AIRGAS SAFETY INC
Form 10-Q
August 09, 2006

Table of Contents

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

þ **QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended: June 30, 2006

Commission file number: 1-9344

AIRGAS, INC.

(Exact name of registrant as specified in its charter)

Delaware	56-0732648
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
259 North Radnor-Chester Road, Suite 100 Radnor, PA	19087-5283
(Address of principal executive offices)	(ZIP code)

(610) 687-5253

(Registrant s telephone number, including area code)

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 þ No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer þ Accelerated filer o Non-accelerated filer o

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

Shares of common stock outstanding at August 7, 2006: 77,801,186 shares

AIRGAS, INC.
FORM 10-Q
June 30, 2006
INDEX

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements

AIRGAS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF EARNINGS
(Unaudited)
(In thousands, except per share amounts)

	Three Months Ended June 30,	
	2006	**2005**
Net Sales	$ 773,036	$ 678,125
Costs and Expenses:		
Cost of products sold (excluding depreciation)	383,219	334,863
Selling, distribution and administrative expenses	275,977	249,849
Depreciation	33,162	29,110
Amortization	1,772	1,299
Total costs and expenses	694,130	615,121
Operating Income	78,906	63,004
Interest expense, net	(13,676)	(13,944)
Discount on securitization of trade receivables	(3,336)	(1,848)
Other income, net	213	912
Earnings before income taxes and minority interest	62,107	48,124
Income taxes	(22,744)	(18,135)
Minority interest in earnings of consolidated affiliate	(711)	(522)
Income from continuing operations	38,652	29,467
Income from discontinued operations, net of tax		180
Net Earnings	$ 38,652	$ 29,647
Net Earnings Per Common Share		
Basic		
Earnings from continuing operations	$ 0.50	$ 0.39
Earnings from discontinued operations		
Net earnings per share	$ 0.50	$ 0.39

Diluted				
Earnings from continuing operations	$	0.48	$	0.38
Earnings from discontinued operations				
Net earnings per share	$	0.48	$	0.38
Weighted average shares outstanding:				
Basic		77,557		76,252
Diluted		82,436		77,951
Comprehensive income	$	40,218	$	29,468

See accompanying notes to consolidated financial statements.

3

Table of Contents

AIRGAS, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(In thousands, except per share amounts)

	(Unaudited) June 30, 2006	March 31, 2006
ASSETS		
Current Assets		
Cash	$ 33,118	$ 34,985
Trade receivables, less allowances for doubtful accounts of $16,175 at June 30, 2006 and $14,782 at March 31, 2006	159,696	132,245
Inventories, net	234,603	229,523
Deferred income tax asset, net	24,411	30,141
Prepaid expenses and other current assets	29,125	31,622
Total current assets	480,953	458,516
Plant and equipment at cost	2,250,050	2,191,673
Less accumulated depreciation	(821,713)	(792,916)
Plant and equipment, net	1,428,337	1,398,757
Goodwill	570,625	566,074
Other intangible assets, net	27,721	26,248
Other non-current assets	24,404	24,817
Total assets	$ 2,532,040	$ 2,474,412
LIABILITIES AND STOCKHOLDERS EQUITY		
Current Liabilities		
Accounts payable, trade	$ 128,669	$ 143,752
Accrued expenses and other current liabilities	198,484	200,001
Current portion of long-term debt	106,010	131,901
Total current liabilities	433,163	475,654
Long-term debt, excluding current portion	675,825	635,726
Deferred income tax liability, net	338,150	327,818
Other non-current liabilities	35,394	30,864
Minority interest in affiliate	57,191	57,191
Commitments and contingencies		

Stockholders Equity		
Preferred stock, no par value, 20,000 shares authorized, no shares issued or outstanding at June 30, 2006 and March 31, 2006		
Common stock, par value $0.01 per share, 200,000 shares authorized, 78,960 and 78,569 shares issued at June 30, 2006 and March 31, 2006, respectively	790	786
Capital in excess of par value	299,967	289,598
Retained earnings	698,377	665,158
Accumulated other comprehensive income	6,317	4,751
Treasury stock, 1,292 common shares at cost at both June 30, 2006 and March 31, 2006	(13,134)	(13,134)
Total stockholders equity	992,317	947,159
Total liabilities and stockholders equity	$ 2,532,040	$ 2,474,412

See accompanying notes to consolidated financial statements.

4

Table of Contents

AIRGAS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

(In thousands)	Three Months Ended June 30, 2006	Three Months Ended June 30, 2005
CASH FLOWS FROM OPERATING ACTIVITIES		
Net earnings	$ 38,652	$ 29,647
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation	33,162	29,110
Amortization	1,772	1,299
Deferred income taxes	14,574	11,082
Loss on sales of plant and equipment	128	122
Minority interest in earnings	711	522
Stock-based compensation expense	2,752	
Stock issued for employee stock purchase plan	2,822	2,514
Changes in assets and liabilities, excluding effects of business acquisitions and divestitures:		
Securitization of trade receivables	(9,700)	24,700
Trade receivables, net	(16,222)	(12,938)
Inventories, net	(3,529)	(3,555)
Prepaid expenses and other current assets	2,174	8,954
Accounts payable, trade	(12,444)	(13,883)
Accrued expenses and other current liabilities	(14,177)	(3,944)
Other long-term assets	(1,314)	3,141
Other long-term liabilities	3,643	(272)
Net cash provided by operating activities	43,004	76,499
CASH FLOWS FROM INVESTING ACTIVITIES		
Capital expenditures	(62,704)	(47,265)
Proceeds from sales of plant and equipment	1,263	735
Business acquisitions and holdback settlements	(3,814)	(72,850)
Other, net	492	398
Net cash used in investing activities	(64,763)	(118,982)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from borrowings	166,219	187,008
Repayment of debt	(152,010)	(176,525)
Minority interest in earnings	(711)	(522)
Exercise of stock options	4,799	5,387
Minority stockholder note prepayment		21,000

Dividends paid to stockholders		(5,433)		(4,631)
Cash overdraft		7,028		13,425
Net cash provided by financing activities		19,892		45,142
Change in cash	$	(1,867)	$	2,659
Cash Beginning of period		34,985		32,640
Cash End of period	$	33,118	$	35,299

See accompanying notes to consolidated financial statements.

5

Table of Contents

AIRGAS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

(1) BASIS OF PRESENTATION

The consolidated financial statements include the accounts of Airgas, Inc. and its subsidiaries (the Company), as well as the Company s consolidated affiliate, National Welders. Intercompany accounts and transactions, including those between the Company and National Welders, are eliminated in consolidation. The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America. These statements do not include all disclosures required for annual financial statements. These financial statements should be read in conjunction with the more complete disclosures contained in the Company s audited consolidated financial statements for the fiscal year ended March 31, 2006.

The preparation of financial statements requires the use of estimates. The consolidated financial statements reflect, in the opinion of management, reasonable estimates and all adjustments necessary to present fairly the Company s financial position, results of operations and cash flows for the periods presented. The interim operating results are not necessarily indicative of the results to be expected for an entire year.

As described in Note 3, the Company divested its subsidiary, Rutland Tool & Supply Co. (Rutland Tool), in December 2005. As a result, Rutland Tool has been reclassified in the Consolidated Statement of Earnings for the three months ended June 30, 2005 as discontinued operations. The Consolidated Statement of Cash Flows for the three months ended June 30, 2005 was not reclassified because the cash flows of Rutland Tool were not significant.

(2) NEW ACCOUNTING PRONOUNCEMENTS

In November 2004, the Financial Accounting Standards Board (FASB) issued SFAS 151, *Inventory Costs,* as an amendment to the guidance provided on *Inventory Pricing* in FASB Accounting Research Bulletin 43. SFAS 151 clarifies the accounting for abnormal amounts of idle facility expense, freight, handling costs and wasted material. This statement requires that if the costs associated with the actual level of spoilage or production defects are greater than the normal range of spoilage or defects, the excess costs should be charged to current period expense. The Company adopted SFAS 151 effective April 1, 2006, as required. Since the Company performs limited manufacturing, the adoption of SFAS 151 did not have a material impact on its results of operations, financial position or liquidity.

In December 2004, the FASB issued SFAS 153, *Exchanges of Nonmonetary Assets,* as an amendment to APB Opinion 29, *Accounting for Nonmonetary Transactions.* SFAS 153 requires nonmonetary exchanges to be accounted for at fair value, recognizing any gains or losses, if the fair value is determinable within reasonable limits and the transaction has commercial substance. The Company adopted SFAS 153 effective April 1, 2006, as required. The adoption of SFAS 153 did not have a material impact on its results of operations, financial position or liquidity.

On June 1, 2005, the FASB issued SFAS 154, *Accounting Changes and Error Corrections,* which requires retrospective application to prior periods financial statements of voluntary changes in accounting principle, unless it is impractical to do so. The Company adopted SFAS 154 effective April 1, 2006, as required.

Table of Contents

AIRGAS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

(2) NEW ACCOUNTING PRONOUNCEMENTS - (Continued)

Effective April 1, 2006, the Company adopted Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment,* (SFAS 123R), which superseded Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees,* (APB 25). SFAS 123R requires that grants of employee stock options, including options to purchase shares under employee stock purchase plans, be recognized as compensation expense based on their fair values. The Company adopted SFAS 123R using the modified prospective method in which compensation cost is recognized from the date of adoption forward for both new awards and the portion of any previously granted awards that vest after the date of adoption. Prior periods are not restated under the modified prospective method of adoption. Prior to April 1, 2006, the Company accounted for its stock-based compensation using the intrinsic value method outlined in APB 25, which provides that compensation expense is recorded on the date of grant only if the current market price of the underlying stock exceeds the exercise price. Accordingly, since the Company does not grant options with exercise prices lower than the market price on the date of grant, no stock-based employee compensation expense was reflected in net earnings prior to the date of adoption. See Note 12 for additional disclosures associated with the adoption of SFAS 123R.

In November 2005, the FASB issued FSP No. FAS 123(R)-3, *Transition Election Related to Accounting for the Tax Effects of Share-Based Payment Awards.* This FAS provides an elective alternative simplified method for calculating the pool of excess tax benefits available to absorb tax deficiencies recognized subsequent to the adoption of SFAS 123R and reported in the Consolidated Statements of Cash Flows. Companies may take up to one year from the effective date of the FSP to evaluate the available transition alternatives and make a one-time election as to which method to adopt. Based on the FSP effective date, the Company must decide on its method of adoption no later than the third quarter of fiscal 2007. The Company is currently in the process of evaluating the alternative methods of adoption.

(3) ACQUISITION & DIVESTITURE

(a) Acquisition

During the three months ended June 30, 2006, the Company completed one acquisition with annual sales of approximately $13 million. Costs in excess of net assets acquired (goodwill) related to the acquisition totaled approximately $260 thousand.

(b) Divestiture

On December 1, 2005, the Company sold its Rutland Tool & Supply Co. (Rutland Tool) subsidiary. Rutland Tool distributed metalworking tools, machine tools and MRO supplies from seven locations and had approximately 180 employees. The results of Rutland Tool for the three months ended June 30, 2005 have been reclassified in the Consolidated Statement of Earnings as discontinued operations. The consolidated Statement of Cash Flows was not reclassified to reflect discontinued operations because the cash flows of Rutland Tool were not significant.

The net sales and operating income for the three months ended June 30, 2005, which were segregated and reported as discontinued operations, were $13 million and $304 thousand, respectively.

Table of Contents

AIRGAS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

(4) EARNINGS PER SHARE

Basic earnings per share is calculated by dividing net earnings by the weighted average number of shares of the Company s common stock outstanding during the period. Outstanding shares consist of issued shares less treasury stock and common stock held by the Employee Benefits Trust. Diluted earnings per share is calculated by dividing net earnings by the weighted average common shares outstanding adjusted for the dilutive effect of common stock equivalents related to stock options and the Company s Employee Stock Purchase plan. The calculation of diluted earnings per share also assumes the conversion of National Welders preferred stock to Airgas common stock.

The table below presents the computation of basic and diluted earnings per share for the three months ended June 30, 2006 and 2005:

	Three Months Ended June 30,	
(In thousands, except per share amounts)	**2006**	**2005**
Basic Earnings per Share Computation		
Numerator		
Income from continuing operations	$ 38,652	$ 29,467
Income from discontinued operations		180
Net earnings	$ 38,652	$ 29,647
Denominator		
Basic shares outstanding	77,557	76,252
Basic earnings per share from continuing operations	$ 0.50	$ 0.39
Basic earnings per share from discontinued operations		
Basic net earnings per share	$ 0.50	$ 0.39

Table of Contents

AIRGAS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

(4) EARNINGS PER SHARE - (Continued)

(In thousands, except per share amounts)	Three Months Ended June 30, 2006	Three Months Ended June 30, 2005
Diluted Earnings per Share Computation		
Numerator		
Income from continuing operations	$ 38,652	$ 29,467
Plus: Preferred stock dividends(1)(2)	711	
Plus: Income taxes on earnings of National Welders(3)	214	
Income from continuing operations assuming preferred stock conversion in 2006	39,577	29,467
Income from discontinued operations		180
Net earnings assuming preferred stock conversion in 2006	$ 39,577	$ 29,647
Denominator		
Basic shares outstanding	77,557	76,252
Incremental shares from assumed conversions		
Stock options and options under the Employee Stock Purchase plan	2,552	1,699
Preferred stock of National Welders(1)	2,327	
Diluted shares outstanding	82,436	77,951
Diluted earnings per share from continuing operations	$ 0.48	$ 0.38
Diluted earnings per share from discontinued operations		
Diluted net earnings per share	$ 0.48	$ 0.38

(1) Pursuant to a joint venture agreement between the Company and the holders of the preferred stock of National Welders, until June 2009, the preferred shareholders have the option to exchange their 3.2 million preferred shares of National Welders either for cash at a price of $17.78 per share or to tender them to the joint venture in exchange for approximately 2.3 million shares of Airgas common stock. If Airgas common stock has a market value of $24.45 per share, the stock and cash redemption options are equivalent. Since the average market price of Airgas common stock for the three months ended June 30, 2006 was in excess of $24.45 per share, conversion of the preferred stock was assumed. The conversion of the preferred stock was not assumed in the three months ended June 30, 2005 because the average price of Airgas common stock was less than $24.45 per share.

(2) If the preferred stockholders of National Welders convert their preferred stock to Airgas common stock, the 5% preferred stock dividend, recognized as Minority interest in earnings of consolidated affiliate, would no longer be paid to the preferred stockholders, resulting in additional net earnings for Airgas.

(3) The earnings of National Welders for tax purposes are treated as a deemed dividend to Airgas, net of an 80% dividend exclusion. Upon the assumed conversion of National Welders preferred stock to Airgas common stock, National Welders would become a wholly owned subsidiary of Airgas. As a wholly owned subsidiary, the net earnings of National Welders would not be subject to additional tax at the Airgas level.

Table of Contents

AIRGAS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

(5) TRADE RECEIVABLES SECURITIZATION

The Company participates in a securitization agreement with two commercial banks to sell up to $250 million of qualifying trade receivables. The agreement will expire in May 2009, but may be renewed subject to renewal provisions contained in the agreement. During the three months ended June 30, 2006, the Company sold, net of its retained interest, $598 million of trade receivables and remitted to bank conduits, pursuant to a servicing agreement, $608 million in collections on those receivables. The amount of outstanding receivables under the agreement was $234 million at June 30, 2006 and $244 million at March 31, 2006.

The transaction has been accounted for as a sale under the provisions of Statement of Financial Accounting Standards No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities.* Under the securitization agreement, eligible trade receivables are sold to bank conduits through a bankruptcy-remote special purpose entity, which is consolidated for financial reporting purposes. The difference between the proceeds from the sale and the carrying value of the receivables is recognized as Discount on securitization of trade receivables in the accompanying Consolidated Statements of Earnings and varies on a monthly basis depending on the amount of receivables sold and market rates. The Company retains a subordinated interest in the receivables sold, which is recorded at the receivables previous carrying value. Subordinated retained interests of approximately $70 million and $63 million are included in Trade receivables in the accompanying Consolidated Balance Sheets at June 30, 2006 and March 31, 2006, respectively. The Company s retained interest is generally collected within 60 days. On a monthly basis, management measures the fair value of the retained interest at management s best estimate of the undiscounted expected future cash collections on the transferred receivables. Changes in the fair value are recognized as bad debt expense. Actual cash collections may differ from these estimates and would directly affect the fair value of the retained interest. In accordance with a servicing agreement, the Company continues to service, administer and collect the trade receivables on behalf of the bank conduits. The servicing fees charged to the bank conduits approximate the costs of collections.

(6) INVENTORIES, NET

Inventories, net, consist of:

(In thousands)	June 30, 2006	March 31, 2006
Hardgoods	$ 208,822	$ 202,894
Gases	&n	