

FERRO CORP
Form 10-Q
August 08, 2007

Table of Contents

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

(Mark One)

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

For the quarterly period ended June 30, 2007

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 1-584
FERRO CORPORATION**

(Exact name of registrant as specified in its charter)

Ohio

(State of Corporation)

34-0217820

(IRS Employer Identification No.)

1000 Lakeside Avenue

Cleveland, OH

(Address of Principal executive offices)

44114

(Zip Code)

216-641-8580

(Telephone Number)

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, 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 Accelerated filer Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). YES NO
At July 31, 2007, there were 43,508,944 shares of Ferro Common Stock, par value \$1.00, outstanding.

Table of Contents

TABLE OF CONTENTS

PART I

<u>Item 1</u>	<u>Financial Statements (Unaudited)</u>	Page 3
<u>Item 2</u>	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	Page 27
<u>Item 3</u>	<u>Quantitative and Qualitative Disclosures about Market Risk</u>	Page 38
<u>Item 4</u>	<u>Controls and Procedures</u>	Page 40

PART II

<u>Item 1</u>	<u>Legal Proceedings</u>	Page 41
<u>Item 1A</u>	<u>Risk Factors</u>	Page 41
<u>Item 2</u>	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	Page 41
<u>Item 3</u>	<u>Defaults Upon Senior Securities</u>	Page 41
<u>Item 4</u>	<u>Submission of Matters to a Vote of Security Holders</u>	Page 41
<u>Item 5</u>	<u>Other Information</u>	Page 41
<u>Item 6</u>	<u>Exhibits</u>	Page 41
<u>EX-31.1</u>		
<u>EX-31.2</u>		
<u>EX-32.1</u>		
<u>EX-32.2</u>		

Table of Contents**PART I FINANCIAL INFORMATION****Item 1. Financial Statements (Unaudited)
Ferro Corporation and Consolidated Subsidiaries
Condensed Consolidated Statements of Income**

	Three months ended June 30,		Six months ended June 30,	
	2007	Adjusted 2006	2007	Adjusted 2006
	(Dollars in thousands, except per share amounts)			
Net sales	\$ 553,658	\$ 538,492	\$ 1,083,363	\$ 1,043,645
Cost of sales	446,131	427,586	869,056	824,905
Gross profit	107,527	110,906	214,307	218,740
Selling, general and administrative expenses	84,386	78,735	163,143	157,839
Restructuring charges	332		1,863	
Other expense (income):				
Interest expense	14,286	18,087	31,732	31,337
Interest earned	(189)	(1,026)	(1,154)	(1,770)
Foreign currency transactions, net	423	219	934	540
Miscellaneous expense (income), net	883	(758)	(386)	2,642
Income before taxes	7,406	15,649	18,175	28,152
Income tax expense	2,808	5,137	7,342	9,244
Income from continuing operations	4,598	10,512	10,833	18,908
Loss on disposal of discontinued operations, net of tax	58	341	214	467
Net income	4,540	10,171	10,619	18,441
Dividends on preferred stock	259	317	545	645
Net income available to common shareholders	\$ 4,281	\$ 9,854	\$ 10,074	\$ 17,796
Per common share data				
Basic earnings:				
From continuing operations	\$ 0.10	\$ 0.24	\$ 0.24	\$ 0.43
From discontinued operations	0.00	(0.01)	0.00	(0.01)
	\$ 0.10	\$ 0.23	\$ 0.24	\$ 0.42
Diluted earnings:				
From continuing operations	\$ 0.10	\$ 0.24	\$ 0.24	\$ 0.43
From discontinued operations	0.00	(0.01)	0.00	(0.01)
	\$ 0.10	\$ 0.23	\$ 0.24	\$ 0.42

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Cash dividends declared	\$ 0.145	\$ 0.145	\$ 0.29	\$ 0.29
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See accompanying notes to condensed consolidated financial statements.

3

Table of Contents**Ferro Corporation and Consolidated Subsidiaries
Condensed Consolidated Balance Sheets**

	June 30, 2007	Adjusted December 31, 2006
	(Dollars in thousands)	
ASSETS		
Current assets		
Cash and cash equivalents	\$ 17,795	\$ 16,985
Accounts and trade notes receivable, net	248,630	220,899
Note receivable from Ferro Finance Corporation	30,199	16,083
Inventories	291,833	269,234
Deposits for precious metals		70,073
Deferred income taxes	12,593	12,291
Other current assets	29,718	25,877
Total current assets	630,768	631,442
Other assets		
Property, plant and equipment, net	525,335	526,802
Goodwill and other intangible assets, net	405,710	406,340
Deferred income taxes	91,388	94,490
Other non-current assets	104,577	82,528
Total assets	\$ 1,757,778	\$ 1,741,602
LIABILITIES and SHAREHOLDERS EQUITY		
Current liabilities		
Loans payable and current portion of long-term debt	\$ 22,790	\$ 10,764
Accounts payable	253,589	237,018
Income taxes		8,951
Accrued payrolls	28,695	33,164
Accrued expenses and other current liabilities	92,820	91,150
Total current liabilities	397,894	381,047
Other liabilities		
Long-term debt, less current portion	536,394	581,654
Postretirement and pension liabilities	188,459	194,427
Deferred income taxes	18,267	11,037
Other non-current liabilities	58,452	21,599
Total liabilities	1,199,466	1,189,764
Series A convertible preferred stock	14,602	16,787
Shareholders equity		
Common stock	52,323	52,323
Paid-in capital	161,112	158,504
Retained earnings	586,309	600,638

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Accumulated other comprehensive loss	(54,662)	(65,138)
Common shares in treasury, at cost	(201,372)	(211,276)
Total shareholders' equity	543,710	535,051
Total liabilities and shareholders' equity	\$ 1,757,778	\$ 1,741,602

See accompanying notes to condensed consolidated financial statements.

4

Table of Contents**Ferro Corporation and Consolidated Subsidiaries
Condensed Consolidated Statement of Shareholders' Equity and Comprehensive Income**

	Common Shares in Treasury		Common Stock	Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Share- holders Equity
	Shares	Amount					
(In thousands, except per share data)							
Balances at December 31, 2006 - Adjusted	9,458	\$ (211,276)	\$ 52,323	\$ 158,504	\$ 600,638	\$ (65,138)	\$ 535,051
Net income					10,619		10,619
Other comprehensive income (loss), net of tax:							
Foreign currency translation adjustment						12,742	12,742
Postemployment benefit liability adjustments						(3)	(3)
Raw material commodity swap adjustments						(1,512)	(1,512)
Interest rate swap adjustments						(751)	(751)
Total comprehensive income							21,095
Cash dividends:							
Common					(12,496)		(12,496)
Preferred					(545)		(545)
Income tax benefits					26		26
Transactions involving benefit plans	(571)	9,904		2,608			12,512
Adjustment to initially apply FIN No. 48 as of January 1, 2007					(11,933)		(11,933)
Balances at June 30, 2007	8,887	\$ (201,372)	\$ 52,323	\$ 161,112	\$ 586,309	\$ (54,662)	\$ 543,710

See accompanying notes to condensed consolidated financial statements.

Table of Contents**Ferro Corporation and Consolidated Subsidiaries
Condensed Consolidated Statements of Cash Flows**

	Six months ended June 30,	
	2007	Adjusted 2006
	(Dollars in thousands)	
Cash flows from operating activities		
Net income	\$ 10,619	\$ 18,441
Depreciation and amortization	43,992	38,892
Precious metals deposits	70,073	(58,000)
Accounts and trade notes receivable, inventories, and accounts payable	(26,190)	(59,501)
Note receivable from Ferro Finance Corporation	(14,116)	67,735
Other changes in current assets and liabilities, net	(7,367)	5,957
Other adjustments, net	(7,149)	5,814
Net cash provided by continuing operations	69,862	19,338
Net cash used for discontinued operations	(45)	(766)
Net cash provided by operating activities	69,817	18,572
Cash flows from investing activities		
Capital expenditures for property, plant and equipment	(30,921)	(20,829)
Proceeds from sale of assets and businesses	1,964	5,606
Cash investment in affiliate	859	(25,000)
Other investing activities		62
Net cash used for investing activities	(28,098)	(40,161)
Cash flows from financing activities		
Net borrowings under short term facilities	10,850	1,136
Proceeds from revolving credit facility	410,295	774,000
Proceeds from term loan facility	55,000	95,000
Principal payments on revolving credit facility	(507,649)	(823,200)
Principal payments on term loan facility	(1,525)	
Debt issue costs paid	(2,086)	(14,402)
Proceeds from exercise of stock options	8,233	2,196
Cash dividends paid	(13,041)	(12,955)
Other financing activities	(1,325)	(1,658)
Net cash (used for) provided by financing activities	(41,248)	20,117
Effect of exchange rate changes on cash	339	(432)
Increase (decrease) in cash and cash equivalents	810	(1,904)
Cash and cash equivalents at beginning of period	16,985	17,413
Cash and cash equivalents at end of period	\$ 17,795	\$ 15,509

Cash paid during the period for:

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Interest	\$ 28,680	\$ 28,081
Income taxes	\$ 6,774	\$ 4,397

See accompanying notes to condensed consolidated financial statements.

6

Table of Contents**Ferro Corporation and Consolidated Subsidiaries****Notes to Condensed Consolidated Financial Statements****1. Basis of Presentation**

Ferro Corporation (Ferro, we, us or the Company) prepared these unaudited condensed consolidated financial statements of Ferro Corporation and its consolidated subsidiaries in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements and, therefore, should be read in conjunction with the consolidated financial statements and related notes included in our Annual Report on Form 10-K for the year ended December 31, 2006. The preparation of financial statements in conformity with U.S. GAAP requires us to make estimates and assumptions that affect the timing and amount of assets, liabilities, equity, revenues and expenses reported and disclosed. Actual amounts could differ from our estimates, resulting in changes in revenues or costs that could have a material impact on the Company's results of operations, financial position, or cash flows. In our opinion, we made all adjustments that are necessary for a fair presentation, and those adjustments are of a normal recurring nature unless otherwise noted. Due to differing business conditions, our various initiatives, and some seasonality, the results for the three and six months ended June 30, 2007, are not necessarily indicative of the results expected in subsequent quarters or for the full year.

Interest earned in the three and six months ended June 30, 2006, of \$1.0 million and \$1.8 million, respectively, was reclassified from miscellaneous (income) expense, net, and is shown separately in the condensed consolidated statements of income.

2. Accounting Methods Adopted in the Six Months Ended June 30, 2007

On January 1, 2007, we elected to change our costing method for our inventories not already costed under the lower of cost or market using the first-in, first-out (FIFO) method, while in prior years, these inventories were costed under the lower of cost or market using the last-in, first-out (LIFO) method. The percentage of inventories accounted for under the LIFO method at December 31, 2006, was 13.8% for U.S. inventories and 6.2% for consolidated inventories. We believe the FIFO method is preferable as it conforms the inventory costing methods for all of our inventories to a single method and improves comparability with our industry peers. The FIFO method also better reflects current acquisition cost of those inventories on our consolidated balance sheets and enhances the matching of future cost of sales with revenues. In accordance with Statement of Financial Accounting Standards No. 154, *Accounting Changes and Error Correction*, all prior periods presented have been adjusted to apply the new method retrospectively. The effect of the change in our inventory costing method includes the LIFO reserve and related impact on the obsolescence reserve. This change increased our inventory balance by \$13.7 million and increased retained earnings, net of income tax effects, by \$8.5 million as of January 1, 2006.

On January 1, 2007, we also changed our accounting method of accruing for major planned overhauls. Financial Accounting Standards Board (FASB) Staff Position No. AUG AIR-1, *Accounting for Planned Maintenance Activities*, (AUG AIR-1), prohibits our prior policy of accruing for major planned overhauls in advance of when the actual costs are incurred. Under our new policy, the costs of major planned overhauls are expensed when incurred. All prior periods presented have been adjusted to apply the new method retrospectively. Adoption of this accounting pronouncement decreased our accrued expenses and other current liabilities by \$2.2 million and increased retained earnings, net of income tax effects, by \$1.5 million as of January 1, 2006.

On January 1, 2007, we adopted FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, (FIN 48). FIN 48 clarifies what criteria must be met prior to recognition of the financial statement benefit of a position taken or expected to be taken in a tax return. This interpretation also provides guidance on de-recognition of income tax assets and liabilities, classification of current and deferred income tax assets and liabilities, accounting for interest and penalties associated with tax positions, accounting for income taxes in interim periods, and income tax disclosures. The adoption of this interpretation decreased the opening balance of retained earnings by \$11.9 million as of January 1, 2007. We have elected to continue to report interest and penalties as income tax expense.

On January 1, 2007, we also adopted Statement of Financial Accounting Standards No. 156, *Accounting for Servicing of Financial Assets – an amendment of FASB Statement No. 140*, (FAS No. 156). This statement requires an

entity to recognize at fair value a servicing asset or liability each time it undertakes an obligation to service a financial asset by

Table of Contents

entering into a servicing contract. We provide collection agent services for our U.S. and certain international receivable sales programs. The collection agent fees received by the Company approximate adequate compensation. Therefore, the adoption of FAS No. 156 did not have an effect on our consolidated financial statements.

We have presented the effects of the changes in accounting principles for inventory costs and for major planned overhauls for 2007 and 2006 below. We have combined certain financial statement line items if they were not affected by the changes in accounting principles.

Condensed Consolidated Statements of Income

	Three months ended June 30, 2007		
	Computed	Change	Reported
	under	to	under
	LIFO	FIFO	FIFO
	(Dollars in thousands, except per share amounts)		
Net sales	\$ 553,658	\$	\$ 553,658
Cost of sales	446,663	(532)	446,131
Gross profit	106,995	532	107,527
Selling, general and administrative expenses	84,386		84,386
Restructuring charges	332		332
Other expense	15,403		15,403
Income before taxes	6,874	532	7,406
Income tax expense	2,612	196	2,808
Income from continuing operations	4,262	336	4,598
Loss on disposal of discontinued operations, net of tax	58		58
Net income	4,204	336	4,540
Dividends on preferred stock	259		259
Net income available to common shareholders	\$ 3,945	\$ 336	\$ 4,281
Per common share data			
Basic earnings:			
From continuing operations	\$ 0.09	\$ 0.01	\$ 0.10
From discontinued operations	0.00	0.00	0.00
	\$ 0.09	\$ 0.01	\$ 0.10
Diluted earnings:			
From continuing operations	\$ 0.09	\$ 0.01	\$ 0.10
From discontinued operations	0.00	0.00	0.00
	\$ 0.09	\$ 0.01	\$ 0.10

Table of Contents

	Six months ended June 30, 2007		
	Computed under LIFO	Change to FIFO	Reported under FIFO
	(Dollars in thousands, except per share amounts)		
Net sales	\$ 1,083,363	\$	\$ 1,083,363
Cost of sales	869,687	(631)	869,056
Gross profit	213,676	631	214,307
Selling, general and administrative expenses	163,143		163,143
Restructuring charges	1,863		1,863
Other expense	31,126		31,126
Income before taxes	17,544	631	18,175
Income tax expense	7,107	235	7,342
Income from continuing operations	10,437	396	10,833
Loss on disposal of discontinued operations, net of tax	214		214
Net income	10,223	396	10,619
Dividends on preferred stock	545		545
Net income available to common shareholders	\$ 9,678	\$ 396	\$ 10,074
Per common share data			
Basic earnings:			
From continuing operations	\$ 0.23	\$ 0.01	\$ 0.24
From discontinued operations	0.00		