

BOWATER INC
Form 10-Q
November 08, 2005

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q**

(Mark One)

- QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2005.**
- 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: 1-1872
BOWATER INCORPORATED**

(Exact Name of Registrant as Specified in its Charter)

Delaware

62-0721803

(State of Incorporation)

(I.R.S. Employer Identification No.)

55 East Camperdown Way, P.O. Box 1028, Greenville, SC 29602

(Address of principal executive offices)(Zip Code)

(864) 271-7733

(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 the filing requirements for at least the past 90 days. Yes No

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes No

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 November 4, 2005.

Class	Outstanding at November 4, 2005
Common Stock, \$1.00 Par Value	55,923,300 Shares

BOWATER INCORPORATED
I N D E X

	Page Number
PART I FINANCIAL INFORMATION	
Item 1. Financial Statements:	
Consolidated Statement of Operations for the Three and Nine Months Ended September 30, 2005, and 2004	3
Consolidated Balance Sheet at September 30, 2005 and December 31, 2004	4
Consolidated Statement of Capital Accounts for the Nine Months Ended September 30, 2005	5
Consolidated Statement of Cash Flows for the Nine Months Ended September 30, 2005 and 2004	6
Notes to Consolidated Financial Statements	7 15
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	16 35
Item 3. Quantitative and Qualitative Disclosures About Market Risk	36
Item 4. Controls and Procedures	36
PART II OTHER INFORMATION	
Item 1. Legal Proceedings	37
Item 6. Exhibits	37
SIGNATURES	38

BOWATER INCORPORATED
CONSOLIDATED STATEMENT OF OPERATIONS
(Unaudited, in millions of US dollars except per-share amounts)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Sales	\$872.9	\$834.0	\$2,607.4	\$2,367.3
Cost of sales, excluding depreciation, amortization and cost of timber harvested	630.5	586.9	1,880.6	1,731.7
Depreciation, amortization and cost of timber harvested	82.5	83.0	245.9	254.1
Distribution costs	83.8	85.2	256.1	241.6
Selling and administrative expense	41.0	39.9	121.0	108.7
Impairment of assets			11.9	
Net gain on sale of assets	9.9	1.7	30.7	5.9
Operating income	45.0	40.7	122.6	37.1
Other expense (income):				
Interest income	(1.0)	(1.1)	(3.2)	(3.2)
Interest expense, net of capitalized interest	50.0	48.4	149.5	146.5
Other, net	(0.9)	(1.3)	(3.8)	(6.4)
	48.1	46.0	142.5	136.9
Loss before income taxes and minority interests	(3.1)	(5.3)	(19.9)	(99.8)
Income tax expense (benefit)	14.5	12.0	1.1	(44.7)
Minority interests in net (income) loss of subsidiaries	(1.6)	0.8	(2.3)	(3.2)
Net loss	(16.0)	(18.1)	(18.7)	(51.9)
Other comprehensive loss, net of tax:				
Foreign currency translation adjustments	3.5	4.0	2.3	1.4
Minimum pension liability adjustments	(1.4)	(3.6)	(0.9)	(1.6)
Net change in derivative instruments	(3.3)	13.8	(47.4)	(39.2)
Comprehensive loss	\$ (17.2)	\$ (3.9)	\$ (64.7)	\$ (91.3)
Basic loss per common share	\$ (0.28)	\$ (0.32)	\$ (0.33)	\$ (0.91)
Diluted loss per common share	\$ (0.28)	\$ (0.32)	\$ (0.33)	\$ (0.91)
Dividends declared per common share	\$ 0.20	\$ 0.20	\$ 0.60	\$ 0.60

See accompanying notes to consolidated financial statements.

BOWATER INCORPORATED
CONSOLIDATED BALANCE SHEET
(Unaudited, in millions of US dollars except per-share amounts)

	September 30, 2005	December 31, 2004
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 23.3	\$ 29.7
Accounts receivable, net	432.9	377.0
Inventories	353.3	327.9
Unrealized gain on hedged transactions	46.6	100.2
Other current assets	57.5	67.9
Total current assets	913.6	902.7
Timber and timberlands	186.2	186.2
Fixed assets, net	3,125.3	3,301.1
Goodwill	828.2	828.2
Other assets	233.5	240.7
Total assets	\$ 5,286.8	\$ 5,458.9
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Current installments of long-term debt	\$ 20.6	\$ 14.0
Short-term bank debt	27.0	73.0
Accounts payable and accrued liabilities	496.7	458.4
Dividends payable	11.2	11.2
Total current liabilities	555.5	556.6
Long-term debt, net of current installments	2,403.0	2,427.9
Pension, other postretirement benefits and other long-term liabilities	494.9	495.2
Deferred income taxes	354.8	403.4
Minority interests in subsidiaries	68.3	68.5
Shareholders equity:		
Common Stock, \$1 par value. Authorized 100,000,000 shares; issued 67,529,294 and 67,438,584 shares at September 30, 2005 and December 31, 2004, respectively	67.5	67.4
Exchangeable Shares, no par value. Unlimited shares authorized; 1,434,445 and 1,466,358 outstanding at September 30, 2005 and December 31, 2004, respectively	68.1	69.7
Additional paid-in capital	1,621.6	1,618.3
Retained earnings	213.5	266.5
Unearned compensation		(0.1)

Edgar Filing: BOWATER INC - Form 10-Q

Accumulated other comprehensive loss	(74.6)	(28.6)
Treasury stock at cost, 11,605,770 and 11,608,385 shares at September 30, 2005 and December 31, 2004, respectively	(485.8)	(485.9)
Total shareholders equity	1,410.3	1,507.3
Total liabilities and shareholders equity	\$ 5,286.8	\$ 5,458.9

See accompanying notes to consolidated financial statements.

4

BOWATER INCORPORATED
CONSOLIDATED STATEMENT OF CAPITAL ACCOUNTS
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2005
(Unaudited, in millions of US dollars except per-share amounts)

(In millions, except share amounts)	Common Stock	Exchangeable Shares	Additional Paid In Capital	Retained Earnings	Unearned Compensation	Accumulated Other Comprehensive Loss	Treasury Stock
Balance at December 31, 2004	\$ 67.4	\$ 69.7	\$ 1,618.3	\$ 266.5	\$ (0.1)	\$ (28.6)	\$ (485.9)
Net loss				(18.7)			
Retraction of Exchangeable Shares (31,913 shares of Common Stock issued and Exchangeable Shares retracted)		(1.6)	1.6				
Dividends on Common Stock (\$0.60 per share)				(34.3)			
Foreign currency translation						2.3	
Stock options exercised (69,000 shares)	0.1		1.8				
Tax benefit on exercise of stock options			0.3				
Reduction of pension plan additional minimum liability, net of tax benefit of \$0.5						(0.9)	
Change in unrealized gain on hedged transactions, net of change in accrued tax of \$29.0						(47.4)	
Restricted stock cancellation (10,203 shares)			(0.4)				
Amortization of unearned compensation on restricted stock					0.1		
Treasury stock used for dividend reinvestment plans and to pay employee and director benefits (2,615 shares)							0.1

Balance at September 30, 2005	\$ 67.5	\$ 68.1	\$ 1,621.6	\$ 213.5	\$	\$ (74.6)	\$ (485.8)
--------------------------------------	---------	---------	------------	----------	----	-----------	------------

See accompanying notes to consolidated financial statements.

5

BOWATER INCORPORATED
CONSOLIDATED STATEMENT OF CASH FLOWS
(Unaudited, in millions of US dollars except per-share amounts)

	Nine Months Ended	
	September 30, 2005	September 30, 2004
Cash flows from operating activities:		
Net loss	\$ (18.7)	\$ (51.9)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation, amortization and cost of timber harvested	245.9	254.1
Impairment of assets	11.9	
Deferred income taxes	(6.9)	(55.4)
Amortization of unearned compensation on restricted stock	0.1	0.7
Minority interests in net loss of subsidiaries	(2.3)	(3.2)
Net gain on fixed assets and land sales	(30.7)	(5.9)
Changes in working capital:		
Accounts receivable, net	(55.9)	(60.6)
Inventories	(26.2)	(15.5)
Income taxes receivable	4.6	
Accounts payable and accrued liabilities	42.4	57.1
Income taxes payable		(26.2)
Other, net	(20.9)	(7.5)
Net cash provided by operating activities	143.3	85.7
Cash flows from investing activities:		
Cash invested in fixed assets, timber and timberlands	(89.6)	(60.3)
Dispositions of assets, including timber and timberlands	33.7	10.3
Net cash used for investing activities	(55.9)	(50.0)
Cash flows from financing activities:		
Cash dividends, including minority interests	(34.3)	(34.6)
Short-term financing	413.9	540.5
Short-term financing repayments	(461.0)	(683.1)
Long-term financing		245.9
Payments of long-term debt	(14.3)	(113.8)
Stock options exercised	1.9	5.1
Net cash used for financing activities	(93.8)	(40.0)
Net decrease in cash and cash equivalents	(6.4)	(4.3)
Cash and cash equivalents:		
Beginning of year	29.7	19.4
End of year	\$ 23.3	\$ 15.1
Supplemental disclosures of cash flow information:		
Cash paid during the year for:		
Interest, including capitalized interest of \$0.6 and \$0	\$ 107.5	\$ 121.9

Income taxes		\$ 1.0	\$ 33.9
	See accompanying notes to consolidated financial statements.		

BOWATER INCORPORATED
Notes to Consolidated Financial Statements Unaudited

1. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying consolidated financial statements include the accounts of Bowater Incorporated and subsidiaries (Bowater). The consolidated balance sheet as of September 30, 2005, and the related statements of operations, capital accounts and cash flows for the periods ended September 30, 2005 and 2004 are unaudited. In our opinion, all adjustments (consisting of normal recurring adjustments) necessary for fair presentation of the interim financial statements have been made. The results of the interim period ended September 30, 2005, are not necessarily indicative of the results to be expected for the full year. These financial statements should be read in conjunction with the consolidated financial statements, critical accounting policies, significant accounting policies and the notes to the consolidated financial statements included in our most recent Annual Report on Form 10-K. Certain prior-year amounts in the financial statements and the notes have been reclassified to conform to the 2005 presentation. The reclassifications had no effect on total shareholders' equity or net loss.

2. Stock Based Compensation

Bowater accounts for stock-based compensation utilizing the intrinsic value method in accordance with Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees. Under APB No. 25, compensation expense for employee stock options is generally not recognized if the exercise price of the option equals or exceeds the fair value of the underlying stock on the date of grant.

The following table represents the pro forma effect on net loss and loss per share if we had applied the fair value-based method and recognition provisions of SFAS No. 123 Accounting for Stock-Based Compensation. The estimated fair value of the option is amortized to expense over the vesting period of the option award, in accordance with the provisions of SFAS No. 123.

<i>(Unaudited, in millions, except per-share amounts)</i>	Three months ended September 30, 2005		Nine months ended September 30, 2005	
	2005	2004	2005	2004
Net loss as reported:	\$(16.0)	\$(18.1)	\$(18.7)	\$(51.9)
Add: Stock-based compensation expense included in net loss, net of related tax effects		0.1		0.5
Deduct: Stock-based compensation expense determined under fair value based methods, net of related tax effects	(1.4)	(1.8)	(4.3)	(5.5)
Pro forma net loss	\$(17.4)	\$(19.8)	\$(23.0)	\$(56.9)
Loss per share:				
Basic, as reported	\$(0.28)	\$(0.32)	\$(0.33)	\$(0.91)
Basic, pro forma	(0.30)	(0.35)	(0.40)	(1.00)
Diluted, as reported	\$(0.28)	\$(0.32)	\$(0.33)	\$(0.91)
Diluted, pro forma	(0.30)	(0.35)	(0.40)	(1.00)

BOWATER INCORPORATED**Notes to Consolidated Financial Statements Unaudited**

The fair value of each option granted in the three and nine months ended September 30, 2005 and 2004, was estimated on the date of grant using the Black-Scholes option-pricing model with the weighted average assumptions below.

	Nine Months Ended September 30,	
	2005	2004
Assumptions:		
Dividend yield	2.2%	1.8%
Expected volatility	29.0%	30.6%
Risk-free interest rate	4.0%	3.4%
Expected option lives in years	7.2	6.8
Weighted average fair value of each option	\$11.16	\$13.88

In January 2005 and 2004, respectively, Bowater granted 740,750 and 862,000 options pursuant to its 2002 stock option plan at an exercise price of \$37 and \$45 per share, respectively. In May 2005, Bowater granted an additional 15,000 options pursuant to its 2002 stock option plan at an exercise price of \$32 per share. The options generally become exercisable over a period of two years and expire 10 years from date of grant.

3. Asset Impairment

During the second quarter of 2005, Bowater management decided to permanently shut the original line at Benton Harbor. This was based on the significant capital spending that would be required for the original line to meet the quality standards of our two newer Nuway lines and because the facility's infrastructure would not support a restart given the recent record production of the new Benton Harbor line. This permanent shut resulted in a one time non-cash asset impairment charge of \$11.9 million. This permanent shut will not have a negative impact on our current operations as the original line had been idled since the third quarter of 2002. For segment reporting purposes, this impairment charge is included in our Coated and Specialty Papers Division.

4. Inventories

	September 30, 2005	December 31, 2004
<i>(Unaudited, in millions)</i>		
At lower of cost or market:		
Raw materials	\$ 92.2	\$ 87.9
Work in process	28.2	23.1
Finished goods	127.1	112.7
Mill stores and other supplies	116.6	114.9
	364.1	338.6
Excess of current cost over LIFO inventory value	(10.8)	(10.7)

\$ 353.3

\$ 327.9

8

BOWATER INCORPORATED
Notes to Consolidated Financial Statements Unaudited

5. Other (Income) Expense

Other, net in the Consolidated Statement of Operations includes the following:

<i>(Unaudited, in millions)</i>	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Foreign exchange (gain) loss	\$ 1.8	\$ 1.2	\$ 3.6	\$ (0.1)
Income from joint venture	(1.3)	(1.7)	(3.1)	(3.2)
Miscellaneous income	(1.4)	(0.8)	(4.3)	(3.1)
	\$ (0.9)	\$ (1.3)	\$ (3.8)	\$ (6.4)

6. Accumulated Other Comprehensive Loss

The components of Accumulated other comprehensive loss in the Consolidated Balance Sheet are as follows:

<i>(Unaudited, in millions)</i>	September 30, 2005	December 31, 2004
Pension plan additional minimum liabilities (1)	\$ (114.0)	\$ (113.1)
Foreign currency translation (2)	10.5	8.2
Unrealized gain on hedging transactions (3)	28.9	76.3
	\$ (74.6)	\$ (28.6)

(1) Net of deferred tax benefit of \$66.0 million and \$65.5 million, respectively.

(2) No tax effect is recorded for foreign currency translation since the foreign net assets translated are deemed permanently invested.

(3)

Net of deferred
tax expense of
\$17.7 million
and
\$46.7 million,
respectively.

BOWATER INCORPORATED
Notes to Consolidated Financial Statements Unaudited

7. Loss Per Share

Basic and diluted loss per share are based on net loss and do not include any impact from Other comprehensive loss.

<i>(Unaudited, in millions, except per-share amounts)</i>	Three months ended September 30, 2005		Nine months ended September 30, 2005	
	2004	2004	2004	2004
Basic computation:				
Basic loss available to common shareholders	\$ (16.0)	\$ (18.1)	\$ (18.7)	\$ (51.9)
Basic weighted average shares outstanding	57.4	57.2		