

BRUSH ENGINEERED MATERIALS INC

Form 10-Q

August 06, 2007

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549**

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 29, 2007

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 001-15885

BRUSH ENGINEERED MATERIALS INC.
(Exact name of Registrant as specified in charter)

Ohio

(State or other jurisdiction of incorporation or organization)

17876 St. Clair Avenue, Cleveland, Ohio
(Address of principal executive offices)

34-1919973

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

44110

(Zip Code)

Registrant's telephone number, including area code:

216-486-4200

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check One)

Large accelerated filer Accelerated filer Non-accelerated filer

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

As of July 31, 2007 there were 20,390,719 shares of Common Stock, no par value, outstanding.

PART I FINANCIAL INFORMATION

BRUSH ENGINEERED MATERIALS INC. AND SUBSIDIARIES

Item 1. Financial Statements

The consolidated financial statements of Brush Engineered Materials Inc. and its subsidiaries for the quarter ended June 29, 2007 are as follows:

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Table of Contents**Consolidated Statements of Income
(Unaudited)**

<i>(Dollars in thousands except share and per share amounts)</i>	Second Quarter Ended		First Half Ended	
	June 29, 2007	June 30, 2006	June 29, 2007	June 30, 2006
Net sales	\$ 233,563	\$ 187,078	\$ 483,877	\$ 354,801
Cost of sales	191,782	147,259	372,712	280,839
Gross margin	41,781	39,819	111,165	73,962
Selling, general and administrative expense	26,564	27,194	55,234	51,103
Research and development expense	1,275	954	2,601	2,035
Other-net	1,325	377	3,858	702
Operating profit	12,617	11,294	49,472	20,122
Interest expense	571	1,125	1,254	2,267
Income before income taxes	12,046	10,169	48,218	17,855
Income taxes	4,107	3,201	17,165	5,660
Net income	\$ 7,939	\$ 6,968	\$ 31,053	\$ 12,195
Per share of common stock: basic	\$ 0.39	\$ 0.36	\$ 1.53	\$ 0.63
Weighted average number of common shares outstanding	20,351,000	19,593,000	20,254,000	19,428,000
Per share of common stock: diluted	\$ 0.38	\$ 0.35	\$ 1.50	\$ 0.62
Weighted average number of common shares outstanding	20,736,000	19,865,000	20,709,000	19,680,000

See notes to consolidated financial statements.

Table of Contents**Consolidated Balance Sheets
(Unaudited)**

<i>(Dollars in thousands)</i>	June 29, 2007	Dec. 31, 2006
Assets		
Current assets		
Cash and cash equivalents	\$ 12,074	\$ 15,644
Accounts receivable	114,097	86,461
Inventories	163,192	151,950
Prepaid expenses	15,262	13,988
Deferred income taxes	3,255	3,541
Total current assets	307,880	271,584
Other assets	12,886	13,577
Related-party notes receivable	98	98
Long-term deferred income taxes	9,785	15,575
Property, plant and equipment	569,298	557,861
Less allowances for depreciation, depletion and amortization	388,142	381,932
	181,156	175,929
Goodwill	21,782	21,843
	\$ 533,587	\$ 498,606
Liabilities and Shareholders Equity		
Current liabilities		
Short-term debt	\$ 30,718	\$ 28,076
Current portion of long-term debt	631	632
Accounts payable	37,340	30,744
Other liabilities and accrued items	51,471	52,161
Unearned revenue	1,683	314
Income taxes	3,696	4,515
Total current liabilities	125,539	116,442
Other long-term liabilities	9,515	11,642
Retirement and post-employment benefits	57,251	59,089
Long-term income taxes	4,331	
Deferred income taxes	128	151
Long-term debt	10,246	20,282
Shareholders equity	326,577	291,000
	\$ 533,587	\$ 498,606

See notes to consolidated financial statements.

Table of Contents**Consolidated Statements of Cash Flows
(Unaudited)**

	First Half Ended	
	June 29, 2007	June 30, 2006
<i>(Dollars in thousands)</i>		
Net income	\$ 31,053	\$ 12,195
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation, depletion and amortization	11,928	11,818
Amortization of deferred financing costs in interest expense	215	301
Derivative financial instrument ineffectiveness	(72)	(426)
Stock-based compensation expense	1,932	696
Decrease (increase) in accounts receivable	(27,752)	(13,443)
Decrease (increase) in inventory	(12,859)	(22,190)
Decrease (increase) in prepaid and other current assets	(999)	(2,972)
Decrease (increase) in deferred income taxes	(3,672)	4,383
Increase (decrease) in accounts payable and accrued expenses	2,069	4,761
Increase (decrease) in unearned revenue	1,369	920
Increase (decrease) in interest and taxes payable	7,960	773
Increase (decrease) in other long-term liabilities	478	2,162
Other net	(202)	6,138
Net cash provided from operating activities	11,448	5,116
Cash flows from investing activities:		
Payments for purchase of property, plant and equipment	(11,156)	(5,978)
Payments for mine development	(6,195)	(46)
Payments for purchase of business net of cash received		(25,694)
Proceeds from sale of business	2,150	
Proceeds from sale of property, plant and equipment	51	
Other investments net	42	33
Net cash used in investing activities	(15,108)	(31,685)
Cash flows from financing activities:		
Proceeds from issuance (repayment) of short-term debt	2,591	864
Proceeds from issuance of long-term debt	15,747	26,000
Repayment of long-term debt	(25,793)	(5,033)
Issuance of common stock under stock option plans	4,864	6,960
Tax benefit from exercise of stock options	2,716	
Net cash provided from financing activities	125	28,791
Effects of exchange rate changes	(35)	(273)
Net change in cash and cash equivalents	(3,570)	1,949
Cash and cash equivalents at beginning of period	15,644	10,642

Cash and cash equivalents at end of period	\$ 12,074	\$ 12,591
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See notes to consolidated financial statements.

Table of Contents**Notes to Consolidated Financial Statements
(Unaudited)****Note A Accounting Policies**

In management's opinion, the accompanying consolidated financial statements contain all adjustments necessary to present fairly the financial position as of June 29, 2007 and December 31, 2006 and the results of operations for the second quarter and first half ended June 29, 2007 and June 30, 2006. All of the adjustments were of a normal and recurring nature.

Note B Inventories

<i>(Dollars in thousands)</i>	June 29, 2007	Dec. 31, 2006
Principally average cost:		
Raw materials and supplies	\$ 35,214	\$ 36,390
Work in process	138,472	124,670
Finished goods	51,333	56,721
Gross inventories	225,019	217,781
Excess of average cost over LIFO inventory value	61,827	65,831
Net inventories	\$ 163,192	\$ 151,950

Note C Pensions and Other Post-retirement Benefits

<i>(Dollars in thousands)</i>	Pension Benefits		Other Benefits	
	Second Quarter Ended		Second Quarter	
	June 29, 2007	June 30, 2006	Ended June 29, 2007	Ended June 30, 2006
Components of net periodic benefit cost				
Service cost	\$ 1,161	\$ 1,254	\$ 75	\$ 74
Interest cost	1,851	1,743	477	475
Expected return on plan assets	(2,156)	(2,079)		
Amortization of prior service cost	(164)	(178)	(9)	(9)
Amortization of net loss/(gain)	436	516		
Net periodic benefit cost	\$ 1,128	\$ 1,256	\$ 543	\$ 540

	Pension Benefits		Other Benefits	
	First Half Ended		First Half Ended	
<i>(Dollars in thousands)</i>	June 29, 2007	June 30, 2006	June 29, 2007	June 30, 2006
Components of net periodic benefit cost				
Service cost	\$ 2,314	\$ 2,507	\$ 150	\$ 148
Interest cost	3,689	3,485	955	951
Expected return on plan assets	(4,297)	(4,157)		
Amortization of prior service cost	(327)	(356)	(18)	(18)
Amortization of net loss/(gain)	869	1,033		
Net periodic benefit cost	\$ 2,248	\$ 2,512	\$ 1,087	\$ 1,081

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Note D Contingencies

Brush Wellman Inc., one of the Company's wholly owned subsidiaries, is a defendant in various legal proceedings where the plaintiffs allege that they have contracted chronic beryllium disease (CBD) or related ailments as a result of exposure to beryllium. Management believes that the Company has substantial defenses and intends to defend these suits vigorously. The Company has recorded a reserve for CBD litigation of \$1.7 million as of June 29, 2007 and \$2.1 million as of December 31, 2006. This reserve covers existing claims only and unasserted claims could give rise to additional losses. Defense costs are expensed as incurred. Final resolution of the asserted claims may be for different amounts than currently reserved. There were no settlement payments made during the first six months of 2007. Portions of the outstanding claims are covered by varying levels of insurance.

In the third quarter 2006, the Court of Common Pleas in Ottawa County, Ohio issued a summary judgment in the Company's favor and awarded the Company damages of \$7.8 million to be paid by the Company's former insurance providers. The Company had filed the lawsuit against its former insurers in attempts to resolve a dispute over how insurance coverage should be applied to incurred legal defense costs and indemnity payments. The Court ruling agreed with the Company's position. The damages, which were stipulated to by the defendants, represent costs previously paid by the Company over a number of years that were not reimbursed by the insurance providers. The damages also include accrued interest on those costs. The award was subsequently increased to \$8.8 million as a result of the defendants stipulating to the attorney's fees incurred in pursuing this action. The Company believes that the defendants will appeal this ruling and therefore all or a portion of the \$8.8 million may not be realized by the Company. Given the uncertainty surrounding the timing and outcome of the appeal process and the possibility for a portion or all of the award to be reversed, the Company has not recorded the impact of the award in its Consolidated Financial Statements as of June 29, 2007.

Williams Advanced Materials Inc. (WAM), one of the Company's wholly owned subsidiaries, and a small number of WAM's customers are defendants in a patent infringement legal case. WAM has provided an indemnity agreement to certain of those customers under which WAM will pay any damages awarded by the court. WAM has not made any indemnification payments nor have they recorded a reserve for losses under these agreements as of June 29, 2007. WAM believes it has strong defenses applicable to both WAM and its customers and is contesting this action. While WAM does not believe that a loss is probable, should their defenses not prevail, the damages to be paid may potentially be material to the Company's results of operations in the period of payment. The court is currently reviewing WAM's motion to transfer the case from New York to California.

The Company has an active environmental compliance program and records reserves for the probable cost of identified environmental remediation projects. The reserves are established based upon analyses conducted by the Company's engineers and outside consultants and are adjusted from time to time based upon on-going studies and the difference between actual and estimated costs. The reserves may also be affected by rulings and negotiations with regulatory agencies. The undiscounted reserve balance was \$5.1 million as of June 29, 2007, unchanged from December 31, 2006. Environmental projects tend to be long term and the final actual remediation costs may differ from the amounts currently recorded.

Note E Comprehensive Income

The reconciliation between net income and comprehensive income for the second quarter and first half ended June 29, 2007 and June 30, 2006 is as follows: