

NORTH AMERICAN GALVANIZING & COATINGS INC

Form 10-Q

May 15, 2007

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 10-Q

QUARTERLY REPORT UNDER SECTION 13 OR 15 (d)  
OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2007

Commission File No. 1-3920

NORTH AMERICAN GALVANIZING & COATINGS, INC.  
(Exact name of the registrant as specified in its charter)

DELAWARE  
(State of Incorporation)

71-0268502  
(I.R.S. Employer Identification No.)

5314 S. YALE AVENUE, SUITE 1000, TULSA, OKLAHOMA 74135  
(Address of principal executive offices)

Former address of registrant: 2250 East 73rd Street, Tulsa, Oklahoma 74136

(918) 494-0964  
(Registrant's telephone number)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 and 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, as defined 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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of March 31, 2007: Common Stock \$ .10 Par Value...8,165,981

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NORTH AMERICAN GALVANIZING & COATINGS, INC.  
AND SUBSIDIARY

INDEX TO QUARTERLY REPORT ON FORM 10-Q

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## FORWARD LOOKING STATEMENTS OR INFORMATION

Certain statements in this Form 10-Q, including information set forth under the caption "Management's Discussion and Analysis of Financial Condition and Results of Operations", constitute "Forward-Looking Statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Such statements are typically punctuated by words or phrases such as "anticipates," "estimate," "should," "may," "management believes," and words or phrases of similar import. The Company cautions investors that such forward-looking statements included in this Form 10-Q, or hereafter included in other publicly available documents filed with the Securities and Exchange Commission, reports to the Company's stockholders and other publicly available statements issued or released by the Company involve significant risks, uncertainties, and other factors which could cause the Company's actual results, performance (financial or operating) or achievements to differ materially from the future results, performance (financial or operating) or achievements expressed or implied by such forward-looking statements. Factors that could cause or contribute to such differences could include, but are not limited to, changes in demand, prices, the raw materials cost of zinc and the cost of natural gas; changes in economic

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conditions of the various markets the Company serves, as well as the other risks detailed herein and in the Company's reports filed with the Securities and Exchange Commission. The Company believes that the important factors set forth in the Company's cautionary statements at Exhibit 99 to this Form 10-Q could cause such a material difference to occur and investors are referred to Exhibit 99 for such cautionary statements.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

TO THE BOARD OF DIRECTORS AND STOCKHOLDERS OF  
NORTH AMERICAN GALVANIZING & COATINGS, INC.

We have reviewed the accompanying condensed consolidated balance sheet of North American Galvanizing & Coatings, Inc. and subsidiary (the "Company") as of March 31, 2007, and the related condensed consolidated statements of income and of cash flows for the three-month periods ended March 31, 2007 and 2006. These interim financial statements are the responsibility of the Company's management.

We conducted our reviews 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 (United States), 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 reviews, we are not aware of any material modifications that should be made to such condensed consolidated interim financial statements for them to be in conformity with accounting principles generally accepted in the United States of America.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of North American Galvanizing & Coatings, Inc. and subsidiary as of December 31, 2006, and the related consolidated statements of income and comprehensive income, stockholders' equity and cash flows for the year then ended (not presented herein); and in our report dated February 14, 2007, we expressed an unqualified opinion on those consolidated financial statements and included an explanatory paragraph related to the adoption of Statement of Financial Accounting Standards No. 123 (R), Share-Based Payment. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of December 31, 2006 is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

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/s/ Deloitte & Touche LLP

Tulsa, Oklahoma  
May 15, 2007

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NORTH AMERICAN GALVANIZING & COATINGS, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS  
(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

	UNAUDITED MARCH 31, 2007	DECEMBER 2006
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash	\$ 976	\$ 1,977
Trade receivables -- less allowances of \$232 for 2007 and \$197 for 2006	14,904	13,037
Inventories	6,423	6,757
Prepaid expenses and other assets	707	837
Deferred tax asset -- net	767	787
	-----	-----
Total current assets	23,777	23,387
<b>PROPERTY, PLANT AND EQUIPMENT -- AT COST:</b>		
Land	2,167	2,167
Galvanizing plants and equipment	37,378	36,847
	-----	-----
	39,545	39,014
Less -- allowance for depreciation	(19,732)	(18,897)
Construction in progress	1,048	1,017
	-----	-----
Total property, plant and equipment -- net	20,861	21,137
GOODWILL	3,448	3,447
OTHER ASSETS	53	247
	-----	-----
TOTAL ASSETS	\$ 48,139	\$ 48,217
	=====	=====
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Current maturities of long-term obligations	\$ 3,636	\$ 777
Current portion of bonds payable	5,078	837
Trade accounts payable	4,647	7,447
Accrued payroll and employee benefits	877	1,087
Accrued taxes	1,498	767
Other accrued liabilities	3,226	3,197
	-----	-----
Total current liabilities	18,962	14,027
	-----	-----

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DEFERRED TAX LIABILITY -- Net	698	80
LONG-TERM OBLIGATIONS	302	3,31
BONDS PAYABLE	--	4,43
	-----	-----
Total liabilities	19,962	22,64
	-----	-----
COMMITMENTS AND CONTINGENCIES (NOTE 6)		
STOCKHOLDERS' EQUITY:		
Common stock -- \$.10 par value, 18,000,000 shares authorized:		
Issued--8,209,925 shares in 2007 and 2006	821	82
Additional paid-in capital	14,108	14,06
Retained earnings	13,424	11,07
Common shares in treasury at cost -- 43,944 in 2007 and 98,253 in 2006	(176)	(39
	-----	-----
Total stockholders' equity	28,177	25,56
	-----	-----
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 48,139	\$ 48,21
	=====	=====

See notes to condensed consolidated interim financial statements.

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NORTH AMERICAN GALVANIZING & COATINGS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)  
THREE MONTHS ENDED MARCH 31, 2007 AND 2006  
(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

	2007	2006
SALES	\$ 23,499	\$ 15,41
COSTS AND EXPENSES:		
Cost of sales	16,212	10,99
Selling, general and administrative expenses	2,364	1,84
Depreciation and amortization	838	64
	-----	-----
Total costs and expenses	19,414	13,48
	-----	-----
OPERATING INCOME	4,085	1,92
Interest expense	187	24
Interest income	(18)	--
	-----	-----
INCOME BEFORE INCOME TAXES	3,916	1,68
INCOME TAX EXPENSE	1,570	70
	-----	-----
NET INCOME	\$ 2,346	\$ 98
	=====	=====

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NET INCOME PER COMMON SHARE:

Net income

Basic	\$	0.29		\$	0.1
Diluted	\$	0.28		\$	0.1

See notes to condensed consolidated interim financial statements.

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NORTH AMERICAN GALVANIZING & COATINGS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)  
THREE MONTHS ENDED MARCH 31, 2007 AND 2006  
(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

	2007		2006
<b>OPERATING ACTIVITIES:</b>			
Net income	\$	2,346	\$ 98
Gain on disposal of assets		--	
Depreciation		838	64
Deferred income taxes		(87)	5
Non-cash directors' fees		107	12
Non-cash share-based compensation		83	1
Changes in operating assets and liabilities:			
Accounts receivable--net		(1,872)	(2,65
Inventories and other assets		650	40
Accounts payable, accrued liabilities and other		(2,233)	(19
		-----	-----
Cash used in operating activities		(168)	(61
<b>INVESTING ACTIVITIES:</b>			
Capital expenditures		(525)	(15
		-----	-----
Cash used in investing activities		(525)	(15
<b>FINANCING ACTIVITIES:</b>			
Payments on long-term obligations		(420)	(6,78
Proceeds from long-term obligations		223	7,19
Payment on bonds		(188)	(23
Proceeds from exercise of stock options		75	--
		-----	-----
Cash (used in) provided by financing activities		(310)	16
DECREASE IN CASH AND CASH EQUIVALENTS		(1,003)	(59
<b>CASH AND CASH EQUIVALENTS:</b>			
Beginning of period		1,979	1,36
		-----	-----
End of period	\$	976	\$ 76
		=====	=====
<b>CASH PAID DURING THE PERIOD FOR:</b>			
Interest	\$	129	\$ 41
		=====	=====

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Income taxes	\$	667	\$	27
		=====		=====

NON-CASH INVESTING AND FINANCING ACTIVITIES:

Acquisitions of fixed assets under capital lease obligations	\$	39	\$	--
		=====		=====

See notes to condensed consolidated interim financial statements.

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NORTH AMERICAN GALVANIZING & COATINGS, INC. AND SUBSIDIARY  
 NOTES TO CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS  
 FOR THE THREE MONTHS ENDED MARCH 31, 2007 AND 2006  
 UNAUDITED

NOTE 1. BASIS OF PRESENTATION

The condensed consolidated interim financial statements included in this report have been prepared by North American Galvanizing & Coatings, Inc. (the "Company") pursuant to its understanding of the rules and regulations of the Securities and Exchange Commission for interim reporting and include all normal and recurring adjustments which are, in the opinion of management, necessary for a fair presentation. The condensed consolidated interim financial statements include the accounts of the Company and its subsidiary.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations for interim reporting. The Company believes that the disclosures are adequate to make the information presented not misleading. However, these interim financial statements should be read in conjunction with the financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2006. The financial data for the interim periods presented may not necessarily reflect the results to be anticipated for the complete year.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the balance sheet dates and the reported amounts of revenues and expenses for each of the periods. Actual results will be determined based on the outcome of future events and could differ from the estimates. The Company's sole business is hot dip galvanizing and coatings which is conducted through its wholly owned subsidiary, North American Galvanizing Company ("NAG").

The Company adopted the provisions of FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes", or FIN 48, on January 1, 2007. FIN 48 clarifies whether or not to recognize assets or liabilities for tax positions taken that may be challenged by a taxing authority. The Company files income tax returns in the U.S. federal jurisdiction and various state jurisdictions. With few exceptions, the Company is no longer subject to U.S. federal and state income tax examinations by tax authorities for years before 2003. In the second quarter of 2006, the Internal Revenue Service (IRS) commenced an examination of the Company's Federal income tax return for 2004 and subsequently added years 2003 and 2005 to the examination. The Company anticipates that the IRS will complete this examination by the end of the second quarter of 2007. The Company had previously recorded \$162,000 relating to anticipated additional federal income taxes as a result of this examination, and does not anticipate that

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further adjustments resulting from this examination, if any, would result in a material change to its financial position or results of operations. This amount is included in income taxes payable at March 31, 2007.

Upon the adoption of FIN 48, the Company commenced a review of all open tax years in all jurisdictions. The Company does not believe it has included any "uncertain tax positions" in its Federal income tax return or any of the state income tax returns it is currently filing. The Company has made an evaluation of the potential impact of additional state taxes being assessed by jurisdictions in which the Company does not currently consider itself liable. The Company does not anticipate that such additional taxes, if any, would result in a material change to its financial position. In connection with the adoption of FIN 48, the Company will include future interest and penalties, if any, related to uncertain tax positions as a component of its provision for taxes.

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### NOTE 2. STOCK OPTIONS

At March 31, 2007 the Company has two share-based compensation plans, which are shareholder-approved, the 2004 Incentive Stock Plan and the Director Stock Unit Program (Note 6). The Company's 2004 Incentive Stock Plan (the Plan) permits the grant of share options and shares to its employees and directors for up to 1,250,000 shares of common stock. The Company believes that such awards better align the interests of its employees and directors with those of its shareholders. Option awards are granted with an exercise price equal to the market price of the Company's stock at the date of grant; those option awards usually vest based on 4 years of continuous service and have 10-year contractual terms.

The compensation cost for the Plan was \$83,000 and \$19,000 for the three-months ended March 31, 2007 and 2006, respectively. No tax benefit was recognized for the 2007 incentive stock plan compensation cost. There was no share-based compensation cost capitalized during 2006 or 2007.

The fair value of options granted under the Company's stock option plans was estimated using the Black-Scholes option-pricing model with the following assumptions used:

	Quarter Ended March 31	
Dollars in Thousands, Except per Share Amounts	2007	2006
Volatility	66%	55%
Discount Rate	4.6%	4.7%
Dividend Yield	--	--
Fair Value	\$3.54	\$1.47

In the first quarter of 2007, the Company issued stock options for 335,000 shares at \$5.20 per share, and issued stock options for 157,500 shares at \$2.10 per share in the first quarter of 2006.

### NOTE 3. EARNINGS PER COMMON SHARE

Basic earnings per common share for the periods presented are computed based upon the weighted average number of shares outstanding, adjusted for stock unit grants. Diluted earnings per common share for the periods presented are based on the weighted average shares outstanding, adjusted for stock unit grants and for the assumed exercise of stock options and warrants using the treasury stock method.



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THREE MONTHS ENDED MARCH 31	NUMBER OF SHARES	
	2007	2006
Basic	8,143,747	7,022,181
Diluted	8,337,157	7,790,182

The options excluded from the calculation of diluted earnings per share, due to the option price exceeding the share market price are 335,000 and 295,000 at March 31, 2007 and 2006, respectively.

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## NOTE 4. LONG-TERM OBLIGATIONS

(DOLLARS IN THOUSANDS)	March 31 2007	December 31 2006
Capital lease obligations	\$ 349	\$ 328
Term loan	3,573	3,751
Other	16	17
	\$ 3,938	\$ 4,096
Less current portion	(3,636)	(778)
	\$ 302	\$ 3,318

The Company's bank credit agreement expires February 28, 2008. Subject to borrowing base limitations, the amended agreement provides (i) an \$8,000,000 maximum revolving credit facility for working capital and general corporate purposes and (ii) a \$5,001,000 term loan that combined the outstanding principal balance of the existing term loan with additional financing for the purchase of assets of a galvanizing facility in February of 2005.

Term loan payments are based on a seven-year amortization schedule with equal monthly payments of principal and interest, and a final balloon payment in February 2008. The term loan may be prepaid without penalty. The revolving line of credit may be paid down without penalty, or additional funds may be borrowed up to the maximum line of credit. At March 31, 2007, the Company had unused borrowing capacity of \$7,612,000 under the line of credit, based on the underlying borrowing base of accounts receivable and inventory. At March 31, 2007, there were no borrowings outstanding under the bank credit agreement, and \$388,000 was reserved for outstanding irrevocable letters of credit to secure payment of current and future workers' compensation claims.

Substantially all of the Company's accounts receivable, inventories, fixed assets and the common stock of its subsidiary are pledged as collateral under the agreement, and the credit agreement is secured by a full and unconditional guaranty from NAG. Amounts borrowed under the agreement bear interest at the prime rate of JPMorgan Chase Bank or the LIBOR rate, at the option of the Company, subject to a rate margin adjustment determined by the Company's consolidated debt service coverage ratio. The interest rate on these borrowings was 8.50% at March 31, 2007. In the event the Company fails to maintain a consolidated debt service coverage ratio for any fiscal quarter of at least 1.25 to 1.00, the Applicable LIBOR Rate Margin will be increased from 3.0% to 5.75%

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and the Applicable Prime Rate Margin will be increased from .25% to 3.00%. Thereafter, the increased rate margin will remain in effect until such time as the Company has maintained a consolidated debt service coverage ratio greater than or equal to 1.25 to 1.00 for a subsequent fiscal quarter.

In the event the Company fails to maintain a consolidated EBITDA to capital expenditures plus current maturity of long-term debt ratio for any fiscal quarter of not less than 1.00 to 1.00, the increase in the Applicable LIBOR Rate Margin ranges from 3.75% to 5.75%, and the increase in the Applicable Prime Rate Margin ranges from 1.00% to 3.00%.

The credit agreement requires the Company to maintain compliance with covenant limits for current ratio, debt to tangible net worth ratio, debt service coverage ratio and a capital expenditures ratio. At March 31, 2007, the Company was in compliance with the covenants, with the exception of the Debt Service Coverage Ratio and Capital Expenditures Coverage Ratio. The covenant violations occurred due to the reclassification of the bonds payable as short-term, based on the agreement with the Internal Revenue Service discussed in Note 5. The Company has obtained a commitment for a new long-term facility financed by another bank and has notified its existing bank that it plans to repay and terminate the current facility. The actual financial ratios compared to the required ratios, were as follows: Current Ratio - actual 1.7 versus minimum required of 1.10; Debt to Tangible Net Worth Ratio - actual .77 vs. maximum permitted of 2.50; Debt Service Coverage Ratio - actual 1.02 versus minimum permitted of 1.25; Capital Expenditures Coverage Ratio - actual .85 versus minimum required of 1.0.

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The company has a signed commitment letter from a bank for a \$25,000,000 revolving credit facility, and the right to increase the facility up to \$10,000,000 in minimum increments of \$5,000,000. The purpose of the new facility is to refinance existing revolving line of credit, term debt, bond debt, issue standby letters of credit, finance acquisitions, and for other general corporate purposes. The credit facility will have a maturity of five years with no principal payments required and no prepayment penalty. The Company plans to complete the refinancing before the bank commitment expires on June 29th, 2007.

### NOTE 5. BONDS PAYABLE

During the first quarter of 2000, the Company issued \$9,050,000 of Harris County Industrial Development Corporation Adjustable Rate Industrial Development Bonds, Series 2000 (the "Bonds"). The Bonds are senior to other debt of the Company. All of the bond proceeds, which were held in trust by Bank One Trust Company, N.A. ("Trustee"), were used by NAG for the purchase of land and construction of a hot dip galvanizing plant in Harris County, Texas. The galvanizing plant was completed and began operation in the first quarter of 2001. The principal amount outstanding on these bonds was \$5,078,000 at March 31, 2007.

The Internal Revenue Service has reviewed the Harris County Industrial Development Corporation Adjustable Rate Industrial Development Bonds and compliance with the Internal Revenue Code section (IRC) 144(a)(4)(ii)'s dollar limitation on capital expenditures within a relevant period. The IRS review concerned whether two operating leases commencing in January 2001 were conditional sales contracts, not true leases, according to Revenue Ruling 55-540. As a result of the review, in March, 2007, the Company entered into a settlement agreement (the "Closing Agreement") with the Harris County Industrial Development Corporation and the Commissioner of the Internal Revenue Service ("IRS"). Pursuant to the terms of the Closing Agreement, the Company agreed to make a payment to the IRS of \$101,260 in settlement of the issues referenced above. As of December 31, 2006 the Company had recorded an estimated liability

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of \$145,000 related to this matter. Furthermore, the Company agreed to redeem all outstanding Bonds on or before June 30, 2007. As a result, the bonds payable of \$5,078,000 are included in short-term liabilities as of March 31, 2007. The Company currently has sufficient borrowing capacity to redeem the Bonds.

### NOTE 6. COMMITMENTS AND CONTINGENCIES

The Company has commitments with domestic and foreign zinc producers and brokers to purchase zinc used in its hot dip galvanizing operations. Commitments for the future delivery of zinc reflect rates then quoted on the London Metals Exchange and are not subject to price adjustment or are based on such quoted prices at the time of delivery. At March 31, 2007 the aggregate commitments for the procurement of zinc at fixed prices were approximately \$900,000. The Company reviews these fixed price contracts for losses using the same methodology employed to estimate the market value of its zinc inventory. The Company had no unpriced commitments for zinc purchases at March 31, 2007.

The Company's financial strategy includes evaluating the selective use of derivative financial instruments to manage zinc and interest costs. As part of its inventory management strategy, the Company expects to continue evaluating hedging instruments to minimize the impact of zinc price fluctuations. The Company had no derivative instruments required to be reported at fair value at March 31, 2007 or December 31, 2006, and did not utilize derivatives in the three-month period ended March 31, 2007 or the year ended December 31, 2006, except for the forward purchase agreements described above, which are accounted for as normal purchases.

The Company's total off-balance sheet contractual obligations at March 31, 2007, consist of approximately \$1,466,000 for long-term operating leases for vehicles, office space, office equipment, galvanizing facilities and galvanizing equipment and approximately \$900,000 for zinc purchase commitments. The various leases for galvanizing facilities, including option renewals, expire from 2007 to 2017. A lease for galvanizing equipment expires in 2007.

On August 30, 2004, the Company was informed by counsel for the Metropolitan Water Reclamation District of Greater Chicago (the "Water District") that the Water District had, on August 25, 2004 filed a Second Amended

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Complaint in the United States District Court, Northern District of Illinois, Eastern Division, naming North American Galvanizing & Coatings, Inc. (formerly known as Kinark Corporation) as an added defendant. Counsel for the Water District also gave the Company notice of the Water District's intent to file (or amend the Complaint to include) a Citizens Suit under the Resource Compensation and Recovery Act ("RCRA") against North American Galvanizing & Coatings, Inc., pursuant to Section 7002 of RCRA, 42 U.S.C. Section 6972. This Second Amended Complaint seeks enforcement of an August 12, 2004 default judgment in the amount of \$1,810,463.34 against Lake River Corporation and Lake River Holding Company, Inc. in connection with the operation of a storage terminal by Lake River Corporation in violation of environmental laws. Lake River Corporation conducted business as a subsidiary of the Company until September 30, 2000, at which time Lake River Corporation was sold to Lake River Holding Company, Inc. and ceased to be a subsidiary of the Company. The Second Amended Complaint asserts that prior to the sale of Lake River Corporation, the Company directly operated the Lake River facility and, accordingly, seeks to have the Court pierce the corporate veil of Lake River Corporation and enforce the default judgment order of August 12, 2004 against the Company. The Company denied the assertions set forth in the Water District's Complaint and on November 13, 2004 filed a partial motion for dismissal of the Second Amended Complaint.

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In December 2004, the Water District filed a Third Amended complaint in the litigation, adding two claims: (1) a common law claim for nuisance; and (2) a claim under the federal Resource Conservation and Recovery Act, in which the Water District argues that the Company is responsible for conditions on the plaintiff's property that present an "imminent and substantial endangerment to human health and the environment." In January 2005, the Company filed a partial motion to dismiss the Third Amended Complaint. On April 12, 2005, the Court issued an order denying in part and granting in part the Company's partial motion to dismiss plaintiff's third amended complaint. The Company filed an appeal with the Seventh Circuit Court of Appeals requesting dismissal of the sole CERCLA claim contained in the Third Amended Complaint that was not dismissed by the United States District Court's April 12, 2005 order. On January 17, 2007, the Seventh Circuit affirmed the judgment of the United States District Court, stating that the Water District has a right of action under CERCLA. The Company is evaluating the judgment and expects to file a motion for reconsideration with the Seventh Circuit. Meanwhile, litigation and discovery in the trial court have been stayed pending mediation.

As a result of the mediation, on April 11, 2007, the Company entered into an Agreement in Principle establishing terms for a conditional settlement. Under the terms of the Agreement in Principle, the Company has agreed to fund 50% of the cost, up to \$350,000, to enroll the site in the Illinois Voluntary Site Remediation Program. These funds will be used to prepare environmental reports for approval by the Illinois Environmental Protection Agency. The parties' shared objective is to obtain a "no further remediation determination" from the Illinois EPA based on a commercial / industrial cleanup standard. If the cost to prepare these reports equals or exceed \$700,000, additional costs above \$700,000 (\$350,000 per party) will be borne 100% by the Water District.

If a remediation plan is required based on the site assessment, the Company has also agreed to fund 50% of the cost to implement the remediation plan, up to a maximum of \$1 million. If the cost to implement the plan is projected to exceed \$2 million, then the Water District will have the option to terminate the agreement and resume the litigation. The Water District will have to choose whether to accept or reject the \$1 million funding commitment from the Company before accepting any payments from the Company for implementation of the remediation plan. The Company does not believe that it can determine whether any cleanup is required or if any final cleanup cost is likely to exceed \$2 million until additional data has been collected and analyzed in connection with the environmental reports. If the Water District elects to accept the maximum funding commitment, the Company has also agreed to remove certain piping and other equipment from one of the parcels. The cost to remove the piping is estimated to be between \$35,000 and \$60,000.

Although the boards of both the Water District and the Company have approved the Agreement in Principle, the agreement of the parties must be embodied in a formal settlement agreement, which is currently in process.

The Company has recorded a liability for \$350,000 related to the Water District claim in recognition of its currently known and estimable funding commitment under the Agreement in Principle. In the event that the Water

District rejects the funding commitment described above, the potential claim could exceed the amount of the previous default judgment. As neither a site evaluation nor a remediation plan has been developed, the Company is unable to make a reasonable estimate of the amount or range of further loss, if any, that could result. Such a liability, if any, could have a material adverse effect on the Company's financial condition, results of operations, or liquidity.

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During the first quarter of 2000, the Company issued \$9,050,000 of Harris County Industrial Development Corporation Adjustable Rate Industrial Development Bonds, Series 2000 (the "Bonds"). The Bonds are senior to other debt of the Company. All of the bond proceeds, which were held in trust by Bank One Trust Company, N.A. ("Trustee"), were used by NAG for the purchase of land and construction of a hot dip galvanizing plant in Harris County, Texas. The galvanizing plant was completed and began operation in the first quarter of 2001. The principal amount outstanding on these bonds was \$5,078,000 at March 31, 2007.

The Internal Revenue Service has reviewed the Harris County Industrial Development Corporation Adjustable Rate Industrial Development Bonds and compliance with the Internal Revenue Code section (IRC) 144(a)(4)(ii)'s dollar limitation on capital expenditures within a relevant period. The IRS review concerned whether two operating leases commencing in January 2001 were conditional sales contracts, not true leases, according to Revenue Ruling 55-540. As a result of the review, in March, 2007, the Company entered into a settlement agreement (the "Closing Agreement") with the Harris County Industrial Development Corporation and the Commissioner of the Internal Revenue Service ("IRS"). Pursuant to the terms of the Closing Agreement, the Company agreed to make a payment to the IRS of \$101,260 in settlement of the issues referenced above. As of December 31, 2006 the Company had recorded an estimated liability of \$145,000 related to this matter. Furthermore, the Company agreed to redeem all outstanding Bonds on or before June 30, 2007. As a result, the bonds payable of \$5,078,000 are included in short-term liabilities as of March 31, 2007. The Company currently has sufficient borrowing capacity to redeem the Bonds.

NAG was notified in 1997 by the Illinois Environmental Protection Agency ("IEPA") that it was one of approximately 60 potentially responsible parties ("PRPs") under the Comprehensive Environmental Response, Compensation, and Liability Information System ("CERCLIS") in connection with cleanup of an abandoned site formerly owned by Sandoval Zinc Co. A number of the PRPs have agreed to work together and with IEPA on a voluntary basis. The Company has been and continues to participate in this volunteer group. The group has retained consultants and legal representatives familiar with IEPA regulations. This volunteer group, with its consultants, has cooperated with IEPA in attempting to better define the environmental issues associated with the Sandoval Zinc site. To that extent, this voluntary group prepared and submitted to IEPA in August 2000 a work plan. The purpose of this work plan is to attempt to define the extent of environmental remediation that might be required, assess risks, and review alternatives to addressing potential remediation. The estimated timeframe for resolution of the IEPA contingency is unknown. The IEPA has yet to respond to this proposed work plan or suggest any other course of action, and there has been no activity in regards to this issue since 2001. The Company does not have any liability accrued relating to the IEPA matter. Until the work plan is approved and completed, the range of potential loss or remediation, if any, is unknown. In addition, the allocation of potential loss between the 60 potentially responsible parties is unknown and not reasonably estimable. Therefore, the Company has no basis for determining potential exposure and estimated remediation costs at this time.

The lease term of a galvanizing facility located in Tulsa, Oklahoma, occupied by Reinforcing Services, Inc. ("RSI"), a subsidiary of North American Galvanizing Company, expired July 31, 2003 and has not been renewed. RSI has exercised an option to purchase the facility, and the landlord is contesting the Company's right to exercise this option. RSI has filed a lawsuit against the landlord seeking enforcement of the right to exercise the option and requested a summary judgment in its favor. The court ruled in favor of RSI and as a result, RSI is negotiating terms of the purchase and related items with the landlord. The Company expects this matter to be resolved during 2007 without negative financial impact.

The Company is committed to complying with all federal, state and local

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environmental laws and regulations and using its best management practices to anticipate and satisfy future requirements. As is typical in the galvanizing business, the Company will have additional environmental compliance costs associated with past, present and

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future operations. Management is committed to discovering and eliminating environmental issues as they arise. Because of frequent changes in environmental technology, laws and regulations management cannot reasonably quantify the Company's potential future costs in this area.

North American Galvanizing & Coatings, Inc. and its subsidiary are parties to a number of other lawsuits and environmental matters which are not discussed herein. Management of the Company, based upon their analysis of known facts and circumstances and reports from legal counsel, does not believe that any other such matter will have a material adverse effect on the results of operations, financial conditions or cash flows of the Company.

### NOTE 7. DIRECTOR STOCK UNIT PROGRAM

On January 1, 2005, the Company implemented the Director Stock Unit Program (approved by the stockholders at the Annual Meeting held July 21, 2004) under which a Director is required to defer 50% of his or her board fee and may elect to defer up to 100% of his or her board fee, plus a matching contribution by the Company that varies from 25% to 75% depending on the level of deferral. Such deferrals are converted into a stock unit grant, payable to the Director five years following the year of deferral. For 2006 and 2007, all of the Company's Outside Directors elected to defer 100% of the annual board fee and the Company's chief executive officer and Inside Director has elected to defer a corresponding amount of his salary. Outside Directors currently receive an annual fee of \$35,000, which includes attendance at board meetings and service on committees of the board. In the first three months of 2006, fees and salary deferred by the Directors represented a total of 60,345 stock unit grants valued at \$2.03 per stock unit. In the first three months of 2007, fees and salary deferred by the Directors represented a total of 20,384 stock unit grants valued at \$5.26 per stock unit. The value of a stock unit grant is the average of the closing prices for a share of the Company's stock for the 10 trading days before the date the director fees otherwise would have been payable in cash.

### NOTE 8. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

T. Stephen Gregory, a director of North American Galvanizing & Coatings, Inc. is the chairman of the board and a shareholder of Gregory Industries, Inc., a customer of the Company. Total sales to Gregory Industries, Inc. for the three-month periods ended March 31, 2007 and 2006 were approximately \$385,000 and \$293,000, respectively. The amount due from Gregory Industries, Inc. included in trade receivables at March 31, 2007 and December 31, 2006 was \$199,000 and \$278,000, respectively.

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### NORTH AMERICAN GALVANIZING & COATINGS, INC. AND SUBSIDIARY

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

##### GENERAL

North American Galvanizing is a leading provider of corrosion protection for

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iron and steel components fabricated by its customers. Hot dip galvanizing is the process of applying a zinc coating to fabricated iron or steel material by immersing the material in a bath consisting primarily of molten zinc. Based on the number of its operating plants, the Company is one of the largest merchant market hot dip galvanizing companies in the United States.

During the three-month period ended March 31, 2007, there were no significant changes to the Company's critical accounting policies previously disclosed in Form 10-K for the year ended December 31, 2006.

The Company adopted the provisions of FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes", or FIN 48, on January 1, 2007. FIN 48 clarifies whether or not to recognize assets or liabilities for tax positions taken that may be challenged by a taxing authority. The Company files income tax returns in the U.S. federal jurisdiction and various state jurisdictions. With few exceptions, the Company is no longer subject to U.S. federal and state income tax examinations by tax authorities for years before 2003. In the second quarter of 2006, the Internal Revenue Service (IRS) commenced an examination of the Company's Federal income tax return for 2004 and subsequently added years 2003 and 2005 to the examination. The Company anticipates that the IRS will complete this examination by the end of the second quarter of 2007. The Company had previously recorded \$162,000 relating to anticipated additional federal income taxes as a result of this examination, and does not anticipate that further adjustments resulting from this examination, if any, would result in a material change to its financial position or results of operations. This amount is included in income taxes payable at March 31, 2007.

Upon the adoption of FIN 48, the Company commenced a review of all open tax years in all jurisdictions. The Company does not believe it has included any "uncertain tax positions" in its Federal income tax return or any of the state income tax returns it is currently filing. The Company has made an evaluation of the potential impact of additional state taxes being assessed by jurisdictions in which the Company does not currently consider itself liable. The Company does not anticipate that such additional taxes, if any, would result in a material change to its financial position. In connection with the adoption of FIN 48, the Company will include future interest and penalties, if any, related to uncertain tax positions as a component of its provision for taxes

The Company's galvanizing plants offer a broad line of services including centrifuge galvanizing for small threaded products, sandblasting, chromate quenching, polymeric coatings, and proprietary INFRASHIELD<sup>SM</sup> Coating Application Systems for polyurethane protective linings and coatings over galvanized surfaces. The Company's mechanical and chemical engineers provide customized assistance with initial fabrication design, project estimates and steel chemistry selection.

The Company's galvanizing and coating operations are composed of eleven facilities located in Colorado, Kentucky, Missouri, Ohio, Oklahoma, Tennessee and Texas. These facilities operate galvanizing kettles ranging in length from 16 feet to 62 feet, and have lifting capacities ranging from 12,000 pounds to 40,000 pounds.

The Company maintains a sales and service network coupled with its galvanizing plants, supplemented by national account business development at the corporate level. In 2006, the Company galvanized in excess of 400,000,000 pounds of steel products for approximately 1,700 customers nationwide.

All of the Company's sales are generated for customers whose end markets are principally in the United States. The Company markets its galvanizing and coating services directly to its customers and does not utilize agents or distributors. Although hot dip galvanizing is considered a mature service industry, the Company is actively

engaged in developing new markets through participation in industry trade shows, metals trade associations and presentation of technical seminars by its national marketing service team.

Hot dip galvanizing provides metals corrosion protection for many product applications used in commercial, construction and industrial markets. The Company's galvanizing can be found in almost every major application and industry that requires corrosion protection where iron or steel is used, including the following end user markets:

- o highway and transportation,
- o power transmission and distribution,
- o wireless and telecommunications,
- o utilities,
- o petrochemical processing,
- o industrial grating,
- o infrastructure including buildings, airports, bridges and power generation;
- o wastewater treatment,
- o fresh water storage and transportation;
- o pulp and paper,
- o pipe and tube,
- o food processing,
- o agricultural (irrigation systems),
- o recreation (boat trailers, marine docks, stadium scaffolds),
- o bridge and pedestrian handrail,
- o commercial and residential lighting poles, and
- o original equipment manufactured products, including general fabrication.

As a value-added service provider, the Company's revenues are directly influenced by the level of economic activity in the various end markets that it serves. Economic activity in those markets that results in the expansion and/or upgrading of physical facilities (i.e., construction) may involve a time-lag factor of several months before translating into a demand for galvanizing fabricated components. Despite the inherent seasonality associated with large project construction work, the Company maintains a relatively stable revenue stream throughout the year by offering fabricators, large and small, reliable and rapid turn-around service.

The Company records revenues when the galvanizing and coating processes are completed. The Company generates all of its operating cash from such revenues, and utilizes a line of credit secured by the underlying accounts receivable and zinc inventory to facilitate working capital needs.

Each of the Company's galvanizing plants operate in a highly competitive environment underscored by pricing pressures, primarily from other public and privately-owned galvanizers and alternative forms of corrosion protection, such as paint. The Company's long-term response to these challenges has been a sustained strategy focusing on providing a reliable quality of galvanizing to standard industry technical specifications and rapid turn-around time on every project, large and small. Key to the success of this strategy is the Company's continuing commitment and long-term record of reinvesting earnings to upgrade its galvanizing facilities and provide technical innovations to improve production efficiencies; and to construct new facilities when market conditions present opportunities for growth. The Company is addressing long-term opportunities to expand its galvanizing and coatings business through programs to increase industry awareness of the proven, unique benefits of galvanizing for



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metals corrosion protection. Each of the Company's galvanizing plants is linked to a centralized system involving sales order entry, facility maintenance and operating procedures, quality assurance, purchasing and credit and accounting that enable the plant to focus on providing galvanizing and coating services in the most cost-effective manner.

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The principal raw materials essential to the Company's galvanizing and coating operations are zinc and various chemicals which are normally available for purchase in the open market.

### KEY INDICATORS

Key industries which historically have provided the Company some indication of the potential demand for galvanizing in the near-term, (i.e., primarily within a year) include highway and transportation, power transmission and distribution, telecommunications and the level of quoting activity for regional metal fabricators. In general, growth in the commercial/industrial sectors of the economy generates new construction and capital spending which ultimately impacts the demand for galvanizing.

Key operating measures utilized by the Company include new orders, zinc inventory, tons of steel galvanized, revenue, pounds and labor costs per hour, zinc usage related to tonnage galvanized, and lost-time safety performance. These measures are reported and analyzed on various cycles, including daily, weekly and monthly.

The Company utilizes a number of key financial measures to evaluate the operations at each of its galvanizing plants, to identify trends and variables impacting operating productivity and current and future business results, which include: return on capital employed, sales, gross profit, fixed and variable costs, selling and general administrative expenses, operating cash flows, capital expenditures, interest expense, and a number of ratios such as profit from operations and accounts receivable turnover. These measures are reviewed by the Company's operating and executive management each month, or more frequently, and compared to prior periods, the current business plan and to standard performance criteria, as applicable.

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### RESULTS OF OPERATIONS

The following table shows the Company's results of operations for the three months ended March 31, 2007 and 2006:

(Dollars in thousands)	
THREE MONTHS ENDED MARCH 31,	
2007	2006
-----	-----
% OF	% OF

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	AMOUNT	SALES	AMOUNT	SALES
Sales	\$ 23,499	100.0%	\$ 15,411	100.0%
Cost of sales	16,212	69.0%	10,996	71.4%
Selling, general and administrative expenses	2,364	10.1%	1,841	11.9%
Depreciation and amortization	838	3.6%	647	4.2%
	-----	-----	-----	-----
Operating income	4,085	17.4%	1,927	12.5%
Interest expense	187	0.8%	241	1.6%
Interest Income	(18)	-0.1%	--	--
	-----	-----	-----	-----
Income before income taxes	3,916	16.7%	1,686	10.9%
Income tax expense	1,570	6.7%	704	4.6%
	-----	-----	-----	-----
Net income	\$ 2,346	10.0%	\$ 982	6.4%
	=====	=====	=====	=====

2007 COMPARED TO 2006

SALES. Sales for the first quarter ended March 31, 2007 increased 52% over the prior year. First quarter 2007 volumes are close to volumes in the first quarter of 2006.

Sales prices have increased in the quarter related to increases in zinc costs. In the three-months ended March 31, 2007, average selling prices for galvanizing and related coating services were 55% higher than the prior year first quarter.

The London Metals Exchange (LME) market price for zinc for the first quarter of 2007 averaged \$1.57 per pound, compared to \$1.02 per pound in the first quarter of 2006, representing a 54% increase. At March 31, 2007, the LME market price for zinc was \$1.49 per pound. The Company's zinc forward purchase program in 2006 resulted in some zinc purchases at lower prices than market during the first quarter of 2006. As of March 31, 2007 pricing on the Company's forward purchase contracts does not differ significantly from market.

COST OF SALES. The increase in cost of sales from 2006 to 2007 resulted mainly from an increase in zinc costs. Forward purchases of zinc at prices lower than current market during the first three months of 2006 reduced cost of sales by \$915,000. Other items impacting cost of sales include increased overhead of \$738,000, including \$350,000 related to Lake River environmental site assessment costs, as agreed to in the mediation discussed in Note 6, increased labor costs, \$497,000, and decreased utility costs, \$110,000.

SELLING, GENERAL AND ADMINISTRATIVE (SG&A) EXPENSES. SG&A increased \$523,000, or 28.0%, from the prior year

first quarter, but decreased as a percent of revenues from 11.9%, first quarter 2006 to 10.1%, first quarter 2007. The increase is due to increases in personnel costs, primarily incentive compensation, \$192,000, amortization of deferred bond

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and loan origination costs related to the IRB Bond agreement, \$186,000, and other increases in bad debt reserves, shareholder services, audit fees, and other totaling \$145,000.

DEPRECIATION EXPENSE. Depreciation expense for the first quarter of 2007 increased \$191,000 from 2006, resulting primarily from a change in depreciation method for two newer galvanizing facilities. The Company previously used the units of production method for machinery and equipment at these facilities. Effective July 1, 2006, the Company changed to the straight-line method.

OPERATING INCOME. Operating income increased \$2,158,000 from the first three months of 2006 to the first three months of 2007. Operating income as a percent of sales increased 4.9% for the first quarter of 2007 versus the first quarter of 2006. Increases in operating income result from the factors explained above.

INCOME TAXES. The Company's effective income tax rates for the first quarter of 2007 and 2006 were 40.1% and 41.7%, respectively. The effective tax rates differ from the federal statutory rate primarily due to state income taxes.

NET INCOME. For the first quarter of 2007, the Company reported net income of \$2,346,000 compared to net income of \$982,000 for the first quarter of 2006. The increase in net income is primarily due to the increase in average selling price from the first three months of 2006 to the first three months of 2007.

### LIQUIDITY AND CAPITAL RESOURCES

The Company's cash flow from operations and borrowings under credit facilities have consistently been adequate to fund its current facilities' working capital and base capital spending requirements. During 2007 and 2006, operating cash flow and borrowings under credit facilities have been the primary sources of liquidity. The Company monitors working capital and planned capital spending to assess liquidity and minimize cyclical cash flow.

Cash flow from operating activities for the first three months of 2007 and 2006 was (\$168,000) and (\$612,000), respectively. The increase of \$444,000 in 2007 cash flow from operations was due to increased net income, offset by increased working capital needs, primarily a decrease in accounts payable and accrued liabilities due to reduction in amounts due to zinc suppliers.

Cash of \$525,000 used in 2007 investing activities through March 31 consisted of capital expenditures for equipment and upgrade of existing galvanizing facilities. Investing activities in the first quarter of 2006 included \$154,000 in capital expenditures. The Company expects base capital expenditures for 2007 to approximate \$4,000,000.

During the first three months of 2007, total debt (current and long-term obligations and bonds payable) decreased \$345,000 to \$9,016,000. Other financing activity during the first quarter of 2007 was proceeds from stock option exercises of \$75,000. During the first three months of 2006, total debt (current and long-term obligations) increased \$167,000 to \$14,888,000. Financing activities for first quarter of 2006 included: payments of \$235,000 to a bond sinking fund, proceeds of \$7,191,000 from a bank line of credit, and payments of \$6,789,000 on the bank line of credit and term loans.

In February 2005, the Company amended a three-year bank credit agreement that was scheduled to expire in December 2007 and extended its maturity to February 28, 2008. Subject to borrowing base limitations, the amended agreement provides (i) an \$8,000,000 maximum revolving credit facility for working capital and general corporate purposes and (ii) a \$5,001,000 term loan that combined the outstanding principal balance of the existing term loan with additional financing for the purchase of assets of a galvanizing facility.

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Term loan payments are based on a seven-year amortization schedule with equal monthly payments of principal and interest, and a final balloon payment in February 2008. The term loan may be prepaid without penalty. The revolving line of credit may be paid down without penalty, or additional funds may be borrowed up to the

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maximum line of credit. At March 31, 2007, the Company had unused borrowing capacity of \$7,612,000 under the line of credit, based on the underlying borrowing base of accounts receivable and inventory. At March 31, 2007, there were no borrowings outstanding under the bank credit agreement, and \$388,000 was reserved for outstanding irrevocable letters of credit to secure payment of current and future workers' compensation claims.

Substantially all of the Company's accounts receivable, inventories, fixed assets and the common stock of its subsidiary are pledged as collateral under the agreement, and the credit agreement is secured by a full and unconditional guaranty from NAG. Amounts borrowed under the agreement bear interest at the prime rate of JPMorgan Chase Bank or the LIBOR rate, at the option of the Company, subject to a rate margin adjustment determined by the Company's consolidated debt service coverage ratio. The interest rate on these borrowings was 8.50% at March 31, 2007. In the event the Company fails to maintain a consolidated debt service coverage ratio for any fiscal quarter of at least 1.25 to 1.00, the Applicable LIBOR Rate Margin will be increased from 3.0% to 5.75% and the Applicable Prime Rate Margin will be increased from .25% to 3.00%. Thereafter, the increased rate margin will remain in effect until such time as the Company has maintained a consolidated debt service coverage ratio greater than or equal to 1.25 to 1.00 for a subsequent fiscal quarter.

In the event the Company fails to maintain a consolidated EBITDA to capital expenditures plus current maturity of long-term debt ratio for any fiscal quarter of not less than 1.00 to 1.00, the increase in the Applicable LIBOR Rate Margin ranges from 3.75% to 5.75%, and the increase in the Applicable Prime Rate Margin ranges from 1.00% to 3.00%.

The credit agreement requires the Company to maintain compliance with covenant limits for current ratio, debt to tangible net worth ratio, debt service coverage ratio and a capital expenditures ratio. At March 31, 2007, the Company was in compliance with the covenants, with the exception of the Debt Service Coverage Ratio and Capital Expenditures Coverage Ratio. The covenant violations occurred due to the reclassification of the bonds payable as short-term, based on the agreement with the Internal Revenue Service discussed in Note 5. The Company has obtained a commitment for a new long-term facility financed by another bank and has notified its existing bank that it plans to repay and terminate the current facility. The actual financial ratios compared to the required ratios, were as follows: Current Ratio - actual 1.7 versus minimum required of 1.10; Debt to Tangible Net Worth Ratio - actual .77 vs. maximum permitted of 2.50; Debt Service Coverage Ratio - actual 1.02 versus minimum permitted of 1.25; Capital Expenditures Coverage Ratio - actual .85 versus minimum required of 1.0.

The company has a signed commitment letter from a bank for a \$25,000,000 revolving credit facility, and the right to increase the facility up to \$10,000,000 in minimum increments of \$5,000,000. The purpose of the new facility is to refinance existing revolving line of credit, term debt, bond debt, issue standby letters of credit, finance acquisitions, and for other general corporate purposes. The credit facility will have a maturity of five years with no principal payments required and no prepayment penalty. The Company plans to complete the refinancing before the bank commitment expires on June 29th, 2007.

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Revenue Service ("IRS"). Pursuant to the terms of the Closing Agreement, the Company agreed to make a payment to the IRS of \$101,260 in settlement of the issues referenced above. As of December 31, 2006 the Company had recorded an estimated liability of \$145,000 related to this matter. Furthermore, the Company agreed to redeem all outstanding Bonds on or before June 30, 2007. As a result, the bonds payable of \$5,078,000 are included in short-term liabilities as of March 31, 2007. The Company currently has sufficient borrowing capacity to redeem the Bonds.

The Company has various commitments primarily related to long-term debt, industrial revenue bonds, operating lease commitments, zinc purchase commitments and vehicle operating leases. The Company's total off-balance sheet contractual obligations at March 31, 2007, consist of approximately \$1,466,000 for long-term operating leases for vehicles, office space, office equipment, galvanizing facilities and galvanizing equipment and approximately \$900,000 for zinc purchase commitments. The various leases for galvanizing facilities, including option renewals, expire from 2007 to 2017. A lease for galvanizing equipment expires in 2007. NAG periodically enters into fixed price purchase commitments with domestic and foreign zinc producers to purchase a portion of its requirements for its hot dip galvanizing operations; commitments for the future delivery of zinc can be for up to one year.

### ENVIRONMENTAL MATTERS

The Company's facilities are subject to extensive environmental legislation and regulations affecting their operations and the discharge of wastes. The cost of compliance with such regulations in the first three months of 2007 and 2006 was approximately \$802,000 and \$308,000, respectively, for the disposal and recycling of wastes generated by the galvanizing operations.

On August 30, 2004, the Company was informed by counsel for the Metropolitan Water Reclamation District of Greater Chicago (the "Water District") that the Water District had, on August 25, 2004 filed a Second Amended Complaint in the United States District Court, Northern District of Illinois, Eastern Division, naming North American Galvanizing & Coatings, Inc. (formerly known as Kinark Corporation) as an added defendant. Counsel for the Water District also gave the Company notice of the Water District's intent to file (or amend the Complaint to include) a Citizens Suit under the Resource Compensation and Recovery Act ("RCRA") against North American Galvanizing & Coatings, Inc., pursuant to Section 7002 of RCRA, 42 U.S.C. Section 6972. This Second Amended Complaint

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seeks enforcement of an August 12, 2004 default judgment in the amount of \$1,810,463.34 against Lake River Corporation and Lake River Holding Company, Inc. in connection with the operation of a storage terminal by Lake River Corporation in violation of environmental laws. Lake River Corporation conducted business as a subsidiary of the Company until September 30, 2000, at which time Lake River Corporation was sold to Lake River Holding Company, Inc. and ceased to be a subsidiary of the Company. The Second Amended Complaint asserts that prior to the sale of Lake River Corporation, the Company directly operated the Lake River facility and, accordingly, seeks to have the Court pierce the corporate veil of Lake River Corporation and enforce the default judgment order of August 12, 2004 against the Company. The Company denied the assertions set forth in the Water District's Complaint and on November 13, 2004 filed a partial motion for dismissal of the Second Amended Complaint.

In December 2004, the Water District filed a Third Amended complaint in the litigation, adding two claims: (1) a common law claim for nuisance; and (2) a claim under the federal Resource Conservation and Recovery Act, in which the Water District argues that the Company is responsible for conditions on the plaintiff's property that present an "imminent and substantial endangerment to human health and the environment." In January 2005, the Company filed a partial motion to dismiss the Third Amended Complaint. On April 12, 2005, the Court issued an order denying in part and granting in part the Company's partial motion to dismiss plaintiff's third amended complaint. The Company filed an appeal with the Seventh Circuit Court of Appeals requesting dismissal of the sole CERCLA claim contained in the Third Amended Complaint that was not dismissed by the United States District Court's April 12, 2005 order. On January 17, 2007, the Seventh Circuit affirmed the judgment of the United States District Court, stating that the Water District has a right of action under CERCLA. The Company is evaluating the judgment and expects to file a motion for reconsideration with the Seventh Circuit. Meanwhile, litigation and discovery in the trial court have been stayed pending mediation.

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As a result of the mediation, on April 11, 2007, the Company entered into an Agreement in Principle establishing terms for a conditional settlement. Under the terms of the Agreement in Principle, the Company has agreed to fund 50% of the cost, up to \$350,000, to enroll the site in the Illinois Voluntary Site Remediation Program. These funds will be used to prepare environmental reports for approval by the Illinois Environmental Protection Agency. The parties' shared objective is to obtain a "no further remediation determination" from the Illinois EPA based on a commercial / industrial cleanup standard. If the cost to prepare these reports equals or exceed \$700,000, additional costs above \$700,000 (\$350,000 per party) will be borne 100% by the Water District.

If a remediation plan is required based on the site assessment, the Company has also agreed to fund 50% of the cost to implement the remediation plan, up to a maximum of \$1 million. If the cost to implement the plan is projected to exceed \$2 million, then the Water District will have the option to terminate the agreement and resume the litigation. The Water District will have to choose whether to accept or reject the \$1 million funding commitment from the Company before accepting any payments from the Company for implementation of the remediation plan. The Company does not believe that it can determine whether any cleanup is required or if any final cleanup cost is likely to exceed \$2 million until additional data has been collected and analyzed in connection with the environmental reports. If the Water District elects to accept the maximum funding commitment, the Company has also agreed to remove certain piping and other equipment from one of the parcels. The cost to remove the piping is estimated to be between \$35,000 and \$60,000.

Although the boards of both the Water District and the Company have approved the

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Agreement in Principle, the agreement of the parties must be embodied in a formal settlement agreement, which is currently in process.

The Company has recorded a liability for \$350,000 related to the Water District claim in recognition of its currently known and estimable funding commitment under the Agreement in Principle. In the event that the Water District rejects the funding commitment described above, the potential claim could exceed the amount of the previous default judgment. As neither a site evaluation nor a remediation plan has been developed, the Company is unable to make a reasonable estimate of the amount or range of further loss, if any, that could result. Such a liability, if any, could have a material adverse effect on the Company's financial condition, results of operations, or liquidity.

NAG was notified in 1997 by the Illinois Environmental Protection Agency ("IEPA") that it was one of approximately 60 potentially responsible parties ("PRPs") under the Comprehensive Environmental Response, Compensation, and Liability Information System ("CERCLIS") in connection with cleanup of an abandoned site formerly owned by Sandoval Zinc Co. A number of the PRPs have agreed to work together and with IEPA on a voluntary basis. The Company has been and continues to participate in this volunteer group. The group has retained consultants and legal representatives familiar with IEPA regulations. This volunteer group, with its consultants, has cooperated with IEPA in attempting to better define the environmental issues associated with the Sandoval Zinc site. To that extent, this voluntary group prepared and submitted to IEPA in August 2000 a work plan. The purpose of this work plan is to attempt to define the extent of environmental remediation that might be required, assess risks, and review alternatives to addressing potential remediation. The estimated timeframe for resolution of the IEPA contingency is unknown. The IEPA has yet to respond to this proposed work plan or suggest any other course of action, and there has been no activity in regards to this issue since 2001. The Company does not have any liability accrued relating to the IEPA matter. Until the work plan is approved and completed, the range of potential loss or remediation, if any, is unknown. In addition, the allocation of potential loss between the 60 potentially responsible parties is unknown and not reasonably estimable. Therefore, the Company has no basis for determining potential exposure and estimated remediation costs at this time.

The Company is committed to complying with all federal, state and local environmental laws and regulations and using its best management practices to anticipate and satisfy future requirements. As is typical in the galvanizing business, the Company will have additional environmental compliance costs associated with past, present and future operations. Management is committed to discovering and eliminating environmental issues as they arise. Because of frequent changes in environmental technology, laws and regulations management cannot reasonably

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quantify the Company's potential future costs in this area.

North American Galvanizing & Coatings, Inc. and its subsidiary are parties to a number of other lawsuits and environmental matters which are not discussed herein. Management of the Company, based upon their analysis of known facts and circumstances and reports from legal counsel, does not believe that any such matter will have a material adverse effect on the results of operations, financial conditions or cash flows of the Company.

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

The Company's operations include managing market risks related to changes in interest rates and zinc commodity prices.

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INTEREST RATE RISK. The Company is exposed to financial market risk related to changes in interest rates. Changing interest rates will affect interest paid on the Company's variable rate debt. At March 31, 2007, the Company's outstanding debt of \$9,016,000 consisted of the following: Variable rate debt aggregating \$3,573,000 under the bank credit agreement, with an effective rate of 8.5% and variable rate debt of \$5,078,000 under the industrial revenue bond agreement, with an effective rate of 4.0%. The borrowings under all of the Company's debt obligations at March 31, 2007 are due as follows: : \$8,712,000 in 2007; \$289,000 in 2008; \$1,000 in 2009 and \$14,000 in years 2010 through 2013. Each increase of 10 basis points in the effective interest rate would result in an annual increase in interest charges on variable rate debt of approximately \$9,000 based on March 31, 2007 outstanding borrowings. The actual effect of changes in interest rates is dependent on actual amounts outstanding under the various loan agreements. The Company monitors interest rates and has sufficient flexibility to renegotiate the loan agreement, without penalty, in the event market conditions and interest rates change.

ZINC PRICE RISK. NAG periodically enters into fixed price purchase commitments with domestic and foreign zinc producers to purchase a portion of its zinc requirements for its hot dip galvanizing operations. Commitments for the future delivery of zinc, typically up to one (1) year, reflect rates quoted on the London Metals Exchange. At March 31, 2007, the aggregate fixed price commitments for the procurement of zinc were approximately \$900,000 (Note 6). With respect to these zinc fixed price purchase commitments, a hypothetical decrease of 10% in the market price of zinc from the March 31, 2007 level represented a potential lost gross margin opportunity of approximately \$9,000.

The Company's financial strategy includes evaluating the selective use of derivative financial instruments to manage zinc and interest costs. As part of its inventory management strategy, the Company recognizes that hedging instruments may be effective in minimizing the impact of zinc price fluctuations. The Company's current zinc forward purchase commitments are considered derivatives, but the Company has elected to account for these purchase commitments as normal purchases.

### ITEM 4. CONTROLS AND PROCEDURES

As of the end of the period covered by this report, management, including our chief executive officer and chief financial officer, evaluated the effectiveness of the design and operation of our disclosure controls and procedures. Based upon, and as of the date of, the evaluation, our chief executive officer and chief financial officer concluded that the disclosure controls and procedures were effective, in all material respects, to ensure that information required to be disclosed in the reports we file and submit under the Exchange Act is recorded, processed, summarized and reported as and when required.

The Company's certifying officers have indicated that there were no significant changes in internal controls over financial reporting that have occurred during the fiscal quarter ended March 31, 2007 that materially affected, or were reasonably likely to materially affect, internal controls over financial reporting.

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## PART II OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS.

On August 30, 2004, the Company was informed by counsel for the Metropolitan Water Reclamation District of Greater Chicago (the "Water District") that the



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Water District had, on August 25, 2004 filed a Second Amended Complaint in the United States District Court, Northern District of Illinois, Eastern Division, naming North American Galvanizing & Coatings, Inc. (formerly known as Kinark Corporation) as an added defendant. Counsel for the Water District also gave the Company notice of the Water District's intent to file (or amend the Complaint to include) a Citizens Suit under the Resource Conservation and Recovery Act ("RCRA") against North American Galvanizing & Coatings, Inc., pursuant to Section 7002 of RCRA, 42 U.S.C. Section 6972. This Second Amended Complaint seeks enforcement of an August 12, 2004 default judgment in the amount of \$1,810,463.34 against Lake River Corporation and Lake River Holding Company, Inc. in connection with the operation of a storage terminal by Lake River Corporation in violation of environmental laws. Lake River Corporation conducted business as a subsidiary of the Company until September 30, 2000, at which time Lake River Corporation was sold to Lake River Holding Company, Inc. and ceased to be a subsidiary of the Company. The Second Amended Complaint asserts that prior to the sale of Lake River Corporation, the Company directly operated the Lake River facility and, accordingly, seeks to have the Court pierce the corporate veil of Lake River Corporation and enforce the default judgment order of August 12, 2004 against the Company. The Company denied the assertions set forth in the Water District's Complaint and on November 13, 2004 filed a partial motion for dismissal of the Second Amended Complaint.

In December 2004, the Water District filed a Third Amended complaint in the litigation, adding two claims: (1) a common law claim for nuisance; and (2) a claim under the federal Resource Conservation and Recovery Act, in which the Water District argues that the Company is responsible for conditions on the plaintiff's property that present an "imminent and substantial endangerment to human health and the environment." In January 2005, the Company filed a partial motion to dismiss the Third Amended Complaint. On April 12, 2005, the Court issued an order denying in part and granting in part the Company's partial motion to dismiss plaintiff's third amended complaint. The Company filed an appeal with the Seventh Circuit Court of Appeals requesting dismissal of the sole CERCLA claim contained in the Third Amended Complaint that was not dismissed by the United States District Court's April 12, 2005 order. On January 17, 2007, the Seventh Circuit affirmed the judgment of the United States District Court, stating that the Water District has a right of action under CERCLA. The Company is evaluating the judgment and expects to file a motion for reconsideration with the Seventh Circuit. Meanwhile, litigation and discovery in the trial court have been stayed pending mediation.

As a result of the mediation, on April 11, 2007, the Company entered into an Agreement in Principle establishing terms for a conditional settlement. Under the terms of the Agreement in Principle, the Company has agreed to fund 50% of the cost, up to \$350,000, to enroll the site in the Illinois Voluntary Site Remediation Program. These funds will be used to prepare environmental reports for approval by the Illinois Environmental Protection Agency. The parties' shared objective is to obtain a "no further remediation determination" from the Illinois EPA based on a commercial / industrial cleanup standard. If the cost to prepare these reports equals or exceeds \$700,000, additional costs above \$700,000 (\$350,000 per party) will be borne 100% by the Water District.

If a remediation plan is required based on the site assessment, the Company has also agreed to fund 50% of the cost to implement the remediation plan, up to a maximum of \$1 million. If the cost to implement the plan is projected to exceed \$2 million, then the Water District will have the option to terminate the agreement and resume the litigation. The Water District will have to choose whether to accept or reject the \$1 million funding commitment from the Company before accepting any payments from the Company for implementation of the remediation plan. The Company does not believe that it can determine whether any cleanup is required or if any final cleanup cost is likely to exceed \$2 million until additional data has been collected and analyzed in connection with the environmental reports. If the Water District elects to accept the maximum

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funding commitment, the Company has also agreed to remove certain piping and other equipment from one of the parcels. The cost to remove the piping is estimated to be between \$35,000 and \$60,000.

Although the boards of both the Water District and the Company have approved the Agreement in Principle, the

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agreement of the parties must be embodied in a formal settlement agreement, which is currently in process.

The Company has recorded a liability for \$350,000 related to the Water District claim in recognition of its currently known and estimable funding commitment under the Agreement in Principle. In the event that the Water District rejects the funding commitment described above, the potential claim could exceed the amount of the previous default judgment. As neither a site evaluation nor a remediation plan has been developed, the Company is unable to make a reasonable estimate of the amount or range of further loss, if any, that could result. Such a liability, if any, could have a material adverse effect on the Company's financial condition, results of operations, or liquidity.

The lease term of a galvanizing facility located in Tulsa, Oklahoma, occupied by Reinforcing Services, Inc. ("RSI"), a subsidiary of North American Galvanizing Company, expired July 31, 2003 and has not been renewed. RSI has exercised an option to purchase the facility, and the landlord is contesting the Company's right to exercise this option. RSI has filed a lawsuit against the landlord seeking enforcement of the right to exercise the option and requested a summary judgment in its favor. The court ruled in favor of RSI and as a result, RSI is negotiating terms of the purchase and related items with the landlord. The Company expects this matter to be resolved during 2007 without negative financial impact.

North American Galvanizing & Coatings, Inc. and its subsidiary are parties to a number of other lawsuits and environmental matters which are not discussed herein. Management of the Company, based upon their analysis of known facts and circumstances and reports from legal counsel, does not believe that any such matter will have a material adverse effect on the results of operations, financial conditions or cash flows of the Company.

### ITEM 1A. RISK FACTORS.

There are no material changes from risk factors as previously disclosed in the Company's Annual Report on Form 10-K filed on February 14, 2007.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS - NOT APPLICABLE.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES - NOT APPLICABLE.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS - NOT APPLICABLE.

ITEM 5. OTHER INFORMATION - NOT APPLICABLE.

ITEM 6. EXHIBITS

NO. DESCRIPTION

3.1 The Company's Restated Certificate of Incorporation (incorporated by reference to Exhibit 3.1 to the Company's Pre-Effective Amendment No. 1 to Registration Statement on Form S-3 (Reg. No. 333-4937) filed on

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June 7, 1996).

- 3.2 The Company's Amended and Restated Bylaws (incorporated by reference to Exhibit 3.2 to the Company's Quarterly Report on Form 10-Q dated March 31, 1996).
- 10.1 Executive Employment Agreement, Ronald J. Evans, dated April 1, 2007.
- 10.2 Metropolitan Water District of Greater Chicago and North American Galvanizing & Coatings, Inc. Agreement in Principle, dated April 11, 2007.

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- 15 Letter from Deloitte & Touche LLP regarding interim financial information.
- 31.1 Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32 Certifications pursuant to 18 U.S.C. Section 1350, as adopted by Section 906 of the Sarbanes-Oxley Act of 2002.
- 99 Cautionary Statements by the Company Regarding Forward-Looking Statements.

SIGNATURES

Pursuant to the requirements of Section 13 and 15(d) of the Securities and Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized:

NORTH AMERICAN GALVANIZING & COATINGS, INC.  
(Registrant)

BY: /S/ BETH B. HOOD  
-----  
Vice President and  
Chief Financial Officer  
(Principal Financial Officer)

Date: May 15, 2007

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