SCHNITZER STEEL INDUSTRIES INC
Form 10-Q
January 08, 2010
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

x **Quarterly Report Pursuant to Section 13 or 15(d)**

of the Securities Exchange Act of 1934

For the Quarterly Period Ended November 30, 2009

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 0-22496

SCHNITZER STEEL INDUSTRIES, INC.

(Exact name of registrant as specified in its charter)

OREGON **(State or other jurisdiction of** **incorporation or organization)**	**93-0341923** **(I.R.S. Employer** **Identification No.)**
3200 NW Yeon Ave. **Portland, OR** **(Address of principal executive offices)**	**97210** **(Zip Code)**

(503) 224-9900

(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 x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

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 the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (check one)

Large accelerated filer x Accelerated filer ¨ Non-accelerated filer ¨ Smaller 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 x

The Registrant had 22,199,706 shares of Class A common stock, par value of $1.00 per share, and 5,566,159 shares of Class B Common Stock, par value of $1.00 per share, outstanding at December 30, 2009.

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SCHNITZER STEEL INDUSTRIES, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited, in thousands, except per share amounts)

	November 30, 2009	August 31, 2009
Assets		
Current assets:		
Cash and cash equivalents	$ 19,981	$ 41,026
Accounts receivable, net	122,397	117,666
Inventories, net	242,969	184,455
Deferred income taxes	7,672	10,027
Refundable income taxes	48,998	46,972
Prepaid expenses and other current assets	7,616	10,868
Total current assets	449,633	411,014
Property, plant and equipment, net	431,067	447,228
Other assets:		
Investment in and advances to joint venture partnerships	11,118	10,812
Goodwill	368,241	366,559
Intangibles, net	23,675	20,422
Other assets	12,141	12,198
Total assets	$ 1,295,875	$ 1,268,233
Liabilities and Equity		
Current liabilities:		
Short-term borrowings and capital lease obligations	$ 24,990	$ 1,317
Accounts payable	59,829	72,289
Accrued payroll and related liabilities	15,520	23,636
Environmental liabilities	2,995	3,148
Accrued income taxes	1,214	776
Other accrued liabilities	35,101	38,963
Total current liabilities	139,649	140,129
Deferred income taxes	47,294	44,523
Long-term debt and capital lease obligations, net of current maturities	144,798	110,414
Environmental liabilities, net of current portion	38,760	38,760
Other long-term liabilities	9,684	11,657
Commitments and contingencies (Note 7)		
Schnitzer Steel Industries, Inc. (SSI) shareholders equity:		
Preferred stock 20,000 shares authorized, none issued		
Class A common stock 75,000 shares $1.00 par value authorized, 22,171 and 21,402 shares issued and outstanding	22,171	21,402
Class B common stock 25,000 shares $1.00 par value authorized, 5,595 and 6,268 shares issued and outstanding	5,595	6,268
Additional paid-in capital	733	
Retained earnings	885,202	894,243
Accumulated other comprehensive loss	(1,799)	(2,546)
Total SSI shareholders equity	911,902	919,367
Noncontrolling interests	3,788	3,383

Total equity		915,690		922,750
Total liabilities and equity	$	1,295,875	$	1,268,233

The accompanying notes to the unaudited condensed consolidated financial statements

are an integral part of these statements.

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SCHNITZER STEEL INDUSTRIES, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited, in thousands, except per share amounts)

	Three Months Ended November 30, 2009	Three Months Ended November 30, 2008
Revenues	$ 394,282	$ 471,964
Operating expense:		
Cost of goods sold	350,938	490,554
Selling, general and administrative	34,446	37,484
Environmental matters	150	(5,613)
Income from joint ventures	(534)	(2,256)
Operating income (loss)	9,282	(48,205)
Other income (expense):		
Interest expense	(618)	(1,354)
Other income, net	419	277
Total other expense	(199)	(1,077)
Income (loss) from continuing operations before income taxes	9,083	(49,282)
Income tax (expense) benefit	(1,864)	16,322
Income (loss) from continuing operations	7,219	(32,960)
Loss from discontinued operations, net of tax	(14,974)	(1,430)
Net loss	(7,755)	(34,390)
Net (income) loss attributable to noncontrolling interests	(814)	388
Net loss attributable to SSI	$ (8,569)	$ (34,002)
Basic:		
Income (loss) per share from continuing operations attributable to SSI	$ 0.23	$ (1.16)
Loss per share from discontinued operations attributable to SSI	(0.54)	(0.05)
Net loss per share attributable to SSI	$ (0.31)	$ (1.21)
Diluted:		
Income (loss) per share from continuing operations attributable to SSI	$ 0.23	$ (1.16)
Loss per share from discontinued operations attributable to SSI	(0.53)	(0.05)
Net loss per share attributable to SSI	$ (0.30)	$ (1.21)
Weighted average number of common shares:		

Basic	27,803	28,016
Diluted	28,130	28,016
Dividends declared per common share	$ 0.17	$ 0.17

The accompanying notes to the unaudited condensed consolidated financial statements

are an integral part of these statements.

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SCHNITZER STEEL INDUSTRIES, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited, in thousands)

	Three Months Ended November 30, 2009	2008
Cash flows from operating activities:		
Net loss	$ (7,755)	$ (34,390)
Noncash items included in net loss:		
Depreciation and amortization	15,327	14,531
Inventory write-down	368	51,968
Deferred income taxes	1,009	(25,897)
Undistributed equity in earnings of joint ventures	(483)	(1,685)
Share-based compensation expense	2,731	4,379
Excess tax (benefits) deficiencies from share-based payment arrangements	(16)	130
(Gain) loss on disposal of a business and other assets	17,103	(502)
Environmental matters	150	(2,376)
Voluntary incentive award forfeitures		(5,504)
Unrealized (gain) loss on derivatives	(1,586)	2,135
Changes in assets and liabilities:		
Accounts receivable	(9,138)	205,803
Inventories	(90,734)	48,004
Refundable income taxes	(1,946)	
Prepaid expenses and other current assets	1,844	3,969
Intangibles and other long term assets	(2)	34
Accounts payable	(11,259)	(90,591)
Accrued payroll liabilities	(6,616)	(40,491)
Other accrued liabilities	883	(9,086)
Accrued income taxes	401	(40,665)
Environmental liabilities	(303)	(471)
Other long-term liabilities	7	(233)
Distributed equity in earnings of joint ventures		300
Net cash provided by (used in) operating activities	(90,015)	79,362
Cash flows from investing activities:		
Capital expenditures	(8,249)	(28,244)
Acquisitions, net of cash acquired	(18,126)	
(Advances to) payments from joint ventures, net	177	(832)
Proceeds from sale of business and other assets	41,083	773
Net cash provided by (used in) investing activities	14,885	(28,303)
Cash flows from financing activities:		
Proceeds from line of credit	112,500	63,500
Repayment of line of credit	(89,000)	(63,500)
Borrowings from long-term debt	190,500	165,017
Repayment of long-term debt	(157,273)	(218,198)
Stock withheld for taxes under employee share-based compensation plan	(2,361)	(1,608)
Excess tax benefits (deficiencies) from share-based payment arrangements	16	(130)
Stock options exercised	443	
Distributions to noncontrolling interests	(409)	
Dividends declared and paid	(472)	(479)
Net cash provided by (used in) financing activities	53,944	(55,398)

Effect of exchange rate changes on cash		141		(661)
Net decrease in cash and cash equivalents		(21,045)		(5,000)
Cash and cash equivalents at beginning of period		41,026		15,039
Cash and cash equivalents at end of period	$	19,981	$	10,039
SUPPLEMENTAL DISCLOSURES:				
Cash paid during the period for:				
Interest	$	219	$	1,404
Income taxes, net of refunds received	$	6	$	49,544

The accompanying notes to the unaudited condensed consolidated financial statements

are an integral part of these statements.

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SCHNITZER STEEL INDUSTRIES, INC.

Note 1 - Summary of Significant Accounting Policies

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of Schnitzer Steel Industries, Inc. (the Company) have been prepared pursuant to generally accepted accounting principles in the United States of America (U.S. GAAP) for interim financial information and the rules and regulations of the United States Securities and Exchange Commission (SEC) for Form 10-Q, including Article 10 of Regulation S-X. The year-end condensed consolidated balance sheet was derived from audited financial statements, but does not include all disclosures required by U.S. GAAP for annual financial statements. Certain information and note disclosures normally included in annual financial statements have been condensed or omitted pursuant to those rules and regulations. In the opinion of management, all normal, recurring adjustments considered necessary for a fair presentation have been included. Although management believes the disclosures made are adequate to ensure the information presented is not misleading, management suggests that these unaudited condensed consolidated financial statements be read in conjunction with the financial statements and notes thereto included in the Company s Annual Report on Form 10-K for the fiscal year ended August 31, 2009. The results for the three months ended November 30, 2009 and 2008 are not necessarily indicative of the results of operations for the entire year. The Company has evaluated subsequent events through January 7, 2010. There were no subsequent events requiring disclosure.

Cash and Cash Equivalents

Cash and cash equivalents include short-term securities that are not restricted by third parties and have an original maturity date of 90 days or less. Included in accounts payable are book overdrafts of $15 million and $23 million as of November 30, 2009 and August 31, 2009, respectively.

Accounts Receivable, net

Accounts receivable represent amounts due from customers on product and other sales. The allowance for doubtful accounts was $6 million at November 30, 2009 and $8 million at August 31, 2009.

Goodwill and Other Intangible Assets, net

On October 2, 2009, the Company entered into a definitive agreement to sell the Company s full-service used auto parts operation, which had been operated as part of the Auto Parts Business (APB) reporting unit. The Company identified this divestiture as a triggering event, which resulted in testing goodwill for impairment. Based on the Company s valuation analysis performed in relation to the divestiture of the full-service operations, the Company determined that the goodwill related to the APB reporting unit was not impaired. The Company will continue to monitor its goodwill and indefinite-lived intangible and long-lived assets for possible future impairment. Refer to Note 6 Goodwill and Intangibles, net for further detail.

On September 1, 2009, the Company adopted the accounting standard for non-recurring, non-financial assets and liabilities that are recognized or disclosed at fair value in the financial statements on a non-recurring basis. Non-recurring, non-financial asset fair value measurements include those used in the Company s test of recoverability of goodwill and indefinite-lived intangible assets, in which the Company determines whether fair values of its applicable reporting units exceed their carrying values. This standard will also impact the accounting for business combinations by using an exit price model when determining the fair values of acquired assets and assumed liabilities.

Accrued Workers Compensation Costs

The Company is self-insured up to a maximum amount for workers compensation claims and as such, a reserve for the costs of unpaid claims and the estimated costs of incurred but not reported claims has been estimated as of the balance sheet date. The Company s exposure to claims is protected by various stop-loss insurance policies. The estimate of this reserve is based on historical claims experience. At November 30, 2009 and August 31, 2009, the Company accrued $6 million for the estimated cost of workers compensation claims.

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Changes in Shareholders Equity and Comprehensive Income (Loss)

The following is a summary of the changes in shareholders equity and comprehensive income (loss) (in thousands):

	2009 SSI shareholders equity	2009 Noncontrolling interests	2009 Total equity	2008 SSI shareholders equity	2008 Noncontrolling interests	2008 Total equity
Balances - September 1,	$ 919,367	$ 3,383	$ 922,750	$ 978,152	$ 4,399	$ 982,551
Net income (loss)	(8,569)	814	(7,755)	(34,002)	(388)	(34,390)
Components of other comprehensive income (loss), net of tax:						
Foreign currency translation	572		572	(2,243)		(2,243)
Net unrealized gain (loss) on cash-flow hedges	175		175	(233)		(233)
Comprehensive income (loss)	(7,822)	814	(7,008)	(36,478)	(388)	(36,866)
Distributions to noncontrolling interests		(409)	(409)			
Stock withheld for taxes under employee share-based compensation plan	(2,361)		(2,361)	(1,608)		(1,608)
Share-based compensation expense	2,731		2,731	4,379		4,379
Dividends declared and paid	(472)		(472)	(479)		(479)
Stock options exercised	443		443			
Excess tax benefits (deficiencies) from share-based payment arrangements	16		16	(130)		(130)
Balances - November 30,	$ 911,902	$ 3,788	$ 915,690	$ 943,836	$ 4,011	$ 947,847

Net Income (Loss) and Dividends per Share

Effective September 1, 2009, the Company adopted the accounting standard for noncontrolling interests in consolidated financial statements. Certain provisions of this accounting standard are required to be adopted retrospectively for all periods presented and include a requirement that the carrying value of noncontrolling interests (previously referred to as minority interests) be removed from the mezzanine section of the balance sheet and reclassified as equity. Further, as a result of adopting this accounting standard, net (income) loss attributable to noncontrolling interests is now deducted from the income (loss) from continuing operations to arrive at the net income (loss) from continuing operations attributable to SSI for purposes of calculating earnings per share (EPS).

Basic net income (loss) per share attributable to SSI is based on the weighted average number of outstanding common shares during the periods presented, including vested deferred stock units (DSUs) and restricted stock units (RSUs). Diluted net income per share attributable to SSI is based on the weighted average number of common shares outstanding, assuming dilution. Potentially dilutive common shares include the assumed exercise of stock options and assumed vesting of performance share, DSU and RSU awards using the treasury stock method. For the three months ended November 30, 2009 and 2008, 179,578 and 1,340,913 common stock equivalent shares, respectively, were considered anti-dilutive and were excluded from the calculation of diluted earnings per share.

	Three Months Ended November 30, 2009	Three Months Ended November 30, 2008
Income (loss) from continuing operations	$ 7,219	$ (32,960)
Net (income) loss attributable to noncontrolling interests	(814)	388
Income (loss) from continuing operations attributable to SSI	6,405	(32,572)

Loss from discontinued operations, net of tax	(14,974)	(1,430)
Net loss attributable to SSI	$ (8,569)	$ (34,002)
Computation of shares:		
Weighted average common shares outstanding - basic	27,803	28,016
Incremental common shares attributable to dilutive stock options, performance share awards, DSUs and RSUs	327	
Weighted average common shares outstanding - diluted	28,130	28,016

SCHNITZER STEEL INDUSTRIES, INC.

Recent Accounting Pronouncements

In December 2008, a new accounting standard was issued regarding an employer s disclosures about the plan assets of a defined benefit pension or postretirement plan and will require additional disclosure regarding investment policies and strategies, fair value of each major asset category based on risks of the assets, inputs and valuations techniques used to estimate fair value, fair value measurement hierarchy levels under pension accounting for each asset category and significant concentration of risk information. This standard will be effective for the Company for the fiscal year ending August 31, 2010.

Reclassifications and Revisions

Certain prior year amounts have been reclassified within cash flows from operating activities to conform to the current year presentation. These changes had no impact on previously reported operating income, net income (loss) or net cash provided by operating activities.

In addition, the Company identified and corrected a classification error in the consolidated statement of cash flows for the discrete quarter ended November 30, 2008 which increased net cash provided by operating activities by $9 million to $79 million and increased net cash used in investing activities by $9 million to $28 million. The Company deemed this error to be immaterial.

Note 2 - Inventories, net

The Company s inventories primarily consist of ferrous and nonferrous processed and unprocessed scrap metal, used and salvaged vehicles and finished steel products, consisting primarily of rebar, merchant bar and wire rod. Inventories are stated at the lower of cost or market for all periods presented.

Inventories, net consisted of the following (in thousands):

	November 30, 2009	August 31, 2009
Processed and unprocessed scrap metal	$ 169,558	$ 77,607
Semi-finished goods (billets)	3,864	9,600
Finished goods	39,103	66,936
Supplies	31,291	31,581
Inventory reserve	(847)	(1,269)
Inventories, net	$ 242,969	$ 184,455

The Company makes certain assumptions regarding future demand and net realizable value in order to assess that inventory is properly recorded at the lower of cost or market. The assumptions are based on both historical experience and current information.

Due to reduced production levels during the first three months of fiscal 2009, the Company recognized $10 million of expense for abnormal production costs that could not be capitalized into inventory.

Note 3 - Property, Plant and Equipment, net

Property, plant and equipment, net consisted of the following (in thousands):

	November 30, 2009	August 31, 2009
Property, plant and equipment	$ 803,165	$ 812,997

Less: accumulated depreciation	(372,098)	(365,769)
Property, plant and equipment, net	$ 431,067	$ 447,228

SCHNITZER STEEL INDUSTRIES, INC.

Note 4 - Business Combinations

On September 1, 2009, the Company adopted the revised accounting standard for business combinations. This standard requires the Company to recognize the assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree at the acquisition date, measured at their fair values as of that date, and requires acquisition costs to be expensed as incurred. The Company expensed $1 million in acquisition costs to selling, general and administrative expenses in the first quarter of fiscal 2010.

In October 2009, the Company completed the acquisition of four self-service used auto parts facilities located near the Company s MRB export facility in Portland, Oregon for $18 million. This acquisition represents the Company s first used auto parts operations in the Pacific Northwest. The acquired facilities will operate under the Company s Pick-N-Pull brand. This acquisition was not material to the Company s financial position or results of operations, and thus proforma information is not presented.

Note 5 - Discontinued Operations

In October 2009, the Company sold its full-service used auto parts operation, which had been operated as part of the APB reporting unit. The Company concluded that the divestiture met the definition of a discontinued operation. Accordingly, the results of this discontinued operation have been reclassified for all periods presented. The sale resulted in a loss of $15 million, net of tax. The loss included the write-off of $12 million of goodwill that was allocated to the full-service operation from the APB reporting segment. Operating results of the discontinued operations are summarized below. The amounts exclude general corporate overhead previously allocated to the full-service used auto parts operation.

	Three Months Ended November 30,	
(In thousands)	**2009**	**2008**
Revenues	$ 9,991	$ 27,152
Loss from discontinued operations before income taxes	$ (292)	$ (2,200)
Loss on sale of full service operations	(17,022)	
Income taxes	2,340	770
Loss from discontinued operations, net of tax	$ (14,974)	$ (1,430)

Assets and liabilities of discontinued operations consisted of the following (in thousands):

	August 31, 2009
Current assets	$ 41,670
Noncurrent assets	$ 8,538
Current liabilities	$ 8,740
Noncurrent liabilities	$ 5,167

Note 6 - Goodwill and Intangibles, net

The Company identified the divestiture of its full service used auto parts operation as a triggering event that required testing the goodwill in the APB reporting segment for impairment. Based on the Company s valuation analysis performed in relation to the divestiture the Company determined that the goodwill was not impaired as of the divestiture date. The Company will continue to monitor its goodwill and indefinite-lived intangible and long-lived assets for possible future impairment.

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SCHNITZER STEEL INDUSTRIES, INC.

The gross changes in the carrying amount of goodwill by reportable segments during the first three months of fiscal 2010 were (in thousands):

	Metals Recycling Business	Auto Parts Business	Total
Balance as of August 31, 2009	$ 228,977	$ 137,582	$ 366,559
Foreign currency translation adjustment		608	608
Acquisitions	(1,162)	14,266	13,104
Divestitures		(12,030)	(12,030)
Balance as of November 30, 2009	$ 227,815	$ 140,426	$ 368,241

The following table presents the Company s intangible assets and their related lives (in thousands):

		November 30, 2009		August 31, 2009	
	Life In Years	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Identifiable intangibles:					
Tradename	Indefinite	$ 750	$	$ 750	$
Tradename	20			972	(227)
Tradename	1 - 6	583	(306)	583	(275)
Marketing agreement	5	1,240	(75)		
Employment agreements	2	1,117	(465)	1,117	(326)
Covenants not to compete	3 - 20	27,083	(10,449)	22,782	(9,949)
Leasehold interests	4 - 25	862	(243)	1,550	(540)
Lease termination fee	15	200	(194)	200	(191)
Permits & licenses	3	80	(20)	80	(13)
Supply contracts	Indefinite	361		361	
Supply contracts	5 - 6	4,363	(1,422)	5,269	(1,931)
Real property options	Indefinite	210		210	
Total		$ 36,849	$ (13,174)	$ 33,874	$ (13,452)