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ACME UNITED CORP
Form 10-Q
August 05, 2008

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2008

OR

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

For the transition period from _____ to _____

Commission file number 001-07698

ACME UNITED CORPORATION
(Exact name of registrant as specified in its charter)

CONNECTICUT (State or other jurisdiction of incorporation or organization)	06-0236700 (I.R.S. Employer Identification No.)
60 ROUND HILL ROAD, FAIRFIELD, CONNECTICUT (Address of principal executive offices)	06824 (Zip Code)

Registrant's telephone number, including area code: (203) 254-6060

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

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act (Check one).
Large accelerated filer Accelerated filer Non-accelerated filer
Small Reporting Company

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

As of July 21, 2008 the registrant had outstanding 3,521,433 shares of its \$2.50

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par value Common Stock.

ACME UNITED CORPORATION

	Page -----
Part I -- FINANCIAL INFORMATION	
Item 1. Financial Statements (Unaudited)	
Condensed Consolidated Balance Sheets as of June 30, 2008 and December 31, 2007.....	3
Condensed Consolidated Statements of Operations for the three and six months ended June 30, 2008 and 2007.....	5
Condensed Consolidated Statements of Cash Flows for the six months ended June 30, 2008 and 2007.....	6
Notes to Condensed Consolidated Financial Statements.....	7
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.....	10
Item 3. Quantitative and Qualitative Disclosure About Market Risk.....	13
Item 4. Controls and Procedures.....	13
Part II -- OTHER INFORMATION	
Item 1. Legal Proceedings.....	14
Item 1A. Risk Factors.....	14
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds...	14
Item 3. Defaults Upon Senior Securities.....	14
Item 4. Submission of Matters to a Vote of Security Holders.....	14
Item 5. Other Information.....	14
Item 6. Exhibits.....	15
Signatures.....	16

(2)

ACME UNITED CORPORATION CONDENSED CONSOLIDATED BALANCE SHEETS (all amounts in thousands)

	June 30, 2008 (unaudited)	December 31, 2007 (Note 1)
	-----	-----
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 3,703	\$ 4,988
Accounts receivable, less allowance	20,852	12,727
Inventories:		
Finished goods	20,304	18,069
Work in process	321	113
Raw materials and supplies	833	753
	-----	-----
	21,458	18,935
Prepaid expenses and other current assets	1,121	1,211
	-----	-----
Total current assets	47,134	37,860
	-----	-----
Property, plant and equipment:		
Land	187	175
Buildings	3,117	2,971
Machinery and equipment	8,619	8,050

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	11,923	11,196
Less accumulated depreciation	9,444	8,717
	2,479	2,479
Other assets	1,838	1,794
Goodwill	89	89
	\$ 51,540	\$ 42,222

See notes to condensed consolidated financial statements.

(3)

ACME UNITED CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS (continued)
(all amounts in thousands)

	June 30, 2008 (unaudited)	December 31, 2007 (Note 1)
LIABILITIES		
Current liabilities:		
Accounts payable	\$ 6,623	\$ 4,575
Other accrued liabilities	4,630	3,959
	11,253	8,534
Total current liabilities		
Long-term debt, less current portion	14,992	10,135
Other	551	507
	26,796	19,175
Total liabilities		
STOCKHOLDERS' EQUITY		
Common stock, par value \$2.50: authorized 8,000,000 shares; issued - 4,293,024 shares in 2008 and 4,267,274 shares in 2007, including treasury stock	10,733	10,668
Additional paid-in capital	3,785	3,550
Retained earnings	16,675	14,473
Treasury stock, at cost - 771,591 shares in 2008 and 714,391 shares in 2007	(6,717)	(5,930)
Accumulated other comprehensive income:		
Translation adjustment	904	921
Minimum pension liability	(635)	(635)
	269	286
Total stockholders' equity	24,744	23,047
Total liabilities and stockholders' equity	\$ 51,540	\$ 42,222

See notes to condensed consolidated financial statements.

(4)

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ACME UNITED CORPORATION
 CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
 (UNAUDITED)
 (all amounts in thousands, except per share amounts)

	Three Months Ended June 30	
	2008	2007
Net sales	\$ 22,708	\$ 18,999
Cost of goods sold	13,790	11,020
Gross Profit	8,918	7,979
Selling, general and administrative expenses	6,121	5,435
Operating income	2,797	2,544
Non-operating items:		
Interest expense, net	90	156
Other expense (income), net	24	41
Total other income	114	197
Income before income taxes	2,683	2,347
Income tax expense	953	825
Net income	\$ 1,730	\$ 1,522
Basic earnings per share	\$ 0.49	\$ 0.43
Diluted earnings per share	\$ 0.47	\$ 0.41
Weighted average number of common shares outstanding- denominator used for basic per share computations	3,518	3,525
Weighted average number of dilutive stock options outstanding	147	171
Denominator used for diluted per share computations	3,665	3,698
Dividends declared per share	\$ 0.04	\$ 0.04

See notes to condensed consolidated financial statements.

(5)

ACME UNITED CORPORATION
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
 (UNAUDITED)
 (all amounts in thousands)

Six Months Ended
June 30,

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	2008	2007
Operating Activities:		
Net income	\$ 2,482	\$ 2,172
Adjustments to reconcile net income to net cash used by operating activities:		
Depreciation	451	406
Amortization	53	23
Stock compensation expense	166	184
Changes in operating assets and liabilities:		
Accounts receivable	(8,122)	(6,962)
Inventories	(2,330)	(1,201)
Prepaid expenses and other current assets	92	(155)
Accounts payable	2,007	2,263
Other accrued liabilities	678	557
Total adjustments	(7,006)	(4,885)
Net cash used by operating activities	(4,524)	(2,713)
Investing Activities:		
Purchase of property, plant, and equipment	(412)	(337)
Purchase of patents and trademarks	(97)	(45)
Net cash used by investing activities	(510)	(382)
Financing Activities:		
Net borrowing of long-term debt	4,851	2,469
Proceeds from issuance of common stock	133	281
Distributions to stockholders	(281)	(246)
Purchase of treasury stock	(787)	(347)
Net cash provided by financing activities	3,916	2,157
Effect of exchange rate changes	(167)	159
Net change in cash and cash equivalents	(1,285)	(781)
Cash and cash equivalents at beginning of period	4,988	3,838
Cash and cash equivalents at end of period	\$ 3,703	\$ 3,057

See notes to condensed consolidated financial statements.

(6)

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

Note 1 -- Basis of Presentation

In the opinion of management, the accompanying condensed consolidated financial statements include all adjustments necessary to present fairly the financial position, results of operations and cash flows of Acme United Corporation (the "Company"). These adjustments are of a normal, recurring

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nature. However, the financial statements do not include all of the disclosures normally required by accounting principles generally accepted in the United States of America or those normally made in the Company's Annual Report on Form 10-K. Please refer to the Company's Annual Report on Form 10-K for the year ended December 31, 2007 for such disclosures. The condensed consolidated balance sheet as of December 31, 2007 was derived from the audited consolidated balance sheet as of that date. The results of operations for interim periods are not necessarily indicative of the results to be expected for the full year. The information included in this Quarterly Report on Form 10-Q should be read in conjunction with the Management's Discussion and Analysis of Financial Condition and Results of Operations and financial statements and notes thereto, included in the Company's 2007 Annual Report on Form 10-K.

Reclassifications - Certain prior year amounts have been reclassified to conform to the current year presentation.

Note 2 -- Contingencies

The Company is involved from time to time in disputes and other litigation in the ordinary course of business and may encounter other contingencies, which may include environmental and other matters. The Company presently believes that none of these matters, individually or in the aggregate, would be likely to have a material adverse impact on its financial position, results of operations or liquidity.

Note 3 -- Pension

Components of net periodic pension cost are as follows:

	Three Months Ended June 30,		Six Months Ended
	2008	2007	2008
Components of net periodic benefit cost:			
Interest cost	\$ 45,000	\$ 45,948	\$ 90,000
Service cost	7,500	6,250	15,000
Expected return on plan assets	(56,250)	(62,048)	(112,500)
Amortization of prior service costs	2,250	2,138	4,500
Amortization of actuarial gain	18,750	24,408	37,500
	\$ 17,250	\$ 16,696	\$ 34,500

Note 4 -- Long Term Debt

On June 23, 2008, the Company modified its revolving loan agreement (the "Modified Loan Agreement") with Wachovia Bank. The amendments include an increase in the maximum borrowing amount from \$15 million to \$20 million; an extension of the maturity date of the loan from June 30, 2009 to June 30, 2010; a decrease in the interest rate to LIBOR plus 7/8% (from LIBOR plus 1.0%) as well as the modification of certain covenant restrictions. Funds borrowed under the Modified Loan Agreement are primarily used for working capital, general operating expenses and certain other purposes.

At June 30, 2008 and December 31, 2007, the Company had outstanding borrowings under the Modified Loan Agreement of \$14,949,000 and \$10,098,000,

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respectively. Based on the scheduled maturity date, the Company has classified the borrowings at June 30, 2008 as long-term liabilities.

(7)

Note 5 -- Shareholder's Equity

During the first six months of 2008, the Company issued 25,750 shares of common stock upon the exercise of outstanding stock options and received proceeds of \$132,818. During the same period, the Company also repurchased 57,200 shares of common stock for treasury. These shares were purchased at fair market value, with a total cost to the Company of \$786,866.

Note 6 -- Segment Information

The Company reports financial information based on the organization structure used by management for making operating and investment decisions and for assessing performance. The Company's reportable business segments consist of (1) United States; (2) Canada and (3) Europe. The activities of the Company's Asian operating segment are closely linked to those of the U.S. operating segment; accordingly, management reviews the financial results of both segments on a consolidated basis, and the results of the Asian operating segment have been aggregated with the results of the United States operating segment to form one reportable segment called the "United States operating segment". The determination of reportable segments is based on the guidance set forth in SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information". Each reportable segment derives its revenue from the sales of cutting devices, measuring instruments and safety products for school, office, home and industrial use.

The chief operating decision maker evaluates the performance of each operating segment based on segment revenues and operating income. Segment amounts are presented after converting to U.S. dollars and consolidating eliminations.

Financial data by segment:

(in thousands)

	Three months ended June 30,		Six months ended
	2008	2007	2008
Sales to external customers:			
United States	\$ 18,018	\$ 14,642	\$ 28,935
Canada	2,988	2,925	4,686
Europe	1,702	1,432	3,356
	\$ 22,708	\$ 18,999	\$ 36,977
Operating income (loss):			
United States	\$ 2,545	\$ 2,294	\$ 3,635
Canada	469	401	579
Europe	(217)	(151)	(349)
	\$ 2,797	\$ 2,544	\$ 3,865

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Interest expense, net	90	156	187
Other expense (income), net	24	41	(162)
	-----	-----	-----
Consolidated income before taxes	\$ 2,683	\$ 2,347	\$ 3,840
	=====	=====	=====

(8)

Assets by segment:

	June 30, 2008	December 31, 2007
	-----	-----
United States	\$ 37,370	\$ 28,350
Canada	8,442	7,886
Europe	5,728	5,986
	-----	-----
Consolidated	\$ 51,540	\$ 42,222
	=====	=====

Note 7 -- Stock Based Compensation

The Company recognizes share-based compensation in accordance with the provisions of Statement of Financial Accounting Standards No. 123R, "Share-Based Payment" ("SFAS 123R"). Share-based compensation expense was \$94,000 and \$131,000 for the quarters ended June 30, 2008 and June 30, 2007, respectively. Share-based compensation expense was \$166,000 and \$184,000 for the six months ended June 30, 2008 and June 30, 2007, respectively. During the three and six months ended June 30, 2008, the Company issued 12,250 options with a weighted average fair value of \$3.86. During the three and six months ended June 30, 2007, the Company issued 97,750 options with a weighted average fair value of \$4.96. The assumptions used to value option grants for the three and six months ended June 30, 2008 and June 30, 2007 are as follows:

	Three months ended June 30,		Six months ended June 30,	
	-----	-----	-----	-----
	2008	2007	2008	2007
	-----	-----	-----	-----
Expected life in years	5	5	5	5
Interest rate	2.95%	4.51 - 5.18%	2.95%	4.51 - 5.18%
Volatility	0.31	0.32	.31	.32
Dividend yield	1.2%	1.1%	1.2%	1.1%

As of June 30, 2008, there was a total of \$398,078 of unrecognized compensation cost related to non-vested share-based payments granted to the Company's employees. The remaining unamortized expense is expected to be recognized over a weighted average period of approximately 2 years.

Note 8 -- Comprehensive Income

Comprehensive income for the three and six months ended June 30, 2008 and June 30, 2007 consisted of the following:

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	Three Months Ended June 30,		Six Months June 30,
	2008	2007	2008
Sales to external customers:			
Net income	\$ 1,730	\$ 1,522	2,482
Other comprehensive income / (loss) - Foreign currency translation	47	469	(16)
Comprehensive income	\$ 1,777	\$ 1,991	\$ 2,466

(9)

MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

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

Forward-Looking Information

The Company may from time to time make written or oral "forward-looking statements" including statements contained in this report and in other communications by the Company, which are made in good faith by the Company pursuant to the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995.

These forward-looking statements include statements of the Company's plans, objectives, expectations, estimates and intentions, which are subject to change based on various important factors (some of which are beyond the Company's control). The following factors, in addition to others not listed, could cause the Company's actual results to differ materially from those expressed in forward looking statements: the strength of the domestic and local economies in which the Company conducts operations, changes in client needs and consumer spending habits, the impact of competition and technological change on the Company, the Company's ability to manage its growth effectively, including its ability to successfully integrate any business which it might acquire, and currency fluctuations. All forward-looking statements in this report are based upon information available to the Company on the date of this report. The Company undertakes no obligation to publicly update or revise any forward-looking statement, whether as a result of new information, future events, or otherwise, except as required by law.

Critical Accounting Policies

There have been no material changes to our critical accounting policies and estimates from the information provided in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2007.

Results of Operations

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Net Sales

Consolidated net sales for the three months ended June 30, 2008 were \$22,708,000 compared with \$18,999,000 in the same period in 2007, a 20% increase (17% at constant currency). Consolidated net sales for the six months ended June 30, 2008 were \$36,977,000, compared with \$31,240,000 for the same period in 2007, an 18% increase (15% at constant currency). Net sales for the three and six months ended June 30, 2008 in the U.S. segment increased 23% and 21%, respectively, primarily as a result of market acceptance of new anti-microbial school scissors, rulers, and math kits and iPoint pencil sharpeners. Net sales in Canada in the three and six months ended June 30, 2008 increased by 3% and 5% in U.S. dollars but declined 5% and 6% in local currency, primarily due to soft demand in the overall office products market. European net sales for the three and six months ended June 30, 2008 increased 18% in U.S. dollars and 3% in local currency.

Traditionally, the Company's sales are stronger in the second and third quarters, and weaker in the first and fourth quarters of the fiscal year, due to the seasonal nature of the back-to-school market.

Gross Profit

Gross profit for the three months ended June 30, 2008 was \$8,918,000 (39.3% of net sales) compared to \$7,979,000 (42.0% of net sales) for the same period in 2007. Gross profit for the six months ended June 30, 2008 was \$14,904,000 (40.3% of net sales) compared to \$13,313,000 (42.6% of net sales) in the same period in 2007. The gross margin declines for the three and six months ended June 30, 2008 were primarily due to increased costs of material, labor and energy, as well as the appreciation of the Chinese currency against the U.S. dollar. Also, during the second quarter of 2008 the company gained additional market share in the highly competitive back to school segment which reduced gross margins.

(10)

Selling, General and Administrative Expenses

Selling, general and administrative ("SG&A") expenses for the three months ended June 30, 2008 were \$6,121,000 (27.0% of net sales) compared with \$5,435,000 (28.6% of net sales) for the same period of 2007, an increase of \$686,000. SG&A expenses for the six months ended June 30, 2008 were \$11,039,000 (29.9% of net sales) compared with \$9,593,000 (30.7% of net sales) in the comparable period of 2007, an increase of \$1,446,000. SG&A expenses increased for the three and six months ended June 30, 2008 primarily as a result of the addition of sales, marketing and quality control personnel as well as incrementally higher freight costs and sales commissions associated with higher sales.

Operating Income

Operating income for the three months ended June 30, 2008 was \$2,797,000 compared with \$2,544,000 in the same period of 2007. Operating income for the six months ended June 30, 2008 was \$3,865,000 compared to \$3,720,000 in the same period of 2007.

Interest Expense

Interest expense for the three months ended June 30, 2008 was \$90,000, compared with \$156,000 for the same period of 2007, a \$66,000 decrease. Interest expense for the six months ended June 30, 2008 was \$187,000 as compared to \$310,000 for the same period in 2007, a \$123,000 decrease. The decrease in interest expense for both the three and six months ended June 30, 2008 was

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primarily the result of lower interest rates under the Company's revolving credit facility, partially offset by a higher average outstanding debt balance.

Other Expense (Income), Net

Net other expense was \$24,000 in the three months ended June 30, 2008 as compared to \$41,000 in the same period of 2007. Net other income was \$162,000 in the first six months of 2008 compared to net other expense of \$14,000 in the first six months of 2007. The increase other expense (income), net for the six months ended June 30, 2008 was primarily due to gains from foreign currency transactions.

Income Taxes

The effective tax rate for the three months ended June 30, 2008 was 36% compared to 35% in the same period of 2007. The effective tax rate for the six months ended June 30, 2008 was 35% compared to 36% in the same period of 2007.

(11)

Financial Condition

Liquidity and Capital Resources

The Company's working capital, current ratio and long-term debt to equity ratio follow:

(000's omitted)	June 30, 2008	December 31, 2007
	-----	-----
Working capital	\$ 35,881	\$ 29,326
Current ratio	4.19	4.44
Long term debt to equity ratio	60.6%	44.0%

During the first six months of 2008, total debt outstanding under the Company's Modified Loan agreement, referred to below, increased by \$4,851,000 compared to total debt at December 31, 2007, principally due to an increase in borrowings for inventory and accounts receivables for the back to school season as well as share repurchases, partially offset by earnings. As of June 30, 2008, \$14,949,000 was outstanding and \$5,051,000 was available for borrowing under the Modified Loan Agreement.

On June 23, 2008, the Company modified its Revolving Loan Agreement (the "Modified Loan Agreement") with Wachovia Bank. The Modified Loan Agreement amends certain provisions of the original Revolving Loan Agreement. The amendments include an increase in the maximum borrowing amount from \$15 million to \$20 million; an extension of the maturity date of the loan from June 30, 2009 to June 30, 2010; and a decrease in the interest rate to LIBOR plus 7/8% (from LIBOR plus 1.0%). Funds borrowed under the Modified Loan Agreement are used for working capital, general operating expenses and certain other purposes.

Cash expected to be generated from operating activities, together with funds available under the Modified Loan Agreement are expected, under current conditions, to be sufficient to finance the Company's planned operations over the next twelve months.

Recently Issued Accounting Standards

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In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" ("SFAS No. 157"). SFAS No. 157 defines fair value, establishes a framework for measuring fair value in GAAP and establishes a hierarchy that categorizes and prioritizes the sources to be used to estimate fair value. SFAS No. 157 also expands financial statement disclosures about fair value measurements. On February 12, 2008, the FASB issued FASB Staff Position (FSP) 157-2 which delays the effective date of SFAS No. 157 for one year, for all non-financial assets and non-financial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). SFAS No. 157 and FSP 157-2 are effective for financial statements issued for fiscal years beginning after November 15, 2007. We will elect a partial deferral of SFAS No. 157 under the provisions of FSP 157-2 related to the measurement of fair value used when evaluating long-lived assets for impairment and valuing asset retirement obligations. The impact of partially adopting SFAS No. 157 effective January 1, 2008 will not be material to our financial statements.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities," ("SFAS No. 159") which provides companies with an option to report selected financial assets and liabilities at fair value in an attempt to reduce both complexity in accounting for financial instruments and the volatility in earnings caused by measuring related assets and liabilities differently. This statement is effective as of the beginning of an entity's first fiscal year beginning after November 15, 2007. The Company chose not to adopt these fair value provisions.

(12)

Item 3. Quantitative and Qualitative Disclosure About Market Risk

There are no material changes in market risks as disclosed in the Company's annual Report on Form 10-K for the year ended December 31, 2007.

Item 4. Controls and Procedures

(a) Evaluation of Internal Controls and Procedures

Our Chief Executive Officer and Chief Financial Officer have reviewed and evaluated the effectiveness of our disclosure controls and procedures, which included inquiries made to certain other of our employees. Based on their evaluation, our Chief Executive Officer and Chief Financial Officer have each concluded that, as of June 30, 2008, our disclosure controls and procedures were effective and sufficient to ensure that we record, process, summarize and report information required to be disclosed by us in our periodic reports filed under the Securities and Exchange Commission's rules and forms.

(b) Changes in Internal Control over Financial Reporting

During the quarter ended June 30, 2008, there were no changes in our internal control over financial reporting that materially affected, or was reasonably likely to materially affect, this control.

(13)

PART II. OTHER INFORMATION

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Item 1 -- Legal Proceedings

The Company is involved from time to time in disputes and other litigation in the ordinary course of business, including certain environmental and other matters. The Company presently believes that none of these matters, individually or in the aggregate, would be likely to have a material adverse impact on its financial position, results of operations, or liquidity.

Item 1A - Risk Factors

See Risk Factors set forth in Part I, Item 1A of the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2007.

Item 2 -- Unregistered Sales of Equity Securities and Use of Proceeds

None.

Item 3 -- Defaults Upon Senior Securities

None.

Item 4 -- Submission of Matters to a Vote of Security Holders

The Company's Annual Meeting of Shareholders was held on April 21, 2008.

A. The following individuals were elected Directors at the Annual Meeting and comprise the entire Board.

	Votes for -----	Votes against -----
Rex Davidson	3,312,187	34,527
Richmond Y. Holden, Jr.	3,306,987	39,728
Walter C. Johnsen	3,123,537	223,118
Susan H. Murphy	3,312,462	34,253
Brian Olschan	3,128,382	218,333
Stevenson E. Ward	3,303,928	42,787

Item 5 -- Other Information

None.

(14)

Item 6 -- Exhibits

Documents filed as part of this report.

Exhibit 31.1 Certification of Walter C. Johnsen pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

Exhibit 31.2 Certification of Paul G. Driscoll pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

Exhibit 32.1 Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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Exhibit 32.2 Certification Pursuant to 18 U.S.C. Section 1350, as
Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

(15)

SIGNATURES

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

ACME UNITED CORPORATION

By /s/ WALTER C. JOHNSEN

 Walter C. Johnsen
 Chairman of the Board and
 Chief Executive Officer

Dated: August 5, 2008

By /s/ PAUL G. DRISCOLL

 Paul G. Driscoll
 Vice President and
 Chief Financial Officer

Dated: August 5, 2008

(16)