

NORTH AMERICAN GALVANIZING & COATINGS INC

Form 10-Q

November 12, 2004

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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 SEPTEMBER 30, 2004

COMMISSION FILE NO. 1-3920

NORTH AMERICAN GALVANIZING & COATINGS, INC.

(Exact name of the registrant as specified in its charter)

DELAWARE

71-0268502

(State of Incorporation)

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

2250 EAST 73RD STREET
TULSA, OKLAHOMA 74136

(Address of principal executive office and zip code)

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

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 [X] NO []

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). YES [] NO [X]

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of November 10, 2004.

Common Stock \$.10 Par Value.....6,797,012

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NORTH AMERICAN GALVANIZING & COATINGS, INC. AND SUBSIDIARY

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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

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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, and the raw materials cost of zinc, changes in economic 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 September 30, 2004, and the related condensed consolidated statements of operations and comprehensive income for the three- and nine-month periods ended September 30, 2004 and 2003 and cash flows for the nine month periods ended September 30, 2004 and 2003. These interim financial statements are the responsibility of the Company's management.

We conducted our reviews in accordance with 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 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 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, 2003, and the related consolidated statements of operations and comprehensive income, stockholders' equity, and cash flows for the year then ended (not presented herein); and in our report dated March 26, 2004, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated sheet as of December 31, 2003 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
 November 10, 2004

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NORTH AMERICAN GALVANIZING & COATINGS, INC. AND SUBSIDIARY
 CONDENSED CONSOLIDATED BALANCE SHEETS

| (DOLLARS IN THOUSANDS) | UNAUDITED SEPTEMBER 30 2004 | December 31 2003 |
|---|-----------------------------------|---------------------|
| ----- | | |
| ASSETS | | |
| CURRENT ASSETS | | |
| Cash | \$ 486 | \$ 56 |
| Investments | -- | 73 |
| Trade receivables, net | 5,412 | 4,594 |
| Inventories | 5,622 | 5,408 |
| Prepaid expenses and other assets | 674 | 87 |
| Deferred tax asset, net | 714 | 746 |
| | ----- | ----- |
| TOTAL CURRENT ASSETS | 12,908 | 10,964 |
| | ----- | ----- |
| PROPERTY, PLANT AND EQUIPMENT, AT COST | | |
| Land | 1,967 | 1,962 |
| Galvanizing plants and equipment | 34,542 | 34,941 |
| | ----- | ----- |
| | 36,509 | 36,903 |
| Less: Allowance for depreciation | 15,013 | 14,529 |
| Construction in progress | 211 | 286 |
| | ----- | ----- |
| TOTAL PROPERTY, PLANT AND EQUIPMENT, NET | 21,707 | 22,660 |
| | ----- | ----- |
| GOODWILL, NET OF ACCUMULATED AMORTIZATION | 3,389 | 3,389 |
| OTHER ASSETS | 313 | 354 |
| | ----- | ----- |
| TOTAL ASSETS | \$ 38,317 | \$ 37,367 |
| | ===== | ===== |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| CURRENT LIABILITIES | | |
| Current maturities of long-term obligations | \$ 1,109 | \$ 1,408 |
| Current portion of bonds payable | 685 | 656 |
| Trade accounts payable | 845 | 480 |
| Accrued payroll and employee benefits | 643 | 623 |
| Other taxes | 439 | 316 |
| Other accrued liabilities | 689 | 874 |
| | ----- | ----- |
| TOTAL CURRENT LIABILITIES | 4,410 | 4,357 |
| | ----- | ----- |

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| | | |
|--|-----------|-----------|
| DEFERRED TAX LIABILITY, NET | 758 | 774 |
| LONG-TERM OBLIGATIONS | 7,636 | 6,768 |
| BONDS PAYABLE | 6,110 | 6,626 |
| SUBORDINATED NOTES PAYABLE | 970 | 957 |
| | ----- | ----- |
| TOTAL LIABILITIES | 19,884 | 19,842 |
| | ----- | ----- |
| COMMITMENTS AND CONTINGENCIES (NOTE 9) | | |
| STOCKHOLDERS' EQUITY | | |
| Common stock | 819 | 819 |
| Additional paid-in capital | 17,267 | 17,343 |
| Retained earnings | 6,041 | 5,496 |
| Other comprehensive income | -- | 6 |
| Common shares in treasury at cost | (5,694) | (5,779) |
| | ----- | ----- |
| TOTAL STOCKHOLDERS' EQUITY | 18,433 | 17,885 |
| | ----- | ----- |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | \$ 38,317 | \$ 37,367 |
| | ===== | ===== |

See notes to condensed consolidated interim financial statements.

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NORTH AMERICAN GALVANIZING & COATINGS, INC. AND SUBSIDIARY
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME
UNAUDITED

| (DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS) | THREE MONTHS ENDED SEPTEMBER 30 | | NINE M SEP |
|---|------------------------------------|----------|---------------|
| | 2004 | 2003 | 2004 |
| SALES | \$ 9,348 | \$ 8,516 | \$ 27,239 |
| Cost of sales | 6,725 | 6,122 | 19,365 |
| Selling, general & administrative expenses | 1,370 | 1,597 | 4,387 |
| Depreciation expense | 686 | 717 | 2,068 |
| | ----- | ----- | ----- |
| TOTAL COSTS AND EXPENSES | 8,781 | 8,436 | 25,820 |
| | ----- | ----- | ----- |
| OPERATING INCOME | 567 | 80 | 1,419 |
| Other income | -- | -- | (25) |
| Interest (income) expense, net | 198 | (109) | 565 |
| | ----- | ----- | ----- |
| Income (loss) from Continuing Operations before income taxes | 369 | 189 | 879 |
| Income tax expense (benefit) | 140 | 99 | 334 |
| | ----- | ----- | ----- |
| INCOME (LOSS) FROM CONTINUING OPERATIONS | 229 | 90 | 545 |
| Discontinued Operations: | | | |

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| | | | |
|--|---------|---------|---------|
| Loss on discontinued operations, net | -- | -- | -- |
| Loss on write-off of assets of discontinued operations, net | -- | -- | -- |
| NET INCOME (LOSS) | \$ 229 | \$ 90 | \$ 545 |
| OTHER COMPREHENSIVE INCOME | | | |
| Unrealized holding gain on investment | -- | -- | 12 |
| Reclassification adjustment for realized gain included in net income | -- | -- | (16) |
| OTHER COMPREHENSIVE INCOME | \$ -- | \$ -- | \$ (4) |
| COMPREHENSIVE INCOME (LOSS) | \$ 229 | \$ 90 | \$ 541 |
| NET INCOME (LOSS) PER COMMON SHARE | | | |
| Continuing Operations: | | | |
| Basic | \$ 0.03 | \$ 0.01 | \$ 0.08 |
| Diluted | \$ 0.03 | \$ 0.01 | \$ 0.07 |
| Discontinued Operations: | | | |
| Basic and Diluted | \$ -- | \$ -- | \$ -- |
| Net Income (Loss): | | | |
| Basic | \$ 0.03 | \$ 0.01 | \$ 0.08 |
| Diluted | \$ 0.03 | \$ 0.01 | \$ 0.07 |

See notes to condensed consolidated interim financial statements.

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NORTH AMERICAN GALVANIZING & COATINGS, INC. AND SUBSIDIARY
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
UNAUDITED

| (DOLLARS IN THOUSANDS) | NINE MONTHS ENDED SEPTEMBER 30 | |
|---|-----------------------------------|----------|
| | 2004 | 2003 |
| OPERATING ACTIVITIES | | |
| Net income (loss) | \$ 545 | \$ (954) |
| Loss from discontinued operations | -- | 1,197 |
| Loss from disposal of fixed assets | 14 | 5 |
| Depreciation | 2,068 | 2,188 |
| Gain on sale of investment | (25) | -- |
| Deferred income taxes | 16 | (579) |
| Non-cash directors' fees | 54 | 49 |
| Changes in assets and liabilities: | | |
| Accounts receivable, net | (818) | (514) |
| Inventories and other assets | (760) | 551 |
| Accounts payable, accrued liabilities and other | 323 | (58) |
| Net cash provided by continuing operations | 1,417 | 1,885 |

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| | | |
|---|----------|----------|
| Net cash provided by discontinued operations | -- | 79 |
| | ----- | ----- |
| CASH PROVIDED BY OPERATING ACTIVITIES | 1,417 | 1,964 |
| | | |
| INVESTING ACTIVITIES | | |
| Proceeds from sale of investment | 92 | -- |
| Capital expenditures | (1,129) | (733) |
| | ----- | ----- |
| CASH USED IN INVESTING ACTIVITIES | (1,037) | (733) |
| | | |
| FINANCING ACTIVITIES | | |
| Purchase of treasury shares | (45) | -- |
| Proceeds from long-term obligations | 13,107 | 11,049 |
| Payments on long-term obligations | (12,525) | (11,793) |
| Payment on bonds | (487) | (460) |
| | ----- | ----- |
| CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES | 50 | (34) |
| | | |
| INCREASE IN CASH | 430 | 27 |
| CASH AT BEGINNING OF PERIOD | 56 | 3 |
| | ----- | ----- |
| CASH AT END OF PERIOD | \$ 486 | \$ 30 |
| | ===== | ===== |

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 AND NINE MONTHS ENDED SEPTEMBER 30, 2004 AND 2003
 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, 2003. 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

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sheet dates and the reported amounts of revenues and expenses for each of the years. Actual results will be determined based on the outcome of future events and could differ from those 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").

NOTE 2. STOCK OPTIONS

The Company accounts for its stock option plans in accordance with Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees", under which no compensation cost has been recognized for stock option awards. Had compensation cost for the Company's stock option plans been determined according to the methodology of Statement of Financial Accounting Standard No.123, "Accounting for Stock Based Compensation" ("SFAS No. 123"), the Company's pro forma net earnings (loss) and basic and diluted earnings (loss) per share for the three and nine months ended September 30, 2004 and 2003 would have been as follows:

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| | Three Months Ended Sep. 30 | |
|--|----------------------------|--------|
| (DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS) | 2004 | 2003 |
| Net Income, as reported | \$ 229 | \$ 90 |
| Compensation cost, net of tax | \$ (8) | \$ (1) |
| Pro forma net income | \$ 221 | \$ 89 |
| Earnings per share: | | |
| Basic - as reported | \$.03 | \$.01 |
| Basic - pro forma | \$.03 | \$.01 |
| Diluted - as reported | \$.03 | \$.01 |
| Diluted - pro forma | \$.03 | \$.01 |

| | Nine Months Ended Sep. 30 | |
|--|---------------------------|----------|
| (DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS) | 2004 | 2003 |
| Net Income (Loss), as reported | \$ 545 | \$ (954) |
| Compensation cost, net of tax | \$ (6) | \$ (9) |
| Pro forma net income (loss) | \$ 539 | \$ (963) |
| Earnings (loss) per share: | | |
| Basic - as reported | \$.08 | \$ (.14) |

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| | | |
|-----------------------|--------------------------|----------------------------|
| Basic - pro forma | ----- \$.08 ----- | ----- \$ (.14) ----- |
| Diluted - as reported | ----- \$.07 ----- | ----- \$ (.14) ----- |
| Diluted - pro forma | ----- \$.09 ----- | ----- \$ (.14) ----- |

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:

| | Three Months Ended Sep. 30 | | Nine Months Ended Sep. 30 | |
|----------------|----------------------------|------------------------|---------------------------|------------------------|
| | ----- 2004 ----- | ----- 2003 ----- | ----- 2004 ----- | ----- 2003 ----- |
| Volatility | 68% | 66% | 67% | 66% |
| Discount Rate | 6% | 5% | 6% | 5% |
| Dividend Yield | 0% | 0% | 0% | 0% |
| Fair Value | \$ 1.03 | \$.75 | \$.97 | \$.75 |

The Company issued stock options for 50,000 shares at an average price per share of \$1.84 and 80,000 shares at \$1.44 per share in the first nine months of 2004 and 2003, respectively.

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NOTE 3. INCOME (LOSS) PER COMMON SHARE

Basic earnings (loss) per common share for the periods presented are computed based upon the weighted average number of shares outstanding. Diluted earnings (loss) per common share for the periods presented are based on the weighted average shares outstanding, adjusted for the assumed exercise of stock options and warrants using the treasury stock method. The Company had a net loss for the nine months ended September 30, 2003 and the effect of including dilutive securities in the earnings per common share would have been anti-dilutive. Accordingly, options and warrants to purchase 675,106 common shares were excluded from the calculation of diluted loss per share for the nine months ended September 30, 2003.

| ----- Three Months Ended Sep. 30 ----- | Number of Shares | |
|--|------------------------|------------------------|
| | ----- 2004 ----- | ----- 2003 ----- |
| Basic | 6,787,297 | 6,767,703 |
| Diluted | 7,493,574 | 7,440,214 |

| ----- Nine Months Ended Sep 30 ----- | Number of Shares | |
|--|------------------------|------------------------|
| | ----- 2004 ----- | ----- 2003 ----- |
| Basic | 6,788,540 | 6,756,846 |
| Diluted | 7,488,701 | 6,756,846 |

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The numbers of exercisable options excluded from the calculation of diluted earnings per share, due to the option price being higher than the share market value, are 296,500 and 319,000 at September 30, 2004 and 2003, respectively.

NOTE 4. INVENTORIES

Inventories consist of raw zinc "pigs," molten zinc in galvanizing kettles and other chemicals and materials used in the galvanizing process. Inventories are stated at the lower of cost or market with market value based on estimated realizable value from the galvanizing process. Zinc cost is determined on a last-in first-out (LIFO) basis. Other inventories are valued primarily on an average cost basis.

NOTE 5. GOODWILL

During the second quarter of 2004, the Company completed the annual impairment test of goodwill for 2004 and concluded goodwill was not impaired. Pursuant to the provisions of SFAS No. 141, "Business Combinations" and SFAS No. 142, "Goodwill and Other Intangible Asset" the Company conducts an annual impairment test of goodwill during the second quarter of each year unless circumstances arise that require more frequent testing.

NOTE 6. BONDS PAYABLE

In 2000, the Company issued \$9,050,000 of Harris County Industrial Development Corporation Adjustable Rate Industrial Development Bonds, Series 2000 (the "Bonds") for the purchase of land and construction of a hot dip galvanizing plant in Harris County, Texas, of which \$6,795,000 remained outstanding at September 30, 2004. The Bonds are senior to other debt of the Company.

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The Bonds bear interest at a variable rate (3.5% at September 30, 2004) that can be converted to a fixed rate upon certain conditions outlined in the bond agreement. Under the amended Reimbursement Agreement with the bank trustee, the Company is permitted to withdraw excess interest from the trustee's Interest Account on or about March 31, June 30, September 30 and December 31 of each year. In the first quarter of 2004, the Company withdrew excess interest of \$72,000 from the Interest Account and applied the proceeds to pay-down the outstanding balance on its bank revolving credit facility. The Company determined that the trustee's Interest Account included excess interest of approximately \$39,000 and \$120,000 for the third quarter and nine-month periods of 2004, which was recognized as a reduction of interest expense by the Company during those periods.

The Bonds are subject to sinking fund redemption, which was \$630,000 for the twelve months ended September 30, 2004 and increases annually thereafter to a maximum redemption of \$960,000 on June 15, 2012. The Company makes monthly principal and interest payments of approximately \$74,000 into a sinking fund. The final maturity date of the Bonds is June 15, 2013. The Company has the option of early redemption of the Bonds at par unless the Bonds are converted to a fixed interest rate, in which case they are redeemable at a premium during a period specified in the bond agreement. The Company's obligation under the bond agreement is secured through a letter of credit with a bank which must remain in effect as long as any Bonds are outstanding. The letter of credit is collateralized by substantially all the assets of the Company.

NOTE 7. SUBORDINATED NOTES PAYABLE

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In 2001, the Company completed a \$1,000,000 private placement of unsecured subordinated debt. The Company utilized the proceeds to partially fund construction of a new galvanizing facility in St. Louis, Missouri in 2002. The amount outstanding on these notes, net of discount, was \$970,000 and \$957,000 at September 30, 2004 and December 31, 2003, respectively. The notes, which mature February 17, 2006 and bear interest at 10% payable annually, were issued with warrants to purchase 666,666 shares of common stock of the Company. Terms of the warrants, which expire February 17, 2008, permit the holder to purchase shares of the Company's common stock at any time prior to the expiration date. The exercise price of \$.856 per share reflects the fair value of the Company's common stock at the time the warrants were issued, as determined by an independent financial advisor. As of September 30, 2004, no warrants had been exercised.

NOTE 8. LONG-TERM OBLIGATIONS

| (Dollars in Thousands) | September 30 2004 | December 31 2003 |
|--------------------------|----------------------|---------------------|
| | | |
| Revolving line of credit | \$ 5,478 | \$ 3,867 |
| Term loan | 775 | 1,567 |
| Construction Loan | 2,472 | 2,722 |
| 9.5% note due 2015 | 20 | 20 |
| | | |
| | \$ 8,745 | \$ 8,176 |
| Less current portion | (1,109) | (1,408) |
| | | |
| | \$ 7,636 | \$ 6,768 |
| | | |

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The Company's bank credit agreement has been amended to expire on October 1, 2005. Subject to borrowing base limitations, the amended bank credit agreement provided (i) a \$7,000,000 maximum revolving line of credit for working capital and general corporate purposes, (ii) a \$1,911,924 term loan and (iii) a \$2,833,332 construction loan.

Term loan payments are based on a three-year amortization schedule with equal monthly payments of principal and interest, and the 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 September 30, 2004, the Company had available borrowing capacity of \$918,000 under the line of credit, based on the underlying borrowing base of accounts receivable and inventory. Payments on the construction loan are based on a 108-month amortization schedule, plus interest, that commenced March 1, 2003, and the loan may be prepaid without penalty.

At September 30, 2004, \$8,725,000 was outstanding under the bank credit agreement, and \$400,000 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 bank credit agreement, and the bank credit agreement is secured by a full

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and unconditional guaranty from NAG. Amounts borrowed under the agreement bear interest at the prime rate of Bank One, Oklahoma 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. 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 to 5.75% and the Applicable Prime Rate Margin will be increased 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 1.0 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 bank 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 September 30, 2004, the Company was in compliance with all of the covenant limits and the actual financial ratios compared to the required ratios, were as follows: Current Ratio - Actual 1.30 to 1.0 vs minimum required of 1.0 to 1.0; Debt to Tangible Net Worth - Actual 1.32 to 1.0 vs maximum permitted of 2.50 to 1.0; Debt Service Coverage - Actual 1.61 to 1.0 vs minimum permitted of 1.25 to 1.0; Capital Expenditures - Actual 1.07 to 1.0 vs minimum required of 1.0 to 1.0.

NOTE 9. COMMITMENTS AND CONTINGENCIES

The Company regularly makes 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 September 30, 2004 the aggregate commitments for the procurement of zinc at fixed prices were approximately \$6.2 million. 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 un-priced commitments for the purchase of approximately 1.3 million pounds of zinc at September 30, 2004.

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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 September 30, 2004 or December 31, 2003, and did not utilize derivatives in the nine months ended September 30, 2004 or the year ended December 31, 2003, except for those forward purchase agreements which are accounted for as normal purchases.

The Company's total off-balance sheet contractual obligations at September 30, 2004, consist of \$1,732,000 for long-term operating leases for two galvanizing facilities and galvanizing equipment, \$396,000 for leased vehicles and \$6,118,000 for zinc purchase commitments. The various leases for galvanizing facilities, including option renewals, expire from 2015 to 2017. A lease for galvanizing equipment expires in 2007. The vehicle leases expire on various dates from 2005 to 2010

NAG was notified in 1997 by the Illinois Environmental Protection Agency

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("IEPA") that it was one of more than 50 potentially responsible parties ("PRPs") for cleanup of an abandoned site formerly owned by Sandoval Zinc Company. Since then approximately 30 additional PRPs have been identified by the IEPA. A number of the PRPs (approximately 12 to 15) 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 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 during 2004. Therefore, the Company has no basis for determining potential exposure and estimated remediation costs at this time.

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 seeks enforcement of the 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 June 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 (North American Galvanizing & Coatings, Inc.). The Company denies the assertions set forth in the Water District's Complaint and will seek to have the Second Amended Complaint dismissed.

The Company will continue to have additional environmental compliance costs associated with operations in the galvanizing business. The Company is committed to complying with the environmental legislation and regulations affecting its operations. Due to the uncertainties associated with future environmental technologies, regulatory interpretations, and prospective legislative activity, management cannot reasonably quantify the Company's potential future costs in this area.

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The Company expenses or capitalizes, where appropriate, environmental expenditures that relate to current operations as they are incurred. Such expenditures are expensed when they are attributable to past operations and are not expected to contribute to current or future revenue generation. The Company records liabilities when remediation or other environmental assessment or clean-up efforts are probable and the cost can be reasonably estimated.

As reported previously, the lease term of a galvanizing facility occupied by Reinforcing Services, Inc. ("RSI"), one of NAG's subsidiaries, expired July 31, 2003 and has not been renewed. RSI has exercised an option to purchase the

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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. The litigation is in the discovery stage and management expects there will be no disruption to its galvanizing business being conducted at the facility.

Various litigation arising in the ordinary course of business is pending against the Company. Management believes that resolution of the Company's litigation and environmental matters should not materially affect the Company's consolidated financial position or liquidity. Should future developments cause the Company to record an additional liability for environmental matters, litigation or customer claims, the recording of such a liability could have a material impact on the results of operations for the period involved.

NOTE 10. TREASURY STOCK

In the first nine months of 2004, the Company issued 32,129 shares of its common stock from Treasury to outside Directors of the Company as payment for their quarterly board fee in lieu of cash payments, and added 26,576 shares to the Treasury from private transaction purchases. Shares issued in lieu of board fees were valued at the average closing price of the Company's common stock for a prior 30-day period, as reported by the American Stock Exchange. Such shares were issued pursuant to the Directors' prior election and notice to the Company to receive up to all of their 2004 quarterly board fees in the Company's stock in lieu of cash. During the first nine months of 2003, the Company issued 32,789 shares for such purpose. Shares acquired in private transactions were purchased at the then closing price of the Company's common stock, as reported by the American Stock Exchange.

NOTE 11. DISCONTINUED OPERATIONS

In the second quarter ended June 30, 2003, the Company recorded a net loss from a discontinued operation of \$77,000, net of taxes of \$45,000, and wrote-off its investment in the formerly idled Houston-Cunningham galvanizing plant as a discontinued operation.

In 2002, the Board of Directors authorized the Company to pursue alternative uses for the Houston-Cunningham plant, which was temporarily idled in late 2001. Management believed the carrying value of the plant and the related galvanizing assets would be realized through future operations of the plant. Accordingly, no write-down was recognized in 2002. However, in late April 2003, new events, combined with a further contraction of the galvanizing business in the Houston market, resulted in the likely inability to maintain the plant as part of the Company's continuing operations. The write-off resulted in a net loss on the abandoned assets of \$754,000, net of taxes of \$443,000, in the second quarter of 2003.

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NOTE 12. PROPOSALS APPROVED BY THE COMPANY'S STOCKHOLDERS

The following proposals were approved by the Company's stockholders at its annual meeting held on July 21, 2004: (a) the 2004 Incentive Stock Plan, to replace a prior stock option plan; (b) The Director Stock Unit Program, a new deferred compensation program to tie a percentage of each director's compensation to the long-term value of the Company's common stock and (c) amendments to the Company's Restated Certificate of Incorporation to provide for a reverse split followed by a forward split of the Company's common stock, at the discretion of the Board of Directors. No date for the Reverse/Forward Split has been set. If the Board determines to implement the Reverse/Forward Split,

the Company will publicly announce its decision in a press release at that time.

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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 iron and steel components fabricated by its customers. 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. 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.

During the nine months ended September 30 , 2004, there were no significant changes to the Company's critical accounting policies previously disclosed in the Company's annual report on Form 10-K for the year ended December 31, 2003. The Company generates revenue by providing galvanizing and other coating services to customers' products. Revenue is recognized when the galvanizing and customer billing processes are completed. For the majority of our business, our customers directly arrange for and are responsible for material transportation and transportation expenses. In those circumstances where the Company incurs freight and handling expenses, they are recorded in cost of goods sold.

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 INFRASHIELDSM Coating Application Systems for polyurethane protective linings and coatings over galvanized surfaces. The Company's structural and chemical engineers provide customized assistance with initial fabrication design, project estimates and steel chemistry selection.

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The Company's galvanizing and coating operations are managed through two regions with ten facilities located in Colorado, Kentucky, Missouri, Oklahoma, Tennessee and Texas. These facilities operate galvanizing kettles ranging in length from 30 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 a typical year, the Company will galvanize in excess of 300,000,000 pounds of steel products for approximately 1,800 customers nationwide. Due to the lower demand for galvanizing throughout 2003, the Company experienced a decline of 17% in pounds of steel products galvanized at its facilities in 2003. During the first nine months of 2004, the Company has experienced a steady, but modest, increase in order volume compared to 2003, but sustained demand from fabricators has been erratic and larger project work has not developed as anticipated. In the first nine months of 2004, the surge in steel prices and some limitation on the availability of steel experienced by our customers has affected the timing of many projects.

All of the Company's sales are generated for domestic 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.

Pricing of the Company's galvanizing services is primarily driven by competitive market conditions and the price of zinc used in the galvanizing process. The galvanizing services business is a mature industry and these pricing factors are well known within the industry. As a value added service provider, the Company offers its

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after-fabrication galvanizing services to large and small fabricators, competing against numerous independent and captive galvanizers, as well as alternative forms of corrosion protection, such as paint. Flexibility in pricing to meet both competition and the short-term turn-around time requirements of fabricators is essential to the Company's pricing strategies.

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 infrastructure including buildings, airports, bridges and power generation
- o industrial grating,
- o wastewater treatment; 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 original equipment manufactured products, including general fabrication

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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 process is 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 industry ASTM 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 metals corrosion protection. Each of the Company's independently operated galvanizing plants is linked to a centralized control 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. 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.

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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: 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 monthly, or more frequently, and compared to prior periods, the current business plan and to standard performance criteria, as applicable.

RESULTS OF OPERATIONS

This table shows the Company's results of operations for the three and nine months ended September 30, 2004, 2003 and 2002:

| (DOLLARS IN THOUSANDS) | THREE MONTHS ENDED SEPTEMBER 30 | | | |
|---|---------------------------------|------------|----------|---|
| | 2004 | | 2003 | |
| | AMOUNT | % OF SALES | AMOUNT | % |
| Sales | \$ 9,348 | 100.0% | \$ 8,516 | |
| Cost of sales | 6,725 | 71.9% | 6,122 | |
| Gross profit | 2,623 | 28.1% | 2,394 | |
| Selling, general & administrative expenses | 1,370 | 14.7% | 1,597 | |
| Depreciation and amortization | 686 | 7.3% | 717 | |
| Operating income | 567 | 6.1% | 80 | |
| Interest (income) expense, net | 198 | 2.2% | (109) | |
| Income from continuing operations before income taxes | 369 | 3.9% | 189 | |
| Income tax expense | 140 | 1.5% | 99 | |
| Net Income | \$ 229 | 2.4% | \$ 90 | |

| (DOLLARS IN THOUSANDS) | NINE MONTHS ENDED SEPTEMBER 30 | | | |
|--|--------------------------------|------------|-----------|---|
| | 2004 | | 2003 | |
| | AMOUNT | % OF SALES | AMOUNT | % |
| Sales | \$ 27,239 | 100.0% | \$ 24,954 | |
| Cost of sales | 19,365 | 71.1% | 17,959 | |
| Gross profit | 7,874 | 28.9% | 6,995 | |
| Selling, general & administrative expenses | 4,387 | 16.1% | 4,463 | |
| Depreciation and amortization | 2,068 | 7.6% | 2,188 | |
| Operating income | 1,419 | 5.2% | 344 | |
| Interest expense, net | 565 | 2.1% | 498 | |
| Other (income), net | (25) | (0.1)% | -- | |
| Income (loss) from continuing operations before income taxes | 879 | 3.2% | (154) | |
| Income tax expense (benefit) | 334 | 1.2% | (31) | |
| Income (loss) from continuing operations before effect of discontinued operations | 545 | 2.0% | (123) | |
| Loss from discontinued operations | -- | -- | (831) | |
| Net Income (Loss) | \$ 545 | 2.0% | \$ (954) | |

KEY DEVELOPMENTS. During 2003 and 2004, the Company reported a number of developments supporting its strategic program to reposition its galvanizing business in the national market.

The Company's new St. Louis galvanizing plant, commissioned in 2003 to replace a smaller plant at the same location, continues to post increased volume with a 40% increase in tonnage for the nine months ended September 30, 2004 over the

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comparable period of 2003. This larger, new facility is providing NAG a strategic base for extending its geographic area of service. A 51-foot kettle at this new facility provides the largest galvanizing capacity in the St. Louis region.

In January 2003, the Company expanded services at its Nashville galvanizing plant with the installation of a state-of-the-art Spinner line to galvanize small products, including bolts and threaded material.

As reported previously, the Company wrote-off its investment in the formerly idled Houston-Cunningham galvanizing plant in the second quarter ended June 30, 2003. The write-off resulted in a net loss on the abandoned assets of \$754,000, net of taxes of \$443,000 in 2003. The net loss from operations for the Cunningham plant was \$77,000 and \$205,000, net of taxes of \$45,000 and \$133,000, for the years ended December 31, 2003 and 2002, respectively. The abandoned Cunningham plant has been classified as a discontinued operation and its expenses are not included in the results of continuing operations discussed below.

2004 COMPARED TO 2003

SALES. North American Galvanizing's sales for the third quarter ended September 30, 2004 were \$9,348,000, an increase of 9.8% over sales of \$8,516,000 for the same period in 2003. Total production volume in the third quarter of 2004 increased 10.1% over the third quarter of 2003, reflecting mixed results among our diversely located galvanizing facilities. At our Texas facilities, higher production volume for the third quarter of 2004 versus last year reflects an increased demand from the power transmission and distribution sector, and also a gradual improvement from industrial construction. In other markets, demand from the highway and transportation sectors has shown a slight improvement over last year, while demand from the capital goods sector continues to reflect weaknesses in the economy. The Company continues to counter pressures from competitive pricing on the basis of reliable quality and timely service.

Sales for the nine-months ended September 30, 2004 rose 9.2% to \$27,239,000 compared to sales of \$24,954,000 in the first nine months of 2003. The increase in sales was due primarily to higher production volume as galvanizing tonnage for the first nine-months of 2004 was up 8.7% compared to the same period of 2003. Slightly higher average selling prices for the nine-months of 2004 also made a modest contribution to increased sales compared to the year earlier period.

GROSS PROFIT. The gross profit margin on sales was 28.1% for the third quarters of both 2004 and 2003. However, primarily due to this year's higher level of sales, gross profit for the third quarter of 2004 increased 9.6% to \$2,623,000, compared to \$2,394,000 in the third quarter of 2003. This year the Company has countered expected increases in zinc and energy prices and the resulting upward pressure on operating costs with gains in galvanizing labor efficiency, an emphasis on controlling operating costs and higher average selling prices. As a result, for the nine months ended September 30, 2004, our gross profit margin on sales improved to 28.9% from 28.0% for the same period of 2003. Gross profit for the nine months ended September 30, 2004 was \$7,874,000 compared to \$6,995,000 for the nine months ended September 30, 2003. The Company expects gross profit margins will remain reasonably stable for the remainder of the current year.

DEPRECIATION EXPENSE. Depreciation expense for the third quarter of 2004 was \$686,000, compared to \$717,000 for the same period a year ago. Depreciation expense was \$2,068,000 and \$2,188,000 for the nine months ended September 30, 2004 and 2003, respectively. The lower depreciation expense for 2004 reflects the difference between fixed assets becoming fully depreciated and a lower level of replacement expenditures.

SELLING, GENERAL AND ADMINISTRATIVE (SG&A) EXPENSES. The Company's SG&A expenses include the combined operating expenses of its centralized corporate functions, as well as the sales and administrative functions at the operating facilities. In the third quarter of 2004, SG&A decreased \$227,000, or 14.2%, to \$1,370,000 from \$1,597,000 in 2003. Expense reductions totaling \$338,000 were achieved primarily in the areas of workers compensation (\$69,000), bad debt reserves, reflecting improved collections (\$131,000), insurance premiums (\$83,000) and professional services (\$21,000). Significant offsetting increases were recorded for group medical insurance (\$28,000), ad valorem taxes (\$17,000), and stockholder services (\$53,000).

For the nine months ended September 30, 2004, SG&A decreased \$76,000, or 1.7%, to \$4,387,000 from \$4,463,000 for the year-ago same period. Primary expense reductions year-to-date 2004 included insurance premiums (\$217,000) and general administrative expenses (\$57,000), which were partially offset by increases for ad valorem taxes (\$72,000), professional and legal services (\$68,000) and stockholder services (\$41,000).

The Company's reserve for doubtful accounts is based on the level of trade receivables outstanding over 90 days and, accordingly, is subject to quarterly increases or decreases reflecting the turnover of accounts. The Company anticipates its 2004 insurance costs will continue to compare favorably with 2003 due to a restructuring of its insurance program. In addition to sales and service support teams assigned to each of its regional galvanizing plants, the Company is continuing corporate-level marketing to expand and develop new national account business. The Company believes its SG&A should continue at approximately the present level for the remainder of 2004. The Company's administrative support staff has been maintained at a constant level and further benefits have been realized from long-term programs to streamline the Company's telecommunications and technology networks, while providing improved service company-wide.

INTEREST EXPENSE. Interest expense for the third quarter of 2004 was \$198,000, in line with the annual budget. This compared to interest expense of \$202,000 for the third quarter of 2003, before the inclusion of a one-time interest income item of \$311,000 for the recovery of accumulated excess interest paid to a bond sinking fund. Accordingly, the Company reported net interest income of \$109,000 for the third quarter of 2003. For the nine months ended September 30, 2004, net interest expense was \$565,000 compared to \$498,000 for the comparable period of 2003. During 2004 the interest rate on the Company's variable rate debt, reflecting changes in the large bank prime rate, has increased from 4.25% to 5.0%, compared to a range of 4.25% to 4.5% during 2003. In 2004, increases in interest expense due to rate increases and higher average borrowings on a bank line of credit have been offset by reductions in term loan balances, lower fees for letters of credit and lower interest on industrial revenue bonds. In September 2003, the Company amended the bond agreement to more nearly reflect the interest rate earned by the bondholders. The amendment provides that the bond trustee will evaluate the interest account at the end of each calendar quarter and refund the excess amount determined, if any, and rebate such excess to the Company. The Company has elected to apply any such rebates to offset the cost of a letter of credit related to the industrial revenue bonds. In the third quarter of 2004, the Company recognized as a reduction of interest expense excess bond interest of \$39,000. There was no comparable recognition of excess bond interest in the third quarter of 2003. The Company's interest expense for the third quarter of 2004 was not impacted by inflation.

OTHER INCOME. In the first quarter of 2004, the Company liquidated its total investment in equity securities and realized a pre-tax gain of \$25,000.

INCOME TAXES. The Company's effective income tax rates on income from continuing

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operations for the third quarters of 2004 and 2003 were 37.9% and 52.4%, respectively. For the nine months ended September 30, 2004 and 2003, the effective tax rates were 38.0% and 20.1%, respectively. The rates for 2003 differed from the federal statutory rate primarily due to state income taxes and adjustments to the estimate of the deferred tax asset accounts. The rates for 2004 differed from the federal statutory rate primarily due to state income taxes.

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DISCONTINUED OPERATIONS. In the quarter ended June 30, 2003, the Company recorded a net loss from a discontinued operation of an idled galvanizing plant of \$77,000, net of taxes of \$45,000. The Company also wrote off its investment in the idled galvanizing plant in the second quarter of 2003, and recorded a net loss of \$754,000, net of taxes of \$443,000. See Note 11, Discontinued Operations, Notes to Condensed Consolidated Interim Financial Statements.

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 capital spending requirements. During the nine month periods ended September 30, 2004, operating cash flow and borrowings under credit facilities have been the primary source of liquidity. The Company monitors working capital and planned capital spending to assess liquidity and minimize cyclical cash flow.

The Company employs a system of cash management, encompassing all of its operations, which concentrates cash in a central bank account for maximum utilization and control. By employing a daily sweep of cash balances and just-in-time disbursement funding, the Company endeavors to minimize its outstanding borrowings from the revolver and also reduce the related interest expense incurred.

Cash flow from operating activities for the first nine months of 2004 and 2003 was \$1,417,000 and \$1,964,000, respectively. The reduction of \$547,000 in 2004 cash flow from operations was due primarily to increases in working capital to support increased sales, partially offset by increases in net income and deferred tax accounts.

The Company anticipates that it will be able to satisfy cash requirements for its ongoing business operations for the foreseeable future with cash generated by operations and borrowings under its existing credit facilities.

Cash of \$1,037,000 used in 2004 investing activities through September 30 consisted of capital expenditures of \$1,129,000 for material handling and process equipment to maintain galvanizing facilities, offset by proceeds of \$92,000 from the sale of investment securities. Capital expenditures of \$733,000 for the comparable nine-month period of 2003 included budgeted capital programs to upgrade existing galvanizing facilities and for the completion of a new galvanizing plant in St. Louis, Missouri. Capital expenditures for the third quarter of 2004 were \$100,000; for the remainder of 2004, expected capital expenditures of approximately \$200,000 are budgeted for maintenance of the Company's existing galvanizing facilities.

Total debt (current and long-term obligations) increased \$95,000 to \$16,510,000 in the nine months ended September 30, 2004. Financing activities for this period of 2004 included payments of \$487,000 to a bond sinking fund, payments of \$1,038,000 on bank term loans and other obligations and proceeds of \$1,620,000 from a bank line of credit. Also during this period, the Company had a net reduction of 5,553 shares held in its Treasury account, resulting from the purchase of 26,576 shares in private transactions, which were offset by the

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issuance of 32,129 shares in lieu of cash for payment of quarterly board fees to its directors. At September 30, 2004 and 2003, the Company held 1,421,235 and 1,440,217 shares, respectively, in its Treasury account.

In September 2003, the Company amended a three-year bank credit agreement that was scheduled to expire in June 2004 and extended its maturity to January 1, 2005. During 2004, the bank has extended maturities under the credit agreement to October 1, 2005. Subject to borrowing base limitations, the amended agreement provided (i) a \$7,000,000 maximum revolving credit facility for working capital and general corporate purposes, (ii) a \$1,911,924 term note and (iii) a \$2,833,332 construction note.

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At September 30, 2004, \$8,725,000 was outstanding under the bank credit agreement, and \$400,000 was reserved for outstanding irrevocable letters of credit for workers' compensation insurance coverage. The Company's commitment to repay the remaining balance of the \$9,050,000 of tax-exempt adjustable rate industrial revenue bonds issued in 2000 is fully secured by an irrevocable letter of credit issued by Bank One Oklahoma, N.A., in favor of Bank One Trust Company (See Note 6 to Condensed Consolidated Financial Statements). At September 30, 2004, the Company had \$918,000 available borrowing capacity, net of outstanding letters of credit, under its revolving line of credit based on the borrowing base calculated under the agreement. During October 2004, the available borrowing capacity under the revolving line of credit improved to approximately \$1,326,000, primarily reflecting an improvement in turnover of trade accounts receivable. The Company believes that its ability to continue to generate cash from operations and its bank credit facilities will provide adequate capital resources and liquidity to support operations and capital expenditures plans for 2004.

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 off-balance sheet contractual obligations at September 30, 2004, consist of \$1,732,000 for long-term operating leases for two galvanizing facilities and galvanizing equipment, \$396,000 for vehicle operating leases and \$6,118,000 for zinc purchase commitments. The various leases for galvanizing facilities, including option renewals, expire from 2015 to 2017. A lease for galvanizing equipment expires in 2007. The vehicle leases expire annually on various dates through 2010. 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 are typically up to one year.

The Company expects to fund these commitments with cash generated from operations and continuation of existing bank credit agreements as they mature. The Company had the following contractual obligations and commercial commitments as of September 30, 2004 (in thousands):

| | PAYMENT DUE OR COMMITMENT EXPIRATION BY PER | | | | |
|--------------------------|---|--------|--------|--------|--------|
| | TOTAL | 2004 | 2005 | 2006 | 2007 |
| Industrial revenue bonds | \$ 6,795 | \$ 169 | \$ 693 | \$ 731 | \$ 767 |
| Long-term debt | 8,745 | 353 | 8,374 | 1 | 1 |
| Subordinated notes | 1,000 | -- | -- | 1,000 | -- |

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| | | | | | |
|------------------------------------|-----------|----------|-----------|----------|----------|
| Facilities operating leases | 1,732 | 124 | 491 | 411 | 379 |
| Vehicle operating leases | 396 | 30 | 116 | 88 | 73 |
| Zinc purchase commitments | 6,118 | 2,101 | 4,017 | -- | -- |
| | ----- | ----- | ----- | ----- | ----- |
| Total contractual cash obligations | \$ 24,786 | \$ 2,777 | \$ 13,691 | \$ 2,231 | \$ 1,220 |
| | ===== | ===== | ===== | ===== | ===== |
| Other contingent commitments: | | | | | |
| Letters of credit* | \$ 7,195 | \$ 569 | \$ 693 | \$ 731 | \$ 767 |

* Amount includes letter of credit relating to debt outstanding under the industrial revenue bond agreement (See Note 6 to Condensed Consolidated Interim Financial Statements).

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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 through the third quarter of 2004 and 2003 were approximately \$703,000 and \$824,000, respectively, for the disposal and recycling of wastes generated by the galvanizing operations.

The status of the Sandoval matter is unchanged from June 30, 2004, when the Company reported the following: NAG was notified in 1997 by the Illinois Environmental Protection Agency ("IEPA") that it was one of more than 50 potentially responsible parties ("PRPs") for cleanup of an abandoned site formerly owned by Sandoval Zinc Company. Since then approximately 30 additional PRPs have been identified by the IEPA.

A number of the PRPs (approximately 12 to 15) 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 IEPA has yet to respond to this proposed work plan or suggest any other course of action. Therefore, the Company has no basis for determining potential exposure and estimated remediation costs at this time.

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 recently filed a Second Amended Complaint in the United States District Court, Northern District of Illinois, Eastern Division, Case No. 03 C 0754, 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 the August 12, 2004 default judgment in the amount of \$1,810,463.34 against Lake River Corporation and Lake

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River Holding Company, Inc. in connection with the operation of a storage terminal by Lake River Corporation. Lake River Corporation conducted business as a subsidiary of the Company until June 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 (North American Galvanizing & Coatings, Inc.). The Company is in the process of reviewing this matter. However, the Company denies the assertions set forth in the Water District's Complaint and will seek to have the Second Amended Complaint dismissed.

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 the frequent changes in environmental technology, laws and regulations management cannot reasonably quantify the Company's potential future costs in this area.

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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.

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 September 30, 2004, the Company's outstanding debt of \$16,049,000, net of a \$30,000 discount related to subordinated debt, consisted of the following: Variable rate debt aggregating \$8,264,000 under the bank credit agreement, with an effective rate of 4.89%; \$6,795,000 under the industrial revenue bond agreement, with an effective rate of 3.5%; and fixed rate debt consisting of \$1,000,000 of 10% subordinated promissory notes and a 9.5% term note of \$20,000. The borrowings under all of the Company's debt obligations at September 30, 2004 are due as follows: \$522,000 in 2004; \$8,606,000 in 2005; \$1,732,000 in 2006 and \$5,219,000 in years 2007 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 \$15,000 based on September 30, 2004 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 year, reflect rates quoted on the London Metals Exchange. At September 30, 2004, the aggregate fixed price commitments for the procurement of zinc were \$6,118,000. With respect to these zinc fixed price purchase commitments, a hypothetical decrease of 10% in the market price of zinc from the June 30, 2004 level represented a potential lost gross margin opportunity of approximately \$612,000; however, lower zinc prices potentially could benefit future earnings for the zinc purchases that are made at the lower market price.

The Company's financial strategy includes evaluating the selective use of

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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 (See Note 9) are considered derivatives, but the Company has elected to account for these purchase commitments as normal purchases.

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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.

There have been no significant changes in our internal controls over financial reporting that occurred during our last fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal controls over financial reporting. There were no significant deficiencies or material weaknesses identified in the evaluation, and therefore, no corrective actions were taken.

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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 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 seeks enforcement of the 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

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River Corporation conducted business as a subsidiary of the Company until June 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 (North American Galvanizing & Coatings, Inc.). The Company denies the assertions set forth in the Water District's Complaint and will seek to have the Second Amended Complaint dismissed.

Various other litigation arising in the ordinary course of business is pending against the Company. Management believes that resolution of this litigation should not materially affect the Company's consolidated financial position or liquidity.

Item 2. Changes in Securities, Use of Proceeds and Issuer Purchase of Equity Securities

The following table contains information about our purchases of our equity securities during the third quarter of 2004.

Issuer Purchases of Equity Securities

| Period | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of a Publicly Announced Plan (1) | Approximate Dollar Value That May Yet Be Purchased Under the Plan (1) |
|-----------------|----------------------------------|------------------------------|---|---|
| July 1-31, 2004 | 120 | \$2.06 | 120 | \$736,568 |

(1) In July 1998, the Board of Directors authorized a share repurchase plan. Shares of common stock may be purchased in private or open market transactions, with an aggregate purchase price limit of no more than \$1 million. As of September 30, 2004, the number of shares purchased and held in Treasury under this plan was 142,772. Unless terminated earlier by resolution of our Board, the plan will expire when we have repurchased all shares authorized for repurchase under the plan.

Item 3. Defaults Upon Senior Securities - Not applicable.

Item 4. Submission of Matters to a Vote of Security Holders - Not applicable.

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Item 5. Other Information - Not applicable.

Item 6. Exhibits

- 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) file on 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

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Form 10-Q dated March 31, 1996).

- 31 Certifications pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32 Certifications pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 99 Cautionary Statements by the Company Related to Forward-Looking Statements.

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SIGNATURES

Pursuant to the requirements of the Securities 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)

/s/ Paul R. Chastain

Vice President and
Chief Financial Officer
(Principal Financial Officer
and Duly Authorized Officer)

Date: November 10, 2004

