FERRO CORP
Form 10-Q
July 25, 2012
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2012

or

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

For the transition period from to

Commission File Number 1-584

FERRO CORPORATION

(Exact name of registrant as specified in its charter)

Ohio	**34-0217820**
(State or other jurisdiction of	**(I.R.S. Employer**
incorporation or organization)	**Identification No.)**
6060 Parkland Boulevard	
Mayfield Heights, OH	**44124**
(Address of principal executive offices)	**(Zip Code)**

216-875-5600

(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES x NO ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES x NO ¨

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

Large accelerated filer x	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). YES ¨ NO x

At June 30, 2012, there were 86,569,612 shares of Ferro Common Stock, par value $1.00, outstanding.

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements (Unaudited)

Ferro Corporation and Subsidiaries

Condensed Consolidated Statements of Operations

	Three months ended June 30, 2012	Three months ended June 30, 2011	Six months ended June 30, 2012	Six months ended June 30, 2011
	(Dollars in thousands, except per share amounts)			
Net sales	$ 481,505	$ 593,974	$ 947,895	$ 1,166,983
Cost of sales	393,660	479,627	771,727	932,310
Gross profit	87,845	114,347	176,168	234,673
Selling, general and administrative expenses	74,645	73,548	152,330	150,366
Restructuring and impairment charges	4,728	1,545	5,039	3,175
Other expense (income):				
Interest expense	6,848	7,352	13,588	14,178
Interest earned	(51)	(69)	(135)	(143)
Foreign currency (gains) losses, net	(221)	1,013	(77)	2,323
Miscellaneous expense (income), net	1,841	(124)	2,235	394
Income before income taxes	55	31,082	3,188	64,380
Income tax expense	2,573	11,461	4,292	21,568
Net (loss) income	(2,518)	19,621	(1,104)	42,812
Less: Net income attributable to noncontrolling interests	330	232	454	533
Net (loss) income attributable to Ferro Corporation	(2,848)	19,389	(1,558)	42,279
Dividends on preferred stock				(165)
Net (loss) income attributable to Ferro Corporation common shareholders	$ (2,848)	$ 19,389	$ (1,558)	$ 42,114
(Loss) earnings per share attributable to Ferro Corporation common shareholders:				
Basic (loss) earnings per share	$ (0.03)	$ 0.23	$ (0.02)	$ 0.49
Diluted (loss) earnings per share	(0.03)	0.22	(0.02)	0.48

See accompanying notes to condensed consolidated financial statements.

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Ferro Corporation and Subsidiaries

Condensed Consolidated Statements of Comprehensive (Loss) Income

	Three months ended June 30, 2012	Three months ended June 30, 2011	Six months ended June 30, 2012	Six months ended June 30, 2011
	(Dollars in thousands)			
Net (loss) income	$ (2,518)	$ 19,621	$ (1,104)	$ 42,812
Other comprehensive (loss) income, net of tax:				
Foreign currency translation	(6,285)	4,872	(6,261)	10,451
Postretirement benefit liabilities	4,033	3,459	5,925	2,968
Total comprehensive (loss) income	(4,770)	27,952	(1,440)	56,231
Less: Comprehensive income attributable to noncontrolling interests	281	301	403	649
Comprehensive (loss) income attributable to Ferro Corporation	$ (5,051)	$ 27,651	$ (1,843)	$ 55,582

See accompanying notes to condensed consolidated financial statements.

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Ferro Corporation and Subsidiaries

Condensed Consolidated Balance Sheets

	June 30, 2012	December 31, 2011
	(Dollars in thousands)	
ASSETS		
Current assets		
Cash and cash equivalents	$ 25,367	$ 22,991
Accounts receivable, net	353,076	306,775
Inventories	217,300	228,813
Deferred income taxes	17,277	17,395
Other receivables	32,437	37,839
Other current assets	13,715	17,086
Total current assets	659,172	630,899
Other assets		
Property, plant and equipment, net	367,184	379,336
Goodwill	215,693	215,601
Amortizable intangible assets, net	13,651	11,056
Deferred income taxes	114,789	117,658
Other non-current assets	87,128	86,101
Total assets	$ 1,457,617	$ 1,440,651
LIABILITIES AND EQUITY		
Current liabilities		
Loans payable and current portion of long-term debt	$ 45,868	$ 11,241
Accounts payable	214,195	214,460
Accrued payrolls	34,659	31,055
Accrued expenses and other current liabilities	68,246	67,878
Total current liabilities	362,968	324,634
Other liabilities		
Long-term debt, less current portion	295,844	298,082
Postretirement and pension liabilities	195,366	215,732
Other non-current liabilities	19,493	19,709
Total liabilities	873,671	858,157
Equity		
Ferro Corporation shareholders equity:		
Common stock, par value $1 per share; 300.0 million shares authorized; 93.4 million shares issued; 86.6 million shares outstanding in 2012 and 2011	93,436	93,436
Paid-in capital	323,441	320,882
Retained earnings	392,078	393,636
Accumulated other comprehensive loss	(82,360)	(82,075)
Common shares in treasury, at cost	(152,904)	(153,617)
Total Ferro Corporation shareholders equity	573,691	572,262
Noncontrolling interests	10,255	10,232
Total equity	583,946	582,494

Total liabilities and equity	$ 1,457,617	$ 1,440,651

See accompanying notes to condensed consolidated financial statements.

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Ferro Corporation and Subsidiaries

Condensed Consolidated Statements of Equity

	Ferro Corporation Shareholders							
	Common Shares in Treasury		Common	Paid-in	Retained	Accumulated Other Comprehensive (Loss)	Non-controlling	Total
	Shares	Amount	Stock	Capital	Earnings	Income	Interests	Equity
					(In thousands)			
Balances at December 31, 2010	7,242	$ (164,257)	$ 93,436	$ 323,015	$ 362,164	$ (50,949)	$ 10,771	$ 574,180
Net income					42,279		533	42,812
Other comprehensive income						13,303	116	13,419
Cash dividends on preferred stock					(165)			(165)
Stock-based compensation transactions	(376)	10,583		(5,493)				5,090
Distributions to noncontrolling interests							(688)	(688)
Balances at June 30, 2011	6,866	$ (153,674)	$ 93,436	$ 317,522	$ 404,278	$ (37,646)	$ 10,732	$ 634,648
Balances at December 31, 2011	6,865	$ (153,617)	$ 93,436	$ 320,882	$ 393,636	$ (82,075)	$ 10,232	$ 582,494
Net (loss) income					(1,558)		454	(1,104)
Other comprehensive loss						(285)	(51)	(336)
Stock-based compensation transactions	1	713		2,559				3,272
Distributions to noncontrolling interests							(380)	(380)
Balances at June 30, 2012	6,866	$ (152,904)	$ 93,436	$ 323,441	$ 392,078	$ (82,360)	$ 10,255	$ 583,946

See accompanying notes to condensed consolidated financial statements.

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Ferro Corporation and Subsidiaries

Condensed Consolidated Statements of Cash Flows

	Six months ended June 30, 2012	Six months ended June 30, 2011
	(Dollars in thousands)	
Cash flows from operating activities		
Net cash provided by (used for) operating activities	$ 5,178	$ (20,758)
Cash flows from investing activities		
Capital expenditures for property, plant and equipment	(35,508)	(31,817)
Proceeds from sale of assets	1,192	2,374
Other investing activities	436	193
Net cash used for investing activities	(33,880)	(29,250)
Cash flows from financing activities		
Net borrowings under loans payable	34,906	57,570
Proceeds from long-term debt	212,996	382,219
Principal payments on long-term debt	(215,174)	(381,771)
Redemption of convertible preferred stock		(9,427)
Cash dividends paid		(165)
Other financing activities	(1,060)	(856)
Net cash provided by financing activities	31,668	47,570
Effect of exchange rate changes on cash and cash equivalents	(590)	771
Increase (decrease) in cash and cash equivalents	2,376	(1,667)
Cash and cash equivalents at beginning of period	22,991	29,035
Cash and cash equivalents at end of period	$ 25,367	$ 27,368
Cash paid during the period for:		
Interest	$ 13,196	$ 12,575
Income taxes	2,098	14,715

See accompanying notes to condensed consolidated financial statements.

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Ferro Corporation and Subsidiaries

Notes to Condensed Consolidated Financial Statements

1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of Ferro Corporation (Ferro, we, us or the Company) have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) for interim financial information, the instructions to Form 10-Q, and Article 10 of Regulation S-X. These statements reflect all normal and recurring adjustments which are, in the opinion of management, necessary to present fairly the financial position, results of operations and cash flows for the periods presented. The preparation of financial statements in conformity with U.S. GAAP requires us to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. These interim condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes included in our Annual Report on Form 10-K for the year ended December 31, 2011.

Operating results for the three and six months ended June 30, 2012, are not necessarily indicative of the results expected in subsequent quarters or for the full year ending December 31, 2012.

2. Recent Accounting Pronouncements

Accounting Standards Adopted in the Six Months Ended June 30, 2012

On January 1, 2012, we adopted Financial Accounting Standards Board (FASB) Accounting Standards Update (ASU) 2011-04, *Fair Value Measurement: Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*, (ASU 2011-04), which is codified in ASC Topic 820, Fair Value Measurement. This pronouncement changes certain fair value measurement guidance and expands certain disclosure requirements. Adoption of this pronouncement did not have a material effect on our consolidated financial statements.

On January 1, 2012, we adopted ASU 2011-05, *Presentation of Comprehensive Income*, (ASU 2011-05) and ASU 2011-12, *Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05*, (ASU 2011-12), which are codified in ASC Topic 220, Comprehensive Income. ASU 2011-05 requires companies to present items of net income, items of other comprehensive income and total comprehensive income in one continuous statement or two separate but consecutive statements. ASU 2011-12 indefinitely defers certain provision of ASU 2011-05 that required companies to present reclassification adjustments out of accumulated other comprehensive income by component in both the statement in which net income is presented and the statement in which other comprehensive income is presented. Adoption of these pronouncements did not have a material effect on our consolidated financial statements.

On January 1, 2012, we adopted ASU 2011-08, *Testing Goodwill for Impairment*, (ASU 2011-08), which is codified in ASC Topic 350, Intangibles Goodwill and Other. This pronouncement permits companies testing goodwill for impairment to first assess qualitative factors to determine whether the two-step impairment test is required. Adoption of this pronouncement did not have a material effect on our consolidated financial statements.

New Accounting Pronouncements Not Yet Adopted

In December 2011, the FASB issued ASU 2011-11, *Disclosures about Offsetting Assets and Liabilities*, (ASU 2011-11), which is codified in ASC Topic 210, Balance Sheet. This pronouncement contains new disclosure requirements about a company s right of setoff and related arrangements associated with its financial and derivative instruments. ASU 2011-11 will be effective for our fiscal year that begins January 1, 2013, and is to be applied retrospectively. We do not expect that adoption of this pronouncement will have a material effect on our consolidated financial statements.

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3. Inventories

	June 30, 2012	December 31, 2011
	(Dollars in thousands)	
Raw materials	$ 78,489	$ 78,199
Work in process	41,736	42,111
Finished goods	97,075	108,503
Total inventories	$ 217,300	$ 228,813

In the production of some of our products, we use precious metals, some of which we obtain from financial institutions under consignment agreements with terms of one year or less. The financial institutions retain ownership of the precious metals and charge us fees based on the amounts we consign. These fees were $1.7 million and $2.7 million for the three months ended June 30, 2012 and 2011, respectively, and were $3.6 million and $4.7 million for the six months ended June 30, 2012 and 2011, respectively. We had on hand precious metals owned by participants in our precious metals consignment program of $178.1 million at June 30, 2012, and $195.0 million at December 31, 2011, measured at fair value based on market prices for identical assets.

4. Property, Plant and Equipment

Property, plant and equipment is reported net of accumulated depreciation of $600.6 million at June 30, 2012, and $599.1 million at December 31, 2011. Unpaid capital expenditure liabilities, which are noncash investing activities, were $6.2 million at June 30, 2012, and $7.3 million at June 30, 2011.

5. Debt

Loans payable and current portion of long-term debt consisted of the following:

	June 30, 2012	December 31, 2011
	(Dollars in thousands)	
Loans payable to banks	$ 7,239	$ 404
Domestic accounts receivable asset securitization program	30,000	
International accounts receivable sales programs	6,486	8,150
Current portion of long-term debt	2,143	2,687
Loans payable and current portion of long-term debt	$ 45,868	$ 11,241

Long-term debt consisted of the following:

	June 30, 2012	December 31, 2011
	(Dollars in thousands)	
7.875% Senior Notes	$ 250,000	$ 250,000
6.50% Convertible Senior Notes, net of unamortized discounts	33,942	33,537
Revolving credit facility	5,529	7,706
Capital lease obligations	3,736	4,459
Other notes	4,780	5,067

Total long-term debt	297,987	300,769
Current portion of long-term debt	(2,143)	(2,687)
Long-term debt, less current portion	$ 295,844	$ 298,082

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Receivable Sales Programs

We have an asset securitization program for Ferro s U.S. trade accounts receivable. We sell interests in our domestic receivables to various purchasers, and we may obtain up to $50.0 million in the form of cash or letters of credit. Advances received under this program are accounted for as borrowings secured by the receivables and included in net cash provided by financing activities. In the second quarter of 2012, we extended the maturity of this credit facility through May 2013. At June 30, 2012, advances received of $30.0 million were secured by $110.2 million of accounts receivable, and based on available and qualifying receivables, $20.0 million of additional borrowings were available under the program. The interest rate under this program is the sum of (A) either (1) commercial paper rates, (2) LIBOR rates, or (3) the federal funds rate plus 0.5% or the prime rate and (B) a fixed margin. At June 30, 2012, the interest rate was 0.6%.

We also have several international programs to sell with recourse trade accounts receivable to financial institutions. Advances received under these programs are accounted for as borrowings secured by the receivables and included in net cash provided by financing activities. At June 30, 2012, the commitments supporting these programs totaled $17.7 million, the advances received of $6.5 million were secured by $14.4 million of accounts receivable, and based on available and qualifying receivables, $5.7 million of additional borrowings were available under the programs. The interest rates under these programs are based on EURIBOR rates plus 1.75%. At June 30, 2012, the weighted-average interest rate was 2.1%.

7.875% Senior Notes

The 7.875% Senior Notes (the Senior Notes) were issued in 2010 at par, bear interest at a rate of 7.875% per year, payable semi-annually in arrears on February 15th and August 15th, and mature on August 15, 2018. Through August 15, 2013, we may redeem up to 35% of the Senior Notes at a price equal to 107.875% of the principal amount using proceeds of certain equity offerings. We may also redeem some or all of the Senior Notes prior to August 15, 2014, at a price equal to the principal amount plus a defined applicable premium. The applicable premium on any redemption date is the greater of 1% of the principal amount of the note or the excess of (1) the present value at such redemption date of the redemption price of the note at August 15, 2014, plus all required interest payments due on the note through August 15, 2014, computed using a discount rate equal to the Treasury Rate as of the redemption date plus 50 basis points; over (2) the principal amount of the note. In addition, we may redeem some or all of the Senior Notes beginning August 15, 2014, at prices ranging from 100% to 103.938% of the principal amount.

The Senior Notes are unsecured obligations and rank equally in right of payment with any other unsecured, unsubordinated obligations. The Senior Notes contain certain affirmative and negative covenants customary for high-yield debt securities, including, but not limited to, restrictions on our ability to incur additional debt, create liens, pay dividends or make other distributions or repurchase our common stock and sell assets outside the ordinary course of business. At June 30, 2012, we were in compliance with the covenants under the Senior Notes indenture.

6.50% Convertible Senior Notes

The 6.50% Convertible Senior Notes (the Convertible Notes) were issued in 2008, bear interest at a rate of 6.5% per year, payable semi-annually in arrears on February 15th and August 15th, and mature on August 15, 2013. We separately account for the liability and equity components of the Convertible Notes in a manner that, when interest cost is recognized in subsequent periods, will reflect our nonconvertible debt borrowing rate at the time the Convertible Notes were issued. The effective interest rate on the liability component is 9.5%. Under certain circumstances, holders of the Convertible Notes may convert their notes prior to maturity. The Convertible Notes are unsecured obligations and rank equally in right of payment with any other unsecured, unsubordinated obligations. The principal amount outstanding was $35.1 million at June 30, 2012, and $35.1 million at December 31, 2011. At June 30, 2012, we were in compliance with the covenants under the Convertible Notes indenture.

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Revolving Credit Facility

In 2010, we entered into the Third Amended and Restated Credit Agreement with a group of lenders for a five-year, $350 million multi-currency senior revolving credit facility (the 2010 Credit Facility). In June 2012, we amended the 2010 Credit Facility (the 2012 Amended Credit Facility) primarily to provide additional operating flexibility. The primary effects of the 2012 Amended Credit Facility were to:

- Increase the maximum permitted leverage ratio (as discussed in Note 6 within Item 8 of the Company s Annual Report on Form 10-K for the year ended December 31, 2011) from 3.50 to 4.25 for the third and fourth quarters of 2012;
- Eliminate the fixed charge coverage covenant;
- Include a quarterly interest coverage covenant (defined as the ratio of EBITDA to cash paid for interest expense and certain other financing expenses), which requires the Company to maintain an interest coverage ratio of not less than (i) 2.50 for the second and third quarters of 2012, (ii) 2.75 for the fourth quarter of 2012, and (iii) 3.00 thereafter;
- Include a maximum capital expenditures covenant limiting the capital expenditures of the Company to (i) $20.0 million for the three months ended June 30, 2012, (ii) $35.0 million for the six months ended September 30, 2012, (iii) $50.0 million for the nine months ended December 31, 2012, (iv) $65.0 million for the twelve months ended March 31, 2013, and (v) $65.0 million for the 2013 fiscal year and each fiscal year thereafter. Certain unused capital expenditures will be permitted to be carried forward to the following fiscal year; and
- Maintain limitations on our ability to make restricted payments, including common stock dividends (as discussed under the 2010 Credit Facility in Note 6 within Item 8 of the Company s Annual Report on Form 10-K for the year ended December 31, 2011).

The 2012 Amended Credit Facility matures on August 24, 2015, and is secured by substantially all of Ferro s assets. After reductions for outstanding letters of credit, we had $340.5 million of additional borrowings available at June 30, 2012. The interest rate under the 2010 Credit Facility is the sum of (A) either (1) LIBOR or (2) the higher of the Federal Funds Rate plus 0.5%, the Prime Rate, or LIBOR plus 1.0% and (B) a variable margin based on the Company s leverage. At June 30, 2012, the interest rate was 3.2%. At June 30, 2012, we were in compliance with the covenants of the 2012 Amended Credit Facility.

6. Financial Instruments

The inputs to the valuation techniques used to measure fair value are classified into the following categories:

Level 1: Quoted market prices in active markets for identical assets or liabilities.

Level 2: Observable market-based inputs or unobservable inputs that are corroborated by market data.

Level 3: Unobservable inputs that are not corroborated by market data.

The following financial instrument assets (liabilities) are presented below at carrying amount, fair value and classification within the fair value hierarchy:

	June 30, 2012					December 31, 2011	
	Carrying	Fair Value				Carrying	
	Amount	Total	Level 1	Level 2	Level 3	Amount	Fair Value
	(Dollars in thousands)						

Cash and cash equivalents	$ 25,367	$ 25,367	$ 25,367	$	$	$ 22,991	$ 22,991
Other receivables	32,437	32,437		32,437		37,839	37,839
Short-term loans payable	(43,725)	(43,725)		(43,725)		(8,554)	(8,554)
7.875% Senior Notes	(250,000)	(248,750)		(248,750)		(250,000)	(253,750)
6.50% Convertible Senior Notes, net of unamortized discounts	(33,942)	(35,241)		(35,241)		(33,537)	(34,589)
Revolving credit facility	(5,529)	(5,388)		(5,388)		(7,706)	(7,973)
Other long-term notes payable	(4,780)	(3,947)		(3,947)		(5,067)	(4,184)
Foreign currency forward contracts, net	4,075	4,075		4,075		6,225	6,225

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The fair values of cash and cash equivalents are based on the fair values of identical assets. The fair value of other receivables and short-term loans payable are based on the present value of expected future cash flows and approximate their carrying amounts due to the short periods to maturity. The fair values of the Senior Notes and the Convertible Notes are based on third-party estimated bid prices. The fair values of the revolving credit facility and the other long-term notes are based on the present value of expected future cash flows and assumptions about current interest rates and the creditworthiness of the Company that market participants would use in pricing the debt.

Foreign currency forward contracts. We manage foreign currency risks principally by entering into forward contracts to mitigate the impact of currency fluctuations on transactions. These forward contracts are not designated as hedging instruments. Gains and losses on these foreign currency forward contracts are netted with gains and losses from currency fluctuations on transactions arising from international trade and reported as foreign currency (gains) losses, net in the condensed consolidated statements of operations. The fair value of these contracts is based on market prices for comparable contracts. We had foreign currency forward contracts with notional amounts of $271.3 million at June 30, 2012, and $249.3 million at December 31, 2011.

The following table presents the effect on our consolidated statements of operations for the six months ended June 30th of foreign currency forward contracts:

	Amount of Gain (Loss) Recognized in Earnings		
	2012	2011	Location of Gain (Loss) in Earnings
	(Dollars in thousands)		
Foreign currency forward contracts	$ 9,533	$ (13,422)	Foreign currency (gains) losses, net

The following table presents the fair value on our consolidated balance sheets of these foreign currency forward contracts:

	June 30, 2012	December 31, 2011	Balance Sheet Location
	(Dollars in thousands)		
Asset derivatives:			
Foreign currency forward contracts	$ 5,068	$ 6,491	Other current assets