

Chaparral Steel CO  
Form 10-Q  
April 13, 2006  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**FORM 10-Q**

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(Mark One)

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

For the quarterly period ended February 28, 2006

**.. 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

000-51307

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**CHAPARRAL STEEL COMPANY**

(Exact Name of Registrant as Specified in its Charter)

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Delaware  
(State or other jurisdiction of

incorporation or organization)

20-2373478  
(I.R.S. Employer

Identification Number)

300 Ward Road

Midlothian, Texas 76065

# Edgar Filing: Chaparral Steel CO - Form 10-Q

(Address of Principal Executive Offices and Zip Code)

(972) 775-8241

(Registrant's Telephone Number, Including Area Code)

Not Applicable

(Former name, former address and former fiscal year, if changed since last report)

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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 Exchange Act). Yes ☐ No ☒

There were 23,023,804 shares of common stock, \$0.01 par value per share, outstanding on April 10, 2006.

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**FORWARD-LOOKING STATEMENTS**

This Quarterly Report contains forward-looking statements. All statements other than statements of historical fact are forward-looking statements. Forward-looking statements may include the words may, will, estimate, intend, continue, believe, expect, plan, or other similar words. Such forward-looking statements may be contained in the Management's Discussion and Analysis of Financial Condition and Results of Operations, among other places. Forward-looking statements include statements concerning:

future results of operations;

future cash flows and liquidity;

future capital expenditures;

competitive pressures and general economic and financial conditions;

levels of construction activity;

levels of import activity;

inclement weather;

the occurrence of unanticipated equipment failures and plant outages;

cost and availability of raw materials, fuel and energy;

environmental conditions and regulations; and

any assumptions underlying any of the foregoing.

Although we believe the expectations reflected in our forward-looking statements are reasonable, actual results could differ materially from those projected or assumed in our forward-looking statements. Our future financial condition and results of operations, as well as any forward-looking statements, are subject to change and are subject to inherent risks and uncertainties, such as those disclosed in this Quarterly Report.

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CHAPARRAL STEEL COMPANY AND SUBSIDIARIES

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**PART I. FINANCIAL INFORMATION**

**ITEM 1. FINANCIAL STATEMENTS**

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Stockholders

Chaparral Steel Company

We have reviewed the accompanying consolidated balance sheet of Chaparral Steel Company and subsidiaries as of February 28, 2006, and the related consolidated statements of operations for the three and nine-month periods ended February 28, 2006 and 2005, the related consolidated statements of cash flows for the nine-month periods ended February 28, 2006 and 2005, and the related statement of stockholders' equity for the nine-month period ended February 28, 2006. These financial statements are the responsibility of the Company's management.

We conducted our review in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the consolidated interim financial statements referred to above for them to be in conformity with U.S. generally accepted accounting principles.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of Chaparral Steel Company and subsidiaries as of May 31, 2005, and the related consolidated statements of operations, stockholders' equity, and cash flows for the year then ended (not presented herein), and in our report dated August 10, 2005, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying consolidated balance sheet as of May 31, 2005, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/ Ernst & Young LLP

Dallas, Texas

April 10, 2006

**Table of Contents****CHAPARRAL STEEL COMPANY AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS****(In thousands, except share data)****(Unaudited)**

	<b>February 28, 2006</b>	<b>May 31, 2005</b>
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 46,061	\$ 9,287
Short-term investments	106,215	
Accounts receivable net	144,871	127,383
Inventories	179,628	246,223
Receivable from Texas Industries, Inc.		40,734
Prepaid expenses	13,248	11,097
<b>Total current assets</b>	<b>490,023</b>	<b>434,724</b>
Other assets:		
Goodwill	85,166	85,166
Investments and deferred charges	16,707	5,099
	<b>101,873</b>	<b>90,265</b>
Property, plant and equipment:		
Land and land improvements	95,656	93,937
Buildings	55,208	54,954
Machinery and equipment	1,029,655	1,025,475
Construction in process	33,605	28,074
	<b>1,214,124</b>	<b>1,202,440</b>
Less depreciation	611,298	575,187
	<b>602,826</b>	<b>627,253</b>
	<b>\$ 1,194,722</b>	<b>\$ 1,152,242</b>
<b>Liabilities and Stockholders Equity</b>		
Current liabilities:		
Trade accounts payable	\$ 76,949	\$ 88,980
Accrued wages, taxes and other liabilities	55,732	20,933
<b>Total current liabilities</b>	<b>132,681</b>	<b>109,913</b>
Deferred income taxes and other credits	151,062	147,563
Long-term debt	300,000	
Long-term payable to Texas Industries, Inc.		543,246
Stockholders equity:		

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Preferred stock, \$0.01 par value, 10,000,000 shares authorized, none issued

Common stock, \$0.01 par value, 100,000,000 shares authorized, 22,963,334 and 22,803,867 shares issued and outstanding, respectively

	230	228
Additional paid-in capital	706,416	206,818
Retained earnings (deficit)	(95,667)	144,474

Total stockholders' equity	610,979	351,520
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	\$ 1,194,722	\$ 1,152,242
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See notes to consolidated financial statements.



**Table of Contents****CHAPARRAL STEEL COMPANY AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF OPERATIONS****(In thousands, except per share data)****(Unaudited)**

	<b>Three months ended February 28,</b>		<b>Nine months ended February 28,</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
Net sales	\$ 374,649	\$ 259,119	\$ 1,061,184	\$ 799,019
Costs and expenses (income)				
Cost of products sold	279,250	219,811	859,691	647,976
Selling, general and administrative	17,714	7,103	34,637	21,159
Interest	7,890	12,197	24,036	36,101
Other income, net	(4,367)	(1,922)	(9,760)	(3,751)
	300,487	237,189	908,604	701,485
Income before income taxes	74,162	21,930	152,580	97,534
Income taxes	24,918	7,683	51,582	34,151
Net income	\$ 49,244	\$ 14,247	\$ 100,998	\$ 63,383
Earnings per share:				
Basic	\$ 2.15	\$ 0.62	\$ 4.42	\$ 2.78
Diluted	\$ 2.06	\$ 0.62	\$ 4.29	\$ 2.78
Average shares outstanding:				
Basic	22,875	22,804	22,828	22,804
Diluted	23,868	22,804	23,520	22,804

See notes to consolidated financial statements.

**Table of Contents****CHAPARRAL STEEL COMPANY AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS****(In thousands)****(Unaudited)**

	<b>Nine months ended</b>	
	<b>February 28,</b>	
	<b>2006</b>	<b>2005</b>
Operating activities:		
Net income	\$ 100,998	\$ 63,383
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation	37,212	36,404
Deferred income taxes	260	25,419
Other net	3,591	3,310
Changes in operating assets and liabilities		
Accounts receivable-net	(17,487)	(14,374)
Inventories	66,595	(67,127)
Prepaid expenses	(966)	(6,983)
Accounts payable	(12,030)	(2,753)
Accrued wages, taxes and other liabilities	36,186	(778)
Other credits	972	435
Receivable from or payable to Texas Industries, Inc.	(10,286)	(26,277)
Net cash provided by operating activities	205,045	10,659
Investing activities:		
Capital expenditures	(11,937)	(14,313)
Purchases of short-term investments	(1,426,735)	
Sales of short-term investments	1,320,520	
Other net	(570)	(396)
Net cash used by investing activities	(118,722)	(14,709)
Financing activities:		
Long-term borrowings	350,000	
Debt retirements	(50,000)	
Debt issuance costs	(9,500)	
Dividend paid to Texas Industries, Inc.	(341,139)	
Issuance of common stock	1,090	1
Net cash used by financing activities	(49,549)	1
Increase (decrease) in cash and cash equivalents	36,774	(4,049)
Cash and cash equivalents at beginning of period	9,287	8,575
Cash and cash equivalents at end of period	\$ 46,061	\$ 4,526

See notes to consolidated financial statements.



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**CHAPARRAL STEEL COMPANY AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY**

(In thousands)

(Unaudited)

			Additional	Retained	Total
	Preferred	Common	Paid-in	Earnings	Stockholders
	Stock	Stock	Capital	(Deficit)	Equity
May 31, 2005	\$	\$ 228	\$ 206,818	\$ 144,474	\$ 351,520
Net income				100,998	100,998
Contribution by Texas Industries, Inc.			496,021		496,021
Dividend to Texas Industries, Inc.				(341,139)	(341,139)
Restricted stock amortization			140		140
Issuance of common stock		2	1,100		1,102
Tax benefit from exercise of stock options			2,337		2,337
February 28, 2006	\$	\$ 230	\$ 706,416	\$ (95,667)	\$ 610,979

See notes to consolidated financial statements.

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**CHAPARRAL STEEL COMPANY AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**1. Description of Business and Basis of Presentation**

Chaparral Steel Company and its subsidiaries (the Company) is a leading supplier of structural steel and steel bar products through a single business segment. The Company produces and sells structural steel, piling products, special bar quality products, merchant bar quality rounds, reinforcing bar and channels from facilities located in Texas and Virginia. Structural steel products include wide flange beams, channels, piling products and other shapes. Steel bar products include specialty bar products and, to a lesser extent, reinforcing bar. The Company sells to steel service centers and steel fabricators for use in the construction industry, as well as to cold finishers, forgers and original equipment manufacturers for use in the railroad, defense, automotive, manufactured housing and energy industries. The Company's products are marketed throughout the United States, Canada and Mexico, and to a limited extent in Europe. All of the Company's long-lived assets are located in the United States.

On December 14, 2004, the board of directors of Texas Industries Inc. (TXI) adopted a plan to spin-off its steel operations, which was completed on July 29, 2005. In anticipation of the spin-off, the Company and TXI entered into the following transactions:

On February 22, 2005, TXI formed a new, wholly-owned subsidiary, Chaparral Steel Company, to serve as the holding company for its steel business. The Company was initially capitalized for \$1,000 and issued 1,000 shares of its common stock, at \$0.01 par value per share, to TXI. On June 7, 2005, the Company's authorized capital stock was increased to 10,000,000 shares of preferred stock, \$0.01 par value per share, and 100,000,000 shares of common stock, \$0.01 par value per share.

On June 25, 2005, TXI transferred to the Company all of the stock of its subsidiaries that were engaged in its steel business, consisting of Chaparral Steel Investments Inc. and its subsidiaries and Chaparral (Virginia) Inc. In addition, the Company issued 22,802,867 additional shares of the Company's common stock to TXI. These transactions have been accounted for as a reorganization of entities under common control. As a result, the assets and liabilities transferred to the Company were recorded at historical cost. In connection with these transactions, on July 6, 2005, TXI also contributed or transferred real estate and transportation assets used in the steel business to the Company. The Company assumed all liabilities arising out of the steel business and the transferred assets.

On July 29, 2005, the Company became an independent, public company. TXI has no further ownership interest in the Company, and the Company has no ownership interest in TXI. In addition, the Company is not a guarantor of any of TXI's indebtedness nor is TXI a guarantor of any of the Company's indebtedness. However, pursuant to our separation and distribution agreement with TXI and certain ancillary agreements, TXI has agreed to indemnify us against certain liabilities and we have agreed to indemnify TXI against certain liabilities. The Company's relationship with TXI is now governed by a separation and distribution agreement and the ancillary agreements described in that agreement. The terms of those agreements are more fully described in note 9 Legal Proceedings and Contingent Liabilities.

For all periods prior to the spin-off, the Company's costs include the allocation of certain corporate expenses from TXI. TXI's corporate expenses have been allocated to the Company based on either the percentage of time employees incurred performing services for the Company or specifically identified costs incurred by TXI for the Company. Management believes that the allocations were made on a reasonable basis. However, the consolidated financial statements may not necessarily reflect the financial position, results of operations and cash flows of the Company in the future, nor is it practical for management to estimate what the financial position, results of operations or cash flows would have been if the Company had been an independent public company for the historical periods presented. See note 12 for additional information.

The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and the instructions to Form 10-Q and Rule 10-01 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 of only normal recurring adjustments) considered necessary for a fair statement of the results

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for the interim periods presented have been included. Operating results for the nine-month period ended February 28, 2006, are not necessarily indicative of the results that may be expected for the year ending May 31, 2006. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company's Annual Report on Form 10-K for the year ended May 31, 2005.

## **2. Summary of Significant Accounting Policies**

*Principles of Consolidation.* The consolidated financial statements include the accounts of Chaparral Steel Company and all subsidiaries.

*Estimates.* The preparation of financial statements and accompanying notes in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported. Actual results could differ from those estimates.

*Fair Value of Financial Instruments.* The estimated fair value of each class of financial instruments as of February 28, 2006 approximates its carrying value except for the Senior Notes having a fixed interest rate. The fair value of the Senior Notes at February 28, 2006, estimated based on over-the-counter quoted prices, was \$331.5 million compared to the carrying amount of \$300.0 million.

*Cash and Cash Equivalents.* Investments with maturities of less than 90 days when purchased are classified as cash equivalents and consist primarily of money market funds and investment grade commercial paper issued by major corporations and financial institutions.

*Short-term investments.* Short-term investments consist of Auction Rate Securities (ARS). At February 28, 2006, these ARS have remaining stated maturities which range from 14 to 34 years, but have their interest rates reset at predetermined intervals, typically less than 30 days, through an auction process. We invest in high credit quality instruments with an active resale market to ensure liquidity and the ability to readily convert these investments into cash to fund current operations or satisfy other cash requirements as needed. Accordingly, we have classified all these securities as available-for-sale and as current assets in the accompanying balance sheet as of February 28, 2006. The ARS are stated at cost which approximates fair value based on market quotes. Net unrealized gains and losses, net of deferred taxes, have not been significant. We expect that the majority of our short-term investments will be sold within one year, regardless of legal maturity date. Purchases and sales activity of ARS are presented as cash flows from investing activities in the consolidated statements of cash flows.

*Receivables.* Management evaluates the ability to collect accounts receivable based on a combination of factors. A reserve for doubtful accounts is maintained based on historical default rates and current economic trends. The reserve is increased if it is anticipated that a specific customer will be unable to make required payments.

*Environmental Liabilities.* The Company is subject to environmental laws and regulations established by federal, state and local authorities and makes provision for the estimated costs related to compliance when it is probable that a reasonably estimable liability has been incurred.

*Legal Contingencies.* The Company and its subsidiaries are defendants in lawsuits which arose in the normal course of business, and make provision for the estimated loss from any claim or legal proceeding when it is probable that a reasonably estimable liability has been incurred.

*Long-lived Assets.* Management reviews long-lived assets for impairment whenever changes in circumstances indicate that the carrying amount of the assets may not be recoverable and records an impairment charge if necessary. Such evaluations compare the carrying amount of an asset to future undiscounted net cash flows expected to be generated by the asset and are significantly impacted by estimates of future prices for the Company's products, capital needs, economic trends and other factors. All of the Company's long-lived assets are located in the United States.

Property, plant and equipment are recorded at cost. Provisions for depreciation are computed generally using the straight-line method. The Company assigns each fixed asset a useful life generally ranging from 5 to 7 years for mobile and other equipment, 10 to 20 years for machinery and equipment and 20 to 40 years for buildings and land improvements. Maintenance and repairs are charged to expense as incurred. Costs incurred for scheduled

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shut-downs to refurbish the facilities are amortized over the benefited period, typically 12 months. Such deferred amounts are included in prepaid expenses on the consolidated balance sheets and amounted to \$6.2 million at February 28, 2006 and \$7.9 million at May 31, 2005.

*Goodwill.* Management tests goodwill for impairment at least annually. If the carrying amount of the goodwill exceeds its fair value, an impairment loss is recognized. In applying a fair-value-based test, estimates are made of the expected future cash flows to be derived from the applicable reporting unit. Similar to the review for impairment of other long-lived assets, the resulting fair value determination is significantly impacted by estimates of future prices for the Company's products, capital needs, economic trends and other factors. At May 31, 2005 the fair value of the Company's goodwill on the balance sheet exceeded its carrying value of \$85.2 million.

*Investments and Deferred Charges.* Investments are composed primarily of life insurance contracts that may be used to fund certain Company benefit agreements. The contracts, recorded at their net cash surrender value, totaled \$7.9 million at February 28, 2006 and \$5.1 million at May 31, 2005. Deferred charges are composed primarily of debt issuance costs that totaled \$8.8 million at February 28, 2006. The costs are associated with various debt issues and amortized over the term of the related debt.

*Other Credits.* Other credits of \$8.8 million at February 28, 2006 and \$7.4 million at May 31, 2005 are composed primarily of liabilities related to the Company's retirement plans, asset retirement obligations and deferred compensation agreements.

*Asset Retirement Obligations.* Effective June 1, 2003, the Company adopted Statement of Financial Accounting Standards (SFAS) No. 143, Accounting for Asset Retirement Obligations, which applies to legal obligations associated with the retirement of long-lived assets.

SFAS No. 143 requires that the fair value of a liability for an asset retirement obligation be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. The fair value of the liability is added to the carrying amount of the associated asset and this additional carrying amount is depreciated over the life of the asset. The liability is accreted at the end of each period through a charge to operating expense. If the obligation is settled for other than the carrying amount of the liability, the Company will recognize a gain or loss on settlement.

The Company incurs legal obligations for asset retirement as part of its normal operations related to the Resource Conservation and Recovery Act closures. Prior to the adoption of SFAS No. 143, the Company generally accrued for land reclamation obligations as incurred. Determining the amount of any asset retirement liability requires estimating the future cost of contracting with third parties to perform the obligation. The estimate is significantly impacted by, among other considerations, management's assumptions regarding the scope of the work required, labor costs, inflation rates, market-risk premiums and closure dates.

Changes in asset retirement obligations for the nine-month periods ended February 28, 2006 and February 28, 2005 are as follows (in thousands):

	Nine months ended	
	February 28, 2006	2005
Balance at beginning of period	\$ 566	\$ 537
Accretion expense	50	45
Settlements	(70)	(31)
Balance at end of period	\$ 546	\$ 551

*Net Sales.* The Company recognizes revenue when the goods are shipped and title and risk of loss transfer to the customer. The Company includes delivery fees in the amount it bills customers to the extent needed to recover the Company's cost of freight and delivery. Net sales from other products were generated from the Company's metals separation operation.

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The following table summarizes the Company's net sales by product line (in thousands):

	Three months ended February 28, 2006		Nine months ended February 28, 2005	
Net sales				
Structural mills	\$ 283,905	\$ 182,238	\$ 793,474	\$ 564,551
Bar mill	59,988	56,875	179,159	173,317
Other products	10,033	7,823	27,731	22,992
Delivery fees	20,723	12,183	60,820	38,159
	\$ 374,649	\$ 259,119	\$ 1,061,184	\$ 799,019

*Other Income.* Other income primarily includes miscellaneous sales and interest income.

*Income Taxes.* The Company uses the liability method of recognizing and classifying deferred income taxes. The Company and its subsidiaries will be included in the consolidated income tax returns of TXI for periods prior to the spin-off and will file stand alone returns for subsequent periods. However, the provision for income taxes for the periods presented has been determined as if the Company had filed separate tax returns. The Company provides valuation allowances to reduce deferred tax assets to amounts that will more likely than not be realized.

*Earnings Per Share ( EPS ).* Basic EPS is computed by dividing net income by the weighted-average number of common shares outstanding during the period. During the nine months ended February 28, 2006, the Company issued 129,467 shares of common stock as a result of the exercise of stock options and 30,000 shares of common stock as a result of non-employee director restricted stock awards. Diluted EPS adjusts net income and the outstanding shares for the dilutive effect of stock options and other equity-based awards.

In thousands except per share	Three months ended February 28, 2006		Nine months ended February 28, 2005	
<b>Earnings</b>				
Net income	\$ 49,244	\$ 14,247	\$ 100,998	\$ 63,383
<b>Shares</b>				
Weighted-average shares outstanding	22,875	22,804	22,828	22,804
Basic weighted-average shares	22,875	22,804	22,828	22,804
Dilutive stock option and other equity-based awards	993		692	
Diluted weighted-average shares	23,868	22,804	23,520	22,804
<b>Net income</b>				
Basic earnings per share	\$ 2.15	\$ 0.62	\$ 4.42	\$ 2.78
Diluted earnings per share	\$ 2.06	\$ 0.62	\$ 4.29	\$ 2.78

*Stock-based Compensation.* The Company's employees and non-employee directors participate in stock compensation plans. The plans provide for the granting of incentive and non-qualified stock options, restricted stock and other equity-based incentive awards for officers, key employees and non-employee directors.

The Company accounts for employee and non-employee director stock options using the intrinsic value method of accounting prescribed by APB Opinion ( APB ) No. 25, Accounting for Stock Issued to Employees, as allowed by SFAS No. 123, Accounting for Stock-Based Compensation. Generally, no expense is recognized related to the Company's stock options because each option's exercise price is set at the



stock's fair market value on the date the option is granted.

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In accordance with SFAS No. 123, the Company discloses the compensation cost based on the estimated fair value at the date of grant recognizing compensation expense ratably over the vesting period. The fair value of each option grant was estimated on the date of grant for purposes of the pro forma disclosures using the Black-Scholes option-pricing model and assumptions applicable to the underlying common stock. In the nine-months ended February 28, 2006, the weighted-average fair value of options granted to the Company's employees ranged from \$8.64 to \$15.92 based on weighted average assumptions for dividend yield of 0.0%, volatility factors ranging from .385 to .461, risk-free interest rates ranging from 4.0% to 4.5% and expected life in years of 6.5.

Therefore, had compensation expense for stock options held by the Company's employee participants been recognized based upon the fair value for awards granted, the Company's net income would have been reduced to the following pro forma amounts (in thousands except per share):

	Three months ended February 28,		Nine months ended February 28,	
	2006	2005	2006	2005
Net income				
As reported	\$ 49,244	\$ 14,247	\$ 100,998	\$ 63,383
Stock-based compensation included in the determination of net income as reported, net of tax	121	5	169	10
Fair value of stock-based compensation, net of tax	(298)	111	(953)	329
Pro forma	\$ 49,067	\$ 14,363	\$ 100,214	\$ 63,722
Net earnings per share-as reported:				
Basic	\$ 2.15	\$ 0.62	\$ 4.42	\$ 2.78
Diluted	2.06	0.62	4.29	2.78
Net earnings per share-pro forma:				
Basic	2.15	0.63	4.39	2.79
Diluted	2.06	0.63	4.26	2.79

In December 2004, the FASB issued SFAS No. 123R, *Share-Based Payment*. SFAS No. 123R is a revision of SFAS No. 123, *Accounting for Stock Based Compensation*, and supersedes APB No. 25. Among other items, SFAS No. 123R eliminates the use of APB No. 25 and the intrinsic value method of accounting, and requires companies to recognize the cost of employee and non-employee director services received in exchange for awards of equity instruments, based on the grant date fair value of those awards, in the financial statements. The current effective date of SFAS No. 123R is the first fiscal year beginning after June 15, 2005, which is the first quarter of the Company's fiscal year ending May 31, 2007. The Company currently expects to adopt SFAS No. 123R effective June 1, 2006 using the modified prospective method. Under the modified prospective method, compensation cost is recognized in the financial statements beginning with the effective date, based on the requirements of SFAS No. 123R for all share-based payments granted after that date, and based on the requirements of SFAS No. 123 for all unvested awards granted prior to the effective date of SFAS No. 123R. Financial information for periods prior to the date of adoption of SFAS No. 123R would not be restated. The Company currently utilizes a standard option pricing model (i.e., Black-Scholes) to measure the fair value of stock options granted to employees and non-employee directors. While SFAS No. 123R permits entities to continue to use such a model, the standard also permits the use of a lattice model. The Company has not yet determined which model it will use to measure the fair value of awards of equity instruments to employees upon the adoption of SFAS No. 123R.

The adoption of SFAS No. 123R will have a significant effect on the Company's future results of operations. However, it will not have an impact on the Company's consolidated financial position. The impact of SFAS No. 123R on the Company's results of operations cannot be predicted at this time, because it will depend on the number of equity awards granted in the future, as well as the model used to value the awards. However, had the Company adopted the requirements of SFAS No. 123R in prior periods, the impact would have approximated the amounts disclosed in the table above.

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SFAS No. 123R also requires that the benefits associated with the tax deductions in excess of recognized compensation cost be reported as a financing cash flow, rather than as an operating cash flow as required under current literature. This requirement will reduce net operating cash flows and increase net financing cash flows in periods after the effective date. These future amounts cannot be estimated, because they depend on, among other things, when employees and non-employee directors exercise stock options. However, the amount of operating cash flows recognized in prior periods for such excess tax deductions was not material.

*Recent Accounting Pronouncements.* In May 2005, the Financial Accounting Standards Board issued SFAS No. 154, Accounting Changes and Error Corrections, which is effective for the Company for reporting changes in accounting principles beginning June 1, 2006. SFAS No. 154 changes the reporting of a change in accounting principle to require retrospective application to prior periods financial statements, unless explicit transition provisions are provided for in new accounting pronouncements or existing pronouncements that are in the transition phase when SFAS No. 154 becomes effective.

### 3. Working Capital

Working capital totaled \$357.3 million at February 28, 2006 and \$324.8 million at May 31, 2005.

Short-term investments were \$106.2 million at February 28, 2006 and none at May 31, 2005 and consisted of Auction Rate Securities all of which had stated maturities of over 10 years but have their interest rates reset at predetermined intervals, typically less than 30 days, through an auction process.

Accounts receivable are presented net of allowances for doubtful receivables of \$3.4 million at February 28, 2006 and \$1.8 million at May 31, 2005. Provisions for bad debts charged to expense were \$1.6 million and \$0.7 million in the nine-month periods ended February 28, 2006 and 2005, respectively. Uncollectible amounts written off were none and \$0.3 million in the nine-month periods ended February 28, 2006 and 2005, respectively.

Inventories consist of (in thousands):

	February 28, 2006	May 31, 2005
Finished product	\$ 59,543	\$ 107,475
Work in process	17,460	22,021
Raw materials and supplies	102,625	116,727
	\$ 179,628	\$ 246,223

Inventories are stated at cost (not in excess of market) with approximately 54% of inventories using the last-in, first-out ( LIFO ) method. If the average cost method (which approximates current replacement cost) had been used, inventory values would have been higher by \$56.5 million at February 28, 2006 and \$63.1 million higher at May 31, 2005. During the nine months ended February 28, 2006, certain inventory quantities were reduced, which resulted in a liquidation of LIFO inventory layers carried at lower costs. The effect of the liquidation was to decrease cost of products sold by \$0.8 million contributing to an overall effect of LIFO in the current period that decreased cost of products sold by a total of \$6.5 million.

In December 2004, the FASB issued SFAS No. 151, Inventory Costs, an amendment of ARB No. 43, Chapter 4, which will become effective for the Company on June 1, 2006. This standard clarifies that abnormal amounts of idle facility expense, freight, handling costs and wasted material should be expensed as incurred and not included in overhead. In addition, this standard requires that the allocation of fixed production overhead costs to inventory be based on the normal capacity of the production facilities.

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Accrued wages, taxes and other liabilities consist of (in thousands):

	February 28, 2006	May 31, 2005
Employee wages and benefits	\$ 25,749	\$ 12,389
Current portion of deferred income taxes		572
Property taxes	1,363	3,156
Current income taxes payable	15,625	412
Interest payable	3,929	
Other liabilities	9,066	4,404
	\$ 55,732	\$ 20,933

**4. Commitments**

The Company entered into an agreement to purchase a minimum monthly amount of processed gases at a base price adjusted quarterly based upon a percentage change in the producer price index. The gases are produced from a facility located at the Company's Texas facility which is owned and operated by an independent third party. This agreement expires in August 2012. At February 28, 2006, the minimum monthly charge was approximately \$0.4 million.

The Company entered into a similar agreement to purchase processed gases for its Virginia facility with the same third party, which expires in December 2014. The agreement specifies that the Company will purchase a minimum monthly amount of processed gases at a base price adjusted quarterly based upon a similar formula. At February 28, 2006, the minimum monthly charge was approximately \$0.1 million. Management believes that the Company's minimum purchase requirements will be satisfied by its consumption of the products in the normal course of business.

The Company entered into an agreement to purchase a minimum monthly amount of mill services at its Texas facility. This agreement expires in December 2014. At February 28, 2006, the minimum monthly charge was approximately \$5,000. The Company entered into a similar agreement to purchase a minimum monthly amount of mill services for its Virginia facility. This agreement expires in June 2012. At February 28, 2006, the minimum monthly charge was approximately \$0.4 million. Management believes that the Company's minimum purchase requirements will be satisfied by its consumption of the products in the normal course of business.

The Company leases certain mobile and other equipment, real estate and other items, which in the normal course of business are renewed or replaced by subsequent leases. Total expense for such operating leases was \$1.3 million and \$1.6 million in the nine-month periods ended February 28, 2006 and 2005, respectively.

Future estimated payments under these agreements as of February 28, 2006 are as follows for the years ending February 28 as noted (in thousands):

	Total	2007	2008	2009	2010-2011	After 2011
Processed gas supply contract	\$ 39,766	\$ 5,813	\$ 5,813	\$ 5,813	\$ 11,626	\$ 10,701
In-plant mill services	28,355	4,453	4,453	4,453	8,906	6,090
Operating lease obligations	2,078	488	76	66	124	1,324
Total	\$ 70,199	\$ 10,754	\$ 10,342	\$ 10,332	\$ 20,656	\$ 18,115

**Table of Contents****5. Long-term Debt**

Long-term debt is comprised of the following (in thousands):

	February 28, 2006	May 31, 2005
Senior secured credit facility expiring in 2010	\$	\$
Senior notes due in 2013, interest rate 10.00%	300,000	
	300,000	
Less current maturities		
	\$ 300,000	\$

On June 16, 2005, the Company entered into a new senior secured revolving credit facility (the "Credit Facility") which provides up to \$150.0 million of available borrowings. The Credit Facility includes a \$25.0 million sub-limit for letters of credit of which \$1.6 million was outstanding at February 28, 2006. Any outstanding letters of credit are deducted from the borrowing availability under the Credit Facility. Amounts drawn under the Credit Facility bear interest either at the LIBOR rate plus a margin of 1.00% to 1.75%, or at a base rate (which will be the higher of the federal funds rate plus 0.5% and the prime rate) plus a margin of up to 1%. The interest rate margins are subject to adjustments based on the Company's leverage ratio. The commitment fee calculated on the unused portion of the Credit Facility ranges from 0.25% to 0.5% per year based on the Company's leverage ratio. The Credit Facility matures June 16, 2010 and may be terminated by the Company at any time. The Credit Facility is secured by security interests in all of the Company's existing and future accounts and inventory, certain related personal property and in all of the equity interest in the Company's present and future domestic subsidiaries and 66% of the equity interest in the Company's present and future foreign subsidiaries. The Credit Facility contains covenants restricting, among other things, prepayment or redemption of the Company's other debt, distributions, dividends, and repurchases of capital stock and other equity interests, acquisitions and investments, indebtedness, liens and affiliate transactions. The Company is required to comply with certain financial tests and to maintain certain financial ratios, such as leverage and interest coverage ratios. On July 6, 2005, the Company borrowed \$50.0 million under the Credit Facility, none of which was outstanding at August 31, 2005. The Company did not borrow any funds under the Credit Facility during the six months ended February 28, 2006; however, \$1.6 million of the facility was utilized to support letters of credit. The amount borrowed under the Credit Facility will fluctuate based upon the Company's cash flow and working capital needs.

In addition, on July 6, 2005, the Company issued \$300.0 million aggregate principal amount of 10% senior notes due July 15, 2013 (the "Senior Notes"). The Senior Notes are unsecured and will effectively be subordinated in right of payment to all of the Company's existing and future senior secured debt, including borrowings under the Company's Credit Facility. The indenture governing the Senior Notes contains covenants limiting the Company's ability and the ability of the Company's subsidiaries to, among other things, incur additional indebtedness, pay dividends or make other distributions or repurchase or redeem stock, make investments, sell assets, incur liens, enter into agreements restricting the Company's subsidiaries' ability to pay dividends, enter into transactions with affiliates and consolidate, merge or sell all or substantially all of the Company's assets or the assets of its subsidiaries. As of February 28, 2006, the Company was in compliance with all loan covenants.

The Company used the net proceeds from the Credit Facility and Senior Notes to pay a cash dividend of \$341.1 million to TXI on July 6, 2005.

In connection with the issuance of the Senior Notes, the Company entered into a registration rights agreement with the initial purchasers of the Senior Notes. The registration rights agreement provides the holders of the Senior Notes certain rights relating to the registration of the Senior Notes under the Securities Act of 1933, as amended. Pursuant to the registration rights agreement, the Company agreed to conduct a registered exchange offer for the Senior Notes or cause to become effective a shelf registration statement providing for the resale of the Senior Notes. On December 2, 2005, the Company completed the offer to exchange our 10% senior notes due 2013, which are registered under the Securities Act of 1933, as amended, for the outstanding 10% Senior Notes due 2013 that were issued in a private offering on July 6, 2005. The terms of the registered notes are substantially identical to the Company's previously outstanding Senior Notes.

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The amount of interest paid was \$19.2 million and \$36.1 million in the nine-month periods ended February 28, 2006 and 2005, respectively. No interest was capitalized in either of the nine-month periods ended February 28, 2006 and 2005.

### **6. Stockholders Rights Plan**

On July 21, 2005, the Company adopted a stockholders rights plan (the "Rights Agreement"). Pursuant to the Rights Agreement, the Company declared a dividend of rights (the "Rights") to purchase, upon the occurrence of certain events, one one-thousandth of a share of the Series A Junior Participating Preferred Stock, par value \$0.01 per share ("Preferred Stock"), for each outstanding share of common stock of the Company. Until the Rights become exercisable, all further issuances of common stock, including common stock issuable upon exercise of outstanding options, will include issuances of Rights. The Rights will be exercisable at \$90.00 per one one-thousandth of a share of Preferred Stock. The Rights will expire on July 29, 2015 unless extended or unless the Rights are earlier redeemed or exchanged by the Company.

The Rights are not exercisable nor are they transferable apart from the common stock of the Company until the earlier of (a) the tenth day after such time as a person or group acquires beneficial ownership of 15% of the common stock of the Company or (b) the tenth business day (unless extended by the Board of Directors) after a person or group announces its intention to commence or commences a tender or exchange offer the consummation of which would result in beneficial ownership by a person or group of 15% or more of the common stock. The earlier of these dates is referred to as the "Distribution Date". As soon as practicable after the Distribution Date, separate right certificates will be issued and the Rights will become exercisable and transferable apart from the common stock of the Company.

The Preferred Stock issuable upon exercise of the Rights will be non-redeemable and rank junior to any other series of the Company's preferred stock that is outstanding. Each whole share of Preferred Stock will be entitled to receive a quarterly preferential dividend of \$1.00 per share but will be entitled to receive, in the aggregate, a dividend of 1,000 times the dividend declared on the common stock. In the event of liquidation, the holders of the Preferred Stock will be entitled to receive a preferential liquidation payment equal to the greater of \$1,000 per share, plus accrued and unpaid dividends, or, in the aggregate, a liquidation payment equal to 1,000 times the payment made per share of the Company's common stock. Each share of Preferred Stock will have 1,000 votes, voting together with the common stock. Finally, in the event of any merger, consolidation or other transaction in which shares of common stock are exchanged for or changed into other stock or securities, cash and/or other property, each share of Preferred Stock would be entitled to receive 1,000 times the amount received per share of common stock.

### **7. Stock Compensation Plans**

Prior to the spin-off, certain of the Company's employees participated in TXI stock option plans which provided that non-qualified and incentive stock options to purchase TXI's common stock could be granted to officers and key employees at an exercise price no less than market price on the date of grant. Outstanding options became exercisable in installments beginning one year after date of grant and expire ten years from the date of grant.

TXI options that were vested at the distribution date of July 29, 2005 and held by individuals who became or were retained as employees of the Company in connection with the spin-off were cancelled and replaced with the new TXI stock options. The exercise price of each new TXI option was based upon the respective market values of the two companies at the time the spin-off was completed so that the aggregate exercise price of the new options, as well as the ratio of the per-share fair market value of the shares to the per-share exercise price of the new TXI options, were the same as the cancelled TXI options. All other terms of the new TXI options remained the same as the cancelled TXI options.

On July 21, 2005, the Board of Directors and on July 22, 2005, TXI as the sole stockholder of the Company approved the Company's Amended and Restated 2005 Omnibus Equity Compensation Plan which provides for grants of stock-based awards, including non-qualified and incentive stock options, restricted stock, restricted stock units, performance shares, and performance units to non-employee directors, officers and key employees of the Company. A maximum of 4,000,000 shares of the Company's common stock is available for issuance to participants under this plan.

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TXI options that were unvested at the date of distribution and held by individuals who became or were retained as employees of the Company in connection with the spin-off were cancelled and replaced with options to purchase shares of the Company's common stock. The exercise price of each new option issued by the Company was based upon the respective market values of the two companies at the time the spin-off was completed so that the aggregate exercise price of the new options, as well as the ratio of the per-share fair market value of the shares to the per-share exercise price of the new options, remained the same as the cancelled TXI options. All other terms of the new Company options, were the same as the cancelled TXI options. On January 13, 2006, certain options originally issued pursuant to TXI's 1993 Stock Option Plan were amended to conform the change of control provisions in such options with the terms of other options issued by the Company. Following the adjustment, there were 1,181,212 options outstanding to purchase shares of the Company's common stock at a weighted-average option price of \$8.39 per share.

During the nine months ended February 28, 2006, officers and key employees were awarded options to purchase 613,713 shares of common stock. The options were granted at the market price of the common stock on the respective dates of grant, which ranged from \$18.40 to \$30.36. The term of the options is ten years and the options vest in equal annual installments over five years.

A summary of TXI and Company option transactions related to the Company's employees and non-employee directors for the nine-month period ended February 28, 2006, follows:

	Shares Under Option	Weighted- Average Option Price
TXI options outstanding at May 31, 2005	393,720	\$ 33.43
Exercised	(31,000)	29.95
Cancelled	(67,500)	34.42
Unvested TXI options outstanding at July 29, 2005	295,220	33.57
Adjustment in connection with the spin-off from TXI	885,992	
Company options converted from TXI outstanding at July 29, 2005	1,181,212	8.39
Exercised	(129,467)	8.51
Cancelled	(5,400)	10.87
Stock appreciation right converted	16,006	6.61
Granted	613,713	20.16
Company options outstanding at February 28, 2006	1,676,064	\$ 12.67

Company options totaling 170,117 were exercisable as of February 28, 2006. Outstanding options expire on various dates through January 12, 2016.

In addition, on January 12, 2006, the Board of Directors granted 30,000 shares of restricted stock to the non-employee directors pursuant to the Company's Amended and Restated 2005 Omnibus Equity Compensation Plan. These awards are consistent with the compensation package for non-employee directors previously approved on July 21, 2005. The Company recorded compensation expense of \$0.1 million related to these grants in the three and nine month periods ended February 28, 2006.

Vesting is contingent upon the restricted stockholder remaining a director of the Company until the specified annual meeting of stockholders. Any shares of restricted stock awarded to a director which have not vested will be forfeited on the resignation or removal of the director.

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### **8. Income Taxes**

Federal income taxes for the interim periods ended February 28, 2006 and February 28, 2005, have been included in the accompanying financial statements on the basis of an estimated annual rate. On October 22, 2004, a new tax law, the American Jobs Creation Act of 2004 (the "Jobs Creation Act"), became effective. Among other provisions, the Jobs Creation Act allows a deduction for income from qualified domestic production activities, which will be phased in from 2005 through 2010. The Company anticipates realizing benefit from this deduction in the current fiscal year which resulted in an estimated annualized effective tax rate of 33.6% and 33.8% for the three and nine month periods ended February 28, 2006 compared to 35.0% for the comparable periods in the prior year. The Company made federal income tax payments of \$36.1 million and \$6.4 million in the nine-month periods ended February 28, 2006 and 2005, respectively.

As of May 31, 2005, the Company has \$751.5 million in Virginia state net operating loss carryforwards that begin to expire in 2019. The Company also has Virginia state credits to offset future income tax liabilities of \$41.9 million that begin to expire in 2018 and \$10 million of credits that do not expire. The Company had a net state deferred tax asset of \$51.9 million at May 31, 2005. Management believes it is more likely than not that this net state deferred tax asset will be unrealized. Therefore, a valuation allowance has been recorded to fully reserve the amount of the net state deferred tax assets.

### **9. Legal Proceedings and Contingent Liabilities**

The Company is subject to federal, state and local environmental laws and regulations concerning, among other matters, air emissions, furnace dust disposal and wastewater discharge. The Company believes it is in substantial compliance with applicable environmental laws and regulations; however, from time to time the Company receives claims from federal and state environmental regulatory agencies and entities asserting that the Company is or may be in violation of certain environmental laws and regulations. Based on its experience in dealing with such claims in the past and the information currently available to it regarding any potential or outstanding claims, the Company believes that such claims will not have a material impact on its consolidated financial condition or results of operations. Despite the Company's compliance and experience, it is possible that the Company could be held liable for future charges, which might be material but are not currently known or estimable. In addition, changes in federal and state laws, regulations and requirements or discovery of currently unknown conditions could require additional expenditures by the Company.

The Company and its subsidiaries are defendants in lawsuits which arose in the normal course of business. In management's judgment the ultimate liability, if any, from such legal proceedings will not have a material effect on the consolidated financial position or results of operations of the Company.

In connection with the Company's spin-off from TXI, the Company entered into a separation and distribution agreement and a tax sharing and indemnification agreement with TXI. In these agreements, the Company has agreed to indemnify TXI and its related parties against, among other things, any liabilities arising out of the businesses, assets or liabilities transferred to the Company and any taxes imposed on TXI in connection with the spin-off that result from the Company's breach of its covenants in the tax sharing and indemnification agreement. TXI has agreed to indemnify the Company and its related parties against, among other things, any liabilities arising out of the businesses, assets or liabilities retained by TXI and any taxes imposed on the Company in connection with the spin-off that result from TXI's breach of its covenants in the tax sharing and indemnification agreement.

The Company and TXI have made certain covenants to each other in connection with the spin-off that prohibit the Company and TXI from taking certain actions. Pursuant to these covenants: (1) neither the Company nor TXI will liquidate, merge, or consolidate with any other person, sell, exchange, distribute or otherwise dispose of their respective assets (or those of certain of their respective subsidiaries) except in the ordinary course of business, or enter into any substantial negotiations, agreements, or arrangements with respect to any such transaction, during the six months following July 29, 2005; (2) the Company and TXI will, for a minimum of two years after the distribution date, continue the active conduct of the steel or cement business, respectively; (3) neither the Company nor TXI will repurchase its stock for two years following the distribution date of the spin-off except in certain circumstances permitted by the IRS; (4) neither the Company nor TXI will take any actions inconsistent with the representations made in the separation and distribution agreement or in connection with the issuance by tax counsel of its legal opinion with respect to the spin-off; and (5) neither the Company nor TXI will take any other action that



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would result in or fail to take any action necessary to prevent any tax being imposed on the spin-off. Each of the Company and TXI may take actions inconsistent with these covenants if it obtains an unqualified opinion of counsel or a private letter ruling from the IRS that such actions will not cause the spin-off to become taxable, except that the Company may not, under any circumstances, take any action described in (1) above.

**10. Retirement Plans**

The Company's employees participate in a defined contribution retirement plan. Prior to January 1, 2006, the Company contributed 2% of each employee's eligible compensation and a variable contribution based on a predetermined formula established annually. After December 31, 2005, the Company will contribute 100% of eligible contributions of up to 3% of employee compensation, and 50% of eligible contributions of the next 2% of employee compensation as defined by the plan. The amount of retirement expense charged to costs and expenses for this plan was \$2.3 million and \$1.9 million in the nine-month periods ended February 28, 2006 and 2005, respectively. It is the Company's policy to fund the plan to the extent of charges to income.

On July 21, 2005, the Board of Directors approved the Chaparral Steel Company financial security plan ( FSP ) a non-qualified defined benefit plan providing death and retirement benefits to the Company's executive and key managerial employees who are invited and elect to participate. The plan is contributory but not funded. Costs and associated assets and liabilities related to the Company's employee participation are included in the financial information contained herein. Amounts payable to participants are to be paid exclusively from the general assets of the Company and are otherwise unsecured.

Life insurance contracts have been purchased that may be used to fund the FSP payments. These insurance contracts, recorded at their net cash surrender value, totaled \$7.9 million at February 28, 2006 and \$5.1 million at May 31, 2005, and are included in investments on the consolidated balance sheets. The amount of FSP benefit expense and the projected FSP benefit obligation are determined using assumptions as of the end of each fiscal year. The weighted-average discount rate used was 6% in the current period. Actuarial gains or losses are recognized when incurred, and therefore, the end of year benefit obligation is the same as the accrued benefit costs recognized in the balance sheet.

As of February 28, 2006, the estimated future benefit payments for each of the five succeeding years are \$0.2 million, \$0.3 million, \$0.4 million, \$0.7 million and \$0.9 million and for the five-year period thereafter an aggregate of \$5.0 million.

The amount of FSP benefit expense was as follows (in thousands):

	<b>Nine months ended February 28,</b>	
	<b>2006</b>	<b>2005</b>
Service cost	\$ 667	\$ 470
Interest cost	331	365
Amortization of transition cost	12	13
Participant contributions	(193)	(159)
	<b>\$ 817</b>	<b>\$ 689</b>

**11. Incentive Plans**

All personnel employed by the Company as of May 31 and not subject to production-based incentive awards share in the pretax income of the Company for the year then ended based on predetermined formulas. The duration of the plan is one year. Certain executives are additionally covered under three-year plans with respect to the fiscal years ending May 31, 2006, 2007 and 2008. New plans will be subject to annual approval by the Company's Board of Directors. Incentive compensation related to these plans is included in selling, general and administrative expense and was \$11.2 million and \$3.4 million in the nine-month periods ended February 28, 2006 and 2005, respectively.

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**12. Transactions with TXI and Affiliates**

Prior to the spin-off, TXI utilized a centralized cash management program for all of its subsidiaries, through which the Company received payments from TXI as a result of cash received from product sales or made payments to TXI or its subsidiaries for purchases of materials or services or for costs incurred on its behalf, including raw material procurement, payroll and capital expenditures. The current receivable from TXI also contained transactions with TXI under an inter-company tax sharing policy. Prior to the spin-off, TXI through one of its subsidiaries provided the Company with common carrier services, transporting finished product to the Company's customers and backhauling materials and supplies for the Company. These costs have been included in cost of products sold in the consolidated statements of operations and were \$0.6 million and \$4.3 million in the nine-month periods ended February 28, 2006 and 2005, respectively. The Company believes that the rates charged to it for transportation services approximate the rates that would have been charged by third parties. Following the spin-off, the Company utilizes assets transferred to it by TXI to operate its own common carrier service. TXI also allocated certain corporate expenses related primarily to shared services and facilities. Management believes that the allocations were made on a reasonable basis.

The long-term payable to TXI consisted of advances made by TXI to the Company for the construction of facilities. During the periods presented, the Company received or paid interest on its balances with TXI and its subsidiaries at a rate of 8%. This rate does not necessarily represent the rate that the Company would have been able to obtain on loans from unaffiliated third parties.

**13. Condensed Consolidating Financial Information**

On July 6, 2005, Chaparral Steel Company (the "Parent Company") issued \$300.0 million principal amount of its 10% senior notes due July 15, 2013. All of the Parent Company's consolidated domestic subsidiaries have guaranteed the 10% senior notes. The guarantees are full and unconditional and are joint and several. There are no significant restrictions on the Parent Company's ability to obtain funds from any of the guarantor subsidiaries in the form of a dividend or loan. Additionally, there are no significant restrictions on a guarantor subsidiary's ability to obtain funds from the Parent Company or its direct or indirect subsidiaries. For periods prior to the quarter ended August 31, 2005, the Parent Company had no significant assets or operations independent of its investment in its subsidiaries.

The following condensed consolidating balance sheet as of February 28, 2006, and the condensed consolidating statement of operations for the three and nine months ended February 28, 2006 and statement of cash flows for the nine months then ended are provided for the Parent Company and all guarantor subsidiaries. The information has been presented as if the Parent Company accounted for its ownership of the guarantor subsidiaries using the equity method of accounting.

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<b>In thousands</b>	<b>Chaparral Steel Company</b>	<b>Guarantor Subsidiaries</b>	<b>Non-Guarantor Subsidiaries</b>	<b>Eliminating Entries</b>	<b>Consolidated</b>
<b><u>Condensed consolidating balance sheet as of February 28, 2006</u></b>					
Cash and cash equivalents	\$ 37,736	\$ 8,325	\$	\$	\$ 46,061
Short-term investments	106,215				106,215
Accounts receivable-net		144,871			144,871
Intercompany receivables		188,402		(188,402)	
Inventories		179,628			179,628
Prepaid expenses	517	12,731			13,248
Total current assets	144,468	533,957		(188,402)	490,023
Goodwill		85,166			85,166
Investments and deferred charges	16,707				16,707
Investments in subsidiaries	965,461			(965,461)	
Property, plant and equipment - net		602,826			602,826
Total assets	\$ 1,126,636	\$ 1,221,949	\$	\$ (1,153,863)	\$ 1,194,722
Trade accounts payable	\$ 60	\$ 76,889	\$	\$	\$ 76,949
Intercompany payables	188,402			(188,402)	
Accrued wages, taxes and other liabilities	19,343	36,389			55,732
Total current liabilities	207,805	113,278		(188,402)	132,681
Deferred income taxes and other credits	7,852	143,210			151,062
Long-term debt	300,000				300,000
Stockholders' equity	610,979	965,461		(965,461)	610,979
Total liabilities and stockholders' equity	\$ 1,126,636	\$ 1,221,949	\$	\$ (1,153,863)	\$ 1,194,722
<b><u>Condensed consolidating statement of operations for the three months ended February 28, 2006</u></b>					
Net sales	\$	\$ 374,649	\$	\$	\$ 374,649
Costs and expenses (income)					
Cost of products sold		279,250			279,250
Selling, general and administrative	404	17,310			17,714
Interest, net	7,890				7,890
Other income	(1,308)	(3,059)			(4,367)
	6,986	293,501			300,487
Income (loss) before income taxes	(6,986)	81,148			74,162
Income taxes (benefit)	(2,917)	27,835			24,918
	(4,069)	53,313			49,244
Equity in earnings (loss) of subsidiaries	53,313			(53,313)	
Net income (loss)	\$ 49,244	\$ 53,313	\$	\$ (53,313)	\$ 49,244

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In thousands	Chaparral Steel Company	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Eliminating Entries	Consolidated
<b>Condensed consolidating statement of operations for the nine months ended February 28, 2006</b>					
Net sales	\$	\$ 1,061,184	\$	\$	\$ 1,061,184
Costs and expenses (income)					
Cost of products sold		859,691			859,691
Selling, general and administrative	568	34,069			34,637
Interest, net	21,190	2,846			24,036
Other income	(1,896)	(7,864)			(9,760)
	19,862	888,742			908,604
Income (loss) before income taxes	(19,862)	172,442			152,580
Income taxes (benefit)	(7,423)	59,005			51,582
	(12,439)	113,437			100,998
Equity in earnings (loss) of subsidiaries	113,437			(113,437)	
Net income (loss)	\$ 100,998	\$ 113,437	\$	\$ (113,437)	\$ 100,998

**Condensed consolidating statement of cash flows for the nine months ended February 28, 2006**

Net cash provided by operating activities	\$ 5,465	\$ 199,580	\$	\$	\$ 205,045
Investing activities					
Capital expenditures		(11,937)			(11,937)
Purchases of short-term investments	(1,426,735)				(1,426,735)
Purchases of short-term investments	1,320,520				1,320,520
Intercompany advances	188,034	(188,034)			
Other-net		(570)			(570)
Net cash provided (used) by investing activities	81,819	(200,541)			(118,722)
Financing activities					
Long-term borrowings	350,000				350,000
Debt issuance costs	(9,500)				(9,500)
Debt retirements	(50,000)				(50,000)
Issuance of common stock	1,090				1,090
Dividend paid to TXI	(341,139)				(341,139)
Net cash used by financing activities	(49,549)				(49,549)
Increase (decrease) in cash and cash equivalents	37,735	(961)			36,774
Cash and cash equivalents at at beginning of period	1	9,286			9,287
Cash and cash equivalents at end of period	\$ 37,736	\$ 8,325	\$	\$	\$ 46,061

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### **ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.**

*You should read the following discussion in conjunction with the consolidated financial statements and the corresponding notes included elsewhere in this Quarterly Report. Certain statements contained in this Management's Discussion and Analysis of Financial Condition and Results of Operations are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. See*

*Forward-Looking Statements. Such statements are subject to risks, uncertainties and other factors, which could cause actual results to differ materially from future results expressed or implied by such forward-looking statements.*

#### **Overview**

We are a leading supplier of structural steel and steel bar products through a single business segment. We produce and sell structural steel, piling products, special bar quality products, merchant bar quality rounds, reinforcing bar and channels from facilities located in Texas and Virginia. Structural steel products include wide flange beams, channels, piling products and other shapes. Steel bar products include specialty bar products and, to a lesser extent, reinforcing bar. We sell to steel service centers and steel fabricators for use in the construction industry, as well as to cold finishers, forgers and original equipment manufacturers for use in the railroad, defense, automotive, manufactured housing and energy industries. Our products are marketed throughout the United States, Canada and Mexico, and to a limited extent in Europe. All of our long-lived assets are located in the United States.

Our sales prices closely track domestic steel industry sales prices and are market based. Domestic demand for structural steel is derived primarily from non-residential construction. Therefore, a significant percentage of our sales are attributable to the level of non-residential construction activity in the United States. The level of activity in non-residential construction is cyclical and is influenced by prevailing economic conditions, including interest rate levels, inflation, consumer spending habits and employment. In addition, we compete in a global steel industry and domestic prices are significantly influenced by global industry prices. The global steel industry is generally characterized by overcapacity, which in the past has resulted in high levels of steel imports into the United States, exerting downward pressure on domestic steel prices. However, in the recent past, world-wide steel and steel scrap demand has risen. Increased steel demand and the relatively weak U.S. dollar have helped curb imports into the United States. These domestic and global factors have combined to produce historically high selling prices. Should global demand weaken, or steel production increase materially, foreign steel production that is currently being exported to or consumed by other countries, may instead be exported to the United States. Additional steel imports into the United States, declining non-residential construction or a material increase in domestic steel production could cause our selling prices to fall. A significant decline in sales prices could materially and adversely affect our financial condition and results of operations.

Our business requires large amounts of capital investment, raw materials, energy, labor and maintenance, and our future success depends on continued access to these resources. At full capacity, our annual steel scrap usage would be 3.4 million tons, which would represent approximately 6% of the U.S. scrap market. We make predominately all steel scrap purchases on the open market where prices are subject to market forces beyond our control. A major portion of the shredded steel requirements of our Texas plant is produced by an on-site shredder operation primarily utilizing crushed auto bodies purchased on the open market. The shredding operation gives us a competitive advantage by providing usable scrap at reduced cost compared to similarly prepared scrap available on the open market. The geographical market that supplies the Texas plant provides some protection from sharply higher raw material prices caused in part by favorable global market conditions. Our Virginia plant began receiving scrap from our on-site, shredding facility (which is operated by an unrelated party) in the fourth quarter of fiscal year 2005. We believe there will be adequate sources of our principal raw materials to meet our near term needs, although probably at higher prices than has historically been the case due to increased global demand for steel.

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### **Various Aspects of Spin-Off from TXI**

We became an independent public company on July 29, 2005, as a result of our spin-off from TXI. See note 1 of the consolidated financial statements.

When we were a subsidiary of TXI, TXI utilized a centralized cash management program for all of its subsidiaries through which we received payments from TXI as a result of cash received from product sales or made payments to TXI or its subsidiaries for purchases of materials or services or for costs incurred on our behalf, including raw material procurement, payroll and capital expenditures. As a result of the spin-off, we are no longer part of this program.

The accompanying financial statements include all costs of our steel business. For periods prior to the spin-off these costs include the allocation of certain corporate expenses from TXI. TXI's corporate expenses were allocated to us based on either the percentage of time employees incurred performing services for us or specifically identified costs incurred by TXI for us. Management believes the allocations were made on a reasonable basis. However, the consolidated financial statements may not necessarily reflect our financial position, results of operations and cash flows in the future.

TXI, through one of its subsidiaries, previously provided us with common carrier services, transporting finished product to our customers and backhauling materials and supplies for us. These costs have been included in cost of products sold in the consolidated statements of operations and were approximately \$0.6 million and \$4.3 million in the nine-month periods ended February 28, 2006 and 2005, respectively. We believe the rates charged to us for transportation services approximate the rates that would have been charged by third parties. Following the spin-off, we are utilizing assets transferred to us by TXI to operate our own common carrier service.

Since 1986, TXI included our operations in its United States consolidated federal income tax return. TXI also included us with it and/or certain of its subsidiaries in consolidated, combined or unitary income tax groups for state tax purposes as required by law. The provision (benefit) for deferred income taxes for the periods presented has been determined as if we had filed separate tax returns. TXI managed its tax position for the benefit of its entire portfolio of businesses and its tax strategies are not necessarily reflective of the tax strategies we will follow.

At various times items of intercompany indebtedness were settled between and among us and our subsidiaries and TXI and its subsidiaries. These intercompany accounts were settled through offsets, contributions of such indebtedness to our capital and other non-cash transfers. As of the effective date of the spin-off, TXI had contributed to capital the net intercompany indebtedness owed to it by us and our subsidiaries and various other assets in the amount of \$496.0 million.

**Table of Contents****Results of Operations**

*Three-month period ended February 28, 2006 compared to the three-month period ended February 28, 2005.*

(In thousands except per ton data)

	Three months ended			
	February 28, 2006	February 28, 2005	Change	% Change
Net sales				
Structural mills	\$ 283,905	\$ 182,238	\$ 101,667	55.8%
Bar mill	59,988	56,875	3,113	5.5%
Other products	10,033	7,823	2,210	28.3%
Delivery fees	20,723	12,183	8,540	70.1%
Total	\$ 374,649	\$ 259,119	\$ 115,530	44.6%
Units shipped (tons)				
Structural	469	318	151	47.5%
Bar	104	83	21	25.3%
Total	573	401	172	42.9%
Average sales price per ton				
Structural	\$ 605	\$ 572	\$ 33	5.8%
Bar	577	687	(110)	(16.0)%
Total	600	596	4	0.7%
Net sales	\$ 374,649	\$ 259,119	\$ 115,530	44.6%
Costs and expenses (income)				
Cost of products sold	279,250	219,811	59,439	27.0%
Selling, general and administrative	17,714	7,103	10,611	149.4%
Interest	7,890	12,197	(4,307)	(35.3)%
Other income, net	(4,367)	(1,922)	(2,445)	127.2%
	300,487	237,189	63,298	26.7%
Income before income taxes	74,162	21,930	52,232	238.2%
Income taxes	24,918	7,683	17,235	224.3%
Net income	\$ 49,244	\$ 14,247	\$ 34,997	245.6%

*Net sales.* Net sales increased \$115.5 million to \$374.6 million from the prior year period. Shipments increased 42.9% to a level of 573,000 tons, as demand for structural products remained strong. Shipping volumes of bar products were up 25.3% from the prior year period. Average selling prices for structural products continued to improve in the current year period while bar product prices declined 16.0% reflecting a lower mix of special bar quality shipments. The increase in shipping volumes accounted for approximately \$102.5 million of increased net sales, while increased pricing for rolled product accounted for approximately \$2.3 million of increased net sales. Delivery fees increased by 70.1% due to the increase in shipments and higher fuel costs. The Company expects that end user demand for its products will remain strong for the three months ending May 31, 2006 at prices comparable to those in the three months ending February 28, 2006.

*Cost of products sold.* Cost of products sold including depreciation and amortization was \$279.2 million, an increase of \$59.4 million from the prior year period. The increase was due primarily to the increase in shipments of 172,000 tons from the prior year period. Energy expense was 29% higher than the prior year period while per ton costs were 13% lower due to increased production in the current year period.

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*Selling, general and administrative.* Selling, general and administrative expense increased \$10.6 million from the prior year period primarily due to an increase in incentive expense of \$6.9 million from the prior year combined with generally higher expenses in the current year period incurred in connection with being a public company.



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*Interest.* Interest expense of \$7.9 million decreased \$4.3 million from the prior year period and was reflective of changes in our capitalization structure described in note 5 of the consolidated financial statements.

*Other income, net.* Other income, net increased by \$2.4 million to \$4.4 million reflecting an increase in miscellaneous sales and interest income from the prior year period.

*Income taxes.* On October 22, 2004, a new tax law, the American Jobs Creation Act of 2004 (the Jobs Creation Act), became effective. Among other provisions, the Jobs Creation Act allows a deduction for income from qualified domestic production activities, which will be phased in from 2005 through 2010. We anticipate realizing benefit from this deduction in the current fiscal year which resulted in an estimated annualized effective tax rate of 33.6% for the current period compared to 35% in the prior year period. The provision for income taxes of \$24.9 million increased \$17.2 million from the prior year period primarily due to the increase in pretax profits and a decrease in the effective tax rate.

*Net income.* Net income improved \$35.0 million to \$49.2 million from the prior year period due to the factors discussed above.

**Table of Contents****Results of Operations**

*Nine-month period ended February 28, 2006 compared to the nine-month period ended February 28, 2005.*

(In thousands except per ton data)

	Nine months ended February 28,		Change	% Change
	2006	2005		
Net sales				
Structural mills	\$ 793,474	\$ 564,551	\$ 228,923	40.5%
Bar mill	179,159	173,317	5,842	3.4%
Other products	27,731	22,992	4,739	20.6%
Delivery fees	60,820	38,159	22,661	59.4%
Total	\$ 1,061,184	\$ 799,019	\$ 262,165	32.8%
Units shipped (tons)				
Structural	1,411	1,013	398	39.3%
Bar	313	270	43	15.9%
Total	1,724	1,283	441	34.4%
Average sales price per ton				
Structural	\$ 562	\$ 557	\$ 5	0.9%
Bar	573	643	(70)	(10.9)%
Total	564	575	(11)	(1.9)%
Net sales	\$ 1,061,184	\$ 799,019	\$ 262,165	32.8%
Costs and expenses (income)				
Cost of products sold	859,691	647,976	211,715	32.7%
Selling, general and administrative	34,637	21,159	13,478	63.7%
Interest	24,036	36,101	(12,065)	(33.4)%
Other income, net	(9,760)	(3,751)	(6,009)	160.2%
	908,604	701,485	207,119	29.5%
Income before income taxes	152,580	97,534	55,046	56.4%
Income taxes	51,582	34,151	17,431	51.0%
Net income	\$ 100,998	\$ 63,383	\$ 37,615	59.3%

*Net sales.* Net sales increased \$262.2 million to \$1.061 billion from the prior year period. Shipments increased 34.4% to a level of 1.7 million tons, as demand for structural products remained strong. Shipping volumes of bar products were 15.9% higher compared to the prior year period. Average selling prices decreased 1.9% from the prior year period reflecting a lower mix of special bar quality shipments. The increase in shipping volumes accounted for approximately \$253.4 million of increased net sales, while decreased pricing for rolled product accounted for approximately \$18.6 million of decreased net sales. Delivery fees increased by 59.4% due to the increase in shipments and higher fuel costs.

*Cost of products sold.* Cost of products sold including depreciation and amortization was \$859.7 million, an increase of \$211.7 million from the prior year period. The increase was due primarily to the higher shipping levels and a 34% increase in energy expense per ton.

*Selling, general and administrative.* Selling, general and administrative expense increased \$13.5 million from the prior year period as an increase in incentive expense of \$7.8 million and an increase in bad debt expense of \$1.0 million combined with generally higher expenses in the current year period for employee wages and professional services incurred in connection with being a public company.

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*Interest.* Interest expense of \$24.0 million decreased \$12.1 million from the prior year period and was reflective of changes in our capitalization structure described in note 5 of the consolidated financial statements. Interest was charged on the balance due TXI that primarily resulted from cash advances received for the construction of production facilities until our current capital structure was put in place on July 6, 2005.

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*Other income, net.* Other income, net increased by \$6.0 million to \$9.8 million due to higher miscellaneous sales in the current year period.

*Income taxes.* The provision for income taxes of \$51.6 million increased \$17.4 million from the prior year period due to the increase in pretax results and a lower effective tax rate in the current period as a result of the provisions of the Jobs Creation Act. The impact of the Jobs Creation Act resulted in an estimated annualized effective tax rate of 33.8% for the current period compared to 35.0% for the prior year period.

*Net income.* Net income improved \$37.6 million to \$101.0 million from the prior year period due to the factors discussed above.

## **Financial Condition, Liquidity and Capital Resources**

Net working capital at February 28, 2006 increased \$32.5 million to \$357.3 million from May 31, 2005, reflecting a \$55.3 million increase in current assets and a \$22.8 million increase in current liabilities. Significant changes in the components of current assets included increases in cash and cash equivalents of \$36.8 million and short-term investments of \$106.2 million. Inventories declined \$66.6 million as shipments exceeded production in the nine-month period ended February 28, 2006. Accounts receivable-net increased \$17.5 million due to higher sales in the month of February 2006 compared to May 2005 and the shorter collection month. All net balances with TXI were contributed to our capital during the current year period. Trade accounts payable decreased \$12.0 million, while accrued wages, taxes and other items increased \$34.8 million primarily due to increases in employee wages and benefits of \$13.4 million, income taxes payable of \$15.2 million and interest payable of \$3.9 million.

In June 2005, we entered into our Credit Facility which provides up to \$150.0 million of available borrowings and we issued \$300.0 million aggregate principal amount of our Senior Notes. We used \$50.0 million of borrowings from our Credit Facility and the net proceeds from our Senior Notes to pay a cash dividend of \$341.1 million to TXI on July 6, 2005 in connection with the spin-off. The Company had no outstanding borrowings under the Credit Facility during the six months ended February 28, 2006; however, \$1.6 million of the facility was utilized to support letters of credit. The amount borrowed under the Credit Facility will fluctuate based upon our cash flow and working capital needs.

In addition to cash and cash equivalents of \$46.1 million and short-term investments of \$106.2 million at February 28, 2006, our primary sources of liquidity are cash provided from operations and borrowings available under the Credit Facility. We fund working capital requirements and capital expenditures primarily with cash from operations. In addition, we lease certain mobile and other equipment used in our operations under operating leases that in the normal course of business are renewed or replaced by subsequent leases.

We believe the net cash provided by our operating activities, supplemented as necessary with borrowings under the Credit Facility, and existing cash and cash equivalents and short-term investments will provide sufficient resources to meet our working capital requirements, debt service and other cash needs over the next year.

### *Cash flows*

Net cash provided by operating activities increased \$194.4 million in the nine-month period ended February 28, 2006 to \$205.0 million, compared to the prior year period. An increase in cash provided by changes in inventories of \$133.7 million was due to higher shipping volumes in the current year period. Net income and the related effect of deferred income taxes increased cash flows \$12.5 million compared to the prior year period. Cash provided by the change in accrued wages, taxes and other items increased \$37.0 million primarily due to increases in employee wages and benefits of \$13.4 million and current income taxes payable of \$15.2 million.

Net cash used by investing activities was \$118.7 million in the current period compared to \$14.7 million in the prior period. Purchases of available-for-sale securities used cash of \$1.427 billion and sales of available-for-sale securities provided cash of \$1.321 billion. Capital expenditures were \$11.9 million in the current period and \$14.3 million in the prior period. Capital expenditures for normal replacement and improvement of our existing equipment are currently estimated to be approximately \$25 million over the next 12 months.

Net cash used by financing activities in the current year period was \$49.5 million which consisted of long-term borrowings of \$350.0 million, debt retirements of \$50.0 million and debt issuance costs of \$9.5 million under our loan agreements described below. In conjunction with our spin-off, we paid a cash dividend to TXI of \$341.1 million in the current year period. Net cash provided by issuance of common stock for the exercise of company stock options was \$1.1 million in the current year period.

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Prior to our spin-off from TXI, net cash provided by operating activities included the effects of TXI's centralized cash management program for all of its subsidiaries, through which we received advances from and made transfers to TXI depending on our cash requirements. Prior to our spin-off from TXI, these transactions were treated as amounts payable to and receivable from TXI.

### *Impact of the distribution and separation from TXI*

On June 16, 2005, we entered into the Credit Facility which provides up to \$150.0 million of available borrowings. The Credit Facility includes a \$25.0 million sub-limit for letters of credit of which \$1.6 million was outstanding at February 28, 2006. Any outstanding letters of credit are deducted from the borrowing availability under the Credit Facility. Amounts drawn under the Credit Facility bear interest either at the LIBOR rate plus a margin of 1.00% to 1.75%, or at a base rate (which will be the higher of the federal funds rate plus 0.50% and the prime rate) plus a margin of up to 1.00%. The interest rate margins are subject to adjustments based on our leverage ratio. The commitment fee calculated on the unused portion of the Credit Facility ranges from 0.25% to 0.50% per year based on our leverage ratio. The Credit Facility matures June 16, 2010 and may be terminated by us at any time. The Credit Facility is secured by security interests in all of our existing and future accounts and inventory, certain related personal property and in all of the equity interest in present and future domestic subsidiaries and 66% of the equity interest in present and future foreign subsidiaries. The Credit Facility contains covenants restricting, among other things, prepayment or redemption of our other debt, distributions, dividends, and repurchases of capital stock and other equity interests, acquisitions and investments, indebtedness, liens and affiliate transactions. We are required to comply with certain financial tests and to maintain certain financial ratios, such as leverage and interest coverage ratios. During the three months ended August 31, 2005, we borrowed and repaid \$50.0 million under the Credit Facility. The Company did not borrow any funds under the Credit Facility during the six months ended February 28, 2006; however, \$1.6 million of the facility was utilized to support letters of credit. The amount borrowed under the Credit Facility will fluctuate based upon our cash flow and working capital needs.

In addition, on July 6, 2005, we issued \$300.0 million aggregate principal amount of our Senior Notes due July 15, 2013. Interest is due semi-annually on January 15<sup>th</sup> and July 15<sup>th</sup>. The Senior Notes are unsecured and will effectively be subordinated in right of payment to all of our existing and future senior secured debt, including borrowings under our Credit Facility. All of our consolidated domestic subsidiaries have guaranteed our Senior Notes. The guarantees are full and unconditional and are joint and several. For periods prior to the quarter ended August 31, 2005, we had no significant assets or operations independent of our investment in our subsidiaries. The indenture governing the Senior Notes contains covenants that will limit our ability and the ability of our subsidiaries to, among other things, incur additional indebtedness, pay dividends or make other distributions or repurchase or redeem stock, make investments, sell assets, incur liens, enter into agreements restricting the ability to pay dividends, enter into transactions with affiliates and consolidate, merge or sell all or substantially all of our or their assets. As of February 28, 2006, we were in compliance with all loan covenants.

On July 6, 2005, we used the net proceeds from our Credit Facility and Senior Notes to pay a cash dividend of \$341.1 million to TXI in connection with the spin-off.

In connection with the issuance of the Senior Notes, we entered into a registration rights agreement with the initial purchasers of the Senior Notes. The registration rights agreement provides the holders of the Senior Notes certain rights relating to the registration of the Senior Notes under the Securities Act of 1933, as amended. Pursuant to the registration rights agreement, we agreed to conduct a registered exchange offer for the Senior Notes or cause to become effective a shelf registration statement providing for the resale of the Senior Notes. On December 2, 2005, we completed the offer to exchange our 10% senior notes due 2013, which are registered under the Securities Act of 1933, as amended, for the outstanding 10% Senior Notes due 2013 that were issued in a private offering on July 6, 2005. The terms of the registered notes are substantially identical to our previously outstanding Senior Notes.

Any intercompany accounts with TXI that remained immediately prior to the spin-off distribution on July 29, 2005 were contributed to our capital. As a result of these transactions, we expect our interest expense will decrease to an estimated annualized expense of approximately \$32 million at the current level of borrowings, compared to historical interest expense of approximately \$47 million for the year ended May 31, 2005.

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### **Other Items**

*Critical accounting policies.* The preparation of financial statements and accompanying notes in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported. Changes in the facts and circumstances could have a significant impact on the resulting financial statements. The critical accounting policies that affect management's more complex judgments and estimates are described in note 2 to the consolidated financial statements and in our Annual Report on Form 10-K for the year ended May 31, 2005.

*Off-balance sheet arrangements.* We have no off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that is material to investors.

*Environmental matters.* We are subject to federal, state and local environmental laws and regulations concerning, among other matters, air emissions, furnace dust disposal and wastewater discharge. We believe we are in substantial compliance with applicable environmental laws and regulations; however, from time to time we receive claims from federal and state environmental regulatory agencies and entities asserting that we are or may be in violation of certain environmental laws and regulations. Based on our experience in dealing with such claims in the past and the information currently available to us regarding any potential or outstanding claims, we believe that such claims will not have a material impact on our financial condition or results of operations. Despite our compliance and experience, it is possible that we could be held liable for future charges which might be material but are not currently known or estimable. However, changes in federal or state laws, regulations or requirements or discovery of currently unknown conditions could require additional expenditures by us.

*Inflation.* We believe inflation has not had a material effect on our results of operations.

### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.**

#### **Market Risk**

We have not entered into derivatives or other financial instruments for trading or speculative purposes.

On June 16, 2005, we entered into the Credit Facility which provides up to \$150 million of available borrowings. Amounts drawn under the Credit Facility bear interest either at the LIBOR rate plus a margin of 1.00% to 1.75%, or at a base rate (which will be the higher of the federal funds rate plus 0.50% and the prime rate) plus a margin of up to 1.00%. The interest rate margins are subject to adjustments based on our leverage ratio. Accordingly, fluctuations in interest rates will impact the interest we pay on borrowings under this Credit Facility. On July 6, 2005, we also issued \$300 million of our Senior Notes. Although fluctuations in interest rates will not impact the interest we pay on this debt, it would impact the fair value of this debt.

In the normal course of our business, we are exposed to market risk for price fluctuations related to the sale of steel products and to the purchase of commodities used in the steel production process, principally scrap steel, electricity and natural gas. We attempt to negotiate the best prices for our raw materials and energy requirements and to obtain prices for our steel products that match market price movements in response to supply and demand. Beginning in January 2004, we implemented a raw material surcharge program, derived from a published scrap price index, designed to pass some of the increased costs associated with rising raw material prices through to customers.

Steel mini-mills consume large amounts of electricity and natural gas. The electric industry has been deregulated in Texas since January 2002. The Texas plant purchases electricity through a local retail electric provider using various long and short term supply arrangements. The Commonwealth of Virginia is in transition to a deregulated market for electricity. Electricity for the Virginia plant is purchased through the local utility under an interruptible supply contract with periodic adjustments for fuel costs. Natural gas is purchased from local gas marketers and delivered to our plants through local transportation agreements. Historically, we have not used financial instruments to mitigate price fluctuations on such purchases; however we may use such financial instruments when appropriate.

We have not engaged in formal hedging activities to mitigate risks associated with fluctuations in currency values, but we do periodically review the potential impact of this risk to ensure that the risk of significant potential losses is minimized.

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**ITEM 4. CONTROLS AND PROCEDURES**

We maintain disclosure controls and procedures designed to ensure that information required to be disclosed in reports filed under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the specified time periods. As of the period covered by this Quarterly Report on Form 10-Q, our Principal Executive Officer and Principal Financial Officer evaluated, with the participation of our management, the effectiveness of our disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)). Based on the evaluation, which disclosed no significant deficiencies or material weaknesses, our Principal Executive Officer and Principal Financial Officer concluded that our disclosure controls and procedures are effective. There were no significant changes in our internal controls and procedures in our most recent fiscal quarter that have materially affected or are reasonably likely to materially affect our internal control over financial reporting.

**PART II. OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS.**

The information required by this item is included in note 9 to the consolidated financial statements, Legal Proceedings and Contingent Liabilities presented in Part I on pages 17-18 and is incorporated herein by reference.

**ITEM 1A. RISK FACTORS.**

None.

**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.**

None.

**ITEM 5. OTHER INFORMATION.**

Effective as of April 11, 2006, the Company entered into Amended and Restated Change of Control/Severance Agreements with certain of its officers, including, each of its four most highly compensated officers (other than its Chief Executive Officer). The amended and restated agreements are identical to the Change of Control/Severance Agreements adopted on January 13, 2006, except that in connection with an event triggering payment of benefits to an officer, the amended and restated agreements will require (in addition to the previously reported benefits) (i) continuation of medical and dental benefits and placement services for a period of two years and (ii) payment of an amount equal to up to twice the incentive compensation paid to the officer with respect to the fiscal year immediately preceding the occurrence of such event. Previously the Change of Control/Severance Agreements required payment of up to one and one-half times the officer's base salary for a period of two years. The Amended and Restated Change of Control/Severance Agreements reduce that potential payment to an amount equal to one times the officer's base salary for such period. After review of similar agreements, the Board of Directors determined that such changes were necessary to make the benefits to be provided by the Company's change of control agreements more competitive.

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### **ITEM 6. EXHIBITS**

#### **Exhibit**

<b>Number</b>	<b>Exhibit Description</b>
3.1	- Amended and Restated Certificate of Incorporation of Chaparral Steel Company (incorporated herein by reference to Exhibit 3.1 to Chaparral Steel Company's Amendment No. 1 to Form 10, dated June 10, 2005, file number 000-51307)
3.2	- Bylaws of Chaparral Steel Company (incorporated herein by reference to Exhibit 3.2 to Chaparral Steel Company's Form 10, dated May 6, 2005, file number 000-51307)
3.3	- Certificate of Designations of Series A Junior Participating Preferred Stock, filed with the Secretary of State of the State of Delaware on July 21, 2005 (incorporated herein by reference to Exhibit 3.1 to Chaparral Steel Company's Current Report on Form 8-K, dated July 21, 2005, file number 000-51307)
4.1	- Reference is made to Exhibit 3.1, Exhibit 3.2 and Exhibit 3.3
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  - 31.2 - Rule 13a-14(a)/15d-14(a) Certification of Principal Financial Officer\*
  - 32.1 - Section 1350 Certification of Principal Executive Officer\*
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\* Filed herewith. The remaining exhibits have been omitted because they are not applicable or the information required therein is included elsewhere in the financial statements or notes thereto.

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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.

CHAPARRAL STEEL COMPANY

April 13, 2006

/s/ J. Celtyn Hughes  
J. Celtyn Hughes  
Vice President and Chief Financial Officer  
(Principal Financial Officer)

April 13, 2006

/s/ M. Kevin Linch  
M. Kevin Linch  
Vice President-Controller  
(Principal Accounting Officer)

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