FERRO CORP
Form 10-Q
October 29, 2012
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2012

or

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

For the transition period from to

Commission File Number 1-584

FERRO CORPORATION

(Exact name of registrant as specified in its charter)

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

216-875-5600

(Registrant s telephone number, including area code)

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

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

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

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

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

At September 30, 2012, there were 86,538,312 shares of Ferro Common Stock, par value $1.00, outstanding.

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements (Unaudited)

Ferro Corporation and Subsidiaries

Condensed Consolidated Statements of Operations

	Three months ended September 30,		Nine months ended September 30,	
	2012	As adjusted 2011	2012	As adjusted 2011
	(Dollars in thousands, except per share amounts)			
Net sales	$ 414,840	$ 546,114	$ 1,362,735	$ 1,713,097
Cost of sales	352,501	442,304	1,124,228	1,374,614
Gross profit	62,339	103,810	238,507	338,483
Selling, general and administrative expenses	65,109	65,766	206,306	210,153
Restructuring and impairment charges	198,790	869	203,829	4,044
Other expense (income):				
Interest expense	7,101	7,030	20,689	21,208
Interest earned	(57)	(50)	(192)	(193)
Foreign currency losses, net	869	1,726	792	4,049
Miscellaneous expense, net	792	64	3,027	458
(Loss) income before income taxes	(210,265)	28,405	(195,944)	98,764
Income tax expense	105,473	9,057	113,618	32,825
Net (loss) income	(315,738)	19,348	(309,562)	65,939
Less: Net income attributable to noncontrolling interests	376	40	830	573
Net (loss) income attributable to Ferro Corporation	(316,114)	19,308	(310,392)	65,366
Dividends on preferred stock				(165)
Net (loss) income attributable to Ferro Corporation common shareholders	$ (316,114)	$ 19,308	$ (310,392)	$ 65,201
(Loss) earnings per share attributable to Ferro Corporation common shareholders:				
Basic (loss) earnings	$ (3.66)	$ 0.22	$ (3.60)	$ 0.76
Diluted (loss) earnings	(3.66)	0.22	(3.60)	0.75

See accompanying notes to condensed consolidated financial statements.

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Ferro Corporation and Subsidiaries

Condensed Consolidated Statements of Comprehensive (Loss) Income

	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
	(Dollars in thousands)			
Net (loss) income	$ (315,738)	$ 19,348	$ (309,562)	$ 65,939
Other comprehensive income (loss), net of tax:				
Foreign currency translation	3,321	(11,013)	(2,940)	(562)
Postretirement benefit liabilities	1,044	582	(311)	(229)
Total comprehensive (loss) income	(311,373)	8,917	(312,813)	65,148
Less: Comprehensive income attributable to noncontrolling interests	442	113	845	762
Comprehensive (loss) income attributable to Ferro Corporation	$ (311,815)	$ 8,804	$ (313,658)	$ 64,386

See accompanying notes to condensed consolidated financial statements.

Ferro Corporation and Subsidiaries

Condensed Consolidated Balance Sheets

	September 30, 2012	As adjusted December 31, 2011
	(Dollars in thousands)	
ASSETS		
Current assets		
Cash and cash equivalents	$ 24,817	$ 22,991
Accounts receivable, net	322,620	306,775
Inventories	212,014	228,813
Deferred income taxes	6,419	17,395
Other receivables	37,338	37,839
Other current assets	12,746	17,086
Total current assets	615,954	630,899
Other assets		
Property, plant and equipment, net	331,894	379,336
Goodwill	68,952	215,601
Amortizable intangible assets, net	14,086	11,056
Deferred income taxes	16,835	117,658
Other non-current assets	71,913	86,101
Total assets	$ 1,119,634	$ 1,440,651
LIABILITIES AND EQUITY		
Current liabilities		
Loans payable and current portion of long-term debt	$ 67,180	$ 11,241
Accounts payable	196,977	214,460
Accrued payrolls	31,564	31,055
Accrued expenses and other current liabilities	69,508	67,878
Total current liabilities	365,229	324,634
Other liabilities		
Long-term debt, less current portion	270,132	298,082
Postretirement and pension liabilities	190,283	215,732
Other non-current liabilities	19,846	19,709
Total liabilities	845,490	858,157
Equity		
Ferro Corporation shareholders equity:		
Common stock, par value $1 per share; 300.0 million shares authorized; 93.4 million shares issued; 86.6 million shares outstanding in 2012 and 2011	93,436	93,436
Paid-in capital	325,137	320,882
Retained (deficit) earnings	(22,730)	287,662
Accumulated other comprehensive income	20,633	23,899
Common shares in treasury, at cost	(153,029)	(153,617)
Total Ferro Corporation shareholders equity	263,447	572,262
Noncontrolling interests	10,697	10,232
Total equity	274,144	582,494

Total liabilities and equity	$ 1,119,634	$ 1,440,651

See accompanying notes to condensed consolidated financial statements.

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Ferro Corporation and Subsidiaries

Condensed Consolidated Statements of Equity

	Ferro Corporation Shareholders							
	Common Shares in Treasury		Common	Paid-in	Retained Earnings	Accumulated Other Comprehensive (Loss)	Non-controlling	
	Shares	Amount	Stock	Capital	(Deficit)	Income	Interests	Total Equity
					(In thousands)			
Balances at December 31, 2010, as originally reported	7,242	$ (164,257)	$ 93,436	$ 323,015	$ 362,164	$ (50,949)	$ 10,771	$ 574,180
Cumulative effect of change in accounting principle (Refer to Note 2)					(78,741)	78,741		
Balances at December 31, 2010, as adjusted	7,242	(164,257)	93,436	323,015	283,423	27,792	10,771	574,180
Net income					65,366		573	65,939
Other comprehensive (loss) income						(980)	189	(791)
Cash dividends on preferred stock					(165)			(165)
Stock-based compensation transactions	(377)	10,683		(4,409)				6,274
Distributions to noncontrolling interests							(938)	(938)
Balances at September 30, 2011	6,865	$ (153,574)	$ 93,436	$ 318,606	$ 348,624	$ 26,812	$ 10,595	$ 644,499
Balances at December 31, 2011, as originally reported	6,865	$ (153,617)	$ 93,436	$ 320,882	$ 393,636	$ (82,075)	$ 10,232	$ 582,494
Cumulative effect of change in accounting principle (Refer to Note 2)					(105,974)	105,974		
Balances at December 31, 2011, as adjusted	6,865	(153,617)	93,436	320,882	287,662	23,899	10,232	582,494
Net (loss) income					(310,392)		830	(309,562)
Other comprehensive (loss) income						(3,266)	15	(3,251)
Stock-based compensation transactions	32	588		4,255				4,843
Distributions to noncontrolling interests							(380)	(380)
Balances at September 30, 2012	6,897	$ (153,029)	$ 93,436	$ 325,137	$ (22,730)	$ 20,633	$ 10,697	$ 274,144

See accompanying notes to condensed consolidated financial statements.

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Ferro Corporation and Subsidiaries

Condensed Consolidated Statements of Cash Flows

	Nine months ended September 30,	
	2012	2011
	(Dollars in thousands)	
Cash flows from operating activities		
Net cash provided by (used for) operating activities	$ 19,536	$ (17,370)
Cash flows from investing activities		
Capital expenditures for property, plant and equipment	(46,245)	(51,923)
Proceeds from sale of assets	2,386	2,374
Other investing activities	96	193
Net cash used for investing activities	(43,763)	(49,356)
Cash flows from financing activities		
Net borrowings under loans payable	22,087	55,496
Proceeds from long-term debt	323,151	530,174
Principal payments on long-term debt	(319,926)	(517,065)
Redemption of convertible preferred stock		(9,427)
Cash dividends paid		(165)
Other financing activities	760	(180)
Net cash provided by financing activities	26,072	58,833
Effect of exchange rate changes on cash and cash equivalents	(19)	758
Increase (decrease) in cash and cash equivalents	1,826	(7,135)
Cash and cash equivalents at beginning of period	22,991	29,035
Cash and cash equivalents at end of period	$ 24,817	$ 21,900
Cash paid during the period for:		
Interest	$ 25,343	$ 24,620
Income taxes	3,130	20,646

See accompanying notes to condensed consolidated financial statements.

Ferro Corporation and Subsidiaries

Notes to Condensed Consolidated Financial Statements

1. Basis of Presentation

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

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

2. Recent Accounting Pronouncements and Change in Accounting Principle

Accounting Standards Adopted in the Nine Months Ended September 30, 2012

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

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

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

Change in Accounting Principle

During the third quarter of 2012, we elected to change our method of recognizing defined benefit pension and other postretirement benefit expense. Historically, we recognized actuarial gains and losses in accumulated other comprehensive loss within shareholders equity on our consolidated balance sheets annually, and these gains and losses were amortized into our operating results over the average remaining service period of plan participants, to the extent such gains and losses were in excess of a corridor.

Under our new method, we will recognize actuarial gains and losses in our operating results in the year in which the gains or losses occur. These gains and losses are generally measured annually as of December 31 and recorded during the fourth quarter, unless an interim remeasurement is required. The remaining components of benefit expense, primarily service and interest costs and the expected return on plan assets, will be recorded quarterly as ongoing benefit expense. While the historical method of recognizing expense was acceptable, we believe the new method is preferable because it results in more timely recognition in our operating results of actuarial gains and losses as they arise. In accordance with ASC Topic 250, Accounting Changes and Error Corrections, all prior periods have been adjusted to apply the new method retrospectively. The effect of the change on retained earnings as of January 1, 2012 and 2011, was a reduction of $106.0 million and $78.7 million, respectively, with a corresponding offset to accumulated other comprehensive loss.

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We have presented the effects of the change in accounting principle on our condensed consolidated financial statements for 2012 and 2011 below. The following table presents the significant effects of the change on our historical condensed consolidated statements of operations, statements of comprehensive (loss) income and balance sheets. There was no effect on our condensed consolidated statements of cash flows.

Condensed Consolidated Statements of Operations Information

	Three months ended September 30, 2012			Nine months ended September 30, 2012		
	Prior accounting method	Effect of accounting change	As reported	Prior accounting method	Effect of accounting change	As reported
	(Dollars in thousands, except per share amounts)					
Net sales	$ 414,840	$	$ 414,840	$ 1,362,735	$	$ 1,362,735
Cost of sales	352,501		352,501	1,124,228		1,124,228
Gross profit	62,339		62,339	238,507		238,507
Selling, general and administrative expenses	69,397	(4,288)	65,109	221,727	(15,421)	206,306
Restructuring and impairment charges	198,790		198,790	203,829		203,829
Other expense (income):						
Interest expense	7,101		7,101	20,689		20,689
Interest earned	(57)		(57)	(192)		(192)
Foreign currency losses, net	869		869	792		792
Miscellaneous expense, net	792		792	3,027		3,027
(Loss) income before income taxes	(214,553)	4,288	(210,265)	(211,365)	15,421	(195,944)
Income tax expense	103,934	1,539	105,473	108,226	5,392	113,618
Net (loss) income	(318,487)	2,749	(315,738)	(319,591)	10,029	(309,562)
Less: Net income attributable to noncontrolling interests	376		376	830		830
Net (loss) income attributable to Ferro Corporation common shareholders	$ (318,863)	$ 2,749	$ (316,114)	$ (320,421)	$ 10,029	$ (310,392)
(Loss) earnings per share attributable to Ferro Corporation common shareholders:						
Basic (loss) earnings	$ (3.69)	$ 0.03	$ (3.66)	$ (3.71)	$ 0.11	$ (3.60)
Diluted (loss) earnings	(3.69)	0.03	(3.66)	(3.71)	0.11	(3.60)

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	Three months ended September 30, 2011 As originally reported	Three months ended September 30, 2011 Effect of accounting change	Three months ended September 30, 2011 As adjusted	Nine months ended September 30, 2011 As originally reported	Nine months ended September 30, 2011 Effect of accounting change	Nine months ended September 30, 2011 As adjusted
	(Dollars in thousands, except per share amounts)					
Net sales	$ 546,114	$	$ 546,114	$ 1,713,097	$	$ 1,713,097
Cost of sales	442,304		442,304	1,374,614		1,374,614
Gross profit	103,810		103,810	338,483		338,483
Selling, general and administrative expenses	67,530	(1,764)	65,766	217,896	(7,743)	210,153
Restructuring and impairment charges	869		869	4,044		4,044
Other expense (income):						
Interest expense	7,030		7,030	21,208		21,208
Interest earned	(50)		(50)	(193)		(193)
Foreign currency losses, net	1,726		1,726	4,049		4,049
Miscellaneous expense, net	64		64	458		458
Income before income taxes	26,641	1,764	28,405	91,021	7,743	98,764
Income tax expense	8,419	638	9,057	29,987	2,838	32,825
Net income	18,222	1,126	19,348	61,034	4,905	65,939
Less: Net income attributable to noncontrolling interests	40		40	573		573
Net income attributable to Ferro Corporation	18,182	1,126	19,308	60,461	4,905	65,366
Dividends on preferred stock				(165)		(165)
Net income attributable to Ferro Corporation common shareholders	$ 18,182	$ 1,126	$ 19,308	$ 60,296	$ 4,905	$ 65,201
Earnings per share attributable to Ferro Corporation common shareholders:						
Basic (loss) earnings	$ 0.21	$ 0.01	$ 0.22	$ 0.70	$ 0.06	$ 0.76
Diluted (loss) earnings	0.21	0.01	0.22	0.69	0.06	0.75

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Condensed Consolidated Statements of Comprehensive (Loss) Income Information

	Three months ended September 30, 2012			Nine months ended September 30, 2012		
	Prior accounting method	Effect of accounting change	As reported	Prior accounting method	Effect of accounting change	As reported
	(Dollars in thousands)					
Net (loss) income	$ (318,487)	$ 2,749	$ (315,738)	$ (319,591)	$ 10,029	$ (309,562)
Other comprehensive income (loss), net of tax:						
Foreign currency translation	3,321		3,321	(2,940)		(2,940)
Postretirement benefit liabilities	3,793	(2,749)	1,044	9,718	(10,029)	(311)
Total comprehensive loss	(311,373)		(311,373)	(312,813)		(312,813)
Less: Comprehensive income attributable to noncontrolling interests	442		442	845		845
Comprehensive loss attributable to Ferro Corporation	$ (311,815)	$	$ (311,815)	$ (313,658)	$	$ (313,658)

	Three months ended September 30, 2011			Nine months ended September 30, 2011		
	Prior accounting method	Effect of accounting change	As reported	Prior accounting method	Effect of accounting change	As reported
	(Dollars in thousands)					
Net income	$ 18,222	$ 1,126	$ 19,348	$ 61,034	$ 4,905	$ 65,939
Other comprehensive (loss) income, net of tax:						
Foreign currency translation	(11,013)		(11,013)	(562)		(562)
Postretirement benefit liabilities	1,708	(1,126)	582	4,676	(4,905)	(229)
Total comprehensive income	8,917		8,917	65,148		65,148
Less: Comprehensive income attributable to noncontrolling interests	113		113	762		762
Comprehensive income attributable to Ferro Corporation	$ 8,804	$	$ 8,804	$ 64,386	$	$ 64,386

Condensed Consolidated Balance Sheets Information

	September 30, 2012			December 31, 2011		
	Prior accounting method	Effect of accounting change	As reported	As originally reported	Effect of accounting change	As adjusted
	(Dollars in thousands)					
Assets						
Total assets	$ 1,119,634	$	$ 1,119,634	$ 1,440,651	$	$ 1,440,651
Liabilities and Equity						
Total liabilities	$ 845,490	$	$ 845,490	$ 858,157	$	$ 858,157
Equity						
Retained earnings	73,215	(95,945)	(22,730)	393,636	(105,974)	287,662
Accumulated other comprehensive (loss) income	(75,312)	95,945	20,633	(82,075)	105,974	23,899

Other equity accounts	276,241		276,241	270,933		270,933
Total equity	274,144		274,144	582,494		582,494
Total liabilities and equity	$ 1,119,634	$	$ 1,119,634	$ 1,440,651	$	$ 1,440,651

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New Accounting Pronouncements Not Yet Adopted

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

3. Inventories

	September 30, 2012	December 31, 2011
	(Dollars in thousands)	
Raw materials	$ 67,672	$ 78,199
Work in process	42,273	42,111
Finished goods	102,069	108,503
Total inventories	$ 212,014	$ 228,813

In the production of some of our products, we use precious metals, some of which we obtain from financial institutions under consignment agreements with terms of one year or less. The financial institutions retain ownership of the precious metals and charge us fees based on the amounts we consign. These fees were $1.4 million and $2.6 million for the three months ended September 30, 2012 and 2011, respectively, and were $5.0 million and $7.3 million for the nine months ended September 30, 2012 and 2011, respectively. We had on hand precious metals owned by participants in our precious metals consignment program of $188.6 million at September 30, 2012, and $187.9 million at December 31, 2011, measured at fair value based on market prices for identical assets.

In the third quarter of 2012, we recorded inventory write-downs of $5.4 million to reflect inventories related to our solar pastes business at the lower of cost or market in accordance with ASC 330, Inventory. The inventory write-downs are classified as cost of sales in our statements of operations and charged to our Electronic Materials segment.

4. Property, Plant and Equipment

Property, plant and equipment is reported net of accumulated depreciation of $659.2 million at September 30, 2012, and $599.1 million at December 31, 2011. Unpaid capital expenditure liabilities, which are noncash investing activities, were $7.3 million at September 30, 2012, and $9.4 million at September 30, 2011.

In the third quarter of 2012, we tested for impairment under ASC 360, Property, Plant, and Equipment, certain property, plant, and equipment held for use, primarily related to deterioration in our forecast for our solar pastes business. As a result, assets held for use with a carrying value of $42.5 million were written down to their fair value of $2.0 million, and the impairment charge of $40.5 million is included in restructuring and impairment charges in our statements of operations. We estimated the fair value of these assets using discounted cash flow models.

Further, we reevaluated in accordance with ASC 360, Property, Plant, and Equipment, certain property, plant, and equipment that was already classified as assets held for sale. As a result, assets held for sale with a carrying value of $14.4 million were written down to their fair value of $3.4 million, and the impairment charge of $11.0 million is included in restructuring and impairment charges in our statements of operations. We estimated the fair value of these assets using discounted cash flow models. At September 30, 2012, total assets held for sale of $3.5 million were classified as other non-current assets due to the nature of the underlying assets, although we expect to sell these assets within the next twelve months. These assets include land and buildings at our Toccoa, Georgia, facility; the Porcelain Enamel facility in Rotterdam, Netherlands; the remaining portion of our Uden, Netherlands, facility; and the Casiglie, Italy facility.

Description	September 30, 2012	Fair Value Measurements Using			Total Gains
		Level 1	Level 2	&n	

Level
3