

SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

Form 10 - K

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

For the fiscal year ended: December 31, 2002

Commission file number: 0-7087

ASTRONICS CORPORATION

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(Exact Name of Registrant as Specified in its Charter)

New York

16-0959303

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(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer Identification No.)

130 Commerce Way  
East Aurora, N.Y. 14240-3408

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(Address of principal executive office)

Registrant's telephone number including area code (716) 655-0800

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

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

\$.01 par value Common Stock; \$.01 par value Class B Stock  
(Title of Class)

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 twelve months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirement for the past 90 days **Yes**  **No**

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

Indicate by checkmark if the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2). Yes  **No**

As of March 7, 2003, 7,751,178 shares were outstanding, consisting of 5,730,055 shares of Common Stock \$.01 Par Value and 2,021,123 shares of Class B Stock \$.01 Par Value. The aggregate market value, as of the last business day of the Company's most recently completed second fiscal quarter, of the shares of Common Stock and Class B Stock of Astronics Corporation held by non-affiliates was approximately \$44,383,614 (assuming conversion of all of the outstanding Class B Stock into Common Stock and assuming the affiliates of the Registrant to be its directors, executive officers and persons known to the Registrant to beneficially own more than 10% of the outstanding capital stock of the Corporation.

DOCUMENTS INCORPORATED BY REFERENCE.

Portions of the Company's 2002 Annual Report to Shareholders are incorporated into Parts I, II and III of this Report. Portions of the Company's Proxy Statement for the 2003 Annual Meeting of Shareholders dated March 24, 2003 are incorporated by reference into Part III of this Report.

**PART I**

**Item 1. BUSINESS**

Astronics is a leader in advanced complex lighting and electronic systems for the global aerospace industry. Astronics provides its products to major aircraft manufacturers, avionics companies and aircraft operators around the world. "Net Sales by Geographic region, Major Customer and Canadian Operations" on page 18 of the Annual Shareholders' Report for the year ended December 31, 2002 is incorporated herein by reference.

The markets for the Company's products are described under the caption "Markets Served" on page 6 of the Annual Shareholders' Report for the year ended December 31, 2002, which is incorporated herein by reference.

### General Development of Business

The major factors affecting the development of the business in 2002 are described on page 2 of the Annual Shareholders' Report for the year ended December 31, 2002, which is incorporated herein by reference. In addition, the caption "Major Program Award" on page 6 of the Annual Shareholders' Report for the year ended December 31, 2002 is incorporated herein by reference.

### Practices as to Maintaining Working Capital

"Liquidity" on page 21 of the Annual Shareholders' Report for the year ended December 31, 2002 is incorporated herein by reference.

### Competitive Conditions

Astronics experiences considerable competition in the Aerospace market sectors we serve, principally with respect to product performance and price, from various competitors, many of which are substantially larger and have greater resources. Success in the Aerospace markets we serve depends upon product innovation, customer support, responsiveness, and cost management. Astronics continues to invest in developing the technologies and engineering support critical to competing in our Aerospace markets.

### Backlog

"Backlog" on page 22 of the Annual Shareholders' Report for the year ended December 31, 2002 is incorporated herein by reference.

### Patents

The Company has a number of patents and has filed numerous applications for others. While the aggregate protection of these patents is of value, the Company does not consider that the successful conduct of any material part of its business is dependent upon the protection afforded by these patents. The Company's patents and patent applications relate to electroluminescence, instrument panels, keyboard technology and various components used in their manufacture. The Company regards its expertise and techniques as proprietary and relies upon trade secret laws and contractual arrangements to protect its rights.

### Research Activities

The Company is engaged in a variety of research and development activities directed to the substantial improvement or new application of the Company's technologies. The extent of the Company's engagement in basic research, however, is not material.

### Employees

The Company's continuing operations employed approximately 412 employees as of December 31, 2002. The Company considers its relations with its employees to be good.

### Available information

The Company files its financial information and other materials required by the SEC electronically with the SEC. These materials can be accessed electronically via the Internet at [www.SEC.GOV](http://www.SEC.GOV). Such materials and other information about the Company are available through the Company's website at [www.astronics.com](http://www.astronics.com).

## **Item 2. PROPERTIES**

The Company owns manufacturing and office facilities of approximately 70,000 square feet in the Buffalo, New York area and 80,000 square feet in Lebanon, New Hampshire. Montreal, Quebec, Canada operations are in leased facilities of approximately 15,000 square feet. The lease expires in 2006.

**Item 3. LEGAL PROCEEDINGS**

There are no material pending legal proceedings, other than routine litigation incidental to the business, to which the Registrant or any of its subsidiaries is a party or of which any of their property is the subject.

**Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

Not applicable.

**PART II**

**Item 5. MARKET FOR THE COMPANY'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS**

Information with respect to the market price of and dividends on the Company's Common Stock and related shareholder matters appears on the inside back cover of the Company's Annual Report to Shareholders for the fiscal year ended December 31, 2002, and is incorporated herein by reference. The Company has not paid any cash dividends in the three year period ended December 31, 2002. It has no plans to pay dividends as it plans to retain all cash from operations as a source of capital to finance growth in the business. There are no restrictions, however on the Company's ability to pay dividends. There were approximately 834 registered shareholders for the Company's Common stock and 926 registered shareholders for the Class B stock, as of March 7, 2003.

**Item 6. SELECTED FINANCIAL DATA**

The data under the caption "Five Year Performance Highlights" on page 1 of the Company's Annual Report to Shareholders for the fiscal year ended December 31, 2002 is incorporated herein by reference.

**Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

Management's discussion and analysis of financial condition, changes in financial condition and results of operations appears on pages 20 through 22 of the Company's Annual Report to Shareholders for the fiscal year ended December 31, 2002, and is incorporated herein by reference.

**Item 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Market risk disclosures appears on page 22 of the Company's Annual Report to Shareholders for the fiscal year ended December 31, 2002, and is incorporated herein by reference.

**Item 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

The Financial Statements of Astronics Corporation which are incorporated by reference in this Annual Report on Form 10-K are described in the accompanying Index to Financial Statements at Item 15 of this Report.

**Item 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE**

Not applicable.

**PART III**

**Item 10. DIRECTORS, EXECUTIVE OFFICERS, PROMOTERS AND CONTROL PERSONS; COMPLIANCE WITH SECTION 16(a) OF THE EXCHANGE ACT**

The information regarding directors is contained under the captions "Election of Directors" and "Security Ownership of Certain Beneficial Owners and Management" in the Company's definitive Proxy Statement dated March 24, 2003 and is incorporated herein by reference.

The executive officers of the Company, their ages, their positions and offices with the Company, and the date each assumed their office with the Company are as follows:

<u>Name and Age Of Executive Officer</u>	<u>Positions and Offices with Astronics</u>	<u>Year First Elected Officer</u>
Kevin T. Keane Age 70	Chairman of the Board and Director of the Company	1970
Peter J. Gundermann Age 40	President, Chief Executive Officer and Director of the Company	2001
David C. Burney Age 40	Vice President-Finance and Treasurer, and Chief Financial Officer of the Company	2003

The principal occupation and employment for all executives listed above for the past five years has been with the Company.

#### **Item 11. EXECUTIVE COMPENSATION**

The information contained under the caption "Executive Compensation" and "Summary Compensation Table" in the Company's definitive Proxy Statement dated March 24, 2003 is incorporated herein by reference.

#### **Item 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT**

The information contained under the caption "Security Ownership of Certain Beneficial Owners and Management" in the Company's definitive Proxy Statement dated March 24, 2003 is incorporated herein by reference.

#### **Equity Compensation Plan Information**

##### Employee Stock Option Plan

The shareholders of Astronics Corporation approved the 2001 Stock Option Plan. This employee stock option plan provides a stock-based incentive program primarily for our officers and managers. Under the plan, the compensation committee of our board of directors may grant options to officers and managers who are expected to contribute to our success. The aggregate number of shares of our Common Stock that may be issued under this plan cannot exceed 1,000,000 shares (subject to adjustment to reflect share distributions). In determining the size of stock option grants, our compensation committee focuses primarily on our performance and the role of our executives and managers in accomplishing performance objectives. Stock options granted under the plan generally become exercisable in equal installments over a five-year period and are granted with an exercise price equal to the fair market value of our Common Stock as of the date of the grant.

##### Directors Stock Option Plan

The shareholders of Astronics approved the 1997 Director Stock Option Plan for non-salaried outside directors. The plan provides for grants of options to our outside directors to purchase up to an aggregate of 151,250 shares of our Common Stock (subject to adjustment to reflect share distributions). Outside directors will be eligible to receive options under this plan at the discretion of a committee appointed by our board of directors who are not eligible to participate in the plan. Under our plan, the option price will be not less than the fair market value of the shares optioned on the date of the

grant. There will not be a limit on the number of options that a participant may be granted under our plan. Options will be exercisable beginning six months after the grant and for so long as the holder remains our director, but not longer than ten years from the date of the grant.

The following table provides information about our common stock that may be issued upon the exercise of options, warrants and rights under all of our existing equity compensation plans as of December 31, 2002, including the Non-Qualified Plan and the Incentive Plan.

<b>Plan Category</b>	<b>Number of Securities to be Issued upon Exercise of Outstanding Options, Warrants and Rights</b>	<b>Weighted Average Exercise Price of Outstanding Options, Warrants and Rights</b>	<b>Number of Securities Remaining for Future Issuance under Equity Compensation Plans (excluding securities reflected in column (a))</b>
Equity compensation plans approved by security holders	392,703	\$6.79	963,664
Equity compensation plans not approved by security holders	0	N/A	0
Total.....	392,703	N/A	963,664

**Item 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS**

The information contained under the caption "Certain Relationships and Related Transactions" in the Company's definitive Proxy Statement dated March 24, 2003 is incorporated herein by reference.

**ITEM 14. CONTROLS AND PROCEDURES**

As of a date within 90 days of the filing date of this report, based on an evaluation of the Company's disclosure controls and procedures (as defined in Rules 13a-14(c) and 15d-14(c) under the Securities Exchange Act of 1934) each of the chief executive officer and the chief financial officer of the Company has concluded that the Company's disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in its Exchange Act reports is recorded, processed, summarized and reported within the applicable time periods specified by the SEC's rules and forms.

There were no significant changes in the Company's internal controls or in any other factors that could significantly affect those controls subsequent to the date of the most recent evaluation of the Company's internal controls by the Company, including any corrective actions with regard to any significant deficiencies or material weaknesses.

**PART IV**

**Item 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K**

(a) The documents filed as a part of this report are as follows:

1. Consolidated Financial Statements
2. Financial Statement Schedules

See Index to Financial Statements and Financial Statement Schedules.

All other consolidated financial schedules are omitted because they are inapplicable, not required, or the information is included elsewhere in the consolidated financial statements or the notes thereto.

### 3. Exhibits

<u>Exhibit No.</u>	<u>Description</u>
2.1	Separation and Distribution Agreement Dated December 7, 2002 by and between MOD-PAC CORP. and the Registrant; Incorporated by reference to exhibit 2.1 of MOD-PAC CORP.'s Form 10/A registration statement dated January 28, 2003
3(a)	Restated Certificate of Incorporation, as amended; incorporated by reference to exhibit 3(a) of the Registrant's December 31, 1988 Annual Report on Form 10-K.
(b)	By-Laws, as amended; incorporated by reference to exhibit 3(b) of the Registrant's December 31, 1996 Annual Report on Form 10-K.
4.1	Unsecured \$8,000,000 Credit Agreement with HSBC Bank USA, dated February 20, 2003
10.1*	Restated Thrift and Profit Sharing Retirement Plan; incorporated by reference to exhibit 10.1 of the Registrant's December 31, 1994 Annual Report on Form 10-KSB.
10.2*	Incentive Stock Option Plan; incorporated by reference to the Registrant's definitive proxy statement dated March 26, 1982.
10.3*	Director Stock Option Plan; incorporated by reference to the Registrant's definitive proxy statement dated March 16, 1984.
10.4*	1992 Incentive Stock Option Plan; incorporated by reference to the Registrant's definitive proxy statement dated March 30, 1992.
10.5*	1993 Director Stock Option Plan; incorporated by reference to the Registrant's definitive proxy statement dated March 19, 1993.
10.6*	1997 Director Stock Option Plan; incorporated by reference to the Registrant's definitive proxy statement dated March 14, 1997.
10.7*	2001 Stock Option Plan; incorporated by reference to the Registrant's definitive proxy statement dated March 19, 2001.
10.8*	Non-Qualified Supplemental Retirement Plan; incorporated by reference from the Registrant's 1999 Annual Report on Form 10-K.
10.9	Interim Services Agreement Dated December 7, 2002 by and between MOD-PAC CORP. and the Registrant; Incorporated by reference to exhibit 10.2 of MOD-PAC CORP.'s Form 10/A registration statement dated January 28, 2003
10.10	Tax Sharing Agreement Dated December 7, 2002 by and between MOD-PAC CORP. and the Registrant; Incorporated by reference to exhibit 10.1 of MOD-PAC CORP.'s Form 10/A registration statement dated January 28, 2003
10.11	Employee Benefits Agreement Dated December 7, 2002 by and between MOD-PAC CORP. and the Registrant; Incorporated by reference to exhibit 10.3 of MOD-PAC CORP.'s Form 10/A registration statement dated January 28, 2003
13	2002 Annual Report to Shareholders; filed herewith. (Except for those portions which are expressly incorporated by reference in this Annual Report on Form 10-K, this exhibit is furnished for the information of the Securities and Exchange Commission and is not deemed to be filed as part of this Annual Report on Form 10-K.)
21	Subsidiaries of the Registrant; filed herewith.
23	Consent of Independent Auditors; filed herewith.
99.1	Certification pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002; filed herewith

\*identifies a management contract or compensatory plan or arrangement as required by Item 15(a)(3) of Form 10-K.

### (b) Reports on Form 8-K

None

ASTRONICS CORPORATION

INDEX TO FINANCIAL STATEMENTS AND FINANCIAL STATEMENT SCHEDULES

The consolidated financial statements, together with the report thereon of Ernst & Young LLP dated January 24, 2003, appearing on pages 7 to 19 of the accompanying 2002 Annual Report to Shareholders are incorporated by reference in this Annual Report on Form 10-K.

Financial schedules for the years 2002, 2001, and 2000:

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**SCHEDULE II**

**ASTRONICS CORPORATION**

Valuation and Qualifying Accounts

(in thousands)

<u>Year</u>	<u>Description</u>	<u>Balance at the Beginning of Period</u>	<u>Charged to Costs and Expense</u>	<u>Write-offs/ Recoveries</u>	<u>Balance at End of Period</u>
2002	Allowance for Doubtful Accounts	\$177	\$ 246	\$(26)	\$397
2001	Allowance for Doubtful Accounts	\$104	\$43	\$30	\$177
2000	Allowance for Doubtful Accounts	\$81	\$12	\$11	\$104

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, on March 27, 2003.

Astronics Corporation

By /s/ Peter J. Gundermann

By /s/ David C. Burney

Peter J. Gundermann, President  
and Chief Executive Officer

David C. Burney, Vice President-Finance  
and Treasurer, Principal Financial and  
Accounting Officer

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

<u>Signature</u>	<u>Title</u>	<u>Date</u>
<u>/s/ Robert T. Brady</u> Robert T. Brady	Director	March 27, 2002
<u>/s/ John B. Drenning</u> John B. Drenning	Director	March 27, 2002
<u>/s/ Peter J. Gundermann</u> Peter J. Gundermann	Director	March 27, 2002
<u>/s/ Kevin T. Keane</u> Kevin T. Keane	Director	March 27, 2002

Robert J. McKenna

**CERTIFICATION**

I, Peter J. Gundermann, President and Chief Executive Officer, certify that:

1. I have reviewed this annual report on Form 10-K of Astronics Corporation;
2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;
3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:
  - a. designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;
  - b. evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this annual report (the "Evaluation Date"); and
  - c. presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
  - a. all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
  - b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this annual report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: March 25, 2003

/s/ Peter J. Gundermann

Peter J. Gundermann  
President and Chief Executive Officer

**CERTIFICATION**

I, David C. Burney, Chief Financial Officer, certify that:

1. I have reviewed this annual report on Form 10-K of Astronics Corporation;
2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;
3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining



disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:

- a. designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;
  - b. evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this annual report (the "Evaluation Date"); and
  - c. presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
- a. all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
  - b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this annual report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: March 25, 2003

/s/ David C. Burney

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David C. Burney  
Chief Financial Officer

## **ASTRONICS CORPORATION**

### **INDEX TO EXHIBITS**

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- 13 2002 Annual Report to Shareholders; filed herewith.  
(Except for those portions which are expressly incorporated by reference in this Annual Report on Form 10-K, this exhibit is furnished for the information of the Securities and Exchange Commission and is not deemed to be filed as part of this Annual Report on Form 10-K.)
- 21 Subsidiaries of the Registrant; filed herewith.
- 23 Consent of Independent Auditors; filed herewith.
- 99.1 Certification pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002; filed herewith

\*identifies a management contract or compensatory plan or arrangement as required by Item 15(a)(3) of Form 10-K.

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# CREDIT AGREEMENT

- Between -

**ASTRONICS CORPORATION**

- And -

**HSBC Bank USA**

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**DATED: February 20, 2003**

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(iii)

**AGREEMENT** dated February 20, 2003 between **ASTRONICS CORPORATION**, a New York corporation ("Company") and **HSBC BANK USA**, a banking corporation organized under the laws of New York ("HSBC Bank").

#### **ARTICLE I. Definitions**

1.1 **Definitions.** As used in this Agreement, unless otherwise specified, the following terms shall have the following respective meanings:

"**Affiliate**" - Any (a) Person who now or hereafter has Control of or is now or hereafter under common Control with, the Company or any Subsidiary or over whom or over which the Company or any Subsidiary now or hereafter has Control, or (b) any Person who is now or hereafter related by blood, by adoption or by marriage to any such Person or now or hereafter resides in the same home as any Person referred to in clause (a) of this sentence.

"**Applicable Interest Margin**" - The margin above or below the applicable LIBOR Rate or Prime Rate, as appropriate, as determined from the Pricing Grid, in order to determine the applicable interest rate for advances under the Line of Credit or to determine the applicable fee for Letters of Credit or the Existing Letter of Credit. The Applicable Interest Margin shall be determined quarterly as of the last day of each fiscal quarter of the Company using a Rolling Four-Quarter Basis and shall be based on the Company's Leverage Ratio as indicated by the levels on the Pricing Grid.

"**Business Day**" - (a) For all purposes other than as set forth in clause (b) of this definition, any day excluding Saturday, Sunday and any day on which banks in New York City are authorized by law or other governmental action to close, and (b) with respect to LIBOR Loans, any day which is a Business Day described in clause (a) and which is also

a day for trading by and between banks in U.S. dollar deposits in the London Interbank Eurodollar Market.

"**Code**" - The Internal Revenue Code of 1986, as amended from time to time.

"**Commonly Controlled Entity**" - An entity, whether or not incorporated, which is under common control with the Company within the meaning of Section 414(b) or (c) of the Code.

"**Company**" - As defined in the preamble of this Agreement.

"**Compliance Certificate**" - - A certificate from the President, or Vice President and Treasurer of the Company in the form of Exhibit B annexed hereto certifying that (a) the Company has complied with and is in compliance with all the terms, covenants and conditions of this Agreement which are binding upon it; (b) there exists no Potential Default or Event of Default as defined in this Agreement, or if this is not the case, that one or more specified Potential Defaults or Events of Default have occurred, together with a description of the action taken or to be taken by Company to cure the same; and (c) the representations and warranties

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contained in this Agreement are true with the same effect as though made on the date of the certificate.

"**Consolidated**" or "**Company on a Consolidated basis**" - The consolidation of the accounts of the Company and its Subsidiaries in accordance with GAAP, including principles of consolidation, consistent with those applied in the preparation of the Consolidated audited financial statements referred to in Section 4.7.

"**Control**" - (a) The power to vote 20% or more of the outstanding shares of any class of stock of a Person which is a corporation, (b) the beneficial ownership of 20% or more of the outstanding shares of any class of stock of a Person which is a corporation, or (c) the power to direct or cause the direction of the management and policies of a Person which is not a corporation, whether by ownership of any stock or other ownership interest, by agreement or otherwise, in each case by or on behalf of a single Person or group of Persons acting as a group for the purposes of filing Schedules 13-D or 13-G with the Securities and Exchange Commission.

"**Credit**" - All extensions of credit set forth in Article II of this Agreement, whether in the form of Line Loans or Letters of Credit.

"**Disposal**" - The intentional or unintentional abandonment, discharge, deposit, injection, dumping, spilling, leaking, storing, burning, thermal destruction or placing of any substance so that it or any of its constituents may enter the Environment.

"**EBITDA**" - For the relevant period, Company's Consolidated earnings before interest, taxes, depreciation and amortization expenses.

"**ECIDA Bond Project**" - A project of Luminescent Systems, Inc. ("LSI"), a Subsidiary of the Company, whereby LSI acquired 15 acres of land in East Aurora, New York at an approximate purchase price of \$350,000; constructed a 70,000 square foot manufacturing facility thereon at a cost of approximately \$4,700,000; and purchased new equipment at a cost of approximately \$1,450,000, all of which was financed by means of a tax-exempt bond issued by the Erie County Industrial Development Agency.

"**Environment**" - Any water including but not limited to surface water and ground water or water vapor; any land including land surface or subsurface; stream sediments; air; fish, wildlife, plants; and all other natural resources or environmental media.

"**Environmental Laws**" - - All federal, state and local environmental, land use, zoning, health, chemical use, safety and sanitation laws, statutes, ordinances, regulations, codes and rules relating to the protection of the Environment and/or governing the use, storage, treatment, generation, transportation, processing, handling, production or disposal of Hazardous Substances and the policies, guidelines, procedures, interpretations, decisions, orders and directives of federal, state and local governmental agencies and authorities with respect thereto to

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the extent that such rules, regulations, policies, guidelines, interpretations, decisions, orders and directives are published or otherwise available to the public or are otherwise known by or available to the Company or any of its Subsidiaries.

**"Environmental Permits"** - All licenses, permits, approvals, authorizations, consents or registrations required by any applicable Environmental Laws and all applicable judicial and administrative orders in connection with ownership, lease, purchase, transfer, closure, use and/or operation of any property for the storage, treatment, generation, transportation, processing, handling, production or disposal of Hazardous Substances or the sale, transfer or conveyance of any such property.

**"ERISA"** - The Employee Retirement Income Security Act of 1974, as amended from time to time and the regulations and rulings promulgated and issued thereunder.

**"Event of Default"** - As defined in Section 7.1 of this Agreement.

**"Excess Cash"** - Company's Consolidated cash in excess of \$1,000,000.

**"Existing Letter of Credit"** - The existing letter of credit in the face amount of \$1,583,000 issued by HSBC Bank to HSBC Bank Canada to secure a term loan to an Affiliate of the Company.

**"GAAP"** - As of the date of any determination, generally accepted accounting principles as promulgated by the Financial Accounting Standards Board and/or the American Institute of Certified Public Accountants, consistently applied and maintained throughout the relevant periods and from period to period.

**"Hazardous Substances"** - Without limitation, any explosives, radioactive materials, friable asbestos, urea formaldehyde foam insulation, polychlorinated biphenyls, petroleum and petroleum products, methane, hazardous materials, hazardous wastes, hazardous or toxic substances and any other material defined as a hazardous substance in Section 101(14) of the Comprehensive Environmental Response, Compensation and Liability Act of 1980 (42 U.S.C. Section 9601 et seq.) the Hazardous Materials Transportation Act, as amended (49 U.S.C. Sections 1801, et seq.), the Resource Conservation and Recovery Act, as amended (42 U.S.C. Section 6901 et seq.), Articles 15 and 27 of the New York State Environmental Conservation Law or any other applicable Environmental Law and in the regulations promulgated thereunder.

**"Indebtedness"** - At a particular date, without duplication, (a) all indebtedness of a Person for borrowed money or for the deferred purchase price of property, (b) the face amount of all letters of credit issued for the account of such Person and, without duplication, all drafts drawn thereunder and not repaid by such Person, (c) all liabilities secured by any lien on any property owned by such Person, even though such Person has not assumed or become liable for the payment thereof, and (d) lease obligations of such Person which, in accordance with GAAP, should be capitalized.

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**"IRB Letters of Credit"** - The two presently outstanding letters of credit in the approximate amount of \$6,386,301 and \$6,553,000 issued by HSBC Bank for the account of the Company to support the New Hampshire Bond Project and the ECIDA Bond Project.

**"Intangibles"** - As of any measurement date, the aggregate of the amounts which are, in accordance with GAAP, carried on the books of a Person for (a) unamortized debt discount and debt expenses, (b) any cost of investments in excess of net assets acquired at the time of acquisition, (c) patents, patent applications, copyrights, trademarks, trade names, goodwill, experimental or organizational expenses and other like intangibles, and (d) any write-up in the book value of any assets resulting from a revaluation thereof.

**"Letter of Credit"** or **"Letters of Credit"** - Individually, and collectively, any, and all, standby or commercial letters of credit issued by HSBC Bank pursuant to this Agreement upon application by the Company exclusive of the Existing Letter of Credit and the IRB Letters of Credit.

**"Letter of Credit Sublimit"** - The \$2,000,000 maximum aggregate face amount of all Letters of Credit which can be outstanding at any one time.

**"Leverage Ratio"** - The ratio of the Company's Total Funded Debt to EBITDA.

**"LIBOR Interest Determination Date"** - A Business Day that is two Business Days prior to the commencement of each LIBOR Interest Period during which the LIBOR Rate will be applicable.

**"LIBOR Interest Period"** - The 30-, 90- or 180-day period selected by the Company pursuant to Section 2.3 hereof during which the LIBOR Rate Option is in effect.

**"LIBOR Loan"** - Any Loan on which interest is calculated based on the LIBOR Rate.

**"LIBOR Rate"** - The reserve adjusted rate of interest per annum determined by HSBC Bank to be applicable to any selected LIBOR Interest Period equal to the average rate per annum which the offices of various leading banks located in London, England offer for deposits in U.S. Dollars in the London Interbank Eurodollar Market at approximately 11:00 am. (London time) on a LIBOR Interest Determination Date in an amount approximately equal to the amount of the applicable Loan.

**"LIBOR Rate Option"** - The Rate Option in which interest is calculated based upon the LIBOR Rate.

**"Line of Credit"** - The financing to be extended by HSBC Bank to the Company in the form of Line Loans or Letters of Credit pursuant to the terms of this Agreement.

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**"Line Loan" or "Line Loans"** - As defined in Section 2.1(a) of this Agreement.

**"Line of Credit Note"** - The demand note issued by the Company to HSBC Bank in the amount of \$8,000,000 to evidence the financing extended by HSBC Bank to the Company in the form of Line Loans pursuant to the terms of this Agreement.

**"Loan" or "Loans"** - Individually and collectively, any Line Loan or Letters of Credit made pursuant to this Agreement.

**"Material Adverse Effect"** - A material adverse effect on the business, operations or financial condition of the Company and its Subsidiaries taken as a whole.

**"Multiemployer Plan"** - A Plan which is a multiemployer plan as defined in Section 4001(a)(3) of ERISA.

**"New Hampshire Bond Project"** - A project of LSI, a Subsidiary of the Company, whereby LSI constructed and equipped an 80,000 square foot manufacturing facility in Lebanon, New Hampshire which was financed by means of a tax-exempt bond issued by the Business Authority of the State of New Hampshire.

**"Note"** - The Line of Credit Note.

**"Permitted Encumbrance"** - Any encumbrance described in Section 6.2 hereof.

**"Person"** - Any individual, corporation, partnership, limited liability company, joint venture, trust, unincorporated association, government or political subdivision or other entity, body, organization or group.

**"Plan"** - Any employee benefits plan which is covered by Title IV of ERISA and in respect of which the Company or a Commonly Controlled Entity is an "employer" as defined in Section 3(5) of ERISA, each of which Plans is listed on Schedule 1 to this Agreement.

**"Potential Default"** - Any event or occurrence which with the giving of notice, or passage of time, or both, constitutes an Event of Default.

**"Pricing Event"** - As defined in Section 2.3 of this Agreement.

**"Pricing Grid"** - The grid set forth in Section 2.3 of this Agreement to determine the interest rate applicable, from time to time, to the Line of Credit and to Letters of Credit and the Existing Letter of Credit.

**"Prime Rate"** - The rate of interest publicly announced by HSBC Bank from time to time as its prime rate and is a base rate for calculating interest on certain loans. The Prime



Rate may or may not be the most favorable rate charged by HSBC Bank to its customers from time to time.

"**Prime Rate Loan**" - Any Loan on which interest is calculated based on the Prime Rate.

"**Prime Rate Option**" - The Rate Option in which interest is calculated based on the Prime Rate.

"**Rate**" - The applicable interest rate as defined in Section 2.3 hereof.

"**Rate Option**" or "**Rate Options**" - The choice of applicable interest rates and LIBOR Interest Periods offered to the Company pursuant to Section 2.3 hereof to establish the interest to be charged on the Credit from time to time.

"**Release**" - Release as defined in Section 101(22) of the Comprehensive Environmental Response, Compensation and Liability Act of 1980, as amended (42 U.S.C. Section 9601 et seq.), and the regulations promulgated thereunder.

"**Reportable Event**" - Any event with regard to a Plan described in Section 4043(b) of ERISA or in regulations issued thereunder.

"**Request Certificate**" - A certificate in the form annexed hereto as Exhibit C with all blanks appropriately completed.

"**Rolling Four-Quarter Basis**" - The four most recently completed consecutive fiscal quarters of the Company immediately preceding a calculation date.

"**Subsidiary**" - Any corporation of which at least 50% of the voting stock is owned by the Company directly or indirectly through one or more Subsidiaries, and any limited liability company of which at least 50% of the membership interests are owned by the Company directly or indirectly through one or more Subsidiaries.

"**Total Funded Debt**" - For the relevant period, the Consolidated indebtedness of the Company for borrowed money to any person, including, without limitation, HSBC Bank, less Company's Excess Cash.

All accounting terms not otherwise defined herein have the meaning assigned to them in accordance with GAAP consistent with those applied in the preparation of the audited Consolidated financial statements of the Company and its Subsidiaries referred to in Section 4.7 of this Agreement. Capitalized words not otherwise defined in this Agreement shall have the meanings set forth in the New York Uniform Commercial Code as in effect on the date of this Agreement.

## **ARTICLE II. The Credit**

### **2.1 Line of Credit.**

(a) **Line Loans.** Subject to the terms and conditions of this Agreement and relying upon the representations and warranties set forth in this Agreement, HSBC Bank may, in its sole discretion, from time to time commencing on the date the conditions specified in Section 3.1 are satisfied, make one or more loans (individually a "Line Loan," or collectively, "Line Loans") to the Company, or issue Letters of Credit for the account of the Company, and the Company may make a request for a Line Loan or Line Loans from HSBC Bank or Letters of Credit to be issued by HSBC Bank, at any one time and from time to time, in amounts not exceeding in the aggregate at any one time outstanding for all such Line Loans and Letters of Credit Eight Million Dollars (\$8,000,000) ("Line Limit"); provided, however, in no event may the aggregate outstanding face amount of Letters of Credit exceed the Letter of Credit Sublimit. Within the Line Limit and subject to the limitations set forth in this Agreement, the Company may borrow, repay and reborrow Line Loans. NOTWITHSTANDING ANYTHING TO THE CONTRARY CONTAINED IN THIS AGREEMENT, THE LINE OF CREDIT SHALL BE ADVANCED IN THE SOLE DISCRETION OF HSBC BANK, SHALL BE REPAYABLE ON DEMAND OF HSBC BANK, AND SHALL BE SUBJECT TO ANNUAL REVIEW BY JUNE 30<sup>TH</sup> OF EACH YEAR AS TO AVAILABILITY.

(b) **Method of Borrowing Line Loans.** If and when the Company wishes HSBC Bank to make a Line Loan available or to continue a Line Loan as a LIBOR Loan or convert a Line Loan from a Prime Rate Loan to a LIBOR Loan or from a LIBOR Loan to a Prime Rate Loan, the Company shall notify HSBC Bank (which notice may be given by telephone or by means of a duly executed Request Certificate) not later than 2:00 p.m. (Buffalo, New York time) on the Business Day on which the Line Loan is to be funded or on the Business Day of the proposed conversion date in the case of a conversion to a Prime Rate Loan or on the LIBOR Interest Determination Date immediately preceding the proposed conversion or continuation date in the case of a conversion to, or continuation of, a LIBOR Loan. The Company shall specify (i) the aggregate amount of the Line Loan to be advanced, continued or converted on a designated date, which shall be at least \$250,000 for LIBOR Loans and at least \$100,000 for Prime Rate Loans, respectively, and in whole multiples of \$250,000 for LIBOR Loans and in whole multiples of \$100,000 for Prime Rate Loans, respectively, (ii) the proposed date on which the Line Loan is to be funded, continued or converted, which shall be a Business Day, (iii) whether such Line Loan is to be a Prime Rate Loan or LIBOR Loan, and (iv) the applicable LIBOR Interest Period, if any. As early as practically possible, but not later than 3:00 p.m. (Buffalo, New York time) on the date on which the Line Loan is to be made, continued or converted and upon fulfillment of the conditions set forth in Article III of this Agreement, HSBC Bank will make the proceeds of such Line Loan available to the Company, or continue or convert the Line Loan as requested. If on any day any Line Loan is outstanding with respect to which a proper and timely notice has not been delivered to HSBC Bank in accordance with the terms of this Agreement specifying the basis for determining the rate of interest, then for that day

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and thereafter until notice has been given with respect to such Line Loan, such Line Loan shall be deemed to be a Prime Rate Loan and shall bear interest accordingly.

HSBC Bank shall not incur any liability to the Company for acting upon any notice referred to above by telephone which HSBC Bank believes in good faith to have been given by a duly authorized officer or other person authorized to borrow on behalf of the Company or for otherwise acting in good faith under this subsection 2.1(b).

(c) **The Line of Credit Note.** The Line Loans made hereunder shall be evidenced by a note of the Company in the form of Exhibit A annexed hereto and made a part hereof, with all blanks appropriately completed, and any and all renewals, replacements, substitutions and extensions thereof ("Line of Credit Note").

The Line of Credit Note shall be payable on demand for the amount of the aggregate outstanding unpaid principal amount of the Line Loans.

The Line of Credit Note shall be inscribed by HSBC Bank as holder of the Line of Credit Note on the reverse side thereof with the amount, the date of making, continuation or conversion of each Loan, each payment of principal, each Loan's character as a LIBOR Loan, or Prime Rate Loan and the dates on which each LIBOR Interest Period shall begin and end, and the outstanding aggregate principal balance of the Line Loans. Any such inscription shall constitute prima facie evidence of the accuracy of the information so inscribed; provided, however, the failure of HSBC Bank to make any such inscription shall not affect the Company's obligations under the Line of Credit Note or this Agreement.

## 2.2 **Letters of Credit, Existing Letters of Credit and IRB Letters of Credit.**

(a) **Letters of Credit.** Within the Line Limit and the Letter of Credit Sublimit, upon application of the Company and review and approval thereof by HSBC Bank, HSBC Bank may from time to time during the period commencing on the date of this Agreement, until the date of demand by HSBC Bank of repayment of all amounts owing under the Line of Credit, issue or continue Letters of Credit for the account of the Company in an aggregate face amount for all Letters of Credit outstanding at any one time not to exceed the Letter of Credit Sublimit; provided, however, HSBC Bank will not issue any Letter of Credit if, after giving effect thereto, the issuance of any such Letter of Credit would cause the Letter of Credit Sublimit to be exceeded.

Each Letter of Credit shall (i) provide for the payment of drafts in United States dollars, presented for honor thereunder by the beneficiary in accordance with the terms thereof, at sight when accompanied by the documents described therein, (ii) have an

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expiration date which is no more than one (1) year from the date of issuance, and (iii) otherwise be in form, content and substance satisfactory to HSBC Bank as the issuer of the Letter of Credit.

(b) **Application by the Company for Issuance of the Letters of Credit**. The Company shall request HSBC Bank in writing to issue a Letter of Credit by delivering to HSBC Bank on or before the date two (2) Business Days prior to the proposed date of issuance, a Letter of Credit application in form and content satisfactory to HSBC Bank completed to the satisfaction of HSBC Bank and such other certificates, documents and other papers and information as HSBC Bank may reasonably request.

(c) **Letter of Credit Fees**. The Company agrees to pay HSBC Bank upon the application by the Company for, and the issuance by HSBC Bank of, any Letter of Credit, as provided for herein, a letter of credit fee: (i) in the case of standby Letters of Credit based on the applicable level of the Pricing Grid and equal to the Applicable Interest Margin for the LIBOR Rate Option for such level on the face amount of such Letter of Credit, and (ii) in the case of commercial Letters of Credit based on HSBC Bank's then standard fees for commercial letters of credit. Such letter of credit fees shall be payable in advance of the issuance of such Letter of Credit, and shall be calculated on the basis of a 360-day year and actual days elapsed. In addition, the Company agrees to pay to HSBC Bank, upon the application for a Letter of Credit, HSBC Bank's customary processing fee for the issuance of any letter of credit, and to pay on demand therefor, after the occurrence of any amendment or drawing, HSBC Bank's then applicable standard amendment and drawing fees.

(d) **Obligation to Reimburse**. HSBC Bank will notify the Company by telephone promptly upon the occurrence of the presentation for payment of any draft drawn pursuant to a Letter of Credit and of the date HSBC Bank intends to pay such draft ("Payment Date") if that is the case, and will endeavor to give such notification two (2) days prior to the Payment Date. With respect to any draft paid pursuant to a Letter of Credit, the Company hereby agrees to pay to HSBC Bank the amount of such draft on the date of payment by depositing with HSBC Bank prior to 10:00 a.m. (Buffalo, New York time) immediately available funds in the amount of such draft. The failure of the Company to so deposit shall be deemed a request for a Line Loan in an aggregate amount equal to the amount paid.

(e) **Unconditional Obligations**. In order to induce HSBC Bank to issue Letters of Credit, the Company agrees that HSBC Bank shall not be responsible or liable for, and the Company's unconditional obligation to reimburse HSBC Bank for amounts paid on account of drawings honored under Letters of Credit shall not be affected by (a) the validity, sufficiency or genuineness of any document or instrument presented to HSBC Bank in connection with a Letter of Credit, even if such document or instrument should in fact prove to be in any or all respects invalid, insufficient, fraudulent or forged, or (b) any action taken or omitted by HSBC Bank in good faith and without gross negligence or willful misconduct in connection with making or not making payment under a Letter of Credit provided HSBC Bank gives any notice required to be given to the Company by any such Letter of Credit.

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(f) **Existing Letter of Credit**. The Existing Letter of Credit will remain in effect except that the per annum fee applicable thereto and payable in advance will be determined on the date of this Agreement based on the then applicable level of the Pricing Grid and equal to the Applicable Interest Margin for the LIBOR Option for such level and calculated on the basis of a 360-day year and actual days elapsed. The Existing Letter of Credit shall also be subject to HSBC Bank's normal and customary amendment and drawing fees upon the occurrence of such events.

(g) **IRB Letters of Credit**. The stand-by letter of credit fees applicable to the IRB Letters of Credit prior to the date of this Agreement shall be adjusted from and after the date of this Agreement to .75% per annum on the face amount of such IRB Letters of Credit with such fees payable annually in advance and calculated on the basis of a 360-day year and actual days elapsed. The applicable reimbursement agreements for the IRB Letters of Credit shall remain in full force and effect except as modified hereby, and shall continue to govern the IRB Letters of Credit.

2.3 **Interest**. The Line of Credit Note shall bear interest payable in arrears before demand on the balance of principal thereof from time to time unpaid (i) monthly on the first day of each month for Prime Rate Loans, and (ii) for LIBOR Loans, interest shall be payable on the earlier of (y) the end of each LIBOR Interest Period, or (z) monthly on the first day of each month.

(a) **Interest Rate Options**. Subject to Section 2.3(e) hereof, the Loans made under this Agreement on or after the date hereof shall bear interest on the unpaid principal amount thereof at a per annum rate of interest determined from the Pricing Grid, and as selected by the Company in accordance with the terms of this Agreement.

If on any day a Loan is outstanding with respect to which a proper and timely notice has not been delivered to HSBC Bank in accordance with the terms of this Agreement specifying the basis for determining the rate of interest, then for that day the Loan shall be deemed to be a Prime Rate Loan and shall bear interest accordingly.

(b) **Pricing Grid**. The applicable initial rates of interest to be charged for each Prime Rate Loan or LIBOR Loan made hereunder shall be initially established as of the date of this Agreement and are listed on the grid set forth below ("Pricing Grid"). The initial pricing shall be subject to adjustment hereafter during the term of this Agreement based on any change in the Company's Leverage Ratio for the most recently completed fiscal quarter of the Company ("Pricing Event"). The Pricing Grid reflects the changed Rate Options which will replace the initial pricing based on a Pricing Event as follows:

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**PRICING GRID**

(a) **Initial Pricing**

Prime Rate Option - Prime Rate minus an increment of 1/4%.

LIBOR Rate Option - LIBOR Rate plus an increment of 1.0%.

(b) **After a Pricing Event**

<b><u>Leverage Ratio</u></b>	<b><u>Applicable Interest Margin</u></b>	
	<b><u>Libor Rate Option</u></b>	<b><u>Prime Rate Option</u></b>
Level I < 1.0	Plus 1.00%	Minus 1/4%
Level II ≥ 1.0 but < 1.5	Plus 1.25%	Plus 0%
Level III ≥ 1.5 but < 2.0	Plus 1.50%	Plus 0%
Level IV ≥ 2.0	Plus 1.75%	Plus 0%

Each change in the Applicable Interest Margin resulting from a change in the Leverage Ratio shall be effective as to any advances or loans then outstanding or thereafter made during the period commencing on and including the date ten (10) Business Days after delivery to HSBC Bank of the Company's financial statements and a Compliance Certificate indicating such change and ending on the date immediately preceding the effective date of the next such change; provided that the Applicable Interest Margin shall be deemed to be in Level IV: (i) at any time a demand for payment has been made on the Line of Credit and such demand has not been satisfied; (ii) while a reimbursement obligation with respect to the Letters of Credit, the Existing Letter of Credit or the IRB Letters of Credit has not been timely met; or (iii) if the Company fails to make timely delivery of any financial statements or Compliance Certificates required under this Agreement during the period commencing on the expiration date of the time for delivery thereof and ending on the date ten (10) Business Days after such documents are delivered.

(c) **Continuation or Conversion**. Subject to the provisions of Sections 2.3(d), 2.7 and 2.8 hereof, the Company shall have the option to continue or to convert all or any part of the outstanding Loans from one permitted Rate Option to another permitted Rate Option for such Loans; provided, however, LIBOR Loans may only be converted on the expiration date of the applicable LIBOR Interest Period; and provided further, Prime Rate Loans may only be converted into LIBOR Loans in amounts equal to at least \$100,000 and in whole multiples of \$100,000.

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(d) **Notice of Rate Option Selected**. After the date of this Agreement, the Company shall notify HSBC Bank (which notice may be given by telephone or by delivery of an executed Request Certificate in the form of Exhibit C) not later than 2:00 p.m. (Buffalo, New York time) on the Business Day of the proposed borrowing date or the conversion date in the case of a conversion to a Prime Rate Loan, or on the LIBOR Interest Determination Date immediately preceding the proposed borrowing, conversion or continuation date in the case of a conversion to a LIBOR Loan or the continuation of a LIBOR Loan. The Company shall specify (i) the proposed

borrowing/conversion/continuation date (which shall be a Business Day), (ii) the amount of the Loans to be converted or continued (which shall equal at least \$100,000 and shall be in whole multiples of \$100,000 for Prime Rate loans and which shall equal at least \$250,000 and shall be in whole multiples of \$250,000 for LIBOR Loans), (iii) whether the proposed borrowing, conversion or continuation shall be a LIBOR Loan or a Prime Rate Loan, and (iv) in the case of the borrowing of, conversion to, or continuation of, a LIBOR Loan the requested LIBOR Interest Period. If as of the Business Day prior to the date of this Agreement with respect to the initial Rate Option or as of the last day of any LIBOR Interest Period after the date hereof, notice has not been given to HSBC Bank in accordance with this Section 2.3(d) with respect to any outstanding LIBOR Loans, then for that day and thereafter until notice has been given with respect to such Loan, such Loan shall bear interest payable monthly in arrears based on the Prime Rate.

HSBC Bank shall not incur any liability to the Company in acting upon telephonic notice which HSBC Bank believes in good faith to have been given by a duly authorized officer or other person authorized to act on behalf of the Company.

Except as provided in Sections 2.7 and 2.8 of this Agreement, notice by the Company for conversion to, or continuation of, LIBOR Loans shall be irrevocable on and after the related LIBOR Interest Determination Date until the expiration of the applicable LIBOR Interest Period, and the Company shall be bound to convert or continue in accordance therewith.

(e) **Computation of Interest.** Interest on the Note shall be calculated on the basis of one three-hundred sixtieth (1/360th) of the Rate thereof in effect for each calendar day such balance of principal is unpaid. In computing interest on any Loan, the date of the making of the Loan (which shall, for purposes of this Section 2.3(e) only, be deemed to include the date of conversion to a Prime Rate Loan) or the first day of a LIBOR Interest Period shall be included and the date of payment (which shall, for the purposes of this Section 2.3(e) only, be deemed to include the date of conversion of a LIBOR Loan) or the expiration date of a LIBOR Interest Period shall be excluded; provided, that if a Loan is repaid on the same day on which it is made, one day's interest shall be paid on that Loan.

(f) **Post-Maturity Interest.** After maturity, whether by acceleration or otherwise, the Applicable Interest Margin on the Note shall be three percent (3%) in excess of the otherwise applicable margin on the Pricing Grid in effect from time to time until the Note is paid in full.

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2.4 **Use of Proceeds.** The Company covenants that it will use the proceeds of the Line Loans advanced under this Agreement to repay existing indebtedness owing by the Company to HSBC Bank USA, and then for working capital, equipment purchases, acquisitions and other general corporate purposes.

2.5 **Prepayment.** The Company shall have the right to repay at any time without premium all or any portion of any Prime Rate Loan, together with interest on the principal so prepaid to the date of such prepayment; provided, however that (i) any partial prepayment of principal shall be in the amount of \$100,000 or a whole multiple thereof and shall be applied to the Line of Credit. The Company shall have the right to repay at any time all or any portion of any LIBOR Loan, together with interest on the principal so repaid to the date of such repayment; provided, however, that (i) any partial repayment of principal shall be in the amount of at least \$100,000 and in whole multiples of \$100,000 and shall be applied to the Line of Credit, and (ii) the Company shall pay to HSBC Bank on demand such amount or amounts as HSBC Bank determines in good faith is necessary to compensate HSBC Bank for any loss, cost, damage and expense sustained or incurred by HSBC Bank with respect to such repayment, provided HSBC Bank provides the Company with a written statement setting forth the basis of computation of such amount.

2.6 **Payments.** All payments by the Company under this Agreement of interest, principal, fees and other expenses shall be made in immediately available funds not later than 12:00 Noon on the due date at the One HSBC Center office of HSBC Bank or such other office as designated by HSBC Bank, unless such amount is paid by HSBC Bank's debiting a deposit account of the Company.

2.7 **Special Provisions Governing LIBOR Loans -Increased Costs.**

(a) In the event that on any LIBOR Interest Determination Date, HSBC Bank shall have determined (which determination shall be final, conclusive and binding) that:

(1) by reason of conditions in the London Interbank Eurodollar Market or of conditions affecting the position of HSBC Bank in such market occurring after the date hereof, adequate fair means do not exist for

establishing the LIBOR Rate, or

(2) by reason of (i) any applicable law or governmental rule, regulation, guideline or order (or any written interpretation thereof and including any new law or governmental rule, regulation, guideline or order but excluding any of the foregoing relating to taxes referred to in Section 2.9) or (ii) other circumstances affecting HSBC Bank or the London

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Interbank Eurodollar Market or the position of HSBC Bank in such market (such as, but not limited to, official reserve requirements), the LIBOR Rate does not represent the effective pricing to HSBC Bank for U.S. dollar deposits of comparable amounts for the relevant period due to such increased costs; then, and in either such event, HSBC Bank shall on such date (and in any event as soon as possible after being notified of a new LIBOR Interest Period) give notice by telephone, confirmed in writing, to the Company of such determination.

(b) Thereafter, the Company shall pay to HSBC Bank upon written request therefor, such additional amounts as HSBC Bank in its sole discretion, shall reasonably determine to be required to compensate HSBC Bank for such increased costs. A certificate setting forth the computation of such additional amounts submitted to the Company by HSBC Bank shall, absent computational error, and if prepared on a good faith reasonable basis, be final, conclusive and binding upon all parties hereto.

(c) In lieu of paying HSBC Bank such additional amounts as required by this Section 2.7, the Company may exercise the following options:

(1) If such determination by HSBC Bank relates only to a LIBOR Loan then being requested by the Company pursuant to the terms hereof, the Company may, on such LIBOR Interest Determination Date by giving notice by telephone to HSBC Bank, withdraw such request;

(2) The Company may, by giving notice by telephone to HSBC Bank require HSBC Bank to make the LIBOR Loan then being requested in the form of a Prime Rate Loan, or to convert its outstanding LIBOR Loan that is so affected into a Prime Rate Loan at the end of the then current LIBOR Interest Period.

## **2.8 Required Termination and Repayment of LIBOR Loans.**

(a) In the event HSBC Bank shall have reasonably determined, at any time (which determination shall be final, conclusive and binding but shall be made only after consultation with the Company), that the making or continuation of any or all of its LIBOR Loans:

(1) has become unlawful by compliance by HSBC Bank in good faith with any applicable law, governmental rule, regulation, guideline or order, or

(2) would cause HSBC Bank severe hardship as a result of a contingency occurring after the date of this Agreement which materially and adversely affects the London Interbank Eurodollar Market (such as, but not limited to disruptions resulting from political or economic events); then, and in either such event, HSBC Bank shall on such date (and in any event as soon as possible after making such determination) give telephonic notice to the

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Company, confirmed in writing, of such determination, identifying which of the LIBOR Loans was so affected.

(b) The Company then shall, upon the termination of the then current LIBOR Interest Period applicable to each LIBOR Loan so affected or, if earlier, when required by law, repay each such affected LIBOR Loan, together with all interest accrued thereon.

(c) In lieu of the repayment to HSBC Bank required by Section 2.8(b), the Company may exercise the following options:

(1) If the determination by HSBC Bank relates only to a LIBOR Loan then being requested by the Company pursuant to the terms hereof, the Company may, on such date by giving notice by telephone to HSBC

Bank, withdraw such request;

(2) The Company may, by giving notice by telephone to HSBC Bank, require HSBC Bank to make the LIBOR Loan then being requested in the form of a Prime Rate Loan or to convert its outstanding LIBOR Loan or Loans that are so affected into a Prime Rate Loan at the end of the then current LIBOR Interest Period applicable to each such LIBOR Loan (or at such earlier time as repayment is otherwise required to be made pursuant to the terms of this Agreement). Such notice shall pertain only to the LIBOR Loan outstanding or to be outstanding during each such affected LIBOR Interest Period.

2.9 **Taxes.** If any taxes or duties of any kind shall be payable, or ruled to be payable, by or to any taxing authority of or in the United States, or any other foreign country, or any political subdivision of any thereof, in respect of any of the transactions contemplated by this Agreement (including, but not limited to, execution, delivery, performance, enforcement, or payment of principal or interest of or under the Line of Credit Note or this Agreement, or the making of the LIBOR Loan), by reason of any now existing or hereafter enacted statute, rule, regulation or other determination (excluding any taxes imposed on or measured by the net income of HSBC Bank), the Company will:

- (1) pay on written request therefor all such taxes or duties, including interest and penalty, if any,
- (2) promptly furnish HSBC Bank with evidence of any such payment, and
- (3) indemnify and hold HSBC Bank and any holder or holders of the Line of Credit Note harmless and indemnified against any liability or liabilities with respect to or in connection with any such taxes or the payment thereof or resulting from any delay or omission to pay such taxes.

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2.10 **Late Charge.** Upon written notice from HSBC Bank to the Company of the failure to make any regularly scheduled payment of interest or principal on the Line of Credit Note within ten (10) days of the due date thereof, the Company promises to pay a late charge equal to five percent (5%) of the amount of any such overdue amount of principal or interest.

2.11 **Charge to Account.** On the date that any principal of or interest on the Note or any fees or charges payable under this Agreement are due, the Company authorizes HSBC Bank to debit account number 770-804683 of the Company maintained with HSBC Bank on such due date in an amount equal to such unpaid principal, interest, fees or charges, as applicable.

### **ARTICLE III. Conditions to the Extension of Credit**

3.1 **Conditions to Extension of Credit.** Without in any way impairing the demand, discretionary nature of the Line of Credit, HSBC Bank's agreement to extend the Credit shall be effective only upon fulfillment of the following conditions at the date of the execution of this Agreement:

(a) **Corporate Action.** The Company shall have taken all necessary and appropriate corporate action and the Board of Directors of the Company shall have adopted resolutions authorizing the Credit, the execution and delivery of this Agreement and the Note, and the taking of all action required of the Company by this Agreement; and the Company shall have furnished to HSBC Bank copies certified as of the date of the execution of this Agreement of such corporate resolutions and such other corporate documents as HSBC Bank shall reasonably request.

(b) **Corporate Documents.** There shall have been furnished to HSBC Bank (i) certificates of the Company's good standing duly issued of recent date by the Secretary of State of New York; (ii) certificates of each Subsidiary's good standing duly issued of recent date by an Official of the jurisdiction of its incorporation; (iii) copies of the certificate of incorporation and all amendments thereto and by-laws of the Company and each Subsidiary, certified by their Secretaries as of the date of the execution of this Agreement; and (iv) certificates of incumbency, dated the date of the execution of this Agreement specifying the officers of the Company and each Subsidiary, together with their specimen signatures.

(c) **Note.** The Company shall have executed and delivered to HSBC Bank the Line of Credit Note, appropriately completed, evidencing the Company's obligation to repay the Line Loans.

(d) **Insurance Certificates**. The Company shall have caused to be delivered to HSBC Bank insurance certificates, binders or policies evidencing compliance with Section 5.5 of this Agreement.

(e) **MOD-PAC CORP.** - On or before March 31, 2003, the Company shall have delivered to HSBC Bank satisfactory evidence of the spin-off of its subsidiary, MOD-PAC CORP.

(f) **Other Matters**. All matters incidental to the execution and delivery of this Agreement and the Note, and all action required on the part of the Company by this Agreement, shall be reasonably satisfactory to HSBC Bank and its counsel.

3.2 **Conditions to Subsequent Extensions of Credit**. Subsequent to the satisfaction of the conditions set forth in Section 3.1, each request to HSBC Bank for a Line Loan, or the conversion or continuation of any LIBOR Loan or Prime Rate Loan, shall constitute confirmation by the Company of all the matters set forth in the form of the Compliance Certificate as of the date of the requested Loan, such continuation or conversion, in the same manner as if a written Compliance Certificate had been delivered even though no Compliance Certificate is required by this Section 3.2. No Line Loans, LIBOR Loans, or Prime Rate Loans shall be made if the Company is unable to make such a confirmation.

#### **ARTICLE IV. Representations and Warranties**

The Company makes the following representations and warranties, which shall be deemed to be continuing representations and warranties so long as any indebtedness of the Company to HSBC Bank, including indebtedness for fees and expenses, shall remain unpaid:

4.1 **Good Standing and Authority**. Each of the Company and each Subsidiary is a corporation, duly organized, validly existing, and in good standing under the laws of the state of its incorporation; has powers and authority to transact the business in which it is engaged; is duly licensed or qualified and in good standing in each jurisdiction in which the conduct of such business requires such licensing or such qualification; and has all necessary power and authority to enter this Agreement and to execute, deliver and perform this Agreement, the Note and any other document executed in connection with this Agreement, all of which have been duly authorized by all proper and necessary corporate and shareholder action.

4.2 **Valid and Binding Obligation**. This Agreement, the Note and any other document executed in connection herewith have been duly executed and delivered by the Company and constitute the legal, valid and binding obligations of the Company and each

Subsidiary, as the case may be, enforceable against the Company or such Subsidiary, as the case may be, in accordance with their respective terms.

4.3 **Good Title**. Each of the Company and each Subsidiary has good and marketable title to all of its assets, none of which is subject to any mortgage, indenture, pledge, lien, conditional sale contract, security interest, encumbrance, claim, trust or charge except Permitted Encumbrances or in favor of HSBC Bank.

4.4 **No Pending Litigation**. There are not any actions, suits, proceedings (whether or not purportedly on behalf of the Company or any Subsidiary) or investigations pending or, to the knowledge of the Company, threatened against the Company or any Subsidiary or any basis therefor, which, if adversely determined, would, in any case or in the aggregate have, or would reasonably be expected to have a Material Adverse Effect, or which question the validity of this Agreement, the Note or other documents required by this Agreement, or any action taken or to be taken pursuant to any of the foregoing.

4.5 **No Consent or Filing**. No consent, license, approval or authorization of, or registration, declaration or filing with, any court, governmental body or authority or other Person is required on the part of the Company or any Subsidiary in connection with the valid execution, delivery or performance of this Agreement, the Note or other documents required by this Agreement or in connection with any of the transactions contemplated thereby.

4.6 **No Violations**. Neither the Company nor any Subsidiary is in violation of any term of its certificate of



incorporation or by-laws, or of any mortgage, borrowing agreement or other instrument or agreement pertaining to Indebtedness for borrowed money which might reasonably be expected to result in a Material Adverse Effect. Neither the Company nor any Subsidiary is in violation of any term of any other indenture, instrument, or agreement to which it is a party or by which it may be bound, resulting, or which might reasonably be expected to result, in a Material Adverse Effect. Neither the Company nor any Subsidiary is in violation of any order, writ, judgment, injunction or decree of any court of competent jurisdiction or of any statute, rule or regulation of any competent governmental authority which might reasonably be expected to result in a Material Adverse Effect. The execution and delivery of this Agreement, the Note and other documents required by this Agreement and the performance of all of the same is and will be in compliance with the foregoing and will not result in any violation or result in the creation of any mortgage, lien, security interest, charge or encumbrance upon any properties or assets except in favor of HSBC Bank. There exists no fact or circumstance not disclosed in this Agreement, in the documents furnished in connection herewith, the Company's filings under the Securities Exchange Act of 1934, or in the financial projections furnished to HSBC Bank which has, or could reasonably be expected to have, a Material Adverse Effect, except those facts and circumstances which generally affect all Persons engaged in the Company's lines of business.

4.7 **Financial Statements.** The Company has furnished to HSBC Bank audited Consolidated financial statements showing the Company's and all Subsidiaries' financial

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condition as of December 31, 2001 and the results of operations and their cash flows for the fiscal year then ended prepared by Ernst & Young LLP, which statements fairly present their Consolidated financial position and the results of their operations as of the date and for the period referred to and have been prepared in accordance with GAAP consistently applied throughout the interval involved. Since the date of such financial statements to the date of execution hereof, there have not been any materially adverse changes in the Consolidated financial condition of the Company and the Subsidiaries from that disclosed in such financial statements. None of the property or assets shown in the Consolidated financial statements delivered to HSBC Bank has been materially adversely affected as the result of any fire, explosion, accident, flood, drought, storm, earthquake, condemnation, requisition, statutory or regulatory change, act of God, or act of public enemy or other casualty, whether or not insured.

4.8 **Tax Returns.** The Company has duly filed all federal and other tax returns required to be filed for itself and all Subsidiaries except where an extension has been obtained and has duly paid all taxes required by such returns through its fiscal year ending December 31, 2001. Federal income tax liability of the Company and the Subsidiaries has been reviewed by the United States Internal Revenue Service through its fiscal year ending December 31, 1999, and the Company has not received any assessments by the Internal Revenue Service or other taxing authority for additional unpaid taxes.

4.9 **Federal Regulations.** Neither the Company nor any Subsidiary is engaged principally, or as one of its important activities, in the business of extending or arranging for the extension of credit for the purpose of purchasing or carrying "margin stock" (as defined in Regulation U issued by the Board of Governors of the Federal Reserve System). Neither the Company nor any Subsidiary owns nor intends to carry or purchase any such "margin stock", and the Company will not use the proceeds of any Line Loan or Letters of Credit to purchase or carry (or refinance any borrowing the proceeds of which were used to purchase or carry) any such "margin stock". Neither the Company nor any Subsidiary is an "investment company" within the meaning of the Investment Company Act of 1940, as amended, or a "holding company," or a "subsidiary company" of a "holding company" or of a "subsidiary company" of a "holding company," within the meaning of the Public Utility Holding Company Act of 1935, as amended.

4.10 **ERISA Matters.** No Plan has been terminated or partially terminated or is insolvent or in reorganization, nor have any proceedings been instituted to terminate or reorganize any Plan; neither the Company nor any Subsidiary has withdrawn from any Plan in a complete or partial withdrawal, nor has a condition occurred which if continued would result in a complete or partial withdrawal; neither the Company nor any Subsidiary has incurred any withdrawal liability, including contingent withdrawal liability, to any Plan pursuant to Title IV of ERISA; neither the Company nor any Subsidiary has incurred any liability to the Pension Benefit Guaranty Corporation other than for required insurance premiums which have been paid when due; no Reportable Event, except for the merger of the Plans referred to above, has occurred; and no Plan or other "employee pension benefit plan" as defined in Section 3(2) of ERISA to which

the Company or any Subsidiary is a party has an "accumulated funding deficiency" (whether or not waived) as defined in Section 302 of ERISA or in Section 412 of the Code. Each Plan and each other "employee benefit plan" as defined in Section 3(3) of ERISA to which the Company or any Subsidiary is a party is in substantial compliance with ERISA, and no such plan, nor any administrator, trustee or fiduciary thereof, to the best knowledge of the Company, has engaged in a prohibited transaction described in Section 406 of ERISA or in Section 4975 of the Code.

4.11 **Subsidiaries; Affiliates.** The Company has no (a) Subsidiaries except (i) as listed on Schedule 3 to this Agreement or (b) Affiliates, other than Kevin Keane and Betty Ann Keane.

4.12 **Compliance.** The present and anticipated conduct of the business and operations of the Company and each Subsidiary and the present and anticipated ownership and use of each asset of the Company and each Subsidiary are in compliance in each material respect with each applicable statute, regulation and other law (including, but not limited to, the Environmental Protection Act, the Occupational Health and Safety Act, the Comprehensive Environmental Response, Compensation and Liability Act and the Resource Conservation and Recovery Act), except where noncompliance would not result in a Material Adverse Effect. Each authorization, approval, permit, consent, franchise and license from, each registration and filing with, each declaration, report and notice to, and each other act by or relating to, any Person necessary for the present or anticipated conduct of the business or operations of the Company and each Subsidiary or for the present or anticipated ownership or use of any material asset of the Company and each Subsidiary has been duly obtained, made, given or done, and is in full force and effect.

4.13 **Fiscal Year.** The fiscal year of the Company is the year ending December 31.

4.14 **Default.** There does not exist any Potential Default or Event of Default.

4.15 **Indebtedness for Borrowed Money.** The Company and its Subsidiaries have no Indebtedness arising from the borrowing of any money, except for Indebtedness (a) to HSBC Bank, (b) outstanding on the date of this Agreement pursuant to any lease, loan or credit facility fully and accurately described in Schedule 2 to this Agreement, (c) incurred with the prior written consent of HSBC Bank, and (d) owing to the Company or a Subsidiary.

4.16 **Securities.** Each outstanding share of stock, debenture, bond, note and other security of the Company has been validly issued in full compliance with each statute, regulation and other law, and, if a share of stock, is fully paid and nonassessable.

4.17 **Environmental Matters.**

(a) No above ground or underground storage tanks containing Hazardous Substances are or have been located on any property owned, leased or operated by the Company or any Subsidiary, except for storage tanks containing diesel fuel, gasoline or waste oil, which tanks are in compliance with all applicable laws, rules and regulations.

(b) No property owned, leased or operated by the Company or any Subsidiary is or has been used for the storage or Disposal of any Hazardous Substance, except in the ordinary course of its business in accordance with applicable Environmental Laws, or for the treatment of Hazardous Substances.

(c) No unpermitted Release of a Hazardous Substance has occurred or is threatened on, at, from or near any property owned, leased or operated by the Company or any Subsidiary, except where such unpermitted Release does not have, and could not reasonably be expected to have, a Material Adverse Effect.

(d) Neither the Company nor any Subsidiary is subject to any existing, pending or threatened suit, claim, notice of violation or request for information under any Environmental Law.

(e) The Company and each Subsidiary are in compliance with all Environmental Laws, except where noncompliance does not have, and could not be reasonably expected to have, a Material Adverse Effect.

(f) All Environmental Permits have been obtained and are in full force and effect, except where the failure to obtain such Environmental Permit is not likely to have a Material Adverse Effect.

(g) There are no agreements, consent orders, decrees, judgment, license or permit conditions or other orders or directives of any federal, state or local court, governmental agency or authority relating to the past, present or future ownership, use, operation, sale, transfer or conveyance of any property owned, leased or operated by the Company or any Subsidiary which required any change in condition or any work, repairs, construction, containment, clean up, investigation, study, removal or other remedial action or capital expenditures.

#### **ARTICLE V. Affirmative Covenants**

During the term of this Agreement, and so long thereafter as any indebtedness of the Company to HSBC Bank under this Agreement or in connection with any letter of credit, including any indebtedness for fees and expenses, shall remain unpaid, the Company will:

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5.1 **Payments.** Duly and punctually pay the principal of and interest on all Indebtedness and all fees incurred by it pursuant to this Agreement in the manner set forth in this Agreement.

5.2 **Future Financial Statements.** Furnish to HSBC Bank (a) within forty-five (45) days after the end of each quarter of each of its fiscal years, unaudited financial statements of the Company and its Subsidiaries, which statements shall consist of Consolidated and summary consolidating balance sheets as of the end of such quarter, and related statements of income, covering the period from the end of the Company's immediately preceding fiscal year to the end of such quarter certified to be correct by the President or chief fiscal officer of the Company, who shall also furnish to HSBC Bank a Compliance Certificate; (b) within ninety (90) days after the end of each of its fiscal years, audited Consolidated financial statements of the Company and its Subsidiaries, which shall consist of a Consolidated balance sheet as of the end of such year and the related statements of income, retained earnings and cash flows covering such fiscal year, prepared and certified, in the case of such Consolidated financial statements, by Ernst & Young LLP, or other independent certified public accountants satisfactory to HSBC Bank and the Company, together with a Compliance Certificate from the President or Vice President and Treasurer of the Company; (c) promptly, after their preparations copies of all such proxy statements, financial statements and reports which the Company sends to its stockholders, and copies of all regular, periodic and special reports, as well as all registration statements, which the Company files with the Securities and Exchange Commission; (d) promptly after the filing thereof with the Pension Benefit Guaranty Corporation, a copy of each annual report filed with respect to each Plan; (e) by the end of each of its fiscal years, a forecast of the statements of income and cash flows as of and through the close of its following fiscal year of the Company and the Subsidiaries; and (f) such additional information, reports or statements (including, without limitation, a Compliance Certificate) as HSBC Bank may from time to time reasonably request regarding the financial and business affairs of the Company and the Subsidiaries.

5.3 **Notice.** Promptly notify HSBC Bank in writing of (a) any pending or future audits of the Company's or any Subsidiary's federal income tax return by the Internal Revenue Service as soon as the Company has knowledge thereof, and the results of each such audit after its completion; and (b) any default by the Company or any Subsidiary in the performance of, or any modifications of, any of the terms or conditions contained in this Agreement, any other agreement, mortgage, indenture or instrument to which the Company or any Subsidiary is a party or which is binding upon the Company or any Subsidiary and of any default by the Company or any Subsidiary in the payment of any of its Indebtedness. The Company shall not, however, be required to so notify HSBC Bank of potential or actual defaults under, or of modifications of terms or provisions of, those documents or agreements pertaining to its transactions in the ordinary course of business (not concerning its Indebtedness) which do not have a Material Adverse Effect or constitute a Potential Default or an Event of Default.

5.4 **Taxes.** Promptly pay and discharge all of its taxes, assessments and other governmental charges (including any charged or assessed on the issuance of the Note) prior to

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the date on which penalties are attached thereto, establish adequate reserves for the payment of such taxes, assessments and governmental charges and make all required withholding and other tax deposits; provided, however, that nothing herein contained shall be interpreted to require the payment of any tax, assessment or charge so long as its validity is being contested in good faith and by appropriate proceedings diligently conducted.

5.5 **Insurance.** (a) Keep, and cause each Subsidiary to keep, all its property so insurable insured at all times with responsible insurance carriers against fire, theft and other risks in coverage, form and amount satisfactory to HSBC Bank; (b) keep, and cause each Subsidiary to keep, adequately insured at all times in reasonable amounts with responsible insurance carriers against liability on account of damage to persons or property and under all applicable worker's compensation laws; (c) promptly deliver to HSBC Bank certificates of insurance, with appropriate endorsements designating HSBC Bank as a named insured as requested by HSBC Bank; and (d) cause each such insurance policy to contain a thirty (30) day notice of cancellation or material change in coverage provision satisfactory to HSBC Bank.

5.6 **Litigation.** Promptly notify HSBC Bank in writing as soon as the Company has knowledge thereof, of the institution or filing of any litigation, action, suit, claim, counterclaim, or administrative proceeding against, or investigation of, the Company or any Subsidiary to which the Company or any Subsidiary is a party by or before any regulatory body or governmental agency (a) the outcome of which may materially and adversely affect the finances or operations of the Company or any Subsidiary or the Company's ability to fulfill its obligations hereunder or which involves more than \$1,000,000 unless adequately covered by insurance, or (b) which questions the validity of this Agreement, the Note or any action taken or to be taken pursuant to any of the foregoing; and furnish or cause to be furnished to HSBC Bank such information regarding the same as HSBC Bank may request.

5.7 **Judgments.** Promptly notify HSBC Bank in writing as soon as the Company has knowledge thereof, of any judgment, order or award of any court, agency or other governmental agency or any arbitrator, (a) the outcome of which may materially and adversely affect the finances or operations of the Company or any Subsidiary or the Company's ability to fulfill its obligations hereunder or which involves more than \$1,000,000 unless adequately covered by insurance, or (b) renders invalid this Agreement, the Note or any action taken or to be taken pursuant to any of the foregoing, and furnish or cause to be furnished to HSBC Bank such information regarding the same as HSBC Bank may request.

5.8 **Corporate Standing.** Maintain, and cause each Subsidiary to maintain, its corporate existence in good standing and remain or become duly licensed or qualified and in good standing in each jurisdiction in which the conduct of its business requires such qualification or licensing, except where the failure to be so licensed or qualified and in good standing would not have a Material Adverse Effect.

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5.9 **Books and Records.** Keep proper books and records in accordance with generally accepted accounting principles consistently applied and notify HSBC Bank promptly in writing of any proposed change in the location at which such books and records are maintained.

5.10 **Compliance with Law.** Comply with all applicable laws and governmental rules and regulations, except where the failure to so comply does not have, and would not be reasonably expected to have, a Material Adverse Effect.

5.11 **Pension Reports.** With respect to each Plan, the Company will furnish the following to HSBC Bank as soon as possible and in any event within thirty days after the Company knows or has reason to know of (a) the occurrence of any Reportable Event with respect to such Plan or (b) the institution of proceedings or the taking of any other action by the Pension Benefit Guaranty Corporation or the Company or any Subsidiary to terminate, withdraw or partially withdraw from any Plan and, with respect to a Multiemployer Plan, the reorganization (as defined in Section 4241 of ERISA) or insolvency (as defined in Section 4245 of ERISA) of such Plan, and in addition to such notice, deliver to HSBC Bank whichever of the following may be applicable: (i) a certificate of the President or chief fiscal officer of the Company setting forth details known to the Company as to such Reportable Event, together with a copy of any notice thereof that is required to be filed with Pension Benefit Guaranty Corporation, or (ii) any notice delivered by Pension Benefit Guaranty Corporation evidencing its intent to institute such proceedings or any notice to Pension Benefit Guaranty Corporation that such Plan is to be terminated, as the case may be.

5.12 **Inspections.** Upon request of HSBC Bank, permit any officer, employee, accountant, attorney or other agent of HSBC Bank upon reasonable notice and during regular business hours to (a) visit and inspect each of the premises of the Company and each Subsidiary, (b) examine, audit, copy and make extracts from each accounting record of the Company, and (c) discuss the business, operations, assets, affairs and condition (financial or other) of the Company and each Subsidiary with a responsible officer of the Company and with the independent accountants of the Company.

### 5.13 **Environmental Compliance.**

(a) Comply with all Environmental Laws.

(b) Promptly notify HSBC Bank in the event of the Disposal of any Hazardous Substance at any property owned, leased or operated by the Company or any Subsidiary, or in the event of any Release, or threatened Release, of a Hazardous Substance, on, at or from any such Property, except when such Disposal or Release is in the ordinary course of the Company's business and in compliance with all applicable Environmental Laws.

(c) Deliver promptly to HSBC Bank (i) copies of any non-routine, material documents received from the United States Environmental Protection Agency or any

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state, county or municipal environmental or health agency concerning the Company's operations except documents of general applicability; and (ii) copies of any documents submitted by the Company to the United States Environmental Protection Agency or any state, county or municipal environmental or health agency concerning its operations, except submissions in the ordinary course of business.

### **ARTICLE VI. Negative Covenants**

During the term of this Agreement and so long thereafter as any of the indebtedness of the Company to HSBC Bank pursuant to this Agreement or in connection with any letter of credit, including any indebtedness for fees and expenses, shall remain unpaid, the Company and each Subsidiary, without the prior written consent of HSBC Bank, will not:

6.1 **Borrowed Money.** Create, incur, assume or suffer to exist any Indebtedness except to HSBC Bank pursuant to this Agreement and as set forth on Schedule 2 attached hereto, and Indebtedness owed by a Subsidiary to the Company or to another Subsidiary or by the Company to a Subsidiary, and Indebtedness not in excess of \$3,000,000 outstanding at any one time incurred for capital leases of fixed assets or fixed asset purchases, and unsecured Indebtedness that is subordinated to the Indebtedness of the Company to HSBC Bank under this Agreement in a manner reasonably satisfactory to HSBC Bank.

6.2 **Encumbrances.** Create, incur, assume or suffer to exist any mortgage, lien, security interest, pledge or other encumbrance on any of its property or assets, whether now owned or hereafter owned or acquired, except in favor of HSBC Bank or a trustee for the benefit of HSBC Bank and except for (a) any lease of any asset as a lessor in the ordinary course of its business and without interference with the conduct of its business or operations, (b) any pledge or deposit made by the Company or any Subsidiary in the ordinary course of its business (i) in connection with any workers' compensation, unemployment insurance, social security or similar statute, regulation or other law or (ii) to secure the payment of any indebtedness, liability or obligation in connection with any letter of credit, bid, tender, trade or government contract, lease, surety, appeal or performance bond or statute, regulation or other law, or of any similar indebtedness, liability or obligation, not incurred in connection with the borrowing of any money or in connection with the deferral of the payment of the purchase price of any asset, (c) any attachment, levy or similar lien with respect to the Company or any Subsidiary arising in connection with any action or other legal proceeding so long as (i) the validity of the claim or judgment secured thereby is being contested in good faith by appropriate proceedings promptly instituted and diligently conducted, (ii) adequate reserves have been appropriately established for such claim or judgment, (iii) the execution or other enforcement of such attachment, levy or similar lien is effectively stayed and (iv) neither such claim or judgment nor such attachment, levy or similar lien has a material adverse effect on the business or operations of the Company or any Subsidiary, (d) any statutory lien in favor of the United States for any amount paid to the

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Company or any Subsidiary as a progress payment pursuant to any government contract, (e) any statutory lien securing the payment of any tax, assessment, fee, charge, fine or penalty imposed by any government or political subdivision upon the Company or any Subsidiary or upon any of its respective assets but not yet due to be paid (excluding any lien arising under ERISA), (f) any statutory lien securing the payment of any claim or demand of any materialman, mechanic, carrier, warehouseman, garageman or landlord against the Company or any Subsidiary, but not yet due to be paid, (g) any reservation, exception, encroachment, easement, right-of-way, covenant, condition, restriction, lease or

similar title exception or encumbrance affecting title to any real property of the Company or any Subsidiary but not interfering with the conduct of its business or operations, (h) liens listed on Schedule 2 hereto and (i) liens on assets securing Indebtedness permitted by Section 6.1 hereof.

6.3 **Guaranties**. Become a guarantor, surety or otherwise liable for the debts or other obligations of any other Person whether by agreement to purchase the indebtedness of any other Person or agreement for the furnishing of funds to any other Person through the purchase of goods, supplies or services (or by way of stock purchase, capital contribution, advance or loan) for the purpose of paying or discharging the indebtedness of any other Person or otherwise, except (a) as an endorser of instruments for the payment of money deposited to its bank account for collection in the ordinary course of business, (b) in favor of HSBC Bank, (c) guaranties of Indebtedness listed on Schedule 2, and (d) guaranties by the Company granted in the ordinary course of business by the Company in connection with ordinary course of business purchase or sale obligations of Subsidiaries under contracts for the purchase or sale of goods.

6.4 **Sale of Assets**. Convey, sell, transfer, lease, or sell and lease back during the term of this Agreement more than five percent (5%) in the aggregate of the property, assets or business of the Company and its Subsidiaries on a consolidated basis to any other Person, except for sales of Inventory in the ordinary course of business and sales of fixed assets no longer needed or in use.

6.5 **Mergers**. Merge or consolidate with or into any other firm or corporation, unless the Company is the entity surviving after the merger or consolidation, or enter into any joint venture or partnership with any other Person.

6.6 **Disposal of Hazardous Substances**. Suffer, cause or permit the Disposal of Hazardous Substances at any property owned, leased or operated by the Company or any Subsidiary, except in the ordinary course of the Company's business in accordance with applicable Environmental Laws.

6.7 **Investments and Advances**. Make any investment in or advances to any other person, firm, or corporation, except (a) advance payments or deposits against purchases made in the ordinary course of the Company's business; (b) direct obligations of the United States of America; (c) any existing investments in, or existing or future advances to, any

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Subsidiary or the Company; or (d) investments which are classified as Cash or Cash Equivalents under GAAP.

6.8 **Change Fiscal Year**. Change the fiscal year of the Company.

## **ARTICLE VII. Default**

7.1 **Events of Default**. Without detracting from the demand nature of the Line of Credit Note, the occurrence of any one or more of the following events shall constitute an event of default (individually, "Event of Default," or, collectively, "Events of Default"):

(a) **Nonpayment**. Nonpayment within ten (10) days after the same becomes due whether by acceleration or otherwise of (i) principal of, or interest on, the Note; (ii) any charge, fee or premium provided for hereunder; or (iii) any reimbursement obligation in connection with any Letter of Credit, the Existing Letter of Credit or the IRB Letters of Credit.

(b) **Negative Covenants**. Default in the observance of any of the covenants or agreements of the Company contained in Article VI.

(c) **Other Covenants**. Default in the observance of any of the covenants or agreements of the Company contained in this Agreement, other than those specified in Sections 5.1 and 7.1(b) hereof or in any other agreement with HSBC Bank, which is not remedied within thirty (30) days after notice thereof by HSBC Bank to the Company.

(d) **Voluntary Insolvency Proceedings**. If the Company or any Subsidiary (i) shall file a petition or request for liquidation, reorganization, arrangement, adjudication as a bankrupt, relief as a debtor or other relief under the bankruptcy, insolvency or similar laws of the United States of America or any state or territory thereof or any foreign jurisdiction, now or hereafter in effect; (ii) shall make a general assignment for the benefit of creditors;

(iii) shall consent to the appointment of a receiver or trustee for the Company or any Subsidiary or any of the Company's or any Subsidiary's assets, including, without limitation, the appointment of or taking possession by a "custodian" as defined in the federal Bankruptcy Code; (iv) shall make any, or send notice of any intended, bulk sale; or (v) shall execute a consent to any other type of insolvency proceeding (under the federal Bankruptcy Code or otherwise) or any formal or informal proceeding for the dissolution or liquidation of, or settlement of claims against or winding up of affairs of, the Company or any Subsidiary.

(e) **Involuntary Insolvency Proceedings.** The appointment of a receiver, trustee, custodian or officer performing similar functions for the Company or any Subsidiary or any of the Company's or any Subsidiary's assets, including, without limitation, the appointment of or taking possession by a "custodian" as defined in the federal Bankruptcy Code; or the filing against the Company or any Subsidiary of a request or petition for liquidation,

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reorganization, arrangement, adjudication as a bankrupt or other relief under the bankruptcy, insolvency or similar laws of the United States of America or any state or territory thereof or any foreign jurisdiction, now or hereafter in effect; or the institution against the Company or any Subsidiary of any other type of insolvency proceeding (under the federal Bankruptcy Code or otherwise) or of any formal or informal proceeding for the dissolution or liquidation of, settlement of claims against or winding up of affairs of the Company or any Subsidiary, and the failure to have such appointment vacated or such filing, petition or proceeding dismissed within ninety (90) days after such appointment, filing or institution.

(f) **Representations.** If any certificate, statement, representation, warranty or financial statement furnished by or on behalf of the Company or any Subsidiary pursuant to or in connection with this Agreement or as an inducement to HSBC Bank to enter into this Agreement or any other lending agreement with the Company shall prove to have been false in any material respect at the time as of which the facts therein set forth were represented, or to have omitted any substantial contingent or unliquidated liability or claim against the Company or any Subsidiary required to be stated therein, or if on the date of the execution of this Agreement there shall have been any materially adverse change in any of the facts disclosed by any such statement or certificate, which change shall not have been disclosed by the Company to HSBC Bank at or prior to the time of such execution.

(g) **Other Indebtedness and Agreements.** The occurrence of a default by the Company in the performance of any other agreement between the Company and HSBC Bank including, without limitation, the Company's obligations under the Limited Continuing Guaranty dated as of July 1, 1999 between the Company and HSBC Bank ("Limited Guaranty"), or nonpayment by the Company or any Subsidiary of any other Indebtedness (other than as evidenced by the Note) owing by the Company or any Subsidiary in an amount equal to or exceeding \$1,000,000 when due (or, if permitted by the terms of the applicable document, within any applicable grace period), whether such Indebtedness shall become due by scheduled maturity, by required prepayment, by acceleration, by demand or otherwise, or failure to perform any term, covenant or agreement on its part to be performed under any agreement or instrument (other than this Agreement or the Limited Guaranty) evidencing or securing or relating to any Indebtedness owing by the Company or any Subsidiary in an amount equal to or exceeding \$1,000,000 when required to be performed if the effect of such failure is to accelerate or to permit the holder to accelerate the maturity of such Indebtedness.

(h) **Judgments.** If any judgment or judgments (other than any judgment for which it is fully insured) against the Company or any Subsidiary remains unpaid, unstayed on appeal, undischarged, unbonded or undismissed for a period of thirty (30) days after entry thereof.

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(i) **Pension Default.**

(i) The Company or any of its Subsidiaries (or any officer or director thereof) shall engage in any "prohibited transaction" (as defined in Section 406 of ERISA or Section 4975 of the Code) involving any Plan,

(ii) any "accumulated funding deficiency" (as defined in Section 302 of ERISA), shall exist with respect to any Plan,

(iii) with respect to any Multiemployer Plan, the Company or any Commonly Controlled Entity fails to make a contribution required to be made thereto, or withdraws therefrom, where in either event the liability of the Company or such Commonly Controlled Entity is in excess of \$100,000,

(iv) a Reportable Event shall occur with respect to, or proceedings shall commence to have a trustee appointed, or a trustee shall be appointed, to administer or to terminate, any Plan which is not a Multiemployer Plan, which Reportable Event or institution of proceedings is, in the reasonable opinion of HSBC Bank, likely to result in the termination of such Plan for purposes of Title IV of ERISA and, in the case of a Reportable Event, the continuance of such Reportable Event unremedied for ten (10) days after notice of such Reportable Event pursuant to Section 4043(a), (c) or (d) of ERISA is given or the continuance of such proceedings for ten (10) days after commencement thereof, as the case may be,

(v) any Plan shall terminate for purposes of Title IV of ERISA, or

(vi) any other similar event or condition shall exist which, together with all other events or conditions in clauses (i) through (v) above, if any, would subject the Company or any of its Subsidiaries to any tax, penalty or other liabilities under ERISA in the aggregate material in relation to the business, operations, property or financial or other condition of the Company and its Subsidiaries taken as a whole.

## 7.2 **Effects of an Event of Default.**

(a) Upon the happening of one or more Events of Default (except a default with respect to the Company under either Section 7.1(d) or 7.1(e) hereof), HSBC Bank may by notice to the Company require the principal of the Note then outstanding to be immediately payable, together with all interest thereon and fees and expenses accruing under this Agreement. Upon such declaration, any obligations HSBC Bank may have to the Company hereunder shall be immediately canceled and the Note shall become immediately due and payable without presentation, demand or further notice of any kind to the Company.

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(b) Upon the happening of one or more Events of Default under Section 7.1(d) or 7.1(e) hereof with respect to the Company, the Note shall become immediately payable without presentation, demand or notice of any kind to the Company.

## **ARTICLE VIII. Indemnification - Costs and Expenses**

8.1 **Indemnification.** The Company agrees to indemnify, defend, and hold harmless HSBC Bank from and against any and all liabilities, claims, damages, penalties, expenditures, losses, or charges, including, but not limited to, all costs of investigation, monitoring, legal representation, remedial response, removal, restoration or permit acquisition, which may now or in the future be undertaken, suffered, paid, awarded, assessed, or otherwise incurred by HSBC Bank, or any other Person as a result of the presence of, Release of or threatened Release of Hazardous Substances on, in, under or near the property owned or operated by the Company or any Subsidiary. The liability of the Company under the covenants of this Section is not limited by any exculpatory provisions in this Agreement and shall survive repayment of the Note, or any transfer or termination of this Agreement regardless of the means of such transfer or termination.

8.2 **Expenses.** The Company shall reimburse HSBC Bank promptly for all of its out-of-pocket expenses including, without limitation, reasonable counsel fees, filing fees, appraisal fees and recording fees incurred in connection with this Agreement and with any indebtedness subject hereto and for any taxes which HSBC Bank may be required to pay in connection with the execution and delivery of this Agreement and the Note. The Company shall further reimburse HSBC Bank promptly for any reasonable expenses, including counsel fees and out-of-pocket expenses, incident to the enforcement of any provision of this Agreement, the Note or any other document executed in connection with this Agreement or in connection with any Letter of Credit, the Existing Letter of Credit or the IRB Letters of Credit. Without limiting the Company's obligation to reimburse HSBC Bank pursuant to this Section 8.2, the Company hereby irrevocably authorizes HSBC Bank to make Line Loans to the Company and to use the proceeds thereof to pay any amount owed by the Company under this Section 8.2 upon the failure of the Company to make such payment, and HSBC Bank agrees to notify the Company of the making of such Line Loans. Any such Line Loans shall be made (i) in the minimum amount necessary and (ii) without regard to the requirements of this Agreement with respect to notice or minimum amount.



**ARTICLE IX. Miscellaneous**

9.1 **Amendments and Waivers.** No modification, rescission, waiver, release or amendment of any provision of this Agreement shall be made except by a written agreement subscribed by duly authorized officers of the Company and HSBC Bank.

9.2 **Delays and Omissions.** No course of dealing and no delay or omission by HSBC Bank in exercising any right or remedy hereunder or with respect to any indebtedness of the Company to HSBC Bank shall operate as a waiver thereof or of any other right or remedy, and no single or partial exercise thereof shall preclude any other or further exercise thereof or the exercise of any other right or remedy. All rights and remedies of HSBC Bank hereunder are cumulative.

9.3 **Participations and Assignments.** The Company shall not assign or otherwise transfer any of the rights of the Company pursuant to this Agreement without the prior written consent of HSBC Bank, and any such assignment or other transfer without such prior written consent shall be void. No consent by HSBC Bank to any such assignment or other transfer shall release the Company from any indebtedness, liability or obligation of the Company pursuant to this Agreement. HSBC Bank shall have the right to assign or otherwise transfer, or to grant any participation in, any indebtedness, liability or obligation of the Company to HSBC Bank pursuant to this Agreement or any of the rights and remedies of HSBC Bank pursuant to this Agreement provided any such assignee, transferee or participant is a lender organized under the laws of the United States of America or under the laws of a State in the United States of America, and assumes all or a pro-rata portion, as appropriate, of the obligations of HSBC Bank hereunder which are being transferred and the assignee/participant is a financial institution with combined capital and surplus in excess of \$250,000,000.

9.4 **Successors and Assigns.** The Company, Subsidiary and HSBC Bank as such terms are used herein shall include the legal representatives, successors and assigns of those parties.

9.5 **Notices.** All notices, requests and demands to or upon the respective parties hereto to be effective shall be in writing, unless otherwise expressly provided herein, and shall be deemed to have been given or made when delivered by hand or by facsimile (with a copy by regular mail), three (3) Business Days after being delivered to a courier for overnight delivery or five (5) Business Days after being deposited in the first class United States mail, addressed as follows, or to such other address as may be hereafter notified by the respective parties hereto:

To the Company:           Astronics Corporation  
                                  1801 Elmwood Avenue  
                                  Buffalo, New York 14207  
                                  Attn: C. Anthony Rider, Vice President-Finance and  
                                  Treasurer  
                                  Facsimile No. 716-447-9201  
                                  Telephone No. 716-447-9013

To HSBC Bank:            HSBC Bank USA  
                                  Commercial Banking Department  
                                  One HSBC Center  
                                  Buffalo, New York 14203  
                                  Attn: William H. Graser, First Vice President  
                                  Facsimile No. 716-855-0384  
                                  Telephone No. 716-841-2556

(With a copy               Phillips, Lytle, Hitchcock,  
which shall not           Blaine & Huber LLP  
itself constitute         3400 HSBC Center  
notice to):                Buffalo, New York 14203

Attn: Raymond H. Seitz, Esq.  
Facsimile No. 716-852-6100  
Telephone No. 716-847-7065

9.6 **Governing Law.** This Agreement, the transactions described herein and the obligations of the parties hereto shall be construed under, and governed by, the internal laws of the State of New York without regard to principles of conflicts of law.

9.7 **Counterparts.** This Agreement may be executed in any number of counterparts and by HSBC Bank and the Company on separate counterparts, each of which when so executed and delivered shall be an original, but all such counterparts shall together constitute one and the same Agreement.

9.8 **Titles.** Titles to the sections of this Agreement are solely for the convenience of the parties, and are not an aid in the interpretation of this Agreement or any part thereof.

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9.9 **Inconsistent Provisions.** The terms of this Agreement and any related agreements, instruments or other documents shall be cumulative except to the extent that they are specifically inconsistent with each other, in which case the terms of this Agreement shall prevail.

9.10 **JURY TRIAL WAIVER.** EACH OF THE PARTIES HERETO WAIVES ANY RIGHT TO TRIAL BY JURY WHICH IT MAY HAVE IN ANY ACTION OR PROCEEDING, IN LAW OR EQUITY, IN CONNECTION WITH THIS AGREEMENT OR THE TRANSACTIONS RELATED HERETO.

9.11 **CONSENT TO JURISDICTION.** THE COMPANY AND HSBC BANK AGREE THAT ANY ACTION OR PROCEEDING TO ENFORCE OR ARISING OUT OF THIS AGREEMENT MAY BE COMMENCED IN THE SUPREME COURT OF NEW YORK IN ERIE COUNTY, OR IN THE DISTRICT COURT OF THE UNITED STATES IN THE WESTERN DISTRICT OF NEW YORK, AND THE COMPANY WAIVES PERSONAL SERVICE OF PROCESS AND AGREES THAT A SUMMONS AND COMPLAINT COMMENCING AN ACTION OR PROCEEDING IN ANY SUCH COURT SHALL BE PROPERLY SERVED AND SHALL CONFER PERSONAL JURISDICTION IF SERVED BY REGISTERED OR CERTIFIED MAIL TO THE COMPANY, OR AS OTHERWISE PROVIDED BY THE LAWS OF THE STATE OF NEW YORK OR THE UNITED STATES.

**IN WITNESS WHEREOF**, the parties hereto have caused this Agreement to be signed by their duly authorized officers, all as of the 20<sup>th</sup> day of February, 2003.

**Company:**

**ASTRONICS CORPORATION**

**By:**

\_\_\_\_\_  
**C. Anthony Rider**  
**Vice President-Finance and Treasurer**

**HSBC Bank:**

**HSBC BANK USA**

**By:**

\_\_\_\_\_  
**William H. Graser**  
**First Vice President**

**EXHIBIT A**

**LINE OF CREDIT NOTE**

**\$8,000,000.00**

**Buffalo, New York**  
**February 20, 2003**

**FOR VALUE RECEIVED**, the undersigned, **ASTRONICS CORPORATION** ("Company"), unconditionally promises to pay **ON DEMAND** to the order of **HSBC BANK USA** ("HSBC Bank") at its One HSBC Center office, Buffalo, New York 14203, or at the holder's option, at such other place as may be designated in writing by the holder, the principal sum equal to the lesser of (a) EIGHT MILLION DOLLARS (\$8,000,000.00) or (b) the aggregate unpaid principal amount of all Line Loans made by HSBC Bank to the Company pursuant to the Credit Agreement dated of even date herewith between the Company and HSBC Bank, as the same may from time to time be amended, supplemented or otherwise modified ("Credit Agreement"), together with interest at the rate and on the terms as specified herein. All capitalized terms used in this Note and not otherwise defined shall have the meanings set forth in the Credit Agreement.

This Note shall bear interest on the balance of principal from time to time unpaid from the date hereof until demand by HSBC Bank at the rates and on the dates determined in accordance with Section 2.3 of the Credit Agreement. Interest shall be calculated on the basis of a 360-day year and actual days elapsed which will result in a higher effective annual rate. Interest on Prime Rate Loans shall be payable monthly in arrears commencing on March 1, 2003 and on the first day of each month thereafter. Interest on LIBOR Loans shall be payable on the earlier of (i) the end of each LIBOR Interest Period, or (ii) the first day of each month. Interest shall also be payable on the date this Note is paid in full. After demand by HSBC Bank, this Note shall bear interest at a rate per annum equal to three percent (3%) in excess of the rate of interest otherwise in effect from time to time; provided, however, in no event shall the rate of interest on this Note exceed the maximum rate authorized by applicable law. Payments of both principal and interest are to be made in lawful money of the United States of America in immediately available funds.

HSBC Bank is authorized to inscribe on the schedule on the reverse side hereof or any continuation thereof ("Schedule") the amount, and the date of making, continuation or conversion of each Line Loan, each payment of principal with respect thereto, its character as a LIBOR Loan or Prime Rate Loan and the dates on which each LIBOR Interest Period shall begin and end. Each entry on the Schedule attached hereto (and any continuation thereof) shall be prima facie evidence of the facts so set forth. No failure by HSBC Bank to make, and no error by HSBC Bank in making, any inscription on the Schedule shall affect the Company's obligation to repay the full principal amount of the Line Loans made by HSBC Bank to the Company or the Company's obligation to pay interest thereon at the agreed upon rate.

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If any payment on this Note becomes due and payable on a day other than a Business Day, the maturity thereof shall be extended to the next succeeding Business Day, and Company will pay interest at the then applicable rate until the date of actual receipt of such payment by the holder of this Note.

No modification, rescission, waiver, release or amendment of any provision of this Note shall be made except by a written agreement subscribed by duly authorized officers of the Company and the holder hereof.

The Company hereby waives diligence, presentment, protest and demand, and also notice of protest, demand, dishonor and nonpayment of this Note.

This Note is the Line of Credit Note referred to in the Credit Agreement, to which reference is hereby made with respect to interest rate options and rights of repayment and applicable fees on the occurrence of certain events.

The Company agrees to pay all out-of-pocket costs and expenses incurred by the holder in preserving the holder's rights, enforcing this Note or in collecting the indebtedness evidenced hereby, including, without limitation, if the holder retains counsel for any such purposes, reasonable attorneys' fees and expenses.

This Note shall be construed under, and governed by, the internal laws of the State of New York without regard to principles of conflicts of laws.

**ASTRONICS CORPORATION**

**By:**

\_\_\_\_\_

**C. Anthony Rider**

**Vice President-Finance and Treasurer**

SCHEDULE

LOANS AND PAYMENT OF PRINCIPAL

TYPE OF LOAN	DATE LOAN MADE, CONTINUED OR CONVERTED	AMOUNT OF LOAN MADE, CONTINUED OR CONVERTED	LIBOR INTEREST PERIOD DATES	AMOUNT OF PRINCIPAL PAID OR PREPAID	AGGREGATE UNPAID PRINCIPAL BALANCE	NOTATION MADE BY AND DATE

EXHIBIT B

**COMPLIANCE CERTIFICATE**

**ASTRONICS CORPORATION** ("Company") hereby certifies to **HSBC BANK USA** ("HSBC Bank") pursuant to the Credit Agreement between the Company and HSBC Bank dated February 20, 2003 ("Agreement"), that:

- Capitalized terms not defined herein shall have the meanings set forth in the Agreement.
- The Company has complied with all the terms, covenants and conditions to be performed or observed by it contained in the Agreement.
- There exists no Potential Default or Event of Default on the date hereof or, if applicable, after giving effect to the Line Loan, LIBOR Loan or Prime Rate Loan made, continued or converted on the date hereof.
- The representations and warranties contained in the Agreement, or in any certificate, document or financial or other statement furnished at any time thereunder are true, correct and complete in all material respects with the same effect as though such representations and warranties had been made on the date hereof, except to the extent that any such representation and warranty relates solely to an earlier date (in which case such representation and warranty shall be true, correct and complete on and as of such earlier date).
- There is no unsatisfied reimbursement obligation of the Company in connection with any Letter of Credit, the Existing Letter of Credit or the IRB Letters of Credit.

WITNESS the signature of a duly authorized officer of the Company on \_\_\_\_\_, 20\_\_.

**ASTRONICS CORPORATION**

By: \_\_\_\_\_

Name: \_\_\_\_\_

Title: \_\_\_\_\_

**EXHIBIT C**

**REQUEST CERTIFICATE**

**Line of Credit**

The undersigned hereby certifies to HSBC Bank USA ("HSBC Bank") in accordance with the terms of a Credit Agreement dated February 20, 2003 from the undersigned to HSBC Bank;

The undersigned requests or has requested by telephone or facsimile notice a:

(Check One)

- new loan
- conversion
- continuation

of a

(Check One)

- LIBOR Loan
- Prime Rate Loan

to a or as a

(Check One)

- LIBOR Loan
- Prime Rate Loan

in the amount of \$ \_\_\_\_\_ for an Interest Period, if applicable, of

(Check One)

- one month.
- three months.
- six months.

The proposed conversion/continuation is to be made on \_\_\_\_\_, 20\_\_ which is a Business Day.

WITNESS the signature of the undersigned authorized signatory of the Company this \_\_\_\_ day of \_\_\_\_\_, 20\_\_.

**ASTRONICS CORPORATION**

**By:** \_\_\_\_\_

**(Title)**

**SCHEDULE 1**

**EMPLOYEE BENEFITS PLAN**

Atro Companies' Profit Sharing/401K Plan

**SCHEDULE 2****LIENS AND INDEBTEDNESS**

<u>Property/Equipment</u>	<u>Owner</u>	<u>Lien Held By</u>	<u>Type</u>	<u>6/30/02 Balance</u>	<u>Due Date</u>
Lot 27, Centerra Business Park 4 Lucent Drive Lebanon, New Hampshire	Luminescent Systems, Inc.	HSBC Bank	Loan	\$6,450,000	06/18
130 Commerce Way East Aurora, New York	Luminescent Systems, Inc.	HSBC Bank	Loan	5,950,000	12/19
130 Commerce Way East Aurora, New York	Luminescent Systems, Inc.	Erie County Industrial Development Agency	Loan	128,000	12/03

**SCHEDULE 3****SUBSIDIARIES; AFFILIATES**

<u>Company</u>	<u>Incorporated</u>
Luminescent Systems, Inc.	New York
Luminescent Systems Europe B.V.B.A.	Belgium
Luminescent Systems of Canada Inc.	Quebec, Canada

# ASTRONICS CORPORATION

Continued Advancement in Lighting and Electronics Systems

## Annual Report 2002

### Astronics Corporation

A leader in advanced complex lighting and electronics systems for the global aerospace industry, Astronics began in 1968 as a research and development company in electroluminescent lighting. It has evolved since its public offering in 1972 to a principal designer and manufacturer of external, cockpit and cabin lighting systems and the supporting electronics and power supplies for the military, commercial transport and general aviation markets. Astronics provides its products to major aircraft manufacturers, avionics companies and operators around the world.

### Our strategy

Astronics' strategy for growth is to continue to develop or acquire the necessary technology to expand our presence on every aircraft where lighting and supporting electronics systems are needed. We will capitalize on the solid reputation we have built for high quality designs, exceptional responsiveness, our strong brand recognition and best-in-class manufacturing practices to continue to grow market share while capturing ever greater share of aircraft lighting and electronics content.

NASDAQ **ATRO**

### 2002 NET SALES \$42.9 million

### FIVE YEAR PERFORMANCE HIGHLIGHT

(dollars in thousands, except for per share data)

	2002	2001	2000	1999	1998
<b>PERFORMANCE</b> (continuing operations)					
Net Sales	\$ 42,940	\$ 52,591	\$ 42,569	\$ 24,827	\$ 23,498
Earnings Before Interest and Tax	6,638	9,261	5,982	3,801	4,161
Operating margin	15.5%	17.6%	14.1%	15.3%	17.7%
Income from Continuing Operations	4,047	5,821	3,500	2,410	2,426

Net Margin	9.4 %	11.1 %	8.2 %	9.7 %	10.3 %
Basic Earnings per Share	0.51	0.72	0.45	0.31	0.32
Weighted Average Shares Outstanding - Basic	8,033	8,052	7,831	7,709	7,618
Diluted Earnings per Share	0.49	0.70	0.43	0.30	0.30
Weighted Average Shares Outstanding - diluted	8,208	8,346	8,221	8,172	8,155
Return on Sales	9.4 %	11.1 %	8.3 %	9.7 %	10.3 %
Return on Average Assets	9.0 %	12.6 %	9.0 %	8.1 %	10.2 %
Return on Average Equity	9.7 %	15.6 %	11.3 %	9.5 %	10.7 %

#### Year End Financial Position

Working Capital	\$ 17,750	\$ 21,646	\$ 13,721	\$ 5,443	\$ 6,305
Total Assets	67,349	71,454	67,020	59,852	43,707
Long-term Debt	13,110	15,529	17,746	15,947	12,108
Shareholders' Equity	42,939	40,671	34,190	27,837	22,730
Book Value per Share	5.46	5.03	4.34	3.57	2.97

#### Other Year End Data

Depreciation and amortization	\$ 1,269	\$ 1,441	\$ 1,310	\$ 934	\$ 754
Capital expenditures	397	838	2,665	9,650	3,814
Shares of Capital Stock Outstanding	7,870	8,085	7,884	7,803	7,658
Number of registered shareholders	834	876	950	964	1,007

## DEAR FELLOW SHAREHOLDERS

2002 was a year of solid operating performance for Astronics in the face of challenging circumstances. It was a period for strategic alignment and a testament to the innovation of our Company with its win as the supplier of the entire external lighting suite for the Joint Strike Fighter. As a result of both the continued weak state of the economy and the inherent nature of military program contract cycles, the challenges we face are not completely behind us, yet we believe we are well situated for this transitional period as we continue our pursuit of being a growing force within the ranks of top tier suppliers to the worldwide aerospace industry.

### Strategic Alignment

In September of 2002, we announced that we would spin-off MOD-PAC CORP., our printing business segment. The spin-off was successfully completed in early 2003. Although a part of Astronics for 30 years, we recognized that as separate companies investors can better realize the value of Astronics' operations, markets, and opportunities, which are significantly different from MOD-PAC's. In effect, we should be able to achieve more appropriate valuation as a pure aerospace industry supplier; a valuation that reflects both the business risk and the potential return associated with the aerospace industry.

We also discontinued operations of our Electroluminescent Lamp (EL) Business Group, which manufactured micro-encapsulated EL lamps for the consumer electronics industry. The EL business had less than \$1 million in sales in 2002. Consistent with the logic behind the spin-off, the elimination of this business allows us to focus our resources toward our aerospace business and the development of technologies and processes that will provide for our growth in this industry.



We continue to focus our development and sales on three market sectors within the aerospace industry: the military, commercial transport, and general aviation, which includes business jets and private aircraft. For these sectors, in varying degrees for each, we provide lighting products and related power systems for cockpits, cabins and controls, and aircraft exteriors.

#### Financial Performance

The wind-down of the extremely successful F-16 lighting systems program and the troubled commercial airline industry measurably impacted sales in 2002 which declined \$9.7 million, or 18%, to \$42.9 million from record levels in 2001 of \$52.6 million. The decrease in net sales is comprised of a \$9.2 million decrease in net sales under our night vision cockpit modification program with the US Air Force for the F-16. Excluding sales from spares and replacements subsequent to the original F-16 program, revenue from the F-16 program was \$10.9 million in 2002 compared with \$20.1 million in 2001.

Despite the decline in sales, gross margin held up well at 28.5% for 2002, slightly better than the 28.3% for 2001. This was primarily because of our efforts to manage our cost structure in preparation for the wind down of the F-16 program. We are continually addressing our operational efficiencies, employing highly flexible manufacturing techniques and processes. As a result, our head count dedicated to continuing operations was reduced 15%, or by 46 people, during 2002. On an annualized basis the estimated cost savings from this reduction was \$1.5 million, which should be realized in 2003. Income from continuing operations for 2002 was \$4.0 million compared with \$5.8 million in 2001, a decline of 31%.

**"Despite the decline in sales, gross margin  
held up well at 28.5% for 2002"**

Our solid balance sheet, with long term debt at 25% of total capitalization, provides us financial flexibility. Additionally, we generate strong levels of cash, having free cash flow in 2002 of \$5.4 million, which enables us to execute our strategy. Free cash flow is defined as net income plus depreciation and amortization less capital expenditures.

#### Continued Advancement: Expanding Our Product content on Aircraft

Winning the award of the Joint Strike Fighter (JSF) program means a significant source of future business for Astronics. Although planned production is not until 2008, we anticipate time will demonstrate that our involvement in this program will be a significant defining event for the Company. The JSF program has launched us into the external lighting product area, a market we have only had a minor role in historically. With this program, we will go beyond cabin and cockpit lighting where we traditionally competed in the military market. For the JSF, we have won the entire external lighting suite to include landing, positioning and anti-collision lighting, and the interface and control systems to operate the suite. Through the development phase, we will design a suite that incorporates advanced technology and create new ideas for external aircraft lighting.

We have also won a number of key cockpit lighting awards from various customers. As a result, we expect growth in our cockpit lighting line, excluding the F-16 program portion of cockpit lighting sales, of around 15% in 2003. Cockpit lighting sales, which represented almost one-half of revenue in 2002, includes cockpit panels, flood lighting, avionics keyboards, and related electronics. Also, approximately 50% of sales related to the F-16 program were cockpit lighting products, while the remainder was external lighting products.

Importantly, even though our F-16 program is ending, we continue to find other opportunities for selling our kit. For example, we are developing relations with foreign F-16 operators. Foreign fleets are smaller, but retrofit programs have valuable repercussions for sales as they allow us to provide our product for the complete fleet in a relatively short period of time versus new build programs, which are typically smaller numbers over a longer period. In addition, this incrementally expands the installed base to which we provide replacement parts.

#### Outlook

We entered 2003 with a backlog of \$17.2 million compared with a backlog of \$27.3 million at the end of 2001. Backlog at the end of 2001 included \$13.5 million for the F-16 program. The end of 2002 backlog included F-16 kits and spares of \$2.9 million, most of which was scheduled to ship in the first quarter. F-16 spares are included in backlog when scheduled for release. We expect the business for spares and kits for U.S. F-16's to approximate \$6.0 million in 2003. As previously mentioned, we expect growth in our cockpit lighting line of 15% in 2003. Given our current

backlog, our sales prospects and assuming no further deterioration, nor any improvement, in the state of the aerospace industry as a whole, we believe that we can achieve planned revenue of \$34 to \$36 million in 2003 with less than approximately \$2 million anticipated from the original F-16 program.

Looking forward, we are strategically broadening our design and manufacturing capabilities to continue to strengthen our impact on, and market share in, the lighting and electronics arena for the aerospace industry. We believe there will be consolidation opportunities among aerospace component suppliers because of the state of the industry. With our solid balance sheet and free cash flow, we have the financial resources to take advantage of these opportunities if they present themselves at reasonable valuations. We will be a selective, strategic buyer looking for assets that will strengthen our overall competency in the aerospace lighting industry.

Thank you for your continued interest in Astronics.

/s/ Kevin T. Keane	/s/Peter J. Gundermann
Kevin T. Keane	Peter J. Gundermann
Chairman	President and CEO

*Astronics provides its technologies in three product categories to three primary market sectors: military aircraft, general aviation (corporate and private jet) and commercial transport. Technology and engineering concepts developed to meet a particular market's requirements often apply to other markets as well, broadening our product offering and capabilities. Astronics is actively pursuing the opportunities resulting from the trend for aircraft manufacturers to outsource the design and manufacture of critical control assemblies. We effectively continue to evolve beyond a component supplier to a systems developer.*

## TECHNOLOGIES AND MARKETS

### COCKPIT LIGHTING SYSTEMS

Comprising almost half of 2002 revenues, cockpit lighting systems are the foundation upon which Astronics has developed its technologies.

Cockpit components include integrally illuminated display panels, avionics keyboards, flood lights, map lights, caution/ indicator panels, ambient light sensors, and a range of power supplies and dimmer units needed to control the lighting system.

Night Vision Cockpit Lighting: Well versed in the technology of night vision lighting, Astronics designed and supplied the upgraded cockpit lighting systems for over 1,100 F-16 Falcons in the U.S. Air Force fleet. Over a four-year period, most every light in the aircraft cockpit was fully retrofitted using Astronics technology. The retrofit program included avionics keyboards, floodlights, instrument lighting and indicators, and

### EXTERIOR LIGHTING SYSTEMS

The Company has long manufactured electroluminescent formation lights for military aircraft, highly specialized lights that are used as positional aids when aircraft are flying in close proximity to one another. The company enjoys a dominant position in this narrow segment, with product on most every military airplane flown in the western world, both rotary and fixed wing.

We recently decided to pursue the broader aircraft exterior lighting market, where products like position, anti-collision, landing/ taxi, logo, wing de-ice, aerial refueling, and approach lights are required. Our efforts were rewarded with the award in 2002 of the Joint Strike Fighter exterior lighting contract. The

### CABIN LIGHTING SYSTEMS

The Company has been involved with emergency egress lighting systems for over fifteen years. These systems are designed to help airline passengers identify aircraft exits in the case of emergency. We provide escape path lighting direct to over 200 airline operators around the world, to include Virgin Atlantic, Air France, Qantas, Singapore Airlines and Cathay Pacific. As with other technologies, once designed into the aircraft, we become the preferred supplier for replacement parts providing for a recurring revenue stream for the life of each aircraft containing our systems. We are expanding our capabilities beyond the escape path to include reading lights, passenger signage and general area lighting systems.

annunciators. Astronics is well suited for providing the upgrade systems for other countries that fly the F-16 in their fleets or to ground applications with night vision requirements.

Joint Strike Fighter program win is a distinct recognition of Astronics' capabilities as a systems developer, and recognizes our strategic effort to evolve into a supplier of comprehensive exterior lighting systems.

"The Company enjoys a **dominant position** in exterior lighting with product **on most U.S. military aircraft.**"

"Production of the **Joint Strike Fighter**, is planned to begin in 2008 and could result in over **\$100 million in sales** for Astronics."

## MARKETS SERVED

### Military Aircraft

*Astronics formation lights fly on almost every aircraft in the western world, including the F-14, F-15, F-16, F-18, A/F-22, AV-8, C-130, C-17, UH-60, CH-47, AH-64, and V-22. We are also on most European aircraft, including the new Eurofighter Typhoon.*

*In addition, we provide cockpit lighting components to most of the newer military aircraft, where night vision lighting is critical. We believe we have a competitive advantage for large retrofit opportunities, like the F-16 night vision program we are just completing. There are a number of other equipment and aircraft in the US military that are likely to undergo similar retrofit operations. Foreign fleets of various aircraft, which include the F-16, are also candidates for retrofit programs.*

*Finally, because our content on aircraft such as the F-22, V-22, RAH-66, and F-35 is significantly greater than what it was on older aircraft, we have greater growth opportunities for replacement and spares with this new generation of military aircraft.*

### Commercial Transport

*The large commercial airlines continued to be severely impacted in 2002 by massive debt, high cost structures, and low passenger miles. Airlines around the world are struggling to achieve profitability and have cut down on capacity, reducing the amount of spare parts they must buy. They have become much more aggressive with suppliers, demanding onerous terms and putting downward pressure on prices. And perhaps most importantly, they have revised downward their plans to buy new aircraft, resulting in production cuts at the major suppliers, Boeing and Airbus.*

*Conversely, regional jet manufacturers, such as Bombardier and Embraer, production rates have not been as severely impacted as the airlines employ smaller aircraft in their fleets. Astronics is among their leading suppliers of escape path systems.*

### General Aviation

*This market was strong in the last few years, fueled by corporate aircraft sales and the rise of fractional ownership programs, which have proven to be very popular. Impacted by the economy and the resulting lower capital spending by corporations, most aircraft manufacturers are predicting flat, or mildly depressed, volumes for 2003. Over the long-term, most aviation industry experts expect the positive trends for general aviation to continue, as technical innovation, reduced costs of ownership, and continuing frustration with the commercial airlines combine to attract new customers.*

*Astronics is a major supplier of cockpit lighting systems to most major aircraft manufacturers including Cessna, Raytheon and Bombardier (Learjet). We view cabin and external lighting as opportunities to expand our content on each aircraft in this market sector.*

## Major Program Award:

*In November 2002, LSI signed a memorandum of agreement to be the developer and supplier of the complete exterior lighting system for the Joint Strike Fighter (JSF). The JSF is a stealthy, supersonic, multi-role fighter for the US Air Force, Navy and Marine Corps, as well as the U.K. Royal Air Force and Royal Navy. Also known as the F-35, aircraft production is planned to begin in 2008 and could result in over \$100 million in sales for Astronics.*

## Financial Summary

### CONSOLIDATED STATEMENT OF INCOME

(in thousands, except per share data)	Year ended December 31,		
	2002	2001	2000
Net Sales	\$ 42,940	\$ 52,591	\$ 42,569
Cost and Expenses			
Cost of Products Sold	30,691	37,718	31,384
Selling, General and Administrative Expenses	5,611	5,539	4,955
Interest Expense, Net of Interest Income of \$245, \$199 and \$200	223	496	628
Loss on Sale of Assets	—	73	308
	<u>36,275</u>	<u>43,826</u>	<u>37,275</u>
Income from Continuing Operations Before Income Taxes	6,415	8,765	5,294
Provision for Income Taxes	<u>2,368</u>	<u>2,944</u>	<u>1,794</u>
Income from Continuing Operations	<u>4,047</u>	<u>5,821</u>	<u>3,500</u>
Income from Discontinued Operations	<u>506</u>	<u>677</u>	<u>2,595</u>
Net Income	\$ 4,553	\$ 6,498	\$ 6,095
Basic Earnings per Share			
Continuing Operations	\$ .51	\$ .72	\$ .45
Discontinued Operations	.06	.09	.33
Net Income	\$ .57	\$ .81	\$ .78
Diluted Earnings per Share			
Continuing Operations	\$ .49	\$ .70	\$ .43
Discontinued Operations	.06	.08	.31
Net Income	\$ .55	\$ .78	\$ .74

**See notes to financial statements.**

**CONSOLIDATED BALANCE SHEET**

(in thousands, except share data)	December 31,	
	2002	2001
<b>Current Assets</b>		
Cash and Cash Equivalents	\$ 7,722	\$ 9,176
Due from MOD-PAC CORP	4,751	—
Accounts Receivable, Net of Allowance for Doubtful Accounts of \$397 in 2002 and \$177 in 2001	4,745	6,797
Inventories	6,139	6,109
Net Current Assets of Discontinued Operations	—	10,164
Prepaid Expenses	434	362
<b>Total Current Assets</b>	<b>23,791</b>	<b>32,608</b>
<b>Property, Plant and Equipment, at Cost</b>		
Land	1,143	1,143
Buildings and Improvements	12,007	12,007
Machinery and Equipment	10,624	10,228
	23,774	23,378
Less Accumulated Depreciation and Amortization	8,111	7,092
<b>Net Property, Plant and Equipment</b>	<b>15,663</b>	<b>16,286</b>
<b>Net Long-term Assets of Discontinued Operations</b>	<b>20,742</b>	<b>15,711</b>
Deferred Income Taxes	1,255	772
Goodwill	2,135	2,135
Other Assets	3,763	3,942
	<b>\$ 67,349</b>	<b>\$ 71,454</b>
<b>Current Liabilities</b>		
Current Maturities of Long-term Debt	\$ 873	\$ 989
Net Current Liabilities of Discontinued Operations	1,034	—
Accounts Payable	1,939	3,284
Accrued Payroll and Employee Benefits	1,565	1,798
Due to MOD-PAC CORP	—	3,933
Other Accrued Expenses	630	613
Income Taxes	—	345
<b>Total Current Liabilities</b>	<b>6,041</b>	<b>10,962</b>
<b>Long-term Debt</b>	<b>13,110</b>	<b>15,529</b>
Supplemental Retirement Plan	4,823	3,868
Other Liabilities	436	424
<b>Shareholders' Equity</b>		
Common Stock, \$01 par Value		
Authorized 10,000,000 Shares, issued 6,441,445 in 2002; 5,975,409 in 2001	64	60
Class B Stock, \$.01 par Value		
Authorized 5,000,000 Shares, issued 2,131,898 in 2002; 2,524,432 in 2001	21	25
Additional Paid-in Capital	3,790	3,433
Accumulated Other Comprehensive Income (loss)	(545)	35
Retained Earnings	42,831	38,278
	46,161	41,831
Less Treasury Stock: 703,295 Shares in 2002; 414,669 Shares in 2001	3,222	1,160
<b>Total Shareholders' Equity</b>	<b>42,939</b>	<b>40,671</b>
	<b>\$ 67,349</b>	<b>\$ 71,454</b>

See note to financial statements.

**CONSOLIDATED STATEMENT OF CASH FLOWS**

Year ended December  
31,  
2002 2001 2002



(net of income taxes of \$28)								45	<u>45</u>
Total Comprehensive Income									\$ <u>6,526</u>
Stock Distribution		1,699	17	84					(29)
Treasury Stock Sold				(28)	(93)	137			
Treasury Stock Purchased				41	461				
Exercise of Stock Options	159	2	16			196			
Class B Stock converted to Common Stock	382	4	(382)	(4)					
Balance at December 31, 2001	5,975\$	60	2,524\$	25	415	\$1,160\$	3,433\$	\$35	\$ 38,278
Net Income for 2002									4,553 \$ 4,553
Minimum Pension Liability Adjustment									
(net of income tax benefit of \$127)								(207)	(207)
Currency Translation Adjustments								(44)	(44)
Mark to Market Adjustments for Derivatives									
(net of income taxes of \$201)								(329)	<u>(329)</u>
Total Comprehensive Income									\$ <u>3,973</u>
Treasury Stock Sold				(6)	(27)	17			
Treasury Stock Purchased				294	2,089				
Exercise of Stock Options	54	—	20	—		340			
Class B Stock converted to Common Stock	412	4	(412)	(4)					
Balance at December 31, 2002	6,441\$	64	2,132\$	21	703	\$3,222\$	3,790\$	(545)	\$ 42,831

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Note 1

#### Summary of Significant Accounting Principles and Practices

##### Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, except for MOD-PAC Corp., which is presented with discontinued operations. All intercompany transactions and balances have been eliminated.

##### Revenue and Expense Recognition

Revenue is recognized on the accrual basis, i.e., at the time of shipment of goods. There are no significant contracts allowing for right of return. A trade receivable is recorded at the value of the sale. The Company performs periodic credit evaluations of its customers' financial condition and generally does not require collateral. Amounts not collected from customers within 120 days of the due date of the invoice are credited to the allowance for doubtful accounts. After collection efforts have been exhausted, uncollected balances are charged off to the allowance. Shipping and handling costs are expensed as incurred and are included in costs of products sold. The Company accounts for its stock-based awards using the intrinsic value method in accordance with Accounting Principles Board Opinion No. 25 and its related interpretations.

The measurement prescribed by APB Opinion No. 25 does not recognize compensation expense if the exercise price of the stock option equals the market price of the underlying stock on the date of grant. Accordingly, no compensation expense related to stock options has been recorded in the financial statements.

The following table provides pro forma earnings information as if the Company recorded compensation expense based on the fair value of stock options:

	2002	2001	2000
Income from Continuing Operations, as reported	\$4,047	\$5,821	\$3,500
Adjustment to record compensation			

expense for Stock Option Awards under the Fair Value Method of Accounting	(273 )	(250 )	(203 )
Pro Forma Income from Continuing Operations	\$3,774	\$5,571	3,297
Net Income, as reported	\$4,553	\$6,498	\$6,095
Adjustment to record compensation expense for Stock Option Awards under the Fair Value Method of Accounting	(363 )	(322 )	(267 )
Pro Forma Net Income	\$4,190	6,176	\$5,828
Pro-Forma Basic Earnings Per Share			
Continuing Operations	\$0.47	\$0.69	\$0.42
Net Income	\$0.52	\$0.77	\$0.74
Pro-Forma Diluted Earnings Per Share			
Continuing Operations	\$0.46	\$0.67	0.4
Net Income	\$0.51	\$0.74	0.71

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

### Cash and Cash Equivalents

All highly liquid instruments with a maturity of three months or less at the time of purchase are considered cash equivalents.

### Inventories

Inventories are stated at the lower of cost or market, cost being determined in accordance with the first-in, first-out method. Inventories at December 31 are as follows:

	(in thousands)	
	2002	2001
Finished Goods	\$ 640	\$ 689
Work in Progress	1,011	1,031
Raw Material	4,488	4,389
	\$ \$6,139	\$ 6,109

### Property, Plant and Equipment

Depreciation of property, plant and equipment is computed on the straight-line method for financial reporting purposes and on accelerated methods for income tax purposes. Estimated useful lives of the assets are as follows: buildings, 40 years; and machinery and equipment, 4-10 years. Leasehold improvements are amortized over the terms of the lease or the lives of the assets, whichever is shorter.

The cost of properties sold or otherwise disposed of and the accumulated depreciation thereon are eliminated from the accounts, and the resulting gain or loss, as well as maintenance and repair expenses, are reflected in income. Renewals and betterments are capitalized.

### Goodwill

On January 1, 2002, the Company adopted the provisions of Statements of Financial Accounting Standards (SFAS) No. 142, "Goodwill and Other Intangible Assets" and (SFAS) No. 141, "Business Combinations." The Company ceased amortizing goodwill on that date. No reclassification of identifiable intangible assets apart from goodwill was necessary as a result of the adoption of these standards. Prior to the adoption of SFAS No. 142, the Company amortized goodwill on a straight-line basis over periods up to 15 years. The Company tests goodwill at the reporting unit level on an annual basis or more frequently if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. The impairment test consists of comparing the fair value of a reporting unit with its carrying amount including goodwill, and, if the carrying amount of the reporting unit exceeds its fair value, comparing the implied fair value of goodwill with its carrying



amount. An impairment loss would be recognized for the carrying amount of goodwill in excess of its implied fair value. Goodwill amortization in 2001 was \$156,000 and 5115,000 in 2000.

#### Income Taxes

The Company recognizes deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the financial reporting and tax basis of assets and liabilities. Deferred tax assets are reduced, if deemed necessary, by a valuation allowance for the amount of tax benefits which are not expected to be realized.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

#### Earnings Per Share

Earnings per share computations are based upon the following table:

	(in thousands, except per share data)		
	2002	2001	2000
Income from Continuing Operations	\$ 4,047	\$ 5,821	\$ 3,500
Income from Discontinued Operations	506	677	2,595
Net Income	<u>\$ 4,553</u>	<u>\$ 6,498</u>	<u>\$ 6,095</u>
Basic Earnings per Share			
Weighted Average Shares	8,033	8,052	7,831
Net Effect of Dilutive Stock Options	175	294	390
Diluted Earnings per Share			
Weighted Average Shares	<u>8,208</u>	<u>8,346</u>	<u>8,221</u>
Basic Earnings per Share			
Continuing Operations	\$ .51	\$ .72	\$ .45
Discontinued Operations	.06	.09	.33
Net Income	<u>\$ .57</u>	<u>\$ .81</u>	<u>\$ .78</u>
Diluted Earnings per Share			
Continuing Operations	\$ .49	\$ .70	\$ .43
Discontinued Operations	.06	.08	.31
Net Income	<u>\$ .55</u>	<u>\$ .78</u>	<u>\$ .74</u>

All earnings per share calculations have been retroactively restated to reflect the effect of stock distribution.

#### Class B Stock

Class B Stock is identical to Common Stock, except Class B Stock has ten votes per share, is automatically converted to Common Stock when sold or transferred, and cannot receive dividends unless an equal or greater amount is declared on Common Stock. At December 31, 2002, approximately 3,000,000 shares of common stock were reserved for issuance upon conversion of the Class B stock and exercise of stock options.

#### Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

#### Long-lived Assets

Long-lived assets to be held and used are initially recorded at cost. The carrying value of these assets is evaluated for recoverability whenever adverse effects or changes in circumstances indicate that the carrying amount may not be recoverable. Impairments are recognized if future undiscounted cash flows and earnings from operations are not expected to be sufficient to recover long-lived assets. The carrying amounts are then reduced by the estimated shortfall of the discounted cash flows.

## **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS** (CONTINUED)

### Derivatives

The Company records all derivatives on the balance sheet at fair value. The accounting for changes in the fair value of derivative depends on the intended use and resulting designation. The Company designates its derivatives based upon the criteria established by SFAS No. 133, 'Accounting for Derivative Instruments and Hedging Activities'. The Company only has derivatives designated as cash flow hedges at December 31, 2002. For a derivative designated as cash flow hedge, the effective portion of the derivative's gain or loss is initially reported as component of other comprehensive income ("OCI") and subsequently reclassified into earnings when the hedged exposure affects earnings. The ineffective portions of all derivatives are recognized immediately into earnings. For derivative not designated as a hedging instrument, the gain or loss is recognized in earnings in the period of change. The Company classifies the cash flows from hedging transactions in the same category as the cash flows from the respective hedged items.

### **Note 2**

#### New Accounting Pronouncements Not Yet Adopted

In July 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit and Disposal Activities." SFAS No. 146 addresses financial accounting and reporting for costs associated with exit or disposal activities. SFAS No. 146 requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred and that an entity's commitment to a plan, by itself, does not create a present obligation to others that meets the definition of a liability. The Company must adopt this standard for exit or disposal activities that are initiated after December 31 2002. The Company believes it will not have a material impact on its results of operations or financial condition.

In April, 2002, the FASB issued SFAS No. 145, "Rescission of FASB Statement No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections." SFAS No. 145 updates, clarifies and simplifies existing accounting pronouncements. It rescinds SFAS No. 4, which required all gains and losses from extinguishment of debt to be aggregated and, if material, classified as an extraordinary item, net of related taxes, and requires that they be reported as part of earnings from operation. SFAS No. 145 also amends SFAS No. 13 to require that certain lease modifications that have economic effects similar to sale-leaseback transactions be accounted for in the same manner as sale-leaseback transactions. The Company will adopt this standard on January 1, 2003, and believes it will not have a material impact on its results of operations or financial condition.

In August 2001, The FASB issued SFAS No. 143, 'Accounting for Asset Retirement Obligations.' Under SFAS No. 143, the fair value of a liability for an asset retirement obligation will be recorded in the period in which it is incurred, and the carrying amount of the related long-lived asset will be increased. Over time, the liability will be adjusted for revisions to either the timing or the amount of the original estimate of cash flows and the passage of time, the capitalized cost will be depreciated over the assets useful life. A gain or loss will be recorded if necessary upon settlement of the liability. The Company will adopt this standard on January 1, 2003, and believes it will not have a material impact on its result of operations or financial condition.

## **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS** (CONTINUED)

### **Note 3**

#### Discontinued Operations

On September 26, 2002, Astronics announced the spin-off of its wholly owned subsidiary MOD-PAC CORP., which operated the Printing and Packaging segment. Later, in December, Astronics announced the discontinuance of the Electroluminescent Lamp Business Group, whose primary business has involved sales of microencapsulated EL lamps to customers in the consumer electronics industry.

No gain or loss has been recorded or will occur in connections with the spin-off of MOD-PAC CORP. As a result of the discontinuance of the Electroluminescent Lamp Business Group, Astronics recorded estimated losses on disposition and other exit—related costs as losses on discontinued operations in the quarter ending December 31, 2002, of \$700,000 after applicable income tax benefit. This charge consists mostly of severance, inventory, and equipment-related expenses.

The consolidated financial statements and related notes for all periods presented have been restated to reflect the Printing and Packaging segment and the Electroluminescent Lamp Business Group as discontinued operations.

Operating results of discontinued operations are summarized:

	2002	2001	2000
Net Sales	\$32,763	\$32,786	\$29,399
Income Before Taxes	725	1,186	3,636
Income Tax Expense	219	509	1,041
Income from Discontinued Operations	\$ 506	\$ 677	\$ 2,595

#### Note 4

##### Long-term Debt

Long-term debt Consists of the following:

(in thousands)

	2002	2001
Revolving Line of Credit with interest at LJBOR plus 60 basis points	\$ 1,457	\$ 3,228
Industrial Revenue Bonds issued through the Erie County, New York Industrial Development Agency payable \$350 annually through 2019 with interest reset weekly (1.2% at December 31, 2002)	5,950	6300
Industrial Revenue Bonds issued through the Business Finance Authority of the State of New Hampshire payable \$400 annually through 2018 with interest reset weekly (1.2% at December 31, 2002)	6,450	6,850
Other	126	140
	13,983	16,518
Less Current Maturities	873	989
	\$13,110	\$15,529

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

The Industrial Revenue Bonds are held by institutional investors and are guaranteed by a bank letter of credit, which is collateralized by certain property, plant and equipment assets, the carrying value of which approximates the principal balance on the bonds. The revolving line of credit is unsecured and provides for borrowing up to \$12,000,000; interest is at bank prime or LIBOR plus 60 basis points. The line is available through June 30, 2004 and may be converted into a four year term loan. The revolving line of credit, among other requirements, imposes certain covenants with which the Company maintains compliance.

Principal maturities of long-term debt (excluding the revolving line of credit) over the next five years are as follows: \$873,000; \$753,000; \$750,000; \$750,000; and \$750,000.

Interest costs of \$164,000 were capitalized in 2000; no interest costs were capitalized in 2002 and 2001.

To offset risks due to fluctuation in interest rates, the Company entered into an interest rate swap on the New York Industrial Revenue Bond through 2005 which effectively fixes the interest rate at 4.09%. The fair value, based

on spot prices of similar contracts, of this derivative instrument which is designated as a cash flow hedge, was a net liability of \$354,000 at December 31, 2002 compared to a net asset of \$73,000 at December 31, 2001. These amounts are included in other assets on the balance sheet.

## Note 5

### Related Party Transactions

During the three years ended December 31, 2002, 2001 and 2000, MOD-PAC CORP., an Astronics subsidiary, performed printing and order fulfillment services for VistaPrint Corporation, resulting in net sales of \$6,198,000, \$3,220,000 and \$594,000, respectively. VistaPrint owed MOD-PAC CORP. \$927,000 and \$1,944,000 at December 31, 2002 and 2001, respectively, related to services. Robert S. Keane, the son of Kevin T. Keane, is a shareholder in and the chief executive officer of VistaPrint Corporation. In addition, Kevin T. Keane is a shareholder in VistaPrint Corporation holding less than 5% of its capital stock.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

## Note 6

### Stock Option and Purchase Plans

A summary of the Company's stock option activity, excluding MOD-PAC employees, and related information for the years ended December 31 follows:

	2002		2001		2000	
	Options	Weighted Average Exercised Price	Options	Weighted Average Exercised Price	Options	Weighted Average Exercised Price
Outstanding at the Beginning of the Year	404,217	\$ 5.47	476,834	\$ 4.08	391,980	\$ 2.81
Options Granted	45,200	\$ 12.12	46,500	\$ 16.15	52,200	\$ 10.52
Adjustments to Maintain Intrinsic Value as a result of						
Stock Distributions	—	—	77,784	1.37	44,479	(40)
Options Exercised	(56,714)	\$ 1.64	(176,067)	\$ 1.76	(11,825)	\$ 2.23
Options Forfeited	—	—	(20,834)	\$	—	
Outstanding at the End of the Year	<u>392,703</u>	\$ 6.79	<u>404,217</u>	\$ 5.47	<u>476,834</u>	\$
Exercisable at December 31	<u>283,702</u>	\$ 4.92	<u>293,895</u>	\$	<u>380,064</u>	\$

Exercise prices for options outstanding as of December 31, 2002 range from \$1.06 to \$16.76. The weighted average remaining contractual life of these options is 4.7 years.

The Company established Incentive Stock Option Plans for the purpose of attracting and retaining executive officers and key employees, and to align managements interest with those of the shareholders. Generally, the options must be exercised within ten years from the grant date and vest ratably over a five-year period. The exercise price for the options is equal to the fair market value at the date of grant. The Company had options outstanding for 215,256 shares under the plans, excluding MOD-PAC employees. At December 31, 2002, 895,150 options are available for future grant under the plan established in 2002.

The Company established the Directors Stock Option Plans for the purpose of attracting and retaining the services of experienced and knowledgeable outside directors, and to align their interest with those of the shareholders. The options must be exercised within ten years from the grant date. The exercise price for the option is equal to the fair market value at the date of grant. The Company had options outstanding for 177,447 shares under the plans at December 31, 2002. At December 31, 2002, 68,514 options are available for future grant under the plan established in 1997.

The fair value for these options was estimated at the date of grant using a Black-Scholes option pricing model with the following weighted-average assumptions for 2002; risk-free interest rate of 6%; dividend yield of 0%; volatility factor of the expected market price of the Company's common stock of ...349; and a weighted average expected life of the option of 6.65 years. The weighted average grant date fair value of options granted during the year was 55.78.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because the Company's employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in managements opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options.

Astronics established the Employee Stock Purchase Plan to encourage employees to invest in Astronics. The plan provides employees that have been with the company for at least a year the option to invest up to 20% of their cash compensation (up to an annual maximum of \$20,000) in Astronics common stock at a price equal to 85% of the fair market value of the Astronics common stock, determined each October 1. Employees are allowed to enroll annually. Employees indicate the number of shares they wish to obtain through the program and their intention to pay for the shares through payroll deductions over the annual cycle of October 1 through September 30. Employees can withdraw anytime during the annual cycle and all money withheld from the employees pay is returned with interest. If an employee remains enrolled in the program, enough money will have been withheld from the employees' pay during the year to pay for all the shares that the employee opted for under the program. At December 31, 2002, employees had outstanding options to purchase 73,921 shares at \$6.11 per share on September 30, 2003.

### Note 7

#### Income Taxes

The provision for income taxes consists of the following:

	(in thousands)		
	2002	2001	2000
Currently Payable			
US Federal	\$2,075	\$2,810	\$ 1,453
Foreign	370	79	79
State	144	303	200
Deferred	(221)	(248)	62
	<u>\$2,368</u>	<u>\$2,944</u>	<u>\$ 1,794</u>

The effective tax rates differ from the statutory federal income tax as follows:

	2002	2001	2000
Statutory Federal Income Tax Rate	34.0%	34.0%	34.0%
Non-deductible Items, Net	.5%	.7%	.3%
Foreign Taxes	1.4%	.3%	.3%
State Income Tax, Net of Federal Income Tax Benefit	.9%	2.3%	2.5%
Research and Development Credits		(3.0)%	(2.7)%
Other	.1%	(.7)%	(.5)%
	36.9%	33.6%	33.9%

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's deferred tax liabilities and assets as of December 31, 2002 and 2001 are as follows:

	(in thousands)	
	2002	2001
Long-term Deferred Tax Liabilities:		
Tax Depreciation over Book Depreciation	\$ 1,143	\$ 751
Long-term Deferred Assets:		
State Investment Tax Credit	286	295
Carryforwards		
Deferred Compensation	1,418	1,108
Loss Reserves associated with Discontinued Operations MaxEL lamp product group	395	—
Other-net	299	120
Total Long-term Deferred Tax Assets	\$ 1,255	\$ 772
Net Long-term Deferred Tax Asset	\$ 1,255	\$ 772

At December 31, 2002, the Company had state investment tax credit carryforwards of 5433,000 expiring through 2017. Accumulated earnings in Canada not repatriated were 5428,000 at December 31, 2002.

### Note 8

#### Profit Sharing/401(k) Plan

The Company has a qualified Profit Sharing/401(k) Plan for the benefit of its eligible full-time employees. The Profit Sharing/401(k) Plan provides for annual contributions based on percentages of pre-tax income. In addition, employees may contribute a portion of their salary to the 401(k) plan which is partially matched by the Company. The plan may be amended or terminated at any time. Total charges to income from continuing operations for the plan were \$582,000, \$743,000 and 5524,000 in 2002, 2001 and 2000, respectively.

### Note 9

#### Supplemental Retirement Plan and Related Post Retirement Benefits

The Company has a non-qualified supplemental retirement defined benefit plan (the "Plan") for certain executives. The Plan provides for benefits based upon average annual compensation and years of service, less offsets for Social Security and Profit Sharing benefits. It is the Company's intent to find the benefits as they become payable. The following table sets forth the benefit obligation and amounts recognized in the balance sheet as of December 31, 2002 and 2001 along with the net period cost for the years then ended.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS** (CONTINUED)

	2002	2001
Change in Benefit Obligation		
Benefit Obligation at beginning of year	\$ 5,763	\$ 3,900
Service Cost	151	102
Interest Cost	399	289
Actuarial Losses	737	1,584
Benefits Paid	(111)	(112)
Benefit Obligation at End of Year	<u>\$ 6,939</u>	<u>\$ 5,763</u>
Benefit Obligation at Year-End		
Unfunded Benefit Obligation	\$ 6,939	\$ 5,763
Unrecognized Prior Service Costs	(1,443)	(1,552)
Unrecognized Actuarial Loss	(2,341)	(1,665)
Net Amount Recognized	<u>\$ 3,155</u>	<u>\$ 2,546</u>
Amounts Recognized in Balance Sheet		
Accrued Expenses - Current	\$ 109	\$ 111
Supplemental Retirement Plan	4,823	3,868
Intangible Asset	(1,443)	(1,433)
Accumulated Other Comprehensive Loss	(334)	—
Net Amount Recognized	<u>\$ 3,155</u>	<u>\$ 2,546</u>
Net Period Cost		
Service Cost - Benefits Earned During Period	151	\$ 102
Interest Cost	399	289
Amortization of Prior Service Cost	109	109
Amortization of Net Actuarial Losses	61	8
Net Periodic Cost	<u>\$ 720</u>	<u>\$ 508</u>
Discount Rate	6.5%	7.0%
Future Average Compensation Increases	5%	5%

The benefit obligation represents the actuarial present value of benefits attributed to employee service rendered, assuming future compensation levels are used to measure the obligation. FASB Statement No. 87, "Employers' Accounting for Pensions," requires the Company to recognize a minimum pension liability equal to the actuarial present value of the accumulated benefit obligations. An intangible asset is required and has been recorded to the extent that the excess of the accumulated benefit obligation over the pension cost recognized relates to prior service costs.

Participants in the non-qualified supplemental retirement plan are entitled to paid medical, dental and long term care insurance benefits upon retirement under the plan. The following table sets forth the benefit obligation and amounts recognized in the balance sheet at December 31, 2002 along with the related service cost for that year.





Continuing Operations	\$	.08	.12	.15	.14	\$	.24	.16	.14	.15
Discontinued Operations		(.01 )	.04	.01	.02		.02	.04	.04	(.01 )
Net Income	\$	.07	.16	.16	.16	\$	.26	.20	.18	.14

## Note 11

### Net Sales by Geographic Region, Major Customers and Canadian Operations

The following table summarizes the Company's net sales by geographic region.

	2002	2001	2000
North America	\$ 36,741	\$ 40,659	\$ 33,443
Europe	3,715	4,083	4,197
South America	1,078	4,712	1,363
Other	1,406	3,137	3,566
	\$ 42,940	\$ 52,591	\$ 42,569

In 2002, 2001 and 2000, approximately 37%, 46% and 47%, respectively of the Company's Net Sales were to the US Air Force.

Net sales recorded by the Company's Canadian operations were \$6.6 million in 2002, \$6.2 million in 2001 and 52.8 million in 2000. Net income from these operations was \$471,000 in 2002, \$344,000 in 2001 and \$85 in 2000.

## REPORT OF INDEPENDENT AUDITORS

To the Shareholders and Board of Directors of Astronics Corporation

We have audited the accompanying consolidated balance sheets of Astronics Corporation as of December 31, 2002 and 2001, and the related consolidated statements of income, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2002. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Astronics Corporation at December 31, 2002 and 2001 and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2002, in conformity with accounting principles generally accepted in the United States.

As discussed in Note 1 to the consolidated financial statements, effective January 1, 2002, the Company adopted the provisions of Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets.

/s/Ernst & Young LLP  
Buffalo, New York  
January 24, 2003

## MANAGEMENT'S STATEMENT OF RESPONSIBILITY

The management of Astronics Corporation is responsible for the contents of the consolidated financial statements, which are prepared in conformity with accounting principles generally accepted in the United States. The consolidated financial statements necessarily include amounts based on judgments and estimates. Financial information elsewhere in the Annual Report is consistent with that in the consolidated financial statements.

The Company maintains an accounting system which includes controls designed to provide reasonable assurance as to the integrity and reliability of the financial records and the protection of assets. The role of Ernst & Young LLP, the independent auditors, is to provide an independent examination of the consolidated financial statements and the underlying transactions in accordance with generally accepted auditing standards.

The Audit Committee of the Board of Directors, composed solely of directors who are not members of management, meets periodically with management and the independent auditors to ensure that their respective responsibilities are properly discharged.

/s/Peter J. Gundermann  
Peter J. Gundermann  
President

/s/ David C. Burney  
David C. Burney  
Vice President and Chief Financial Officer

## MANAGEMENT'S DISCUSSION AND ANALYSIS

### Net Sales

Net sales for 2002 decreased by \$9.7 million to 42.9 million from 52.6 million in 2001, a decrease of 18.4%. The decrease in net sales is comprised of a \$9.2 million decrease in net sales under our night vision cockpit modification program with the US Air Force for the F-16. Excluding sales from spares and replacements subsequent to the original F-16 program, revenue from the F-16 program was \$10.9 million in 2002 compared with \$20.1 million in 2001. The balance of the decline in net sales is attributable to the depressed state of the commercial aviation industry.

Net sales for 2001 increased by \$10.0 million to \$52.6 million from \$42.6 million in 2000, an increase of 23.5%. The increase in net sales is comprised in part, of a \$5.8 million increase in net sales under the F-16 program. Excluding sales from spares and replacements subsequent to the origin F-16 program, revenue from the F-16 program was \$20.1 million in 2001 compared with \$18.3 million in 2000. Also contributing to the increase in sales in 2001 was \$2.4 million attributable to the May 2000 acquisition of our avionics keyboard manufacturer located near Montreal, Quebec, Canada. In 2000, we reported seven and one-half months of sales from this operation, or \$1.9 million compared with a full year in 2001 of \$4.3 million.

### Expenses

Cost of goods sold, as a percentage of net sales, declined .2% to 71.5% in 2002 from 71.7% in 2001 as a result of net production efficiencies. Higher indirect labor as a percent of net sales was offset by reductions in material cost and usage.

Cost of goods sold, as a percentage of net sales, declined 2.0% to 71.7% in 2001 from 73.7% in 2000 as a result of net production efficiencies. Higher labor as a percent of net sales was offset by reductions in material cost and usage.

Selling, general and administrative expenses increased \$.1 million to \$5.6 million in 2002 from \$5.5 million in 2001. An increase in the bad debt provision of \$.2 million and costs related to the spin-off of MOD-PAC CORP. of \$.2 million were largely offset by employee cost reductions of \$.3 million.

Selling, general and administrative expenses increased \$.6 million to \$5.5 million in 2001 from \$4.9 million in

2000 due to increased sales expense of 11.2 million and increased administrative costs of 11.4 million.

#### Income from Continuing Operations Before Taxes

Income from Continuing Operations Before Taxes in 2002 decreased to \$6.4 million a decrease of \$2.4 million, or 27.3%, from 2001's \$8.8 million. This decrease was mainly a result of the 18.4% decrease in net sales.

Income from Continuing Operations Before Taxes in 2001 increased to \$8.8 million an increase of \$3.5 million, or 66.0%, over \$5.3 million in 2000. This increase was a result of the 23.5% increase in sales and lower costs of goods sold as a percentage of net sales.

#### Income Taxes

The Company's effective income tax rate was 36.9% in 2002, 3.3% higher than the effective tax rate of 33.6% in 2001 because of lower federal research and development tax credits in 2002 compared with 2001. Additionally, income taxes on our Canadian operations are assessed at slightly higher rates than we incur in our U.S. operations. In 2002, our Canadian operations contributed 12.5% of our income before tax compared with 6.2% the year before.

The Company's effective tax rate was 33.6% in 2001, or 0.3% lower than the effective tax rate in 2000 of 33.9%. The effective tax rate in both these years benefited from research and development credits.

### MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

#### Liquidity

Cash flow from operating activities was \$5.6 million in 2002 compared with \$9.6 million in 2001. This decrease of \$4 million was attributable, in part, to the \$1.8 million decrease in income from continuing operations in 2002 compared with 2001. Most of the remaining \$2.2 million of the \$4 million decrease was attributable to the relative net change in working capital components in 2002 compared with 2001. The net change in working capital components was a decrease of 11.2 million compared with a decrease of 2.3 million in 2001.

Cash flow from operating activities in 2001 was \$9.6 million compared with net cash used by operating activities of \$1.5 million in 2000. This change of \$11.1 million is mostly attributable to the relative net change in working capital components in 2001 compared with 2000. The net change in working capital components was a decrease of \$2.5 million in 2001 compared with an increase of 6.7 million in 2000. The balance of the increase in cash from operating activities in 2001 compared with 2000 was attributable to the 112.3 million increase in income from continuing operations.

Cash used in investing activities was 11.7 million in 2002 compared with \$1.0 million in 2001, as a result of a 11.4 million decrease in capital expenditures. Cash used in investing activities was \$1.0 million in 2001 compared with \$6.9 million in 2000. In 2000, the Company acquired its avionic keyboard manufacturing operations in Quebec, Canada for \$3.3 million and tooling and equipment related to a push button actuator product line for 11.3 million. In addition, capital expenditures in 2000 were \$2.7 million because the Company completed the construction of its manufacturing facility in East Aurora, New York.

At December 31, 2002, the Company had cash and cash equivalents of \$7.7 million. In March of 2003 MOD-PAC CORP will close on its senior debt financing and will pay the balance it owes the Company, which at December 31, 2002, was \$4.8 million. The cash balance and the receipt of cash from MOD-PAC CORP., will be sufficient to meet the Company's cash needs for working capital, debt service and capital expenditures during 2003.

#### Significant Accounting Policies

The preparation of the Company's financial statements requires management to make estimates, assumptions and judgments that affect the amounts reported. These estimates, assumptions and judgments are affected by management's application of accounting policies, which are discussed in note 1 to the Consolidated Financial Statements. The company's critical accounting policies relate to inventory valuation and pension assumptions.

As of December 31, 2002, inventories, net of valuation reserves, represent 26% of current assets. Inventories are stated at lower of cost or market with cost being determined on the first in, first out method of valuation. The Company provides valuation reserves to provide for slow moving or obsolete inventory or to reduce inventory to net realizable value. Determining the appropriate reserve for inventory valuation requires significant knowledge of the business. Management considers overall inventory levels in relation to forecasted demand, which includes firm

backing. As of December 31, 2002 the Company's reserve for inventory valuation was \$382 thousand or 6% of gross inventories.

The company maintains a supplemental retirement plan for certain executives. The accounting for this plan is based in part on certain assumptions that may be highly uncertain and may have a material impact on the financial statements if different reasonable assumptions had been used. The assumptions for increases in compensation and the discount rate for determining the cost recognized in 2002 were 5% and 7%. The discount rate used for the projected benefit obligation as of December 31, 2002 was 6%. The assumption for compensation increases takes a long-term view of inflation and performance based salary adjustments based on the Company's approach to executive compensation. For determining the discount rate the Company considers long-term interest rates for high-grade corporate bonds.

#### MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

The Company's foreign operations do not result in significant currency risks because nearly all of the Company's consolidated net sales are denominated in U.S. dollars. The Company has limited exposure to fluctuations in Canadian currency exchange rates to the U.S. dollar. Net assets held in, or measured in, Canadian dollars amounted to 11.9 million at December 31, 2002. Risk due to fluctuation in interest rates is a function of the Company's floating rate debt obligations, which total approximately \$13.9 million at December 31, 2002. To offset this exposure, the Company entered into an interest rate swap on its New York Industrial Revenue Bond through 2005, which effectively fixes the interest rate at 4.09% on this \$5.95 million obligation. As a result, a change of 1% in interest rates would impact annual net income by less than \$50,000.

#### Dividends

In the fourth quarter of 2001 and 2000, the Company paid a 25% and 10% share distribution, respectively. Management believes that it should retain the capital generated from operating activities for investments in increased technologies, acquisitions and debt retirement. Accordingly, there are no plans to institute a cash dividend program.

#### Backlog

At December 31, 2002, the Company's backlog was \$17.2 million as compared to \$27.3 million at December 31, 2001. The decrease is mainly attributable to the F-16 program. Approximately \$13 million of the backlog at December 31, 2002, is scheduled to ship in 2003. Most of the Company's sales occur on a "book and ship" basis. Large, long term contracts, such as the F-16 NVIS retrofit production program, is an exception. The F-16 NVIS spares program, which is expected to bring the Company \$5 to 116 million in annual net sales, is conducted on a book and ship basis. At December 31, 2002, total F-16 program backing was \$2.9 million.

## FORWARD LOOKING STATEMENTS

This Annual Report to Shareholders contains certain forward looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 that involves uncertainties and risks. These statements are identified by the use of the words "believes," "expects," "intends," "anticipates" and words of similar import. Readers are cautioned not to place undue reliance on these forward looking statements as various uncertainties and risks could cause actual results to differ materially from those anticipated in these statements. These uncertainties and risks include the success of the Company with effectively executing its plans; the timeliness of product deliveries by vendors and other vendor performance issues; changes in demand for our products from the U.S. government and other customers; the acceptance by the market of new products developed; our success in cross selling products to different customers and markets; changes in government contracts; as well as other general economic conditions and other factors.

## CORPORATE HEADQUARTERS

Astronics Corporation

130 Commerce Way

East Aurora, New York 14052

716-655-0800

E-mail: [invest@sastronics.com](mailto:invest@sastronics.com)

Web Site: [www.astronics.com](http://www.astronics.com)

### COMPANIES OF ASTRONICS

Luminescent Systems, Inc.,  
Lebanon, New Hampshire  
East Aurora, New York  
Luminescent Systems Europe  
By. B. A., Brussels, Belgium  
Luminescent Systems Canada, Inc.  
Dorval, Quebec  
Canada

### ANNUAL MEETING

The 2003 annual meeting of shareholders will be held on April 24, 2003, at 10:00 AM. at Luminescent Systems, Inc., 130 Commerce Way, East Aurora, New York.

### STOCK EXCHANGE LISTING

**NASDAQ NM: ATRO**

### TRANSFER AGENT AND REGISTRAR

For services such as change of address, replacement of lost certificates, and changes in registered ownership, or for inquiries as to your account, contact:

American Stock Transfer & Trust Co.

59 Maiden Lane

New York, NY 10038

Tel: 800-937-5449

Fax: 718236-2641

Website: [www.amstock.com](http://www.amstock.com)

### INVESTOR RELATIONS

Investors, stock brokers, security analysts and others seeking information about Astronics Corporation should contact:

David Burney, Chief Financial Officer, 716-655-0800 or email at [invest@astronics.com](mailto:invest@astronics.com).

Additional information is available on our web site at:

[www.astronics.com](http://www.astronics.com).

## STOCK PRICES

The adjacent table sets forth the range of prices for the Company's Common Stock, traded on the Nasdaq National Market System, for each quarterly period during the last two years. The approximate number of shareholders of record as of February 28, 2003 was 835 for Common Stock and 926 for Class B Stock.

2002		HIGH		LOW
First	\$	13.25	\$	8.75
Second		9.95		7.53
Third		8.55		5.50
Fourth		8.00		5.80
2001		HIGH		LOW
First	\$	11.94	\$	9.19
Second		16.40		9.16
Third		12.36		7.72
Fourth		14.20		8.49

## ATTORNEYS

**Hodgson Russ LLP**

**Buffalo, New York**

## INDEPENDENT

### AU D ITORS

**Ernst & Young LLP**

**Buffalo, New York**

## FORM 10-K

### ANNUAL REPORT

The Company's Form 10-K Annual Report to the Securities and Exchange Commission provides certain additional information. A copy of this report may be obtained upon request to Shareholder Relations, Astronics Corporation, 130 Commerce Way, East Aurora, NY 14052.

## BOARD OF DIRECTORS

**Robert T. Brady**  
Chairman of the Board, President and Chief Executive Officer,  
Moog, Inc.  
*Committees, Audit\*, Compensation, Nominating/Governance*

**John B. Drenning**  
Partner, Hodgson Russ LLP  
*Committees, Audit\*, Compensation, Nominating/Governance*

**Peter J. Gundermann**  
President and Chief Executive Officer,  
Astronics Corporation

**Kevin T. Keane**  
Chairman of the Board,  
Astronics Corporation

**Robert J. McKenna**  
President and Chief Executive Officer,  
Wenger Corporation

## **OFFICERS**

**Claude Bougie**  
Vice President,  
Luminescent Systems Canada, Inc.

**David C. Burney**  
Vice President and Chief Financial Officer

**Peter J. Gundermann**  
President and Chief Executive Officer

**Frank C. Johns, III**  
Vice President,  
Luminescent Systems, Inc.

**Kevin T. Keane**  
Chairman of the Board

**James S. Kramer**  
Vice President,  
Luminescent Systems, Inc.

**Richard M. Miller**  
Vice President,  
Luminescent Systems, Inc.









**CERTIFICATION**

Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906  
of the Sarbanes-Oxley Act of 2002

Pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, each of the undersigned officers of Astronics Corporation (the "Company"), does hereby certify, to such officer's knowledge, that:

The Annual Report on Form 10-K for the year ended December 31, 2002 (the "Form 10-K") of the Company fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934 and the information contained in the Form 10-K fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: March 25, 2003

/s/ Peter J. Gundermann

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Peter J. Gundermann

Title: Chief Executive Officer

Dated: March 25, 2003

/s/ David C. Burney

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David C. Burney

Title: Chief Financial Officer

**EXHIBIT 21**

**ASTRONICS CORPORATION**

**SUBSIDIARIES OF THE REGISTRANT**

<u>Subsidiary</u>	<u>Ownership Percentage</u>	<u>State (Province), Country of Incorporation</u>
Luminescent Systems, Inc.	100%	New York, USA
LSI - Canada, Inc.	100%	Quebec, Canada
Astronics Air, LLC	100%	New York, USA
LSI - Europe B.V.B.A.	100%	Brussels, Belgium

**EXHIBIT 23**

Consent and Report of Independent Auditors

Board of Directors  
Astronics Corporation

We consent to the incorporation by reference in this Annual Report (Form 10-K) of Astronics Corporation of our report dated January 24, 2003, included in the 2002 Annual Report to Shareholders of Astronics Corporation.

Our audits also included the financial statement schedule of Astronics Corporation listed in Item 15(a). This schedule is the responsibility of the Company's management. Our responsibility is to express an opinion based on our audits. In our opinion, the financial statement schedule referred to above, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

We also consent to the incorporation by reference in the Registration Statement on Form S-8 (No. 33-42981) and the Registration Statement on Form S-8 (No. 333-87463) pertaining to the Employee Stock Purchase Plan of Astronics Corporation of our reports dated January 24, 2003, with respect to the consolidated financial statements incorporated herein by reference, and our report included in the preceding paragraph with respect to the financial statement schedule included in this Annual Report (Form 10-K) for the year ended December 31, 2002.

We also consent to the incorporation by reference in the Registration Statement on Form S-8 (No. 33-65141) filed with the Securities and Exchange Commission for the registration of 732,132 shares of Astronics Corporation common stock of our reports dated January 24, 2003, with respect to the consolidated financial statements incorporated herein by reference, and our report included in the preceding paragraph with respect to the financial statement schedule included in this Annual Report (Form 10-K) for the year ended December 31, 2002.

ERNST & YOUNG LLP

Buffalo, New York  
March 25, 2003