference.

Form 8-K filed on June 12, 2009 disclosing the change in the Company s Independent Registered Public Accounting Firm from UHY LLP to Fiondella, Milone & LaSaracina LLP is incorporated herein by reference.

Form 8-K/A filed on June 17, 2009 disclosing the change in the Company s Independent Registered Public Accounting Firm from UHY LLP to Fiondella, Milone & LaSaracina LLP is incorporated herein by reference.

Form 8-K filed on June 23, 2009 setting forth the amendment to the Company s loan agreements is incorporated herein by reference.

Form 8-K/A filed on June 24, 2009 setting forth the amendment to the Company s loan agreements is incorporated herein by reference.

Form 8-K filed on July 22, 2009 setting forth the press release reporting the Company s earnings for the quarter ended July 4, 2009 is incorporated herein by reference.

Form 8-K filed on October 21, 2009 setting forth the press release reporting the Company s earnings for the quarter ended October 3, 2009 is incorporated herein by reference.

Form 8-K filed on October 22, 2009 setting forth an amendment to extend the Employment Agreement with the Company s Chairman is incorporated herein by reference.

Form 8-K filed on November 17, 2009 setting forth the amendment to the Company s loan agreements is incorporated herein by reference.

Form 8-K filed on February 1, 2010 setting forth the change in banking relationship from Bank of America, N.A. to People s United Bank is incorporated herein by reference.

Form 8-K filed on February 9, 2010 setting forth the press release reporting the Company s earnings for the quarter and fiscal year ended January 2, 2010 is incorporated herein by reference.

Form 8-K filed on February 11, 2010 setting forth the 2010 Executive Incentive Program is incorporated herein by reference.

(c) None.

The Eastern Company and Subsidiaries

Schedule II Valuation and Qualifying accounts

COL. A	COL. B	COL. C ADDITIONS (1)	(2)	COL. D	COL. E
Description	Balance at Beginning of Period	Charged to Costs and Expenses	Charged to Other Accounts-Describe	Deductions Describe	Balance at End of Period
Fiscal year ended January 2, 2010:					
Deducted from asset accounts:					
Allowance for doubtful accounts	$328,000	$320,716		$256,716 (a)	$392,000
Fiscal year ended January 3, 2009:					
Deducted from asset accounts:					
Allowance for doubtful accounts	$342,000	$132,988		$146,988 (a)	$328,000
Fiscal year ended December 29, 2007:					
Deducted from asset accounts:					
Allowance for doubtful accounts	$319,000	$ 45,740		$22,740 (a)	$342,000

(a) Uncollectible accounts written off, net of recoveries.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

Dated: March 11, 2010	THE EASTERN COMPANY By /s/ John L. Sullivan III **John L. Sullivan III** Vice President and Chief Financial Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

/s/ Leonard F. Leganza **Leonard F. Leganza** Chairman, President and Chief Executive Officer	March 11, 2010
/s/ John L. Sullivan III **John L. Sullivan III** Vice President and Chief Financial Officer	March 11, 2010
/s/ Kenneth R. Sapack **Kenneth R. Sapack** Chief Accounting Officer	March 11, 2010
/s/ John W. Everets **John W. Everets** Director	March 11, 2010
/s/ Charles W. Henry **Charles W. Henry** Director	March 11, 2010
/s/ David C. Robinson **David C. Robinson** Director	March 11, 2010
/s/ Donald S. Tuttle III **Donald S. Tuttle III** Director	March 11, 2010

EXHIBIT INDEX

(3)	Restated Certificate of Incorporation dated August 14, 1991 is incorporated by reference to the Registrant s Annual Report on Form 10-K for the fiscal year ended December 28, 1991 and the Registrant s Form 8-K filed on February 13, 1991. Amended and restated bylaws dated July 29, 1996 is incorporated by reference to the Registrant s Form 8-K filed on July 29, 1996.
(4)	Rights Agreement entered into between the Registrant and American Stock Transfer & Trust Company dated as of July 23, 2008 and Letter to all shareholders of the Registrant, dated June 23, 2008 together with Press Release dated June 23, 2008 describing the issuance of a Purchase Rights dividend distribution are incorporated by reference to the Registrant s Form 8-K filed on July 23, 2008.
(10) (a)	The Eastern Company 1995 Executive Stock Incentive Plan effective as of April 26, 1995 incorporated by reference to the Registrant s Form S-8 filed on February 7, 1997.
(b)	The Eastern Company Directors Fee Program effective as of October 1, 1996 incorporated by reference to the Registrant s Form S-8 filed on February 7, 1997, as amended by Amendment No.1 and Amendment No. 2 are incorporated by reference to the Registrant s Form 10-K filed on March 29, 2000 and Amendment No. 3 is incorporated by reference to the Registrant s Form 10-K filed on March 22, 2004.
(c)	The Eastern Company 1997 Directors Stock Option Plan effective as of September 17, 1997 incorporated by reference to the Registrant s Form S-8 filed on May 3, 2004.
(d)	Supplemental Retirement Plan dated September 9, 1998 with Leonard F. Leganza is incorporated by reference to the Registrant s Annual Report on Form 10-K for the fiscal year ended January 2, 1999, as amended by amendment incorporated by reference to the Registrant s Current Report on Form 8-K dated December 14, 2007.
(e)	The Eastern Company 2000 Executive Stock Incentive Plan effective July 2000 is incorporated by reference to the Registrant s Annual Report on Form 10-K for the fiscal year ended December 30, 2000.
(f)	Employment Agreement dated February 22, 2005 with Leonard F. Leganza is incorporated by reference to the Registrant s Current Report on Form 8-K dated February 22, 2005, as amended by amendments incorporated by reference to the Registrant s Current Report on Form 8-K dated October 25, 2007, Current Report on Form 8-K dated December 14, 2007, Current Report on Form 8-K dated October 22, 2008 and Current Report on Form 8-K dated October 22, 2009.
(g)	The Eastern Company 2010 Executive Incentive Program is incorporated by reference to the Registrant s Current Report on Form 8-K dated February 11, 2010.
(14)	The Eastern Company Code of Business Conduct and Ethics is incorporated by reference. The Eastern Company Code of Business Conduct and Ethics is available free of charge on the Company s Internet website at http://www.easterncompany.com under the section labeled Corporate Governance .

(21) List of subsidiaries as follows:

Eberhard Hardware Mfg. Ltd., a private corporation organized under the laws of the Province of Ontario, Canada.

Canadian Commercial Vehicles Corporation, a private corporation organized under the laws of the Province of British Columbia, Canada.

Eastern Industrial Ltd., a private corporation organized under the laws of the Peoples Republic of China.

World Lock Co. Ltd., a private corporation organized under the laws of Taiwan (The Republic of China).

Sesamee Mexicana, Subsidiary, a private corporation organized under the laws of Mexico.

World Security Industries Co. Ltd., a private corporation organized under the laws of Hong Kong.

(23) Consents of independent registered public accounting firms attached hereto on pages 65 and 66.

(31) Certifications required by Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

(32) Certifications pursuant to Rule 13a-14(b) and 18 USC 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(99) Letter to our shareholders from the Annual Report 2010 is attached on page 70.