

DYNAMIC MATERIALS CORP
Form 10-Q
October 28, 2010
[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 AND EXCHANGE ACT OF 1934**

For the quarterly period ended September 30, 2010

OR

- TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES ACT OF 1934**

FOR THE TRANSITION PERIOD FROM TO .

Commission file number 001-14775

DYNAMIC MATERIALS CORPORATION

(Exact name of Registrant as Specified in its Charter)

Delaware
(State of Incorporation or Organization)

84-0608431
(I.R.S. Employer Identification No.)

5405 Spine Road, Boulder, Colorado 80301

(Address of principal executive offices, including zip code)

(303) 665-5700

(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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer <input type="checkbox"/>	Accelerated filer <input checked="" type="checkbox"/>
Non-accelerated filer <input type="checkbox"/> (Do not check if smaller reporting company)	Smaller reporting company <input type="checkbox"/>

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

The number of shares of Common Stock outstanding was 13,202,177 as of October 28, 2010.

Table of Contents

CAUTIONARY NOTE ABOUT FORWARD-LOOKING STATEMENTS

This quarterly report on Form 10-Q contains forward-looking statements within the meaning of section 27A of the Securities Act of 1933 and section 21E of the Securities Exchange Act of 1934. In particular, we direct your attention to Part I, Item 1- Condensed Consolidated Financial Statements; Item 2 - Management's Discussion and Analysis of Financial Condition and Results of Operations; Item 3 - Quantitative and Qualitative Disclosures About Market Risk; and Part II, Item 1A Risk Factors. We intend the forward-looking statements throughout this quarterly report on Form 10-Q and the information incorporated by reference herein to be covered by the safe harbor provisions for forward-looking statements. Statements contained in this report which are not historical facts are forward-looking statements that involve risks and uncertainties that could cause actual results to differ materially from projected results. All projections, guidance and other statements regarding our expected financial position and operating results, our business strategy and the outcome of any contingencies are forward-looking statements. These statements can sometimes be identified by our use of forward-looking words such as may, believe, plan, anticipate, estimate, expect, intend, and other phrases of similar meaning. The forward-looking information is based on information available as of the date of this quarterly report and on numerous assumptions and developments that are not within our control. Although we believe that our expectations as expressed in these forward-looking statements are reasonable, we cannot assure you that our expectations will turn out to be correct. Factors that could cause actual results to differ materially include, but are not limited to, the following: changes in global economic conditions; the ability to obtain new contracts at attractive prices; the size and timing of customer orders and shipment; our ability to realize sales from our backlog; fluctuations in customer demand; fluctuations in foreign currencies; competitive factors; the timely completion of contracts; the timing and size of expenditures; the timely receipt of government approvals and permits; the price and availability of metal and other raw material; the adequacy of local labor supplies at our facilities; current or future limits on manufacturing capacity at our various operations; our ability to successfully integrate acquired businesses; the availability and cost of funds; and general economic conditions, both domestic and foreign, impacting our business and the business of the end-market users we serve. Readers are cautioned not to place undue reliance on these forward-looking statements, which reflect management's analysis only as of the date hereof. We undertake no obligation to publicly release the results of any revision to these forward-looking statements that may be made to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

Table of Contents

INDEX

PART I - FINANCIAL INFORMATION

<u>Item 1</u>	<u>Condensed Consolidated Financial Statements</u>	4
	<u>Consolidated Balance Sheets as of September 30, 2010 (unaudited) and December 31, 2009</u>	4
	<u>Consolidated Statements of Operations for the three and nine months ended September 30, 2010 and 2009 (unaudited)</u>	6
	<u>Consolidated Statement of Stockholders' Equity for the nine months ended September 30, 2010 (unaudited)</u>	7
	<u>Consolidated Statements of Cash Flows for the nine months ended September 30, 2010 and 2009 (unaudited)</u>	8
	<u>Notes to Condensed Consolidated Financial Statements (unaudited)</u>	10
<u>Item 2</u>	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	25
<u>Item 3</u>	<u>Quantitative and Qualitative Disclosure about Market Risk</u>	42
<u>Item 4</u>	<u>Controls and Procedures</u>	42

PART II - OTHER INFORMATION

<u>Item 1</u>	<u>Legal Proceedings</u>	43
<u>Item 1A</u>	<u>Risk Factors</u>	43
<u>Item 2</u>	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	43
<u>Item 3</u>	<u>Defaults Upon Senior Securities</u>	43
<u>Item 4</u>	<u>Removed and Reserved</u>	43
<u>Item 5</u>	<u>Other Information</u>	43
<u>Item 6</u>	<u>Exhibits</u>	43
	<u>Signatures</u>	44

Table of Contents**Part I - FINANCIAL INFORMATION****ITEM 1. Condensed Consolidated Financial Statements**DYNAMIC MATERIALS CORPORATION & SUBSIDIARIESCONDENSED CONSOLIDATED BALANCE SHEETS

(Dollars in Thousands)

	September 30, 2010 (unaudited)	December 31, 2009
<u>ASSETS</u>		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 11,097	\$ 22,411
Accounts receivable, net of allowance for doubtful accounts of \$444 and \$390, respectively	27,390	25,807
Inventories	36,797	32,501
Prepaid expenses and other	3,465	2,397
Related party receivables and loans		2,806
Current deferred tax assets	885	2,052
Total current assets	79,634	87,974
PROPERTY, PLANT AND EQUIPMENT	66,826	64,944
Less - accumulated depreciation	(26,356)	(22,892)
Property, plant and equipment, net	40,470	42,052
GOODWILL, net	40,414	43,164
PURCHASED INTANGIBLE ASSETS, net	50,962	49,079
DEFERRED TAX ASSETS	940	332
OTHER ASSETS, net	1,046	1,443
INVESTMENT IN JOINT VENTURES		1,132
TOTAL ASSETS	\$ 213,466	\$ 225,176

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

Table of ContentsDYNAMIC MATERIALS CORPORATION & SUBSIDIARIESCONDENSED CONSOLIDATED BALANCE SHEETS

(Dollars in Thousands, Except Share Data)

	September 30, 2010 (unaudited)	December 31, 2009
<u>LIABILITIES AND STOCKHOLDERS EQUITY</u>		
CURRENT LIABILITIES:		
Accounts payable	\$ 11,386	\$ 9,183
Accrued expenses	3,613	4,808
Dividend payable	528	515
Accrued income taxes	847	1,485
Accrued employee compensation and benefits	3,185	4,048
Customer advances	5,128	6,528
Lines of credit	6,735	1,777
Current maturities on long-term debt	7,567	13,485
Current portion of capital lease obligations	301	306
Current deferred tax liabilities	23	
Total current liabilities	39,313	42,135
LONG-TERM DEBT	23,541	34,120
CAPITAL LEASE OBLIGATIONS	214	436
DEFERRED TAX LIABILITIES	13,469	15,217
OTHER LONG-TERM LIABILITIES	1,140	1,157
Total liabilities	77,677	93,065
COMMITMENTS AND CONTINGENT LIABILITIES		
STOCKHOLDERS EQUITY:		
Preferred stock, \$0.05 par value; 4,000,000 shares authorized; no issued and outstanding shares		
Common stock, \$0.05 par value; 25,000,000 shares authorized; 13,202,177 and 12,870,363 shares issued and outstanding, respectively	660	643
Additional paid-in capital	51,332	46,080
Retained earnings	87,424	85,048
Other cumulative comprehensive income (loss)	(3,627)	340
Total stockholders equity	135,789	132,111
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	\$ 213,466	\$ 225,176

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

Table of ContentsDYNAMIC MATERIALS CORPORATION & SUBSIDIARIESCONDENSED CONSOLIDATED STATEMENTS OF OPERATIONSFOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2010 AND 2009(Dollars in Thousands, Except Share Data)(unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2010	2009	2010	2009
NET SALES	\$ 41,298	\$ 34,690	\$ 109,913	\$ 122,268
COST OF PRODUCTS SOLD	30,445	25,936	82,819	89,032
Gross profit	10,853	8,754	27,094	33,236
COSTS AND EXPENSES:				
General and administrative expenses	3,487	2,749	9,990	9,318
Selling expenses	3,047	2,212	7,918	6,376
Amortization of purchased intangible assets	1,376	1,293	3,913	3,709
Total costs and expenses	7,910	6,254	21,821	19,403
INCOME FROM OPERATIONS	2,943	2,500	5,273	13,833
OTHER INCOME (EXPENSE):				
Gain on step acquisition of joint ventures			2,117	
Other income (expense), net	(416)	(633)	(402)	(560)
Interest expense	(667)	(752)	(2,473)	(2,521)
Interest income	6	41	71	145
Equity in earnings of joint ventures		91	255	170
INCOME BEFORE INCOME TAXES	1,866	1,247	4,841	11,067
INCOME TAX PROVISION	540	151	891	3,540
NET INCOME	\$ 1,326	\$ 1,096	\$ 3,950	\$ 7,527
INCOME PER SHARE:				
Basic	\$ 0.10	\$ 0.09	\$ 0.30	\$ 0.59
Diluted	\$ 0.10	\$ 0.08	\$ 0.30	\$ 0.58
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING:				
Basic	12,939,274	12,632,406	12,807,826	12,597,023
Diluted	12,951,397	12,645,500	12,820,508	12,621,970
DIVIDENDS DECLARED PER COMMON SHARE	\$ 0.04	\$ 0.04	\$ 0.12	\$ 0.08

Edgar Filing: DYNAMIC MATERIALS CORP - Form 10-Q

The accompanying notes are in integral part of these Condensed Consolidated Financial Statements.

Table of ContentsDYNAMIC MATERIALS CORPORATION & SUBSIDIARIESCONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITYFOR THE NINE MONTHS ENDED SEPTEMBER 30, 2010

(Amounts in Thousands)

(unaudited)

	Common Stock		Additional	Retained	Other	Total	Comprehensive
	Shares	Amount	Paid-In	Earnings	Cumulative		Loss
			Capital		Income/(loss)		for the Period
Balances, December 31, 2009	12,870	\$ 643	\$ 46,080	\$ 85,048	\$ 340	\$ 132,111	
Shares issued for AECO acquisition	222	11	3,290			3,301	
Shares issued in connection with stock compensation plans	110	6	64			70	
Tax impact of stock-based compensation			(639)			(639)	
Stock-based compensation			2,537			2,537	
Dividends				(1,574)		(1,574)	
Net income				3,950		3,950	3,950
Derivative valuation, net of tax of \$248					365	365	365
Change in cumulative foreign currency translation adjustment					(4,332)	(4,332)	(4,332)
Balances, September 30, 2010	13,202	\$ 660	\$ 51,332	\$ 87,424	\$ (3,627)	\$ 135,789	\$ (17)

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

Table of Contents

DYNAMIC MATERIALS CORPORATION & SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2010 AND 2009

(Dollars in Thousands)

(unaudited)

	2010	2009
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$ 3,950	\$ 7,527
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation (including capital lease amortization)	3,908	3,701
Amortization of purchased intangible assets	3,913	3,709
Amortization of capitalized debt issuance costs	489	215
Stock-based compensation	2,537	2,657
Deferred income tax benefit	(953)	(1,875)
Equity in earnings of joint ventures	(255)	(170)
Gain on step acquisition of joint ventures	(2,117)	
Change in (excluding assets acquired):		
Accounts receivable, net	2,465	13,632
Inventories	1,198	3,334
Prepaid expenses and other	321	496
Accounts payable	(2,075)	(5,980)
Customer advances	(1,327)	246
Accrued expenses and other liabilities	(1,800)	(4,078)
Net cash provided by operating activities	10,254	23,414
CASH FLOWS FROM INVESTING ACTIVITIES:		
Acquisition of Austin Explosives Company	(3,620)	
Step acquisition of joint ventures, net of cash acquired	(2,065)	
Acquisition of property, plant and equipment	(2,309)	(3,238)
Change in other non-current assets	(59)	42
Net cash used in investing activities	(8,053)	(3,196)

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

Table of ContentsDYNAMIC MATERIALS CORPORATION & SUBSIDIARIESCONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWSFOR THE NINE MONTHS ENDED SEPTEMBER 30, 2010 AND 2009(Dollars in Thousands)(unaudited)

	2010	2009
CASH FLOWS FROM FINANCING ACTIVITIES:		
Payment on syndicated term loans	(15,374)	(3,912)
Payment on Nord LB term loans	(593)	(653)
Borrowings on bank lines of credit, net	4,682	
Payment on capital lease obligations	(215)	(132)
Payment of dividends	(1,561)	(513)
Payment of deferred debt issuance costs		(58)
Net proceeds from issuance of common stock to employees and directors	70	373
Tax impact of stock-based compensation	(639)	90
Net cash used in financing activities	(13,630)	(4,805)
EFFECTS OF EXCHANGE RATES ON CASH	115	258
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(11,314)	15,671
CASH AND CASH EQUIVALENTS, beginning of the period	22,411	14,360
CASH AND CASH EQUIVALENTS, end of the period	\$ 11,097	\$ 30,031

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

Table of Contents

DYNAMIC MATERIALS CORPORATION & SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Currency Amounts in Thousands, Except Share and Per Share Data)

(unaudited)

1. BASIS OF PRESENTATION

The information included in the Condensed Consolidated Financial Statements is unaudited but includes all normal and recurring adjustments which, in the opinion of management, are necessary for a fair presentation of the interim periods presented. These Condensed Consolidated Financial Statements should be read in conjunction with the financial statements that are included in the Company's Annual Report filed on Form 10-K for the year ended December 31, 2009.

2. SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

The Condensed Consolidated Financial Statements include the accounts of the Company and its controlled subsidiaries. Only subsidiaries in which controlling interests are maintained are consolidated. The equity method is used to account for our ownership in subsidiaries where we do not have a controlling interest. All significant intercompany accounts, profits, and transactions have been eliminated in consolidation.

Foreign Operations and Foreign Exchange Rate Risk

The functional currency for the Company's foreign operations is the applicable local currency for each affiliate company. Assets and liabilities of foreign subsidiaries for which the functional currency is the local currency are translated at exchange rates in effect at period-end, and the statements of operations are translated at the average exchange rates during the period. Exchange rate fluctuations on translating foreign currency financial statements into U.S. Dollars that result in unrealized gains or losses are referred to as translation adjustments. Cumulative translation adjustments are recorded as a separate component of stockholders' equity and are included in other cumulative comprehensive income (loss). Transactions denominated in currencies other than the local currency are recorded based on exchange rates at the time such transactions arise. Subsequent changes in exchange rates result in transaction gains and losses which are reflected in income as unrealized (based on

Edgar Filing: DYNAMIC MATERIALS CORP - Form 10-Q

period-end translations) or realized upon settlement of the transactions. Cash flows from the Company's operations in foreign countries are translated at actual exchange rates when known or at the average rate for the period. As a result, amounts related to assets and liabilities reported in the consolidated statements of cash flows will not agree to changes in the corresponding balances in the consolidated balance sheets. The effects of exchange rate changes on cash balances held in foreign currencies are reported as a separate line item below cash flows from financing activities.

In September 2010, the Company's German subsidiary, DYNAenergetics, entered into a currency swap agreement with its bank to hedge the currency risk associated with a large U.S. Dollar order (\$2,700) that was recently awarded to the Company. Under the agreement, DYNAenergetics will exchange \$2,700 for Euros at an exchange rate of 1.269 U.S. Dollars per Euro between January 18, 2011 and February 15, 2011 (the date range of expected payment settlement on this order). The Company has not designated this derivative as an effective cash

Table of Contents

flow hedge and as such, gains and losses related to changes in its valuation will be recorded in the statement of operations. During the three months and nine months ended September 30, 2010, the Company recorded a gain on this currency swap agreement of \$185 based on the U.S. Dollar to Euro exchange rate as of September 30, 2010. The gain is classified in other income in the Company's statement of operations.

Revenue Recognition

Sales of clad metal products and welding services are generally based upon customer specifications set forth in customer purchase orders and require us to provide certifications relative to metals used, services performed, and the results of any non-destructive testing that the customer has requested be performed. All issues of conformity of the product to specifications are resolved before the product is shipped and billed. Products related to the oilfield products segment, which include detonating cords, detonators, bi-directional boosters, and shaped charges, as well as seismic related explosives and accessories, are standard in nature. In all cases, revenue is recognized only when all four of the following criteria have been satisfied: persuasive evidence of an arrangement exists; the price is fixed or determinable; delivery has occurred; and collection is reasonably assured. For contracts that require multiple shipments, revenue is recorded only for the units included in each individual shipment. If, as a contract proceeds toward completion, projected total cost on an individual contract indicates a probable loss, the Company will account for such anticipated loss.

Fair Value of Financial Instruments

The carrying values of cash and cash equivalents, trade accounts receivable and payable, and accrued expenses are considered to approximate fair value due to the short-term nature of these instruments. Based upon the 150 basis point increase in our LIBOR/EURIBOR basis borrowing spread negotiated in the October 21, 2009 amendment to our syndicated credit agreement, we believe the fair value of our long-term debt approximates its carrying value at September 30, 2010. The majority of the Company's debt was incurred in connection with the acquisition of DYNAenergetics.

Additionally, the Company has an interest rate swap agreement (see Note 9) and a foreign currency hedge agreement (see disclosure above in Note 2), which are recorded at fair value. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The Company is required to use an established hierarchy for fair value measurements based upon the inputs to the valuation and the degree to which they are observable or not observable in the market. The three levels in the hierarchy are as follows:

- Level 1 Inputs to the valuation based upon quoted prices (unadjusted) for identical assets or liabilities in active markets that are accessible as of the measurement date.
- Level 2 Inputs to the valuation include quoted prices in either markets that are not active, or in active markets for similar assets or liabilities, inputs other than quoted prices that are observable, and inputs that are derived principally from or corroborated by observable market data.

Edgar Filing: DYNAMIC MATERIALS CORP - Form 10-Q

- Level 3 Inputs to the valuation that are unobservable inputs for the asset or liability.

The highest priority is assigned to Level 1 inputs and the lowest priority to Level 3 inputs.

Table of Contents

The Company's interest rate swap and foreign currency hedge agreements are not exchange listed and are therefore valued with models that use Level 2 inputs. The degree to which the Company's credit worthiness impacts the value requires management judgment but as of September 30, 2010 and December 31, 2009, the impact of this assessment on the overall value of the outstanding interest rate swap was not significant and the Company's valuation of the agreement is classified within Level 2 of the hierarchy.

The Company has recorded the fair value of its derivatives as follows:

	September 30, 2010		December 31, 2009	
	Balance sheet location	Fair value	Balance sheet location	Fair value
Interest rate swap	Accrued expenses	\$ 164	Accrued expenses	\$ 820
Foreign currency hedge	Prepaid expenses and other	\$ 185	Prepaid expenses and other	\$

Related Party Transactions

Prior to acquiring the remaining outstanding interests in its unconsolidated joint ventures on April 30, 2010 (See Note 3), the Company had related party transactions with these joint ventures. Additionally the Company had related party transactions with the former owners of LRI Oil Tools Inc. (LRI). The Company also had transactions in the period from January 1 through September 30, 2009 with LRI who, at the time, was the non-controlling interest partner in one of the Company's consolidated joint ventures. A summary of related party balances as of December 31, 2009 is summarized below:

	Accounts receivable from and loan to	
DYNAenergetics RUS	\$	2,265
Perfoline		466
Former owners of LRI		75
Total	\$	2,806

Table of Contents

A summary of related party transactions for the three months ended September 30, 2009 and the nine months ended September 30, 2010 and 2009 is summarized below:

	Three Months Ended September 30, 2009	
	Sales to	Interest income from
DYNAenergetics RUS	\$ 366	\$
Perfoline	3	12
Minority Interest Partner	301	
Total	\$ 670	\$ 12

	Nine Months Ended September 30, 2010		Nine Months Ended September 30, 2009	
	Sales to	Interest income from	Sales to	Interest income from
DYNAenergetics RUS	\$ 663	\$	\$ 1,100	\$
Perfoline	19	13	59	31
Minority Interest Partner			745	
Total	\$ 682	\$ 13	\$ 1,904	\$ 31

Earnings Per Share

Unvested awards of share-based payments with rights to receive dividends or dividend equivalents, such as the Company's restricted stock awards (RSAs), are considered participating securities for purposes of calculating earnings per share (EPS) and require the use of the two class method for calculating EPS. Under this method, a portion of net income is allocated to these participating securities and therefore is excluded from the calculation of EPS allocated to common stock, as shown in the table below.

Edgar Filing: DYNAMIC MATERIALS CORP - Form 10-Q

Table of Contents

Computation and reconciliation of earnings per common share are as follows:

	For the Three Months Ended September 30, 2010			For the Three Months Ended September 30, 2009		
	Income	Shares	EPS	Income	Shares	EPS
Basic earnings per share:						
Net income	\$ 1,326			\$ 1,096		
Less income allocated to RSAs	(26)			(22)		
Net income allocated to common stock for EPS calculation	\$ 1,300	12,939,274	\$ 0.10	\$ 1,074	12,632,406	\$ 0.09
Adjust shares for Dilutives:						
Stock-based compensation plans		12,123			13,094	
Diluted earnings per share:						
Net income	\$ 1,326			\$ 1,096		
Less income allocated to RSAs	(26)			(22)		
Net income allocated to common stock for EPS calculation	\$ 1,300	12,951,397	\$ 0.10	\$ 1,074	12,645,500	\$ 0.08
	For the Nine Months Ended September 30, 2010			For the Nine Months Ended September 30, 2009		
	Income	Shares	EPS	Income	Shares	EPS
Basic earnings per share:						
Net income	\$ 3,950			\$ 7,527		
Less income allocated to RSAs	(79)			(148)		
Net income allocated to common stock for EPS calculation	\$ 3,871	12,807,826	\$ 0.30	\$ 7,379	12,597,023	\$ 0.59
Adjust shares for Dilutives:						
Stock-based compensation plans		12,682			24,947	
Diluted earnings per share:						
Net income	\$ 3,950			\$ 7,527		
Less income allocated to RSAs	(79)			(148)		
Net income allocated to common stock for EPS calculation	\$ 3,871	12,820,508	\$ 0.30	\$ 7,379	12,621,970	\$ 0.58

3. ACQUISITIONS

Austin Explosives

Edgar Filing: DYNAMIC MATERIALS CORP - Form 10-Q

On June 4, 2010, the Company completed its acquisition of Texas-based, Austin Explosives Company (AECO), which is now operating under the name DYNAenergetics US, Inc. This business is now part of the Company's Oilfield Products business segment. AECO had been a long-time distributor of DYNAenergetics shaped charges. This acquisition, along with the acquisition of the outstanding interests in our Russian joint ventures (discussed below), further expands the Company's Oilfield Products business, and positions the segment to capitalize on the long-term demand from the oil and gas industry. From June 5, 2010 through September 30, 2010,

Table of Contents

DYNAenergetics US, Inc. contributed incremental net sales of \$2,187 and an incremental net loss of \$10 after the elimination of intercompany sales and the related gross profit. On a standalone basis, DYNAenergetics U.S., Inc. reported sales of \$6,097 and net income of \$290 for the same period.

The acquisition was structured as an asset purchase valued at \$6,921 which was financed by (i) the payment of \$3,620 in cash and (ii) the issuance of 222,445 shares of common stock of the Company (valued at \$3,301).

The purchase price of the acquisition was allocated to the Company's tangible and identifiable intangible assets based on their fair values as determined by appraisals performed as of the acquisition date. The allocation of the purchase price to the assets of AECO was as follows:

Current assets	\$	5,792
Property, plant and equipment		368
Intangible assets		4,773
Deferred tax assets		7
Other assets		81
Total assets acquired		11,021
Current liabilities		4,100
Total liabilities assumed		4,100
Net assets acquired	\$	6,921

The Company acquired identifiable finite-lived intangible assets as a result of the acquisition of AECO. The finite-lived intangible assets acquired were classified as customer relationships and were valued at \$4,773 which will be amortized over 11 years. These amounts are included in Intangible Assets and are further discussed in Note 7.

Russian Joint Ventures

On April 30, 2010 the Company purchased the outstanding minority-owned interests in its two Russian joint ventures that were previously majority-owned by the Company's Oilfield Products business segment. These joint ventures include DYNAenergetics RUS, which is a Russian trading company that sells the Company's oilfield products, and Perfoline, which is a Russian manufacturer of perforating gun systems. The Company paid a combined \$2,065 for the respective 45% and 34.81% outstanding stakes in DYNAenergetics RUS and Perfoline. From April 30, 2010 through September 30, 2010, DYNAenergetics RUS and Perfoline contributed incremental net sales of \$2,548 and incremental net income of \$213 after the elimination of intercompany sales and the related gross profit. As standalone companies, these two entities reported sales of \$3,165 and net income of \$311 for the same period.

Prior to the acquisition date, the Company accounted for its 55% and 65.19% interest in DYNAenergetics RUS and Perfoline, respectively, as equity-method investments (See Note 4). The acquisition date fair value of the previous equity interest was \$3,533. The Company recognized a gain of \$2,117 as a result of revaluing its prior equity interest held before the acquisition. The gain is included in the line item gain on step

acquisition of joint ventures in the consolidated statement of operations.

Table of Contents

Appraisals performed as of the acquisition date resulted in a new fair value of the combined entities of \$5,598 which was allocated to the Company's tangible and identifiable intangible assets as follows:

Current assets	\$	5,243
Property, plant and equipment		411
Intangible assets		3,669
Deferred tax assets		12
Other assets		56
Total assets acquired		9,391
Line of credit		36
Other current liabilities		2,547
Deferred tax liabilities		813
Other long term liabilities		397
Total liabilities assumed		3,793
Fair value of net assets following step acquisition	\$	5,598

The Company acquired identifiable finite-lived intangible assets as a result of acquiring the remaining interests of DYNAenergetics RUS and Perfoline. The finite-lived intangible assets acquired were classified as customer relationships and were valued at \$3,669 which will be amortized over 11 years. These amounts are included in Intangible Assets and are further discussed in Note 7.

LRI Oil Tools Inc.

On October 1, 2009, the Company completed its acquisition of LRI Oil Tools Inc. (LRI), which is part of the Oilfield Products business. LRI produces and distributes perforating equipment for use by the oil and gas exploration and production industry. The business had a long-term strategic relationship with the Company's Oilfield Products segment and had served for several years as its sole Canadian distributor. From January 1, 2010 through September 30, 2010, LRI contributed incremental net sales of \$7,399 and incremental net income of \$525 after the elimination of intercompany sales and related gross profit. On a standalone basis, LRI reported sales of \$10,808 and net income of \$666 for the same period.

The acquisition was valued at \$5,946 and was financed by (i) the payment of \$284 in cash, net of cash acquired of \$15, (ii) the issuance of 4,875 shares of common stock of the Company (valued at \$94), and (iii) the assumption of \$5,553 (5,982 Canadian Dollars (CAD)) of LRI's debt. The assumed debt consisted of \$2,676 (2,883 CAD) for a line of credit, \$2,445 (2,634 CAD) for loans with the former owners of LRI and \$432 (465 CAD) for capital lease obligations.

Table of Contents

The purchase price of the acquisition was allocated to the Company's tangible and identifiable intangible assets based on their fair values as determined by appraisals performed as of the acquisition date. The allocation of the purchase price to the assets and liabilities of LRI was as follows:

Current assets	\$	5,430
Property, plant and equipment		2,191
Intangible assets		1,117
Deferred tax assets		298
Other assets		1
Total assets acquired		9,037
Line of credit		2,676
Other current liabilities		2,448
Long term debt		2,877
Deferred tax liabilities		643
Total liabilities assumed		8,644
Net assets acquired	\$	393

The Company acquired identifiable finite-lived intangible assets as a result of the acquisition of LRI. The finite-lived intangible assets acquired are classified and valued as follows:

	Value	Amortization Period
Core technology	\$ 347	15 years
Customer relationships	770	15 years
Total intangible assets	\$ 1,117	

These amounts are included in Intangible Assets and are further discussed in Note 7.

Table of ContentsPro Forma Statement of Operations

The following table presents the pro-forma combined results of operations for the three months ended September 30, 2009 and the nine months ended September 30, 2010 and September 30, 2009, respectively, assuming (i) the acquisitions of LRI, AECO and the Russian joint ventures had occurred on January 1, 2010 and January 1, 2009; (ii) pro-forma amortization expense of the purchased intangible assets; (iii) pro-forma depreciation expense of the fair value of purchased property, plant and equipment; (iv) reduction of interest expense assuming the Company paid down LRI's debt by 2,200 CAD (1,200 CAD for the loans to former owners of LRI and 1,000 CAD for the line of credit) immediately following the acquisition (net of a related pro forma reduction in interest income); (v) elimination of intercompany sales; and (vi) increase in interest expense for borrowing 1,500 Euros to fund the acquisition of the Russian joint ventures:

	Three Months Ended September 30, 2009		Nine Months Ended September 30, 2010		2009
Net sales	\$	38,781	\$	117,202	\$ 134,613
Income from operations	\$	2,027	\$	5,620	\$ 12,646
Net income	\$	527	\$	3,852	\$ 6,127
Net income per share:					
Basic	\$	0.04	\$	0.29	\$ 0.47
Diluted	\$	0.04	\$	0.29	\$ 0.47

Since all acquisitions were completed prior to June 30, 2010, a pro forma statement of operations was not necessary for the three months ended September 30, 2010. The pro-forma results above are not necessarily indicative of the operating results that would have actually occurred if the acquisitions had been in effect on the dates indicated, nor are they necessarily indicative of future results of the combined companies.

4. INVESTMENT IN JOINT VENTURES

As discussed in Note 2, on April 30, 2010, the Company acquired the remaining minority-owned interests in two joint ventures that were previously majority-owned by the Company's Oilfield Product's business segment. Prior to the April 30, 2010 step acquisition, these investments, which include DYNAenergetics RUS and Perfoline, were accounted for under the equity method due to certain non-controlling interest veto rights that allowed the non-controlling interest shareholders to participate in ordinary course of business decisions. Operating results from January 1, 2010 through April 30, 2010 include the Company's proportionate share of income from these unconsolidated joint ventures. Investments in these joint ventures totaled \$1,132 as of December 31, 2009. As a result of the step acquisition, the Company now consolidates the financial statements of these entities.

Table of Contents

Summarized unaudited financial information for the joint ventures accounted for under the equity method as of December 31, 2009 and for the three months ended September 30, 2009 and the nine months ended September 30, 2010 and 2009 is as follows:

	December 31, 2009	
Current assets	\$	5,350
Noncurrent assets		655
Total assets	\$	6,005
Current liabilities	\$	2,892
Noncurrent liabilities		555
Equity		2,558
Total liabilities and equity	\$	6,005

	Three Months Ended September 30, 2009		Nine Months Ended September 30, 2009		2010 (a)	
Net sales	\$	1,645	\$	2,575	\$	4,427
Gross Profit	\$	455	\$	656	\$	1,271
Operating income	\$	233	\$	302	\$	596
Net income	\$	168	\$	468	\$	310
Equity in earnings of joint ventures	\$	91	\$	255	\$	170

(a) Through April 30, 2010

5. INVENTORY

The components of inventory are as follows at September 30, 2010 and December 31, 2009:

	September 30, 2010		December 31, 2009	
Raw materials	\$	10,262	\$	10,321
Work-in-process		14,641		15,963
Finished goods		11,164		5,526
Supplies		730		691
	\$	36,797	\$	32,501

Table of Contents**6. GOODWILL**

The changes to the carrying amount of goodwill during the period are summarized below:

	Explosive Metalworking Group		Oilfield Products		Total
Goodwill balance at December 31, 2009	\$ 24,577	\$	18,587	\$	43,164
Adjustment due to recognition of tax benefit of tax amortization of certain goodwill	(256)		(327)		(583)
Adjustment due to exchange rate differences	(1,194)		(973)		(2,167)
Goodwill balance at September 30, 2010	\$ 23,127	\$	17,287	\$	40,414

7. PURCHASED INTANGIBLE ASSETS

The following table presents details of our purchased intangible assets, other than goodwill, as of September 30, 2010:

	Gross		Accumulated Amortization		Net
Core technology	\$ 23,147	\$	(3,299)	\$	19,848
Customer relationships	39,854		(10,154)		29,700
Trademarks / Trade names	2,481		(1,067)		1,414
Total intangible assets	\$ 65,482	\$	(14,520)	\$	50,962

The following table presents details of our purchased intangible assets, other than goodwill, as of December 31, 2009:

	Gross		Accumulated Amortization		Net
Core technology	\$ 24,347	\$	(2,555)	\$	21,792
Customer relationships	33,161		(7,657)		25,504
Trademarks / Trade names	2,613		(830)		1,783
Total intangible assets	\$ 60,121	\$	(11,042)	\$	49,079

The change in the gross value of our purchased intangible assets from December 31, 2009 to September 30, 2010 reflects the additional intangible assets associated with the acquisitions of AECO and the two Russian joint ventures (see Note 3) and by the impact of foreign currency translation adjustments.

8. CUSTOMER ADVANCES

On occasion, customers make advance payments prior to the shipment of their orders in order to help finance the Company's inventory investment on large orders or to keep credit limits at acceptable levels. As of September 30, 2010 and December 31, 2009, customer advances totaled \$5,128 and \$6,528 respectively.

Table of Contents**9. DEBT**

Lines of credit consisted of the following at September 30, 2010 and December 31, 2009:

	September 30, 2010		December 31, 2009
HSBC line of credit	\$ 81	\$	1,774
Syndicated credit agreement revolving loan	3,403		
Commerzbank line of credit	1,518		3
Nord LB line of credit	1,733		
	\$ 6,735	\$	1,777

Long-term debt consists of the following at September 30, 2010 and December 31, 2009:

	September 30, 2010		December 31, 2009
Syndicated credit agreement term loan	\$ 28,997	\$	31,005
Syndicated credit agreement Euro term loan			13,826
Nord LB 3,000 Euro term loan	817		1,505
Loans with former owners of LRI	1,294		1,269
	31,108		47,605
Less current maturities	(7,567)		(13,485)
Long-term debt	\$ 23,541	\$	34,120

In March of 2010, the Company made required prepayments of principal under the U.S. Dollar and Euro term loans in the amounts of \$2,008 and 626 Euros (\$868), respectively, from excess cash flow generated in 2009. Additionally, the Company made a March payment of 9,020 Euros (\$12,498) to retire the remaining principal balance outstanding under the Euro term loan, which was scheduled to mature on November 16, 2012.

Loan Covenants and Restrictions

The Company's existing loan agreements include various covenants and restrictions, certain of which relate to the incurrence of additional indebtedness; mortgaging, pledging or disposition of major assets; limits on capital expenditures; and maintenance of specified financial ratios. As of September 30, 2010, the Company was in compliance with all financial covenants and other provisions of its debt agreements.

Swap Agreement

On November 17, 2008, the Company entered into a two-year interest rate swap agreement with an initial notional amount of \$40,500 (decreasing to \$33,750 in November 2009) that effectively converted the LIBOR based variable rate U.S. borrowings under the syndicated credit agreement to a fixed rate of 4.87% (6.37% effective October 21, 2009 due to an amendment in the Company's syndicated credit facility and the Company's current leverage ratio). The Company had designated the swap agreement as an effective cash flow hedge with matched terms and, as a result, changes in the fair value of the swap agreement were recorded in other comprehensive income with the offset as a swap agreement asset or liability. During March 2009 and March

Table of Contents

2010, the Company made repayments of \$2,744 and \$2,008, respectively, on its variable rate U.S. borrowings and in both cases elected to de-designate the related portion of the cash flow hedge. These principal payments were required under the terms of the Company's syndicated credit facility since certain annually calculated cash flow measures were met. Settlements and changes in the fair value related to the de-designated portion of the cash flow hedge are recorded as realized and unrealized gains/losses on swap agreement within other income in the Company's statement of operations. The Company recorded an immaterial loss of less than \$100 during 2009 and an immaterial gain of approximately \$43 during the nine months ended September 30, 2010.

10. BUSINESS SEGMENTS

The Company is organized in the following three segments: Explosive Metalworking, Oilfield Products, and AMK Welding. The Explosive Metalworking segment uses explosives to perform metal cladding and shock synthesis of industrial diamonds. The most significant product of this group is clad metal which is used in the fabrication of pressure vessels, heat exchangers, and transition joints for various industries, including upstream oil and gas, oil refinery, petrochemicals, hydrometallurgy, aluminum production, shipbuilding, power generation, industrial refrigeration, and similar industries. The Oilfield Products segment manufactures, markets and sells oilfield perforating equipment and explosives, including detonating cords, detonators, bi-directional boosters and shaped charges, and seismic related explosives and accessories. AMK Welding utilizes a number of welding technologies to weld components for manufacturers of jet engine and ground-based turbines.

The accounting policies of all the segments are the same as those described in the summary of significant accounting policies. The Company's reportable segments are separately managed strategic business units that offer different products and services. Each segment's products are marketed to different customer types and require different manufacturing processes and technologies.

Table of Contents

Segment information is presented for the three and nine months ended September 30, 2010 and 2009 as follows:

	Explosive Metalworking Group	Oilfield Products	AMK Welding	Total
For the three months ended September 30, 2010:				
Net sales	\$ 24,925	\$ 13,208	\$ 3,165	\$ 41,298
Depreciation and amortization	\$ 1,608	\$ 1,152	\$ 120	\$ 2,880
Income from operations	\$ 1,225	\$ 1,691	\$ 861	\$ 3,777
Unallocated amounts:				
Stock-based compensation				(834)
Other expense				(416)
Interest expense				(667)
Interest income				6
Consolidated income before income taxes				\$ 1,866

	Explosive Metalworking Group	Oilfield Products	AMK Welding	Total
For the three months ended September 30, 2009:				
Net sales	\$ 27,327	\$ 5,123	\$ 2,240	\$ 34,690
Depreciation and amortization	\$ 1,527	\$ 912	\$ 114	\$ 2,553
Income (loss) from operations	\$ 3,370	\$ (414)	\$ 441	\$ 3,397
Equity in earnings of joint ventures	\$	\$ 91	\$	91
Unallocated amounts:				
Stock-based compensation				(897)
Other expense				(633)
Interest expense				(752)
Interest income				41
Consolidated income before income taxes				\$ 1,247

	Explosive Metalworking Group	Oilfield Products	AMK Welding	Total
For the nine months ended September 30, 2010:				
Net sales	\$ 72,921	\$ 28,868	\$ 8,124	\$ 109,913
Depreciation and amortization	\$ 4,340	\$ 3,131	\$ 350	\$ 7,821
Income from operations	\$ 4,408	\$ 1,490	\$ 1,912	\$ 7,810
Equity in earnings of joint ventures	\$	\$ 255	\$	255
Unallocated amounts:				
Stock-based compensation				(2,537)
Other income				1,715
Interest expense				(2,473)
Interest income				71
Consolidated income before income taxes				\$ 4,841

Table of Contents

	Explosive Metalworking Group	Oilfield Products	AMK Welding	Total
For the nine months ended September 30, 2009:				
Net sales	\$ 102,403	\$ 13,171	\$ 6,694	\$ 122,268
Depreciation and amortization	\$ 4,452	\$ 2,616	\$ 342	\$ 7,410
Income (loss) from operations	\$ 17,381	\$ (2,013)	\$ 1,122	\$ 16,490
Equity in earnings of joint ventures	\$	\$ 170	\$	\$ 170
Unallocated amounts:				
Stock-based compensation				(2,657)
Other expense				(560)
Interest expense				(2,521)
Interest income				145
Consolidated income before income taxes			\$	11,067

During the three months ended September 30, 2010, no sales to any one customer accounted for more than 10% of total net sales. During the nine months ended September 30, 2010, sales to one customer represented \$11,882 (10.8%) of total net sales. During the three months ended September 30, 2009, sales to one customer represented approximately \$4,033 (11.6%) of total net sales. During the nine months ended September 30, 2009, no sales to any one customer accounted for more than 10% of total sales.

11. COMPREHENSIVE INCOME (LOSS)

The Company's comprehensive income (loss) for the three and nine months ended September 30, 2010 and 2009 was as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Net income for the period	\$ 1,326	\$ 1,096	\$ 3,950	\$ 7,527
Interest rate swap valuation adjustment, net of tax	123	104	365	301
Foreign currency translation adjustment	11,240	3,942	(4,332)	3,747
Comprehensive income (loss)	\$ 12,689	\$ 5,142	\$ (17)	\$ 11,575

Other cumulative comprehensive income (loss) as of September 30, 2010 and December 31, 2009 consisted of the following:

	September 30, 2010	December 31, 2009
Currency translation adjustment	\$ (3,538)	\$ 794
Interest rate swap valuation adjustment, net of tax of \$51 and \$299, respectively	(89)	(454)
	\$ (3,627)	\$ 340

Table of Contents

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

The following discussion should be read in conjunction with our historical consolidated financial statements and notes, as well as the selected historical consolidated financial data that are included in the Company's Annual Report filed on Form 10-K for the year ended December 31, 2009.

Unless stated otherwise, all currency amounts in this discussion are presented in thousands (000's).

Executive Overview

Our business is organized into three segments: Explosive Metalworking, Oilfield Products, and AMK Welding. For the nine months ended September 30, 2010, Explosive Metalworking accounted for 66% of our net sales and 56% of our income from operations before consideration of stock-based compensation expense, which is not allocated to our business segments. Our Oilfield Products and AMK Welding segments accounted for 26% and 8%, respectively, of our year-to-date 2010 net sales and 19% and 25%, respectively, of our year-to-date income from operations before consideration of stock-based compensation expense.

Our net sales for the nine months ended September 30, 2010 decreased by \$12,355 (10.1%) compared to the same period of 2009, reflecting a year-to-year net sales decrease of \$29,482 (28.8%) for our Explosive Metalworking segment, which was partially offset by sales increases of \$15,697 (119.2%) and \$1,430 (21.4%) for our Oilfield Products and AMK Welding segments, respectively. Excluding incremental sales of \$12,134 from the acquisitions of LRI and Austin Explosives on October 1, 2009 and June 4, 2010, respectively, and the step acquisition of two Russian joint ventures that was completed on April 30, 2010, our Oilfield Products segment reported an increase of \$3,563 or 27.1% in its year-to-date 2010 net sales. Our consolidated income from operations decreased to \$5,273 for the nine months ended September 30, 2010 from \$13,833 for the same period of 2009. This \$8,560 decrease reflects a decline in Explosive Metalworking's operating income of \$12,973 which was partially offset by a \$3,503 increase in the operating results reported by our Oilfield Products segment from an operating loss of \$2,013 in 2009 to operating income of \$1,490 for the first nine months of 2010, an increase in operating income for AMK Welding of \$790, and a \$120 decrease in stock-based compensation expense. We recorded net income of \$3,950 for the nine months ended September 30, 2010 compared to net income of \$7,527 for the same period of 2009.

Impact of Current Economic Situation on the Company

The Company was only minimally impacted in 2008 by the global economic slowdown. However, during 2009 and the first nine months of 2010, we experienced a significant slowdown in Explosive Metalworking sales to some of the markets we serve. The explosion-welded clad plate market is dependent upon sales of products for use by customers in a number of heavy industries, including oil and gas, alternative energy, chemicals and petrochemicals, hydrometallurgy, aluminum production, shipbuilding, power generation, and industrial refrigeration. These industries tend to be cyclical in nature and the current worldwide economic downturn has affected many of these markets. Despite the slowdown we have already seen in certain sectors, including chemical, petrochemical and hydrometallurgy, quoting activity in other end markets remains relatively healthy, and we continue to track an extensive list of projects. While timing of new order inflow remains difficult to predict, we believe that our Explosive Metalworking segment is well-positioned to benefit as global economic conditions improve.

Table of Contents

As a result of our Explosive Metalworking backlog decreasing from \$97,247 at December 31, 2008 to \$49,584 at December 31, 2009 and relatively low booking activity during the first nine months of 2010 which further reduced our backlog amount to \$41,154 at September 30, 2010, we currently expect that our 2010 consolidated net sales will decline by approximately 8% from the consolidated net sales that we reported in 2009. In light of the slowdown in order inflow that we have experienced, we continue to manage expenses carefully. Despite the significant sales and net income declines that we reported in the first nine months of 2010, we generated cash flow from operations of \$10,254 and expect to generate positive cash flow from operations for the full year 2010.

Net sales

Explosive Metalworking's revenues are generated principally from sales of clad metal plates and sales of transition joints, which are made from clad plates, to customers that fabricate industrial equipment for various industries, including oil and gas, petrochemicals, alternative energy, hydrometallurgy, aluminum production, shipbuilding, power generation, industrial refrigeration, and similar industries. While a large portion of the demand for our clad metal products is driven by new plant construction and large plant expansion projects, maintenance and retrofit projects at existing chemical processing, petrochemical processing, oil refining, and aluminum smelting facilities also account for a significant portion of total demand.

Oilfield Products' revenues are generated principally from sales of shaped charges, detonators and detonating cord, and bidirectional booster sand perforating guns to customers who perform the perforation of oil and gas wells and from sales of seismic products to customers involved in oil and gas exploration activities.

AMK Welding's revenues are generated from welding, heat treatment, and inspection services that are provided with respect to customer-supplied parts for customers primarily involved in the power generation industry and aircraft engine markets.

A significant portion of our revenue is derived from a relatively small number of customers; therefore, the failure to complete existing contracts on a timely basis, to receive payment for such services in a timely manner, or to enter into future contracts at projected volumes and profitability levels could adversely affect our ability to meet cash requirements exclusively through operating activities. We attempt to minimize the risk of losing customers or specific contracts by continually improving product quality, delivering product on time and competing aggressively on the basis of price.

Gross profit and cost of products sold

Cost of products sold for Explosive Metalworking includes the cost of metals and alloys used to manufacture clad metal plates, the cost of explosives, employee compensation and benefits, freight, outside processing costs, depreciation of manufacturing facilities and equipment, manufacturing supplies and other manufacturing overhead expenses.

Cost of products sold for Oilfield Products includes the cost of metals, explosives and other raw materials used to manufacture shaped charges, detonating products and perforating guns as well as employee compensation and benefits, depreciation of manufacturing facilities and

Edgar Filing: DYNAMIC MATERIALS CORP - Form 10-Q

equipment, manufacturing supplies and other manufacturing overhead expenses.

AMK Welding's cost of products sold consists principally of employee compensation and benefits, welding supplies (wire and gas), depreciation of manufacturing facilities and equipment, outside services and other manufacturing overhead expenses.

Table of Contents*Income taxes*

Our effective income tax rate decreased to 18.4% for the nine months ended September 30, 2010 from 32.0% for the same period of 2009. After adjusting for the non-recurring gain on the step acquisition of two Russian joint ventures, our effective tax rate on the remaining ordinary pretax income that we reported for the first nine months of 2010 was 30.5%. Based upon existing tax regulations and current federal, state and foreign statutory tax rates, an expected reduction in our 2010 consolidated pre-tax income from that reported in 2009, and the amount of our projected 2010 consolidated pre-tax income that we expect to be generated by our U.S. and foreign operations, respectively, we currently expect our blended effective tax rate for 2010 to range between 22% and 23%. Our full year 2009 effective tax rate was 33.9% and, for 2011 and subsequent years, we expect that our blended effective tax rate will return to a normalized level of 33% to 35%.

Backlog

We use backlog as a primary means of measuring the immediate outlook for our Explosive Metalworking business. We define backlog at any given point in time as consisting of all firm, unfulfilled purchase orders and commitments at that time. Generally speaking, we expect to fill most backlog orders within the following 12 months. From experience, most firm purchase orders and commitments are realized.

Our backlog with respect to the Explosive Metalworking segment decreased to \$41,154 at September 30, 2010 from \$49,584 at December 31, 2009 and was well below the backlog of \$97,247 that we reported at December 31, 2008. In light of the slowdown in order inflow and decrease in backlog that we have experienced for our Explosive Metalworking segment, we are currently anticipating that our consolidated net sales for fiscal 2010 will be approximately 8% lower than the consolidated net sales that we reported in 2009.

Three and Nine Months Ended September 30, 2010 Compared to Three and Nine Months Ended September 30, 2009*Net sales*

	Three Months Ended September 30,			Change	Percentage Change
	2010	2009			
Net sales	\$ 41,298	\$ 34,690	\$ 6,608	19.0%	

	Nine Months Ended September 30,			Change	Percentage Change
	2010	2009			
Net sales	\$ 109,913	\$ 122,268	\$ (12,355)	(10.1)%	

Net sales for the third quarter of 2010 increased 19.0% to \$41,298 from \$34,690 for the third quarter of 2009. Explosive Metalworking sales decreased 8.8% to \$24,925 for the three months ended September 30, 2010 (60% of total sales) from \$27,327 for the same period of 2009 (79% of total sales). The decrease in Explosive Metalworking sales reflects a business slowdown in several of the industries that this business

segment serves.

Oilfield Products contributed \$13,208 to third quarter 2010 sales (32% of total sales), which represents a 157.8% increase from sales of \$5,123 for the third quarter of 2009 (15% of

Edgar Filing: DYNAMIC MATERIALS CORP - Form 10-Q

Table of Contents

total sales). Excluding incremental sales of \$5,194 from our acquisitions of LRI and Austin Explosives and the step acquisition of two Russian joint ventures, the third quarter 2010 sales increase for Oilfield Products was \$2,891 or 56.4%.

AMK Welding contributed \$3,165 to third quarter 2010 sales (8% of total sales), which represents a 41.3% increase from sales of \$2,240 for the third quarter of 2009 (6% of total sales).

Our consolidated net sales for the nine months ended September 30, 2010 decreased 10.1% to \$109,913 from \$122,268 in the same period of 2009. Explosive Metalworking sales decreased 28.8% to \$72,921 for the nine months ended September 30, 2010 (66% of total sales) from \$102,403 for the same period of 2009 (84% of total sales).

Oilfield Products contributed \$28,868 to year-to-date 2010 sales (26% of total sales), which represents a 119.2% increase from sales of \$13,171 for year-to-date 2009 sales (11% of total sales). Excluding incremental sales of \$12,134 from our acquisitions of LRI and Austin Explosives and step acquisition of two Russian joint ventures, the year-to-date 2010 sales increase for Oilfield Products was \$3,563 or 27.1%.

AMK Welding contributed \$8,124 to the first nine months of 2010 sales (8% of total sales), which represents a 21.4% increase from sales of \$6,694 in the same period 2009 (5% of total sales).

Gross profit

	Three Months Ended September 30,			Change	Percentage Change	
	2010		2009			
Gross profit	\$	10,853	\$	8,754	\$ 2,099	24.0%
Consolidated gross profit margin rate		26.3%		25.2%		

	Nine Months Ended September 30,			Change	Percentage Change	
	2010		2009			
Gross profit	\$	27,094	\$	33,236	\$ (6,142)	(18.5)%
Consolidated gross profit margin rate		24.7%		27.2%		

Gross profit increased by 24.0% to \$10,853 for the three months ended September 30, 2010 from \$8,754 for the three months ended September 30, 2009. Our third quarter 2010 consolidated gross profit margin rate increased to 26.3% from the 25.2% gross margin that we reported for the third quarter of 2009. For the nine months ended September 30, 2010, gross profit decreased by 18.5% to \$27,094 from \$33,236 for the same period of 2009. Our year to date consolidated gross profit margin rate decreased to 24.7% from 27.2% for the first nine months of 2009.

Edgar Filing: DYNAMIC MATERIALS CORP - Form 10-Q

The gross margin for Explosive Metalworking decreased from 25.8% for the third quarter of 2009 to 18.7% for the third quarter of 2010. This 27.5% decrease in the Explosive Metalworking third quarter gross margin rate relates entirely to our U.S. cladding division where the gross margin of 20.1% for the third quarter of 2010 was 37% lower than the gross margin reported for the third quarter of 2009 on a year-to-year sales increase of 1.6%. Despite a 31.4% decline in their third quarter 2010 sales, our European cladding divisions reported a gross margin of 14.0% in the third quarter of 2010 which was higher than the third quarter 2009 gross margin of 12.4%. Our gross margin for the Explosive Metalworking segment decreased to 20.0% for the nine months ended September 30, 2010 from 28.3% for the same period in 2009. This 29.3%

Table of Contents

decrease in the nine-month Explosive Metalworking gross margin rate reflects a 31.4% decrease in our U.S. gross margin from 34.5% in 2009 to 23.7% in 2010 and a decrease in our European gross margin from 19.0% in 2009 to 11.5% in 2010 on year-to-year sales declines of 16.9% and 46.3%, respectively. While lower sales and the resultant less favorable absorption of fixed manufacturing overhead costs have negatively impacted gross margins reported by all of our cladding divisions, the significant decline in our U.S. gross margin rate for the third quarter and first nine months of 2010 compared to the same periods in 2009 relates principally to unfavorable changes in product mix and an extremely competitive pricing environment in certain end markets that comprise a significant portion of our 2010 sales. Historically, gross margins for our European explosion welding divisions have been lower than those reported by our U.S. division due to less efficient fixed manufacturing cost structures associated with our smaller European facilities and this has again been the case during the first nine months of 2010. While our European cladding divisions also face a competitive pricing environment, the principal reason for the large decrease in our European gross margin rate for the first nine months of 2010 compared to the same period in 2009 is the 46.3% decline in sales. As has been the case historically, we expect to see continued fluctuations in Explosive Metalworking's quarterly gross margin rates in the future that result from fluctuations in quarterly sales volume and changes in product mix. Based upon the reported year-to-date gross margin, the composition of our September 30, 2010 backlog and the anticipated mix of new orders that we expect to ship before the end of the year, we expect the full year 2010 gross margin to be in the range of 18% to 20% for our Explosive Metalworking segment.

Oilfield Products reported a gross margin of 39.2% for the third quarter of 2010 compared to a gross margin of 22.4% for the third quarter of 2009. Oilfield Products reported a gross margin of 35.0% for the first nine months of 2010 compared to a gross margin of 21.7% for the first nine months of 2009. The increase in Oilfield Products' gross margin for the third quarter and first nine months of 2010 relates principally to the significant sales increases that are discussed above and favorable changes in product/customer mix. Gross margins reported by the Oilfield Products segment also reflect the incremental margin on intercompany sales to recently acquired former distributors in Canada, the U.S. and Russia as these acquired entities sell products through to the end customers. We currently expect Oilfield Products to report full year 2010 sales in excess of \$40,000 and a gross margin in the range of 33% to 35%.

The gross margin for AMK Welding increased to 34.9% for the third quarter of 2010 from 29.7% for the third quarter of 2009. The gross margin for AMK Welding increased to 32.7% in the first nine months of 2010 from 26.5% in the first nine months of 2009. These increases in AMK Welding's gross margin relate principally to the sales increases discussed above and resultant more favorable absorption of fixed manufacturing overhead expenses. AMK Welding sales for the full year 2010 are expected to approximate \$10,500 and its full year gross margin is expected to be in the range of 32% to 34%.

General and administrative expenses

	Three Months Ended			Change	Percentage Change	
	2010	September 30,	2009			
General & administrative expenses	\$	3,487	\$	2,749	\$ 738	26.8%
Percentage of net sales		8.4%		7.9%		

Table of Contents

	Nine Months Ended September 30,			Change	Percentage Change
	2010	2009			
General & administrative expenses	\$ 9,990	\$ 9,318	\$ 672	7.2%	
Percentage of net sales	9.1%	7.6%			

General and administrative expenses increased by \$738, or 26.8%, to \$3,487 in the third quarter of 2010 from \$2,749 in the third quarter of 2009. Excluding incremental general and administrative expenses of \$428 that resulted from the acquisitions of LRI, Austin Explosives and the Russian joint ventures, our general and administrative expenses increased by \$310 or 11.3% compared to the prior year third quarter. This increase includes an increase of \$178 in salaries, an increase in accrued incentive compensation of \$121 and a net increase of \$11 in all other spending categories. As a percentage of net sales, general and administrative expenses increased to 8.4% in the third quarter of 2010 from 7.9% in the third quarter of 2009.

General and administrative expenses for the nine months ended September 30, 2010 totaled \$9,990 compared to \$9,318 for the same period of 2009, an increase of \$672 or 7.2%. Excluding incremental general and administrative expenses of \$924 that resulted from the acquisitions of LRI, Austin Explosives and the Russian joint ventures, our general and administrative expenses decreased by \$252 or 2.7%. This decrease includes an increase of \$252 in salaries that was entirely offset by an \$88 decrease in accrued incentive compensation and a net decrease of \$416 in all other expenses categories that reflects the impact of tight controls over discretionary spending. As a percentage of net sales, general and administrative expenses increased to 9.1% in the first nine months of 2010 from 7.6% in the first nine months of 2009.

Selling expenses

	Three Months Ended September 30,			Change	Percentage Change
	2010	2009			
Selling expenses	\$ 3,047	\$ 2,212	\$ 835	37.7%	
Percentage of net sales	7.4%	6.4%			

	Nine Months Ended September 30,			Change	Percentage Change
	2010	2009			
Selling expenses	\$ 7,918	\$ 6,376	\$ 1,542	24.2%	
Percentage of net sales	7.2%	5.2%			

Selling expenses, which include sales commissions of \$75 in 2010 and \$237 in 2009, increased by 37.7% to \$3,047 in the third quarter of 2010 from \$2,212 in the third quarter of 2009. Excluding incremental selling expenses of \$1,260 that resulted from the acquisitions of LRI, Austin Explosives and the Russian joint ventures, our selling expenses decreased by \$425 or 19.2%. This \$425 decrease in our selling expenses includes increased selling expenses of \$86 at our U.S. divisions that was offset by decreased selling expenses of \$511 at our European divisions. The decrease in European selling expenses relates principally to staff reductions within our European explosion welding facilities and lower sales commissions. The \$86 increase in our U.S. selling expenses reflects increased travel expenses of \$62, a \$57 increase in bad debt expense and a net decrease of \$33 in other spending categories. As a percentage of net sales, selling expenses increased to 7.4% in the third quarter of 2010 from 6.4% in the third quarter of 2009.

Table of Contents

Selling expenses increased by 24.2% to \$7,918 in the nine months ended September 30, 2010 from \$6,376 in the same period of 2009. These selling expenses include sales commissions of \$646 and \$1,045 for 2010 and 2009, respectively. Excluding incremental selling expenses of \$2,489 that resulted from the acquisitions of LRI, Austin Explosives and the Russian joint ventures, our selling expenses decreased by \$947 or 14.9%. This \$947 decrease in our selling expenses includes decreased selling expenses of \$907 and \$40 at our European and U.S. divisions, respectively. The decrease in European selling expenses relates principally to staff reductions within our European explosion welding facilities and lower sales commissions. The \$40 decrease in our U.S. selling expenses reflects decreased sales commissions of \$205, a \$195 decrease in salaries and accrued incentive compensation and a net increase of \$360 in other spending categories. As a percentage of net sales, selling expenses increased to 7.2% in the first nine months of 2010 from 5.2% in the first nine months of 2009.

Amortization expenses

	Three Months Ended September 30,				Change	Percentage Change	
	2010		2009				
Amortization of purchased intangible assets	\$	1,376	\$	1,293	\$	83	6.4%
Percentage of net sales		3.3%		3.7%			

	Nine Months Ended September 30,				Change	Percentage Change	
	2010		2009				
Amortization of purchased intangible assets	\$	3,913	\$	3,709	\$	204	5.5%
Percentage of net sales		3.6%		3.0%			

Amortization expense relates to the amortization of values assigned to intangible assets in connection with the November 15, 2007 acquisition of DYNAenergetics, our October 1, 2009 acquisition of LRI, our April 30, 2010 acquisition of the Russian joint ventures and our June 5, 2010 acquisition of Austin Explosives. Amortization expense for the three months ended September 30, 2010 includes \$1,012, \$276 and \$88 relating to values assigned to customer relationships, core technology and trademarks/trade names, respectively. Amortization expense for the three months ended September 30, 2009 includes \$897, \$299 and \$97 relating to values assigned to customer relationships, core technology and trademarks/trade names, respectively.

Amortization expense for the nine months ended September 30, 2010 includes \$2,799, \$845 and \$269 relating to values assigned to customer relationships, core technology and trademarks/trade names, respectively. Amortization expense for the nine months ended September 30, 2009 includes \$2,572, \$858 and \$279 relating to values assigned to customer relationships, core technology and trademarks/trade names, respectively. Amortization expense (as measured in Euros) associated with the DYNAenergetics acquisition is expected to approximate 3,603 in 2010, and 2010 amortization expense (as measured in Canadian Dollars) associated with the LRI acquisition is expected to approximate 80 CAD. Amortization expense associated with the acquisition of Austin Explosives is expected to approximate \$249 for approximately seven months of 2010 and amortization expense associated with the acquisition of the Russian joint ventures is expected to approximate 185 for eight months of 2010.

Table of Contents*Operating income*

	Three Months Ended September 30,				Change	Percentage Change
	2010	2009	2010	2009		
Operating income	\$ 2,943	\$ 2,500	\$ 443		17.7%	

	Nine Months Ended September 30,				Change	Percentage Change
	2010	2009	2010	2009		
Operating income	\$ 5,273	\$ 13,833	\$ (8,560)		(61.9)%	

Income from operations (operating income) increased by \$443 to \$2,943 in the third quarter of 2010 from \$2,500 in the third quarter of 2009. For the nine months ended September 30, 2010, operating income decreased by 61.9% to \$5,273 from \$13,833 for the same period of 2009.

Explosive Metalworking reported operating income of \$1,225 in the third quarter of 2010 compared to \$3,370 in the third quarter of 2009. This 63.6% decrease in Explosive Metalworking operating income is largely attributable to the 8.8% decrease in net sales and the 27.5% decline in the gross margin rate as discussed above. Explosive Metalworking reported operating income of \$4,408 in the nine months ended September 30, 2010 compared to \$17,381 in the same period of 2009. This 74.6% decrease in Explosive Metalworking operating income is largely attributable to the 28.8% decrease in net sales and the 29.3% decline in the gross margin rate as discussed above.

Oilfield Products reported operating income of \$1,691 for the third quarter of 2010 as compared to an operating loss of \$414 for the third quarter of 2009. For the nine months ended September 30, 2010, Oilfield Products reported operating income of \$1,490 compared to an operating loss of \$2,013 for the same period of 2009. The significant improvement in operating results for our Oilfield Products segment is attributable to the significant increases in sales and gross profit as discussed above that reflect the incremental sales and gross profit from the acquisitions of LRI, Austin Explosives and the Russian joint ventures as well as an increase in global oil and gas drilling activities, particularly in North America.

AMK Welding reported operating income of \$861 for the three months ended September 30, 2010 as compared to \$441 for the same period of 2009. AMK Welding reporting operating income of \$1,912 for the nine months ended September 30, 2010 compared to \$1,122 for the same nine month period of 2009. The improvement in AMK s operating income is largely attributable to sales increases of 41.3% and 21.4% for the three and nine month periods, respectively,

Operating income for the three and nine months ended September 30, 2010 includes \$834 and \$2,537, respectively, of stock-based compensation. Operating income for the three and nine months ended September 30, 2009 includes \$897 and \$2,657, respectively, of stock-based compensation. This expense is not allocated to our business segments and thus is not included in the above third quarter operating income or loss totals for Explosive Metalworking, Oilfield Products and AMK Welding.

Table of Contents*Gain on step acquisition of joint ventures*

	Three Months Ended September 30,			Change	Percentage Change
	2010	2009			
Gain on step acquisition of joint ventures	\$	\$	\$		N/A

	Nine Months Ended September 30,			Change	Percentage Change
	2010	2009			
Gain on step acquisition of joint ventures	\$	2,117	\$	\$ 2,117	N/A

During the second quarter of 2010, we acquired the remaining non-controlling interests in two Russian joint ventures that were previously majority-owned. Prior to the acquisition date, we accounted for the joint ventures as equity investments. As a result of the acquisition of the remaining non-controlling interests, we now consolidate these entities. In accordance with accounting standards applicable to transactions of this nature, we determined the fair value of our interests in these joint ventures immediately prior to the purchase and recognized a resultant gain of \$2,117.

Other income (expense), net

	Three Months Ended September 30,			Change	Percentage Change
	2010	2009			
Other income (expense), net	\$	(416)	\$	(633) \$ 217	(34.3)%

	Nine Months Ended September 30,			Change	Percentage Change
	2010	2009			
Other income (expense), net	\$	(402)	\$	(560) \$ 158	(28.2)%

Net other expense for the three months ended September 30, 2010 was \$416 compared to net other expense of \$633 for the same period of 2009. For year to date 2010, we recorded net other expense of \$402 compared to net other expense of \$560 for the same period of 2009. The net other expense for the three and nine month periods relates principally to realized and unrealized foreign exchange losses recognized by consolidated subsidiaries that prepare their financial statements in functional currencies other than the U.S. Dollar. For 2010, the foreign exchange losses recorded by our Swedish, German and Russian subsidiaries reflect the weakening of the Euro against the Swedish Krona, the weakening of the U.S. Dollar against the Euro and the weakening of the Russian Ruble against the Euro, respectively. These losses were partially offset by a gain of \$185 on our currency swap agreement. For 2009 the foreign exchange losses recorded by our Swedish, German and Kazakhstani subsidiaries reflect the weakening of the Euro against the Swedish Krona, the weakening of the U.S. Dollar against and Euro and the weakening of the Kazakhstan Tenge against the Euro, respectively.

Table of Contents*Interest income (expense), net*

	Three Months Ended September 30,			Change	Percentage Change
	2010	2009			
Interest income (expense), net	\$ (661)	\$ (711)	\$ 50	(7.0)%	

	Nine Months Ended September 30,			Change	Percentage Change
	2010	2009			
Interest income (expense), net	\$ (2,402)	\$ (2,376)	\$ (26)	1.1%	

We recorded net interest expense of \$661 in the third quarter of 2010 compared to net interest expense of \$711 in the same period of 2009. We recorded net interest expense of \$2,402 in the nine months ended September 30, 2010 compared to net interest expense of \$2,376 for the same nine month period of 2009. Year-to-date 2010 interest expense included a non-recurring, non-cash charge of \$251 related to the write-off of unamortized debt issuance costs associated with the March prepayment, in the amount of \$12,498 (9,020 Euros), of the remaining balance of the Euro term loan that was outstanding under our bank syndicate credit facility. This Euro term loan was scheduled to mature on November 16, 2012. The decrease in interest expense for the comparable three month periods ended September 30 is attributable to a significant reduction in average outstanding borrowings during the respective quarters that resulted from scheduled term loan payments and the March prepayment of the Euro term loan. Interest savings from these term loan reductions was partially offset by higher average interest rates in 2010 that relate principally to the October 2009 amendment to our bank syndicate credit facility which resulted in an increase in the interest rate charged on outstanding borrowings of 1.5% per annum.

Income tax provision

	Three Months Ended September 30,			Change	Percentage Change
	2010	2009			
Income tax provision	\$ 540	\$ 151	\$ 389	257.6%	
Effective tax rate	28.9%	12.1%			

	Nine Months Ended September 30,			Change	Percentage Change
	2010	2009			
Income tax provision	\$ 891	\$ 3,540	\$ (2,649)	(74.8)%	
Effective tax rate	18.4%	32.0%			

We recorded an income tax provision of \$540 in the third quarter of 2010 compared to \$151 in the third quarter of 2009. Our overall effective tax rate decreased to 28.9% in the third quarter of 2010 from an effective tax rate of 12.1% in the prior year third quarter. Our consolidated income tax provision for the three months ended September 30, 2010 and 2009 included provisions of \$510 and \$1,079, respectively, related to U.S. taxes, with the remainder relating to a net foreign tax provision of \$30 in 2010 and a net foreign tax benefit of \$928 in 2009 associated with our foreign operations and holding companies located in Canada, France, Germany, Sweden, Russia, Kazakhstan and Luxembourg.

Table of Contents

For the nine months ended September 30, 2010, we recorded an income tax provision of \$891 compared to \$3,540 in the same period of 2009. Our year-to-date 2010 income tax provision included a provision of \$59 associated with the \$2,117 non-recurring gain that we recorded on the acquisition of non-controlling interests in two Russian joint ventures as discussed above and a provision of \$832 on the remaining ordinary pretax income of \$2,724. The effective tax rate decreased to 18.4% for the first nine months of 2010 from 32.0% in the first nine months of 2009 due principally to the low tax rate applicable to the non-recurring gain on the acquisition of non-controlling interests in two Russian joint ventures. Our effective tax rate on the \$832 of ordinary pretax income that we reported for the nine months ended September 30, 2010 was 30.5%. Our consolidated income tax provision for the nine months ended September 30, 2010 and 2009 included \$1,359 and \$4,250, respectively, related to U.S. taxes, with the remainder relating to a net foreign tax benefit of \$468 in 2010 and a net foreign tax benefit of \$710 in 2009 associated with our foreign operations and holding companies.

We expect our blended effective tax rate for 2010 to range from 22% to 23% based upon the low effective tax rate we experienced during the first nine months of 2010 and our current projection of full year consolidated pre-tax income. Our full year 2009 effective tax rate was 33.9% and we expect that our blended effective tax rate will return to a normalized level of 33% to 35% in 2011 and subsequent years.

Adjusted EBITDA

	Three Months Ended September 30,			Change	Percentage Change
	2010	2009			
Adjusted EBITDA	\$ 6,657	\$ 5,950	\$ 707	11.9%	

	Nine Months Ended September 30,			Change	Percentage Change
	2010	2009			
Adjusted EBITDA	\$ 15,631	\$ 23,900	\$ (8,269)	(34.6)%	

Adjusted EBITDA is a non-GAAP measure that we use as an indicator of the ongoing operating performance and the cash generating ability of the Company. The following is a reconciliation of the most directly comparable GAAP measure to Adjusted EBITDA.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Income from operations	\$ 2,943	\$ 2,500	\$ 5,273	\$ 13,833
Adjustments:				
Stock-based compensation	834	897	2,537	2,657
Depreciation	1,504	1,260	3,908	3,701
Amortization of purchased intangibles	1,376	1,293	3,913	3,709
Adjusted EBITDA	\$ 6,657	\$ 5,950	\$ 15,631	\$ 23,900

Adjusted EBITDA increased by 11.9% to \$6,657 in the third quarter of 2010 from \$5,950 in the third quarter of 2009 primarily due to the \$443 increase in operating income. Adjusted EBITDA decreased by 34.6% to \$15,631 in the nine months ended September 30, 2010 from \$23,900 in the same period of 2009 primarily due to the \$8,560 decrease in operating income.

Table of Contents

Liquidity and Capital Resources

We have historically financed our operations from a combination of internally generated cash flow, revolving credit borrowings, various long-term debt arrangements, and the issuance of common stock. In connection with the acquisition of DYNAenergetics in 2007, we entered into a five-year syndicated credit agreement. The credit agreement, which provided term loans of \$45,000 and 14,000 Euros and revolving credit loan availability of \$25,000 and 7,000 Euros, is through a syndicate of seven banks.

There are two significant financial covenants under our credit facility, the leverage ratio and fixed charge coverage ratio requirements. The leverage ratio is defined in the credit facility as Consolidated Funded Indebtedness at the balance sheet date as compared to Consolidated EBITDA, which is defined as earnings before provisions for income taxes, interest expense, depreciation and amortization, extraordinary, non-recurring charges and other non-cash charges, for the previous twelve months. For the year ended December 31, 2009 and nine months ended September 30, 2010, Consolidated EBITDA approximated the Adjusted EBITDA that we reported for the respective periods. As of December 31, 2009, the maximum leverage ratio permitted by our credit facility was 2.0 to 1.0. The actual leverage ratio as of December 31, 2009 was 1.69 to 1.0. The maximum leverage ratio permitted as of September 30 and December 31, 2010 is 2.0 to 1.0 and 1.5 to 1.0, respectively. The actual leverage ratio as of September 30, 2010 was 1.77 to 1.0.

The fixed charge ratio, as defined in the credit facility, means, for any period, the ratio of Earnings Available for Fixed Charges to Fixed Charges. Earnings Available for Fixed Charges equals Consolidated EBITDA plus lease expenses minus cash income taxes and non-financed capital expenditures. Fixed Charges equals the sum of cash interest expense, lease expense, scheduled principal payments and cash dividends. As of December 31, 2009, the minimum fixed charge ratio permitted by our credit facility was 1.1 to 1.0. The actual fixed charge ratio as of December 31, 2009 was 1.31 to 1.0. The minimum fixed charge coverage ratio permitted for the twelve month periods ending September 30 and December 31, 2010 is 1.0 to 1.0. The actual fixed charge ratio as of September 30, 2010 was 1.19 to 1.0.

As a result of the slowdown in our business during 2009 which has continued into the early part of 2010, we were concerned about our ability to comply with financial covenants as of March 31, 2010 and subsequent quarters of 2010. In an effort to alleviate this concern and remain in compliance with financial covenants as of March 31, 2010 and in future periods, we made a March prepayment of the remaining principal balance due under our bank syndicated Euro term loan in the amount of \$12,498 (9,020 Euros) and, on April 19, 2010, amended the credit agreement to exclude scheduled principal payments under the Euro term loan from fixed charge coverage ratio computations for March 31, 2010 and forward.

In connection with the October 1, 2009 acquisition of LRI, we assumed outstanding debt obligations including line of credit loans, loans with the former owners and capital lease obligations in the amounts of \$2,676 (2,883 CAD), \$2,445 (2,634 CAD) and \$432 (465 CAD), respectively.

As of September 30, 2010, a U.S. Dollar term loan of \$28,997 was outstanding under our syndicated credit agreement, \$817 was outstanding under term loan obligations of DYNAenergetics and \$1,294 was outstanding under loan agreements with the former owners of LRI. We had \$3,403 in outstanding revolving credit borrowings under our syndicated credit

Table of Contents

agreement and \$3,251 outstanding under our separate DYNAenergetics line of credit agreements with German banks. We also had \$81 outstanding under the line of credit assumed with the acquisition of LRI. While we had approximately \$38,986 of unutilized revolving credit loan capacity as of September 30, 2010 under our various credit facilities, future borrowings are subject to compliance with financial covenants that could significantly limit availability.

We believe that cash flow from operations and funds available under our current credit facilities and any future replacement thereof will be sufficient to fund the working capital, debt service, and capital expenditure requirements of our current business operations for the foreseeable future. Nevertheless, our ability to generate sufficient cash flows from operations will depend upon our success in executing our strategies. If we are unable to (i) realize sales from our backlog; (ii) secure new customer orders at attractive prices; and (iii) continue to implement cost-effective internal processes, our ability to meet cash requirements through operating activities could be impacted. Furthermore, any restriction on the availability of borrowings under our credit facilities could negatively affect our ability to meet future cash requirements.

Debt and other contractual obligations and commitments

Our existing loan agreements include various covenants and restrictions, certain of which relate to the payment of dividends or other distributions to stockholders, redemption of capital stock, incurrence of additional indebtedness, mortgaging, pledging or disposition of major assets, and maintenance of specified financial ratios. As of September 30, 2010, we were in compliance with all financial covenants and other provisions of our debt agreements.

Other than the unscheduled \$12,498 (9,020 Euros) prepayment of the remaining principal balance on our bank syndicate Euro term loan, the Company's principal cash flows related to debt obligations and other contractual obligations and commitments have not materially changed since December 31, 2009.

Cash flows from operating activities

Net cash flows provided by operating activities for the nine months ended September 30, 2010 totaled \$10,254. Significant sources of operating cash flow included net income of \$3,950, non-cash depreciation and amortization expense of \$8,310, stock-based compensation of \$2,537. These sources of operating cash flow were partially offset by a \$2,117 gain on step acquisition of joint ventures and a deferred income tax benefit of \$953 and net negative changes in working capital of \$1,218. Net negative changes in working capital included decreases in accounts payable, accrued expenses and customer advances of \$2,075, \$1,800 and \$1,327, respectively. These negative changes in working capital were partially offset by decreases in accounts receivable and inventory of \$2,465 and \$1,198, respectively.

Net cash flows provided by operating activities for the nine months ended September 30, 2009 totaled \$23,414. Significant sources of operating cash flow included net income of \$7,527, non-cash depreciation and amortization expense of \$7,625, stock-based compensation of \$2,657 and net positive changes in various components of working capital in the amount of \$7,650. These sources of operating cash flow were partially offset by a deferred income tax benefit of \$1,875. Net positive changes in working capital included decreases in accounts receivable, inventories and prepaid expenses of \$13,632, \$3,334 and \$496, respectively, and an increase in customer advances of \$246. These positive changes in working capital were partially offset by decreases in accounts payable and accrued expenses of \$5,980 and \$4,078, respectively.

Table of Contents

Cash flows from investing activities

Net cash flows used in investing activities for the nine months ended September 30, 2010 totaled \$8,053 which included investments in acquisitions of \$5,685 and capital expenditures of \$2,309.

Net cash flows used by investing activities for the nine months ended September 30, 2009 totaled \$3,196 and consisted almost entirely of capital expenditures.

Cash flows from financing activities

Net cash flows used in financing activities for the nine months ended September 30, 2010 were \$13,630, which included \$2,876 in required prepayments of term loans under our syndicated credit agreement from excess cash flow that we generated in fiscal year 2009, \$12,498 to prepay the remaining principal balance of our Euro term loan under our syndicated credit agreement, \$593 in principal payments on Nord LB term loans, payment of quarterly dividends of \$1,561, \$639 for the negative tax impact of stock-based compensation and payment on capital lease obligations of \$215. These uses of cash were partially offset by net borrowings on bank lines of credit of \$4,682 and \$70 in net proceeds from the issuance of common stock relating to the exercise of stock options.

Net cash flows used in financing activities for the nine months ended September 30, 2009 were \$4,805, which consisted primarily of \$3,912 in required prepayments of term loans under our syndicated credit agreement from excess cash flow that we generated in fiscal year 2008, \$653 in principal payments on Nord LB term loans, payment of quarterly dividends of \$513 and payment on capital lease obligations of \$132. These uses of cash flow were slightly offset by \$373 in net proceeds from the issuance of common stock relating to the exercise of stock options.

Payment of Dividends

On September 22, 2010, our board of directors declared a quarterly cash dividend of \$0.04 per share which was paid on October 15, 2010. The dividend totaled \$528 and was payable to shareholders of record as of September 30, 2010. We also paid a quarterly cash dividend of \$0.04 per share in the first and second quarters of 2010 totaling \$518 and \$528, respectively. We paid a quarterly cash dividend of \$0.04 per share in the third and fourth quarters of 2009.

We may continue to pay quarterly dividends in the future subject to capital availability and periodic determinations that cash dividends are in compliance with our debt covenants and are in the best interests of our stockholders, but we cannot assure you that such payments will continue. Future dividends may be affected by, among other items, our views on potential future capital requirements, future business prospects, debt covenant compliance, changes in federal income tax laws, or any other factors that our board of directors deems relevant. Any decision to pay cash dividends is and will continue to be at the discretion of board of directors.

Critical Accounting Policies

Our historical consolidated financial statements and notes to our historical consolidated financial statements contain information that is pertinent to our management's discussion and analysis of financial condition and results of operations. Preparation of financial statements in conformity with accounting principles generally accepted in the United States requires that our management make estimates, judgments and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and the disclosure of contingent assets and liabilities. However, the accounting principles used by us generally do not change our reported cash flows or

Table of Contents

liquidity. Interpretation of the existing rules must be done and judgments made on how the specifics of a given rule apply to us.

In management's opinion, the more significant reporting areas impacted by management's judgments and estimates are revenue recognition, asset impairments, impact of foreign currency exchange rate risks and income taxes. Management's judgments and estimates in these areas are based on information available from both internal and external sources, and actual results could differ from the estimates, as additional information becomes known. We believe the following to be our most critical accounting policies.

Revenue recognition

Sales of clad metal products and welding services are generally based upon customer specifications set forth in customer purchase orders and require us to provide certifications relative to metals used, services performed and the results of any non-destructive testing that the customer has requested be performed. All issues of conformity of the product to specifications are resolved before the product is shipped and billed. Products related to the oilfield products segment, which include detonating cords, detonators, bi-directional boosters and shaped charges, as well as, seismic related explosives and accessories, are standard in nature. In all cases, revenue is recognized only when all four of the following criteria have been satisfied: persuasive evidence of an arrangement exists; the price is fixed or determinable; delivery has occurred; and collection is reasonably assured. For contracts that require multiple shipments, revenue is recorded only for the units included in each individual shipment. If, as a contract proceeds toward completion, projected total cost on an individual contract indicates a probable loss, the Company will account for such anticipated loss.

Asset impairments

We review our long-lived assets to be held and used by us for impairment whenever events or changes in circumstances indicate their carrying amount may not be recoverable. In so doing, we estimate the future net cash flows expected to result from the use of these assets and their eventual disposition. If the sum of the expected future net cash flows (undiscounted and without interest charges) is less than the carrying amount of these assets, an impairment loss is recognized to reduce the asset to its estimated fair value. Otherwise, an impairment loss is not recognized. Long-lived assets to be disposed of, if any, are reported at the lower of carrying amount or fair value less costs to sell.

Business Combinations

We account for our business acquisitions using the purchase method of accounting. We allocate the total cost of the acquisition to the underlying net assets based on their respective estimated fair values. As part of this allocation process, we identify and attribute values and estimated lives to the intangible assets acquired. These determinations involve significant estimates and assumptions regarding multiple, highly subjective variables, including those with respect to future cash flows, discount rates, asset lives, and the use of different valuation models and therefore require considerable judgment. Our estimates and assumptions are based, in part, on the availability of listed market prices or other transparent market data. These determinations affect the amount of amortization expense recognized in future periods. We base our fair value estimates on assumptions we believe to be reasonable but are inherently uncertain.

Table of Contents

Goodwill and Other Intangible Assets

We review the carrying value of goodwill at least annually to assess impairment because it is not amortized. Additionally, we review the carrying value of any intangible asset or goodwill whenever events or changes in circumstances indicate that its carrying amount may not be recoverable. Examples of such events or changes in circumstances, many of which are subjective in nature, include significant negative industry or economic trends, significant changes in the manner of our use of the acquired assets or our strategy, a significant decrease in the market value of the asset, and a significant change in legal factors or in the business climate that could affect the value of the asset. We assess impairment by comparing the fair value of an identifiable intangible asset or goodwill with its carrying value. The determination of fair value involves significant management judgment as described further below. Impairments are expensed when incurred. Specifically, we test for impairment as follows:

Goodwill

We test goodwill for impairment on a reporting unit level on at least an annual basis. A reporting unit is a group of businesses (i) for which discrete financial information is available and (ii) that have similar economic characteristics. We test goodwill for impairment using the following two-step approach:

The first step is a comparison of each reporting unit's fair value to its carrying value. We estimate fair value using the best information available, including market information and discounted cash flow projections, also referred to as the income approach. The income approach uses a reporting unit's projection of estimated operating results and cash flows that is discounted using a weighted-average cost of capital that reflects current market conditions. The projections incorporate our best estimates of economic and market conditions over the projected period including growth rates in sales and estimates of future expected changes in operating margins and cash expenditures. Other significant estimates and assumptions include terminal value growth rates, future estimates of capital expenditures and changes in future working capital requirements. We validate our estimates of fair value under the income approach by comparing the values to fair value estimates using a market approach.

If the carrying value of the reporting unit is higher than its fair value, there is an indication that impairment may exist, and the second step must be performed to measure the amount of impairment loss. In the second step, we allocate the fair value of the reporting unit to the assets and liabilities of the reporting unit as if it had just been acquired in a business combination and as if the purchase price was equivalent to the fair value of the reporting unit. The excess of the fair value of the reporting unit over the amounts assigned to its assets and liabilities is referred to as the implied fair value of goodwill. We then compare that implied fair value of the reporting unit's goodwill to the carrying value of that goodwill. If the implied fair value is less than the carrying value, we recognize an impairment loss for the excess.

Our impairment testing in the fourth quarter of 2009 did not result in a determination that any of our goodwill was impaired. The fair value of the Explosives Metalworking reporting unit was \$171.7 million at December 31, 2009 compared to its carrying value of \$108.4 million. The fair value of the Oilfield Products reporting unit was \$74.2 million at December 31, 2009 compared to its carrying value of \$63.6 million. A discount rate of 17% was utilized in the income approach component of the model used to measure fair value. A future impairment is possible and could occur if (i) the unit's operating results underperform what we have estimated or (ii) additional volatility of the capital markets or other factors should cause us to raise the discount rate utilized in our discounted cash flow analysis or decrease the multiples utilized in our market-based analysis.

Table of Contents

The use of different estimates or assumptions within our discounted cash flow model when determining the fair value of our reporting units or using methodologies other than as described above could result in different values for reporting units and could result in an impairment charge.

Intangible assets subject to amortization

An intangible asset that is subject to amortization is reviewed when impairment indicators are present. We compare the expected undiscounted future operating cash flows associated with finite-lived assets to their respective carrying values to determine if the asset is fully recoverable. If the expected future operating cash flows are not sufficient to recover the carrying value, we estimate the fair value of the asset. Impairment is recognized when the carrying amount of the asset is not recoverable and when the carrying value exceeds fair value. The projected cash flows require several assumptions related to, among other things, relevant market factors, revenue growth, if any, and operating margins.

Impact of foreign currency exchange rate risks

The functional currency for our foreign operations is the applicable local currency for each affiliate company. Assets and liabilities of foreign subsidiaries for which the functional currency is the local currency are translated at exchange rates in effect at period-end, and the statements of operations are translated at the average exchange rates during the period. Exchange rate fluctuations on translating foreign currency financial statements into U.S. Dollars that result in unrealized gains or losses are referred to as translation adjustments. Cumulative translation adjustments are recorded as a separate component of stockholders' equity and are included in other cumulative comprehensive income (loss). Transactions denominated in currencies other than the local currency are recorded based on exchange rates at the time such transactions arise. Subsequent changes in exchange rates result in transaction gains and losses, which are reflected in income as unrealized (based on period-end translations) or realized upon settlement of the transactions. Cash flows from our operations in foreign countries are translated at actual exchange rates when known, or at the average rate for the period. As a result, amounts related to assets and liabilities reported in the consolidated statements of cash flows will not agree to changes in the corresponding balances in the consolidated balance sheets. The effects of exchange rate changes on cash balances held in foreign currencies are reported as a separate line item below cash flows from financing activities.

Income taxes

We are required to recognize deferred tax assets and deferred tax liabilities for the expected future income tax consequences of transactions that have been included in our financial statements but not our tax returns. Deferred tax assets and liabilities are determined based on income tax credits and on the temporary differences between the Consolidated Financial Statement basis and the tax basis of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. We routinely evaluate deferred tax assets to determine if they will, more likely than not, be recovered from future projected taxable income; if not, we record an appropriate valuation allowance.

Stock-Based Compensation Expense

Edgar Filing: DYNAMIC MATERIALS CORP - Form 10-Q

We are required to account for stock-based compensation under fair value recognition provisions. The stock-based compensation cost is estimated at the grant date based on the value of the award and is recognized as expense ratably over the requisite service period of the award. The fair value of restricted stock awards is based on the fair value of the Company's stock on the date of grant. For the last several years we have not granted stock options. Were we to do so, determining the appropriate fair value model and calculating the fair value of stock options at the

Table of Contents

grant date would require judgment, including estimating stock price volatility, forfeiture rates, and expected option life.

ITEM 3. Quantitative and Qualitative Disclosure about Market Risk

There have been no events that materially affect our quantitative and qualitative disclosure about market risk from that reported in our Annual Report on Form 10-K for the year ended December 31, 2009.

ITEM 4. Controls and Procedures

The Company maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in the Company's Exchange Act reports is accurately recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to the Company's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management necessarily applied its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

As of September 30, 2010, the Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e)). Based on that evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective at the reasonable assurance level. There have been no changes in the Company's internal controls during the quarter ended September 30, 2010 or in other factors that could materially affect the Company's internal controls over financial reporting.

The Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, does not expect that the Company's disclosure controls or its internal controls will prevent all errors and all fraud. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. As a result of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple errors or mistakes. As a result of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected. Accordingly, the Company's disclosure controls and procedures are designed to provide reasonable, not absolute, assurance that the disclosure controls and procedures are met.

Table of Contents

Part II - OTHER INFORMATION

Item 1. Legal Proceedings

None.

Item 1A. Risk Factors

There have been no significant changes in the risk factors identified as being attendant to our business in our Annual Report on Form 10-K for the year ended December 31, 2009.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Removed and Reserved

None.

Item 5. Other Information

None.

Item 6.

Exhibits

- 31.1 Certification of the President and Chief Executive Officer pursuant to 17 CFR 240.13a-14(a) or 17 CFR 240.15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of the Vice President and Chief Financial Officer pursuant to 17 CFR 240.13a-14(a) or 17 CFR 240.15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of the President and Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of the Vice President and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

Table of Contents

SIGNATURES

In accordance with the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

DYNAMIC MATERIALS CORPORATION
(Registrant)

Date: October 28, 2010

/s/ Richard A. Santa
Richard A. Santa, Senior Vice President and Chief Financial Officer
(Duly Authorized Officer and Principal Financial and Accounting
Officer)