



260 North Elm Street

Westfield, MA 01085

(413) 568-9571

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

Fellow Shareholders

Despite a depression in the building construction industry generally, and HVAC in particular, Mestek continues to make progress. Sales were up about 8.5%. Earnings per share increased 67% for 2011 amounting to \$1.15 per share as compared to \$0.69 in 2010.

Net Loss from Discontinued Operations for 2011 was (\$0.54) per share. We are very pleased that these operations have now been fully eliminated as a result of the work done by Stewart Reed and Stephen Shea.

You will note that consistent with these results, the Consolidated Statement of Cash Flow indicates a positive Cash Flow of about \$20 million in 2011 making our Balance Sheet even stronger. As makers of capital equipment, we have noticed that our customers and their customers, who are the owners of large businesses, are now quite interested in the financials of their suppliers. This has been a comparative advantage. As our financials show, Mestek has built dependable, long lasting quality products over the years and will continue to do so for many years to come.

We are spending over \$3 million per year for Research & Development and in terms of acquisition activity; we are looking at opportunities that would increase our family of high efficiency HVAC franchises.

The Company acquired Linel Signature Skylights, LLC for \$6.3 million on March 5, 2012. This included the manufacturing facilities and office and land owned by Linel Properties, LLC. Linel manufactures building exterior panels and skylights which are used in commercial and institutional buildings. The Company is committed to growing its Mestek Architectural products division based on the combined strengths of Linel Signature Skylights, Colt Sunshades, and American Warming and Ventilation architectural products.

The Company has also reached an agreement in principle to acquire the remaining 50% interest in the Dadanco active chilled beam (ACB) technology we have been promoting since 2007. ACB is an innovative energy efficient commercial air conditioning technology which has seen substantial growth in the United States in recent years.

We anticipate that our Cash Flows from operations will continue to allow us to support the growth of these recent acquisitions which will require continuing product development and market development resources.

Respectfully,

John E. Reed  
Chairman & CEO

## **SELECTED FINANCIAL DATA**

Selected financial data for the Company for each of the last five years is shown in the following table, which is derived from and should be read in conjunction with the Consolidated Financial Statements included elsewhere in this report. Selected financial data reflecting the operations of acquired businesses is shown only for periods following the related acquisition. The Summary of Operations data reflects the operations of CareCentric, Inc. under the heading discontinued Operations, as more fully explained in Note 4 of the Notes to the Consolidated Financial Statements.

### SUMMARY OF FINANCIAL POSITION as of December 31,

(Dollars in thousands except per share data)

|   | <u>2011</u> | <u>2010</u> | <u>2009</u> | <u>2008</u> | <u>2007</u> |
|---|-------------|-------------|-------------|-------------|-------------|
| Total Assets                              | \$ 200,513  | \$ 195,980  | \$ 208,949  | \$ 210,584  | \$ 220,528  |
| Working Capital                           | 70,518      | 49,469      | 36,126      | 45,201      | 40,025      |
| Total Debt                                | 11,833      | 13,067      | 26,478      | 31,616      | 42,152      |
| Shareholders' Equity                      | 129,429     | 122,709     | 120,111     | 109,964     | 107,557     |
| Shareholders' Equity Per Common Share (1) | \$ 17.36    | \$ 16.24    | \$15.09     | \$ 13.96    | \$ 13.33    |

### SUMMARY OF OPERATIONS for the years ended December 31,

(Dollars in thousands except per share data)

|  | <u>2011</u>       | <u>2010</u>       | <u>2009</u>       | <u>2008</u>       | <u>2007</u>       |
|--|-------------------|-------------------|-------------------|-------------------|-------------------|
| Revenues from Continuing Operations          | <u>\$ 304,624</u> | <u>\$ 280,863</u> | <u>\$ 288,851</u> | <u>\$ 373,533</u> | <u>\$ 378,280</u> |
| Net Income from Continuing Operations        | <u>\$ 12,755</u>  | <u>\$ 8,642</u>   | <u>\$ 5,239</u>   | <u>\$ 6,336</u>   | <u>\$ 5,806</u>   |
| Net Loss from Discontinued Operations        | <u>\$ (4,075)</u> | <u>\$ (3,197)</u> | <u>\$ (765)</u>   | <u>\$ (900)</u>   | <u>\$ (4,175)</u> |
| Net Income                                   | <u>\$ 8,680</u>   | <u>\$ 5,445</u>   | <u>\$ 4,474</u>   | <u>\$ 5,436</u>   | <u>\$ 1,631</u>   |
| <u>Earnings per Common Share:</u>            |                   |                   |                   |                   |                   |
| Basic and Diluted Earnings per Common Share: |                   |                   |                   |                   |                   |
| Net Income from Continuing Operations        | <u>\$ 1.69</u>    | <u>\$ 1.09</u>    | <u>\$ 0.66</u>    | <u>\$ 0.80</u>    | <u>\$ 0.71</u>    |
| Net Loss from Discontinued Operations        | <u>\$ (0.54)</u>  | <u>\$ (0.40)</u>  | <u>\$ (0.10)</u>  | <u>\$ (0.11)</u>  | <u>\$ (0.51)</u>  |
| Net Income                                   | <u>\$ 1.15</u>    | <u>\$ 0.69</u>    | <u>\$ 0.56</u>    | <u>\$ 0.69</u>    | <u>\$ 0.20</u>    |

- (1) Equity per common share amounts are computed using the common shares outstanding as of December 31, 2011, 2010, 2009, 2008, and 2007.

## **REPORT OF INDEPENDENT AUDITORS**

The Board of Directors and Shareholders of Mestek, Inc.

We have audited the accompanying consolidated balance sheets of Mestek, Inc. and subsidiaries ("the Company") as of December 31, 2011 and 2010, and the related consolidated statements of operations, shareholders' equity and comprehensive income, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Mestek, Inc. and subsidiaries as of December 31, 2011 and 2010, and the consolidated results of operations and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

DATE

Boston, Massachusetts

**MESTEK, INC.**  
**CONSOLIDATED BALANCE SHEETS**  
**As of December 31, 2011 and 2010**

|   | <u>2011</u>            | <u>2010</u>       |
|---|------------------------|-------------------|
|   | (Dollars in thousands) |                   |
| ASSETS  |                        |                   |
| Current Assets:   |                        |                   |
| Cash and Cash Equivalents   | \$ 22,016              | \$ 1,792          |
| Accounts Receivable - less allowances of \$3,393 and \$2,250 respectively | 44,864                 | 45,610            |
| Inventories – net   | 41,235                 | 41,018            |
| Deferred Tax Assets   | 3,648                  | 4,373             |
| Other Current Assets  | <u>4,184</u>           | <u>4,230</u>      |
| Total Current Assets  | 115,947                | 97,023            |
| Property and Equipment – net  | 34,819                 | 35,920            |
| Property Held for Sale  | 7,621                  | 8,171             |
| Deferred Tax Assets   | 15,057                 | 20,721            |
| Other Assets – net  | 5,787                  | 6,277             |
| Goodwill  | <u>21,282</u>          | <u>20,950</u>     |
| Total Assets  | 200,513                | 189,062           |
| Net Assets of Discontinued Operations                                     | <u>---</u>             | <u>6,918</u>      |
| Total Assets  | <u>\$ 200,513</u>      | <u>\$ 195,980</u> |

See Accompanying Notes to the Consolidated Financial Statements.

**MESTEK, INC.**  
**CONSOLIDATED BALANCE SHEETS (cont.)**  
**As of December 31, 2011 and 2010**

**LIABILITIES AND SHAREHOLDERS' EQUITY**

**Current Liabilities:**

|  |               |               |
|--|---------------|---------------|
| Short Term Notes Payable                           | \$ -          | \$ 128        |
| Current Portion of Long-Term Debt                  | 277           | 883           |
| Accounts Payable                                   | 11,684        | 12,557        |
| Accrued Payroll and Related Expenses               | 12,344        | 12,188        |
| Customer Deposits                                  | 7,622         | 7,594         |
| Current Portion of Environmental Reserves          | 400           | 205           |
| Warranty Reserve                                   | 3,467         | 3,309         |
| Other Accrued Liabilities                          | 9,635         | 8,794         |
| Current Liabilities of Discontinued Operations     | <u>-</u>      | <u>1,896</u>  |
| Current Liabilities                                | 45,429        | 47,554        |
| Environmental Reserves – long term                 | 9,782         | 10,802        |
| Long-Term Debt (including Discontinued Operations) | 11,556        | 12,056        |
| Other Liabilities                                  | <u>2,692</u>  | <u>1,213</u>  |
| Total Liabilities                                  | <u>69,459</u> | <u>71,625</u> |

**Shareholders' Equity:**

**Controlling Interest:**

|   |                   |                   |
|---|-------------------|-------------------|
| Common Stock, no par, stated value \$0.05 per share,<br>8,333,726 and 8,433,190 shares issued, respectively | 415               | 420               |
| Paid in Capital   | 5,391             | 6,433             |
| Retained Earnings   | 134,655           | 125,975           |
| Treasury Shares, at cost (878,010 common shares)  | (11,293)          | (11,293)          |
| Accumulated Other Comprehensive Income  | <u>261</u>        | <u>1,174</u>      |
| Total Mestek, Inc. Shareholders' Equity   | 129,429           | 122,709           |
| Non-controlling Interest  | <u>1,625</u>      | <u>1,646</u>      |
| Total Shareholders' Equity  | <u>131,054</u>    | <u>124,355</u>    |
| Total Liabilities and Shareholders' Equity  | <u>\$ 200,513</u> | <u>\$ 195,980</u> |

See Accompanying Notes to the Consolidated Financial Statements.

**MESTEK, INC.**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
**For the years ended December 31, 2011 and 2010**

|   | <u>2011</u>   | <u>2010</u>     |
|---|---|-----------------|
|   | (Dollars and Shares in<br>thousands, except<br>earnings per common share) |                 |
| Net Sales   | \$ 304,624  | \$ 280,863      |
| Cost of Goods Sold  | <u>213,158</u>  | <u>196,950</u>  |
| Gross Profit  | 91,466  | 83,913          |
| Selling Expense   | 35,201  | 35,289          |
| General and Administrative Expense                                    | 22,023  | 19,938          |
| Engineering Expense   | 10,172  | 10,144          |
| Loss on Sale of Property and Equipment                                | 902   | 92              |
| Plant Shutdown Expense and Other Restructuring Charges                | 1,446   | 3,190           |
| Long-Lived Asset Impairment   | <u>-</u>  | <u>166</u>      |
| Operating Profit  | 21,722  | 15,094          |
| Interest Income (Expense) – net                                       | (232)   | (637)           |
| Other Income (Expense) – net  | <u>(124)</u>  | <u>(173)</u>    |
| Income from Continuing Operations Before Income Taxes                 | 21,366  | 14,284          |
| Provision for Income Taxes  | <u>8,588</u>  | <u>5,585</u>    |
| Net Income from Continuing Operations                                 | 12,778  | 8,699           |
| Less: Net Income – Non-controlling Interest                           | <u>23</u>   | <u>57</u>       |
| Net Income From Continuing Operations<br>attributable to Mestek, Inc. | 12,755  | 8,642           |
| Discontinued Operations:  |   |                 |
| Loss on Sale of Discontinued Operations                               | (2,254)   | ---             |
| Loss from Operations of Discontinued Operations                       | (1,267)   | (6,198)         |
| Applicable Income Tax (Expense) Benefit                               | (554)   | 3,001           |
| Loss from Discontinued Operations                                     | <u>(4,075)</u>  | <u>(3,197)</u>  |
| Net Income attributable to Mestek, Inc.                               | <u>\$ 8,680</u>   | <u>\$ 5,445</u> |
| Basic and Diluted Earnings per Common Share, Continuing Operations    | 1.69  | 1.09            |
| Basic and Diluted Earnings per Common Share, Discontinued Operations  | <u>(0.54)</u>   | <u>(0.40)</u>   |
| Basic and Diluted Earnings Per Common Share                           | <u>\$ 1.15</u>  | <u>\$ 0.69</u>  |
| Basic and Diluted Weighted Average Shares Outstanding                 | <u>7,555</u>  | <u>7,932</u>    |

See Accompanying Notes to the Consolidated Financial Statements.

**MESTEK, INC.**  
**CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY AND COMPREHENSIVE INCOME**  
**For the years ended December 31, 2011 and 2010**

| (Dollars in thousands)  | Common<br>Stock | Paid In<br>Capital | Retained<br>Earnings | Treasury<br>Shares | Accumulated<br>Other<br>Comprehensive<br>Income | Non-<br>Controlling<br>Interests | Total      |
|---|-----------------|--------------------|----------------------|--------------------|---|----------------------------------|------------|
| Balance – December 31, 2009   | \$ 440          | \$ 9,963           | \$ 120,530           | \$ (11,293)        | \$ 471  | \$ 1,244                         | \$ 121,355 |
| Net Income  | -               | -                  | 5,445                | -                  | -   | 57                               | 5,502      |
| Net Change in Ownership Percentage of<br>DMJV                       | -               | -                  | -                    | -                  | -   | 345                              | 345        |
| Cumulative Translation Adjustment                                   | -               | -                  | -                    | -                  | 579   | -                                | 579        |
| Changes in Minimum Liability –<br>Defined Benefit Plan – Net of Tax | -               | -                  | -                    | -                  | 124   | -                                | 124        |
| Net Comprehensive Income  |                 |                    |                      |                    |   |                                  | 6,550      |
| Common Shares Repurchased and<br>Cancelled (see Note 11)            | (20)            | (3,530)            | -                    | -                  | -   | -                                | (3,550)    |
| Balance – December 31, 2010   | 420             | 6,433              | 125,975              | (11,293)           | 1,174   | 1,646                            | 124,355    |
| Net Income  |                 |                    | 8,680                |                    |   | 23                               | 8,703      |
| Net Change in Ownership Percentage of<br>DMJV                       |                 |                    |                      |                    |   | (44)                             | (44)       |
| Cumulative Translation Adjustment                                   |                 |                    |                      |                    | 5   |                                  | 5          |
| Changes in Minimum Liability –<br>Defined Benefit Plan – Net of Tax |                 |                    |                      |                    | (918)   |                                  | (918)      |
| Net Comprehensive Income  |                 |                    |                      |                    |   |                                  | 7,746      |
| Stock Based Compensation (see note 12)                              |                 | 196                |                      |                    |   |                                  | 196        |
| Common Shares Repurchased and<br>Cancelled<br>(see Note 11)         | (5)             | (1,238)            |                      |                    |   |                                  | (1,243)    |
| Balance – December 31, 2011   | \$ 415          | \$ 5,391           | \$ 134,655           | \$ (11,293)        | \$ 261  | \$ 1,625                         | \$ 131,054 |

See Accompanying Notes to the Consolidated Financial Statements

**MESTEK, INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**For the years ended December 31, 2011 and 2010**

|   | <u>2011</u>            | <u>2010</u>     |
|---|------------------------|-----------------|
|   | (Dollars in thousands) |                 |
| Cash Flows from Operating Activities:   |                        |                 |
| Net Income Attributable to Mestek, Inc.   | \$ 8,680               | \$ 5,445        |
| Add Net Loss from Discontinued Operations   | 4,075                  | 3,197           |
| Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:   |                        |                 |
| Depreciation and Amortization   | 4,190                  | 5,071           |
| Goodwill and Long-Lived Asset Impairment  | ---                    | 166             |
| Provision for Deferred Taxes  | 6,401                  | 1,474           |
| Stock Compensation Expense  | 196                    | ---             |
| Provision for Losses on Accounts Receivable, net of write-offs and recoveries       | 1,153                  | 618             |
| (Gain) Loss on Sale of Property and Equipment                                       | 902                    | (92)            |
| Increase (Decrease) in Non-controlling Interests                                    | 21                     | 402             |
| Change in Assets and Liabilities:   |                        |                 |
| Accounts Receivable   | (95)                   | (3,821)         |
| Inventory   | 11                     | 7,345           |
| Accounts Payable  | (951)                  | (2,953)         |
| Environmental Reserves  | (825)                  | (801)           |
| Other Assets and Liabilities, net   | (498)                  | 8,300           |
| Net Cash Provided by Continuing Operating Activities                                | 23,260                 | 24,351          |
| Net Cash Used in Discontinued Operations  | (499)                  | (4,599)         |
| Net Cash Provided by Operating Activities   | 22,761                 | 19,752          |
| Cash Flows from Investing Activities:   |                        |                 |
| Capital Expenditures  | (2,049)                | (3,378)         |
| Proceeds from Sale of Fixed Assets  | 476                    | 123             |
| Net Cash Used in Continuing Investing Activities                                    | (1,573)                | (3,255)         |
| Net Cash Provided by (Used in) Investing Activities of Discontinued Operations      | 1,981                  | ---             |
| Net Cash Provided by (Used in) Investing Activities                                 | 408                    | (3,255)         |
| Cash Flows from Financing Activities:   |                        |                 |
| Net Repayments Under Revolving Credit Agreements                                    | (128)                  | (8,809)         |
| Principal Payments Under Long-Term Debt Obligations                                 | (1,106)                | (4,344)         |
| Common Stock Repurchased and Cancelled in "Going Private" Transaction (see Note 14) | (1,243)                | (3,550)         |
| Net Cash Provided by Continuing Financing Activities                                | (2,477)                | (16,703)        |
| Net Increase (Decrease) in Cash and Cash Equivalents                                | 20,692                 | (206)           |
| Exchange Rate Effect on Cash and Cash Equivalents                                   | (468)                  | 162             |
| Cash and Cash Equivalents - Beginning of Period                                     | 1,792                  | 1,836           |
| Cash and Cash Equivalents - End of Period   | <u>\$ 22,016</u>       | <u>\$ 1,792</u> |

See Accompanying Notes to the Consolidated Financial Statements.



**MESTEK, INC.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**DECEMBER 31, 2011 and 2010**

**1. SIGNIFICANT ACCOUNTING POLICIES**

**Basis of Presentation**

The Consolidated Financial Statements include the accounts of Mestek, Inc. (Mestek), its majority owned subsidiaries and the accounts of Dadanco-Mestek Joint Venture LLC and Maynard Aviation LLC (see Note 4) (collectively the "Company"). The operating assets of a subsidiary which were sold in 2011 (see Note 4) are presented as a discontinued operation. All material inter-company accounts and transactions have been eliminated in consolidation.

**Use of Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. The most significant estimates and assumptions relate to revenue recognition, accounts receivable valuations, inventory valuations, goodwill valuation, intangible asset valuations, warranty costs, product liability costs, environmental reserves, workers compensation claims reserves, health care claims reserves, accounting for income taxes and the realization of deferred tax assets. Actual amounts could differ significantly from these estimates.

**Revenue Recognition**

The Company's revenue recognition activities relate almost entirely to the manufacture and sale of heating, ventilating and air conditioning ("HVAC") products and equipment and metal forming equipment. Under generally accepted accounting principles, revenues are considered to have been earned when the Company has substantially accomplished what it must do to be entitled to the benefits represented by the revenues. With respect to sales of the Company's HVAC or metal forming equipment, the following criteria represent preconditions to the recognition of revenue:

- \* persuasive evidence of an arrangement must exist;
- \* delivery has occurred or services rendered;
- \* the sales price to the customer is fixed or determinable; and
- \* collection is reasonably assured.

As a result of the CareCentric, Inc. (CareCentric) merger in April 2009 (Note 4), the Company earned a portion of its revenues from the delivery of software, hosting and support services, and from the delivery of professional and on-demand services. The majority of software licensing, hosting and support revenues were earned under subscription service arrangements ("subscriptions"), which were recognized ratably over the subscription period. See Note 4 regarding the sale of CareCentric's operating assets.

**Cash Equivalents**

The Company considers all highly liquid investments with a maturity of 90 days or less at the time of purchase to be cash equivalents. Cash equivalents include investments in an institutional money market fund, which invests in U.S. Treasury bills, notes and bonds, and/or repurchase agreements, backed by such obligations.

**Accounts and Notes Receivable**

Accounts and notes receivable are reduced by an allowance for amounts that may become uncollectible in the future. The accounts receivable estimated allowance for uncollectible amounts is based primarily on specific analyses of accounts in the receivable portfolio and historical write-off experience.

## **Inventories**

Inventories are valued at the lower of cost or market. Cost of inventories is principally determined by the last-in, first-out (“LIFO”) method. Approximately 75% and 73% of inventory cost were determined using the LIFO method for the years ended December 31, 2011 and 2010, respectively, with the remaining inventories determined using the first-in, first-out method.

## **Property and Equipment**

Property and equipment are carried at cost. Depreciation and amortization are computed using the straight-line and accelerated methods over the estimated useful lives of the assets or, for leasehold improvements, the life of the lease, if shorter. When assets are retired or otherwise disposed of, the cost and related accumulated depreciation are removed from the accounts and any resulting gain or loss is reflected in income for the period. The cost of maintenance and repairs is charged to income as incurred; significant improvements are capitalized.

## **Goodwill and Other Intangible Assets**

The Company accounts for goodwill in accordance with Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) 350-20 “Goodwill and Other Intangible Assets” (“ASC 350-20”). Under ASC 350-20, the carrying value of goodwill is evaluated for impairment on at least an annual basis. In 2011, the company early adopted Accounting Standards Update (ASU) 2011-08. Intangibles – Goodwill and Other (Topic 350): Testing Goodwill for Impairment, which allowed the Company to assess certain qualitative factors in evaluating the recoverability of its goodwill, prior to performing a two-step impairment analysis. The assessment indicated that impairment at December 31, 2011 was unlikely.

The Company performed an annual impairment test as of December 31, 2010 for its’ HVAC and Metal Forming Segment. There was no impairment in any segment as of December 31, 2010.

Goodwill and Intangible Assets consisted of the following at:

|   | <b>December 31,</b> |                  |
|---|---------------------|------------------|
|   | <b>2011</b>         | <b>2010</b>      |
| Goodwill  | \$ 69,943           | \$ 69,620        |
| Accumulated Amortization  | (48,661)            | (48,670)         |
| Goodwill – net  | <u>\$ 21,282</u>    | <u>\$ 20,950</u> |
| Patents, Rights and Trademarks                                  | \$ 4,350            | \$ 4,353         |
| Accumulated Amortization, Patents, Rights and Trademarks        | (3,340)             | (3,151)          |
| Patents, Rights and Trademarks – net (included in other assets) | <u>\$ 1,010</u>     | <u>\$ 1,202</u>  |

Amortization expense relating to the intangible assets for the years ending December 31, 2011 and 2010 was \$155,000 and \$267,000, respectively.

## **Advertising Expense**

Advertising costs are charged to operations as incurred. Such charges aggregated \$2,185,000 and \$2,380,000, for the years ended December 31, 2011, and 2010, respectively, and are included in Selling Expense in the accompanying statements of operations.

## **Research and Development Expense**

Research and development expenses are charged to operations as incurred. Such charges aggregated \$3,217,000 and \$3,263,000, for the years ended December 31, 2011, and 2010, respectively.

### **Treasury Shares**

Common stock held in the Company's treasury has been recorded at cost. If treasury stock is re-issued, proceeds in excess of cost are credited to paid-in-capital.

### **Earnings per Common Share**

Basic earnings per share have been computed using the weighted average number of common shares outstanding. Common stock options of the Company, as more fully described in Note 11, were considered in the computation of diluted earnings per share, except when such effect would be anti-dilutive.

### **Currency Translation**

Assets and liabilities denominated in foreign currencies are translated into U.S. dollars at exchange rates prevailing on the balance sheet date. The Statement of Operations is translated at average exchange rates. Adjustments resulting from the translation of financial statements are excluded from the determination of income and are accumulated in Other Comprehensive Income as a separate component of Shareholders' Equity. Transaction gains and losses are included in other expense and were not material in 2011 or 2010.

### **Income Taxes**

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

### **Other Comprehensive Income**

For the years ended December 31, 2011, and 2010, the components of Other Comprehensive Income (Loss) consisted of foreign currency translation adjustments and changes in the additional minimum liability from terminated defined benefit pension plans (see Note 9).

The components of Other Comprehensive Income (net of tax) at December 31:

|   | <u>2011</u>            | <u>2010</u>   |
|---|------------------------|---------------|
|   | (Dollars in thousands) |               |
| Cumulative Translation Adjustment                             | \$ 5                   | \$ 579        |
| Changes in Additional Minimum Liability Defined Benefit Plans | <u>(918)</u>           | <u>124</u>    |
| Other Comprehensive Income                                    | <u>\$ (913)</u>        | <u>\$ 703</u> |

### **Fair Value of Financial Instruments, Concentration of Credit and other Risk and Significant Customers**

The carrying values of cash, cash equivalents, accounts receivable, accounts payable, accrued expenses and short term bank debt approximate fair market value due to the short-term nature of these financial instruments. The carrying value of long-term debt approximates fair market value, which is based on quoted market prices or on rates available to the Company for debt with similar terms and maturities. Financial instruments that potentially subject the Company to concentrations of credit risk are principally cash, cash equivalents, and accounts receivable.

The Company has no significant off-balance-sheet or concentration of credit risk exposure such as foreign exchange contracts or option contracts. The Company maintains its cash and cash equivalents with established financial institutions. Certain cash in foreign institutions may be subject to temporary withdrawal restrictions. Concentration of credit risk with respect to accounts receivable is limited to certain customers to whom the Company makes substantial sales. To reduce its credit risk, the Company routinely assesses the financial strength of its customers. The Company maintains an allowance for potential credit losses but historically has not experienced any significant losses related to individual customers or groups of customers beyond what is provided for in the allowance. No individual customer accounted for more than 10% of revenues in 2011 or 2010. No individual

customer accounted for more than 10% of the Company's accounts receivable at December 31, 2011 or 2010.

### **Stock-Based Compensation**

The Company accounts for stock-based compensation in accordance with FASB ASC 718, "Compensation – Stock Compensation". FASB ASC 718 requires all share-based payments to employees, including grants of employee stock options and modifications to existing stock options to be recognized in the statement of operations based on their fair values.

Under the fair-value method, stock-based compensation associated with stock awards is determined based on the estimated fair value of the award itself, measured using either current market data or an established option-pricing model. The Company utilizes the Black-Scholes option pricing model to determine the fair value of options granted and has elected the accrual method for recognizing compensation costs.

The determination of the fair value of stock-based payment awards utilizing the Black-Scholes model is affected by the stock price and a number of assumptions, including expected volatility, expected life, risk-free interest rate and expected dividends. The Company does not have a history of market prices of the common stock as it is not a public company, and as such volatility is estimated using historical volatilities of similar public entities. The expected life of the awards is estimated based on the simplified method. The risk-free interest rate assumption is based on observed interest rates appropriate for the terms of our awards. The dividend yield assumption is based on history and expectation of paying no dividends. Forfeitures are estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Forfeitures represent only the unvested portion of a surrendered option and the Company has estimated a 0% forfeiture rate as of December 31, 2011.

The fair value of stock options issued was measured with the following weighted average assumptions for the year ended December 31, 2011:

|                         |            |
|-------------------------|------------|
| Risk-free interest rate | 4.31%      |
| Expected dividend yield | 0%         |
| Expected volatility     | 45.0%      |
| Expected life of option | 6.27 years |

The weighted-average fair value of stock options granted during the year ended December 31, 2011, under the Black-Scholes option pricing model was \$4.69 per share. For the year ended December 31, 2011, the Company recorded stock-based compensation expense of \$196,000 in connection with share based payment awards. As of December 31, 2011, there was \$615,000 of unrecognized compensation expense related to non-vested stock awards that is expected to be recognized through 2015.

### **Defined Benefit Plans**

The Company accounts for its terminated defined benefit pension plans in accordance with FASB ASC 715 which requires plan sponsors of defined benefit pension and other postretirement benefit plans (collectively, "Benefit Plans") to recognize the funded status of their Benefit Plans in the consolidated balance sheet, measure the fair value of plan assets and benefit obligations as of the date of the fiscal year-end statement of financial position, and provide additional disclosures (see Note 9).

### **Reclassification/Recasting**

Reclassifications have been made to previously-issued financial statements to conform to the current year presentation. See Note 4 relating to the Company's investment in CareCentric and the required retroactive application of the equity method.

## 2. INVENTORIES

Inventories consisted of the following at December 31:

|   | <u>2011</u>            | <u>2010</u>      |
|---|------------------------|------------------|
|   | (Dollars in thousands) |                  |
| Finished Goods                            | \$ 12,057              | \$ 9,787         |
| Work-in-progress                          | 16,576                 | 17,860           |
| Raw materials                             | <u>27,088</u>          | <u>26,871</u>    |
|   | 55,721                 | 54,518           |
| Less reserve for LIFO method of valuation | <u>(14,486)</u>        | <u>(13,500)</u>  |
|   | <u>\$ 41,235</u>       | <u>\$ 41,018</u> |

The Company uses the last-in first-out LIFO method of valuing substantial portions of its inventory. Approximately \$386,000 of expense was recorded in the period ended December 31, 2011 under the LIFO method. Approximately \$2,081,000 of income was recorded in the period ended December 31, 2010 due to reductions in LIFO inventory levels.

## 3. PROPERTY AND EQUIPMENT

Property and equipment consisted of the following at December 31:

|                          | <u>2011</u>            | <u>2010</u>      | <u>Depreciation<br/>and<br/>Amortization<br/>Est. Useful<br/>Lives</u> |
|--------------------------|------------------------|------------------|--|
|                          | (Dollars in thousands) |                  |  |
| Land                     | \$ 1,694               | \$ 1,811         |  |
| Buildings                | 22,538                 | 25,328           | 19-39 Years  |
| Leasehold Improvements   | 6,330                  | 6,918            | 15-39 Years  |
| Equipment                | <u>99,788</u>          | <u>96,600</u>    | 3-10 Years   |
|                          | 130,350                | 130,657          |  |
| Accumulated Depreciation | <u>(95,531)</u>        | <u>(94,737)</u>  |  |
|                          | <u>\$ 34,819</u>       | <u>\$ 35,920</u> |  |

The above amounts include \$1,978,000, and \$1,578,000 at December 31, 2011 and 2010, respectively, in assets that had not yet been placed in service by the Company. No depreciation was recorded in the related periods for these assets. Assets classified as "Property Held for Sale" are excluded from the amounts listed above.

Depreciation and amortization expense was \$4,190,000 and \$4,753,000 for the years ended December 31, 2011 and 2010, respectively.

## 4. INVESTMENTS, MERGER AND DIVESTITURES

### CareCentric, Inc. ("CareCentric")

During April of 2011, the Company's subsidiary, CareCentric, Inc. sold its operating assets in two separate transactions to two unrelated third parties for a total of \$3.0 million. CareCentric recorded a net investment loss of \$2.254 million on the two transactions. The loss is net of accrued interest payable to certain shareholders forgiven by those shareholders in 2011. The net amount of interest forgiven was \$2,053,000.

The accompanying consolidated statement of operations have been restated to reflect the discontinuation of CareCentric's operations. CareCentric's results of operations are reflected in the discontinued operations section of the consolidated statements of operations.

The results of operations of the discontinued business were as follows for 2011 and 2010, respectively:

|                            | December 31, 2011 | December 31-2010 |
|----------------------------|-------------------|------------------|
|                            | (in thousands)    |                  |
| Revenues                   | \$3,265           | \$16,660         |
| (Loss) Income before Taxes | (\$1,267)         | (\$6,198)        |

#### **Dadanco-Mestek Joint Venture LLC (the "JV")**

On August 9, 2007, Mestek, Inc., through its' wholly owned subsidiary Active Chilled Beam, LLC ("ACB") entered into a joint venture agreement with Dadanco Pty. Ltd. through its' wholly owned subsidiary Dadanco US, Inc. ("Dadanco"), in the form of a limited liability company, Dadanco-Mestek Joint Venture LLC. The joint venture was formed for the purposes of development, marketing, sale and distribution of proprietary patented technology relating to the induction air process in heat, ventilating and air conditioning applications in commercial real estate.

A 50% membership interest was issued to ACB in consideration of a cash capital contribution of \$125,000. The remaining 50% membership interest was issued to Dadanco in consideration for a waiver of license royalty for the first calendar year payable to Dadanco Pty. Ltd. In addition, an initial line of credit was made available to the JV funded by ACB in the amount of \$375,000. On January 15, 2010, the JV board members agreed to refinance the Company's advances in excess of the original commitment of \$375,000 at an interest rate of 15%. The original line of credit remained in effect and earns the Company a rate of interest equal to the prime rate plus 100 basis points.

In 2010, Mestek agreed to replace the 15% credit facility negotiated in January with a 3 year revolving line of credit in the amount of \$3.0 million at a rate of 12.5%, with a liquidation preference accruing at an annualized rate of 10% of the unpaid monthly balance. In addition, the agreement contains a provision requiring the conversion of debt to equity for each calendar quarter end in which a balance remains payable to Mestek by the JV

The Company has determined that it is required to consolidate the operations of the JV due to the fact that the Company is contractually at risk for 100% of the joint venture's debt funding (see Note 8).

#### **Maynard Aviation LLC:**

In 2006, the Company acquired a one-third interest in Maynard Aviation LLC ("Maynard"). In January 2011, the Company acquired an additional one third interest in Maynard for \$55,000, plus the assumption of an additional one third of Maynard's then outstanding indebtedness, And on December 30, 2011, the Company acquired the remaining one-third interest in Maynard for \$160,000 in cash and the assumption of the remaining Maynard indebtedness. Maynard is fully consolidated at December 31, 2011 (approximately \$1.5M in total assets). The net assets were recorded at estimated fair value and no goodwill or other intangibles were recognized.

## **5. DEBT**

### **Short-term Debt**

Short-term debt consisted of the following at December 31:

|                                   | <u>2011</u>            | <u>2010</u>     |
|-----------------------------------|------------------------|-----------------|
|                                   | (Dollars in thousands) |                 |
| Revolving Loan Agreement          | \$ -                   | \$ 128          |
| Current Portion of Long-term Debt | <u>277</u>             | <u>883</u>      |
| Total Short Term Debt             | <u>\$ 277</u>          | <u>\$ 1,011</u> |

**Revolving Loan Agreement** – On December 20, 2010, the Company entered into a three year, \$60,000,000, committed, secured, multi-bank revolving loan and letter of credit facility (the “Facility”), led by Bank of America. Borrowings under the Facility bear interest, at the Company’s election, at a floating rate based on the lenders’ prime or base rate or, for short term borrowings, at a rate based upon the daily British Bankers Association (“BBA”) LIBOR rate plus 125 basis points (1.44%) as of December 31, 2011. The Facility contains affirmative and negative covenants typical of such financing transactions, and specific financial covenants which require the Company to maintain a minimum consolidated tangible net worth, a minimum cash flow coverage ratio and a maximum cash flow leverage ratio. As of December 31, 2011, the Company was in compliance with all of the financial covenants required under the Facility. Revolving borrowings under the Facility are due and payable in full on the maturity date of the Facility, which is December 19, 2013. The credit agreement relating to the Facility also contains restrictions regarding the creation of indebtedness, the occurrence of mergers or consolidations, the sale of subsidiary stock and the payment of dividends in excess of 50% of net income.

The Company had outstanding at December 31, 2011, \$7,693,000, in standby letters of credit issued in connection with the TCE PI Trust (see Note 10), and \$2,928,000 issued principally in connection with its commercial insurance programs. In addition, a letter of credit was issued on July 19, 2005 in the amount of \$4,481,000 in connection with the \$4,430,000 Industrial Development Authority Bond, for the City of Bridgeton, MO (see below). The balance on this letter of credit as of December 31, 2011 was \$3,161,000.

On June 10, 2009, in connection with negotiations with the Company’s lending syndicate relative to the CareCentric merger, Omega Flex, (a former subsidiary) loaned the Company \$3,250,000. The note was an 18 month balloon note bearing interest at 6% per annum maturing on October 20, 2010. In connection with the loan, Omega Flex entered into a subordination agreement with the lending syndicate. The note was paid and cancelled on October 20, 2010.

### **Long-term Debt**

Long-term debt consisted of the following at December 31:

|  | <u>2011</u>            | <u>2010</u>      |
|--|------------------------|------------------|
|  | (Dollars in thousands) |                  |
| Industrial Development Bond – PA       | \$ -                   | \$ 900           |
| Industrial Development Bond – MO       | 3,125                  | 3,530            |
| Notes Payable to John and Stewart Reed | 6,946                  | 6,946            |
| Other Notes Payable                    | <u>1,762</u>           | <u>1,578</u>     |
|  | 11,833                 | 12,954           |
| Less Current Maturities                | <u>(277)</u>           | <u>(898)</u>     |
| Long Term Debt                         | <u>\$ 11,556</u>       | <u>\$ 12,056</u> |

**Industrial Development Bond** – On April 19, 2002, the Company’s subsidiary, Boyertown Foundry Company, Inc. (“BFC”), borrowed \$5,512,490 under a note issued through the Berks County Industrial Development Authority in Berks County, PA, in connection with a project to upgrade BFC’s foundry equipment in Boyertown, PA. The note, bearing interest at 4.93% per annum, matured on April 19, 2012, and was payable in equal monthly payments of principal and interest over the term of the loan. The note is secured by a loan and security agreement under which the equipment purchased by BFC with the loan proceeds is pledged as security for the note. The bond was paid in full on February 17, 2011.

**Industrial Development Bond - MO** – On June 17, 2005, the Company acquired an 80,000 square foot manufacturing facility in Bridgeton, Missouri, for \$2,940,000, which was used to consolidate existing Formtek Metal Processing business units. On July 19, 2005, the Company refinanced this transaction as part of a 25-year-tax-exempt Industrial Development Bond totaling \$4,430,000. The proceeds were used to reimburse the Company for the acquisition of real estate and for construction, renovation, furnishing and equipping of the existing building. The note bears interest at a variable rate that considers prevailing market conditions and is set weekly by the remarketing agent, Banc of America Securities LLC. At no time may the interest rate exceed the maximum annual rate of 12.00%. Interest is payable monthly with a minimum optional redemption of principal due on July 1 of each

year until maturity at July 1, 2030. The effective rate of interest paid in 2011, including letter of credit costs, was 1.62%. The minimum optional redemption amount in each of the second five years is \$175,000. The note is secured by a letter of credit with Bank of America, N.A.

Notes Payable – Others – In connection with the CareCentric merger in 2006, the Company purchased the \$8.1 million dollar line of credit CareCentric maintained with Wainwright Bank, and assumed the three year Amended and Restated Convertible Non-revolving Line of Credit dated December 31, 2007 in the amount of \$16 million. Contemporaneously with the merger, the Company converted its' \$8.1 million portion of the \$16 million Line of Credit to paid in capital. The balance of the line of credit \$6,946,000, is payable to John E. Reed and Stewart B. Reed, majority stockholders of the Company. These notes no longer accrue interest as of April 11, 2011. The balance of the notes payable to others, \$792,000 relate to miscellaneous notes payable to John E. Reed and Barrett O'Donnell assumed by the Company as a result of the merger.

Banc of America Leasing and Capital – In connection with the acquisition of Maynard Aviation LLC, the Company assumed each members portion of the loan payable by Maynard on its 1990 Beach Craft Super 200 Turbo Prop aircraft. The note matures on November 20, 2013 and has a balance of \$969,000 at December 31, 2011. The note bears interest at a rate of LIBOR plus 325 basis points adjusted monthly. The effective rate of interest at December 31, 2011 was 3.50%. The company is currently in negotiation with Banc of America Leasing and Capital to purchase the note payable by Maynard Aviation.

The Company had outstanding at December 31, 2011, \$7,693,000, in standby letters of credit issued in connection with the TCE PI Trust (see Note 10), and \$2,928,000 issued principally in connection with its commercial insurance programs. In addition, a letter of credit was issued on July 19, 2005 in the amount of \$4,481,000 in connection with the \$4,430,000 Industrial Development Authority Bond, for the City of Bridgeton, MO (see below). The balance on this letter of credit as of December 31, 2011 was \$3,161,000.

On June 10, 2009, in connection with negotiations with the Company's lending syndicate relative to the CareCentric merger, Omega Flex, (a former subsidiary) loaned the Company \$3,250,000. The note was an 18 month balloon note bearing interest at 6% per annum maturing on October 20, 2010. In connection with the loan, Omega Flex entered into a subordination agreement with the lending syndicate. The note was paid and cancelled on October 20, 2010.

Maturities of debt in each of the next five years and thereafter are as follows in thousands:

|                        | <u>Long-term<br/>Debt</u> |
|------------------------|---------------------------|
| 2012                   | \$ 277                    |
| 2013                   | 1,042                     |
| 2014                   | 175                       |
| 2015                   | 7,913                     |
| 2016                   | 175                       |
| Thereafter             | <u>2,251</u>              |
| Total Debt Maturities: | <u>\$ 11,833</u>          |

The fair value of the Company's long-term debt is estimated based on the current interest rates offered to the Company for debt of the same remaining maturities. Management believes the carrying value of debt and the contractual values of the outstanding letters of credit approximate their fair values as of December 31, 2011.

Cash paid for interest was \$243,000 and \$850,000, during the years ended December 31, 2011 and 2010, respectively. Interest expense totaled \$498,000 and \$746,000 for the years ended December 31, 2011 and 2010, respectively.



## 6. INCOME TAXES

The provision for income taxes consisted of the following:

|                                | <u>2011</u>            | <u>2010</u>     |
|--------------------------------|------------------------|-----------------|
|                                | (Dollars in thousands) |                 |
| Federal Income Tax:            |                        |                 |
| Current                        | \$ -                   | \$ 58           |
| Deferred                       | 6,071                  | 1,552           |
| State Income Tax:              |                        |                 |
| Current                        | 1,414                  | 136             |
| Deferred                       | 170                    | 167             |
| Foreign Income Tax:            |                        |                 |
| Current                        | 1,544                  | 671             |
| Deferred                       | <u>(57)</u>            | <u>-</u>        |
| Provision for Income Taxes     | <u>\$ 9,142</u>        | <u>\$ 2,584</u> |
| Discontinued Operations        | 554                    | (3,001)         |
| Continuing Operations          | <u>8,588</u>           | <u>5,585</u>    |
| Total Provision for Income Tax | <u>\$ 9,142</u>        | <u>\$ 2,584</u> |

Income before income taxes included foreign income of \$5,243,000 and \$2,975,000, in 2011 and 2010, respectively.

Total income tax expense differed from statutory income tax expense computed by applying the U.S. federal income tax rate of 35% to earnings before income tax, as follows:

|   | <u>2011</u>            | <u>2010</u>     |
|---|------------------------|-----------------|
|   | (Dollars in thousands) |                 |
| Computed "Expected" Income Tax Expense                  | \$ 6,298               | \$ 2,748        |
| Permanent Difference Related to Discontinued Operations | 2,027                  | -               |
| State Income Tax, Net Of Federal Tax Expense            | 1,297                  | 200             |
| Foreign Source Income                                   | (670)                  | (341)           |
| Other – Net   | <u>190</u>             | <u>(23)</u>     |
| Income Tax Expense                                      | <u>\$ 9,142</u>        | <u>\$ 2,584</u> |

Deferred income tax (expense) benefit results from temporary differences in the recognition of income and expense for income tax and financial reporting purposes. The components of and changes in the net deferred tax assets (liabilities) which give rise to this deferred income tax (expense) benefit for the years ended December 31, 2011 and 2010 are as follows:

|  | <u>2011</u>            | <u>2010</u>   |
|--|------------------------|---------------|
|  | (Dollars in thousands) |               |
| <u>Deferred Tax Assets:</u>                  |                        |               |
| Warranty Reserve                             | \$ 1,244               | \$ 1,204      |
| Remediation Reserve                          | 3,502                  | 4,172         |
| Compensated Absences                         | 626                    | 768           |
| Inventory Valuation                          | 597                    | 1,064         |
| Workers Compensation Reserve                 | 346                    | 507           |
| Unearned Subscription Revenue                | -                      | 511           |
| Net Operating Loss Carry Forward             | 13,172                 | 17,898        |
| Impairment of Goodwill and Long Lived Assets | 436                    | 466           |
| Accounts Receivable Valuation                | 1,176                  | 907           |
| Deferred Benefits Plan                       | 1,777                  | 1,071         |
| Other  | <u>1,017</u>           | <u>158</u>    |
| Total Deferred Tax Assets                    | <u>23,893</u>          | <u>28,726</u> |

|                                  | <u>2011</u>            | <u>2010</u>      |
|----------------------------------|------------------------|------------------|
|                                  | (Dollars in thousands) |                  |
| <u>Deferred Tax Liabilities:</u> |                        |                  |
| Prepaid Expenses                 | (1,088)                | (1,169)          |
| Depreciation and Amortization    | <u>(4,099)</u>         | <u>(2,459)</u>   |
| Total Deferred Tax Liabilities   | <u>(5,187)</u>         | <u>(3,628)</u>   |
| Net Deferred Tax Asset           | <u>\$ 18,706</u>       | <u>\$ 25,098</u> |

The Company has federal net operating loss carry-forwards of approximately \$37.7 million, which expire from 2011 through 2028. At December 31, 2011, the Company has net operating loss carry forwards, research and development credit and alternative minimum tax credit carry forwards, which are available to reduce future income taxes payable, subject to applicable Federal rules and limitations.

Management believes it is more likely than not that the Company will have sufficient taxable income when these temporary differences are reversed and that the deferred tax asset will be realized and accordingly no valuation allowance is deemed necessary. The income of certain foreign subsidiaries is considered permanently invested and additional U.S. taxes have not been provided. Such income amounted to approximately \$1,914,000 through December 31, 2011.

The Company paid a total of \$1,278,000 and \$1,107,000 in income taxes to federal, state, and foreign tax jurisdictions for the years ended 2011 and 2010, respectively.

The Company adopted new guidance required for uncertainty in income taxes as of January 1, 2009 without material impact on its financial statements. The company recognizes interest and penalties related to uncertain tax positions, if any, as a component of the provision for income taxes in the accompanying statements of operations. At December 31, 2011 and 2010, the potential interest and penalties attributable to any uncertainties were *de minimus*.

The Company and its subsidiaries file income tax returns in the United States and various state jurisdictions. In the normal course of business, the Company is regularly audited by U.S. federal, state or local tax examinations by tax authorities in its major jurisdictions for years before 2007.

## 7. LEASES AND RELATED PARTY TRANSACTIONS

### Related Party Leases

The Company leases various manufacturing facilities and equipment from companies owned by certain officers and directors of the Company, either directly or indirectly, through affiliates. The leases generally provide that the Company will bear the cost of property taxes and insurance.

Details of the principal operating leases with related parties as of December 31, 2011, including the effect of renewals and amendments executed subsequent to December 31, 2011, are as follows:

|                                 | <u>Date of<br/>Lease</u> | <u>Term</u> | <u>Basic<br/>Annual<br/>Rent</u> | <u>Minimum<br/>Future<br/>Rentals</u> |
|---------------------------------|--------------------------|-------------|----------------------------------|---------------------------------------|
|                                 |                          |             | (Dollars in thousands)           |                                       |
| Sterling Realty Trust:          |                          |             |                                  |                                       |
| Land and Building-Main          | 09/30/05                 | 5 years     | \$ 282                           | \$ 0                                  |
| Land and Building Beacon Morris | 07/01/08                 | 5 years     | \$ 91                            | \$ 137                                |
| Land and Building-South Complex | 01/01/94                 | 14 years    | \$ 306                           | \$ 0                                  |
| Land and Building Torrington    | 05/01/04                 | 10 years    | \$ 315                           | \$ 520                                |
| Rudbeek Realty Corp.:           |                          |             |                                  |                                       |
| Farmville Location              | 07/01/97                 | 13.5 years  | \$ 436                           | \$ 0                                  |
| MacKeeber:                      |                          |             |                                  |                                       |
| South Windsor, CT               | 09/01/06                 | 5 years     | \$ 436                           | \$ 0                                  |

### **All Leases**

Rent expense for operating leases, including those with related parties, was \$3,219,000 and \$3,400,000, for the years ended December 31, 2011, and 2010, respectively. Rents to related parties were approximately \$1,765,000 and \$1,728,000, for the years ended December 31, 2011, and 2010, respectively.

Future minimum lease payments under all non-cancelable leases as of December 31, 2011 are as follows:

| <b><u>Years Ending December 31,</u></b> | <b><u>Operating Leases</u></b><br>(Dollars in thousands) |
|---|--|
| 2012                                    | \$ 1,742   |
| 2013                                    | 1,163  |
| 2014                                    | 778  |
| 2015                                    | 651  |
| 2016                                    | 651  |
| Thereafter                              | <u>1,843</u>   |
| Total Minimum Lease payments            | <u>\$ 6,828</u>  |

### **Other Related Party Transactions**

On October 13, 2006, the Company loaned \$611,000 to Stephen Shea, its Chief Financial Officer, in connection with his exercise in 2005 of incentive stock options. The loan bore interest at 4.5%, originally matured on October 13, 2009, and is secured by a pledge of 40,000 common shares of the Company's Stock.

On October 13, 2009, the company amended and restated the \$611,000 loan to extend the maturity to October 13, 2010, and added additional security in the form of a pledge of the proceeds from a term life insurance policy in the name of Stephen Shea to the company by Mr. Shea and his named beneficiary. The loan automatically renews for a period of one year at each anniversary date.

## **8. VARIABLE INTEREST ENTITIES**

On January 1, 2010, the Company adopted ASU 2009-17, "Consolidations (Topic 810): Improvements to Financial Reporting by Enterprises Involved with Variable Interest Entities." ASU 2009-17 amends the consolidation guidance applicable to variable interest entities ("VIE's) and requires additional disclosures concerning an enterprise's continuing involvement with VIEs. The Company evaluated the impact of this guidance and determined that the adoption did not result in the requirement to consolidate any additional VIE's.

### **Consolidated Variable Interest Entities**

The company holds a variable interest in a joint venture for which the company is the primary beneficiary (see Note 4 – Dadanco-Mestek Joint Venture LLC). The entity is a development stage enterprise that produces Active Chilled Beams for use in commercial heating, ventilation and air conditioning systems. The Company's variable interest in this entity relates to cost plus arrangements between the joint venture and the Company and the Company's provision of a \$3.0 million line of credit facility.

As the primary beneficiary of this VIE, the entity's assets, liabilities and results of operations are included in the Company's consolidated financial statements. The other equity holders' interests are reflected in 'Non-controlling interests' in the consolidated balance sheets.

The following table summarizes the carrying amounts of the entity's assets and liabilities included in the Company's consolidated balance sheets at December 31, 2011 and December 31, 2010:

| Assets And Liabilities of Consolidated VIEs  | December 31,<br>2011 | December 31,<br>2010 |
|--|----------------------|----------------------|
| In millions:                                 |                      |                      |
| Current Assets (restricted 2011:\$1,269)     | \$ 1,269             | \$ 1,516             |
| Property (restricted 2011:\$175)             | 175                  | 118                  |
| Total assets                                 | <u>\$ 1,444</u>      | <u>\$ 1,634</u>      |
| Current liabilities (nonrecourse 2011 \$159) | \$ 1,801             | \$ 1,348             |
| Total liabilities                            | <u>\$ 1,801</u>      | <u>\$ 1,348</u>      |

Amounts presented in the consolidated balance sheets and the table above as restricted assets or nonrecourse obligations relating to consolidated VIE's at December 31, 2011 are adjusted for intercompany eliminations, parental guarantees and residual value guarantees.

## 9. EMPLOYEE BENEFIT PLANS

### **Defined Contribution and 401-K Plans**

The Company maintains a qualified non-contributory profit-sharing plan ("Profit-Sharing Plan") covering all eligible employees. Contributions to the Profit-Sharing Plan were approximately \$1,000,000 and \$826,700 for the years ended December 31, 2011 and 2010, respectively. Contributions to the Profit Sharing Plan are defined as a minimum of \$600,000 plus 5% of the excess operating profits of the Company exceeding \$12,000,000, subject to the maximum allowed under the Employee Retirement Income Security Act of 1974, ("ERISA"). Contributions to the Profit-Sharing Plan are allocated to participants based upon the prior profit sharing formula contribution: three percent (3%) of gross wages up to the current Old Age, Survivors, and Disability ("OASDI") limit and six percent (6%) of the excess over the OASDI limit, as a percentage of the total contribution under the previous profit sharing formula. The Profit-Sharing Plan's vesting terms for contributions made prior to October 1, 2001 are twenty percent (20%) vesting after 3 years of service, forty percent (40%) after 4 years, sixty percent (60%) after 5 years, eighty percent (80%) after 6 years, and one hundred percent (100%) vesting after 7 years. The Profit-Sharing Plan's vesting terms for contributions made after October 1, 2001 are twenty percent (20%) vesting after 2 years of service, forty percent (40%) after 3 years, sixty percent (60%) after 4 years, eighty percent (80%) after 5 years, and one hundred percent (100%) vesting after 6 years.

The Company maintains a retirement savings plan ("Retirement Savings Plan") qualified under Internal Revenue Code Section 401(k) for employees covered under certain collective bargaining agreements. Service eligibility requirements differ by division and collective bargaining agreements. Participants may elect to have up to fifty percent (50%) of their compensation withheld, up to the maximum allowed by the Internal Revenue Code. Participants may also elect to make after tax voluntary contributions up to an additional ten percent (10%) of their gross earnings each year within the legal limits. The Company contributes differing amounts depending upon each division's collective bargaining agreement. Contributions are funded on a current basis. Company contributions to the Retirement Savings Plan were \$231,000 and \$243,000, for the years ended December 31, 2011 and 2010, respectively.

The Company maintains a separate qualified 401(k) plan ("401(k) Plan") for salaried employees not covered by a collective bargaining agreement who choose to participate. Participants may elect to have up to fifty percent (50%) of their compensation withheld, up to the maximum allowed by the Internal Revenue Code. Participants may also elect to make after tax voluntary contributions up to an additional ten percent (10%) of their gross earnings each year within the legal limits. Effective January 1, 2010. The Company contributes \$0.333 of each \$1.00 deferred by participants, deposited in to the 401(k) Plan not to exceed two percent (2.0%) of an employee's compensation. The Company does not match any amounts for withholding from participants in excess of six percent (6%) of their compensation or for any after tax voluntary contributions. Contributions are funded on a current basis. Contributions to the Plan were \$774,000 and \$529,000, for the years ended December 31, 2011 and 2010, respectively.

## **Defined Benefit Plans**

On December 31, 2006, the Company began recognizing the funded status (i.e., the difference between the fair value of plan assets and the projected benefit obligations) of its pension plans in the consolidated balance sheets with a corresponding adjustment to Accumulated Other Comprehensive Income, net of tax.

The Company's second-tier subsidiary, Met-Coil, maintained, prior to its acquisition by the Company's subsidiary, Formtek, Inc. on June 3, 2000, several defined benefit pension plans (the "Met-Coil Plans") covering certain of its employees. The Met-Coil Plans were "frozen" and merged prior to the acquisition, effectively locking in retirement benefits earned to that date and precluding any further benefits for future service. Due to adverse investment performance in recent years and reduced expectations of future investment earnings, the combined Met-Coil Plan's administrator has determined that the accumulated benefit obligation (the present value of future pension obligations to plan participants) exceeds the fair market value of the Met-Coil Plan's assets as of December 31, 2011 and 2010. The Company has recorded charges in 2011 and 2010, net of related tax effect, to the Shareholders' Equity section of the consolidated Balance Sheet contained herein of (\$435,000) and (\$79,000), respectively, under the heading Changes in Additional Minimum Liability-Defined Benefit Plan. Pension expense under the Met-Coil Plans was \$225,000 and \$211,000, for the years ended December 31, 2011, and 2010, respectively.

In connection with the acquisition of the assets of Airtherm Manufacturing Company and Airtherm Products, Inc. in 2000, the Company assumed certain obligations related to the defined benefit plan maintained by Airtherm, the Airtherm Retirement Income Plan, prior to the acquisition date. The Airtherm LLC Retirement Income Plan was "frozen" prior to acquisition in a manner similar to the Met-Coil Plans described above. In accordance with GAAP, the Company recorded charges in 2011 and 2010, net of related tax effect, to the Shareholders' Equity section of the Consolidated Balance Sheet contained herein of (\$483,000) and (\$45,000), respectively, relating to the Airtherm LLC Retirement Income Plan under the heading Changes in Additional Minimum Liability-Defined Benefit Plan. Pension expense under the Airtherm LLC Retirement Income Plan was \$46,000 and \$82,000, for the years ended December 31, 2011, and 2010, respectively.

The Company uses a December 31 measurement date for the Airtherm LLC Retirement Income Plan and the Met-Coil Plans.

In accordance with FASB ASC 715, net unrecognized actuarial losses included in Accumulated Other Comprehensive Income are recognized as net periodic pension cost pursuant to the Company's accounting policy for amortizing such amounts. Further, actuarial gains and losses that arise in subsequent periods and are not recognized as net periodic pension cost in the same periods are recognized as a component of other comprehensive income. Those amounts are recognized as a component of net periodic pension cost on the same basis as the amounts recognized in accumulated other comprehensive income.

### **Benefit Obligation and Funded Status**

|  | <b>Met-Coil</b>        |                 | <b>Airtherm</b>   |                 |
|--|------------------------|-----------------|-------------------|-----------------|
|  | <b>2011</b>            | <b>2010</b>     | <b>2011</b>       | <b>2010</b>     |
|  | (Dollars in thousands) |                 |                   |                 |
| (1) Accumulated Benefit Obligation at the End of the Year              | <u>\$ 4,467</u>        | <u>\$ 3,822</u> | <u>\$ 5,100</u>   | <u>\$ 4,364</u> |
| (2) Change in Projected Benefit Obligation on a Measurement Year Basis |                        |                 |                   |                 |
| Projected Benefit Obligation at the Beginning of the Period            | \$ 3,822               | \$ 3,792        | \$ 4,364          | \$ 4,274        |
| Service Cost   | 20                     | 17              | -                 | -               |
| Interest Cost  | 208                    | 211             | 237               | 240             |
| Actuarial Loss   | 757                    | 58              | 740               | 70              |
| Benefits Paid  | <u>(341)</u>           | <u>(256)</u>    | <u>(242)</u>      | <u>(220)</u>    |
| Projected Benefit Obligation at the End of the Period                  | <u>4,467</u>           | <u>3,822</u>    | <u>5,100</u>      | <u>4,364</u>    |
| (3) Change in Plan Assets on a Measurement Year Basis                  |                        |                 |                   |                 |
| Fair Value of Plan Assets at the Beginning of the Period               | 3,034                  | 2,876           | 4,003             | 3,840           |
| Actual Return on Plan Assets   | 40                     | 320             | 200               | 351             |
| Benefits Paid  | <u>(341)</u>           | <u>(256)</u>    | <u>(242)</u>      | <u>(220)</u>    |
| Employer Contributions   | <u>244</u>             | <u>94</u>       | <u>-</u>          | <u>31</u>       |
| Fair Value of Assets at the End of the Period                          | <u>2,977</u>           | <u>3,034</u>    | <u>3,961</u>      | <u>4,002</u>    |
| (4) Funded Status at the End of the Measurement Year                   | <u>\$ (1,490)</u>      | <u>\$ (788)</u> | <u>\$ (1,138)</u> | <u>\$ (362)</u> |
| (5) Weighted Average Assumptions at the End of the Year                |                        |                 |                   |                 |
| Discount Rate  | 4.10%                  | 5.65%           | 5.65%             | 5.65%           |
| Rate of Compensation Increase  | N/A                    | N/A             | N/A               | N/A             |

Net Periodic Pension Cost

|  | <b>Met-Coil</b>        |                | <b>Airtherm</b> |                |
|--|------------------------|----------------|-----------------|----------------|
|  | <b>2011</b>            | <b>2010</b>    | <b>2011</b>     | <b>2010</b>    |
|  | (Dollars in thousands) |                |                 |                |
| (1) Service Cost   | \$ 20                  | \$ 17          | \$ -            | \$ -           |
| (2) Interest Cost  | 209                    | 211            | 237             | 240            |
| (3) Expected Return on Plan Assets   | (208)                  | (195)          | (232)           | (224)          |
| (4) Amortization of Net Loss   | 204                    | 178            | 41              | 66             |
| (5) Total Net Periodic Pension Cost  | <u>225</u>             | <u>211</u>     | <u>46</u>       | <u>82</u>      |
| (6) Net (Gain)/Loss Incurred in Year   | 926                    | (67)           | 773             | (57)           |
| (7) Amortization of Net Gain   | <u>(205)</u>           | <u>(178)</u>   | <u>(41)</u>     | <u>(66)</u>    |
| (8) Other Changes in Plan Assets and Benefit Obligations<br>Recognized in Other Comprehensive Income | <u>721</u>             | <u>(245)</u>   | <u>732</u>      | <u>(123)</u>   |
| (9) Total Recognized in Net Periodic Pension Cost and other<br>Comprehensive Income (Loss)           | <u>\$ (946)</u>        | <u>\$ (34)</u> | <u>\$ 778</u>   | <u>\$ (41)</u> |
| (10) Expected Return on Plan Assets  | 7.00%                  | 7.00%          | 6.00%           | 6.00%          |

Expected Amortizations

|  | <b>Met-Coil</b>        |             | <b>Airtherm</b> |             |
|--|------------------------|-------------|-----------------|-------------|
|  | <b>2011</b>            | <b>2010</b> | <b>2011</b>     | <b>2010</b> |
|  | (Dollars in thousands) |             |                 |             |
| (1) Expected Amortization of Net Loss (Gain) | \$ 329                 | \$ 175      | \$ 141          | \$ 47       |

Plan Assets

|                        | <b>Met-Coil</b>                     |             | <b>Airtherm</b>                     |             |
|------------------------|-------------------------------------|-------------|-------------------------------------|-------------|
|                        | <b>Percentage of Plan Assets at</b> |             | <b>Percentage of Plan Assets at</b> |             |
|                        | <b>December 31</b>                  |             | <b>December 31</b>                  |             |
|                        | <b>2011</b>                         | <b>2010</b> | <b>2011</b>                         | <b>2010</b> |
|                        | (Dollars in thousands)              |             |                                     |             |
| (1) Plan Assets        |                                     |             |                                     |             |
| (a) Equity Securities* | 58%                                 | 57%         | 0%                                  | 0%          |
| (b) Debt Securities    | 41%                                 | 42%         | 13%                                 | 13%         |
| (c) Cash & Equivalents | 0%                                  | 0%          | 0%                                  | 0%          |
| (d) Other              | <u>1%</u>                           | <u>1%</u>   | <u>87%</u>                          | <u>87%</u>  |
| (e) Total              | <u>100%</u>                         | <u>100%</u> | <u>100%</u>                         | <u>100%</u> |

\* Includes no Mestek common stock at either December 31, 2011 or 2010.

Long-Term Rate of Return Assumption – Met-Coil

The approach used to determine the expected long-term rate of return on plan assets assumption is based on weighting historical market index returns for various asset classes in proportion to the plan assets. Typically, the Trust holds approximately 60% of assets in equity securities and 40% in fixed income securities. Weighting 10-year compounded trailing returns on equity and fixed income indices in proportion to the above asset mix yields an expected long-term return of 7%.

Long-Term Rate of Return Assumption – Airtherm

The approach used to determine the expected long-term rate of return on plan assets assumption is based on weighting historical market index returns for various assets classes in proportion to the plan assets. The assets of the Plan are invested in the general account of Prudential Retirement. The general account is invested in corporate bonds and mortgages, which were expected to return between 6.0% and 6.4%, and Private Placements which were

expected to return approximately 6.25%. This yielded an expected long -term assumption of 6.0%.

### Cash Flows

|  | <b>Met-Coil</b>        | <b>Airtherm</b> |
|--|------------------------|-----------------|
|  | (Dollars in thousands) |                 |
| (1) Expected Contributions for Fiscal Year Ending 12/31/2011   |                        |                 |
| (a) Expected Employer Contributions  | \$ 144                 | \$ 30           |
| (b) Expected Employee Contributions  | -                      | -               |
| (2) Estimated Future Benefit Payments Reflecting Expected Future Service for the Fiscal Year(s) Ending |                        |                 |
| (a) 12/31/2012   | \$ 250                 | \$ 279          |
| (b) 12/31/2013   | 250                    | 287             |
| (c) 12/31/2014   | 260                    | 298             |
| (d) 12/31/2015   | 271                    | 324             |
| (e) 12/31/2016   | 271                    | 346             |
| (f) 12/31/2017 - 12/31/2021  | 1,391                  | 1,714           |

### Other Accounting Items

|  | <b>Met-Coil</b>        |               | <b>Airtherm</b> |             |
|--|------------------------|---------------|-----------------|-------------|
|  | <b>2011</b>            | <b>2010</b>   | <b>2011</b>     | <b>2010</b> |
|  | (Dollars in thousands) |               |                 |             |
| Alternative Amortization Methods Used to Amortize Prior Service Cost | Straight Line          | Straight Line | N/A             | N/A         |
| Unrecognized Net (Gain)/Loss   | Straight Line          | Straight Line | **              | **          |
| Average Future Service / Lifetime                                    | 6.31                   | 8.46          | 7.32            | 7.16        |

\*\* Excess (if any) over 10% of the greater of the projected benefit obligation or the market-related value of plan assets is divided by the average remaining service period of active employees expected to receive benefits under the plan.

### Fair Value Measurements

Accounting for *Fair Value Measurements* establishes a framework for measuring fair value. That framework provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1 measurements) and the lowest priority to unobservable inputs (level 3 measurements). The three levels of the fair value hierarchy are described as follows:

Level 1 Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the plans have the ability to access.

Level 2 Inputs to the valuation methodology include:

- quoted prices for similar assets or liabilities in active markets;
- quoted prices for identical or similar assets or liabilities in inactive markets;
- inputs other than quoted prices that are observable for the assets or liability; and
- inputs that are derived principally from or corroborated by observable market data by correlation or other means.

If the asset or liability has a specified (contractual) term, the level 2 input must be observable for substantially the full term of the asset or liability.

Level 3 Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The asset or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

Following is a description of the valuation methodologies used for assets measured at fair value.

*Insurance contract in a guaranteed deposit fund:* Valued at fair value by discounting the related cash flows based on current yields of similar instruments with comparable durations considering the creditworthiness of the issuer.

*Pooled separate accounts:* Valued at fair value by discounting the related cash flows based on current yields of similar instruments with comparable durations considering the creditworthiness of the issuer.

The following table sets forth by level, within the fair value hierarchy, the Airtherm Retirement Income Pension Plan assets at fair value as of December 31, 2011:

|                            | <u>Level 1</u> | <u>Level 2</u>      | <u>Level 3</u> | <u>Total</u>        |
|----------------------------|----------------|---------------------|----------------|---------------------|
| Insurance contract         | -              | \$ 3,444,289        | -              | \$ 3,444,289        |
| Pooled separate accounts   | -              | <u>516,353</u>      | -              | <u>516,353</u>      |
| Total assets at fair value | <u>\$ -</u>    | <u>\$ 3,960,642</u> | <u>\$ -</u>    | <u>\$ 3,960,642</u> |

The following table sets forth by level, within the fair value hierarchy, the Met-Coil Systems Corporation Pension Plan assets at fair value as of December 31, 2011:

|                            | <u>Level 1</u>      | <u>Level 2</u>      | <u>Level 3</u> | <u>Total</u>        |
|----------------------------|---------------------|---------------------|----------------|---------------------|
| Insurance contract         | -                   | \$ 21,833           | -              | \$ 21,833           |
| Pooled Separate Accounts   | -                   | 1,223,456           | -              | 1,223,456           |
| Mutual funds               | <u>\$ 1,731,239</u> | <u>-</u>            | <u>-</u>       | <u>1,731,239</u>    |
| Total assets at fair value | <u>\$ 1,731,239</u> | <u>\$ 1,245,289</u> | <u>\$ -</u>    | <u>\$ 2,976,528</u> |

## 10. COMMITMENTS AND CONTINGENCIES

### Indemnifications

The Company is obligated under Indemnity Agreements ("Indemnity Agreements") executed on behalf of 23 of the Company's officers and directors. Under the terms of the Indemnity Agreements, the Company is contingently liable for costs which may be incurred by the officers and directors in connection with claims arising by reason of these individuals' roles as officers and directors of the Company.

### Contingencies

#### Letters of Credit

The Company had outstanding at December 31, 2011, \$7,693,000 in standby letters of credit issued in connection with the TCE PI Trust (see Note 5) and \$2,928,000 issued principally in connection with its commercial insurance programs. In addition, a letter of credit was issued on July 19, 2005 in the amount of \$4,481,000 in connection with the \$4,430,000 Industrial Development Authority Bond (see Note 5) for the City of Bridgeton, MO, the balance of which is reduced to reflect principal payments made on the note. The balance on the Bridgeton Industrial Development Authority letter of credit was \$3,161,000 as of December 31, 2011.



## Insurance

The Company retains significant obligations under its commercial general liability insurance policies for product liability and other losses. For losses occurring in the policy years ending October 1, 2004 through 2011, the Company maintains commercial general liability insurance, retaining liability for the first \$2,000,000 per occurrence of commercial general liability claims (including products liability claims), subject to an agreed aggregate. For losses occurring in the policy year ended October 31, 2003, the Company retained liability for the first \$500,000 per occurrence of commercial general liability claims (including product liability), subject to an agreed aggregate. In addition, the Company retained liability for the first \$250,000 per occurrence of workers compensation coverage, subject to an agreed aggregate.

## Litigation

The Company is subject to several legal actions and proceedings in which various monetary claims are asserted. Management, after consultation with its corporate legal department and outside counsel, does not anticipate that any ultimate liability arising out of all such litigation and proceedings will have a material adverse effect on the financial condition of the Company except as set forth below.

## Environmental Litigation and Remediation Reserves

The Company maintains an environmental reserve related to the settlement of litigation in 2004 connected with the Company's Lisle, IL manufacturing facility. The environmental reserve covers the Company's obligations to perform certain soil and ground water remediation procedures at the Lisle facility and the Company's related obligation to fund a trust (the "TCE PI Trust") established in connection with the settlement for the purpose of administering future personal injury claims relating to the Lisle facility.

Activity related to the environmental reserve in 2011 and 2010 was as follows:

|                                       | <u>2011</u>            | <u>2010</u>      |
|---------------------------------------|------------------------|------------------|
|                                       | (Dollars in thousands) |                  |
| Balance Beginning of the Year         | \$ 11,007              | \$ 11,809        |
| Less Remediation Related Expenditures | (698)                  | (710)            |
| Less TCE PI Trust Fund Payments       | <u>(127)</u>           | <u>(92)</u>      |
| Balance End of the Year               | <u>\$ 10,182</u>       | <u>\$ 11,007</u> |

These reserves have been established in accordance with ASC 450 "Contingencies". They represent management's best estimate of these liabilities, and are based upon known or anticipated claims analysis estimated by various legal, scientific and economic experts. There is no assurance that these reserves will be adequate to meet all potentials personal and property claims arising from the environmental contamination at the Lisle, IL site, however, claim activity has been lower to date than originally forecasted.

The Company is continuing with the remediation of the Lisle, IL facility, pursuant to a work plan for the site while awaiting approval from the IEPA of the ground water remedial standards to be achieved by the work plan, as well as the methodology for ground water remediation. The Company has guaranteed to the IEPA up to \$3 million of remediation costs incurred by either Met-Coil or, if Met-Coil fails to perform the remediation, the IEPA.

Based on claim experience through December 31, 2011, the Company has classified \$400,000 of the above reserve as current as of December 31, 2011. The Company has updated its formal independent analyses of claim and remediation cost estimates as of December 31, 2011 and expects to revise its reserves in future periods as a result of actual activity.

## Other Claims Alleging Releases of Hazardous Materials or Asbestos Related Liability

As of December 31, 2011, the Company is a party to approximately 137 asbestos-related lawsuits, primarily in Texas where numerous asbestos-related actions have been filed against numerous defendants. The lawsuits previously pending against the Company in Illinois have all been resolved by plaintiffs' dismissals without payment.

Almost all of these suits seek to establish liability against the Company as successor to companies that may have manufactured, sold or distributed asbestos-related products, and who are currently in existence and defending thousands of asbestos related cases, or because the Company currently sells and distributes boilers, an industry that has been historically associated with asbestos-related products. The Company believes it has valid defenses to all of the pending claims and vigorously contests that it is a successor to companies that may have manufactured, sold or distributed any product containing asbestos materials. However, the results of asbestos litigation have been unpredictable, and accordingly, an adverse decision or adverse decisions in these cases, individually or in the aggregate, could materially adversely affect the financial position and results of operation of the Company and could expose the Company to substantial additional asbestos related litigation and the defense costs thereof, which defense costs, because of the sheer number of asbestos claimants and the historical course of the litigation process in this area has the potential to become substantial, though these costs are not capable of estimation at this time. The total requested damages of these cases are over \$3 billion. To date, however, the Company has had approximately 300 asbestos-related cases dismissed without any payment and it settled approximately twenty-five asbestos-related cases for a *de minimis* value. However, there can be no assurance the Company will be able to successfully defend or settle any pending litigation.

In addition to the Lisle, IL site, the Company has been named or contacted by state authorities and/or the EPA regarding the Company's asserted liability or has otherwise determined it may be required to expend funds for the remediation of certain other sites in North Carolina, Connecticut and Pennsylvania.

The Company continues to investigate all of these matters. Given the information presently known, no estimation can be made of any liability which the Company may have with respect to these matters. There can be no assurance, but based on the information presently available to it, the Company does not believe that any of these matters will be material to the Company's financial position or results of operations.

ASC 410 "Asset Retirement and Environmental Obligations" was effective for fiscal years ending after December 15, 2005. ASC 410 requires that an entity recognize a liability for the fair value of a conditional asset retirement obligation if the fair value of the liability can be reasonably estimated. At December 31, 2011 and 2010, the Company is unable to estimate the ranges or probabilities of any potential asset retirement obligations.

## **11. SHAREHOLDERS' EQUITY**

Mestek has authorized common stock of 20,000,000 shares with no par value, and a stated value of \$0.05 per share. As of December 31, 2011, John E. Reed, Chairman and CEO of Mestek, and Stewart B. Reed, Vice Chairman and Chief Operating Officer and a director of Mestek and son of John E. Reed, together beneficially own a majority of the outstanding shares of Mestek's common stock.

The Company did not repurchase any of its common shares in the open market in 2011 or 2010.

As more fully explained in Note 13, the Company repurchased 99,464 shares of common stock in a Dutch auction on December 23, 2011 at a total cost of \$1,243,300. The shares repurchased in the Dutch auction have been retired.

## **12. STOCK OPTION PLANS**

In 2011, the Company adopted a stock option plan (the Plan) that provides for the granting of qualified (also known as incentive stock options) and nonqualified stock options to Company directors, officers, employees, and consultants. A total of 300,000 shares of the Company's common stock were issuable under the Plan.

Employee and Director stock option activity for the year ended December 31, 2011 was as follows:

|                                  | Number of<br><u>Options</u> | Exercise<br>Price<br><u>Range</u> | Weighted-<br>Average<br>Exercise<br>Price |
|----------------------------------|-----------------------------|-----------------------------------|---|
| Outstanding at December 31, 2010 | 0                           |                                   |   |
| Granted – Sept 20, 2011          | 173,000                     | \$9.30                            | \$9.30                                    |
| Exercised                        | ---                         | ---                               | ---                                       |
| Forfeited/cancelled              | ---                         | ---                               | ---                                       |
| Outstanding at December 31, 2011 | 173,000                     | 9.30                              | 9.30                                      |
| Exercisable at December 31, 2011 | <u>35,000</u>               | <u>\$ 9.30</u>                    | <u>\$ 9.30</u>                            |

The following table summarizes information about stock options outstanding at December 31, 2011:

| <u>Options Vested and Expected to Vest</u> |                       |   |  | <u>Options Vested</u> |   |  |
|--|-----------------------|---|--|-----------------------|---|--|
| Exercise<br>Price                          | Number<br>Outstanding | Weighted<br>Average<br>Remaining<br>Contractual<br>Life (Years) | Weighted<br>Average<br>Exercise<br>Price | Number<br>Exercisable | Weighted<br>Average<br>Remaining<br>Contractual<br>Life (Years) | Weighted<br>Average<br>Exercise<br>Price |
| \$9.30                                     | 173,000               | 9.75  | \$9.30                                   | 35,000                | 9.75  | \$9.30                                   |

At December 31, 2011, 127,000 shares remain available for future grant.

### 13. MESTEK “GOING PRIVATE” TRANSACTION

On August 29, 2006 the Company's shareholders voted to take the Company private by approving amendments to the Company's Articles of Incorporation resulting in a 1-for-2,000 reverse split of the Company's issued and outstanding shares of common stock, which had the effect of cashing out those shareholders holding fewer than 2,000 shares at a price of \$15.24 per share, followed by a 2,000-for-1 forward stock split which restored share balances for those who held 2,000 or more pre-split shares. The Company recorded a liability at that time in the amount of \$7,544,166 representing 495,024 common shares at \$15.24 which was charged to common stock at \$.05 per share and paid in capital at \$15.19 per share. This liability was substantially paid as of December 31, 2006, except for a de minimis amount relating to un-located shareholders. In December 2008, the Company completed a reconciliation of the “going private” transaction with the records of the transfer agent. As a result of this reconciliation, the Company accrued an additional liability with respect to the transaction of \$15,636 representing 1,026 common shares at \$15.24 per share. The purpose of the reverse split and cash payment in lieu of fractional share was to reduce the number of the Company's shareholders of record to below 300 which permitted the Company to deregister its securities under the Securities Exchange Act of 1934 (the “1934 Act”), and terminate its obligations to file annual, quarterly, and other current reports with the Securities Exchange Commission. The Company filed for such termination of registration on September 19, 2006.

A general description of the terms and conditions of the transaction is as follows:

#### Structure

The transaction took the form of a 1-for-2,000 reverse split of the Company's issued and outstanding shares of common stock. The transaction had the effect of cashing out only those shareholders holding fewer than 2,000 Shares (the “Cashed Out Shareholders”) as of the effective date of the transaction (August 29, 2006). The percentage of shares held by Cashed Out Shareholders as of the effective date of the transaction is referred to as the “Cashed Out Percentage.”

## **Consideration**

In exchange for his, her or its shares, each Cashed Out Shareholder received \$15.24 per share (the “Transaction Price”), and a contingent payment right now expired. Shareholders holding 2,000 shares or more did not receive a cash payment and remained shareholders of the Company.

## **Shareholder Protections**

As described below, the transaction included economic protections for the Cashed Out Shareholders and the Company’s shareholders after the transaction and corporate governance commitments by the Company (the “Shareholder Protections”). The Company amended its by-laws to include provisions that (1) reflect the Shareholder Protections and (2) prohibit the amendment of the Shareholder Protections without the approval of a majority of the Company’s board of directors, for a period of five years following the Transaction.

Under Pennsylvania law, the going private transaction required the approval of a majority of the votes cast by shareholders voting at a meeting where a quorum was present, either in person or by proxy, with each share representing one vote. In addition, the language of the going private transaction required “majority of minority” voting, or “neutralized voting”, which meant that, in addition to the statutory approval requirement, a majority of votes cast by the “unaffiliated shareholders” needed to approve the transaction, along with a majority of the votes cast by the “affiliated shareholders”. The “affiliated shareholders” included owners of more than 10% of the issued and outstanding common stock of the Company, and directors and executive officers of the Company, as well as members of such owners, directors and executive officers’ immediate families and certain trusts for the benefit of such owners, directors, executive officers or members of their immediate families. “Unaffiliated shareholders” are all other shareholders of the Company.

## **Economic Protections**

As a result of this transaction, the Company’s common shares are no longer listed on the New York Stock Exchange. Subsequent to the transaction the Company’s shares are quoted daily by the stock quotation service known as the “Pink Sheets” ([www.pinksheets.com](http://www.pinksheets.com)). The Company posts its quarterly unaudited and annual audited results on the Pink Sheets web site for public access. The Company will undertake to use reasonable efforts to cause its common stock to continue to be published on the Pink Sheets publication service including, without limitation, providing the information (1) required by the Securities Exchange Act of 1934, as amended, and (2) necessary to complete a NASD Form 211 to a SEC registered broker-dealer that is a member of the NASD. The Company also undertakes to assist individuals and institutions to liquidate their substantial holdings including, without limitation, using its best efforts to find a broker willing to execute Pink Sheets orders in the Company’s common stock.

## **Dutch Auction**

In each of the five calendar years immediately following the transaction, the Company will undertake to hold one Dutch auction for its common stock, and to purchase up to \$2,500,000 of its common stock in each auction. This commitment is subject to the Company’s ability to meet reasonable constraints imposed by bank covenants and financial ratios, as determined by a majority of the Company’s board of directors and independent directors.

On November 27, 2007, the Company completed the first Dutch auction required by this transaction. The Company repurchased and cancelled 169,496 shares of common stock at \$14.75 per share at a total cost of \$2.5 million.

On December 8, 2008, the Company completed the second Dutch auction required by this transaction. The Company repurchased and cancelled 187,500 shares of common stock at \$8.00 per share at a total cost of \$1.5 million.

On December 16, 2009, the Company completed the third Dutch auction required by this transaction. The Company repurchased and cancelled 28,839 shares of common stock at \$7.00 per share at a total cost of \$201,873.

On December 8, 2010, the Company completed the fourth Dutch auction required by this transaction. The Company repurchased and cancelled 405,738 shares of common stock at \$8.75 per share at a total cost of \$3,550,208.

On December 23, 2011 the Company completed the fifth and final Dutch auction required by this transaction. The Company repurchased and cancelled 99,464 shares of common stock at \$12.50 per share at a total cost of \$1,243,300.

### **Corporate Governance Protections**

**Board and committee composition.** A majority of the Company's board will continue to consist of independent directors, as defined by the New York Stock Exchange ("Independent Directors"). The Company's Audit and Compensation Committees consists entirely of Independent Directors.

**Financial reporting.** The Company provides each of its shareholders, via Over the Counter ([www.otc.com](http://www.otc.com)) with quarterly and annual financial reports, similar in general content to, but not necessarily in as great detail or in the same format as, the reports required by the Securities Exchange Act of 1934, as amended.

**Shareholder questions.** The Company's management will entertain questions asked by its shareholders and answer the questions fully and frankly.

**Conflicts.** The Company will disclose to the Independent Directors and its shareholders information relating to (1) any interested transaction as may be proposed, whether involving an insider or otherwise posing a conflict of interest, and (2) compensation paid to the Company's management.

**Whistleblower hotline.** The Company will provide a hotline to facilitate outside shareholders', employees', suppliers' and others' confidential reporting of improper conduct to the Company's Audit Committee or other designated governing body.

## **14. PLANT SHUTDOWNS, OTHER RESTRUCTURING CHARGES AND GAIN ON SALE OF PRODUCT LINE**

### **Plant Shutdowns**

On December 4, 2008 the Company consolidated operations at Yoder Manufacturing with Formtek's other Cleveland, OH facility. The Company recorded an impairment charge of \$513,000 to write down the carrying value on the property to its' expected selling price. This asset is classified as Property Held for Sale at December 31, 2011 and December 31, 2010.

In September of 2005, the Company's Metal Forming Segment, ("Formtek") announced plans to close its Lisle, IL ("Lockformer") manufacturing facility and combine manufacturing operations with the operations of St. Louis, MO, based Engel Industries ("Engel"), a complementary business in the Metal Forming Segment, in a modern 80,000 sq. ft. upgraded facility purchased by the Company on June 17, 2005 in Bridgeton, MO. The Lockformer and Engel relocations were substantially completed as of June 30, 2006. The Lockformer facility in Lisle Ill classified as "Property Held for Sale" at December 31, 2011 and 2010.

The Company is accounting for the costs related to these "exit and disposal" activities, employee severance and related costs of shutting down manufacturing operations, in accordance with ASC 420 *Exit or Disposal Cost Obligations*. In the years ended December 31, 2011 and 2010, the Company incurred \$1,380,000 and \$3,105,000, respectively, of such "exit and disposal" costs which are classified separately in the accompanying financial statements in accordance with ASC 420.

### **Other Restructuring Costs**

During the years ended December 31, 2011 and 2010, the Company incurred \$66,000 and \$85,000 respectively, in professional fees and related costs connected with the "going private" transaction (see Note 13).

### **Loss on Sale of Assets**

On various occasions during 2011 the Company sold certain surplus manufacturing assets of the Company's idled manufacturing facilities for \$476,000, resulting in a net loss of \$902,000.

## **15. SUBSEQUENT EVENTS**

The Company has evaluated subsequent events through April 13, 2012, the date which the financial statements were available to be issued. The Company identified two additional events requiring disclosure.

### **Acquisition of Linel Signature Skylights, LLC and Linel Properties LLC**

On March 5, 2012, the Company acquired the assets of Linel Signature Skylights, LLC, and the related office and manufacturing facilities and land owned by Linel Properties, LLC, for a total consideration of approximately \$6.3 million. Linel manufactures skylights used in commercial and institutional buildings and also manufactures building exterior panels.

### **Agreement to Purchase the Australian Membership Interest in DMJV**

The Company has an agreement in principle to acquire the membership interest in Dadanco-Mestek Joint Venture LLC held by Dadanco US Inc. and Dadanco Pty Limited. The terms of the acquisition are being negotiated and no definitive purchase price has been established.