

THE EASTERN

COMPANY



## 2006 ANNUAL REPORT

LETTER TO OUR SHAREHOLDERS

Our company performed very well in 2006, delivering record sales and profits. Sales grew by a solid 27%, increasing to \$138 million from \$109 million in 2005. Net income more than doubled, rising to \$9.7 million from \$4.4 million. This level of earnings represents a 21% return on investment for the year as compared to a 10% return in 2005.

We are also pleased that year-to-year quarterly sales comparisons were favorable throughout 2006. By the end of the year, we had completed 17 consecutive quarters in which sales surpassed their year-earlier levels. Based on our improved backlog—\$38 million at the end of 2006 compared to \$17 million at the end of 2005—we anticipate that this trend will continue into 2007.

Our gross margin and operating cash flow improved as well. Gross margin increased to 25% from 23% in 2005, while operating cash flow increased to \$8 million from \$5 million.

Several factors contributed to last year’s excellent performance, including lean manufacturing techniques that improved our productivity; continued product innovation; and a strengthened supply chain that enabled us to successfully meet our commitments. But the most significant factor was a \$31 million military contract awarded to the Company. The contract called for our Eberhard division to design and manufacture door latching systems for a project to retrofit military Humvees with improved armor. This military business especially benefited our fourth-quarter results.

Other noteworthy events of 2006 included the following.

In April of 2006, we announced a 9% (\$.01 per share) increase in our regular quarterly stock dividend. The increase reflected our confidence in the Company’s continuing success and our desire that shareholders participate in that success. Eastern has made regular dividend payments for the last 66 years. The dividend of \$.08 per share paid in December 2006 was our 265th consecutive payment.

As another sign of our confidence in the Company, in September of 2006 we announced a stock split whereby our shareholders would receive one additional share of common stock for every two shares they owned. We believed that the stock split would bring our share price to a level that would be attractive to individual investors; improve the liquidity of our stock; and increase the shareholder base of the Company.

Also in September, we acquired the assets and business of The Royal Lock Corporation, based in Wauconda, Ill. We are integrating this business into our Illinois Lock division, which is part of the Security Products segment. The acquisition will expand our range of lock and hardware products and broaden our marketing and distribution capabilities. The full impact of this acquisition will be reflected in our 2007 operating results.

In November of 2006, we purchased the assets of Summit Manufacturing, Inc., based in Newington, CT. Through the purchase we acquired a line of latches sold primarily to the major appliance market. This product will enable our Greenwald division to extend its reach into markets beyond commercial laundry, which the division currently serves.

**Segment Results**  
The Industrial Hardware Group had an extremely successful year, even apart from the favorable impact of the military contract. Sales increased 40% to \$75 million from \$54 million in 2005, while operating earnings increased 151% to \$13.1 million from \$5.2 million. New and improved products were responsible for all of the sales increase.



Senior executive officers, from left to right: Brian H. Kay, Leonard V. Samela, Leonard F. Leganza, John L. Sullivan III, and Thomas D. Melkus.



Royal Lock Products (above) and the Summit Oven Latch (below).



We received our first orders under the military contract in September 2006. The awarding of this contract was a significant tribute to the engineering expertise of the Eberhard division, since the contract called for the design of a very complex door latching system. We congratulate the men and women of the Eberhard division not only for their expertise but also for being able to meet this contract’s very demanding production requirements and delivery schedules. The contract will be fulfilled in April 2007, but we are seeking additional opportunities to supply custom latching and locking mechanisms for use on other military vehicles.

The Security Products Group turned in mixed results. Sales grew by 13% to \$50 million from \$44 million in 2005. However, operating profits decreased 1% to \$4.5 million from \$4.6 million. Prices for raw materials such as zinc, stainless steel and brass increased significantly during the year, but the competitive nature of this business prevented us from raising the prices of our products. As a result, our margins were adversely affected.

While we are pleased with the segment’s overall sales performance in 2006, it was somewhat constrained by a decrease in our sales of drop meters, meter cases and smart card systems for the commercial laundry industry. The decrease was partly due to the merger of Whirlpool and Maytag during 2006. Following the merger, the companies began to rationalize their product line offerings for the commercial laundry industry, in some cases delaying the completion of new product design and the release of new orders for delivery of the products we sell to them. In the coming year, we expect our sales and earnings to improve as we integrate the products added through our Royal Lock and Summit Manufacturing acquisitions. We do not expect to incur any additional overhead expenses in connection with those acquisitions.

The Metal Products Group achieved a 19% increase in sales, but again experienced an operating loss. Sales grew to \$13 million from \$11 million in 2005. The 2006 operating loss of \$1.8 million was comparable to the 2005 result.

In previous reports to you, I had discussed our restructuring plans for our Metal Products facility. The primary goal of that restructuring was to enable us to cast greater quantities of ductile iron in addition to casting malleable iron. We would then be in a stronger position to execute our sales and marketing plans for ductile iron.



New ductile iron casting.

In making the required modifications, we experienced some “bumps in the road,” such as equipment glitches and learning curves. But the project has essentially been completed, and we expect to see more positive results from the Metal Products Group in 2007. In addition, we continue to firmly believe that coal will play a dominant role in meeting global energy requirements. Sales of our proprietary roof anchors for the mining industry could benefit greatly from increasing underground coal mining activity worldwide.

**Outlook**  
In all of our operating units, we will continue to confront the challenge of improving or at least maintaining our operating profit margins, particularly in the face of global competition. We have achieved higher levels of efficiency by applying a variety of techniques and disciplines in our manufacturing processes. However, in many instances, we have found it necessary to outsource product to our World Lock and World Security subsidiaries in Taiwan and Hong Kong and to our Eastern Industrial subsidiary in Shanghai. We have also utilized non-affiliated Asian sources. Despite the need to outsource many of our requirements, we have been able to maintain our levels of employment and skills in the United States. We expect these conditions to continue.

Looking ahead, I believe that we are in a good competitive position and strong financial condition, and these advantages will enable us to sustain profitable growth.

In the area of corporate governance, regulatory agencies and professional organizations in 2006 spent considerable time studying and discussing Section 404 of the Sarbanes-Oxley Act. Section 404 requires publicly traded companies to document, test and assess their internal financial controls. The discussions mainly dealt with providing compliance relief to “smaller companies” in order to alleviate the extensive effort and expenditure involved in reaching compliance with Section 404.

We had hoped that such compliance relief might be coming our way. However, based on the current regulations and our current market capitalization, we are no longer considered a smaller company as that term was defined. Therefore, we are continuing with our compliance efforts. To date, the Company has completed the required documentation and has proceeded to perform preliminary testing of its internal controls. Further testing will occur during 2007.

We expect to be subject to full compliance with Section 404 requirements for the 2007 fiscal year. This means that our 2007 Form 10-K must incorporate the mandated disclosures, including management’s evaluation of internal controls over financial reporting, and our independent public accounting firm’s certification of those controls.

The enclosed 10-K report contains the detailed and audited financial reports of the Company for 2006. I urge all of you to read it.

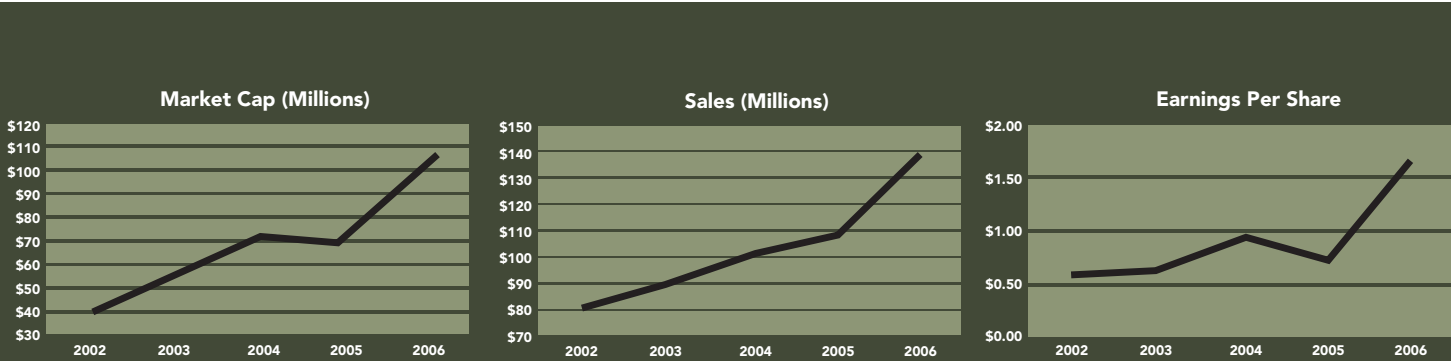
I thank our shareholders for their support and confidence, our employees for their dedication and hard work, and our directors for their wise counsel.

Leonard F. Leganza  
Chairman of the Board, President and Chief Executive Officer

FINANCIAL HIGHLIGHTS

IN THOUSANDS

	2006	2005	2004	2003	2002
Net Sales	\$138,465	\$109,107	\$100,130	\$88,307	\$81,337
Net Income	9,659	4,367	4,758	3,362	3,292
Income Taxes	5,187	2,653	2,071	2,028	1,442
Income Before Taxes	14,846	7,020	6,829	5,390	4,734
Interest Expense	1,098	1,014	1,044	1,303	1,716
Depreciation and Amortization	3,746	3,460	3,461	3,619	3,565
Capital Expenditures	6,722	1,750	2,062	2,763	1,560
Dividends Paid	1,715	1,600	1,596	1,593	1,598
PER SHARE DATA					
Net Income (Diluted)	\$1.67	\$0.75	\$0.85	\$0.61	\$0.60
Net Book Value	9.43	7.92	7.80	7.38	6.86
Tangible Net Worth	6.30	5.61	5.42	4.92	4.38
Net Working Capital	6.16	5.36	4.75	4.54	4.64
Dividends	0.31	0.29	0.29	0.29	0.29
Average Shares Outstanding (Diluted)	5,768,108	5,828,837	5,618,552	5,488,448	5,521,626
FINANCIAL RATIOS					
Return on Investment	21%	10%	12%	9%	8%
Net Income as a % of Sales	7%	4%	5%	4%	4%
Gross Profit Margin	25%	23%	25%	24%	25%
Sales per Employee (in thousands)	\$199	\$170	\$158	\$161	\$146
Net Income per Employee (in thousands)	\$14	\$7	\$8	\$6	\$6
Current Ratio	2.5	3.3	2.9	3.5	3.5



SUMMARIZED FINANCIAL DATA

	2006	2005	2004
Statement of Earnings			
Net sales	\$ 138,465,411	\$ 109,107,290	\$ 100,130,158
Cost of products sold	103,881,660	84,374,501	74,999,119
Other expenses	19,737,703	17,712,482	18,302,000
	<u>123,619,363</u>	<u>102,086,983</u>	<u>93,301,119</u>
Income before income taxes	14,846,048	7,020,307	6,829,039
Income taxes	5,187,300	2,653,120	2,071,338
NET INCOME	<u>\$ 9,658,748</u>	<u>\$ 4,367,187</u>	<u>\$ 4,757,701</u>
Net income per share:			
Basic	\$ 1.76	\$ 0.80	\$ 0.87
Diluted	\$ 1.67	\$ 0.75	\$ 0.85
Balance Sheets			
ASSETS			
Current assets	\$ 59,326,242	\$ 45,045,156	\$ 40,424,441
Property, plant and equipment, net	25,815,717	22,396,686	23,906,547
Prepaid pension cost	266,358	723,826	348,634
Interest rate swap asset	-	32,081	-
Other assets, net	18,076,627	13,424,086	13,392,143
TOTAL ASSETS	<u>\$ 103,484,944</u>	<u>\$ 81,621,835</u>	<u>\$ 78,071,765</u>
LIABILITIES AND SHAREHOLDERS' EQUITY			
Current liabilities	\$ 23,780,282	\$ 13,822,582	\$ 13,732,694
Deferred income taxes	1,123,537	895,019	1,452,134
Long-term debt, less current portion	17,506,802	12,384,338	11,804,861
Accrued postretirement benefits	1,221,156	2,078,056	2,219,821
Accrued pension cost	5,323,550	6,270,075	4,885,160
Interest rate swap obligation	138,412	-	160,417
Shareholders' equity	54,391,205	46,171,765	43,816,678
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	<u>\$ 103,484,944</u>	<u>\$ 81,621,835</u>	<u>\$ 78,071,765</u>
CASH FLOWS			
CASH FLOWS FROM OPERATIONS:			
Net income	\$ 9,658,748	\$ 4,367,187	\$ 4,757,701
Depreciation and amortization	3,745,693	3,459,747	3,461,411
Other, net	(5,541,487)	(2,628,529)	(3,365,299)
Net cash provided by operating activities	7,862,954	5,198,405	4,853,813
INVESTING ACTIVITIES:			
Purchases of property, plant and equipment	(6,721,581)	(1,750,252)	(2,062,313)
Business acquisitions	(7,536,916)	-	-
Other	19,374	750	13,367
Net cash used by investing activities	(14,239,123)	(1,749,502)	(2,048,946)
FINANCING ACTIVITIES:			
Payments on debt	(15,255,099)	(3,009,811)	(2,007,357)
Proceeds from term loan	20,000,000	-	-
Proceeds from revolving credit loan	-	3,000,000	-
Tax benefit from disqualifying disposition of incentive stock options	-	6,403	-
Cash payment for fractional shares resulting from 3 for 2 stock split	(1,633)	-	-
Proceeds from sales of Common Stock	203,700	-	324,800
Purchases of Common Stock for treasury	-	-	(142,193)
Dividends paid	(1,715,035)	(1,600,100)	(1,595,985)
Net cash provided (used) by financing activities	3,231,933	(1,603,508)	(3,420,735)
Effect of exchange rate changes on cash	(100,253)	80,046	139,558
Net (decrease) increase in cash and cash equivalents	(3,244,489)	1,925,441	(476,310)
Cash and cash equivalents at beginning of year	6,345,947	4,420,506	4,896,816
Cash and cash equivalents at end of year	<u>\$ 3,101,458</u>	<u>\$ 6,345,947</u>	<u>\$ 4,420,506</u>

The information presented above has been derived from the audited consolidated financial statements of the Company as presented in the Form 10-K included in this report.



# INDUSTRIAL HARDWARE GROUP

## Eberhard Manufacturing Division

The Eberhard Manufacturing Division of Cleveland, Ohio is a leading designer and manufacturer of industrial latching systems servicing various Original Equipment Manufacturers throughout North America. The extensive selection of products Eberhard provides includes external and internal operating handles and rotary latches for military, fire and rescue, service body, and other specialty and commercial vehicles; operating push buttons and slam latches for the automotive and truck accessory toolboxes and tonneau covers. Eberhard also provides many other enclosure devices such as locking gear for over the road tractor trailers, operating devices for school and commercial busses as well as many access door devices for electrical, electronic and specialty metal enclosures.



## Eberhard Hardware Manufacturing Division

Eberhard Hardware Manufacturing Limited of Ontario, Canada provides the wide line of traditional industrial latching products to the Canadian market as well as specialty hardware items for global markets. Working with toolbox OEM's in Canada and the United States, new and improved latching systems have also been developed. Additional specialty products include various connectors, brackets, stampings and assemblies for the appliance and electrical OEM markets.



## Sesamee Mexicana, S.A. de C.V.

Sesamee Mexicana is a distribution center for the Eberhard Manufacturing Division as well as other manufacturers of industrial and vehicular components. Located near Mexico City, Sesamee services the Original Equipment Manufacturers in the vehicular body, electrical enclosure and instrument case markets with hardware, drawer slides, rubber gaskets, and pneumatic gas springs as well as other complementary components.

## Canadian Commercial Vehicles Corporation

Canadian Commercial Vehicles ("CCV") is a full-service custom manufacturer of state-of-the-art lightweight honeycomb structures, fabricated metal products and assemblies for transport, construction, and industrial applications.



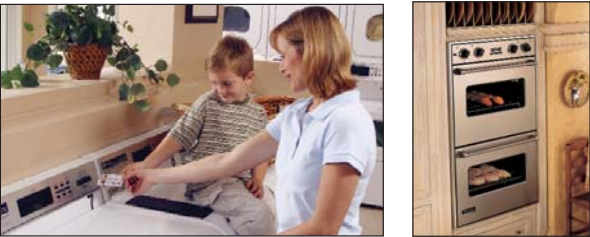
## Eastern Industrial Limited

Eastern Industrial, Ltd., Shanghai offers comprehensive capabilities for Asian sourcing, machine tool design, engineering, rapid prototyping, extensive manufacturing including metal stampings and plastic injection molding to final assembly.





SECURITY PRODUCTS GROUP



Greenwald Industries Division

The Greenwald Industries Division has been a leading supplier of coin acceptors, metering and security products for the self-service laundry market throughout the world for over 50 years. Greenwald is also a leading developer of Smart Card technology applications. Smart Cards contain embedded microchip(s) and are more durable and secure than magnetic strip cards. And with Greenwald's acquisition of Summit Manufacturing, Greenwald has entered the consumer appliance market.



The Illinois Lock Company/  
CCL Security Products/Royal Lock Division  
World Lock Co. Ltd.  
World Security Industries Co. Ltd.

The Illinois Lock Company/CCL Security Products/Royal Lock Division produces custom-engineered locks for a variety of original equipment manufacturers and is a leading producer of keyless locks sold under well-known brand names such as Sesamee, Presto and Huski. With our Asian operations, World Lock and World Security, the Company can offer competitive pricing, service and delivery in a global economy.



METAL PRODUCTS GROUP



Frazer & Jones Division

The Frazer & Jones Division is the leading producer of rock anchors in North America. These proprietary anchoring devices are a key component for underground mine roof support in coal and metallurgical mines. In the construction industry the rock anchors are used in tunneling, securing cross-country transmission towers and hydro construction. The Frazer & Jones Division is the only producer in the Western Hemisphere to combine design, engineering and the manufacturing of these products. Frazer & Jones also produces ductile and malleable iron castings to customer engineered specifications for the industrial hardware, pipefitting and construction industries.



BOARD OF DIRECTORS

**John W. Everets**  
Chairman  
Yorkshire Capital  
Boston, Massachusetts

**Charles W. Henry**  
Partner of Kernan & Henry  
Waterbury, Connecticut

**Leonard F. Leganza**  
Chairman of the Board, President  
and Chief Executive Officer  
of the Company

**David C. Robinson**  
Consultant

**Donald S. Tuttle, III**  
Vice President Investments  
UBS Financial Services, Inc.  
Middlebury, Connecticut

**Russell G. McMillen**  
Director Emeritus

OFFICERS AND EXECUTIVES

**Leonard F. Leganza**  
Chairman of the Board, President  
and Chief Executive Officer

**John L. Sullivan III**  
Vice President and  
Chief Financial Officer

**Kenneth R. Sapack**  
Chief Accounting Officer

**Gene A. Finelli**  
Treasurer

**Theresa P. Dews**  
Secretary

**Brian H. Kay**  
Vice President  
Eberhard Manufacturing Division  
Eberhard Hardware Manufacturing, Ltd.  
Sesamee Mexicana, S.A. de C.V.  
Canadian Commercial Vehicles Corporation

**Thomas D. Melkus**  
Vice President  
Illinois Lock Company/  
CCL Security Products/  
Royal Lock Division

**Leonard V. Samela**  
Vice President  
Greenwald Industries Division

**Roger Chang**  
Managing Director  
World Lock Co. Ltd.  
World Security Industries Co. Ltd.

**Richard E. Luehr**  
Managing Director  
Canadian Commercial Vehicles Corporation

**Mark F. Novakowski**  
Managing Director  
Frazer & Jones Division

NOTES

Annual Meeting

The annual meeting of shareholders of The Eastern Company will be held on Wednesday, April 25, 2007 at 11:00a.m., local time, at the office of the Company, 112 Bridge Street, Naugatuck, CT 06770

Independent Registered Public Accounting Firm

UHY LLP, Hartford, Connecticut

Transfer Agent and Registrar

American Stock Transfer & Trust Co.  
40 Wall Street, New York, NY 10005  
1-800-937-5449

Dividend Reinvestment & Stock Purchase Plan

The Eastern Company offers a Dividend Reinvestment Plan (DRP) which also features a no-load stock purchase program. It is available to all interested investors who would like to initiate or increase their holdings in Eastern Company stock. To receive a brochure and application form for this plan, contact The Eastern Company directly at (203) 729-2255, ext. 104, or phone the program administrator, American Stock Transfer & Trust Co. at 1-800-278-4353. You may also enroll online by logging onto [www.INVESTPOWER.com](http://www.INVESTPOWER.com) and by entering the Company Ticker Symbol EML under Plan Search.

Forward-Looking Statements

This Annual Report contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Such statements reflect the Company's current expectations regarding its products, its markets and its future financial and operating performance. These statements, however, are subject to risks and uncertainties that may cause the Company's actual results in future periods to differ materially from those expected. Such risks and uncertainties include, but are not limited to, unanticipated slowdowns in the Company's major markets, changing customer preferences, lack of success of new products, loss of customers, competition, increased raw material prices, problems associated with foreign sourcing of parts and products, worldwide conditions and foreign currency fluctuations that may affect results of operations and other factors discussed from time to time in the Company's filings with the Securities and Exchange Commission. The Company is not obligated to update or revise the aforementioned statements for those new developments.

Common Stock Market Prices and Dividends Paid

The Company's Common Stock is traded on the American Stock Exchange (ticker symbol EML). High and low stock prices and dividend payments for the past two years were:

2006			
Quarter	Sales Price		Cash Dividends
	High	Low	Declared
First	\$14.67	\$12.50	\$.07
Second	\$15.10	\$13.27	\$.08
Third	\$18.83	\$13.70	\$.08
Fourth	\$19.40	\$16.20	\$.08

2005			
Quarter	Sales Price		Cash Dividends
	High	Low	Declared
First	\$15.97	\$12.87	\$.07
Second	\$15.70	\$13.33	\$.07
Third	\$17.50	\$14.17	\$.07
Fourth	\$15.63	\$12.97	\$.07

# THE EASTERN COMPANY

## INDUSTRIAL HARDWARE GROUP

Eberhard Manufacturing Division  
Cleveland, Ohio  
[www.eberhard.com](http://www.eberhard.com)

Eberhard Hardware Manufacturing, Ltd.  
Tillsonburg, Ontario, Canada  
[www.eberhardcanada.com](http://www.eberhardcanada.com)

Canadian Commercial Vehicles Corporation  
Kelowna, British Columbia, Canada  
[www.ccvbc.com](http://www.ccvbc.com)

Eastern Industrial, Ltd.  
Shanghai, China  
[www.eischina.com](http://www.eischina.com)

Sesamee Mexicana, S.A. de C.V.  
Lerma, Mexico  
[www.sesamee.com.mx](http://www.sesamee.com.mx)

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## SECURITY PRODUCTS GROUP

Greenwald Industries Division  
Chester, Connecticut  
[www.greenwaldindustries.com](http://www.greenwaldindustries.com)

The Illinois Lock Company/  
CCL Security Products/Royal Lock Division  
Wheeling, Illinois  
[www.illinoislock.com](http://www.illinoislock.com)  
[www.cclsecurity.com](http://www.cclsecurity.com)  
[www.royallock.com](http://www.royallock.com)

World Lock Co. Ltd.  
World Security Industries Co. Ltd.  
Taipei, Taiwan; China  
[www.worldlock.com.tw](http://www.worldlock.com.tw)

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## METAL PRODUCTS GROUP

Frazer & Jones Division  
Syracuse, New York  
[www.frazerandjones.com](http://www.frazerandjones.com)

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