

CLARCOR INC.  
Form 10-Q  
September 21, 2012

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 September 1, 2012

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

CLARCOR Inc.  
(Exact name of registrant as specified in its charter)

|   |                                     |   |
|---|-------------------------------------|---|
| Delaware<br>(State or other jurisdiction of<br>incorporation or organization) | 1-11024<br>(Commission File Number) | 36-0922490<br>(I.R.S. Employer<br>Identification No.) |
|---|-------------------------------------|---|

840 Crescent Centre Drive, Suite 600, Franklin, Tennessee 37067  
(Address of principal executive offices)

Registrant's telephone number, including area code: 615-771-3100

No Change  
(Former name, former address and former fiscal year, if changed since last report.)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T 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 definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act:

Large accelerated filer     Accelerated filer                      Non-accelerated filer                      Smaller reporting company

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

As of September 17, 2012, there were 50,063,223 common shares with a par value of \$1 per share were outstanding.

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\* Item omitted because the item is not applicable

## Part I. FINANCIAL INFORMATION

## Item 1. Financial Statements

CLARCOR Inc.

## CONSOLIDATED CONDENSED STATEMENTS OF EARNINGS

(Dollars in thousands except per share data)

(Unaudited)

|   | Quarter Ended        |                    | Nine Months Ended    |                    |
|---|----------------------|--------------------|----------------------|--------------------|
|   | September 1,<br>2012 | August 27,<br>2011 | September 1,<br>2012 | August 27,<br>2011 |
| Net sales   | \$286,733            | \$284,819          | \$828,852            | \$819,072          |
| Cost of sales   | 191,845              | 188,945            | 549,563              | 542,783            |
| Gross profit  | 94,888               | 95,874             | 279,289              | 276,289            |
| Selling and administrative expenses                           | 48,707               | 49,413             | 149,685              | 149,757            |
| Operating profit  | 46,181               | 46,461             | 129,604              | 126,532            |
| Other income (expense):                                       |                      |                    |                      |                    |
| Interest expense  | (176                 | ) (87              | ) (364               | ) (352             |
| Interest income   | 156                  | 170                | 459                  | 446                |
| Other, net  | (186                 | ) 16               | 309                  | (412               |
|   | (206                 | ) 99               | 404                  | (318               |
| Earnings before income taxes                                  | 45,975               | 46,560             | 130,008              | 126,214            |
| Provision for income taxes                                    | 15,564               | 14,401             | 43,026               | 39,253             |
| Net earnings  | 30,411               | 32,159             | 86,982               | 86,961             |
| Net earnings attributable to noncontrolling interests         | (141                 | ) (89              | ) (306               | ) (202             |
| Net earnings attributable to CLARCOR Inc.                     | \$30,270             | \$32,070           | \$86,676             | \$86,759           |
| Net earnings per share attributable to CLARCOR Inc. - Basic   | \$0.60               | \$0.63             | \$1.72               | \$1.72             |
| Net earnings per share attributable to CLARCOR Inc. - Diluted | \$0.60               | \$0.63             | \$1.70               | \$1.69             |
| Weighted average number of shares outstanding - Basic         | 50,283,340           | 50,527,206         | 50,357,567           | 50,563,556         |
| Weighted average number of shares outstanding - Diluted       | 50,863,894           | 51,200,241         | 50,979,542           | 51,256,621         |
| Dividends paid per share                                      | \$0.1200             | \$0.1050           | \$0.3600             | \$0.3150           |

See Notes to Consolidated Condensed Financial Statements

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CLARCOR Inc.  
CONSOLIDATED CONDENSED BALANCE SHEETS  
(Dollars in thousands)  
(Unaudited)

|   | September 1,<br>2012 | December 3,<br>2011 |
|---|----------------------|---------------------|
| <b>ASSETS</b>   |                      |                     |
| Current assets:   |                      |                     |
| Cash and cash equivalents   | \$ 165,347           | \$ 155,999          |
| Restricted cash   | 869                  | 1,105               |
| Accounts receivable, less allowance for losses of \$9,524 and \$9,795, respectively           | 212,687              | 206,664             |
| Inventories   | 210,521              | 200,274             |
| Deferred income taxes   | 32,377               | 25,974              |
| Income taxes receivable   | —                    | 3,373               |
| Prepaid expenses and other current assets   | 7,324                | 7,510               |
| Total current assets  | 629,125              | 600,899             |
| Plant assets, at cost, less accumulated depreciation of \$309,822 and \$293,111, respectively | 195,239              | 184,992             |
| Assets held for sale  | 2,000                | 2,000               |
| Goodwill  | 241,602              | 235,530             |
| Acquired intangible assets, less accumulated amortization                                     | 96,871               | 98,674              |
| Deferred income taxes   | 361                  | 749                 |
| Other noncurrent assets   | 16,221               | 12,089              |
| Total assets  | \$ 1,181,419         | \$ 1,134,933        |
| <b>LIABILITIES</b>  |                      |                     |
| Current liabilities:  |                      |                     |
| Current portion of long-term debt   | \$ 208               | \$ 1,289            |
| Accounts payable and accrued liabilities  | 166,190              | 155,585             |
| Income taxes payable  | 1,504                | 3,176               |
| Total current liabilities   | 167,902              | 160,050             |
| Long-term debt, less current portion  | 16,551               | 15,981              |
| Long-term pension and postretirement healthcare benefits liabilities                          | 35,124               | 74,524              |
| Deferred income taxes   | 54,586               | 36,194              |
| Other long-term liabilities   | 8,774                | 11,069              |
| Total liabilities   | 282,937              | 297,818             |
| Contingencies ( <u>Note 11</u> )  |                      |                     |
| Redeemable noncontrolling interests   | 1,707                | 1,557               |
| <b>SHAREHOLDERS' EQUITY</b>   |                      |                     |
| Capital stock   | 50,076               | 50,145              |
| Capital in excess of par value  | 14,223               | 19,453              |
| Accumulated other comprehensive loss  | (46,625              | ) (44,391           |
| Retained earnings   | 878,193              | 809,520             |
| Total CLARCOR Inc. equity   | 895,867              | 834,727             |
| Noncontrolling interests  | 908                  | 831                 |

|  |             |             |
|--|-------------|-------------|
| Total shareholders' equity                 | 896,775     | 835,558     |
| Total liabilities and shareholders' equity | \$1,181,419 | \$1,134,933 |

See Notes to Consolidated Condensed Financial Statements

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## CLARCOR Inc.

## CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS

(Dollars in thousands)

(Unaudited)

|  | Nine Months Ended    |                    |
|--|----------------------|--------------------|
|  | September 1,<br>2012 | August 27,<br>2011 |
| Cash flows from operating activities:                                |                      |                    |
| Net earnings   | \$86,982             | \$86,961           |
| Depreciation   | 19,387               | 20,679             |
| Amortization   | 4,383                | 4,160              |
| Other noncash items  | (24                  | ) 180              |
| Net loss (gain) on disposition of assets                             | (792                 | ) 168              |
| Stock-based compensation expense                                     | 5,397                | 4,786              |
| Excess tax benefit from stock-based compensation                     | (2,606               | ) (2,338           |
| Deferred income taxes  | 8,355                | (1,353             |
| Change in assets and liabilities                                     | (41,325              | ) (43,934          |
| Net cash provided by operating activities                            | 79,757               | 69,309             |
| Cash flows from investing activities:                                |                      |                    |
| Restricted cash  | (79                  | ) (317             |
| Business acquisitions, net of cash acquired                          | (11,974              | ) (14,160          |
| Additions to plant assets  | (29,473              | ) (16,789          |
| Proceeds from disposition of plant assets                            | 502                  | 244                |
| Investment in affiliates   | (801                 | ) (100             |
| Net cash used in investing activities                                | (41,825              | ) (31,122          |
| Cash flows from financing activities:                                |                      |                    |
| Payments on long-term debt   | (1,253               | ) (1,825           |
| Payment of financing costs   | (564                 | ) —                |
| Sale of capital stock under stock option and employee purchase plans | 5,389                | 6,900              |
| Payments for repurchase of common stock                              | (16,724              | ) (18,204          |
| Excess tax benefit from stock-based compensation                     | 2,606                | 2,338              |
| Dividend paid to noncontrolling interests                            | —                    | (321               |
| Cash dividends paid  | (18,132              | ) (15,927          |
| Net cash used in financing activities                                | (28,678              | ) (27,039          |
| Net effect of exchange rate changes on cash                          | 94                   | (1,105             |
| Net change in cash and cash equivalents                              | 9,348                | 10,043             |
| Cash and cash equivalents, beginning of period                       | 155,999              | 117,022            |
| Cash and cash equivalents, end of period                             | \$165,347            | \$127,065          |
| Cash paid during the period for:                                     |                      |                    |
| Interest   | \$319                | \$95               |
| Income taxes, net of refunds   | \$27,827             | \$26,505           |

See Notes to Consolidated Condensed Financial Statements





CLARCOR Inc.

## NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Dollars in thousands except share data)

(Unaudited)

## 1. CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

## Basis of Presentation

CLARCOR Inc. and its subsidiaries (collectively, the “Company” or “CLARCOR”) is a global provider of filtration products, filtration systems and services, and consumer and industrial packaging products. As discussed further in Note 13, the Company has three reportable segments: Engine/Mobile Filtration, Industrial/Environmental Filtration and Packaging. The Consolidated Condensed Financial Statements include all domestic and foreign subsidiaries that were more than 50% owned and controlled as of each respective reporting period presented. All intercompany accounts and transactions have been eliminated.

The Consolidated Condensed Statements of Earnings and the Consolidated Condensed Statements of Cash Flows for the periods ended September 1, 2012 and August 27, 2011 and the Consolidated Condensed Balance Sheet as of September 1, 2012 have been prepared by the Company without audit. The Consolidated Condensed Financial Statements have been prepared on the same basis as those in the Company’s Annual Report on Form 10-K for the fiscal year ended December 3, 2011 (“2011 Form 10-K”). The December 3, 2011 Consolidated Condensed Balance Sheet data was derived from the Company’s year-end audited Consolidated Financial Statements as presented in the 2011 Form 10-K but does not include all disclosures required by accounting principles generally accepted in the United States of America (“U.S. GAAP”). In the opinion of management, all adjustments (which include only normal recurring adjustments) necessary to present fairly the financial position, results of operations and cash flows have been made. The results of operations for the period ended September 1, 2012, are not necessarily indicative of the operating results for the full year. The information included in this Form 10-Q should be read in conjunction with the audited Consolidated Financial Statements and accompanying notes included in the 2011 Form 10-K.

## Cash and Cash Equivalents and Restricted Cash

Highly liquid investments with an original maturity of three months or less when purchased and that are readily saleable are considered to be cash and cash equivalents. Restricted cash represents funds held in escrow and cash balances held by German banks as collateral for certain guarantees of overseas subsidiaries. Restricted cash classified as current corresponds to guarantees that expire within one year. The Company also has \$1,809 and \$1,590 of noncurrent restricted cash recorded in Other noncurrent assets as of September 1, 2012 and December 3, 2011, respectively, corresponding to guarantees and escrow agreements that expire longer than one year from the dates of the Consolidated Condensed Balance Sheets.

## Inventories

Inventories are valued at the lower of cost or market primarily determined on the first-in, first-out (“FIFO”) method of inventory costing, which approximates current cost. Inventories are summarized as follows:

|                   | September 1,<br>2012 | December 3,<br>2011 |
|-------------------|----------------------|---------------------|
| Raw materials     | \$74,158             | \$72,289            |
| Work in process   | 36,327               | 30,957              |
| Finished products | 100,036              | 97,028              |
| Inventories       | \$210,521            | \$200,274           |



CLARCOR Inc.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Dollars in thousands except share data)

(Unaudited)

New Accounting Guidance

In July 2012, the Financial Accounting Standards Board ("FASB") issued amendments to its indefinite-lived intangible assets impairment testing guidance to simplify how entities test for indefinite-lived intangible asset impairments. The objective of the amendments is to reduce cost and complexity by providing an entity with the option to make a qualitative assessment about the likelihood that an indefinite-lived intangible asset is impaired to determine whether it should perform a quantitative impairment test. The amendments also enhance the consistency of impairment testing guidance by permitting an entity to assess qualitative factors to determine whether it is necessary to calculate the asset's fair value when testing an indefinite-lived intangible asset for impairment, which is equivalent to the impairment testing requirements for other long-lived assets. The amendments are effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012, although early adoption is permitted. The Company does not expect the adoption of this guidance on, or before, December 2, 2012 to have a material impact on the Consolidated Financial Statements.

In September 2011, the FASB issued amendments to its goodwill impairment testing guidance to simplify how entities test for goodwill impairments. The amendments are intended to reduce complexity and cost by providing a company the option of making an initial qualitative evaluation about the likelihood of goodwill impairment in determining whether it should calculate the fair value of a reporting unit. The amendments also include examples of events and circumstances that a company should consider in evaluating whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. The amendments are effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011, although early adoption is permitted. The Company does not expect the adoption of this guidance on, or before, December 2, 2012 to have a material impact on the Consolidated Financial Statements.

In June 2011, the FASB issued amendments to its comprehensive income guidance to (a) improve the comparability, consistency and transparency of financial reporting, (b) increase the prominence of items reported in other comprehensive income and (c) facilitate the convergence of U.S. GAAP with International Financial Reporting Standards ("IFRS"). The amendments require all non-owner changes in shareholders' equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The required amendments, pursuant to the guidance, must be applied retrospectively. In December 2011, the FASB issued amendments to defer certain presentation requirements of the initial guidance. The guidance is effective for fiscal years and interim periods within those years, beginning after December 15, 2011, although early adoption is permitted. The adoption of this guidance on December 2, 2012 will affect the presentation of the Consolidated Statements of Earnings and the Consolidated Statements of Shareholders' Equity, but will not have a material effect on the Company's financial position or results of operations.

In May 2011, the FASB issued guidance amending fair value measurement and disclosure requirements in order to align U.S. GAAP and IFRS. Consequently, the amendments change the wording used to describe many of the requirements in U.S. GAAP for measuring fair value and for disclosing information about fair value measurements. Some of the amendments clarify the intent about the application of existing fair value measurement requirements, while other amendments change a particular principle or requirement for measuring fair value or for disclosing information about fair value measurements. The impact of adopting this guidance on March 4, 2012 was not material to the Consolidated Condensed Financial Statements.

In December 2010, the FASB issued guidance which amends the pro forma disclosure requirements for business combinations and specifies that if a public company presents comparative financial statements, the company should disclose revenue and earnings of the combined entity as though business combinations occurring during the year had occurred as of the beginning of the comparable prior annual reporting period only. The guidance also expands the pro forma disclosure requirements to include a description of the nature and amount of material, nonrecurring pro forma adjustments directly attributable to the business combination included in the reported pro forma revenue and earnings. The impact of adopting this guidance on December 4, 2011 was not material to the Consolidated Condensed Financial Statements.

CLARCOR Inc.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Dollars in thousands except share data)

(Unaudited)

2. BUSINESS ACQUISITIONS, INVESTMENTS AND REDEEMABLE NONCONTROLLING INTERESTS

Business Acquisitions

On May 9, 2012, the Company acquired 100% of the shares in Modular Engineering Company Pty Ltd. ("Modular") for \$7,875. An initial payment of \$5,237 was made at closing and the remaining purchase price will be paid in equal annual installments on the first and second anniversaries of the closing date. Modular, a manufacturer of pressure vessels, process and storage tanks and other natural gas filtration products and distributor of aftermarket elements is located in Henderson, Western Australia. The acquisition of Modular gives the Company first-fit manufacturing capabilities in Western Australia, as well as a platform for aftermarket growth throughout the region. Modular has been combined into an existing Company subsidiary, which is part of the Company's Industrial/Environmental Filtration segment. Net sales and Operating profit attributable to Modular for both the three and nine months ended September 1, 2012 were not material to the results of the Company. The Company incurred costs of \$250 related to the acquisition of Modular which are included in Selling and administrative expenses in the Consolidated Condensed Statements of Earnings. An allocation of the purchase price for the acquisition has been made to major categories of assets and liabilities. Acquired finite-lived intangible assets of \$2,552 were recorded in connection with the purchase. The \$5,339 excess of the initial purchase price over the estimated fair value of the assets acquired and liabilities assumed was recorded as goodwill, which is not deductible for income tax purposes.

On December 30, 2011, the Company purchased certain assets of PDDA Filtration, Inc. ("PDDA"), a privately-held provider of filtration solutions, for \$530. PDDA specializes in liquid process filtration products, serving customers in diverse industries including chemical processing, food and beverage, oil and gas, power generation, water, wine and biofuel production. The purchased assets were combined into the Industrial/Environmental Filtration segment. The acquisition is not material to the results of the Company. An allocation of the purchase price for the acquisition has been made to major categories of assets and liabilities. Inventory acquired was valued at \$80. Acquired intangible assets included customer relationships valued at \$400 which are being amortized over their estimated useful life of five years and a non-compete agreement valued at \$50 being amortized over three years. A contingent liability of \$200 for a potential earn-out payment was also recognized. The Company did not recognize any goodwill in connection with this acquisition.

On December 29, 2010, the Company acquired 100% of the outstanding membership interests in TransWeb LLC ("TransWeb"), a privately-owned manufacturer of media used in a variety of end-use applications, including respirators and heating, ventilation and air conditioning ("HVAC") filters. Founded in 1996 and based in Vineland, New Jersey, TransWeb had supplied media to a subsidiary of the Company for several years prior to the acquisition. TransWeb was acquired to expand the Company's technology capabilities in the area of media development and to enhance the product offerings of the Company's filtration operating companies. TransWeb's results are included in the Industrial/Environmental Filtration segment from the date of acquisition. Net sales and Operating profit (loss) attributable to TransWeb for the three and nine months ended September 1, 2012 were \$2,143, \$(73) and \$7,908, \$440, respectively. Net sales and Operating profit attributable to TransWeb for the three and nine months ended August 27, 2011 were \$3,935, \$794 and \$8,828, \$1,268, respectively. The base purchase price to acquire TransWeb was \$30,017, excluding cash acquired. Of the base purchase price, the Company withheld payment of \$17,000 pending resolution of 3M litigation, which funds may be used by the Company in connection with the same (see [Note 11](#)). A contingent liability for a potential earn-out payment to one of the former owners, recorded on the acquisition date at fair value by applying the income approach, was also recognized. The acquisition-date estimated fair value of the contingent consideration payment of \$1,018 was recorded as a component of the consideration transferred in

exchange for the equity interests of TransWeb in accordance with accounting guidance. The contingent liability for the earn-out payment will continue to be accounted for and measured at fair value until the contingency is settled during fiscal year 2016. The fair value measurement of the contingent consideration payment is based on significant inputs not observed in the market and thus represents a Level 3 measurement as defined by accounting literature (see Note 6).

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CLARCOR Inc.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Dollars in thousands except share data)

(Unaudited)

### Investments

Effective May 1, 2008, the Company acquired a 30% share in BioProcessH2O LLC (“BPH”), a Rhode Island-based manufacturer of industrial waste water and water reuse filtration systems, for \$4,000. Under the terms of the agreement with BPH, the Company has the right, but not the obligation, to acquire additional ownership shares and eventually complete ownership of BPH over several years at a price based on, among other factors, BPH’s operating income. The investment, with a carrying amount of \$3,138 and \$3,229, at September 1, 2012 and December 3, 2011, respectively, included in Other noncurrent assets in the Consolidated Condensed Balance Sheets, is being accounted for under the equity method of accounting. The carrying amount is adjusted each period to recognize the Company’s share of the earnings or losses of BPH, included in Other, net in the Consolidated Condensed Statements of Earnings, based on the percentage of ownership, as well as the receipt of any dividends. During the nine months ended September 1, 2012 and August 27, 2011, the Company did not receive any dividends from BPH. The equity investment is periodically reviewed for indicators of impairment.

The Company also owns a 14.85% share in BioProcess Algae LLC (“Algae”), a Delaware-based company developing technology to grow and harvest algae which can be used to consume carbon dioxide and also be used as a renewable energy source. During the nine months ended September 1, 2012, the Company invested an additional \$1,114 into Algae, \$446 which has not yet been funded and is included in Accounts payable and accrued liabilities in the accompanying Consolidated Condensed Balance Sheets. The investment, with a carrying amount of \$1,812 and \$698, at September 1, 2012 and December 3, 2011, respectively, included in Other noncurrent assets, is being accounted for under the cost method of accounting. Under the cost method, the Company recognizes dividends as income when received and reviews the cost basis of the investment for impairment if factors indicate that a decrease in value of the investment has occurred. During the nine months ended September 1, 2012 and August 27, 2011, the Company received dividends from Algae of \$1,200 and \$0, respectively, which is included in Other, net in the Consolidated Condensed Statements of Earnings.

### Redeemable Noncontrolling Interests

In March 2007, the Company acquired an 80% ownership share in Sinfa SA (“SINFA”), a manufacturer of automotive and heavy-duty engine filters based in Casablanca, Morocco. As part of the purchase agreement, the Company and the noncontrolling owners each have an option to require the purchase of the remaining 20% ownership shares by the Company after December 31, 2012 which would result in SINFA becoming a wholly owned subsidiary. The remaining 20% of SINFA owned by the noncontrolling owners has been reported as Redeemable noncontrolling interests and classified as mezzanine equity in the Consolidated Condensed Balance Sheets. The Redeemable noncontrolling interests will be accreted to the redemption price, through equity, at the point at which the redemption becomes probable. The Company has not recorded any accretion to date.

### 3. INCENTIVE PLANS AND STOCK-BASED COMPENSATION

On March 23, 2009, the shareholders of CLARCOR approved the 2009 Incentive Plan, which replaced the 2004 Incentive Plan. The 2009 Incentive Plan allows the Company to grant stock options, restricted stock unit awards, restricted stock, performance awards and other awards to officers, directors and key employees of up to 3,800,000 shares during a ten-year period that ends in December 2019. Upon share option exercise or restricted stock unit award conversion, the Company issues new shares unless treasury shares are available. The key provisions of the Company’s



stock-based incentive plans are described in Note M of the Company's Consolidated Financial Statements included in the 2011 Form 10-K.

### Stock Options

Nonqualified stock options are granted at exercise prices equal to the market price of CLARCOR common stock at the date of grant, which is the date the Company's Board of Directors approves the grant and the participants receive it. The Company's Board of Directors determines the vesting requirements for stock options at the time of grant and may accelerate vesting. In general, options granted to key employees vest 25% per year beginning at the end of the first year; therefore, they become fully exercisable at the end of four years. Vesting may be accelerated in the event of retirement, disability or death of a participant or change in control of the Company. Options granted to non-employee directors vest immediately. All options expire ten years from the date of grant unless otherwise terminated.

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CLARCOR Inc.

## NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Dollars in thousands except share data)

(Unaudited)

The following table summarizes information related to stock options and stock option exercises during the nine months ended September 1, 2012 and August 27, 2011.

|  | Quarter Ended        |                    | Nine Months Ended    |                    |
|--|----------------------|--------------------|----------------------|--------------------|
|  | September 1,<br>2012 | August 27,<br>2011 | September 1,<br>2012 | August 27,<br>2011 |
| Pre-tax compensation expense   | \$ 1,089             | \$ 967             | \$ 4,307             | \$ 3,817           |
| Deferred tax benefits  | (400 )               | (356 )             | (1,583 )             | (1,403 )           |
| Excess tax benefits associated with tax deductions over the amount of compensation expense recognized in the consolidated condensed financial statements | 119                  | 297                | 2,606                | 2,338              |
| Fair value of stock options on date of grant   | —                    | 27                 | 6,407                | 5,803              |
| Total intrinsic value of stock options exercised   | 614                  | 885                | 8,360                | 7,443              |
| Cash received upon exercise of stock options   | 1,218                | 772                | 4,469                | 6,009              |
| Tax benefit realized from exercise of stock options, net   | 113                  | 297                | 2,594                | 2,332              |
| Addition to capital in excess of par value due to exercise of stock options  | 1,293                | 1,033              | 5,352                | 7,027              |

The following table summarizes activity for the nine months ended September 1, 2012 with respect to stock options granted by the Company and includes options granted under the 1994 Incentive Plan, the 2004 Incentive Plan and the 2009 Incentive Plan.

|                                  | Options Granted<br>Under Incentive<br>Plans | Weighted<br>Average<br>Exercise Price |
|----------------------------------|---|---------------------------------------|
| Outstanding at beginning of year | 2,907,533                                   | \$32.39                               |
| Granted                          | 512,850                                     | \$49.84                               |
| Exercised                        | (329,466)                                   | \$25.02                               |
| Surrendered                      | (22,404)                                    | \$39.32                               |
| Outstanding at end of period     | 3,068,513                                   | \$36.05                               |
| Exercisable at end of period     | 2,059,794                                   | \$32.50                               |

At September 1, 2012, there was \$5,765 of unrecognized compensation cost related to option awards which the Company expects to recognize over a weighted-average period of 2.57 years.

The following table summarizes information about the Company's outstanding and exercisable options at September 1, 2012.

| Range of Exercise Prices | Options Outstanding |                                 |                          | Options Exercisable |                                 |                          |
|--------------------------|---------------------|---------------------------------|--------------------------|---------------------|---------------------------------|--------------------------|
|                          | Number              | Weighted Average Exercise Price | Weighted Intrinsic Value | Number              | Weighted Average Exercise Price | Weighted Intrinsic Value |
| \$16.15 - \$22.80        | 145,400             | \$21.40                         | \$3,889                  | 145,400             | \$21.40                         | \$3,889                  |

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|                   |           |         |          |      |           |         |          |      |
|-------------------|-----------|---------|----------|------|-----------|---------|----------|------|
| \$25.31 - \$38.06 | 1,948,402 | \$31.88 | 31,682   | 4.97 | 1,689,934 | \$31.79 | 27,631   | 4.67 |
| \$40.73 - \$44.07 | 466,361   | \$43.00 | 2,394    | 8.33 | 161,210   | \$43.30 | 780      | 8.40 |
| \$49.35 - \$49.91 | 508,350   | \$49.84 | —        | 9.33 | 63,250    | \$49.38 | —        | 9.57 |
|                   | 3,068,513 | \$36.05 | \$37,965 | 6.03 | 2,059,794 | \$32.50 | \$32,300 | 4.86 |

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CLARCOR Inc.

## NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Dollars in thousands except share data)

(Unaudited)

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions by grant year.

|   | Nine Months Ended    |                    |  |   |
|---|----------------------|--------------------|--|---|
|   | September 1,<br>2012 | August 27,<br>2011 |  |   |
| Weighted average fair value per option at the date of grant for options granted | \$12.49              | \$11.73            |  |   |
| Risk-free interest rate   | 1.38                 | % 2.52             |  | % |
| Expected dividend yield   | 0.96                 | % 0.97             |  | % |
| Expected volatility factor  | 26.52                | % 25.54            |  | % |
| Expected option term in years   | 6.1                  | 6.4                |  |   |

The expected option term in years selected for options granted during each period presented represents the period of time that the options are expected to be outstanding based on historical data of option holder exercise and termination behavior. Expected volatilities are based upon historical volatility of the Company's monthly stock closing prices over a period equal to the expected life of each option grant. The risk-free interest rate is selected based on yields from U.S. Treasury zero-coupon issues with a remaining term approximately equal to the expected term of the options being valued. Expected dividend yield is based on the estimated dividend yield determined on the date of issuance.

## Restricted Stock Unit Awards

The Company's restricted stock unit awards are considered nonvested share awards. The restricted stock unit awards require no payment from the employee. Compensation cost is recorded based on the market price of the stock on the grant date and is recorded equally over the vesting period of four years. During the vesting period, officers and key employees receive compensation equal to the amount of dividends declared on common shares they would have been entitled to receive had the shares been issued. Upon vesting, employees may elect to defer receipt of their shares. There were 98,587 and 103,390 vested and deferred shares at September 1, 2012 and December 3, 2011, respectively.

The following table summarizes information related to restricted stock unit awards during the nine months ended September 1, 2012 and August 27, 2011.

|   | Quarter Ended        |                    | Nine Months Ended    |                    |
|---|----------------------|--------------------|----------------------|--------------------|
|   | September 1,<br>2012 | August 27,<br>2011 | September 1,<br>2012 | August 27,<br>2011 |
| Pre-tax compensation expense  | \$ 156               | \$ 119             | \$ 1,090             | \$ 969             |
| Deferred tax benefits   | (58                  | ) (44              | ) (401               | ) (356             |
| Excess tax (expense) benefits associated with tax deductions under the amount of compensation expense recognized in the consolidated condensed financial statements | (14                  | ) (40              | ) (38                | ) 43               |
| Fair value of restricted stock unit awards on date of grant   | —                    | —                  | 1,489                | 1,263              |
| Fair value of restricted stock unit awards vested   | —                    | —                  | 997                  | 905                |



CLARCOR Inc.

## NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Dollars in thousands except share data)

(Unaudited)

The following table summarizes activity for the nine months ended September 1, 2012 with respect to the restricted stock unit awards.

|                                | Units    | Weighted<br>Average<br>Grant Date<br>Fair Value |
|--------------------------------|----------|---|
| Nonvested at beginning of year | 71,545   | \$36.95   |
| Granted                        | 29,839   | \$49.91   |
| Vested                         | (27,710) | \$35.99   |
| Nonvested at end of period     | 73,674   | \$42.56   |

As of September 1, 2012, there was \$1,186 of total unrecognized compensation cost related to restricted stock unit awards which the Company expects to recognize over a weighted-average period of 2.80 years.

## 4. COMPREHENSIVE EARNINGS

Total comprehensive earnings (loss) and its components are as follows:

| Quarter Ended                           | Total Comprehensive Earnings (Loss), Net of Tax: |   |                                     |   |
|---|--|---|-------------------------------------|---|
|   | Net Earnings                                     | Foreign<br>Currency and<br>Other<br>Adjustments | Pension<br>Liability<br>Adjustments | Total<br>Comprehensive<br>Earnings (Loss) |
| September 1, 2012                       |  |   |                                     |   |
| CLARCOR Inc.                            | \$30,270   | \$5,001   | \$1,072                             | \$36,343                                  |
| Non-redeemable noncontrolling interests | 70   | 64  | —                                   | 134                                       |
| Redeemable noncontrolling interests     | 71   | 21  | —                                   | 92  |
|   | \$30,411   | \$5,086   | \$1,072                             | \$36,569                                  |
| August 27, 2011                         |  |   |                                     |   |
| CLARCOR Inc.                            | \$32,070   | \$(681)   | ) \$711                             | \$32,100                                  |
| Non-redeemable noncontrolling interests | 82   | (190)   | ) —                                 | (108)                                     |
| Redeemable noncontrolling interests     | 7  | 187   | —                                   | 194                                       |
|   | \$32,159   | \$(684)   | ) \$711                             | \$32,186                                  |
| Nine Months Ended                       |  |   |                                     |   |
| September 1, 2012                       |  |   |                                     |   |
| CLARCOR Inc.                            | \$86,676   | \$(5,471)                                       | ) \$3,237                           | \$84,442                                  |
| Non-redeemable noncontrolling interests | 65   | 12  | —                                   | 77  |
| Redeemable noncontrolling interests     | 241  | (91)  | ) —                                 | 150                                       |
|   | \$86,982   | \$(5,550)                                       | ) \$3,237                           | \$84,669                                  |
| August 27, 2011                         |  |   |                                     |   |
| CLARCOR Inc.                            | \$86,759   | \$8,747   | \$2,917                             | \$98,423                                  |
| Non-redeemable noncontrolling interests | 188  | (189)   | ) —                                 | (1)                                       |
| Redeemable noncontrolling interests     | 14   | 68  | —                                   | 82  |

\$86,961

\$8,626

\$2,917

\$98,504

CLARCOR Inc.

## NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Dollars in thousands except share data)

(Unaudited)

The components of the ending balances of Accumulated other comprehensive loss are as follows:

|                                      | September 1,<br>2012 | December 3,<br>2011 |
|--------------------------------------|----------------------|---------------------|
| Pension liability, net of tax        | \$(41,419 )          | \$(44,656 )         |
| Translation adjustments, net of tax  | (5,206 )             | ) 265               |
| Accumulated other comprehensive loss | \$(46,625 )          | ) \$(44,391 )       |

## 5. GOODWILL AND ACQUIRED INTANGIBLE ASSETS

All goodwill is stated on a gross basis, as the Company has not recorded any impairment charges against goodwill. The following table reconciles the activity for goodwill by segment for the nine months ended September 1, 2012.

|                                  | Engine/Mobile<br>Filtration | Industrial/<br>Environmental<br>Filtration | Packaging | Total     |
|----------------------------------|-----------------------------|--|-----------|-----------|
| Goodwill at beginning of year    | \$21,087                    | \$214,443                                  | \$—       | \$235,530 |
| Acquisition                      | —                           | 5,596                                      | —         | 5,596     |
| Currency translation adjustments | 245                         | 231  | —         | 476       |
| Goodwill at end of period        | \$21,332                    | \$220,270                                  | \$—       | \$241,602 |

The following table summarizes acquired intangibles by segment. Other acquired intangibles include parts manufacturer regulatory approvals, developed technology, patents and non-compete agreements.

|                                   | Engine/Mobile<br>Filtration | Industrial/<br>Environmental<br>Filtration | Packaging | Total     |
|-----------------------------------|-----------------------------|--|-----------|-----------|
| September 1, 2012                 |                             |  |           |           |
| Indefinite Lived Intangibles:     |                             |  |           |           |
| Trademarks - indefinite lived     | \$603                       | \$41,487                                   | \$—       | \$42,090  |
| Finite Lived Intangibles:         |                             |  |           |           |
| Trademarks, gross - finite lived  | \$294                       | \$488                                      | \$—       | \$782     |
| Accumulated amortization          | (85 )                       | ) (312 )                                   | ) —       | (397 )    |
| Trademarks, net - finite lived    | \$209                       | \$176                                      | \$—       | \$385     |
| Customer relationships, gross     | \$4,244                     | \$45,488                                   | \$—       | \$49,732  |
| Accumulated amortization          | (1,660 )                    | ) (15,972 )                                | ) —       | (17,632 ) |
| Customer relationships, net       | \$2,584                     | \$29,516                                   | \$—       | \$32,100  |
| Other acquired intangibles, gross | \$243                       | \$39,878                                   | \$—       | \$40,121  |
| Accumulated amortization          | (243 )                      | ) (17,582 )                                | ) —       | (17,825 ) |
| Other acquired intangibles, net   | \$—                         | \$22,296                                   | \$—       | \$22,296  |



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|   |         |          |     |          |
|---|---------|----------|-----|----------|
| Total finite lived intangible assets, net                 | \$2,793 | \$51,988 | \$— | \$54,781 |
| Acquired intangible assets, less accumulated amortization | \$3,396 | \$93,475 | \$— | \$96,871 |

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CLARCOR Inc.

## NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Dollars in thousands except share data)

(Unaudited)

The following table summarizes estimated amortization expense.

|                  |         |
|------------------|---------|
| Fiscal year 2012 | \$5,890 |
| Fiscal year 2013 | 5,914   |
| Fiscal year 2014 | 5,712   |
| Fiscal year 2015 | 5,646   |
| Fiscal year 2016 | 5,510   |

## 6. FAIR VALUE MEASUREMENTS

## Fair Value Measurements

The Company measures certain assets and liabilities at fair value as discussed throughout the notes to its quarterly and annual financial statements. Fair value is the exchange price that would be received for an asset or paid to transfer a liability, an exit price, in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants. Fair value measurements are categorized in a hierarchy based upon the observability of inputs used in valuation techniques. Observable inputs are the highest level and reflect market data obtained from independent sources, while unobservable inputs are the lowest level and reflect internally developed market assumptions. The Company classifies fair value measurements by the following hierarchy:

Level 1 – Quoted active market prices for identical assets

Level 2 – Significant other observable inputs, such as quoted prices for similar (but not identical) instruments in active markets, quoted prices for identical or similar instruments in markets which are not active and model determined valuations in which all significant inputs or significant value-drivers are observable in active markets

Level 3 – Significant unobservable inputs, such as model determined valuations in which one or more significant inputs or significant value-drivers are unobservable

Assets or liabilities that have recurring fair value measurements are shown below:

|   | Fair Value Measurements at Reporting Date |         |         |         |
|---|---|---------|---------|---------|
|   | Total                                     | Level 1 | Level 2 | Level 3 |
| September 1, 2012   |   |         |         |         |
| Restricted trust, included in Other noncurrent assets                 |   |         |         |         |
| Mutual fund investments - equities                                    | \$617                                     | \$617   | \$—     | \$—     |
| Mutual fund investments - bonds                                       | 441                                       | 441     | —       | —       |
| Cash and equivalents  | 27  | 27      | —       | —       |
| Total restricted trust  | \$1,085                                   | \$1,085 | \$—     | \$—     |
| TransWeb contingent earn-out, included in Other long-term liabilities | \$1,255                                   | \$—     | \$—     | \$1,255 |



CLARCOR Inc.

## NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Dollars in thousands except share data)

(Unaudited)

|   | Fair Value Measurements at Reporting Date |         |         |         |
|---|---|---------|---------|---------|
|   | Total                                     | Level 1 | Level 2 | Level 3 |
| December 3, 2011  |   |         |         |         |
| Restricted trust, included in Other noncurrent assets                 |   |         |         |         |
| Mutual fund investments - equities                                    | \$659                                     | \$659   | \$—     | \$—     |
| Mutual fund investments - bonds                                       | 472                                       | 472     | —       | —       |
| Total restricted trust  | \$1,131                                   | \$1,131 | \$—     | \$—     |
| TransWeb contingent earn-out, included in Other long-term liabilities | \$1,123                                   | \$—     | \$—     | \$1,123 |

The restricted trust, which is used to fund certain payments for the Company's U.S. combined nonqualified pension plans, consists of actively traded equity and bond funds. The TransWeb contingent earn-out payment was established in connection with the acquisition of TransWeb (see [Note 2](#)). There were no changes in the fair value determination methods or significant assumptions used in those methods during the nine months ended September 1, 2012. There were no transfers between Level 1 and Level 2 and there were no transfers into or out of Level 3 during the nine months ended September 1, 2012. The Company's policy is to recognize transfers on the actual date of transfer.

The acquisition-date estimated fair value of the TransWeb contingent earn-out payment was \$1,018. The contingent liability for the earn-out payment will continue to be accounted for and measured at fair value until the contingency is settled during fiscal year 2016. The fair value measurement of the contingent earn-out payment is based primarily on projected 2014 and 2015 TransWeb earnings, which represent significant inputs not observed in the market and thus represents a Level 3 measurement as defined by accounting literature. The contingent consideration payment is revalued to its current fair value at each reporting date. Any increase or decrease in the fair value, as a result of changes in significant inputs such as the discount rate, the discount period or other factors used in the calculation, is recognized in Selling and administrative expenses in the Consolidated Condensed Statements of Earnings in the period the estimated fair value changes. The fair value of the contingent consideration was estimated using a probability-weighted discounted cash flow model with a discount rate of 11.9%. The fair value of the TransWeb contingent earn-out payment increased by \$132, based on changes in the remaining discount period, during the nine months ended September 1, 2012.

## Fair Values of Financial Instruments

The fair values of the Company's financial instruments, which are cash and cash equivalents, restricted cash, accounts receivable, the restricted trust and accounts payable and accrued liabilities, approximated the carrying values of those financial instruments at both September 1, 2012 and December 3, 2011. An expected present value technique is used to estimate the fair value of long-term debt. Long-term debt had a fair value estimate of \$16,571 and \$16,716 at September 1, 2012 and December 3, 2011, respectively. The Company's fair value estimate of its long-term debt represents a Level 2 measurement as it is based on the current interest rates available to the Company for debt with similar remaining maturities. The carrying value for the long-term debt at September 1, 2012 and December 3, 2011 is \$16,759 and \$17,270, respectively.



CLARCOR Inc.

## NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Dollars in thousands except share data)

(Unaudited)

## 7. ACCOUNTS PAYABLE, ACCRUED LIABILITIES AND GUARANTEES

Accounts payable and accrued liabilities at September 1, 2012 and December 3, 2011 were as follows:

|  | September 1,<br>2012 | December 3,<br>2011 |
|--|----------------------|---------------------|
| Accounts payable                         | \$63,795             | \$64,701            |
| Accrued salaries, wages and commissions  | 12,229               | 24,760              |
| Compensated absences                     | 9,039                | 8,530               |
| Accrued insurance liabilities            | 8,272                | 9,017               |
| Customer deposits                        | 15,544               | 8,727               |
| Other accrued liabilities                | 57,311               | 39,850              |
| Accounts payable and accrued liabilities | \$166,190            | \$155,585           |

The Company has letters of credit totaling \$28,272 and \$25,623 as of September 1, 2012 and December 3, 2011, respectively, issued to various government agencies, primarily related to industrial revenue bonds, and to insurance companies and other commercial entities in support of its obligations. The Company believes that no payments will be required resulting from these obligations.

In the ordinary course of business, the Company also provides routine indemnifications and other guarantees whose terms range in duration and are often not explicitly defined. The Company does not believe these will have a material impact on the results of operations or financial condition of the Company.

Warranties are recorded as a liability on the balance sheet and as charges to current expense for estimated normal warranty costs and, if applicable, for specific performance issues known to exist on products already sold. The expenses estimated to be incurred are provided at the time of sale and adjusted as needed, based primarily upon experience. Changes in the Company's warranty accrual, which is included in Other accrued liabilities, are as follows:

|  | Nine Months Ended    |                    |
|--|----------------------|--------------------|
|  | September 1,<br>2012 | August 27,<br>2011 |
| Warranty accrual at beginning of period              | \$2,580              | \$3,499            |
| Warranty accrual added through business acquisitions | 32                   | —                  |
| Accruals for warranties issued during the period     | 242                  | 587                |
| Adjustments related to pre-existing warranties       | 120                  | 50                 |
| Settlements made during the period                   | (631)                | (941)              |
| Other adjustments, including currency translation    | (36)                 | (237)              |
| Warranty accrual at end of period                    | \$2,307              | \$2,958            |

CLARCOR Inc.

## NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Dollars in thousands except share data)

(Unaudited)

## 8. LONG-TERM DEBT

On April 5, 2012, the Company refinanced its existing \$250,000 revolving credit facility, which was scheduled to expire on December 18, 2012, by entering into a new five-year multicurrency revolving credit agreement (“Credit Facility”) with a group of financial institutions. Under the new Credit Facility, the Company may borrow up to \$150,000, which includes a \$10,000 swing line sub-facility, as well as an accordion feature that allows the Company to increase the Credit Facility by a total of up to \$100,000, subject to securing additional commitments from existing lenders or new lending institutions. At the Company's election, loans made under the Credit Facility bear interest at either (1) a defined base rate, which varies with the highest of the defined prime rate, the federal funds rate, or a specified margin over the one-month London Interbank Offered Rate (“LIBOR”), or (2) LIBOR plus an applicable margin. Swing line loans bear interest at the defined base rate plus an applicable margin. Commitment fees and letter of credit fees are also payable under the Credit Facility. Borrowings under the Credit Facility are unsecured, but are guaranteed by substantially all of the Company's material domestic subsidiaries. The Credit Facility also contains certain covenants customary to such agreements, as well as customary events of default. At September 1, 2012, there were no borrowings outstanding on the Credit Facility. The Credit Facility includes a \$50,000 letter of credit sub-facility, against which \$16,012 in letters of credit had been issued at September 1, 2012. In connection with the refinancing of the Credit Facility, the Company paid \$564 of financing costs, capitalized in Other noncurrent assets, which will be amortized to interest expense over the life of the Credit Facility.

## 9. PENSION AND OTHER POSTRETIREMENT PLANS

The Company provides various retirement benefits, including defined benefit plans and postretirement healthcare plans covering certain current and retired employees in the U.S. and abroad. During the first quarter of 2011, the Company recorded settlement costs in connection with the retirement of one of its former executive officers.

Components of net periodic benefit cost and Company contributions for these plans were as follows:

|   | Quarter Ended        |                    | Nine Months Ended    |                    |
|---|----------------------|--------------------|----------------------|--------------------|
|   | September 1,<br>2012 | August 27,<br>2011 | September 1,<br>2012 | August 27,<br>2011 |
| Pension Benefits:                                 |                      |                    |                      |                    |
| Components of net periodic benefit cost (income): |                      |                    |                      |                    |
| Service cost                                      | \$529                | \$492              | \$1,589              | \$1,476            |
| Interest cost                                     | 1,978                | 2,013              | 5,937                | 6,037              |
| Expected return on plan assets                    | (2,103)              | (1,923)            | (6,311)              | (5,766)            |
| Settlement cost                                   | —                    | —                  | —                    | 1,368              |
| Amortization of unrecognized:                     |                      |                    |                      |                    |
| Prior service cost                                | (2)                  | (98)               | (8)                  | (296)              |
| Net actuarial loss (gain)                         | 1,909                | 1,265              | 5,727                | 3,688              |
| Net periodic benefit cost (income)                | \$2,311              | \$1,749            | \$6,934              | \$6,507            |
| Cash contributions                                | \$5,369              | \$10,510           | \$20,297             | \$12,752           |
| Postretirement Healthcare Benefits:               |                      |                    |                      |                    |
| Components of net periodic benefit cost (income): |                      |                    |                      |                    |
| Interest cost                                     | \$4                  | \$6                | \$12                 | \$18               |

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Amortization of unrecognized:

|                                    |       |   |       |   |        |   |        |   |
|------------------------------------|-------|---|-------|---|--------|---|--------|---|
| Prior service cost                 | (31   | ) | (31   | ) | (93    | ) | (93    | ) |
| Net actuarial loss (gain)          | (30   | ) | (32   | ) | (90    | ) | (96    | ) |
| Net periodic benefit cost (income) | \$(57 | ) | \$(57 | ) | \$(171 | ) | \$(171 | ) |
| Cash contributions                 | \$25  |   | \$30  |   | \$75   |   | \$90   |   |

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CLARCOR Inc.

## NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Dollars in thousands except share data)

(Unaudited)

The Company's policy is to contribute to its qualified U.S. and non-U.S. pension plans at least the minimum amount required by applicable laws and regulations, to contribute to the U.S. combined nonqualified plans when required for benefit payments, and to contribute to the postretirement healthcare benefit plan an amount equal to the benefit payments. The Company, from time to time, makes voluntary contributions in excess of the minimum amount required as economic conditions warrant. The Company expects to contribute up to the following amounts to its various plans to pay benefits during 2012.

|  |          |
|--|----------|
| U.S. Qualified Plans                   | \$20,054 |
| U.S. Combined Nonqualified Plans       | 150      |
| Non-U.S. Plan                          | 415      |
| Postretirement Healthcare Benefit Plan | 99       |
| Total expected contributions           | \$20,718 |

During the quarter and nine months ended September 1, 2012, the Company contributed \$5,394 and \$20,372, respectively, to its various plans. In addition to the plan assets related to its qualified plans, the Company has also funded \$1,085 and \$1,131 at September 1, 2012 and December 3, 2011, respectively, into a restricted trust for its U.S. combined nonqualified plans (see [Note 6](#)). This trust is included in Other noncurrent assets in the Consolidated Condensed Balance Sheets.

## 10. INCOME TAXES

The following is a reconciliation of the beginning and ending amount of gross unrecognized tax benefits for uncertain tax positions, including positions which impact only the timing of tax benefits.

|  | Nine Months Ended    |                    |
|--|----------------------|--------------------|
|  | September 1,<br>2012 | August 27,<br>2011 |
| Unrecognized tax benefits at beginning of year               | \$3,015              | \$2,783            |
| Additions for current period tax positions                   | 257                  | 450                |
| Reductions for prior period tax positions                    | (6                   | ) —                |
| Reductions for lapse of statute of limitations / settlements | (390                 | ) —                |
| Changes in interest and penalties                            | 38                   | 100                |
| Unrecognized tax benefits at end of period                   | \$2,914              | \$3,333            |

At September 1, 2012, the amount of unrecognized tax benefit, that would impact the effective tax rate if recognized, was \$2,045. The Company recognizes interest and penalties related to unrecognized benefits in income tax expense. At September 1, 2012, the Company had \$506 accrued for the payment of interest and penalties.

Due to the various jurisdictions in which the Company files tax returns and the uncertainty regarding the timing of settlements, it is possible that there could be other significant changes in the amount of unrecognized tax benefits in the next twelve months; however, the amount cannot be estimated.

The Company is regularly audited by federal, state and foreign tax authorities. The Internal Revenue Service has completed its audits of the Company's U.S. income tax returns through fiscal year 2009. With few exceptions, the

Company is no longer subject to income tax examinations by state or foreign tax jurisdictions for years prior to 2006.

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CLARCOR Inc.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Dollars in thousands except share data)

(Unaudited)

## 11. CONTINGENCIES

### Legal Contingencies

From time to time, the Company is subject to lawsuits, investigations and disputes (some of which involve substantial claimed amounts) arising out of the conduct of its business, including matters relating to commercial transactions, product liability, intellectual property and other matters. Items included in these other matters are discussed below. The Company believes recorded reserves in its Consolidated Condensed Financial Statements are adequate in light of the probable and estimable outcomes of the items discussed below. Any recorded liabilities were not material to the Company's financial position, results of operation or liquidity and the Company does not currently believe that any pending claims or litigation, including those identified below, will materially affect its financial position, results of operations or liquidity.

#### Donaldson

On May 15, 2009, Donaldson Company, Inc. ("Donaldson") filed a lawsuit in the U.S. Federal District Court for the District of Minnesota, alleging that certain "ChannelFlow®" engine/mobile filters manufactured and sold by, Baldwin Filters, Inc., a subsidiary of the Company, infringed one or more patents held by Donaldson. On February 1, 2012, the parties entered into a settlement agreement ending the lawsuit, the terms of which are confidential. Pursuant to the settlement agreement, Baldwin agreed to pay certain present and future amounts to Donaldson in exchange for a license to produce certain existing ChannelFlow® products. The Company expensed \$531 related to this settlement in the nine months ended September 1, 2012, which is included in Selling and administrative expenses in the accompanying Consolidated Condensed Statements of Earnings.

#### Antitrust/Qui Tam

On March 31, 2008, S&E Quick Lube, a filter distributor, filed suit in U.S. District Court for the District of Connecticut alleging that virtually every major North American engine filter manufacturer, including the Company's subsidiary, Baldwin Filters, Inc. (the "Defendant Group" and "Baldwin," respectively), engaged in a conspiracy to fix prices, rig bids and allocate U.S. customers for aftermarket filters. The suit is a purported class action on behalf of direct purchasers of filters from the Defendant Group. Parallel purported class actions, including on behalf of indirect purchasers of filters, were filed by other plaintiffs against the Defendant Group in a variety of jurisdictions in the United States and Canada. In addition, the Attorneys General of the State of Florida and the County of Suffolk, New York filed complaints against the Defendant Group based on these same allegations, and the Attorney General of the State of Washington requested various documents, information and cooperation, which the Company agreed to provide. All of the U.S. cases, including the actions brought by and/or on behalf of governmental entities, were consolidated into a single multi-district litigation in the Northern District of Illinois (the "Court"). The Company has consistently denied any wrongdoing whatsoever and has vigorously defended the action.

On October 7, 2011, Baldwin entered into a settlement agreement ("Settlement Agreement") with the putative plaintiff classes involved in the action, including the State of Florida. Pursuant to the terms of the Settlement Agreement, Baldwin denied any wrongdoing whatsoever but agreed to pay a total of \$625, which was fully reserved in fiscal year 2011, to a settlement fund to be divided among the plaintiff classes in exchange for a full and complete release of all claims with prejudice.

The Company entered into the Settlement Agreement to free itself from the expense of ongoing litigation, which was anticipated to be many times greater than the agreed settlement amount. The Company has paid the majority of the settlement amount into escrow. The Settlement Agreement will become effective after the Court enters a final judgment order approving the Settlement Agreement and dismissing the causes of action against Baldwin with prejudice and without costs, and the time for appealing the foregoing expires. The Company is unable to predict when these conditions will be satisfied, but the Company is unaware of any objections or obstacles, and believes that these conditions will be satisfied in due course and in keeping with normal judicial time lines.

CLARCOR Inc.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Dollars in thousands except share data)

(Unaudited)

TransWeb/3M

On May 21, 2010, 3M Company and 3M Innovative Properties (“3M”) brought a lawsuit against TransWeb in the United States District Court for the District of Minnesota, alleging that certain TransWeb products infringe certain 3M patents. Shortly after receiving service of process in this litigation, TransWeb filed its own complaint against 3M in the United States District Court for the District of New Jersey, seeking a declaratory judgment that the asserted patents are invalid and that the products in question do not infringe. 3M withdrew its Minnesota action, and the parties are currently litigating the matter in New Jersey. The litigation in question was filed and underway before the Company acquired TransWeb in December 2010, but the Company assumed the risk of this litigation as a result of the acquisition. The Company is vigorously defending the action and pursuing related claims. In this regard, on June 3, 2011, TransWeb filed a Second Amended Complaint against 3M, (i) seeking declaratory judgment that the asserted 3M patents are invalid, the TransWeb products in question do not infringe, and the 3M patents are unenforceable due to inequitable conduct by 3M in obtaining the patents, (ii) alleging patent infringement by 3M of a patent held by TransWeb, and (iii) alleging antitrust violations by 3M in connection with the personal respirator market. The Company has since dropped its patent infringement allegations against 3M, but continues to allege and pursue its inequitable conduct and antitrust claims. On May 24, 2012, the court tentatively set the case for trial on September 4, 2012, which the court subsequently postponed until October 29, 2012. Each side has also filed dispositive motions seeking the court to rule, as a matter, of law, that it is entitled to judgment in their respective favor in respect of one or more aspects of the case. The Company is unable to predict how or when the court will rule on these motions.

The Company acquired TransWeb on December 29, 2010 (see Note 2). Of the base purchase price, the Company withheld payment of \$17,000 pending resolution of the 3M litigation, which funds may be used by the Company in connection with the same. Any litigation related amounts incurred in excess of the amount withheld will be expensed and paid by the Company. The Company currently does not anticipate total litigation related amounts to exceed the amount withheld. 3M is not seeking damages in connection with its allegations, but rather is seeking only forward-looking injunctive relief to bar TransWeb from selling products that infringe the 3M patents at issue. During the quarter and nine months ended September 1, 2012, the Company applied legal charges of \$2,014 and \$6,421 against the withheld payment, leaving a remaining balance of \$4,250, which is included in Other accrued liabilities (see Note 7). Since the acquisition, the Company has applied legal charges of \$12,750 against the withheld payment.

Other

Additionally, the Company is party to various proceedings relating to environmental issues. The U.S. Environmental Protection Agency and/or other responsible state agencies have designated the Company as a potentially responsible party, along with other companies, in remedial activities for the cleanup of waste sites under the Comprehensive Environmental Response, Compensation, and Liability Act (“the federal Superfund statute”). Although it is not certain what future environmental claims, if any, may be asserted, the Company currently believes that its potential liability for known environmental matters is not material. However, environmental and related remediation costs are difficult to quantify for a number of reasons, including the number of parties involved, the difficulty in determining the nature and extent of the contamination at issue, the length of time remediation may require, the complexity of the environmental regulation and the continuing advancement of remediation technology. Applicable federal law may impose joint and several liability on each potentially responsible party for the cleanup.

In addition to the matters cited above, the Company is involved in legal actions arising in the normal course of business. The Company records provisions with respect to identified claims or lawsuits when it is probable that a

liability has been incurred and the amount of the loss can be reasonably estimated. Claims and lawsuits are reviewed quarterly and provisions are taken or adjusted to reflect the status of a particular matter.

Other Contingencies

In the event of a change in control of the Company, termination benefits are likely to be required for certain executive officers and other employees.

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CLARCOR Inc.

## NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Dollars in thousands except share data)

(Unaudited)

## 12. EARNINGS PER SHARE AND STOCK REPURCHASE ACTIVITY

Diluted earnings per share reflect the impact of outstanding stock options as if exercised during the periods presented using the treasury stock method. The following table provides a reconciliation of the numerators and denominators utilized in the calculation of basic and diluted earnings per share.

|   | Quarter Ended        |                    | Nine Months Ended    |                    |
|---|----------------------|--------------------|----------------------|--------------------|
|   | September 1,<br>2012 | August 27,<br>2011 | September 1,<br>2012 | August 27,<br>2011 |
| Weighted average number of shares outstanding - Basic         | 50,283,340           | 50,527,206         | 50,357,567           | 50,563,556         |
| Dilutive effect of stock-based arrangements                   | 580,554              | 673,035            | 621,975              | 693,065            |
| Weighted average number of shares outstanding - Diluted       | 50,863,894           | 51,200,241         | 50,979,542           | 51,256,621         |
| Net earnings attributable to CLARCOR Inc.                     | \$30,270             | \$32,070           | \$86,676             | \$86,759           |
| Net earnings per share attributable to CLARCOR Inc. - Basic   | \$0.60               | \$0.63             | \$1.72               | \$1.72             |
| Net earnings per share attributable to CLARCOR Inc. - Diluted | \$0.60               | \$0.63             | \$1.70               | \$1.69             |

The following table provides additional information regarding the calculation of earnings per share and stock repurchase activity.

|  | Quarter Ended        |                    | Nine Months Ended    |                    |
|--|----------------------|--------------------|----------------------|--------------------|
|  | September 1,<br>2012 | August 27,<br>2011 | September 1,<br>2012 | August 27,<br>2011 |
| Number of antidilutive options with exercise prices greater than the average market price excluded from the computation of dilutive earnings per share | 508,350              | 60,000             | 509,600              | 60,000             |
| Common stock repurchased and retired pursuant to the Company's stock repurchase program  | \$5,341              | \$9,312            | \$16,724             | \$18,204           |
| Number of shares repurchased and retired pursuant to the Company's stock repurchase program  | 110,300              | 222,051            | 337,800              | 427,051            |

As of September 1, 2012, there was approximately \$187,682 available under the Company's \$250,000 stock repurchase program for future purchases.

CLARCOR Inc.

## NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Dollars in thousands except share data)

(Unaudited)

## 13. SEGMENT INFORMATION

The Company operates in three principal product segments: Engine/Mobile Filtration, Industrial/Environmental Filtration and Packaging. Net sales represent sales to unaffiliated customers as reported in the Consolidated Condensed Statements of Earnings. Intersegment sales were not material. Unallocated amounts consist of interest expense, interest income and other non-operating income and expense items. Assets are those assets used in each business segment. Corporate assets consist of cash, deferred income taxes, corporate facility and equipment and various other assets that are not specific to an operating segment. The Company operates as a consolidated entity, including cooperation between segments, cost allocating and sharing of certain assets. As such, the Company makes no representation, that if operated on a standalone basis, these segments would report net sales, operating profit and other financial data reflected below.

Segment information is summarized as follows:

|                                     | Quarter Ended        |                    | Nine Months Ended    |                     |
|-------------------------------------|----------------------|--------------------|----------------------|---------------------|
|                                     | September 1,<br>2012 | August 27,<br>2011 | September 1,<br>2012 | August 27,<br>2011  |
| Net sales:                          |                      |                    |                      |                     |
| Engine/Mobile Filtration            | \$ 126,903           | \$ 129,467         | \$ 377,863           | \$ 372,071          |
| Industrial/Environmental Filtration | 138,532              | 132,380            | 394,275              | 377,998             |
| Packaging                           | 21,298               | 22,972             | 56,714               | 69,003              |
|                                     | \$ 286,733           | \$ 284,819         | \$ 828,852           | \$ 819,072          |
| Operating profit:                   |                      |                    |                      |                     |
| Engine/Mobile Filtration            | \$ 28,478            | \$ 30,175          | \$ 81,403            | \$ 80,969           |
| Industrial/Environmental Filtration | 15,741               | 13,650             | 44,193               | 37,077              |
| Packaging                           | 1,962                | 2,636              | 4,008                | 8,486               |
|                                     | 46,181               | 46,461             | 129,604              | 126,532             |
| Other income (expense), net         | (206                 | ) 99               | 404                  | (318                |
| Earnings before income taxes        | \$ 45,975            | \$ 46,560          | \$ 130,008           | \$ 126,214          |
|                                     |                      |                    | September 1,<br>2012 | December 3,<br>2011 |
| Identifiable assets:                |                      |                    |                      |                     |
| Engine/Mobile Filtration            |                      |                    | \$ 362,870           | \$ 338,197          |
| Industrial/Environmental Filtration |                      |                    | 704,820              | 693,266             |
| Packaging                           |                      |                    | 39,930               | 39,571              |
| Corporate                           |                      |                    | 73,799               | 63,899              |
|                                     |                      |                    | \$ 1,181,419         | \$ 1,134,933        |



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

The information presented in this discussion should be read in conjunction with other financial information provided in the Consolidated Condensed Financial Statements and accompanying notes and with the audited Consolidated Financial Statements and accompanying notes included in the 2011 Form 10-K. Except as otherwise set forth herein, references to particular years refer to our applicable fiscal year. The analysis of operating results focuses on our three reportable business segments: Engine/Mobile Filtration, Industrial/Environmental Filtration and Packaging.

## EXECUTIVE SUMMARY

Management Discussion Snapshot  
(In thousands except per share data)

|  | Third Quarter |           |           |         |  | First Nine Months |           |         |         |  |
|--|---------------|-----------|-----------|---------|--|-------------------|-----------|---------|---------|--|
|  | 2012          | 2011      | Change    |         |  | 2012              | 2011      | Change  |         |  |
|  |               |           | \$        | %       |  |                   |           | \$      | %       |  |
| Net sales  | \$286,733     | \$284,819 | \$1,914   | 1 %     |  | \$828,852         | \$819,072 | \$9,780 | 1 %     |  |
| Cost of sales                                      | 191,845       | 188,945   | 2,900     | 2 %     |  | 549,563           | 542,783   | 6,780   | 1 %     |  |
| Gross profit                                       | 94,888        | 95,874    | (986 )    | -1 %    |  | 279,289           | 276,289   | 3,000   | 1 %     |  |
| Selling and administrative expenses                | 48,707        | 49,413    | (706 )    | -1 %    |  | 149,685           | 149,757   | (72 )   | — %     |  |
| Operating profit                                   | 46,181        | 46,461    | (280 )    | -1 %    |  | 129,604           | 126,532   | 3,072   | 2 %     |  |
| Other income (expense)                             | (206 )        | 99        | (305 )    |         |  | 404               | (318 )    | 722     |         |  |
| Provision for income taxes                         | 15,564        | 14,401    | 1,163     | 8 %     |  | 43,026            | 39,253    | 3,773   | 10 %    |  |
| Net earnings attributable to CLARCOR               | 30,270        | 32,070    | (1,800 )  | -6 %    |  | 86,676            | 86,759    | (83 )   | — %     |  |
| Weighted average diluted shares                    | 50,864        | 51,200    | (336 )    | -1 %    |  | 50,980            | 51,257    | (277 )  | -1 %    |  |
| Diluted earnings per share attributable to CLARCOR | \$0.60        | \$0.63    | \$(0.03 ) | -5 %    |  | \$1.70            | \$1.69    | \$0.01  | 1 %     |  |
| Percentages:                                       |               |           |           |         |  |                   |           |         |         |  |
| Gross margin                                       | 33.1 %        | 33.7 %    |           | -0.6 pt |  | 33.7 %            | 33.7 %    |         | — pt    |  |
| Selling and administrative percentage              | 17.0 %        | 17.4 %    |           | -0.4 pt |  | 18.1 %            | 18.3 %    |         | -0.2 pt |  |
| Operating margin                                   | 16.1 %        | 16.3 %    |           | -0.2 pt |  | 15.6 %            | 15.4 %    |         | 0.2 pt  |  |
| Effective tax rate                                 | 33.9 %        | 30.9 %    |           | 3.0 pt  |  | 33.1 %            | 31.1 %    |         | 2.0 pt  |  |
| Net earnings margin                                | 10.6 %        | 11.3 %    |           | -0.7 pt |  | 10.5 %            | 10.6 %    |         | -0.1 pt |  |

Third Quarter

Net Sales

Net sales increased \$1.9 million, or 1%, in the third quarter of 2012 from the third quarter of 2011. Estimated components of this 1% increase in net sales are as follows:

|                  |     |    |
|------------------|-----|----|
| Volume           | 2   | %  |
| Pricing          | 1   | %  |
| Foreign exchange | (2) | )% |
|                  | 1   | %  |

Our \$1.9 million, or 1%, increase in net sales in the third quarter of 2012 from the third quarter of 2011 was due to a \$6.2 million, or 5%, increase in net sales at our Industrial/Environmental Filtration segment partially offset by a \$2.6 million, or 2%, reduction in net sales at our Engine/Mobile Filtration segment and a \$1.7 million, or 7%, reduction in net sales at our Packaging segment.

The 5% increase in net sales at our Industrial/Environmental Filtration segment was influenced by 11% higher foreign sales and a 2% increase in sales within the U.S. Foreign sales, which increased 20% when adjusted for changes in foreign currency, were driven by higher natural gas vessel and aftermarket filter sales in Asia and other geographies throughout the world including sales arising from our acquisition of Modular Engineering in Australia in the second quarter of 2012. The 2% increase in U.S. sales in this segment was primarily the result of higher sales at our Total Filtration Services (TFS) distribution business and higher natural gas vessel and aftermarket filter sales offset by lower sales of aviation and marine fuel filtration vessels and aftermarket filters to both commercial and military customers and lower sales of filtration media to third-party customers.

The 2% decline in net sales at our Engine/Mobile Filtration segment was the result of a 1% decline in U.S. sales and a 3% reduction in sales outside the U.S. Lower growth in the U.S. was due to continued softness in heavy-duty engine filter order volume from our independent distributors--our primary distribution channel. The 3% reduction in foreign sales was negatively influenced by changes in foreign currency exchange rates. When adjusted for foreign currency, sales outside the U.S. increased 2% compared with the third quarter of 2011. These higher foreign sales were the result of higher sales in Europe and Africa and increased export sales of heavy-duty engine filtration products from the U.S.

The 7% reduction in net sales at our Packaging segment was primarily driven by lower confection and smokeless tobacco packaging sales. The reduction in confection packaging sales was due to business lost at the end of 2011 from a large customer. The decline in smokeless tobacco packaging sales was due to one of our customers qualifying a second sourced supplier at the end of 2011, which we believe was due to their corporate policy.

#### Cost of Sales

Our cost of sales increased \$2.9 million, or 2%, in the third quarter of 2012 from the third quarter of 2011. This increase was greater than the 1% increase in net sales. As a result, our cost of sales as percentage of net sales increased to 66.9% from 66.3% in the third quarter of 2011. Our material costs increased approximately 1% from the third quarter of 2011. However, we were effectively able to pass through these higher material costs through 1% higher pricing to our customers. As a result, our material cost as a percentage of net sales remained relatively flat in the third quarter of 2012 compared with the last year's third quarter. All other manufacturing costs including direct labor and manufacturing overhead increased 5% compared with the 1% increase in net sales from the third quarter of 2011. As a result, our gross margin percentage in the third quarter of 2012 declined to 33.1% from 33.7% in last year's third quarter.

#### Selling and Administrative Expenses

Selling and administrative expenses declined \$0.7 million, or 1%, in the third quarter of 2012 from the third quarter of 2011. This reduction was primarily the result of lower compensation expense related to our company-wide profit sharing program partially offset by higher employee costs to support anticipated future growth and higher bad debt expense due to a significant recovery in the third quarter of 2011. Since selling and administrative expenses decreased 1% while sales increased 1%, our selling and administrative expenses as a percentage of net sales decreased to 17.0% in the third quarter of 2012 from 17.4% in last year's third quarter.



## First Nine Months

## Net Sales

Net sales increased \$9.8 million, or 1%, in the first nine months of 2012 from the first nine months of 2011. Estimated components of this 1% increase in net sales are as follows:

|                  |     |    |
|------------------|-----|----|
| Volume           | 1   | %  |
| Pricing          | 1   | %  |
| Foreign exchange | (1) | )% |
|                  | 1   | %  |

Our \$9.8 million, or 1%, increase in net sales was due to a combined \$22.1 million, or 3%, increase in net sales at our Engine/Mobile Filtration and Industrial/Environmental Filtration segments partially offset by a \$12.3 million, or 18%, reduction in net sales at our Packaging segment.

Net sales at our Engine/Mobile Filtration segment increased 2%, including a 3% increase in U.S. sales and a 1% reduction in foreign sales. Our growth in the U.S. was driven by strong heavy-duty engine filter aftermarket demand in the first quarter partially offset by slower sales growth rates in the second and third quarters. Lower foreign sales were negatively influenced by changes in foreign currency exchange rates.

- When adjusted for foreign currency, sales outside the U.S. increased 2% in the first nine months of 2012--heavily influenced by strong heavy-duty engine filtration product export growth offset by a decline in heavy-duty engine filter sales in China due to lower diesel engine manufacturing volume.

Net sales at our Industrial/Environmental Filtration segment increased 4%, including a 5% increase in the U.S. and a 3% increase in foreign markets. Higher sales in the U.S. were primarily the result of higher sales at our Total Filtration Services (TFS) distribution business and higher natural gas vessel sales to support shale gas drilling activity partially offset by lower sales of aviation and marine fuel filtration vessels and aftermarket filters to both commercial and military customers. The 3% increase in foreign sales was negatively influenced by changes in foreign currency exchange rates. When adjusted for foreign currency, sales outside the U.S. increased 9% compared with the first nine months of 2011. These higher foreign sales were driven by higher natural gas vessel and aftermarket filter sales in Asia and other geographies throughout the world including sales arising from our acquisition of Modular Engineering in Australia in the second quarter of 2012.

The \$12.3 million, or 18%, reduction in net sales at our Packaging segment was primarily driven by lower smokeless tobacco and confection packaging sales and lower sales in other markets due to inventory and production scheduling adjustments by our customers. The decline in smokeless tobacco packaging sales was due to one of our customers qualifying a second sourced supplier at the end of 2011 which we believe was due to their corporate policy, and the reduction in confection packaging sales was due to lost business from a large customer at the end of 2011.

## Cost of Sales

Our cost of sales increased \$6.8 million, or 1%, in the first nine months of 2012 from the first nine months of 2011. This 1% increase in cost of sales was in line with our 1% increase in net sales. As a result, our cost of sales as a percentage of net sales remained constant at 66.3%. Our material costs increased approximately 2% from the first nine months of 2011. However, we were effectively able to pass through these higher material costs through 1% higher pricing to our customers. As a result, our material costs as a percentage of net sales remained relatively constant in the first nine months of 2012 from the first nine months last year. All other manufacturing costs including direct labor and

manufacturing overhead increased consistent with the 1% increase in net sales from the first nine months of 2011. As a result, our gross margin percentage in the first nine months of 2012 remained unchanged from 33.7% in the first nine months of 2011.

## Selling and Administrative Expenses

Selling and administrative expenses declined less than 1% in the first nine months of 2012 from the first nine months of 2011. This reduction was primarily the result of lower compensation expense related to our company-wide profit sharing program, partially offset by higher employee costs, higher bad debt expense in part due to a significant recovery in the third quarter of 2011 and a payment for the settlement of a patent dispute in the first quarter of 2012. Since selling and administrative expenses declined less than 1% while net sales increased 1%, our selling and administrative expenses as a percentage of net sales declined to 18.1% from 18.3% in the first nine months of last year.

## Other Items

Other significant items impacting the comparison between the periods presented are as follows:

### Acquisitions

The acquisition of PDDA Filtration, Inc. ("PDDA") on December 30, 2011 and the acquisition of Modular Engineering Company Pty Ltd. ("Modular") on May 9, 2012 increased our 2012 net sales and operating profit as follows:

| (Dollars in thousands) | Third Quarter | First Nine Months |
|------------------------|---------------|-------------------|
| Net sales              | \$3,882       | \$6,185           |
| Operating profit       | 261           | 387               |

### Foreign Exchange

The average exchange rate for foreign currencies versus the U.S. dollar unfavorably impacted our 2012 translated U.S. dollar value of net sales and operating profit compared to the same periods in 2011 as follows:

| (Dollars in thousands) | Third Quarter | First Nine Months |
|------------------------|---------------|-------------------|
| Net sales              | \$(5,784)     | \$(10,452)        |
| Operating profit       | (952)         | (1,796)           |

### Other income (expense)

#### Interest expense

Net interest expense in the third quarter and the first nine months of each 2012 and 2011 was not significant.

#### Foreign currency gains (losses)

We recognized foreign currency gains (losses) in other income (expense) as follows:

| (Dollars in thousands) | Third Quarter | First Nine Months |
|------------------------|---------------|-------------------|
| 2012                   | \$(184)       | \$(701)           |
| 2011                   | 126           | (284)             |

#### Other income (expense)

Other income (expense) in the first nine months of 2012 included the receipt of a \$1.2 million dividend pursuant to our investment in BioProcess Algae LLC.





Provisions for income taxes

Our higher effective tax rates for the third quarter and first nine months of 2012 compared with the same periods in 2011 were primarily due to the research and experimentation tax credit not being renewed for 2012 and a \$1.0 million tax benefit related to the release of a valuation allowance at a foreign subsidiary in 2011 that did not recur in 2012. This \$1.0 million tax benefit lowered the third quarter 2011 average tax rate by approximately 2.2 percentage points.

Shares outstanding

Average diluted shares outstanding declined 0.3 million shares in both the third quarter and first nine months of 2012 compared with the same prior year periods as our repurchases of common stock were only partially offset by incremental dilutive shares related to the issuance of stock options and restricted shares.

SEGMENT ANALYSIS

| (Dollars in thousands)              | Third Quarter |         |           |         | First Nine Months |         |           |         |
|-------------------------------------|---------------|---------|-----------|---------|-------------------|---------|-----------|---------|
|                                     | 2012          | % Total | 2011      | % Total | 2012              | % Total | 2011      | % Total |
| Net sales:                          |               |         |           |         |                   |         |           |         |
| Engine/Mobile Filtration            | \$126,903     | 44 %    | \$129,467 | 45 %    | \$377,863         | 46 %    | \$372,071 | 45 %    |
| Industrial/Environmental Filtration | 138,532       | 48 %    | 132,380   | 46 %    | 394,275           | 48 %    | 377,998   | 46 %    |
| Packaging                           | 21,298        | 8 %     | 22,972    | 9 %     | 56,714            | 6 %     | 69,003    | 9 %     |
|                                     | \$286,733     | 100 %   | \$284,819 | 100 %   | \$828,852         | 100 %   | \$819,072 | 100 %   |
| Gross profit:                       |               |         |           |         |                   |         |           |         |
| Engine/Mobile Filtration            | \$45,830      | 48 %    | \$48,474  | 51 %    | \$137,565         | 49 %    | \$136,869 | 50 %    |
| Industrial/Environmental Filtration | 44,963        | 47 %    | 42,489    | 44 %    | 131,132           | 47 %    | 123,556   | 45 %    |
| Packaging                           | 4,095         | 5 %     | 4,911     | 5 %     | 10,592            | 4 %     | 15,864    | 5 %     |
|                                     | \$94,888      | 100 %   | \$95,874  | 100 %   | \$279,289         | 100 %   | \$276,289 | 100 %   |
| Operating profit:                   |               |         |           |         |                   |         |           |         |
| Engine/Mobile Filtration            | \$28,478      | 62 %    | \$30,175  | 65 %    | \$81,403          | 63 %    | \$80,969  | 64 %    |
| Industrial/Environmental Filtration | 15,741        | 34 %    | 13,650    | 29 %    | 44,193            | 34 %    | 37,077    | 29 %    |
| Packaging                           | 1,962         | 4 %     | 2,636     | 6 %     | 4,008             | 3 %     | 8,486     | 7 %     |
|                                     | \$46,181      | 100 %   | \$46,461  | 100 %   | \$129,604         | 100 %   | \$126,532 | 100 %   |
| Gross margin:                       |               |         |           |         |                   |         |           |         |
| Engine/Mobile Filtration            | 36.1          | %       | 37.4      | %       | 36.4              | %       | 36.8      | %       |
| Industrial/Environmental Filtration | 32.5          | %       | 32.1      | %       | 33.3              | %       | 32.7      | %       |
| Packaging                           | 19.2          | %       | 21.4      | %       | 18.7              | %       | 23.0      | %       |
|                                     | 33.1          | %       | 33.7      | %       | 33.7              | %       | 33.7      | %       |

Operating margin:

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|                                     |      |   |      |   |      |   |      |   |
|-------------------------------------|------|---|------|---|------|---|------|---|
| Engine/Mobile Filtration            | 22.4 | % | 23.3 | % | 21.5 | % | 21.8 | % |
| Industrial/Environmental Filtration | 11.4 | % | 10.3 | % | 11.2 | % | 9.8  | % |
| Packaging                           | 9.2  | % | 11.5 | % | 7.1  | % | 12.3 | % |
|                                     | 16.1 | % | 16.3 | % | 15.6 | % | 15.4 | % |

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## Engine/Mobile Filtration Segment

| (Dollars in thousands)                | Third Quarter     |           | Change    |      |    |
|---------------------------------------|-------------------|-----------|-----------|------|----|
|                                       | 2012              | 2011      | \$        | %    |    |
| Net sales                             | \$126,903         | \$129,467 | \$(2,564) | -2   | %  |
| Cost of sales                         | 81,073            | 80,993    | 80        | —    | %  |
| Gross profit                          | 45,830            | 48,474    | (2,644)   | -5   | %  |
| Selling and administrative expenses   | 17,352            | 18,299    | (947)     | -5   | %  |
| Operating profit                      | 28,478            | 30,175    | (1,697)   | -6   | %  |
| Gross margin                          | 36.1%             | 37.4%     |           | -1.3 | pt |
| Selling and administrative percentage | 13.7%             | 14.1%     |           | -0.4 | pt |
| Operating margin                      | 22.4%             | 23.3%     |           | -0.9 | pt |
|                                       | First Nine Months |           | Change    |      |    |
| (Dollars in thousands)                | 2012              | 2011      | \$        | %    |    |
| Net sales                             | \$377,863         | \$372,071 | \$5,792   | 2    | %  |
| Cost of sales                         | 240,298           | 235,202   | 5,096     | 2    | %  |
| Gross profit                          | 137,565           | 136,869   | 696       | 1    | %  |
| Selling and administrative expenses   | 56,162            | 55,900    | 262       | —    | %  |
| Operating profit                      | 81,403            | 80,969    | 434       | 1    | %  |
| Gross margin                          | 36.4%             | 36.8%     |           | -0.4 | pt |
| Selling and administrative percentage | 14.9%             | 15.0%     |           | -0.1 | pt |
| Operating margin                      | 21.5%             | 21.8%     |           | -0.3 | pt |

Our Engine/Mobile Filtration segment primarily sells aftermarket filters for heavy-duty trucks and off-highway vehicles, locomotives and automobiles. The largest market included in this segment includes heavy-duty engine truck filters produced at our Baldwin business unit.

## Net Sales

The changes in net sales for our Engine/Mobile Filtration segment in the third quarter and nine months year to date of 2012 from comparable periods in 2011 are detailed in the following tables:

|                  | Third Quarter |    | First Nine Months |    |
|------------------|---------------|----|-------------------|----|
|                  |               | %  |                   | %  |
| Volume           | —             | %  | 2                 | %  |
| Pricing          | —             | %  | 1                 | %  |
| Foreign exchange | (2)           | )% | (1)               | )% |
|                  | (2)           | )% | 2                 | %  |

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| (Dollars in thousands)               | Third Quarter | First Nine Months |
|--------------------------------------|---------------|-------------------|
| 2011                                 | \$ 129,467    | \$ 372,071        |
| U.S. net sales                       | (871 )        | 7,599             |
| Foreign net sales (including export) | 964           | 2,661             |
| Foreign exchange                     | (2,657 )      | (4,468 )          |
| Net (decrease) increase              | (2,564 )      | 5,792             |
| 2012                                 | \$ 126,903    | \$ 377,863        |

The net changes in U.S. net sales for our Engine/Mobile Filtration segment in the third quarter and nine months year to date of 2012 from comparable periods in 2011 are detailed as follows:

| (Dollars in thousands)                | Third Quarter | First Nine Months |
|---------------------------------------|---------------|-------------------|
| Heavy-duty engine filters             | \$(1,687 )    | \$6,337           |
| Locomotive filters                    | 516           | 364               |
| Other                                 | 300           | 898               |
| (Decrease) increase in U.S. net sales | \$(871 )      | \$7,599           |

Our U.S. net sales declined 1% in the third quarter but increased 2% in the first nine months of 2012 compared with the same periods in 2011. The 1% decline in U.S. net sales in the third quarter of 2012 was primarily the result of lower heavy-duty engine filtration product sales partially offset by higher sales of locomotive filters to support Class I railroad customers. The reduction in third quarter net sales of heavy-duty engine filters was driven by lower year-over-year demand from our U.S. independent distributors--our primary distribution channel. We believe that our independent distributors have been negatively impacted by slower current and expected future industry demand. However, we believe we have maintained our market share through the first nine months of 2012 as we have added independent distributors on a net basis, and we have recently developed and launched significant aftermarket programs with major original equipment manufacturers. We launched these programs in the third quarter of 2012, but the full aftermarket sales potential of these programs is not expected to be realized until the end of 2013. The 2% growth in U.S. net sales in the first nine months of 2012 was the result of 12% growth in the first quarter offset by slower growth in both the second and third quarters due to slower industry demand.

To further illustrate the drivers behind our net sales results, the net changes in foreign net sales (adjusted for changes in foreign currency) for our Engine/Mobile Filtration segment in the third quarter and nine months year to date of 2012 from comparable periods in 2011 are detailed as follows:

| (Dollars in thousands)  | Third Quarter | First Nine Months |
|---|---------------|-------------------|
| Local sales in Europe, North and South Africa, Australia and Mexico                 | \$461         | \$2,800           |
| China first-fit OEM filter sales  | 236           | (4,110 )          |
| Export sales primarily to Canada, Southeast Asia, South America and the Middle East | 228           | 3,953             |
| Other   | 39            | 18                |
| Increase in foreign net sales   | \$964         | \$2,661           |

Lower heavy-duty engine filter sales in China in the first nine months of 2012 were primarily the result of a reduction in local diesel engine manufacturing volume in 2012 compared with 2011 due to macroeconomic issues.



## Cost of Sales

Cost of sales increased slightly in the third quarter of 2012 compared with the third quarter of 2011 despite a 2% reduction in net sales. Our material costs declined approximately 1% while our pricing remained flat compared with the third quarter of 2011. As a result, our material cost as a percentage of net sales remained relatively flat from the third quarter of 2011. Other components of cost of sales, including direct labor and manufacturing overhead, increased about 2% while net sales declined 2% primarily reflecting lower absorption of fixed manufacturing costs due to lower net sales. As a result, costs of sales as a percentage of net sales increased to 63.9% in the third quarter of 2012 from 62.6% in last year's third quarter.

Cost of sales increased \$5.1 million, or 2%, in the first nine months of 2012 from the first nine months of 2011. This increase was primarily the result of the 2% increase in net sales in the first nine months of 2012 compared with the same period last year. Although material costs increased about 1%, we were able to pass through these higher material costs to our customers through 1% higher pricing. As a result, our material cost as a percentage of net sales increased only slightly in the first nine months of 2012 compared with the first nine months of 2011. Other components of cost of sales including direct labor and manufacturing overhead increased less than 3% while net sales increased 2%. As a result, costs of sales as a percentage of net sales increased to 63.6% in the first nine months of 2012 from 63.2% in the first nine months of 2011.

## Selling and Administrative Expenses

Selling and administrative expenses decreased \$0.9 million, or less than 5%, in the third quarter of 2012 from the third quarter of 2011. This reduction was primarily the result of lower incentive compensation and legal expenses, due to the settlement of various legal proceedings in previous quarters, offset by higher employee costs. With selling and administrative expenses in this segment declining 5% while our net sales declined 2%, our selling and administrative expenses as a percentage of net sales declined to 13.7% in the third quarter of 2012 from 14.1% in the third quarter of 2011.

Selling and administrative expenses increased \$0.3 million, or less than 1%, in the first nine months of 2012 from the first nine months of 2011. This increase was primarily the result of higher employee costs to support anticipated future domestic and foreign growth and a payment for the settlement of a patent dispute partially offset by lower legal expenses, due to the settlement of various legal proceedings, and lower incentive compensation expense. With selling and administrative expenses increasing less than 1% while our net sales increased 2%, our selling and administrative expenses as a percentage of net sales declined to 14.9% in the first nine months of 2012 from 15.0% in the first nine months of 2011.

## Industrial/Environmental Filtration Segment

| (Dollars in thousands)              | Third Quarter |            | Change   |     |    |
|-------------------------------------|---------------|------------|----------|-----|----|
|                                     | 2012          | 2011       | \$       | %   |    |
| Net sales                           | \$ 138,532    | \$ 132,380 | \$ 6,152 | 5   | %  |
| Cost of sales                       | 93,569        | 89,891     | 3,678    | 4   | %  |
| Gross profit                        | 44,963        | 42,489     | 2,474    | 6   | %  |
| Selling and administrative expenses | 29,222        | 28,839     | 383      | 1   | %  |
| Operating profit                    | 15,741        | 13,650     | 2,091    | 15  | %  |
| Gross margin                        | 32.5%         | 32.1%      |          | 0.4 | pt |

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|                                       |       |       |      |    |
|---------------------------------------|-------|-------|------|----|
| Selling and administrative percentage | 21.1% | 21.8% | -0.7 | pt |
| Operating margin                      | 11.4% | 10.3% | 1.1  | pt |

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| (Dollars in thousands)                | First Nine Months |           | Change   |      |    |
|---------------------------------------|-------------------|-----------|----------|------|----|
|                                       | 2012              | 2011      | \$       | %    |    |
| Net sales                             | \$394,275         | \$377,998 | \$16,277 | 4    | %  |
| Cost of sales                         | 263,143           | 254,442   | 8,701    | 3    | %  |
| Gross profit                          | 131,132           | 123,556   | 7,576    | 6    | %  |
| Selling and administrative expenses   | 86,939            | 86,479    | 460      | 1    | %  |
| Operating profit                      | 44,193            | 37,077    | 7,116    | 19   | %  |
| Gross margin                          | 33.3%             | 32.7%     |          | 0.6  | pt |
| Selling and administrative percentage | 22.1%             | 22.9%     |          | -0.8 | pt |
| Operating margin                      | 11.2%             | 9.8%      |          | 1.4  | pt |

Our Industrial/Environmental Filtration segment sells a variety of filtration products to various end-markets. Included in this market are HVAC filters, natural gas vessels and aftermarket filters, aviation fuel filters and filter systems, and other markets including oil drilling, aerospace, fibers and resins and dust collector systems.

#### Net Sales

The changes in net sales for our Industrial/Environmental Filtration segment in the third quarter and nine months year to date of 2012 from comparable periods in 2011 are detailed in the following tables:

|                  | Third Quarter |    | First Nine Months |    |
|------------------|---------------|----|-------------------|----|
| Volume           | 6             | %  | 4                 | %  |
| Pricing          | 1             | %  | 2                 | %  |
| Foreign exchange | (2            | )% | (2                | )% |
|                  | 5             | %  | 4                 | %  |

| (Dollars in thousands)               | Third Quarter | First Nine Months |        |   |
|--------------------------------------|---------------|-------------------|--------|---|
| 2011                                 | \$132,380     | \$377,998         |        |   |
| U.S. net sales                       | 2,346         | 12,788            |        |   |
| Foreign net sales (including export) | 6,932         | 9,473             |        |   |
| Foreign exchange                     | (3,126        | )                 | (5,984 | ) |
| Net increase                         | 6,152         | 16,277            |        |   |
| 2012                                 | \$138,532     | \$394,275         |        |   |



The net changes in U.S. net sales for our Industrial/Environmental Filtration segment in the third quarter and nine months year to date of 2012 from comparable periods in 2011 are detailed as follows:

| (Dollars in thousands)                                 | Third Quarter | First Nine Months |
|--|---------------|-------------------|
| Filter sales through Total Filtration Services ("TFS") | \$2,698       | \$7,894           |
| Natural gas - vessels and aftermarket filters          | 2,525         | 4,671             |
| Dust collector systems                                 | 903           | 2,144             |
| Filtration media sales through TransWeb                | (1,579 )      | (1,950 )          |
| Air filtration   | (1,259 )      | 379               |
| Aviation - vessels and aftermarket filters             | (630 )        | (2,439 )          |
| Aerospace, oil drilling and other industrial filters   | (419 )        | 2,022             |
| Other  | 107           | 67                |
| Increase in U.S. net sales                             | \$2,346       | \$12,788          |

Higher sales at TFS were in part the result of the acquisition of PDDA Filtration, Inc. in the first quarter of 2012 which contributed \$0.9 million of U.S. net sales in the third quarter and \$2.7 million in the first nine months of 2012. The balance of the net sales increase at TFS was the result of higher filter sales to a variety of markets including automotive, metals, food and beverage, oil and gas, chemical and general industrial.

Higher sales in the natural gas market in the third quarter and first nine months of 2012 compared with the same periods last year were primarily due to higher vessel and aftermarket filter sales to support natural gas drilling, processing and delivery from shale formations

Higher dust collector system sales were the result of higher OEM sales of Dust Hog® products including weld fume collection systems

Lower sales of filtration media at TransWeb is primarily the result of lower order volume from a significant customer due to slower industry demand in the end-market it serves

- Sales of air filtration products declined in the third quarter of 2012 from last year's third quarter primarily due to the loss of a low margin retail account and lower swine filtration product sales pursuant to the negative impact of the summer drought in the U.S. Higher sales in the first nine months of 2012 were driven by sales from a significant new commercial customer commencing in the third quarter of 2011 and the impact of a price increase in the first half of 2012 partially offset by lower retail and swine filtration product sales.

Lower sales in the aviation and marine fuel filtration markets in the third quarter and the first nine months of 2012 were the result of reduced sales to both commercial and military customers. Lower sales in commercial aviation were due to lower aftermarket filter demand as several airports have removed fueling equipment from service in addition to lower vessel demand as the pace of airport build and expansion in the U.S. has declined. The reduction in U.S. military aviation and marine sales was primarily due to the significant decline in U.S. military operations around the world.

- Lower sales to the aerospace, oil drilling and other industrial markets in the third quarter of 2012 were primarily due to lower filtration sales to the commercial aerospace market as a primary customer adjusted its inventory levels. Higher sales in the first nine months of 2012 were driven by higher sales of off-shore oil drilling filtration products and higher general industrial filter sales.



To further illustrate the drivers behind our net sales results, the net changes in foreign net sales (adjusted for changes in foreign currency) for our Industrial/Environmental Filtration segment in the third quarter and nine months year to date of 2012 from comparable periods in 2011 are detailed as follows:

| (Dollars in thousands)   | Third Quarter | First Nine Months |
|--|---------------|-------------------|
| Natural gas vessel and aftermarket filter sales (Asia, Mexico, Canada) | \$3,438       | \$7,726           |
| Acquisition of Modular Engineering Company (Australia)                 | 3,043         | 3,660             |
| Aviation vessel and aftermarket filter sales (Europe)                  | 443           | (1,362 )          |
| Dust collector sales (Europe)  | 182           | 2,186             |
| Off-shore oil drilling filter export sales (Europe, Asia)              | 435           | (2,555 )          |
| Other  | (609 )        | (182 )            |
| Increase in foreign net sales  | \$6,932       | \$9,473           |

#### Cost of Sales

Cost of sales increased \$3.7 million, or 4%, in the third quarter of 2012 from the third quarter of 2011 while net sales increased 5%. As a result, our cost of sales as a percentage of net sales declined to 67.5% in the third quarter of 2012 from 67.9% in the third quarter of 2011. Although material costs increased about 2%, we were able to pass through these higher material costs to our customers through 1% higher pricing. As a result, our material cost as a percentage of net sales remained relatively flat compared with the third quarter of 2011. Other components of cost of sales including direct labor and manufacturing overhead increased in-line with the 5% increase in net sales.

Cost of sales increased \$8.7 million, or 3%, in the first nine months of 2012 from the first nine months of 2011 while net sales increased 4%. As a result, our cost of sales as a percentage of net sales declined to 66.7% from 67.3% in the first nine months of 2011. Although material cost increased about 3%, we were able to pass through these higher material costs to our customers through 2% higher pricing. As a result, our material cost as a percentage of net sales remained relatively flat compared with the first nine months of 2011. Other components of cost of sales including direct labor and manufacturing overhead increased 3% or less than the 4% increase in net sales--reflective of labor efficiencies and overhead absorption benefits driven by the higher volume.

#### Selling and Administrative Expenses

Selling and administrative expenses increased \$0.4 million, or 1%, in the third quarter of 2012 from the third quarter of 2011. This increase was primarily the result of a significant bad debt recovery in last year's third quarter. With selling and administrative expenses increasing 1% while our net sales increased 5%, we reduced our selling and administrative expenses as a percentage of net sales to 21.1% in the third quarter of 2012 from 21.8% in last year's third quarter.

Selling and administrative expenses increased \$0.5 million, or 1%, in the first nine months of 2012 from the first nine months of 2011. This increase was primarily the result of a significant bad debt recovery in last year's third quarter. With selling and administrative expenses increasing less than 1% while our net sales increased 4%, we reduced our selling and administrative expenses as a percentage of net sales to 22.1% in the first nine months of 2012 from 22.9% in the first nine months of last year.

## Packaging Segment

| (Dollars in thousands)                | Third Quarter     |          | Change     |      |    |
|---------------------------------------|-------------------|----------|------------|------|----|
|                                       | 2012              | 2011     | \$         | %    |    |
| Net sales                             | \$21,298          | \$22,972 | \$(1,674)  | -7   | %  |
| Cost of sales                         | 17,203            | 18,061   | (858)      | -5   | %  |
| Gross profit                          | 4,095             | 4,911    | (816)      | -17  | %  |
| Selling and administrative expenses   | 2,133             | 2,275    | (142)      | -6   | %  |
| Operating profit                      | 1,962             | 2,636    | (674)      | -26  | %  |
| Gross margin                          | 19.2%             | 21.4%    |            | -2.2 | pt |
| Selling and administrative percentage | 10.0%             | 9.9%     |            | 0.1  | pt |
| Operating margin                      | 9.2%              | 11.5%    |            | -2.3 | pt |
|                                       | First Nine Months |          | Change     |      |    |
| (Dollars in thousands)                | 2012              | 2011     | \$         | %    |    |
| Net sales                             | \$56,714          | \$69,003 | \$(12,289) | -18  | %  |
| Cost of sales                         | 46,122            | 53,139   | (7,017)    | -13  | %  |
| Gross profit                          | 10,592            | 15,864   | (5,272)    | -33  | %  |
| Selling and administrative expenses   | 6,584             | 7,378    | (794)      | -11  | %  |
| Operating profit                      | 4,008             | 8,486    | (4,478)    | -53  | %  |
| Gross margin                          | 18.7%             | 23.0%    |            | -4.3 | pt |
| Selling and administrative percentage | 11.5%             | 10.7%    |            | 0.8  | pt |
| Operating margin                      | 7.1%              | 12.3%    |            | -5.2 | pt |

Our Packaging segment manufactures and sells consumer and industrial packaging products.

## Net Sales

The \$1.7 million, or 7%, reduction in net sales in the third quarter and the \$12.3 million, or 18%, reduction in net sales in the first nine months of 2012 at our Packaging segment from comparable periods last year are detailed in the following table:

| (Dollars in thousands)      | Third Quarter | First Nine Months |
|-----------------------------|---------------|-------------------|
| Confection packaging        | \$(2,180)     | \$(5,038)         |
| Smokeless tobacco packaging | (1,087)       | (3,744)           |
| Spice packaging             | 912           | (160)             |
| Promotional packaging       | 520           | 230               |
| Film packaging              | 163           | (733)             |
| Decorated flat sheet metal  | 34            | (3,032)           |
| Other                       | (36)          | 188               |
| Decrease in U.S. net sales  | \$(1,674)     | \$(12,289)        |



The reduction in confection sales for the third quarter and the first nine months of 2012 was primarily due to the loss of a single product packaging business from a large customer at the end of 2011. Lower sales of smokeless tobacco packaging for the third quarter and the first nine months of 2012 was primarily due to one of our major customers having qualified a second supplier which we believe was due to their corporate policy. Lower film packaging sales in the first nine months of 2012 was driven by lower general demand for film products and also influenced by the bankruptcy of Kodak. Lower sales of decorated flat sheet metal in the first nine months of 2012 was due to lost business and lower general demand from several customers.

#### Cost of Sales

Cost of sales declined \$0.9 million, or 5%, in the third quarter of 2012 from the third quarter of 2011. This reduction was primarily driven by the 7% reduction in net sales. Cost of sales as a percentage of net sales increased to 80.8% in the third quarter of 2012 from 78.6% in the third quarter of 2011. This increase was primarily related to lower absorption of fixed manufacturing costs pursuant to the reduction in net sales partially offset by lower material costs as a percentage of net sales primarily from a change in product mix.

Cost of sales declined \$7.0 million, or 13%, in the first nine months of 2012 from the first nine months of 2011. This reduction was primarily driven by the 18% reduction in net sales. Cost of sales as a percentage of net sales increased to 81.3% in the first nine months of 2012 from 77.0% in the first nine months year of 2011. This increase was primarily related to lower absorption of fixed manufacturing costs pursuant to the reduction in net sales partially offset by lower material costs as a percentage of sales from a change in product mix.

#### Selling and Administrative Expenses

Selling and administrative expenses declined \$0.1 million, or 6%, in the third quarter of 2012 from the third quarter of 2011. Since the percentage reduction in selling and administrative expenses was less than the 7% reduction in net sales, selling and administrative expenses as percentage of net sales increased to 10.0% in the third quarter of 2012 from 9.9% in the third quarter of 2011.

Selling and administrative expenses declined \$0.8 million, or 11%, in the first nine months of 2012 from the first nine months of 2011. Since the percentage reduction in selling and administrative expenses was less than the 18% reduction in net sales, selling and administrative expenses as a percentage of net sale increased to 11.5% from 10.7% in the first nine months of 2012. The \$0.8 million reduction in selling and administrative expense was across many categories as we actively managed our discretionary costs in response to lower sales and was partially offset by \$0.2 million of bad debt expense recognized in the first quarter of 2012 pursuant to the Kodak bankruptcy.

### FINANCIAL CONDITION

#### Liquidity and Capital Resources

We believe that our operations will continue to generate cash and that sufficient cash, cash equivalents and borrowings under our Credit Facility will be available to fund operating needs, pay dividends, invest in the development of new products and filter media, fund planned capital expenditures, including the expansion of facilities, provide for interest and principal payments related to debt agreements, fund pension contributions and repurchase our common stock. We also continue to assess acquisition opportunities in related filtration businesses. Any such acquisitions could affect operating cash flows and require changes in our debt and capitalization.

We had cash, cash equivalents and restricted cash of \$166.2 million at the end of the third quarter of 2012. Approximately \$85.4 million of this cash was held at entities outside the U.S. Although we plan to use this cash at our non-U.S. entities, if we repatriated this cash to the U.S., we could incur significant tax expense since most of this cash is considered permanently invested for U.S. tax purposes. Cash and cash equivalents are held by financial institutions throughout the world. We regularly review the credit worthiness of these institutions and believe our funds are not at significant risk.

Our current ratio of 3.7 at the end of the third quarter of 2012 decreased from 3.8 at year-end 2011. This decrease was primarily due to a \$20.4 million increase to other current liabilities as a result of certain pension benefit payments that become due in fiscal 2013. This was partially offset by a \$9.8 million reduction in accounts payable and accrued liabilities due primarily to a \$11.2 million reduction in accrued incentive compensation for our company-wide profit sharing program as we paid amounts due under our 2011 profit-sharing program in the first quarter of 2012.

We entered into our new Credit Facility in April 2012 under which we may borrow up to \$150.0 million under a selection of currencies and rate formulas. Our Credit Facility includes an accordion feature that will allow us to increase the Credit Facility by up to \$100.0 million subject to securing additional commitments from existing lenders or new lending institutions. We believe the financial institutions that are party to this arrangement have adequate capital resources and will be able to fund future borrowings under our Credit Facility. At our election, the interest rate under our Credit Facility is based upon either a defined base rate or LIBOR plus an applicable margin. At the end of the third quarter of 2012, the one-month LIBOR interest rate plus margin was 0.8%. At the end of the third quarter of 2012, there were no borrowings outstanding on our Credit Facility, but we had approximately \$16.0 million outstanding on a \$50.0 million letter of credit sub-facility. Accordingly, we had \$134.0 million available for further borrowing at the end of the third quarter of 2012. Our Credit Facility expires in April 2017.

Total long-term debt of \$16.6 million at the end of the third quarter of 2012 included \$15.8 million outstanding on industrial revenue bonds and \$0.9 million of other long-term debt. At the end of the third quarter of 2012, we were in compliance with all financial covenants as included in our Credit Facility. We expect to be in compliance with these covenants in the foreseeable future. The ratio of total debt to total capitalization (defined as long-term debt plus total shareholders' equity) was 1.8% at the end of the third quarter of 2012 down from 2.0% at year-end 2011.

We had 50.1 million shares of common stock outstanding at the end of the third quarter of 2012, consistent with the amount outstanding at year-end 2011. Shares issued pursuant to stock incentive plans were offset by shares repurchased in the nine months year to date of 2012. Shareholders' equity increased to \$896.8 million at the end of the third quarter of 2012 from \$835.6 million at year-end 2011. This \$61.2 million increase resulted mainly from additional net earnings of \$86.7 million, items related to stock compensation and option activity pursuant to incentive plans of \$11.4 million, pension amounts affecting Accumulated other comprehensive loss of \$3.2 million partially offset by dividend payments of \$18.1 million, stock repurchases of \$16.7 million and currency translation adjustments of \$5.5 million.

#### Cash Flow

Net cash provided by operating activities increased \$10.5 million to \$79.8 million in the first nine months of 2012 from \$69.3 million in the first nine months of 2011. This increase was primarily due to a change of \$9.7 million in the non-cash adjustment for deferred taxes.

Net cash used in investing activities increased \$10.7 million in the first nine months of 2012 from the first nine months of 2011 primarily due to a \$12.7 million increase in capital expenditures primarily related to the expansion of our heavy-duty engine filter facility in Yankton, South Dakota, offset by a \$2.2 million decrease to Business acquisitions, net of cash acquired.

Net cash used in financing activities increased \$1.6 million in the first nine months of 2012 from the first nine months of 2011 primarily as the result of a \$2.2 million increase in dividends paid and a \$1.5 million decrease in cash paid for the repurchase of common stock.

We will continue to assess repurchases of our common stock. In June 2010, our Board of Directors authorized a \$250.0 million stock repurchase program of our common stock in the open market and through private transactions over a three-year period. During the first nine months of 2012, we repurchased and retired 0.3 million shares of our common stock for \$16.7 million at an approximate average price of \$49.51. At the end of the third quarter of 2012, there was approximately \$187.7 million available for repurchase under the current authorization. Future repurchases of our common stock may be made after considering cash flow requirements for internal growth, capital expenditures, acquisitions, interest rates and the market price of our common stock.



At the end of the third quarter of 2012, our gross liability for uncertain income tax provisions was \$2.9 million including interest and penalties. Due to the high degree of uncertainty regarding the timing of potential future cash outflows associated with these liabilities, we were unable to make a reasonably reliable estimate of the amount and period in which these remaining liabilities might be paid.

#### Off-Balance Sheet Arrangements

Our off-balance sheet arrangements relate to various operating leases as discussed in Note H to the Consolidated Financial Statements in our 2011 Form 10-K. We had no variable interest entity or special purpose entity agreements during the nine months year to date of 2012 or fiscal year 2011.

## OTHER MATTERS

### Critical Accounting Policies

Our critical accounting policies, including the assumptions and judgments underlying them, are disclosed in our 2011 Form 10-K in Management's Discussion and Analysis of Financial Condition and Results of Operations. There have been no material changes in our critical accounting policies set forth in our 2011 Form 10-K. These policies have been consistently applied in all material respects. While the estimates and judgments associated with the application of these policies may be affected by different assumptions or conditions, we believe the estimates and judgments associated with the reported amounts are appropriate in the circumstances.

### Environmental Matters and Climate Change and Energy Legislation and Regulation

Our operations are subject to U.S. and non-U.S. environmental laws and regulations governing emissions to air; discharges to water; the generation, handling, storage, transportation, treatment and disposal of waste materials; and the cleanup of contaminated properties. Currently, we believe that any potential environmental liabilities with respect to our former or existing operations are not material, but there is no assurance that we will not be adversely impacted by such liabilities, costs or claims in the future, either under present laws and regulations or those that may be adopted or imposed in the future.

Foreign, federal, state and local regulatory and legislative bodies have proposed various legislative and regulatory measures relating to climate change, regulating greenhouse gas emissions and energy policies. Due to the uncertainty in the regulatory and legislative processes, as well as the scope of such requirements and initiatives, we cannot currently determine the effect such legislation and regulation may have on our operations.

The potential physical impacts of climate change on our operations are also highly uncertain and would vary depending on type of physical impact and geographic location. Climate change physical impacts could include changing temperatures, water shortages, changes in weather and rainfall patterns, and changing storm patterns and intensities. The occurrence of one or more natural disasters, whether due to climate change or naturally occurring, such as tornadoes, hurricanes, earthquakes and other forms of severe weather in the U.S. or in a country in which we operate or in which our suppliers or customers are located could adversely impact our operations and financial performance. Such events could result in:

- physical damage to and complete or partial closure of one or more of our manufacturing facilities
- temporary or long-term disruption in the supply of raw materials from our suppliers
- disruption in the transport of our products to customers and end users
- delay in the delivery of our products to our customers

### Recent Relevant Accounting Pronouncements

A discussion of recent relevant accounting pronouncements is included in Note 1 to the Consolidated Condensed Financial Statements.

### Forward-Looking Information is Subject to Risk and Uncertainty

This Third Quarter 2012 Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. All statements made in this Form 10-Q, other than statements of historical fact, are forward-looking statements. You can identify these statements from use of the words “may,” “should,” “could,” “potential,” “continue,” “plan,” “forecast,” “estimate,” “project,” “believe,” “intent,” “anticipate,” “expect,” “target,” “is likely,” “will,” or the negative of these terms, and similar expressions. These statements are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. These forward-looking statements may include, among other things:

- statements and assumptions relating to anticipated future growth, earnings, earnings per share and other financial performance measures;
- statements regarding management's short-term and long-term performance goals;
- statements regarding anticipated order patterns from our customers or the anticipated economic conditions of the industries and markets that we serve;
- statements related to the performance of the U.S. and other economies generally;
- statements relating to the anticipated effects on results of operations or financial condition from recent and expected developments or events, including acquisitions;
- statements regarding our current cost structure positions and ability to capitalize on anticipated growth initiatives;
- statements related to whether the conditions to the Settlement Agreement will be satisfied or the timing of the satisfaction of such conditions, or related to whether final judicial approval of the Settlement Agreement will be obtained;
- statements related to sales potential of the launch of our new OEM aftermarket programs;
- statements related to future repurchases of our common stock;
- statements related to tax positions and unrecognized tax benefits;
- statements related to our cash resources, borrowing capacity and compliance with financial covenants under the Credit Facility;
- statements related to anticipated total litigation related amounts with respect to the 3M lawsuit referenced in [Note 11](#);
- and
- any other statements or assumptions that are not historical facts.

We believe that our expectations are based on reasonable assumptions. However, these forward-looking statements involve known and unknown risks, uncertainties and other important factors that could cause our actual results, performance or achievements, or industry results, to differ materially from our expectations of future results, performance or achievements expressed or implied by these forward-looking statements. These factors include, but are not only limited to, risks associated with: (1) world economic factors and the ongoing economic uncertainty impacting many regions of the world, (2) reductions in sales volume and orders, (3) our customers' financial condition, (4) currency fluctuations, particularly increases or decreases in the U.S. dollar against other currencies, (5) commodity price increases and/or limited availability of raw materials and component products, including steel, (6) compliance costs associated with environmental laws and regulations, (7) political factors, (8) our international operations, (9) highly competitive markets, (10) governmental laws and regulations, including the impact of the economic stimulus and financial reform measures being implemented by governments around the world, (11) the implementation of new information systems, (12) potential global events resulting in instability and unpredictability in the world's markets, including financial bailouts of sovereign nations, political changes, military and terrorist activities, health outbreaks and other factors, (13) changes in accounting standards or adoption of new accounting standards, (14) adverse effects of natural disasters, (15) legal challenges with respect to intellectual property, and (16) other factors described in more detail in the “Risk Factors” section of our 2011 Form 10-K. In addition, our past results of operations do not necessarily indicate our future results. Our future results may differ materially from our past results as a result of various risks

and uncertainties, including these and other risk factors detailed from time to time in our filings with the Securities and Exchange Commission.

You should not place undue reliance on any forward-looking statements. These statements speak only as of the date of this Third Quarter 2012 Form 10-Q. Except as otherwise required by applicable laws, we undertake no obligation to publicly update or revise any forward-looking statements or the risks described in this Third Quarter 2012 Form 10-Q, whether as a result of new information, future events, changed circumstances or any other reason after the date of this Third Quarter 2012 Form 10-Q.

### Item 3. Quantitative and Qualitative Disclosures About Market Risk

Our interest expense on long-term debt is sensitive to changes in interest rates. In addition, changes in foreign currency exchange rates may affect assets, liabilities and commitments that are to be settled in cash and are denominated in foreign currencies. Market risks are also discussed in our 2011 Form 10-K in “Item 7A. Quantitative and Qualitative Disclosures about Market Risk.” There have been no material changes to the disclosure regarding market risk set forth in our 2011 Form 10-K.

### Item 4. Controls and Procedures

We have established disclosure controls and procedures, which are designed to ensure that information required to be disclosed in reports filed or submitted under the Securities Exchange Act of 1934 (“Exchange Act”) is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission’s rules and forms. Our management, with the participation of Christopher L. Conway, President and Chief Executive Officer, and David J. Fallon, Chief Financial Officer and Chief Accounting Officer, evaluated the effectiveness of our disclosure controls and procedures as of September 1, 2012.

Based on their evaluation, such officers concluded that our disclosure controls and procedures pursuant to Rules 13a–15(e) of the Exchange Act were effective as of September 1, 2012, in achieving the objectives for which they were designed. No change in our internal control over financial reporting occurred during our most recent fiscal quarter ended September 1, 2012, that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## Part II. OTHER INFORMATION

### Item 1. Legal Proceedings

The information required by this Item is incorporated by reference from Note 11 included in Part I, Item 1 of this Third Quarter 2012 Form 10-Q.

### Item 1A. Risk Factors

There have been no material changes to the risk factors disclosed in “Item 1A. Risk Factors” in our 2011 Form 10-K.

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

On June 22, 2010, our Board of Directors approved a three-year, \$250 million stock repurchase program. Pursuant to the authorization, we may purchase shares from time to time in the open market or through privately negotiated transactions through June 22, 2013. We have no obligation to repurchase shares under the authorization, and the timing, actual number and values of shares to be purchased will depend on our stock price and market conditions. As set forth in the table below, we repurchased 110,300 shares of our common stock during the fiscal quarter ended September 1, 2012. The amount of \$187,681,767 remained available for purchase under such program at the end of the third quarter of 2012.

## COMPANY PURCHASES OF EQUITY SECURITIES

| Period                                   | (a)<br>Total<br>number of<br>shares<br>purchased | (b)<br>Average<br>price paid<br>per share | (c)<br>Total number of<br>shares purchased<br>as part of the<br>Company's publicly<br>announced plan | (d)<br>Maximum approximate<br>dollar value of shares that<br>may yet be purchased<br>under the Plan |
|--|--|---|--|---|
| June 3, 2012 through July 7, 2012        | 30,500   | \$49.10                                   | 30,500   | \$191,525,317   |
| July 8, 2012 through August 4, 2012      | 39,900   | \$48.03                                   | 39,900   | \$189,608,739   |
| August 5, 2012 through September 1, 2012 | 39,900   | \$48.30                                   | 39,900   | \$187,681,767   |
| Total                                    | 110,300  |   | 110,300  |   |

## Item 6. Exhibits

## a. Exhibits:

- \* 31.1 Certification of Christopher L. Conway pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- \* 31.2 Certification of David J. Fallon pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- \*\* 32 Certification pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- \*\*\* 101.INS XBRL Instance Document
- \*\*\* 101.SCH XBRL Taxonomy Extension Schema Document
- \*\*\* 101.CAL XBRL Taxonomy Extension Calculation Linkbase
- \*\*\* 101.DEF XBRL Taxonomy Extension Definition Linkbase
- \*\*\* 101.LAB XBRL Taxonomy Extension Label Linkbase
- \*\*\* 101.PRE XBRL Taxonomy Extension Presentation Linkbase

\* Filed herewith.

\*\* Furnished herewith.

\*\*\* Submitted electronically with this 2012 Quarterly Report on Form 10-Q.

SIGNATURES

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

CLARCOR Inc.  
(Registrant)

September 21, 2012  
(Date)

By /s/ Christopher L. Conway  
Christopher L. Conway  
President and Chief Executive Officer

September 21, 2012  
(Date)

By /s/ David J. Fallon  
David J. Fallon  
Chief Financial Officer and Chief Accounting Officer