

Aleris International, Inc.
Form 10-Q
November 13, 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

.. **Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
Commission File No. 1-7170

Aleris International, Inc.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or organization)

75-2008280

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

25825 Science Park Drive, Suite 400

Beachwood, Ohio 44122

(Address of principal executive offices) (Zip Code)

(216) 910-3400

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(Registrant's telephone number, including area code)

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

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

Large accelerated filer Accelerated filer Non-accelerated filer

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the close of business on October 31, 2007.

Common Stock, \$0.01 par value: 900 shares

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Table of Contents**PART I. FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****ALERIS INTERNATIONAL, INC.****CONSOLIDATED BALANCE SHEET**

(in millions, except share and per share data)

	September 30, 2007 (Unaudited)	December 31, 2006
ASSETS		
Current Assets		
Cash and cash equivalents	\$ 124.5	\$ 126.1
Accounts receivable (net of allowance of \$10.3 and \$9.9 at September 30, 2007 and December 31, 2006, respectively)	896.1	692.5
Inventories	946.0	1,023.6
Deferred income taxes	34.6	34.6
Prepaid expenses	23.1	20.6
Derivative financial instruments	55.9	77.5
Other current assets	22.8	18.3
Total Current Assets	2,103.0	1,993.2
Property, plant and equipment, net	1,388.0	1,223.1
Goodwill	1,345.4	1,362.4
Intangible assets, net	375.2	84.1
Derivative financial instruments	64.5	48.5
Deferred income taxes	8.1	8.1
Other assets	92.1	89.0
	\$ 5,376.3	\$ 4,808.4
LIABILITIES AND STOCKHOLDER S EQUITY		
Current Liabilities		
Accounts payable	\$ 721.4	\$ 554.3
Accrued liabilities	268.9	338.7
Deferred income taxes	33.9	37.7
Current maturities of long-term debt	18.6	20.5
Total Current Liabilities	1,042.8	951.2
Long-term debt	2,869.4	2,567.5
Deferred income taxes	256.3	141.2
Accrued pension benefits	183.5	179.2
Accrued postretirement benefits	58.2	57.5
Other long-term liabilities	82.4	66.4
Stockholder s Equity		
Preferred stock; par value \$.01; 100 shares authorized; none issued at September 30, 2007 and December 31, 2006, respectively		
Common stock; par value \$.01; 900 shares authorized and issued at September 30, 2007 and December 31, 2006, respectively		
Additional paid-in capital	852.6	848.8

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Retained deficit	(18.1)	(3.4)
Accumulated other comprehensive income	49.2	
Total Stockholder's Equity	883.7	845.4
	\$ 5,376.3	\$ 4,808.4

See Notes to Consolidated Financial Statements.

Table of Contents**ALERIS INTERNATIONAL, INC.****CONSOLIDATED STATEMENT OF OPERATIONS**

(Unaudited)

(in millions)

	(Successor)	(Predecessor)	(Successor)	(Predecessor)
	For the three months ended		For the nine months ended	
	September 30		September 30	
	2007	2006	2007	2006
Revenues	\$ 1,664.3	\$ 1,395.0	\$ 4,879.5	\$ 3,255.4
Cost of sales	1,575.8	1,289.6	4,603.7	2,933.6
Gross profit	88.5	105.4	275.8	321.8
Selling, general and administrative expense	83.8	54.2	204.1	114.2
Restructuring and other charges	2.3	2.6	11.2	2.3
(Gains) losses on derivative financial instruments	(12.4)	10.7	(47.7)	5.5
Operating income	14.8	37.9	108.2	199.8
Interest expense	58.3	26.6	168.8	54.3
Interest income	(3.4)	(0.9)	(5.6)	(1.5)
Loss on early extinguishment of debt		53.7		53.7
Other expense (income), net	0.8	(2.8)	8.1	(1.7)
(Loss) income before provision for income taxes and minority interests	(40.9)	(38.7)	(63.1)	95.0
(Benefit from) provision for income taxes	(44.6)	(14.7)	(49.0)	35.0
Income (loss) before minority interests	3.7	(24.0)	(14.1)	60.0
Minority interests, net of provision for income taxes	0.2	0.2	0.6	0.6
Net income (loss)	\$ 3.5	\$ (24.2)	\$ (14.7)	\$ 59.4

See Notes to Consolidated Financial Statements.

Table of Contents**ALERIS INTERNATIONAL, INC.****CONSOLIDATED STATEMENT OF CASH FLOWS**

(Unaudited)

(in millions)

	(Successor) For the nine months ended	(Predecessor) For the nine months ended
	September 30	
	2007	2006
Operating activities		
Net (loss) income	\$ (14.7)	\$ 59.4
Depreciation and amortization	154.3	63.4
(Benefit from) provision for deferred income taxes	(50.3)	(2.9)
Excess income tax benefits from exercise of stock options		(3.6)
Restructuring and other charges:		
Charges	11.2	2.3
Payments	(11.9)	(5.9)
Non-cash loss on early extinguishment of debt		16.4
Stock-based compensation expense	2.9	7.1
Unrealized (gains) losses on derivative financial instruments	(26.0)	7.1
Charges related to step up in carrying value of inventory	57.2	9.1
Other non-cash charges	8.1	3.7
Changes in operating assets and liabilities:		
Accounts receivable	(86.6)	(119.2)
Inventories	150.8	5.6
Other assets	37.4	3.3
Accounts payable and accrued liabilities	(21.6)	105.0
Net cash provided by operating activities	210.8	150.8
Investing activities		
Acquisition of Aleris International, Inc.	(11.5)	
Purchase of businesses, net of cash acquired	(314.7)	(824.3)
Payments for property, plant and equipment	(135.5)	(53.5)
Proceeds from sale of property, plant and equipment	0.4	1.5
Other	(0.8)	(0.1)
Net cash used by investing activities	(462.1)	(876.4)
Financing activities		
Net proceeds from long-term revolving credit facilities	155.9	36.2
Payments on long-term debt	(6.2)	(327.6)
Proceeds from issuance of long-term debt	100.0	1,154.7
Debt issuance costs	(3.7)	(29.9)
Change in restricted cash	0.3	(9.2)
Proceeds from exercise of stock options		1.5
Excess income tax benefits from exercise of stock options		3.6
Repurchase of common stock for treasury		(2.6)
Other	(0.6)	(0.7)
Net cash used by financing activities	245.7	826.0
Effect of exchange rate differences on cash and cash equivalents	4.0	0.4

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Net (decrease) increase in cash and cash equivalents	(1.6)	100.8
Cash and cash equivalents at beginning of period	126.1	6.8
Cash and cash equivalents at end of period	\$ 124.5	\$ 107.6

See Notes to Consolidated Financial Statements.

Table of Contents**ALERIS INTERNATIONAL, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)****SEPTEMBER 30, 2007****(amounts in millions, except share and per share data)****NOTE A BASIS OF PRESENTATION**

On July 14, 2006, Texas Pacific Group (TPG) formed Aurora Acquisition Holdings, Inc. (Holdings) and Aurora Acquisition Merger Sub, Inc. (Merger Sub), for purposes of acquiring Aleris International, Inc. (we, our or the Company). On August 7, 2006, we entered into an Agreement and Plan of Merger with Holdings, pursuant to which each share of our common stock (other than shares held in treasury or owned by Holdings) would be converted into the right to receive \$52.50 in cash, subject to stockholder approval. The acquisition of the Company (the Acquisition) was completed on December 19, 2006 at which time TPG and certain members of our management made a cash contribution of \$844.9 and a non-cash contribution of \$3.9 to Holdings in exchange for 8,520,000 shares of Holdings stock. The non-cash contribution consisted of shares of common stock held by management. Holdings contributed this amount to Merger Sub in exchange for Merger Sub issuing 900 shares of its common stock to Holdings. The cash contribution, along with the additional indebtedness jointly entered into by us and Merger Sub, was used to acquire and retire all of our then outstanding common stock, redeem all stock options and non-vested stock, refinance substantially all of our indebtedness and to pay fees and expenses associated with the Acquisition. Immediately upon consummation of the Acquisition, Merger Sub was merged with and into the Company. As the surviving corporation in the merger, we assumed, by operation of law, all of the rights and obligations of Merger Sub.

The Acquisition was recorded as of December 19, 2006. The accompanying consolidated financial statements as of September 30, 2007 and December 31, 2006 and for the three and nine months ended September 30, 2007 (the Successor period) include the preliminary application of purchase accounting and the establishment of a new basis of accounting necessitated by the Acquisition. The accompanying financial statements for the three and nine months ended September 30, 2006 (the Predecessor period) do not reflect this new basis of accounting.

The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three and nine months ended September 30, 2007 are not necessarily indicative of the results that may be expected for the year ending December 31, 2007. The accompanying financial statements include the accounts of Aleris International, Inc. and all of its subsidiaries (collectively, except where the context otherwise requires, referred to as we, us, our or similar terms). All intercompany accounts and transactions have been eliminated. For further information, refer to the consolidated financial statements and footnotes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2006.

NOTE B INVENTORIES

The components of inventories are:

	(Successor)	
	September 30, 2007	December 31, 2006
Finished goods	\$ 325.2	\$ 344.4
Raw materials	282.3	369.3
Work in process	284.8	270.7
Supplies	53.7	39.2
	\$ 946.0	\$ 1,023.6

At December 31, 2006, consolidated inventories included approximately \$58.0 associated with the write-up of acquired inventory to fair value in connection with the Acquisition. Substantially all of this write-up was included within Cost of Sales in the consolidated statement of operations

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for the nine months ended September 30, 2007.

NOTE C ACQUISITIONS

During the nine months ended September 30, 2007, we completed three acquisitions (collectively referred to as the 2007 acquisitions). On September 11, 2007, we completed our purchase of Wabash Alloys (Wabash), a producer of aluminum casting alloys and molten metal, from Connell Limited partnership, for a cash purchase price of \$171.6, including acquisition related

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expenses. The purchase price paid was funded through additional indebtedness as discussed in Note E. The purchase price paid has been allocated based on the estimated fair values of the assets acquired and liabilities assumed. The purchase price allocation is preliminary and final determination of required purchase accounting adjustments will be made upon the completion of an independent appraisal of the fair value of related long-lived tangible and intangible assets, the determination of the fair value of certain other acquired assets and liabilities, the completion of integration plans, and the finalization of the related deferred tax assets and liabilities. The results of Wabash are included in the results of operations for the three and nine months ended September 30, 2007 since the date of acquisition. The acquisition of Wabash is expected to provide opportunities to broaden our customer base and optimize processing capabilities within our specification alloy operations.

The following presents the preliminary allocation of the purchase price related to the Wabash acquisition:

Current assets	\$ 138.3
Property, plant and equipment	53.7
Goodwill	76.2
Current liabilities	(96.6)
Cash paid	\$ 171.6
Less: cash acquired	(5.6)
Cash paid, net of cash acquired	\$ 166.0

Also, during the nine months ended September 30, 2007, we completed the acquisitions of EKCO Products and Alumox Holding AS (other acquisitions made in 2007) for an aggregate cash purchase price of \$53.2, including acquisition related expenses. The purchase price allocations associated with these acquisitions is preliminary and subject to finalization in the remainder of the allocation periods. The results of operations of the acquired businesses are included in the results of operations of the global rolled and extruded products and global recycling reportable segments for the three and nine months ended September 30, 2007 since the date of acquisition.

On August 1, 2006, we acquired the downstream aluminum business of Corus Group plc (Corus Aluminum) for a cash purchase price of 695.5 (approximately \$885.7), subject to adjustment based on the finalization of working capital delivered and net debt assumed. In August 2007, we paid Corus Group plc a purchase price adjustment of 70.0 (approximately \$95.5) and paid the final purchase price adjustment of 1.4 (approximately \$2.0) in October 2007.

Unaudited Pro Forma Information

The following unaudited pro forma financial information for the three and nine months ended September 30, 2007 and 2006 presents our combined results of operations as if the Acquisition and related refinancing as well as the acquisitions of Corus Aluminum and the 2007 acquisitions had occurred on January 1, 2006. The unaudited pro forma information is not necessarily indicative of the consolidated results of operations that would have occurred had the acquisitions been made at the beginning of the period presented or the future results of combined operations.

	Three months ended September 30,		Nine months ended September 30,	
	2007	2006	2007	2006
Revenues	\$ 1,793.8	\$ 1,822.6	\$ 5,474.5	\$ 5,299.7
Gross profit	87.7	134.9	295.1	504.1
Net income (loss)	7.2	(53.7)	(17.6)	0.1

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The following table details the changes in the carrying amount of goodwill for the nine months ended September 30, 2007.

	Unallocated goodwill	Global rolled and extruded products	Global recycling	Global zinc	Total
Balance at December 31, 2006	\$ 1,362.4	\$	\$	\$	\$ 1,362.4
Acquisitions		2.9	89.7		92.6
Purchase price allocation adjustments	(1,362.4)	862.5	295.1	99.1	(105.7)
Currency translation adjustments		(1.0)	(2.9)		(3.9)
Balance at September 30, 2007	\$	\$ 864.4	\$ 381.9	\$ 99.1	\$ 1,345.4

During the nine months ended September 30, 2007 we recorded adjustments to the preliminary purchase price allocation associated with the Acquisition to reflect the preliminary appraised values of our long-lived assets, to increase the estimated purchase price paid for our acquisition of Corus Aluminum, to finalize the adjustment necessary to state the acquired inventories to their fair value, to record certain liabilities assumed, and to record deferred income taxes related to purchase price allocation adjustments. Based on the preliminary valuation of intangible assets completed during the third quarter related to the Acquisition, we recorded \$28.2 of amortization expense, approximately \$16.6 of which relates to the six months ended June 30, 2007. Net income for the three months ended September 30, 2007 was negatively impacted by approximately \$15.4 related to this change in estimate. The purchase price allocation associated with the Acquisition remains preliminary and subject to the finalization of the valuations of the acquired tangible and intangible long-lived assets, the finalization of our restructuring initiatives and the determination of deferred income taxes. In addition, the allocation of goodwill to the reporting units is preliminary and may change based on the finalization of the appraisals of the acquired fixed and intangible assets. The following presents the adjusted preliminary allocation of the purchase price related to the Acquisition:

Current assets	\$ 899.9
Property, plant and equipment	1,231.6
Goodwill	1,254.5
Other assets	442.8
Long-term debt	(1,467.1)
Accrued pension and post-retirement benefits	(236.7)
Other long-term liabilities	(388.1)
Cash paid	\$ 1,736.9

During the third quarter of 2007, we acquired Wabash for a cash purchase price of \$171.6, including acquisition related expenses. The preliminary purchase price allocation resulted in \$76.2 of goodwill which has been included within the global recycling segment. The purchase price allocation is subject to the finalization of appraisals of the acquired tangible and intangible assets and the completion of our restructuring initiatives.

The preliminary purchase price allocations for other acquisitions made in 2007 resulted in \$16.4 of goodwill which has been included within the global rolled products and the global recycling segments. These purchase price allocations are subject to the finalization of appraisals of the acquired tangible and intangible assets and the completion of our restructuring initiatives.

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The following table summarizes the details of other intangible assets recorded on our consolidated balance sheet as of September 30, 2007 and December 31, 2006:

	September 30, 2007			December 31, 2006		
	Gross carrying amount	Accumulated amortization	Net carrying amount	Gross carrying amount	Accumulated amortization	Net carrying amount
Trade name and trademarks	\$ 103.6	\$	\$ 103.6	\$ 7.8	\$	\$ 7.8
Technology	35.8	(2.6)	33.2	12.8	(0.1)	12.7
Customer contracts & relationships	269.2	(30.8)	238.4	64.0	(0.4)	63.6
	\$ 408.6	\$ (33.4)	\$ 375.2	\$ 84.6	\$ 0.5	\$ 84.1

The fair value of these intangible assets is subject to the completion of a third party appraisal and may differ from the amounts shown herein.

NOTE E LONG-TERM DEBT

Our long-term debt is summarized as follows:

	September 30, 2007	December 31, 2006
Revolving Credit Facility	\$ 504.2	\$ 328.6
Term Loan Facility	1,250.8	1,225.0
9% Senior Notes, due December 15, 2014	600.0	600.0
9% New Senior Notes, due December 15, 2014, net of discount	100.0	
10% Senior Subordinated Notes, due December 15, 2016	400.0	400.0
Other	33.0	34.4
Subtotal	2,888.0	2,588.0
Less current maturities	18.6	20.5
Total	\$ 2,869.4	\$ 2,567.5

On August 23, 2007, in connection with our acquisition of Wabash, we entered into an incremental commitment agreement, thereby amending our revolving credit facility (defined below). This agreement increased the facility size by \$100.0, to up to \$850.0, subject to applicable borrowing bases. In addition, on September 1, 2007 we issued \$105.4 aggregate principal amount of 9% senior notes (new senior notes). We incurred \$4.4 of fees and expenses associated with issuing the new senior notes and amending our revolving credit facility which have been capitalized as debt issuance costs.

On December 19, 2006, in conjunction with the Acquisition, we amended and restated the \$750.0 revolving credit facility entered into on August 1, 2006 in connection with the acquisition of Corus Aluminum (the revolving credit facility) to, in part, increase the maximum borrowings by \$100.0, subject to lender approval. In addition, we amended and restated the term loan facility entered into on August 1, 2006 to increase the maximum borrowings to \$825.0 and 303.0 (the term loan facility and, together with the revolving credit facility, the 2006 credit facilities). We also issued \$600.0 of senior notes (the senior notes) and \$400.0 of senior subordinated notes (the senior subordinated notes). We used proceeds from these facilities to refinance substantially all of our existing indebtedness and to fund a portion of the purchase price of the Acquisition. We incurred \$87.2 of fees and expenses associated with the refinancing which have been capitalized as debt issuance costs.

Revolving Credit Facility

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Our revolving credit facility provides senior secured financing of up to \$850.0. We and certain of our U.S. and international subsidiaries are borrowers under this revolving credit facility. The availability of funds to the borrowers located in each jurisdiction is subject to a borrowing base for that jurisdiction, calculated on the basis of a predetermined percentage of the value of selected accounts receivable and U.S. and Canadian inventory, less certain ineligible amounts. Non-U.S. borrowers also have the ability to borrow under this revolving credit facility based on excess availability under the borrowing base applicable to U.S. borrowers, subject to certain sublimits. The revolving credit facility provides for the issuance of up to \$50.0 of letters of credit as well as borrowings on same-day notice, referred to as swingline loans, and will be available in U.S. dollars, Canadian dollars, euros and certain other currencies. As of September 30, 2007, we estimate that our borrowing base would have supported borrowings of \$775.0. After giving effect to the \$504.2 of outstanding borrowings as well as outstanding letters of credit of \$34.1, we had \$236.7 available for borrowing as of September 30, 2007.

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The weighted average interest rate under the revolving credit facility as of September 30, 2007 was 6.8%.

There is no scheduled amortization under the revolving credit facility. The principal amount outstanding will be due and payable in full at maturity, on December 19, 2011.

Term Loan Facility

Our term loan facility is a seven-year credit facility maturing on December 19, 2013. The term loan facility permits \$825.0 in U.S. dollar borrowings and 303.0 in euro borrowings. We have borrowed the maximum amount under this term loan facility as of September 30, 2007. On March 16, 2007, the Company amended the term loan agreement, to reduce the pricing grid for loans under the amended term loan facility was reduced by 37.5 basis points. In addition, as amended, the term loan facility provides that in the case of certain future repricing transactions, we will pay the existing lenders under the term loan facility a fee equal to 1% of the aggregate principal amount of all loans prepaid, converted or outstanding in the repricing transaction.

In March 2007, we entered into an interest rate swap to fix the base interest rate paid on \$700.0 of the amount outstanding under the term loan facility. Under the terms of the swap agreement, we will receive interest based upon LIBOR and pay a base rate of 4.93%. The swap matures in March 2010.

At September 30, 2007, the weighted average interest rate for borrowings under the term loan facility was 7.2%.

Senior Notes

On December 19, 2006, Merger Sub, Inc. issued \$600.0 aggregate original principal amount of 9.0% / 9.75% senior notes under a senior indenture (the senior indenture). As the surviving corporation in the Acquisition, we assumed all the obligations of Merger Sub under the senior indenture. The senior notes mature on December 15, 2014.

For any interest payment period through December 15, 2010, we may, at our option, elect to pay interest on the senior notes entirely in cash (cash interest), entirely by increasing the principal amount of the outstanding senior notes or by issuing additional senior notes (PIK interest) or by paying 50% of the interest on the senior notes in cash interest and the remaining portion of such interest in PIK interest. Cash interest on the senior notes accrues at the rate of 9% per annum. PIK interest on the senior notes accrues at the rate of 9.75% per annum. After December 15, 2010, we will make all interest payments on the senior notes entirely in cash. All senior notes mature on December 15, 2014 and have the same rights and benefits as the senior notes issued on December 19, 2006. Interest on the senior notes is payable semi-annually in arrears on each June 15 and December 15, and commenced on June 15, 2007 with a cash interest payment.

Senior Subordinated Notes

On December 19, 2006, Merger Sub issued \$400.0 aggregate original principal amount of 10.0% senior subordinated notes under a senior subordinated indenture (the senior subordinated indenture). As the surviving corporation in the Acquisition, we assumed all the obligations of Merger Sub under the senior subordinated indenture. The senior subordinated notes mature on December 15, 2016. Interest on the senior subordinated notes is payable in cash semi-annually in arrears on each June 15 and December 15, and commenced on June 15, 2007.

New Senior Notes

On September 11, 2007, we issued \$105.4 aggregate original principal amount of 9% new senior notes. Deutsche Bank Securities, Inc. purchased the new senior notes with an original issue discount at 94.87%, less an initial purchaser's fee and commitment fee. The new senior notes mature on December 15, 2014. Interest on the new senior notes is payable in cash semi-annually in arrears on each June 15 and December 15, commencing on December 15, 2007.

NOTE F COMMITMENTS AND CONTINGENCIES

Environmental Proceedings and Asset Retirement Obligations

Our operations are subject to environmental laws and regulations governing air emissions, wastewater discharges, the handling, disposal and remediation of hazardous substances and wastes and employee health and safety. These laws can impose joint and several liabilities for releases or threatened releases of hazardous substances upon statutorily defined parties, including us, regardless of fault or the lawfulness of the original

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activity or disposal. Given the changing nature of environmental legal requirements, we may be required, from time to time, to take environmental control measures at some of our facilities to meet future requirements.

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Currently and from time to time, we are a party to notices of violation brought by environmental agencies concerning the laws governing air emissions. In connection with certain pending proceedings, we are in discussions with government authorities for the purpose of resolving similar issues that have arisen at a number of our facilities in different states. At present, discussions are not sufficiently advanced to determine the scope of relief or the amount of penalties. However, with respect to these pending proceedings, the Company does not anticipate that the amount of penalties would have a material adverse effect on our financial position or results of operations.

We have been named as a potentially responsible party in certain proceedings initiated pursuant to the Comprehensive Environmental Response, Compensation, and Liability Act and similar state statutes and may be named a potentially responsible party in other similar proceedings in the future. It is not anticipated that the costs incurred in connection with the presently pending proceedings will, individually or in the aggregate, have a material adverse effect on our financial position or results of operations.

We are performing operations and maintenance at two Superfund sites for matters arising out of past waste disposal activity associated with closed facilities. We are also under orders by agencies in four states for environmental remediation at five sites, two of which are located at our operating facilities.

During the third quarter of 2007, we increased our reserves for environmental remediation liabilities at certain of our locations acquired in connection with the acquisition of Corus Aluminum. As Corus Group plc has indemnified us for any pre-existing environmental liabilities, we have recorded a receivable included within *Other Assets* in the consolidated balance sheet. Our reserves for environmental remediation liabilities totaled \$22.6 and \$15.0 at September 30, 2007 and December 31, 2006, respectively, and have been classified as *Other long-term liabilities* in the consolidated balance sheet.

In addition to environmental liabilities, we have recorded asset retirement obligations associated with legal requirements related primarily to the normal operation of our landfills and the retirement of the related assets. At September 30, 2007 and December 31, 2006, our total asset retirement obligations for our landfills were \$11.7 and \$12.0, respectively.

Legal Proceedings

We are a party from time to time to what we believe are routine litigation and proceedings considered part of the ordinary course of our business. We believe that the outcome of such existing proceedings would not have a material adverse effect on our financial position, results of operations or cash flows.

NOTE G COMPREHENSIVE INCOME (LOSS)

The following table presents the components of comprehensive income (loss) for the three and nine months ended September 30, 2007 and 2006.

	(Successor) For the three months ended		(Predecessor) For the nine months ended	
	September 30 2007	September 30 2006	September 30 2007	September 30 2006
Net income (loss)	\$ 3.5	\$ (24.2)	\$ (14.7)	\$ 59.4
Changes in other comprehensive income (loss), net of tax:				
Currency translation adjustments	32.2	(2.8)	53.9	3.5
Unrealized (losses) gains on derivative financial instruments:				
Net change from periodic revaluations	(3.9)	(0.8)	(5.7)	(19.5)
Net amount reclassified to income	(4.1)	(1.5)	(2.0)	(3.0)
Income tax effect	3.1	1.2	3.0	8.9
Net unrealized (losses) gains on derivative financial instruments	(4.9)	(1.1)	(4.7)	(13.6)
Comprehensive income (loss)	\$ 30.8	\$ (28.1)	\$ 34.5	\$ 49.3

See Note L for further information relating to our derivative financial instruments.

NOTE H SEGMENT REPORTING

Our operating segments consist of global rolled and extruded products, global recycling, global specification alloy, and global zinc. Our global rolled and extruded products segment produces aluminum sheet, plate and extruded and fabricated products for distributors and customers serving the aerospace, building and construction, transportation and consumer durables industry segments. For financial reporting purposes, the global recycling and global specification alloy operating segments have been aggregated into the

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global recycling reportable segment. The global recycling segment represents all of our aluminum melting, processing, alloying and salt cake recycling activities. We have aggregated these businesses because the products produced are identical (except for minor differences in chemical composition), are delivered in the same manner (either molten or in bars), the raw materials used are very similar, the production processes and equipment used are identical and the long-term gross margins have been and are expected to remain similar. Our global zinc segment represents all of our zinc melting, processing and trading activities.

Measurement of Segment Profit or Loss and Segment Assets

Our measure of the profitability of our operating segments is referred to as segment income. Segment income excludes provisions for income taxes, restructuring and other charges, interest, unrealized losses (gains) on derivative financial instruments and corporate general and administrative costs, including depreciation of corporate assets. Intersegment sales and transfers are recorded at market value. Consolidated cash, long-term debt, net capitalized debt costs, deferred tax assets and assets recorded at corporate are not allocated to the reportable segments.

Reportable Segment Information

The following table shows our segment assets as of September 30, 2007 and December 31, 2006:

	(Successor)	
	September 30, 2007	December 31, 2006
Assets:		
Global rolled and extruded products	\$ 3,534.2	\$ 2,480.7
Global recycling	1,298.2	597.8
Global zinc	282.3	184.4
Other unallocated assets	261.6	1,545.5
Total assets	\$ 5,376.3	\$ 4,808.4

The following table shows our revenues and segment income for the three and nine months ended September 30, 2007 and 2006:

	(Successor) For the three months ended		(Predecessor) For the nine months ended	
	September 30		September 30	
	2007	2006	2007	2006
Revenues:				
Global rolled and extruded products	\$ 1,146.3	\$ 877.6	\$ 3,299.8	\$ 1,767.9
Global recycling	425.1	375.7	1,267.1	1,110.3
Global zinc	133.0	148.8	423.6	397.4
Intersegment revenues	(40.1)	(7.1)	(111.0)	(20.2)
Total revenues	\$ 1,664.3	\$ 1,395.0	\$ 4,879.5	\$ 3,255.4
Segment income:				
Global rolled and extruded products	\$ 41.7	\$ 40.4	\$ 80.0	\$ 135.2
Global recycling	9.0	22.2	49.9	69.8
Global zinc	3.6	14.2	10.1	49.2
Total segment income	\$ 54.3	\$ 76.8	\$ 140.0	\$ 254.2

Unallocated amounts:

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Corporate general and administrative expenses	\$ (20.5)	\$ (18.9)	\$ (57.6)	\$ (52.1)
Restructuring and other charges	(2.3)	(2.6)	(11.2)	(2.3)
Loss from early extinguishment of debt		(53.7)		(53.7)
Interest expense	(58.3)	(26.6)	(168.8)	(54.3)
Unrealized (losses) gains on derivative financial instruments	(21.6)	(24.3)	26.0	(7.1)
Realized hedge gain on foreign currency derivative	1.9	9.8	0.9	9.8
Interest and other income, net	5.6	0.8	7.6	0.5
(Loss) income before provision for income taxes and minority interests	\$ (40.9)	\$ (38.7)	\$ (63.1)	\$ 95.0

Table of Contents**NOTE I STOCK-BASED COMPENSATION*****Successor Stock-Based Compensation Plan***

In February 2007 the Board of Directors of Holdings approved the Aurora Acquisition Holdings, Inc. Amended and Restated Management Equity Incentive Plan (2007 Plan). Under the 2007 Plan, Holdings may grant up to 740,870 stock options. During the nine months ended September 30, 2007, Holdings granted 663,766 stock options to certain members of the Company s senior management. The options have a weighted average exercise price of \$100.98 and a ten year life with 60% of the options vesting ratably over five years and 40% vesting upon the occurrence of a liquidity event, as defined under the terms of the 2007 Plan agreement, and the achievement of certain returns on TPG s investment. A portion of the time-based options will be paid out upon a liquidity event should the event occur prior to full vesting of these awards. While the time based portion of the options will be expensed over the requisite service period, the event-based awards will not be expensed until the occurrence of the liquidity event.

During the three and nine months ended September 30, 2007, we recorded \$1.1 and \$2.9, respectively, of compensation expense associated with these options. The weighted-average fair value of the time and event-based options was approximately \$51.38 and \$36.18 per option, respectively. At September 30, 2007, there was \$17.6 of compensation expense that will be recognized over the next five years and \$9.6 of compensation expense that will be recognized upon the occurrence of the liquidity event.

The Company used the Monte Carlo Simulation method to estimate the fair value of the stock options granted in 2007. Under this method, the estimate of fair value is affected by the assumptions included in the following table, certain of which are highly complex and subjective. Expected equity volatility was determined based upon historical stock prices of our peer companies. The expected term of the event-based options granted was determined based upon a range of estimates regarding the timing of a liquidity event. The following table summarizes the significant assumption used to determine the fair value of the stock options granted during the nine months ended September 30, 2007:

Expected timing of liquidity event in years	2-7
Weighted average expected option life in years	4.6
Risk-free interest rate	4.8%
Equity volatility factor	65.8%
Dividend yield	0.0%

Predecessor Stock-Based Compensation Plan

As of December 31, 2006, 185,017 share units which were granted prior to the Acquisition remained outstanding. During the nine months ended September 30, 2007, the Company paid \$11.5 to holders of these share units. The payments have been classified as Investing activities in the consolidated statement of cash flows.

NOTE J INCOME TAXES

Our effective tax (benefit) rate was (110.0)% and (37.0)% for the three months ended September 30, 2007 and 2006, respectively, and (78.4)% and 36.8% for the nine months ended September 30, 2007 and 2006, respectively. The effective tax (benefit) rate for the nine months ended September 30, 2007 differs from the federal statutory rate applied to losses before income taxes primarily as a result of the mix of income, losses and tax rates between tax jurisdictions. Also, in the third quarter of 2007, we reported a discrete item to reflect a change in the combined German statutory rate for corporate income tax and trade tax from approximately 38.4% to 29.5% effective January 1, 2008, resulting from legislation that was enacted on July 6, 2007. The income tax benefit reported for the first nine months was adjusted to reflect the effects of the change in the tax law and resulted in a tax benefit of \$31.6 during the third quarter after the application of the newly enacted rates to the existing deferred balances.

At September 30, 2007, we had valuation allowances to reduce certain deferred tax assets to amounts that are more likely than not to be realized. The remaining valuation allowances relate to our potential inability to utilize certain foreign net operating loss carry forwards and U.S. state net operating loss and tax credit carry forwards. We intend to maintain these valuation allowances until

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sufficient positive evidence exists (such as cumulative positive earnings and estimated future taxable income) to support their reversal. Any subsequent reversal of the valuation allowances will be recorded against goodwill, other identifiable intangible assets or income tax expense.

We adopted the provisions of Financial Accounting Standards Board Interpretation (FIN) No. 48, Accounting for Uncertainty in Income Taxes-an Interpretation of FASB Statement No. 109 on January 1, 2007. The effect of adoption was not material. As of the date of adoption, we had \$1.9 of unrecognized tax benefits, all of which would be recorded against goodwill and other identifiable intangible assets. As of September 30, 2007, we have \$3.2 of unrecognized tax benefits. The incremental \$1.3 of unrecognized benefit will impact our effective rate if recognized.

We recognize interest and penalties related to uncertain tax positions within the Provision for income taxes in the consolidated statement of operations. As of September 30, 2007, we had approximately \$0.1 of accrued interest related to uncertain tax positions.

The 2001 through 2006 tax years remain open to examination by the major taxing jurisdictions to which we are subject. We do not anticipate any significant changes to our total unrecognized tax benefits through the end of the first quarter of 2008. The Internal Revenue Service is currently examining the Aleris 2004 U.S. Federal income tax return. After completion of the 2004 examination, it is expected that the Internal Revenue Service will also examine the 2005 and 2006 U.S. Federal income tax returns.

NOTE K EMPLOYEE BENEFITS

Defined Benefit Pension Plans

Components of the net periodic benefit expense for the three and nine months ended September 30, 2007 and 2006 are as follows:

	U.S. pension benefits				European and Canadian pension benefits			
	(Successor)		(Predecessor)		(Successor)		(Predecessor)	
	For the three months ended		For the nine months ended		For the three months ended		For the nine months ended	
	September 30		September 30		September 30		September 30	
	2007	2006	2007	2006	2007	2006	2007	2006
Service cost	\$ 0.7	\$ 0.8	\$ 2.0	\$ 2.6	\$ 1.5	\$ 1.0	\$ 4.2	\$ 1.3
Interest cost	1.9	1.8	5.6	5.3	3.1	2.1	9.1	2.6
Amortization of net loss						0.1		0.3
Expected return on plan assets	(2.3)	(2.1)	(6.7)	(5.9)	(2.0)	(1.1)	(5.7)	(1.1)
Net periodic benefit cost	\$ 0.3	\$ 0.5	\$ 0.9	\$ 2.0	\$ 2.6	\$ 2.1	\$ 7.6	\$ 3.1

Other Postretirement Benefit Plans

The components of net postretirement benefit expense for the three and nine months ended September 30, 2007 and 2006 are as follows:

	(Successor)		(Predecessor)	
	For the three months ended		For the nine months ended	
	September 30		September 30	
	2007	2006	2007	2006
Service cost	\$ 0.2	\$ 0.2	\$ 0.7	\$ 0.7
Interest cost	0.9	0.8	2.5	2.2
Net periodic benefit cost	\$ 1.1	\$ 1.0	\$ 3.2	\$ 2.9

Table of Contents**NOTE L DERIVATIVE FINANCIAL INSTRUMENTS**

We enter into derivatives to hedge the cost of energy, the sale and purchase prices of certain aluminum and zinc products as well as certain alloys used in our production processes, and certain currency and interest rate exposures. The fair value gains (losses) of outstanding derivative contracts are included in the consolidated balance sheet as *Derivative financial instruments* and as a component of *Other current liabilities*. The fair value of our derivative financial instruments and amounts deferred in *Accumulated other comprehensive income* as of September 30, 2007 and December 31, 2006 are as follows:

	September 30, 2007		December 31, 2006	
	Fair value	Deferred losses, net of tax	Fair value	Deferred gains, net of tax
Natural gas	\$ (2.9)	\$ (1.8)	\$ (1.0)	\$
Aluminum	60.0		89.7	
Zinc	11.2		0.4	
Currency	19.8		11.2	
Interest rate	(4.8)	(2.9)		

During the three and nine months ended September 30, 2006, our natural gas, zinc and certain of our aluminum derivative financial instruments were accounted for as hedges and met SFAS No. 133's requirements for hedge accounting treatment. As such, the changes in the fair value of certain of these cash flow hedges accumulated on our consolidated balance sheet (in *Accumulated other comprehensive income*) until the underlying hedged item impacted earnings. In conjunction with the preliminary purchase price allocation related to the Acquisition, all amounts previously included within *Accumulated other comprehensive income* were eliminated. Subsequent to the Acquisition, we do not treat our aluminum, zinc and currency derivative financial instruments as hedges for accounting purposes and, as a result, all changes in the fair value of these derivatives since the Acquisition date have been, and will continue to be, included within our results of operations.

Both realized and unrealized gains and losses on those derivative financial instruments that are not accounted for as hedges under SFAS No. 133 are included within *(Gains) losses on derivative financial instruments* in the consolidated statement of operations while realized gains and losses on those derivative financial instruments that are accounted for as hedges under SFAS No. 133 are included within *Cost of sales*. The following table summarizes realized gains and losses on derivative financial instruments for the three and nine months ended September 30, 2007 and 2006:

	(Successor) For the three months ended September 30, 2007		(Predecessor) For the three months ended September 30, 2006		(Successor) For the nine months ended September 30, 2007		(Predecessor) For the nine months ended September 30, 2006	
	Cost of sales	Gains (losses) on derivative financial instruments	Cost of sales	Gains (losses) on derivative financial instruments	Cost of sales	Gains (losses) on derivative financial instruments	Cost of sales	Gains (losses) on derivative financial instruments
Natural gas	\$ (4.1)	\$	\$ (0.2)	\$	\$ (2.0)	\$	\$ 2.7	\$
Aluminum		25.9		3.5		14.7		(8.5)
Zinc		3.3	1.8			2.5	0.3	
Currency		4.8		10.1		4.5		10.1

Natural Gas Hedging

In order to manage our price exposure for natural gas purchases, we have fixed the future price of a portion of our natural gas requirements by entering into financial hedge agreements. Under these agreements, payments are made or received based on the differential between the monthly closing price on the New York Mercantile Exchange (*NYMEX*) and the contractual hedge price. These contracts are primarily accounted for as cash flow hedges, with the related gains and losses recognized in *Cost of sales* when the gas is consumed. In addition, we have cost escalators included in some of our long-term supply contracts with customers, which limit our exposure to natural gas price risk.

Aluminum Hedging

The selling prices of the majority of the global rolled and extruded products segment's customer orders are established at the time of order entry or, for certain customers, under long-term contracts. As the related raw materials used to produce these orders are purchased several months or years after the selling prices are fixed, the global rolled and extruded products segment is subject to the risk of changes in the price of the raw materials it purchases. In order to manage this exposure, London Metal Exchange (LME) future or forward purchase contracts are entered into at the time the selling prices are fixed. In addition, the global rolled and extruded

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products segment enters into future sales contracts to protect the fair value of a portion of its aluminum inventory against a potential decline in aluminum selling prices. We do not treat these derivative financial instruments as hedges for accounting purposes. Accordingly, the changes in the fair value of the contracts are recorded within (Gains) losses on derivative financial instruments in the consolidated statement of operations rather than being deferred in Accumulated other comprehensive income and subsequently being included within cost of sales.

The global recycling segment also enters into LME high-grade aluminum forward sales and purchase contracts to mitigate the risk associated with changes in metal prices. These contracts are not accounted for as hedges and, as a result, the changes in fair value of the contracts are recorded within (Gains) losses on derivative financial instruments in the consolidated statement of operations.

Zinc Hedging

In the normal course of business, the global zinc segment enters into fixed-price sales and purchase contracts with a number of its customers and suppliers. In order to hedge the risk of changing LME zinc prices, we enter into LME forward sale and future purchase contracts. During 2006 effective portions of these hedges were included within Accumulated other comprehensive income while the ineffective portions were included within (Gains) losses on derivative financial instruments. Subsequent to the Acquisition, we no longer treat these derivative financial instruments as hedges for accounting purposes. As a result, the changes in fair value of the contracts are recorded within (Gains) losses on derivative financial instruments in the consolidated statement of operations.

During 2007, we also entered into price collars and swaps designed to protect a portion of our forecasted zinc sales from changes in the LME price of zinc. These derivatives have not been accounted for as hedges and the changes in their fair value are included within (Gains) losses on derivative financial instruments in the consolidated statement of operations.

Currency Hedging

Certain of our purchases and sales are denominated in currencies other than the functional currency of the entities entering into these agreements. We have entered into foreign currency forward contracts to mitigate the impact of currency fluctuations associated with these transactions. As with the acquired aluminum and zinc derivatives, we do not account for currency derivatives as hedges and, as a result, the changes in their fair value are recorded within (Gains) losses on derivative financial instruments within the consolidated statement of operations.

During the second quarter of 2006, we entered into currency option contracts to fix approximately 275.0 of the purchase price expected to be paid to acquire Corus Aluminum. As that purchase price was denominated in euros, we were exposed to fluctuations in the U.S. Dollar-Euro exchange rate. We entered into these hedges to reduce that risk for a portion of the purchase price expected to be funded in U.S. Dollars. As these hedges matured in the third quarter of 2006, the previously recorded unrealized gains were reversed and realized gains of approximately \$9.8 were recorded within (Gains) losses on derivative financial instruments.

Interest Rate Hedging

As discussed in Note E, during the nine months ended September 30, 2007, we entered into an interest rate swap to fix the interest rate on a portion of our variable rate borrowings under the term loan facility. Changes in the fair value of the interest rate swap are recorded within Accumulated other comprehensive income.

NOTE M RESTRUCTURING AND OTHER CHARGES

During the three and nine months ended September 30, 2007, we incurred restructuring and other charges of \$2.3 and \$11.2, respectively, primarily related to potential acquisitions that were not consummated and start-up costs associated with our European headquarters, which are included in Other below. During the three and nine months ended September 30, 2006, we recorded restructuring and other charges primarily related to investment advisor and other costs associated with the Acquisition as well as charges related to the closure of our Carson, California rolling mill.

During the nine months ended September 30, 2007, we announced the closure of a specification alloys plant in Dickson, Tennessee, which we acquired in connection with our acquisition of Wabash. We expect to close this facility in the fourth quarter of 2007. During the three and nine months ended September 30, 2007, we recorded adjustments to the purchase price allocation of \$3.3 related to the closure of this facility. We expect to record additional adjustments to the purchase price allocation as restructuring activities related the operations we acquired in the acquisition of Wabash continue.

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The following table shows the activity and reserve balances related to these restructuring programs for the nine months ended September 30, 2007:

For the nine months ended September 30, 2007	Employee severance and benefit costs	Fees associated with the Acquisition	Exit costs	Other	Total
Balance at December 31, 2006	\$ 1.1	\$ 2.0	\$ 1.6	\$ 8.3	\$ 4.7
Charges recorded in the statement of operations	2.0	0.9		8.3	11.2
Adjustments to the allocation of the Wabash purchase price	0.5		2.6	0.2	3.3
Cash payments	(2.1)	(2.9)	(0.4)	(7.3)	(12.7)
Balance at September 30, 2007	\$ 1.5	\$ 3.8	\$ 3.8	\$ 1.2	\$ 6.5

NOTE N RELATED PARTY TRANSACTIONS

As discussed in Note I, we recorded \$1.1 and \$2.9 of compensation expense for the three and nine months ended September 30, 2007, respectively, associated with the stock option plan of Holdings, the beneficiaries of which are members of our senior management. In addition, during the three and nine months ended September 30, 2007 we recorded \$2.3 and \$6.9, respectively, of management fees paid to affiliates of TPG.

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Certain of our subsidiaries (the Guarantor Subsidiaries) are guarantors of the indebtedness under our senior notes and senior subordinated notes. Condensed consolidating financial statements of Aleris International, Inc., the Guarantor Subsidiaries, and those subsidiaries of Aleris International, Inc. that are not guaranteeing the indebtedness under the senior notes or the senior subordinated notes (the Non-Guarantor Subsidiaries) are presented below. The condensed consolidating balance sheets are presented as of September 30, 2007 and December 31, 2006, the condensed consolidating statements of operations are presented for the three and nine months ended September 30, 2007 and 2006 and the statements of cash flows are presented for the nine months ended September 30, 2007 and 2006.

	As of September 30, 2007 (Successor)				
	Aleris International, Inc.	Combined guarantor subsidiaries	Combined non-guarantor subsidiaries	Eliminations	Consolidated
ASSETS					
Current Assets					
Cash and cash equivalents	\$ 4.0	\$ 16.5	\$ 104.0	\$	\$ 124.5
Accounts receivable, net	13.2	375.2	507.7		896.1
Inventories	3.0	324.5	618.5		946.0
Deferred income taxes	33.8		0.8		34.6
Prepaid expenses	0.8	10.4	11.9		23.1
Derivative financial instruments	1.0	16.4	38.5		55.9
Other current assets	4.4	3.2	15.2		22.8
Total Current Assets	60.2	746.2	1,296.6		2,103.0
Property, plant and equipment, net	32.7	365.3	990.0		1,388.0
Goodwill	552.3	887.1	(94.0)		1,345.4
Intangible assets, net	69.9	211.4	93.9		375.2
Deferred income taxes			8.1		8.1
Other assets	69.4	8.0	79.9		157.3
Investments in subsidiaries/intercompany receivable (payable), net	2,574.5	(1,041.4)	206.2	(1,740.0)	(0.7)
	\$ 3,359.0	\$ 1,176.6	\$ 2,580.7	\$ (1,740.0)	\$ 5,376.3
LIABILITIES AND STOCKHOLDER S EQUITY					
Current Liabilities					
Accounts payable	\$ 46.7	\$ 266.6	\$ 408.1	\$	\$ 721.4
Accrued liabilities	28.7	72.5	167.7		268.9
Deferred income taxes	(3.9)		37.8		33.9
Current maturities of long-term debt	8.3	0.6	9.7		18.6
Total Current Liabilities	79.8	339.7	623.3		1,042.8
Long-term debt	2,227.1	1.9	640.4		2,869.4
Deferred income taxes					