TREX CO INC
Form 10-Q
November 04, 2008
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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, 2008

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	
Winchester, Virginia	**22603-8605**
(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)

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

Large accelerated filer ¨ Accelerated filer x Non-accelerated filer ¨ Smaller reporting company ¨

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 October 30, 2008 was 15,318,445 shares.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

TREX COMPANY, INC.

Condensed Consolidated Balance Sheets

(In thousands)

	December 31, 2007	September 30, 2008 (unaudited)
Assets		
Current assets:		
Cash and cash equivalents	$ 66	$ 42,757
Accounts receivable, net	6,588	19,177
Inventories	92,569	49,052
Prepaid expenses and other assets	2,617	3,250
Income taxes receivable	2,376	2,532
Deferred income taxes	16,007	16,007
Total current assets	120,223	132,775
Property, plant, and equipment, net	193,944	181,315
Goodwill	6,837	6,837
Other assets	7,722	7,869
Total assets	$ 328,726	$ 328,796
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	$ 19,776	$ 10,766
Accrued expenses	21,583	21,522
Accrued warranty	21,084	11,137
Current portion of long-term debt	1,198	1,267
Total current liabilities	63,641	44,692
Deferred income taxes	15,763	15,798
Accrued taxes	3,620	3,525
Non-current accrued warranty	18,901	13,634
Debt-related derivatives	1,044	1,054
Long-term debt	131,730	130,770
Total liabilities	234,699	209,473
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; 15,076,738 and 15,318,445 shares issued and outstanding at December 31, 2007 and September 30, 2008, respectively	151	153
Additional paid in capital	66,523	68,247
Accumulated other comprehensive loss	(557)	(496)
Retained earnings	27,910	51,419

Total stockholders equity		94,027		119,323
Total liabilities and stockholders equity	$	328,726	$	328,796

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,		Nine Months Ended September 30,	
	2007	**2008**	**2007**	**2008**
Net sales	$ 63,971	$ 85,379	$ 298,663	$ 299,905
Cost of sales	73,631	61,827	254,530	215,372
Gross profit (loss)	(9,660)	23,552	44,133	84,533
Selling, general and administrative expenses	52,074	15,112	91,974	54,338
Income (loss) from operations	(61,734)	8,440	(47,841)	30,195
Interest expense, net	2,021	2,041	6,241	6,901
Income (loss) before income taxes	(63,755)	6,399	(54,082)	23,294
Benefit for income taxes	(22,528)	(318)	(19,168)	(215)
Net income (loss)	$ (41,227)	$ 6,717	$ (34,914)	$ 23,509
Basic earnings (loss) per common share	$ (2.77)	$ 0.45	$ (2.35)	$ 1.57
Basic weighted average common shares outstanding	14,892,507	14,964,110	14,878,951	14,952,210
Diluted earnings (loss) per common share	$ (2.77)	$ 0.44	$ (2.35)	$ 1.56
Diluted weighted average common shares outstanding	14,892,507	15,253,680	14,878,951	15,082,325

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, 2007	Nine Months Ended September 30, 2008
Operating Activities		
Net income (loss)	$ (34,914)	$ 23,509
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	16,552	19,522
Equity method losses (income)	(483)	17
Derivatives	(153)	107
Deferred income taxes	(18,364)	
Accrued taxes	(516)	(95)
Stock-based compensation	3,116	1,618
Loss on disposal of property, plant, and equipment	4	21
Changes in operating assets and liabilities:		
Accounts receivable	(9,001)	(12,590)
Inventories	37,791	43,517
Prepaid expenses and other assets	713	(559)
Accounts payable	(23,951)	(9,011)
Accrued expenses	45,515	(15,344)
Income taxes receivable	(843)	(85)
Net cash provided by operating activities	15,466	50,627
Investing Activities		
Note receivable, net		(702)
Expenditures for property, plant and equipment	(21,197)	(6,214)
Proceeds from sales of property, plant and equipment		42
Net cash used in investing activities	(21,197)	(6,874)
Financing Activities		
Financing costs	(3,628)	(279)
Proceeds from sale of convertible senior subordinated notes	97,500	
Principal payments under mortgages and notes	(24,789)	(891)
Borrowings under line of credit	86,120	44,178
Principal payments under line of credit	(130,252)	(44,178)
Repurchases of common stock	(377)	(74)
Proceeds from employee stock purchase and option plans	252	182
Tax effect of stock-based compensation	(21)	
Net cash (used in) provided by financing activities	24,805	(1,062)
Net increase in cash and cash equivalents	19,074	42,691
Cash and cash equivalents at beginning of period	672	66

Cash and cash equivalents at end of period	$ 19,746	$ 42,757
Supplemental Disclosure:		
Cash paid for interest, net of capitalized interest	$ 4,459	$ 7,366
Cash paid (received) for income taxes, net	$ 618	$ (45)

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, 2007 and 2008

(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, 2008 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, 2006 and 2007 and for each of the three years in the period ended December 31, 2007 included in the annual report of Trex Company, Inc. on Form 10-K, as filed with the Securities and Exchange Commission.

The Company s critical accounting policies are included in the Company s Annual Report of Form 10-K for the year ended December 31, 2007.

Certain reclassifications have been made in the presentation of the financial statements for the nine months ended September 30, 2007 to conform to the presentation of the financial statements for the nine months ended September 30, 2008.

3. NEW ACCOUNTING STANDARDS

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Standards (SFAS) No. 157, *Fair Value Measurements*, which defines fair value, establishes a framework for measuring fair value in accordance with 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. In February 2008, the FASB issued Staff Position (FSP) No. 157-2 which delays the effective date of SFAS 157 one year for all nonfinancial assets and nonfinancial liabilities, except those recognized or disclosed at fair value in the financial statements on a recurring basis. The Company adopted this standard effective January 1, 2008 with no impact on its results of operations and financial position. See Note 8 to the accompanying condensed consolidated financial statements for additional disclosure.

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, which 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. The Company did not elect to measure any additional assets or liabilities at fair value that are not already measured at fair value under existing standards. Therefore, the adoption of this standard had no impact on the Company s results of operations and financial position.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities an amendment of FASB Statement No. 133*. SFAS No. 161 requires enhanced disclosure related to derivatives and hedging activities and thereby seeks to improve the transparency of financial reporting. Under SFAS No. 161, entities are required to provide enhanced disclosures relating to: (a) how and why an entity uses derivative instruments; (b) how derivative instruments and related hedge items are accounted for under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, and its related interpretations; and (c) how derivative instruments and related hedged items affect an entity s financial position, financial performance, and cash flows. SFAS No. 161 must be applied prospectively to all derivative instruments and non-derivative instruments that are designated and qualify as hedging instruments and related hedged items accounted for under

SFAS No. 133 for all financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with earlier application encouraged. The Company is evaluating the effect that the adoption of SFAS No. 161 will have on its results of operations and financial position.

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In May 2008, the FASB issued FSP APB 14-1, *Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement).* FSP APB 14-1 requires the proceeds from the issuance of convertible debt instruments that may be settled in cash upon conversion to be allocated between a liability component and an equity component. The resulting debt discount will be amortized over the period the convertible debt is expected to be outstanding as additional non-cash interest expense. The FSP is effective for fiscal years beginning after December 15, 2008, and is applied retrospectively to prior periods. The Company is currently evaluating the potential impact that the adoption of FSP APB 14-1 will have on its results of operations and financial position.

4. COMPREHENSIVE INCOME

The Company s comprehensive income was $(41.3) million and $6.7 million for the three months ended September 30, 2007 and 2008, respectively and $(35.1) million and $23.5 million for the nine months ended September 30, 2007 and 2008, respectively. Comprehensive income consists of net income and net unrealized gains and losses on interest-rate swap contracts.

5. INVENTORIES

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

	December 31, 2007	September 30, 2008
Finished goods	$ 72,916	$ 32,704
Raw materials	19,653	16,348
Total inventories	$ 92,569	$ 49,052

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 nine months ended September 30, 2008, management decided to reclaim certain finished goods inventories that did not meet company quality specifications. As a result, the Company recorded a $1.4 million and a $3.2 million charge, respectively, in the three and nine months ending September 30, 2008 to write down the affected inventory, which will be used in the Company s manufacturing process in the future, to the weighted-average raw material costs.

For the three months and nine months ended September 30, 2008, 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 a benefit of $1.3 million and a benefit of $1.0 million during the three months and nine months ended September 30, 2008, respectively.

An actual valuation of inventory under the LIFO method 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 ar