

NATCO GROUP INC
Form 10-Q
August 06, 2008
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2008

OR

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

For the transition period from _____ to _____
Commission file number 1-15603

NATCO Group Inc.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of

incorporation or organization)

11210 Equity Drive

Houston, Texas
(Address of principal executive offices)

22-2906892
(I.R.S. Employer

Identification No.)

77041
(Zip Code)

713-849-7500

(Registrant's telephone number, including area code)

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

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

Large accelerated filer
Accelerated filer

Non-accelerated filer
Smaller reporting company

(Do not check if a smaller reporting company)

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

As of July 31, 2008, the issuer had outstanding 20,187,590 shares of common stock, par value \$0.01 per share.

Table of Contents

NATCO GROUP INC.

FORM 10-Q

For the Quarter Ended June 30, 2008

TABLE OF CONTENTS

	Page No.
PART I	FINANCIAL INFORMATION
Item 1.	<u>Financial Statements</u>
	<u>Consolidated Balance Sheets June 30, 2008 (unaudited) and December 31, 2007</u>
	<u>Unaudited Consolidated Statements of Operations Three and Six Months Ended June 30, 2008 and 2007</u>
	<u>Unaudited Consolidated Statements of Cash Flows Six Months Ended June 30, 2008 and 2007</u>
	<u>Notes to Unaudited Consolidated Financial Statements</u>
Item 2.	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>
Item 3.	<u>Quantitative and Qualitative Disclosures About Market Risk</u>
Item 4.	<u>Controls and Procedures</u>
PART II	OTHER INFORMATION
Item 2.	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>
Item 4.	<u>Submission of Matters to a Vote of Security Holders</u>
Item 6.	<u>Exhibits</u>
	<u>Signatures</u>

Table of Contents**PART I FINANCIAL INFORMATION****Item 1. Financial Statements****NATCO GROUP INC. AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS****(in thousands, except share and par value data)**

	June 30, 2008 (unaudited)	December 31, 2007
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 42,529	\$ 63,577
Trade accounts receivable, less allowance for doubtful accounts of \$1,334 and \$1,435 as of June 30, 2008 and December 31, 2007, respectively	141,112	139,054
Inventories, net	49,282	46,456
Deferred income tax assets, net	6,972	6,927
Prepaid expenses and other current assets	8,581	5,266
Total current assets	248,476	261,280
Property, plant and equipment, net	56,442	46,651
Goodwill, net	109,563	99,469
Deferred income tax assets, net	691	3,373
Intangible and other assets, net	25,176	12,940
Total assets	\$ 440,348	\$ 423,713
LIABILITIES, REDEEMABLE CONVERTIBLE PREFERRED STOCK AND STOCKHOLDERS EQUITY		
Current liabilities:		
Trade accounts payable and other	\$ 50,874	\$ 51,552
Accrued expenses	54,063	61,298
Customer advanced billings and payments	39,381	35,652
Income taxes payable		2,478
Total current liabilities	144,318	150,980
Long-term deferred tax liabilities	3,451	3,418
Postretirement benefits and other long-term liabilities	11,836	9,192
Total liabilities	159,605	163,590
Commitments and contingencies (See Note 9, Contingencies)		
Minority interest	2,362	1,226
Series B redeemable convertible preferred stock, \$.01 par value; 15,000 shares authorized, zero and 9,915 shares issued and outstanding (net of issuance costs) as of June 30, 2008 and December 31, 2007, respectively		9,401
Stockholders' equity:		
Preferred stock, \$.01 par value. Authorized 5,000,000 shares (of which 500,000 are designated as Series A and 15,000 are designated as Series B); no shares issued and outstanding (except Series B Preferred shares above)		
Series A preferred stock, \$.01 par value; 500,000 shares authorized; no shares issued and outstanding	200	186

Edgar Filing: NATCO GROUP INC - Form 10-Q

Common stock, \$.01 par value; 50,000,000 shares authorized; 20,036,760 and 18,646,778 shares issued and outstanding as of June 30, 2008 and December 31, 2007, respectively

Additional paid-in-capital	153,080	140,527
Retained earnings	117,537	101,739
Treasury stock, 1,500 and 1,168 shares as of June 30, 2008 and December 31, 2007, respectively	(54)	(59)
Accumulated other comprehensive income	7,618	7,103
Total stockholders' equity	278,381	249,496
Total liabilities, redeemable convertible preferred stock and stockholders' equity	\$ 440,348	\$ 423,713

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

Table of Contents**NATCO GROUP INC. AND SUBSIDIARIES****UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS**

(in thousands, except earnings per share data)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2008	2007	2008	2007
Revenue:				
Products	\$ 134,356	\$ 109,090	\$ 256,783	\$ 211,125
Services	26,042	31,604	55,585	56,998
Total revenue	\$ 160,398	\$ 140,694	\$ 312,368	\$ 268,123
Cost of goods sold and services:				
Products	\$ 102,604	\$ 82,284	\$ 192,460	\$ 160,101
Services	13,654	17,823	29,393	31,340
Total cost of goods sold and services	\$ 116,258	\$ 100,107	\$ 221,853	\$ 191,441
Gross profit	\$ 44,140	\$ 40,587	\$ 90,515	\$ 76,682
Selling, general and administrative expense	31,424	20,488	59,258	40,866
Depreciation and amortization expense	2,799	1,501	4,851	2,891
Interest expense	139	37	234	180
Interest income	(225)	(621)	(609)	(962)
Minority interest (income) expense	712	(85)	1,091	(24)
(Gain) loss on unconsolidated investment	(118)	22	(83)	108
Other, net	(155)	508	992	1,064
Income before income taxes	\$ 9,564	\$ 18,737	\$ 24,781	\$ 32,559
Income tax provision	3,371	6,595	8,735	11,640
Net income	\$ 6,193	\$ 12,142	\$ 16,046	\$ 20,919
Preferred stock dividends		375	248	750
Net income available to common stockholders	\$ 6,193	\$ 11,767	\$ 15,798	\$ 20,169
Earnings per share:				
-Basic	\$ 0.32	\$ 0.68	\$ 0.83	\$ 1.17
-Diluted	\$ 0.31	\$ 0.62	\$ 0.81	\$ 1.07
Weighted average number of shares of common stock:				
-Basic	19,552	17,259	18,960	17,229
-Diluted	19,807	19,565	19,811	19,524

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

Table of Contents**NATCO GROUP INC. AND SUBSIDIARIES****UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(in thousands)

	Six Months Ended June 30,	
	2008	2007
Cash flows from operating activities:		
Net income	\$ 16,046	\$ 20,919
Adjustments to reconcile net income to net cash provided by operating activities:		
Deferred income tax benefit	(1,594)	(1,669)
Depreciation and amortization expense	4,851	2,891
Non-cash interest expense	67	54
Share-based compensation expense	3,207	1,826
Excess tax benefit of share-based compensation	2	97
Minority interest (income) expense	1,091	(24)
(Gain) loss from unconsolidated investment	(83)	108
Net periodic cost on postretirement benefit liability	(282)	(202)
Net payments on postretirement benefit liability	(355)	(412)
(Gain) loss on sale of property, plant and equipment	(37)	16
Change in assets and liabilities:		
Decrease (increase) in trade accounts receivable	6,262	(8,018)
Decrease (increase) in inventories	1,181	(4,887)
Increase in prepaid expense and other current assets	(1,949)	(18)
Increase in long-term assets	(807)	(78)
Increase in long-term liabilities	2,408	400
(Decrease) increase in accounts payable	(3,051)	7,686
Decrease in accrued expenses	(8,963)	(3,158)
(Decrease) increase in taxes	(4,255)	773
Increase in customer advanced billings and payments	2,737	3,919
Net cash provided by operating activities	16,476	20,223
Cash flows from investing activities:		
Capital expenditures for property, plant and equipment	(10,786)	(5,373)
Acquisitions, net of cash acquired	(24,098)	(384)
Proceeds from sales of property, plant and equipment	56	20
Net cash used in investing activities	(34,828)	(5,737)
Cash flows from financing activities:		
Short term borrowings, net	280	
Proceeds from stock issuances related to stock options, net	324	1,071
Excess tax benefit of share-based compensation	255	1,140
Change in bank overdrafts	(2,293)	732
Dividends paid	(248)	(750)
Treasury shares acquired	(1,043)	(7)
Net cash provided by (used in) financing activities	(2,725)	2,186
Effect of exchange rate changes on cash and cash equivalents	29	735

Edgar Filing: NATCO GROUP INC - Form 10-Q

Increase (decrease) in cash and cash equivalents	(21,048)	17,407
Cash and cash equivalents at beginning of period	63,577	35,238
Cash and cash equivalents at end of period	\$ 42,529	\$ 52,645
Cash paid for interest	\$ 195	\$ 201
Cash paid for income taxes	\$ 14,472	\$ 10,492

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

Table of Contents**NATCO GROUP INC. AND SUBSIDIARIES****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS****(1) Organization and Basis of Presentation**

NATCO Group Inc. is one of the industry leaders in the development of oil and gas process technology. The Company's products and services are used in onshore and offshore fields in most major oil and gas producing regions of the world.

The accompanying interim consolidated financial statements and related disclosures are unaudited and prepared by NATCO Group Inc. pursuant to accounting principles generally accepted in the United States of America (US GAAP) and the rules and regulations of the United States Securities and Exchange Commission (SEC). As permitted by these regulations, certain information and footnote disclosures that would typically be required in financial statements prepared in accordance with US GAAP have been condensed or omitted. However, the Company's management believes that these statements reflect all the normal recurring and non-recurring adjustments necessary for a fair presentation, in all material respects, of the results of operations for the periods presented. These consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes included in the Company's Annual Report on Form 10-K filing for the year ended December 31, 2007 which includes a summary of our significant accounting policies and other disclosures. No changes were made to our significant accounting policies during the three months ended June 30, 2008.

The preparation of financial statements requires the Company's management to make estimates and assumptions that affect the amounts reported in the unaudited consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

Segment information, as described in Note 13, Industry Segments, has been reclassified to reflect the redefined segments effective January 1, 2008, as disclosed in our Annual Report on Form 10-K filing for the year ended December 31, 2007.

References to NATCO and the Company are used throughout this document and relate collectively to NATCO Group Inc. and its consolidated subsidiaries.

(2) Inventories

Inventories consisted of the following amounts:

	June 30, 2008 (unaudited)	December 31, 2007
	(in thousands)	
Finished goods	\$ 16,516	\$ 15,100
Work-in-process	16,677	18,387
Raw materials and supplies	27,881	23,003
Inventories at FIFO, LIFO and weighted average	61,074	56,490
LIFO and other valuation reserves	(11,792)	(10,034)
Net inventories	\$ 49,282	\$ 46,456

Table of Contents**NATCO GROUP INC. AND SUBSIDIARIES****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The Company's net inventories as of June 30, 2008 and December 31, 2007 by valuation method were:

	June 30, 2008 (unaudited)	December 31, 2007
	(in thousands)	
FIFO	\$ 6,584	\$ 8,635
Weighted average cost	701	570
LIFO	41,997	37,251
Net inventories	\$ 49,282	\$ 46,456

(3) Costs and Estimated Earnings on Uncompleted Contracts Using Percentage-of-Completion Method

Costs and estimated earnings on uncompleted contracts using the percentage-of-completion method were as follows:

	June 30, 2008 (unaudited)	December 31, 2007
	(in thousands)	
Cost incurred on uncompleted contracts	\$ 293,513	\$ 255,584
Estimated earnings	126,259	99,864
	419,772	355,448
Less billings to date	408,512	338,667
	\$ 11,260	\$ 16,781
Included in the accompanying balance sheet under the captions:		
Trade accounts receivable	\$ 41,388	\$ 45,438
Customer advanced billings and payments	(30,128)	(28,657)
	\$ 11,260	\$ 16,781

(4) Goodwill and Intangible Assets*Goodwill*

Net goodwill by segment as of June 30, 2008 and December 31, 2007 was as follows:

June 30, 2008 (unaudited)	December 31, 2007
---------------------------------	----------------------

Edgar Filing: NATCO GROUP INC - Form 10-Q

	(in thousands)	
Integrated Engineered Solutions	\$ 85,492	\$ 83,964
Standard & Traditional	19,687	11,121
Automation & Controls	4,384	4,384
 Total	 \$ 109,563	 \$ 99,469

Changes in the carrying amount of goodwill were as follows (unaudited, in thousands):

Balance at December 31, 2007	\$ 99,469
Goodwill associated with Linco-Electromatic, Inc. acquisition	8,495
Foreign currency translation and other	1,599
 Balance at June 30, 2008	 \$ 109,563

Table of Contents**NATCO GROUP INC. AND SUBSIDIARIES****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

As of December 31, 2007, goodwill was not impaired. During the six months ended June 30, 2008, no additional testing was performed as management noted no indications of goodwill impairment.

Intangible Assets

Intangible assets subject to amortization as of June 30, 2008 and December 31, 2007 were:

	As of June 30, 2008		As of December 31, 2007	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
	(in thousands)			
Deferred financing fees	\$ 946	\$ 573	\$ 946	\$ 506
Patents	6,999	448	6,532	202
Customer relationships	15,100	383	5,579	
Other	2,794	810	770	355
Total	\$ 25,839	\$ 2,214	\$ 13,827	\$ 1,063

Amortization and interest expense related to deferred financing fees, patents and other of \$881,000 and \$1.2 million were recognized for the three and six months ended June 30, 2008 compared to \$83,000 and \$161,000 for the three and six months ended June 30, 2007, respectively.

(5) Warranty Costs

Estimated future warranty obligations related to products are charged to cost of goods sold in the period in which the related revenue is recognized. A reconciliation of the changes in the Company's aggregate product warranty liability included in the consolidated balance sheet liability account "Accrued expenses" for the six months ended June 30, 2008, is set forth below (unaudited, in thousands).

Balance at December 31, 2007	\$ 3,265
Foreign currency translation	10
Payments/charges	(1,139)
Net accruals	1,690
Balance at June 30, 2008	\$ 3,826

(6) Income Taxes

NATCO's effective income tax rate for each of the three and six months ended June 30, 2008 was 35.2%, which exceeded the amount that would have resulted from applying the U.S. federal statutory tax rate due to the impact of state income taxes, foreign income tax rate differentials and permanent differences.

Effective January 1, 2007, the Company adopted the provisions of FIN 48, "Accounting for Uncertainty in Income Taxes." As of December 31, 2007, the Company provided for a liability of \$920,000 for unrecognized tax benefits related to various federal income tax matters. If recognized, the entire amount of the liability would affect the effective tax rate. There was no change to the balance during the six months ended

Edgar Filing: NATCO GROUP INC - Form 10-Q

June 30, 2008.

We believe that no current tax positions that have resulted in unrecognized tax benefits will significantly increase or decrease within the next year.

Any interest and penalties that may be incurred as part of this liability would be recognized as a component of interest expense and other expense, respectively. No interest or penalty expenses had been recognized as of

Table of Contents**NATCO GROUP INC. AND SUBSIDIARIES****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

June 30, 2008. The Company's US federal tax returns currently open to audit by the Internal Revenue Service relate to the years ended December 31, 2004 through 2006.

(7) Debt

As of June 30, 2008, the Company had available capacity under various credit agreements of \$73.4 million. Below is a discussion of the Company's existing credit facilities. For further discussion of our credit facilities, see the Company's 2007 Annual Report on Form 10-K.

In July 2006, the Company entered into a revolving credit facilities agreement with a maturity of June 30, 2011 and a total borrowing capacity of \$85.0 million. The Company pays commitment fees on the undrawn portion of the facility, depending upon the ratio of Funded Debt to EBITDA, which was calculated at 0.25% at June 30, 2008.

In June 2007, the Company entered into an export sales credit facility with a total borrowing capacity of \$10.0 million. The facility, which will expire on June 15, 2010, is partially guaranteed by the US Export-Import Bank and is subject to certain borrowing base limitations. Interest on borrowings under the facility is either (1) the lender's prime rate less 0.50% or (2) the London Interbank Offered Rate plus 1.35%, at the Company's election.

There were no borrowings outstanding under these facilities as of December 31, 2007 or June 30, 2008.

The Company had total letters of credit outstanding of \$20.4 million and available borrowing capacity of \$72.8 million at June 30, 2008. Availability under our credit facilities is reduced by the amount of outstanding letters of credit and borrowings. The letters of credit, which support various contract performance and warranties, expire at various dates through December 31, 2012. Fees related to these letters of credit were approximately 1.0% of the outstanding balance at June 30, 2008. At June 30, 2008, the Company had unsecured letters of credit and bonds totaling approximately \$1.2 million related to its international subsidiaries.

On February 29, 2008, the Company's NATCO Japan subsidiary signed a three-month promissory note with a Japanese bank of approximately \$800,000 at a quarterly prime rate of 0.47%. As of June 30, 2008, this note had been paid in full.

(8) Postretirement Benefits*Health Care and Life Insurance Plans*

The following table summarizes the components of net periodic cost on postretirement benefit liability under the Company's postretirement health care and life insurance benefit plans as of June 30, 2008 and 2007, respectively:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2008	2007	2008	2007
	(unaudited, in thousands)			
Interest cost	\$ 86	\$ 100	\$ 163	\$ 204
Amortization of:				
Prior service cost	(445)	(394)	(889)	(834)
Net loss from previous years and certain adjustments	142	489	444	745
Net periodic cost (benefit) on postretirement benefit liability	\$ (217)	\$ 195	\$ (282)	\$ 115

Table of Contents

NATCO GROUP INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

During the three and six months ended June 30, 2008, the Company made contributions of \$206,000 and \$355,000, respectively, to the Company's postretirement health care and life insurance benefit plans, compared to \$211,000 and \$412,000, respectively, during the three and six months ended June 30, 2007. We expect to contribute an aggregate of \$666,000 to the plans during 2008.

Defined Contribution Plans

During the three and six months ended June 30, 2008, the Company made contributions aggregating \$1.0 million and \$2.1 million, respectively, to the Company's defined contribution plans maintained in the US, Canada and the UK. This amount included certain additional discretionary matching contributions provided by the Company to eligible employees in the US and Canadian plans.

(9) Contingencies

FCPA Review

On February 28, 2008, the Audit Committee of the Board of Directors of the Company, with the assistance of outside counsel, initiated a review of certain payments made in a foreign jurisdiction in which the Company operates, which may present compliance issues under the Foreign Corrupt Practices Act (FCPA). Based on the results of the internal review, the Company has determined that the payments were made to one or more person(s) who identified themselves as government employees, in order to obtain certain work permits and licenses, and to satisfy certain penalties assessed by the authorities. The Audit Committee also has been reviewing operations in several other jurisdictions in which the Company does business. The internal review is substantially complete. At this time, with respect to the initial jurisdiction referenced above, we have determined, with a reasonable amount of assurance, that the total of the payments at issue is less than \$220,000. With respect to the other jurisdictions referenced above, the payments at issue are of a similarly immaterial amount. In total, the Company presently believes, in the aggregate, all payments referenced above are of an immaterial amount and expects this matter to have no effect on the Company's previously reported financial results.

We have reported this matter to the Securities and Exchange Commission (SEC) and the US Department of Justice (DOJ) and have kept them apprised as to the status of the review. On March 11, 2008, the SEC informed us that it had opened a preliminary inquiry into the matter. The Company is cooperating with this inquiry. As part of any resolution of this matter, the DOJ, the SEC or other governmental authorities could seek criminal or civil sanctions, including monetary fines and penalties, against the Company and/or certain of its employees, as well as additional changes to its business practices and compliance programs in the event that the review or any governmental investigation identifies violations of law. To the extent any payments are determined to be illegal in a foreign jurisdiction, it is possible that there could be civil or criminal penalties assessed in that jurisdiction. As of June 30, 2008, we recorded \$7.1 million for legal and other professional services incurred related to the Audit Committee's review. Although we do not expect this matter to have a material adverse effect on our business or financial condition, we can give no assurance to that effect.

(10) Litigation

In the reporting period in which an unfavorable outcome of litigation becomes probable and estimable, we accrue for the amount in our financial statements, according to the requirements of Statements of Financial Accounting Standards (SFAS) No. 5, Accounting for Contingencies. The Company did not have any material litigation pending at June 30, 2008.

NATCO and its subsidiaries are defendants or otherwise involved in an internal review and related SEC inquiry as discussed in Note 9, Contingencies, as well as a number of other legal proceedings in the ordinary

Table of Contents**NATCO GROUP INC. AND SUBSIDIARIES****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

course of their business. While we insure against the risk of these proceedings to the extent deemed prudent by our management, we can offer no assurance that the type or value of this insurance will meet the liabilities that may arise from any pending or future legal proceedings related to our business activities. Although we cannot predict the outcome of any legal proceedings with certainty, in the opinion of management, our ultimate liability with respect to these pending lawsuits is not expected to have a material adverse effect on our business, financial condition or results of operations.

(11) Share-Based Compensation

As of June 30, 2008, the Company had 601,661 shares available for future awards under its long-term incentive compensation plans. The Company may elect to issue new shares or treasury shares, if any, under its long-term incentive compensation plans.

The components of total share-based compensation expense, related to all of the Company's share-based options and awards recognized for the three months ended June 30, 2008 and 2007, were:

	For the Three Months Ended June 30,	
	2008	2007
	(unaudited, in thousands)	
Total share-based compensation expense	\$ 1,627	\$ 976
Less: Tax benefit of share-based compensation expense	(560)	(353)
Share-based compensation expense, net of tax, recognized in income	\$ 1,067	\$ 623

The components of total share-based compensation expense, related to all of the Company's share-based options and awards recognized for the six months ended June 30, 2008 and 2007, were:

	For the Six Months Ended June 30,	
	2008	2007
	(unaudited, in thousands)	
Total share-based compensation expense	\$ 3,207	\$ 1,826
Less: Tax benefit of share-based compensation expense	(1,111)	(660)
Share-based compensation expense, net of tax, recognized in income	\$ 2,096	\$ 1,166

The Company granted a total of 17,000 and 100,500 shares of restricted stock and 8,000 and 28,000 stock options to certain key employees during the three and six month periods ending June 30, 2008, respectively. There were no changes in methods or assumptions used to measure share-based awards, and there was no significant impact of share-based arrangements on the Company's cash flow for the six month period ended June 30, 2008.

(12) Earnings per Share

Per SFAS No. 128 Earnings per Share, the basic earnings per share is computed by dividing net income available to common stockholders by the weighted average number of shares outstanding for the period. The diluted earnings per common and potential common share is computed using net income available to common stockholders divided by the sum of the weighted average number of shares outstanding for the period and

Edgar Filing: NATCO GROUP INC - Form 10-Q

any incremental shares associated with (1) stock options and awards determined by using the Treasury method and

Table of Contents**NATCO GROUP INC. AND SUBSIDIARIES****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

(2) convertible preferred stock determined by applying the if-converted method. Net income available to common stockholders represents net income less convertible preferred stock dividends accrued.

The Company computes incremental shares according to the requirements of SFAS No. 123R, Shared-based Payment. The assumed proceeds include the windfall tax benefit related to unrecognized compensation expense. If anti-dilutive common shares related to stock options and restricted stock was included in our calculation, the impact would have been an increase of approximately 22,000 shares and 97,000 shares, in the three months ended June 30, 2008 and 2007, respectively, and an increase of approximately 34,000 shares and 136,000 shares, in the six months ended June 30, 2008 and 2007, respectively.

For the three and six months ended June 30, 2007, the Company included 1.9 million shares issuable upon conversion of the Series B Redeemable Convertible Shares (preferred shares) in the calculation of the diluted weighted average shares, as the inclusion of these shares was dilutive at the level of income for the periods. During July and August of 2007 a total of 5,085 of these shares were converted into a total of 651,502 shares of the Company s common stock pursuant to a formula specified in the certificate of designations with respect to the preferred stock. The remaining preferred shares were converted into 1.3 million shares of the Company s common stock pursuant to the same formula on March 25, 2008.

The following tables present the computation of basic and diluted earnings per common and potential common share for the three and six months ended June 30, 2008 and 2007, respectively:

	For the Three Months Ended June 30, 2008			For the Three Months Ended June 30, 2007		
	Income	Weighted Average Shares Outstanding	Per-Share Amount	Income	Weighted Average Shares Outstanding	Per-Share Amount
Net income	\$ 6,193			\$ 12,142		
Less: Convertible preferred stock dividends accrued				(375)		
Basic EPS:						
Income available to common stockholders	\$ 6,193	19,552	\$ 0.32	\$ 11,767	17,259	\$ 0.68
Effect of dilutive securities:						
Stock options		193			301	
Restricted stock		62			83	
Convertible preferred stock					1,922	
Diluted EPS:						
Plus: Convertible preferred stock dividends accrued				375		
Income available to common stockholders	\$ 6,193	19,807	\$ 0.31	\$ 12,142	19,565	\$ 0.62

Table of Contents

NATCO GROUP INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	For the Six Months Ended June 30, 2008			For the Six Months Ended June 30, 2007		
	Income	Weighted Average Shares Outstanding	Per-Share Amount	Income	Weighted Average Shares Outstanding	Per-Share Amount
Net income	\$ 16,046			\$ 20,919		
Less: Convertible preferred stock dividends accrued	(248)			(750)		
<i>Basic EPS:</i>						
Income available to common stockholders	\$ 15,798	18,960	\$ 0.83	\$ 20,169	17,229	\$ 1.17
Effect of dilutive securities:						
Stock options		190			295	
Restricted stock		68			78	
Convertible preferred stock		593			1,922	
<i>Diluted EPS:</i>						