TREX CO INC
Form 10-Q
November 08, 2007
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# UNITED STATES

# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
**For the quarterly period ended September 30, 2007**

**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: 001-14649**

# Trex Company, Inc.

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

| | |
|---|---|
| **Delaware** | **54-1910453** |
| **(State or other jurisdiction of** | **(I.R.S. Employer** |
| **incorporation or organization)** | **Identification No.)** |
| **160 Exeter Drive** | **22603-8605** |

**Winchester, Virginia**
**(Address of principal executive offices)** **(Zip Code)**
**Registrant s telephone number, including area code: (540) 542-6300**

**Not Applicable**

**(Former name, former address and former fiscal year,**

**if changed since last report)**

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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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ¨ Accelerated filer x Non-accelerated filer ¨

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

The number of shares of the registrant s common stock, par value $.01 per share, outstanding at November 6, 2007 was 15,076,738 shares.

**TREX COMPANY, INC.**

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**PART I. FINANCIAL INFORMATION**

**Item 1. Financial Statements**

**TREX COMPANY, INC.**

**Condensed Consolidated Balance Sheets**

(In thousands)

| | December 31, 2006 | September 30, 2007 (unaudited) |
|---|---|---|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | $ 672 | $ 19,746 |
| Accounts receivable, net | 18,140 | 27,141 |
| Inventories | 111,434 | 73,643 |
| Prepaid expenses and other current assets | 3,201 | 3,436 |
| Income taxes receivable | 6,480 | 7,524 |
| Deferred income taxes | 3,180 | 10,653 |
| Total current assets | 143,107 | 142,143 |
| Property, plant, and equipment, net | 198,525 | 203,166 |
| Goodwill | 6,837 | 6,837 |
| Debt-related derivatives | 359 | 153 |
| Other assets | 3,489 | 6,652 |
| Total assets | $ 352,317 | $ 358,951 |
| LIABILITIES AND STOCKHOLDERS EQUITY | | |
| Current liabilities: | | |
| Accounts payable | $ 40,248 | $ 16,297 |
| Accrued expenses | 17,586 | 18,686 |
| Accrued warranty | 2,467 | 19,538 |
| Line of credit | 44,132 | |
| Current portion of long-term debt | 9,115 | 35,716 |
| Total current liabilities | 113,548 | 90,237 |
| Deferred income taxes | 17,217 | 5,089 |
| Accrued taxes | | 2,396 |
| Non-current accrued warranty | | 28,453 |
| Debt-related derivatives | 747 | 705 |
| Long-term debt | 51,390 | 97,500 |
| Total liabilities | 182,902 | 224,380 |
| Stockholders equity: | | |
| Preferred stock, $0.01 par value, 3,000,000 shares authorized; none issued and outstanding | | |
| Common stock, $0.01 par value, 40,000,000 shares authorized; 14,913,889 and 15,076,738 shares issued and outstanding at December 31, 2006 and September 30, 2007, respectively | 149 | 151 |

| | | |
|---|---|---|
| Additional paid in capital | 62,986 | 65,956 |
| Accumulated other comprehensive loss | (278) | (444) |
| Retained earnings | 106,558 | 68,908 |
| Total stockholders equity | 169,415 | 134,571 |
| Total liabilities and stockholders equity | $ 352,317 | $ 358,951 |

**SEE ACCOMPANYING NOTES TO CONDENSED CONSOLIDATED**

**FINANCIAL STATEMENTS (UNAUDITED).**

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**TREX COMPANY, INC.**

**Condensed Consolidated Statements of Operations**

(unaudited)

(In thousands, except share and per share data)

| | Three Months Ended September 30, 2006 | Three Months Ended September 30, 2007 | Nine Months Ended September 30, 2006 | Nine Months Ended September 30, 2007 |
|---|---|---|---|---|
| Net sales | $ 78,098 | $ 63,971 | $ 304,849 | $ 298,663 |
| Cost of sales | 55,116 | 73,631 | 220,928 | 254,530 |
| Gross profit (loss) | 22,982 | (9,660) | 83,921 | 44,133 |
| Selling, general and administrative expenses | 15,419 | 52,074 | 56,738 | 91,974 |
| Income (loss) from operations | 7,563 | (61,734) | 27,183 | (47,841) |
| Interest expense, net | 305 | 2,021 | 2,151 | 6,241 |
| Income (loss) before income taxes | 7,258 | (63,755) | 25,032 | (54,082) |
| Provision (benefit) for income taxes | 2,679 | (22,528) | 8,898 | (19,168) |
| Net income (loss) | $ 4,579 | $ (41,227) | $ 16,134 | $ (34,914) |
| Basic earnings (loss) per common share | $ 0.31 | $ (2.77) | $ 1.09 | $ (2.35) |
| Basic weighted average common shares outstanding | 14,838,343 | 14,892,507 | 14,825,287 | 14,878,951 |
| Diluted earnings (loss) per common share | $ 0.31 | $ (2.77) | $ 1.08 | $ (2.35) |
| Diluted weighted average common shares outstanding | 14,921,151 | 14,892,507 | 14,908,475 | 14,878,951 |

**SEE ACCOMPANYING NOTES TO CONDENSED CONSOLIDATED**

**FINANCIAL STATEMENTS (UNAUDITED).**

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**TREX COMPANY, INC.**

**Condensed Consolidated Statements of Cash Flows**

(unaudited)

(In thousands)

| | Nine Months Ended September 30, 2006 | Nine Months Ended September 30, 2007 |
|---|---|---|
| **OPERATING ACTIVITIES** | | |
| Net income (loss) | $ 16,134 | $ (34,914) |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation | 15,248 | 16,552 |
| Equity method income | (116) | (483) |
| Deferred income taxes | 1,706 | (18,517) |
| Accrued taxes | | (516) |
| Stock-based compensation | 2,049 | 3,116 |
| Loss on disposal of property, plant, and equipment | 221 | 4 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (10,792) | (9,001) |
| Inventories | (21,039) | 37,791 |
| Prepaid expenses and other assets | 218 | 713 |
| Accounts payable | 8,940 | (23,951) |
| Accrued expenses and accrued warranty | 4,137 | 45,515 |
| Income taxes receivable | 8,354 | (843) |
| Net cash provided by operating activities | 25,060 | 15,466 |
| **INVESTING ACTIVITIES** | | |
| Expenditures for property, plant and equipment | (14,533) | (21,197) |
| Net cash used in investing activities | (14,533) | (21,197) |
| **FINANCING ACTIVITIES** | | |
| Financing costs | | (3,628) |
| Proceeds from sale of convertible senior subordinated notes | | 97,500 |
| Principal payments under mortgages and notes | (8,767) | (24,789) |
| Borrowings under line of credit | 50,709 | 86,120 |
| Principal payments under line of credit | (51,579) | (130,252) |
| Repurchases of common stock | (431) | (377) |
| Proceeds from employee stock purchase and option plans | 331 | 252 |
| Tax effect of stock-based compensation | 50 | (21) |
| Net cash (used in) provided by financing activities | (9,687) | 24,805 |
| Net increase in cash and cash equivalents | 840 | 19,074 |
| Cash and cash equivalents at beginning of period | 1,395 | 672 |
| Cash and cash equivalents at end of period | $ 2,235 | $ 19,746 |

| | | |
|---|---|---|
| Supplemental Disclosure: | | |
| Cash paid for interest, net of capitalized interest | $ 1,835 | $ 4,459 |
| Cash paid (received) for income taxes, net | $ (528) | $ 618 |

**SEE ACCOMPANYING NOTES TO CONDENSED CONSOLIDATED**

**FINANCIAL STATEMENTS (UNAUDITED).**

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**TREX COMPANY, INC.**

**Notes to Condensed Consolidated Financial Statements**

**For the Nine Months Ended September 30, 2006 and 2007**

**(unaudited)**

**1. BUSINESS AND ORGANIZATION**

Trex Company, Inc. (together with its subsidiaries, the Company ) manufactures wood/plastic composite products primarily for residential and commercial decking, railing and fencing applications. Trex Wood-Polymer® lumber ( Trex ) is manufactured in a proprietary process that combines waste wood fibers and reclaimed polyethylene ( PE material ). The Company operates in one business segment.

**2. BASIS OF PRESENTATION**

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, the accompanying condensed consolidated financial statements do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments (consisting of normal and recurring adjustments) considered necessary for a fair presentation have been included in the accompanying condensed consolidated financial statements. The consolidated results of operations for the nine months ended September 30, 2007 are not necessarily indicative of the results that may be expected for the full fiscal year. These condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements as of December 31, 2005 and 2006 and for each of the three years in the period ended December 31, 2006 included in the annual report of Trex Company, Inc. on Form 10-K, as filed with the Securities and Exchange Commission (the 2006 Form 10-K ).

The Company s critical accounting policies are included in the 2006 Form 10-K. Since the year ended December 31, 2006, there have been no significant changes in the Company s critical accounting policies and estimates other than the warranty liability estimates, which resulted in the Company increasing its warranty liability to $48.0 million in the three months ended September 30, 2007. See Note 13.

Certain reclassifications have been made in the presentation of the financial statements for the periods prior to fiscal year 2007 to conform to the presentation of the financial statements for the nine months ended September 30, 2007.

**3. NEW ACCOUNTING STANDARDS**

In June 2006, the Financial Accounting Standards Board ( FASB ) issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109* ( FIN 48 ). This interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. It also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. The provisions of FIN 48 are effective for the Company for the year ending December 31, 2007, with the cumulative effect of the change in accounting principle recorded as an adjustment to the opening balance of retained earnings. The Company adopted the provisions of FIN 48 effective January 1, 2007, and recorded a cumulative effect change to retained earnings of $2.7 million. See Note 10 for additional disclosure regarding adoption of FIN 48.

In September 2006, the FASB issued Statement of Financial Accounting Standards ( SFAS ) No. 157, *Fair Value Measurements*. SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, with earlier application encouraged. The Company is evaluating the effect that the adoption of SFAS No. 157 will have on its results of operations and financial position.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Liabilities.* SFAS No. 159 permits entities to choose to elect to measure eligible financial instruments at fair value. This provides entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without being required to apply complex hedge accounting provisions. SFAS No. 159 applies to fiscal years beginning after November 15, 2007, with early adoption permitted for an entity that has also elected to apply the provisions of SFAS No. 157. An entity is prohibited from retrospectively applying SFAS No. 159, unless it chooses early adoption. The Company is evaluating the effect that the adoption of SFAS No. 159 will have on its results of operations and financial position.

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**4. COMPREHENSIVE INCOME (LOSS)**

The Company s comprehensive income (loss) was $4.2 million and $(41.3) million for the three months ended September 30, 2006 and 2007, respectively, and $16.3 million and $(35.1) million for the nine months ended September 30, 2006 and 2007, respectively. Comprehensive income (loss) consists of net income (loss) and net unrealized gains and losses on interest-rate swap contracts.

**5. INVENTORY**

Inventories, at LIFO (last-in, first-out) value, consist of the following (in thousands):

| | December 31, 2006 | September 30, 2007 |
|---|---|---|
| Finished goods | $ 83,224 | $ 57,180 |
| Raw materials | 28,210 | 16,463 |
| Total inventories | $ 111,434 | $ 73,643 |

Inventory is stated at the lower of standard cost or net realizable value. The Company periodically reviews its inventory for slow moving or obsolete items and writes down the related products to estimated net realizable value. During the three months ended September 30, 2007, management decided to reclaim certain finished goods inventories for future use in the Company s manufacturing process. As a result, the Company recorded a $9.4 million charge to write down the affected inventory to reclaim value.

For the three months and nine months ended September 30, 2007, due to the liquidation of certain inventories, a portion of the Company s cost of sales is based on prior year costs rather than current year costs. As a result, the Company recognized an expense of $0.4 million and a benefit of $1.0 million during the three months and nine months ended September 30, 2007, respectively.

An actual valuation of inventory under LIFO can be made only at the end of each year based on the inventory levels and costs at that time. Accordingly, interim LIFO calculations are based on management s estimates of expected year-end inventory levels and costs. Since inventory levels and costs are subject to factors beyond management s control, interim results are subject to the final year-end LIFO inventory valuation.

**6. ACCRUED EXPENSES**

Accrued expenses consist of the following (in thousands):

| | December 31, 2006 | September 30, 2007 |
|---|---|---|
| Accrued compensation and benefits | $ 4,491 | $ 5,408 |
| Accrued interest | 624 | 2,655 |
| Accrued sales and marketing costs | 4,242 | 2,328 |
| Accrued customer relations costs | 1,597 | 2,073 |