TREX CO INC
Form 10-Q
May 10, 2007
Table of Contents

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 March 31, 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)

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 by 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 May 3, 2007 was 15,090,952 shares.

Table of Contents

TREX COMPANY, INC.

INDEX

Table of Contents

PART I

FINANCIAL INFORMATION

Item 1. Financial Statements

TREX COMPANY, INC.

Condensed Consolidated Balance Sheets

(In thousands)

	December 31, 2006	March 31, 2007 (unaudited)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 672	$ 886
Accounts receivable, net	18,140	70,715
Inventories	111,434	90,782
Prepaid expenses and other assets	3,201	2,610
Income taxes receivable	6,480	5,044
Deferred income taxes	3,180	3,231
Total current assets	143,107	173,268
Property, plant, and equipment, net	198,525	204,160
Goodwill	6,837	6,837
Debt-related derivatives	359	279
Other assets	3,489	3,597
Total assets	$ 352,317	$ 388,141
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 40,248	$ 37,453
Accrued expenses	20,053	21,513
Line of credit	44,132	78,386
Current portion of long-term debt	9,115	9,135
Total current liabilities	113,548	146,487
Deferred income taxes	17,217	16,187
Accrued taxes		2,757
Debt-related derivatives	747	742
Long-term debt	51,390	51,096
Total liabilities	182,902	217,269
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 15,091,254 shares issued and outstanding at December 31, 2006 and March 31, 2007, respectively	149	151
Additional paid in capital	62,986	63,641

Accumulated other comprehensive loss	(278)	(467)
Retained earnings	106,558	107,547
Total stockholders equity	169,415	170,872
Total liabilities and stockholders equity	$ 352,317	$ 388,141

See Accompanying Notes to Condensed Consolidated

Financial Statements (Unaudited).

1

Table of Contents

TREX COMPANY, INC.

Condensed Consolidated Statements of Operations

(unaudited)

(In thousands, except share and per share data)

	Three Months Ended March 31, 2006	Three Months Ended March 31, 2007
Net sales	$ 105,297	$ 115,913
Cost of sales	80,122	91,284
Gross profit	25,175	24,629
Selling, general and administrative expenses	17,765	17,039
Income from operations	7,410	7,590
Interest expense, net	942	1,694
Income before income taxes	6,468	5,896
Provision for income taxes	2,403	2,171
Net income	$ 4,065	$ 3,725
Basic earnings per common share	$ 0.27	$ 0.25
Basic weighted average common shares outstanding	14,803,858	14,856,315
Diluted earnings per common share	$ 0.27	$ 0.25
Diluted weighted average common shares outstanding	14,860,203	14,898,851

See Accompanying Notes to Condensed Consolidated

Financial Statements (Unaudited).

Table of Contents

TREX COMPANY, INC.

Condensed Consolidated Statements of Cash Flows

(unaudited)

(In thousands)

	Three Months Ended March 31, 2006	Three Months Ended March 31, 2007
OPERATING ACTIVITIES		
Net income	$ 4,065	$ 3,725
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation	5,029	5,132
Equity method income	(39)	(93)
Deferred income taxes	972	(108)
Accrued taxes		123
Stock-based compensation	711	951
Loss on disposal of property, plant and equipment	34	
Other non-cash income	(152)	(15)
Changes in operating assets and liabilities:		
Accounts receivable	(41,283)	(52,575)
Inventories	7,283	20,652
Prepaid expenses and other assets	(1,680)	591
Accounts payable	12,582	(2,795)
Accrued expenses	1,039	71
Income taxes receivable	7,901	1,637
Net cash used in operating activities	(3,538)	(22,704)
INVESTING ACTIVITIES		
Expenditures for property, plant and equipment	(2,379)	(10,767)
Net cash used in investing activities	(2,379)	(10,767)
FINANCING ACTIVITIES		
Principal payments under mortgages and notes	(250)	(274)
Borrowings under line of credit	33,018	54,070
Principal payments under line of credit	(27,077)	(19,816)
Repurchases of common stock	(431)	(377)
Proceeds from employee stock purchase and option plans	110	108
Tax effect of stock-based compensation	75	(26)
Net cash provided by financing activities	5,445	33,685
Net increase (decrease) in cash and cash equivalents	(472)	214
Cash and cash equivalents at beginning of period	1,395	672
Cash and cash equivalents at end of period	$ 923	$ 886
Supplemental Disclosure:		
Cash paid for interest, net of capitalized interest	$ 259	$ 996

Cash paid (received) for income taxes, net	$	(5,995)	$	307

See Accompanying Notes to Condensed Consolidated

Financial Statements (Unaudited).

TREX COMPANY, INC.

Notes to Condensed Consolidated Financial Statements

For the Three Months Ended March 31, 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 three months ended March 31, 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 Company s critical accounting policies are included in the Company s Annual Report of Form 10-K for the year ended December 31, 2006.

Certain reclassifications have been made in the presentation of the financial statements for the three months ended March 31, 2006 to conform with the presentation of the financial statements for the three months ended March 31, 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 charge 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.

4

Table of Contents

4. COMPREHENSIVE INCOME

The Company s comprehensive income was $4.4 million and $3.5 million for the three months ended March 31, 2006 and 2007, respectively. Comprehensive income consists of net income 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	March 31, 2007
Finished goods	$ 83,224	$ 65,564
Raw materials	28,210	25,218
	$ 111,434	$ 90,782

For the three months ended March 31, 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 a benefit of $0.5 million during the three months ended March 31, 2007.

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 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	March 31, 2007
Accrued compensation and benefits	$ 4,491	$ 3,990
Accrued sales and marketing costs	4,242	3,691
Accrued customer relations costs	3,632	3,381
Accrued rent obligations	2,421	2,286
Accrued interest	624	1,995
Accrued manufacturing expenses	2,394	1,983
Accrued freight	481	1,625
Accrued taxes		296
Accrued professional and legal costs	461	303
Other	1,307	1,963
Total	$ 20,053	$ 21,513

7. DEBT

The Company s outstanding debt consists of senior notes, a variable-rate promissory note, real estate loans and a revolving credit facility. The revolving credit facility provides for borrowing up to $100.0 million through June 30, 2007 and $20.0 million through September 30, 2007. The Company s ability to borrow under its revolving credit facility is tied to a borrowing base that consists of certain receivables and inventories. At March 31, 2007, the Company had $78.4 million of borrowings outstanding and approximately $20.5 million of available borrowing capacity under its revolving credit facility.

The senior notes, real estate loans, revolving credit facility, and bond loan documents contain negative and financial covenants. As of March 31, 2007, the Company was in compliance with these covenants.

The Company uses interest-rate swap contracts to manage its exposure to fluctuations in the interest rates under its variable-rate real estate loans and variable-rate promissory note. At March 31, 2007, the Company had limited its interest rate exposure on all of its $11.2 million real estate loans to an annual effective rate of approximately 9.0%. In addition, of its $25.0 million promissory note, the Company had limited its interest rate exposure to an annual effective rate of approximately 3.12% through January 2012 on $10.0 million of the principal amount and to an annual effective rate of approximately 2.95% through January 2010 on an additional $10.0 million of the principal amount.

Table of Contents

8. EARNINGS PER SHARE

The following table sets forth the computation of basic and diluted earnings per share (in thousands, except share and per share data):

	Three Months Ended March 31, 2006	Three Months Ended March 31, 2007
Numerator:		
Net income available to common shareholders	$ 4,065	$ 3,725
Denominator:		
Basic weighted average shares outstanding	14,803,858	14,856,315
Effect of dilutive securities: Stock options	24,625	16,393
Restricted stock	31,720	26,143
Diluted weighted average shares outstanding	14,860,203	14,898,851
Basic earnings per share	$ 0.27	$ 0.25
Diluted earnings per share	$ 0.27	$ 0.25

9. STOCK-BASED COMPENSATION

Effective January 1, 2006, the Company adopted the fair value recognition provisions of SFAS No. 123(R), *Share-Based Payment*, using the modified prospective transition method. Under that transition method, compensation cost includes (1) compensation cost for all share-based payments granted prior to, but not yet vested as of, January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123, and (2) compensation cost for all share-based payments granted subsequent to January 1, 2006, based on the grant date fair value estimated in accordance with the provisions of SFAS No. 123(R).

The Company has one stock-based compensation plan, the 2005 Stock Incentive Plan (the 2005 Plan), which was approved by its shareholders. The 2005 Plan is administered by the Compensation Committee of the Company s Board of Directors. Stock-based compensation is granted to officers, directors and certain key employees in accordance with the provisions of the 2005 Plan. The 2005 Plan provides for grants of stock options, stock appreciation rights (SARs), restricted stock and performance share awards. The total aggregate number of shares of the Company s common stock that may be issued under the 2005 Plan is 2,150,000.

The fair value of each stock option award and SAR is estimated on the date of grant using a Black-Scholes option-pricing formula. For stock options and SARs issued in the three months ended March 31, 2006 and 2007, respectively, the assumptions shown in the followin