

TOOTSIE ROLL INDUSTRIES INC

Form 10-Q

November 10, 2011

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended October 1, 2011

OR

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

For the transition period from to

COMMISSION FILE NUMBER 1-1361

Tootsie Roll Industries, Inc.

(Exact Name of Registrant as Specified in its Charter)

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VIRGINIA
(State of Incorporation)

22-1318955
(I.R.S. Employer Identification No.)

7401 South Cicero Avenue, Chicago, Illinois
(Address of Principal Executive Offices)

60629
(Zip Code)

773-838-3400

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date (October 1, 2011).

Class	Outstanding
Common Stock, \$.69 4/9 par value	36,807,153
Class B Common Stock, \$.69 4/9 par value	21,032,365

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TOOTSIE ROLL INDUSTRIES, INC. AND SUBSIDIARIES

OCTOBER 1, 2011

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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. See Forward-Looking Statements under Part I Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations of this Quarterly Report on Form 10-Q.

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PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

TOOTSIE ROLL INDUSTRIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

(in thousands)

	October 1, 2011 (Unaudited)	December 31, 2010	October 2, 2010 (Unaudited)
ASSETS			
<u>CURRENT ASSETS</u>			
Cash & cash equivalents	\$ 25,690	\$ 115,976	\$ 58,862
Investments	9,440	7,996	8,841
Trade accounts receivable, Less allowances of \$2,621, \$1,531 & \$2,949	96,743	37,394	100,602
Other receivables	4,386	9,961	4,999
Inventories, at cost			
Finished goods & work in process	52,174	36,935	43,835
Raw material & supplies	30,835	22,141	31,061
Prepaid expenses	4,516	6,499	4,780
Deferred income taxes	621	689	1,237
Total current assets	224,405	237,591	254,217
<u>PROPERTY, PLANT & EQUIPMENT, at cost</u>			
Land	21,542	21,619	21,605
Buildings	102,798	102,934	102,419
Machinery & equipment	305,582	307,178	298,102
Construction in progress	21,831	9,243	15,237
	451,753	440,974	437,363
Less-accumulated depreciation	238,395	225,482	220,923
Net property, plant and equipment	213,358	215,492	216,440
<u>OTHER ASSETS</u>			
Goodwill	73,237	73,237	73,237
Trademarks	175,024	175,024	175,024
Investments	98,523	64,461	60,480
Split dollar life insurance	74,429	74,441	74,627
Prepaid expenses	4,029	6,680	7,534
Investment in joint venture	4,325	4,254	3,522
Deferred income taxes	8,291	9,203	10,476
Total other assets	437,858	407,300	404,900
Total assets	\$ 875,621	\$ 860,383	\$ 875,557

(The accompanying notes are an integral part of these statements.)

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(in thousands except per share data)

	October 1, 2011 (Unaudited)	December 31, 2010	October 2, 2010 (Unaudited)
<u>LIABILITIES AND SHAREHOLDERS EQUITY CURRENT</u>			
<u>LIABILITIES</u>			
Accounts payable	\$ 17,421	\$ 9,791	\$ 17,553
Dividends payable	4,627	4,529	4,554
Accrued liabilities	47,773	44,185	49,552
Income taxes payable	3,661		5,074
Total current liabilities	73,482	58,505	76,733
<u>NONCURRENT LIABILITIES</u>			
Deferred income taxes	46,560	48,743	42,734
Postretirement health care and life insurance benefits	22,256	20,689	17,837
Industrial development bonds	7,500	7,500	7,500
Liability for uncertain tax positions	9,560	9,835	16,183
Deferred compensation and other liabilities	45,110	46,157	42,470
Total noncurrent liabilities	130,986	132,924	126,724
<u>SHAREHOLDERS EQUITY</u>			
Common Stock, \$.69-4/9 par value- 120,000 shares authorized; 36,807, 36,057 & 36,459, respectively, issued	25,560	25,040	25,319
Class B common stock, \$.69-4/9 par value- 40,000 shares authorized; 21,032, 20,466 & 20,476, respectively, issued	14,606	14,212	14,219
Capital in excess of par value	541,362	505,495	516,369
Retained earnings	108,977	137,412	132,356
Accumulated other comprehensive loss	(17,360)	(11,213)	(14,171)
Treasury stock (at cost)- 71, 69 & 69 shares, respectively	(1,992)	(1,992)	(1,992)
Total shareholders equity	671,153	668,954	672,100
Total liabilities and shareholders equity	\$ 875,621	\$ 860,383	\$ 875,557

(The accompanying notes are an integral part of these statements.)

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TOOTSIE ROLL INDUSTRIES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF
EARNINGS, COMPREHENSIVE EARNINGS AND RETAINED EARNINGS
(in thousands except per share amounts) (UNAUDITED)

	Quarter Ended	
	October 1, 2011	October 2, 2010
Net product sales	\$ 186,784	\$ 191,045
Rental and royalty revenue	1,072	1,080
Total revenue	187,856	192,125
Product cost of goods sold	133,041	129,021
Rental and royalty cost	264	274
Total costs	133,305	129,295
Product gross margin	53,743	62,024
Rental and royalty gross margin	808	806
Total gross margin	54,551	62,830
Selling, marketing and administrative expenses	25,425	31,242
Earnings from operations	29,126	31,588
Other income (expense), net	(3,777)	4,618
Earnings before income taxes	25,349	36,206
Provision for income taxes	7,011	9,722
Net earnings	18,338	26,484
Other comprehensive income (loss):		
Foreign currency translation adjustments	(3,554)	183
Unrealized losses on securities	(68)	(2,322)
Unrealized gains on derivatives	314	4,451
Reclassification of realized gains on derivatives to net earnings	(1,551)	(906)
Other comprehensive income (loss), before tax	(4,859)	1,406
Income tax (expense) benefit related to items of other comprehensive income	599	(388)
Other comprehensive income (loss), net of tax	(4,260)	1,018
Comprehensive earnings	\$ 14,078	\$ 27,502

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Retained earnings at beginning of period	\$ 95,261	\$ 110,420
Net earnings	18,338	26,484
Cash dividends	(4,622)	(4,548)
Retained earnings at end of period	\$ 108,977	\$ 132,356
Net earnings per share	\$ 0.32	\$ 0.45
Dividends per share *	\$ 0.08	\$ 0.08
Average number of shares outstanding	57,822	58,596

*Does not include 3% stock dividend to shareholders of record on 3/8/11 and 3/9/10.

(The accompanying notes are an integral part of these statements.)

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TOOTSIE ROLL INDUSTRIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF

EARNINGS, COMPREHENSIVE EARNINGS AND RETAINED EARNINGS

(in thousands except per share amounts) (UNAUDITED)

	Year to Date Ended	
	October 1, 2011	October 2, 2010
Net product sales	\$ 399,991	\$ 399,315
Rental and royalty revenue	3,080	3,206
Total revenue	403,071	402,521
Product cost of goods sold	278,572	266,504
Rental and royalty cost	772	823
Total costs	279,344	267,327
Product gross margin	121,419	132,811
Rental and royalty gross margin	2,308	2,383
Total gross margin	123,727	135,194
Selling, marketing and administrative expenses	77,560	79,112
Earnings from operations	46,167	56,082
Other income, net	216	5,976
Earnings before income taxes	46,383	62,058
Provision for income taxes	13,880	17,923
Net earnings	32,503	44,135
Other comprehensive income (loss):		
Foreign currency translation adjustments	(2,104)	(402)
Unrealized gains (losses) on securities	1,708	(1,810)
Unrealized gains (losses) on derivatives	(545)	1,449
Reclassification of gains on derivatives to net earnings	(7,552)	(2,443)
Other comprehensive loss, before tax	(8,493)	(3,206)
Income tax benefit related to items of other comprehensive income	2,346	1,432
Other comprehensive loss, net of tax	(6,147)	(1,774)
Comprehensive earnings	\$ 26,356	\$ 42,361

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Retained earnings at beginning of period	\$	137,412	\$	148,582
Net earnings		32,503		44,135
Cash dividends		(13,763)		(13,556)
Stock dividends 3%		(47,175)		(46,805)
Retained earnings at end of period	\$	108,977	\$	132,356
Net earnings per share	\$	0.56	\$	0.75
Dividends per share *	\$	0.24	\$	0.24
Average number of shares outstanding		57,978		58,795

*Does not include 3% stock dividend to shareholders of record on 3/8/11 and 3/9/10.

(The accompanying notes are an integral part of these statements.)

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TOOTSIE ROLL INDUSTRIES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands of dollars) (UNAUDITED)

	Year to Date Ended	
	October 1, 2011	October 2, 2010
<u>CASH FLOWS FROM OPERATING ACTIVITIES:</u>		
Net earnings	\$ 32,503	\$ 44,135
Adjustments to reconcile net earnings to net cash used in operating activities:		
Depreciation and amortization	14,465	13,802
(Gain) loss from equity method investment	(24)	372
Amortization of marketable securities	893	367
Changes in operating assets and liabilities:		
Accounts receivable	(60,001)	(62,889)
Other receivables	2,692	1,027
Inventories	(24,544)	(18,333)
Prepaid expenses and other assets	4,571	4,356
Accounts payable and accrued liabilities	11,609	15,389
Income taxes payable and deferred	(809)	5,061
Postretirement health care and life insurance benefits	1,567	1,163
Deferred compensation and other liabilities	1,447	1,388
Other	(789)	206
Net cash from (used in) operating activities	(16,420)	6,044
<u>CASH FLOWS FROM INVESTING ACTIVITIES:</u>		
Capital expenditures	(12,677)	(9,389)
Net purchases of trading securities	(2,967)	(2,699)
Purchase of available for sale securities	(38,722)	(5,283)
Sale and maturity of available for sale securities	4,559	4,503
Net cash used in investing activities	(49,807)	(12,868)
<u>CASH FLOWS FROM FINANCING ACTIVITIES:</u>		
Dividends paid in cash	(13,788)	(13,583)
Shares purchased and retired	(10,271)	(11,721)
Net cash used in financing activities	(24,059)	(25,304)
Decrease in cash and cash equivalents	(90,286)	(32,128)
Cash and cash equivalents at beginning of year	115,976	90,990
Cash and cash equivalents at end of quarter	\$ 25,690	\$ 58,862
Supplemental cash flow information:		
Income taxes paid, net	\$ 9,385	\$ 12,581
Interest paid	\$ 33	\$ 129
Stock dividend issued	\$ 47,053	\$ 46,682

(The accompanying notes are an integral part of these statements.)

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TOOTSIE ROLL INDUSTRIES, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

OCTOBER 1, 2011

(in thousands except per share amounts) (UNAUDITED)

Note 1 Significant Accounting Policies

General Information

Foregoing data has been prepared from the unaudited financial records of Tootsie Roll Industries, Inc. and Subsidiaries (the Company) and in the opinion of management all adjustments necessary for a fair statement of the results for the interim period have been reflected. All adjustments were of a normal and recurring nature. Certain reclassifications have been made to the prior year financial statements to conform to the current year presentation. These consolidated financial statements should be read in conjunction with the consolidated financial statements and the related notes included in the Company's 2010 Annual Report on Form 10-K.

Results of operations for the period ended October 1, 2011 are not necessarily indicative of results to be expected for the year to end December 31, 2011 because of the seasonal nature of the Company's operations. Historically, the third quarter has been the Company's largest sales quarter due to Halloween sales.

Revision

During 2010, the Company identified certain liabilities for uncertain tax positions that should not have been recorded based on a reevaluation of the related facts. Management has concluded that the effects of the correcting adjustments were not material to the Company's previously issued quarterly and annual financial statements. The Company has revised the previously issued financial statements in this quarterly report and will do so in future filings. The revised financial statements reflect an increase in retained earnings at the beginning of the quarter and year 2010 of \$2,749 and \$2,654, respectively. The revised financial statements also reflect changes to the provision for income tax expense which resulted in a decrease in net earnings for the third quarter and year to date 2010 of \$867 and \$772, respectively.

Accounting Pronouncements

In May 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2011-04, Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and

International Financial Reporting Standards (IFRS). ASU 2011-04 represents converged guidance between U.S. GAAP and IFRS resulting in common requirements for measuring fair value and for disclosing information about fair value measurements. This new guidance will be effective for fiscal years beginning after December 15, 2011 and subsequent interim periods. The Company is currently assessing the impact, if any, on the consolidated financial statements.

In June 2011, the FASB issued ASU 2011-05, Presentation of Comprehensive Income. ASU 2011-05 requires us to present components of other comprehensive income and of net income in one continuous statement of comprehensive income or in two separate, but consecutive, statements. The option to report other comprehensive income within the statement of equity has been removed. This new presentation of comprehensive income will be effective for fiscal years beginning after December 15, 2011 and subsequent interim periods.

In September 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2011-08, Testing Goodwill for Impairment. The revised standard is intended to reduce the cost and complexity of the annual goodwill impairment test by providing entities an option to perform a qualitative assessment to determine whether further impairment testing is necessary. An entity has the option to first assess qualitative factors to determine whether it is necessary to perform the current two-step test. If an entity believes, as a result of its qualitative assessment, that it is more-likely-than-not that the fair value of a reporting unit is less than its carrying amount, the quantitative impairment test is required. Otherwise, no further testing is required. The revised standard is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. The Company currently believes there will be no impact on its consolidated financial statements.

In September 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2011-09, Compensation-Retirement Benefits-Multiemployer Plans which amends the guidance in ASC 715-80. The amendments in ASU 2011-09 provide additional disclosure requirements for entities which participate in multi-employer pension plans. The purpose of the new disclosures is to provide financial statement users with information about an employer's level of

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participation in and the financial health of significant plans. The new disclosures are effective for annual periods ending after December 15, 2011. There will be no impact on the Company's consolidated financial statements as the changes relate only to additional disclosures.

Note 2 Average Shares Outstanding

Average shares outstanding for the nine months ended October 1, 2011 reflect stock purchases of 373 shares for \$10,271 and a 3% stock dividend distributed on April 7, 2011. Average shares outstanding for the nine months ended October 2, 2010 reflect stock purchases of 454 shares for \$11,721 and a 3% stock dividend distributed on April 8, 2010.

Note 3 Income Taxes

The Company is subject to taxation in the U.S. and various state and foreign jurisdictions. The Company remains subject to examination by U.S. federal and state and foreign tax authorities for the years 2008 through 2010. Certain foreign jurisdictions are subject to examinations for the years 2004 through 2010.

Note 4 Fair Value Measurements

Current accounting guidance defines fair value as the price that would be received in the sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Guidance requires disclosure of the extent to which fair value is used to measure financial assets and liabilities, the inputs utilized in calculating valuation measurements, and the effect of the measurement of significant unobservable inputs on earnings, or changes in net assets, as of the measurement date. Guidance establishes a three-level valuation hierarchy based upon the transparency of inputs utilized in the measurement and valuation of financial assets or liabilities as of the measurement date. Level 1 inputs include quoted prices for identical instruments and are the most observable. Level 2 inputs include quoted prices for similar assets and observable inputs such as interest rates, foreign currency exchange rates, commodity rates and yield curves. Level 3 inputs are not observable in the market and include management's own judgments about the assumptions market participants would use in pricing the asset or liability. The use of observable and unobservable inputs is reflected in the hierarchy assessment disclosed in the table below.

As of October 1, 2011, December 31, 2010 and October 2, 2010, the Company held certain financial assets that are required to be measured at fair value on a recurring basis. These included derivative hedging instruments related to the purchase of certain raw materials, investments in trading securities and available for sale securities, including auction rate securities (ARS). The Company's available for sale and trading securities principally consist of municipal bonds and mutual funds that are publicly traded.

The following table presents information about the Company's financial assets and liabilities measured at fair value as of October 1, 2011, December 31, 2010 and October 2, 2010, and indicates the fair value hierarchy of the valuation techniques utilized by the Company to determine such fair value:

	Total Fair Value	Estimated Fair Value October 1, 2011 Input Levels Used		
		Level 1	Level 2	Level 3
Cash and cash equivalents	\$ 25,690	\$ 25,690	\$	\$
ARS	8,130			8,130
Available-for-sale securities excluding ARS	60,802		60,802	
Foreign currency forward contracts	(108)		(108)	
Commodity futures contracts	345	345		
Commodity options contracts				
Trading securities	39,031	39,031		
Total assets measured at fair value	\$ 133,890	\$ 65,066	\$ 60,694	\$ 8,130

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	Estimated Fair Value December 31, 2010			
	Total Fair Value	Level 1	Input Levels Used	
			Level 2	Level 3
Cash and cash equivalents	\$ 115,976	\$ 115,976	\$	\$
ARS	6,775			6,775
Available-for-sale securities excluding ARS	27,178		27,178	
Foreign currency forward contracts	942		942	
Commodity futures contracts	2,310	2,310		
Commodity options contracts	5,369	5,369		
Trading securities	38,504	38,504		
Total assets measured at fair value	\$ 197,054	\$ 162,159	\$ 28,120	\$ 6,775

	Estimated Fair Value October 2, 2010			
	Total Fair Value	Level 1	Input Levels Used	
			Level 2	Level 3
Cash and cash equivalents	\$ 58,862	\$ 58,862	\$	\$
ARS	5,960			5,960
Available-for-sale securities excluding ARS	27,203		27,203	
Foreign currency forward contracts	820		820	
Commodity futures contracts	647	647		
Commodity options contracts	1,486	1,486		
Trading securities	36,158	36,158		
Total assets measured at fair value	\$ 131,136	\$ 97,153	\$ 28,023	\$ 5,960

As of October 1, 2011, the Company's long term investments included an ARS, Jefferson County Alabama Sewer Revenue Refunding Warrants, reported at a fair value of \$8,130 after reflecting a \$5,140 other than temporary impairment and a \$280 temporary decline in market value against its \$13,550 par value. In 2008, this ARS was determined to be other than temporarily impaired due to the duration and severity of the decline in fair value. The Company estimated the fair value of this ARS utilizing a valuation model with Level 3 inputs. This valuation model considered, among other items, a limited number of market trades, the credit risk of the collateral underlying the ARS, the credit risk of the bond insurer, interest rates and the amount and timing of expected future cash flows including the Company's assumption about the market expectation of the next successful auction. See Management's Discussion and Analysis of Financial Condition and Results of Operations regarding Jefferson County ARS. The Company classified this ARS as non-current and has included it in long term investments on the Condensed Consolidated Statements of Financial Position at October 1, 2011, December 31, 2010 and October 2, 2010 because the Company believes that the current condition of the ARS market may take more than twelve months to improve.

The following table presents additional information about the Company's financial instruments (all ARS) measured at fair value on a recurring basis using significant unobservable inputs (Level 3) at October 1, 2011 and October 2, 2010:

	2011	2010
Balance at January 1	\$ 6,775	\$ 7,710
Unrealized gain (loss) in other comprehensive loss	1,355	(1,750)
Balance at October 1 and October 2, respectively	\$ 8,130	\$ 5,960

The \$7,500 carrying amount of the Company's industrial revenue development bonds at October 1, 2011 and October 2, 2010 approximates its estimated fair value as the bonds have a floating interest rate.

Note 5 Derivative Instruments and Hedging Activities

From time to time, the Company uses derivative instruments, including foreign currency forward contracts, commodity futures contracts and commodity option contracts to manage its exposures to foreign exchange and commodity prices. Commodity futures contracts and most commodity option contracts are intended and effective as hedges of market price risks associated with the anticipated purchase of certain raw materials (primarily sugar). Foreign currency forward contracts are intended and effective as hedges of the Company's exposure to the variability of cash flows, primarily related to the foreign exchange rate changes of products manufactured in Canada and sold in the United States, and periodic equipment purchases

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from foreign suppliers denominated in a foreign currency. The Company does not engage in trading or other speculative use of derivative instruments.

The Company recognizes all derivative instruments as either assets or liabilities at fair value in the Condensed Consolidated Statement of Financial Position. Derivative assets are recorded in other receivables and derivative liabilities are recorded in accrued liabilities. The Company uses either hedge accounting or mark-to-market accounting for its derivative instruments. Derivatives that qualify for hedge accounting are designated as cash flow hedges by formally documenting the hedge relationships, including identification of the hedging instruments, the hedged items and other critical terms, as well as the Company's risk management objectives and strategies for undertaking the hedge transaction.

Changes in the fair value of the Company's cash flow hedges are recorded in accumulated other comprehensive loss, net of tax, and are reclassified to earnings in the periods in which earnings are affected by the hedged item. Substantially all amounts reported in accumulated other comprehensive loss for commodity derivatives are expected to be reclassified to cost of goods sold. Substantially all amounts reported in accumulated other comprehensive loss for foreign currency derivatives are expected to be reclassified to other income (expense), net.

The following table summarizes the Company's outstanding derivative contracts and their effects on its Condensed Consolidated Statements of Financial Position at October 1, 2011, December 31, 2010 and October 2, 2010:

	Notional Amounts	October 1, 2011	
		Assets	Liabilities
Derivatives designated as hedging instruments:			
Foreign currency forward contracts	\$ 7,840	\$	\$ (108)
Commodity futures contracts	5,473	445	(100)
Commodity option contracts			
Total derivatives designated as hedges		445	(208)
Derivatives not designated as hedging instruments:			
Commodity option contracts			
Total derivatives not designated as hedges			
Total derivatives		\$ 445	\$ (208)
	Notional Amounts	December 31, 2010	
		Assets	Liabilities
Derivatives designated as hedging instruments:			
Foreign currency forward contracts	\$ 3,572	\$ 942	\$
Commodity futures contracts	4,407	2,310	
Commodity option contracts	10,344	5,481	(112)
Total derivatives designated as hedges		8,733	(112)
Derivatives not designated as hedging instruments:			
Commodity option contracts			