AMERICAN STANDARD COMPANIES INC
Form 10-Q
July 30, 2003

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SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2003

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 1-11415

AMERICAN STANDARD COMPANIES INC.

(Exact name of Registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	13-3465896 (I.R.S. Employer Identification No.)
One Centennial Avenue, P.O. Box 6820, Piscataway, NJ (Address of principal executive offices)	08855-6820 (Zip Code)
Registrant s telephone number, including area code	(732) 980-6000

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.

[X] Yes [ ] No

Indicate by check mark whether the registrant is an accelerated filer (as defined by Rule 12b-2 of the Exchange Act)

[X] Yes [_] No

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

Common stock, $.01 par value, outstanding at July 25, 2003	72,256,449 shares

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PART 1. FINANCIAL INFORMATION

Item 1. Financial Statements

American Standard Companies Inc. (the Company) is a Delaware corporation that owns all the outstanding common stock of American Standard Inc. and American Standard International Inc. (ASII), both Delaware corporations. American Standard or the Company will refer to the Company, or to the Company and American Standard Inc. and ASII including their subsidiaries, as the context requires.

AMERICAN STANDARD COMPANIES INC. AND SUBSIDIARIES
UNAUDITED SUMMARY STATEMENT OF INCOME
(Dollars in millions except per share amounts)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2003	**2002**	**2003**	**2002**
Sales	$ 2,265.0	$ 2,086.5	$ 4,215.6	$ 3,848.4
Cost and expenses				
Cost of sales	1,700.7	1,557.0	3,186.5	2,909.6
Selling and administrative expenses	335.1	302.6	659.2	584.9
Other expense	5.1	5.3	23.1	13.4
Interest expense	30.1	32.6	60.3	66.0
	2,071.0	1,897.5	3,929.1	3,573.9
Income before income taxes	194.0	189.0	286.5	274.5
Income taxes	60.1	62.9	88.8	91.4
Net income	$ 133.9	$ 126.1	$ 197.7	$ 183.1
Net income per common share				
Basic	$ 1.86	$ 1.74	$ 2.75	$ 2.53
Diluted	$ 1.83	$ 1.71	$ 2.70	$ 2.48
Average common shares outstanding				
Basic	71,873,438	72,450,074	72,006,795	72,341,957
Diluted	73,207,727	73,935,940	73,293,221	73,704,707

See accompanying notes

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Item 1. Financial Statements (continued)

AMERICAN STANDARD COMPANIES INC. AND SUBSIDIARIES
UNAUDITED SUMMARY BALANCE SHEET
(Dollars in millions, except share data)

	June 30, 2003	December 31, 2002
Current assets:		
Cash and cash equivalents	$ 181.0	$ 96.6
Accounts receivable, less allowance for doubtful accounts: June 2003 $42.9; Dec. 2002 $38.1	1,155.7	881.4
Inventories:		
Finished products	551.3	486.1
Products in process	165.3	138.1
Raw materials	176.4	146.5
Other current assets	332.1	265.7
Total current assets	2,561.8	2,014.4
Facilities, less accumulated depreciation: June 2003 $877.2; Dec. 2002 $773.2	1,455.1	1,430.1
Goodwill, less accumulated amortization: June 2003 $386.7; Dec. 2002 $370.9	1,059.5	1,012.8
Capitalized software costs, less accumulated amortization: June 2003 $164.0; Dec. 2002 $131.7	239.7	242.0
Other assets	466.9	444.5
Total assets	$ 5,783.0	$ 5,143.8
Current liabilities:		
Loans payable to banks	$ 65.5	$ 36.3
Current portion of long-term debt	4.0	4.5
Accounts payable	777.6	601.6
Accrued payrolls	256.8	281.0
Current portion of warranties	127.7	118.0
Taxes on income	169.4	98.9
Other accrued liabilities	640.5	525.3
Total current liabilities	2,041.5	1,665.6
Long-term debt	1,912.6	1,918.4
Reserve for post-retirement benefits	667.9	623.3
Warranties	207.2	197.9
Other liabilities	508.4	508.8
Total liabilities	5,337.6	4,914.0
Shareholders equity:		
Preferred stock, 2,000,000 shares authorized, none issued and outstanding		
Common stock $.01 par value, 200,000,000 shares authorized; shares issued and outstanding: 72,094,908 in 2003; 72,613,736 in 2002	.7	.7
Capital surplus	736.0	724.4
Unearned compensation	(1.5)	(2.3)
Treasury stock	(583.8)	(534.6)
Retained earnings	625.7	428.0

Accumulated other comprehensive income:		
Foreign currency translation effects	(255.5)	(309.2)
Deferred gain (loss) on hedge contracts, net of tax	(.2)	(2.0)
Minimum pension liability adjustment, net of tax	(76.0)	(75.2)
Total shareholders equity	445.4	229.8
	$5,783.0	$5,143.8

See accompanying notes

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Item 1. Financial Statements (continued)

AMERICAN STANDARD COMPANIES INC. AND SUBSIDIARIES
UNAUDITED SUMMARY STATEMENT OF CASH FLOWS
(Dollars in millions)

	Six months ended June 30,	
	2003	**2002**
Cash provided (used) by:		
Operating activities:		
Net income	$ 197.7	$ 183.1
Adjustments to reconcile net income to net cash provided by operations:		
Depreciation	79.2	72.5
Amortization of capitalized software and other intangibles	39.8	27.9
Non-cash stock compensation	32.1	26.2
Equity in net income of unconsolidated joint ventures, net of dividends received	(3.4)	(3.9)
Other	(6.9)	(20.8)
Changes in assets and liabilities:		
Accounts receivable	(248.5)	(153.4)
Inventories	(87.2)	(61.9)
Accounts payable	148.2	51.1
Other accrued liabilities and taxes	155.2	25.0
Post-retirement benefits	20.5	25.6
Other assets	(92.2)	11.9
Other long-term liabilities	10.2	(1.0)
Net cash provided by operating activities before proceeds from initial sale of receivables	244.7	182.3
Proceeds from initial sale of receivables, net		182.0
Net cash provided by operating activities	244.7	364.3
Investing activities:		
Purchase of property, plant and equipment	(61.2)	(55.6)
Investments in affiliated companies and other businesses	(22.5)	(22.0)
Investments in computer software	(19.6)	(19.6)
Other	0.3	11.8
Net cash used by investing activities	(103.0)	(85.4)
Financing activities:		
Proceeds from issuance of long-term debt	32.4	
Repayments of long-term debt	(127.2)	(39.0)
Net change in revolving credit facilities	46.9	(119.6)
Net change in other short-term debt	27.6	(10.4)
Purchases of treasury stock	(90.6)	(120.6)
Proceeds from exercise of stock options	16.5	47.6
Proceeds from foreign exchange forward contracts on receivables sales	34.3	
Other	3.6	3.9
Net cash used by financing activities	(56.5)	(238.1)
Effect of exchange rate changes on cash and cash equivalents	(.8)	1.4

Net increase in cash and cash equivalents	84.4	42.2
Cash and cash equivalents at beginning of period	96.6	82.1
Cash and cash equivalents at end of period	$ 181.0	$ 124.3
Cash interest paid	61.7	64.9
Cash taxes paid	2.6	96.4

See accompanying notes

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AMERICAN STANDARD COMPANIES INC.
NOTES TO FINANCIAL STATEMENTS

Note 1. Basis of Financial Statement Presentation

The accompanying condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions for Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments, consisting only of normal recurring items, considered necessary for a fair presentation of financial data have been included. The results of operations for interim periods are not necessarily indicative of the results that may be expected for the entire year. The condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and accompanying notes included in the Company s Annual Report on Form 10-K for the year ended December 31, 2002.

Note 2. Comprehensive Income

Total comprehensive income consisted of the following (dollars in millions):

	Three months ended June 30,		Six months ended June 30,	
	2003	**2002**	**2003**	**2002**
Net income	$133.9	$126.1	$197.7	$183.1
Foreign currency translation effects	65.2	55.5	53.7	40.3
Deferred gain (loss) on hedge contracts, net of tax	.6	(2.2)	1.8	3.0
Minimum pension liability adjustment	(1.1)		(.8)	
Total comprehensive income	$198.6	$179.4	$252.4	$226.4

Note 3. Earnings Per Share

The average number of outstanding shares of common stock used in computing diluted earnings per share for the three months ended June 30, 2003 and 2002 included 1,334,289 and 1,485,866 average incremental shares, respectively, for the assumed exercise of stock options. The six-month periods ended June 30, 2003 and 2002 included 1,286,426 and 1,362,750 average incremental shares, respectively.

Note 4. Debt

In January 2003, a European subsidiary of the Company issued 30 million ($31 million) of 7.59% Guaranteed Senior Bonds due 2013 in a private placement as part of changes in the financial structure and organization of its European subsidiaries. The Company guarantees the bonds. The proceeds were used to repay borrowings under bank credit agreements.

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Note 5. Stock-Based Compensation

The Company has three stock-based compensation plans the 2002 Omnibus Incentive Plan, the Stock Incentive Plan and the Employee Stock Purchase Plan (ESPP) which are described in Note 12 of Notes to Financial Statements in the Company s 2002 Annual Report on Form 10-K. Under the first two plans, the Company has granted options to employees and directors to acquire a fixed number of shares of the Company s common stock at a specified price, and also has made grants of restricted shares. Under the ESPP, employees are entitled to purchase shares of the Company s common stock at a discount of 15% from the market price on the date of purchase. The Company accounts for these plans under the recognition and measurement principles of APB Opinion No. 25, *Accounting for Stock Issued to Employees (APB 25),* and related Interpretations. Compensation cost is not recorded for substantially all options granted because the option exercise price was equal to the market value of the underlying common stock on the date of grant. Nor is compensation cost recorded for the 15% discount on shares purchased under the ESPP, which is not considered compensation under APB 25. Compensation cost is recorded for the value of restricted share awards, amortized over the vesting period of the award.

The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of FASB Statement No. 123, *Accounting for Stock-Based Compensation,* to stock-based employee compensation (dollars in millions except per share data).

	Three Months Ended June 30,		Six Months Ended June 30,	
	2003	**2002**	**2003**	**2002**
Net income, as reported	$133.9	$126.1	$197.7	$183.1
Deduct: Total stock-based compensation expense determined under fair value based method for all stock option awards, net of tax, and discounts under the ESPP	5.1	5.9	10.1	11.3
Pro forma net income	$128.8	$120.2	$187.6	$171.8
Earnings per share:				
Basic as reported	$ 1.86	$ 1.74	$ 2.75	$ 2.53
Basic pro forma	$ 1.79	$ 1.66	$ 2.61	$ 2.38
Diluted as reported	$ 1.83	$ 1.71	$ 2.70	$ 2.48
Diluted pro forma	$ 1.76	$ 1.63	$ 2.56	$ 2.33

The weighted average fair value per option of grants made during the three months and six months ended June 30, 2003 was $20.96 and for the corresponding periods of 2002 was $18.24. The fair value of the stock options was estimated at the date of grant using the Black-Scholes option-pricing model with the following assumptions: risk-free interest rate of 2.48% in 2003 and 2.49% in 2002; volatility of 28.4% and 29% in 2003 and 2002, respectively; an expected average life of 5 years in 2003 and 2002; and a dividend yield of zero.

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Note 6. Warranties and Guarantees

In November 2002, the Financial Accounting Standards Board (FASB) issued Interpretation No. 45, *Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others.* The Company adopted the disclosure requirements of that Interpretation effective December 31, 2002. The accounting requirements of that Interpretation were effective January 1, 2003 and had no material effect on the Company.

Products sold by the Company are covered by a basic limited warranty with terms and conditions that vary depending upon the product and country in which sold. The limited warranty covers the equipment, parts and labor (in certain cases) necessary to satisfy the warranty obligation for a period ranging from one to ten years generally, and for the lifetime of certain bath and kitchen faucets. The Company estimates the costs that may be incurred under its warranty obligations and records a liability in the amount of such costs at the time product revenue is recognized. Factors that affect the Company s warranty liability include the number of units sold, historical and anticipated rates of warranty claims, and cost per claim. The Company periodically assesses the adequacy of its recorded warranty liabilities and adjusts the amounts as necessary. Costs to satisfy warranty claims are charged as incurred to the accrued warranty liability.

The Company also sells a variety of extended warranty contracts for up to ten years on certain air conditioning products. Revenues from the sales of extended warranties are deferred and amortized on a straight-line basis over the terms of the contracts or based upon historical experience. Actual costs to satisfy claims on extended warranty contracts are charged to cost of sales as incurred and were $8.4 million and $6.9 million for the three months ended June 30, 2003 and 2002, respectively, and $16.4 million and $13.9 million for the six months ended June 30, 2003 and 2002, respectively. Total warranty expense was $42.9 million and $44.0 million for the three months ended June 30, 2003 and 2002, respectively, and $78.1 million and $77.4 million for the six-month periods then ended, respectively.

Following is a summary of changes in the Company s product warranty liability for the three and six months ended June 30, 2003 and 2002 (dollars in millions).

	Three Months Ended June 30,		Six Months Ended June 30,	
	2003	2002	2003	2002
Balance of basic warranty costs accrued and deferred income on extended warranty contracts, beginning of period	$ 321.7	$ 304.0	$ 315.9	$ 299.9
Warranty costs accrued	29.2	35.4	60.0	61.7
Extended warranty contracts sold	17.4	13.7	31.8	26.5
Warranty claims settled	(25.0)	(20.8)	(52.9)	(42.8)
Amortization of deferred income on extended warranty contracts	(9.7)	(7.1)	(21.6)	(20.2)
Increases (decreases) in pre-existing warranties, net	1.3	1.7	1.7	1.8
Balance of basic warranty costs accrued and deferred income on extended warranty contracts, end of period	334.9	326.9	334.9	326.9
Current portion included in current liabilities	(127.7)	(129.4)	(127.7)	(129.4)
Long-term warranty liability	$ 207.2	$ 197.5	$ 207.2	$ 197.5

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The Company has commitments and performance guarantees, including energy savings guarantees totaling $32 million as of June 30, 2003, extending from 2003 to 2024, under long-term contracts related to its air conditioning equipment, system controls, and service and maintenance. Through June 30, 2003, the Company has experienced no net losses under such arrangements and considers the probability of losses to be unlikely.

The Company fully and unconditionally guarantees the payment obligations under all the Company s Senior Notes that were issued by its wholly owned subsidiary American Standard Inc. See Note 8 of Notes to Financial Statements. The Company also guarantees other debt obligations issued by other subsidiaries, including obligations under a $41 million Euro-denominated credit facility and $31 million of Euro-denominated Senior Bonds.

Note 7. Effect of Recently Issued Accounting Standards

The Financial Accounting Standards Board (FASB) has recently issued several new Statements and Interpretations. For the disclosures required by Statement of Financial Accounting Standards No. 148, *Accounting for Stock-Based Compensation Transition and Disclosure*, see Note 5 of Notes to Financial Statements. For the disclosures required by Interpretation No. 45, *Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others,* see Note 6 of Notes to Financial Statements. Other Statements and Interpretations recently issued by the FASB that are applicable to the Company have little or no immediate effect and will have an effect in the future only in the event the Company enters into transactions governed by those statements. Those included statements No. 143, *Accounting for Asset Retirement Obligations;* No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets;* No. 145*, Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13 (leases), and Technical Corrections*; No. 146, *Accounting for Costs Associated with Exit or Disposal Activities;* No. 149, *Amendment of Statement 133 on Derivative Instruments and Hedging Activities;* and No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity.* The Company is evaluating the effect of Interpretation No. 46, *Consolidation of Variable Interest Entities,* which will become effective for the Company in the third quarter of 2003, and believes it will have little impact, if any.

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Note 8. Supplemental Consolidating Condensed Financial Information

The Company s 100% owned subsidiary, American Standard Inc. (ASI) issued all of the Company s Senior Notes. American Standard Companies Inc. (the Parent Company) fully and unconditionally guarantees the payment obligations under these securities (the ASI Public Debt). In lieu of providing separate financial statements for ASI, included is the accompanying consolidating condensed financial information. Management believes that separate financial statements of ASI are not material to investors. The following supplemental financial information sets forth, on an unconsolidated basis, statements of income for the three months and six months ended June 30, 2003 and 2002, statements of cash flows for the six months ended June 30, 2003 and 2002 and balance sheets as of June 30, 2003 and December 31, 2002 for the Parent Company, ASI, and the subsidiaries of the Parent Company which are not subsidiaries of ASI (the Other Subsidiaries). None of the Other Subsidiaries guarantees the ASI Public Debt. The equity method of accounting is used to reflect investments of the Parent Company in ASI and Other Subsidiaries.

CONSOLIDATING CONDENSED STATEMENTS OF INCOME
FOR THE THREE MONTHS ENDED JUNE 30, 2003
(Unaudited)

(Dollars in millions)	Parent Company	ASI	Other Subsidiaries	Eliminations	Consolidated Total
Sales		$1,239.6	$1,137.8	$(112.4)	$2,265.0
Costs and expenses:					
Cost of sales		943.7	869.4	(112.4)	1,700.7
Selling and administrative expenses		179.1	156.0		335.1
Other (income) expense		(5.7)	10.8		5.1
Interest expense		27.0	3.1		30.1
Intercompany interest expense (income)		(2.6)	2.6		
Total expenses		1,141.5	1,041.9	(112.4)	2,071.0
Income before income taxes and equity in net income of consolidated subsidiaries		98.1	95.9		194.0
Income taxes		35.1	25.0		60.1
Income before equity in net income of consolidated subsidiaries		63.0	70.9		133.9
Equity in net income of consolidated subsidiaries	$133.9			(133.9)	
Net income	$133.9	$ 63.0	$ 70.9	$(133.9)	$ 133.9

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Note 8. Supplemental Consolidating Condensed Financial Information (continued)

CONSOLIDATING CONDENSED STATEMENTS OF INCOME
FOR THE SIX MONTHS ENDED JUNE 30, 2003
(Unaudited)

(Dollars in millions)	Parent Company	ASI	Other Subsidiaries	Eliminations	Consolidated Total
Sales		$2,274.3	$2,155.3	$(214.0)	$4,215.6
Costs and expenses:					
Cost of sales		1,749.1	1,651.4	(214.0)	3,186.5
Selling and administrative expenses		360.7	298.5		659.2
Other expense		(5.2)	28.3		23.1
Interest expense		54.6	5.7		60.3
Intercompany interest expense (income)		.5	(.5)		
Total expenses		2,159.7	1,983.4	(214.0)	3,929.1
Income before income taxes and equity in net income of consolidated subsidiaries		114.6	171.9		286.5
Income taxes		40.6	48.2		88.8
Income before equity in net income of consolidated subsidiaries		74.0	123.7		197.7
Equity in net income of consolidated subsidiaries	$197.7			(197.7)	
Net income	$197.7	$ 74.0	$ 123.7	$(197.7)	$ 197.7

CONSOLIDATING CONDENSED BALANCE SHEETS
AS OF JUNE 30, 2003
(Unaudited)

(Dollars in millions)	Parent Company	ASI	Other Subsidiaries	Eliminations	Consolidated Total
ASSETS					
Current assets:					
Cash and cash equivalents	$ 0.5	$ 20.0	$ 160.5		$ 181.0
Accounts receivable, net		533.2	622.5		1,155.7
Inventories		364.8	528.2		893.0
Other current assets		205.4	126.7		332.1
Total current assets	0.5	1,123.4	1,437.9		2,561.8
Facilities, net		572.3	882.8		1,455.1
Goodwill, net		132.9	926.6		1,059.5
Investment in subsidiaries	1,150.0			$(1,150.0)	
Other assets		651.2	55.4		706.6
Total assets	$1,150.5	$ 2,479.8	$3,302.7	$(1,150.0)	$5,783.0

LIABILITIES AND SHAREHOLDERS (DEFICIT) EQUITY					
Current liabilities:					
Loans payable to banks		$ 20.0	$ 45.5		$ 65.5
Current maturities of long-term debt		2.1	1.9		4.0
Other current liabilities		974.9	997.1		1,972.0
Total current liabilities		997.0	1,044.5		2,041.5
Long-term debt		1,812.5	100.1		1,912.6
Reserve for postretirement benefits		366.0	301.9		667.9
Intercompany accounts, net	$ 705.1	165.1	(870.2)		
Other long-term liabilities		405.6	310.1		715.6
Total liabilities	705.1	3,746.2	886.3	$	5,337.6
Total shareholders (deficit) equity	445.4	(1,266.4)	2,416.4	(1,150.0)	445.4
Total liabilities and shareholders equity	$1,150.5	$ 2,479.8	$3,302.7	$(1,150.0)	$5,783.0

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Note 8. Supplemental Consolidating Condensed Financial Information (continued)

CONSOLIDATING CONDENSED STATEMENTS OF CASH FLOW
FOR THE SIX MONTHS ENDED JUNE 30, 2003
(Unaudited)

(Dollars in millions)	Parent Company	ASI	Other Subsidiaries	Eliminations	Consolidated Total
Cash provided (used) by:					
Operating activities:					
Net income	$ 197.7	$ 74.0	$ 123.7	$ (197.7)	$ 197.7
Adjustments to reconcile net income to net cash provided (used) by operations:					
Depreciation and amortization		47.7	71.3		119.0
Equity in earnings of unconsolidated joint ventures, net of dividends received		(1.1)	(2.3)		(3.4)
Non-cash stock compensation		32.1			32.1
Equity in net income of subsidiaries	(197.7)			197.7	
Other		(7.2)	.3		(6.9)
Changes in assets and liabilities:					
Accounts receivable		(79.7)	(168.8)		(248.5)
Inventories		(10.9)	(76.3)		(87.2)
Accounts payable		113.1	35.1		148.2
Other accrued liabilities and taxes		21.4	133.8		155.2
Post-retirement benefits		20.2	.3		20.5
Other assets		(65.3)	(26.9)		(92.2)
Other long-term liabilities		5.7	4.5		10.2
Net cash provided by operating activities		150.0	94.7		244.7
Investing activities:					