SCHNITZER STEEL INDUSTRIES INC
Form 10-Q
January 08, 2007

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

þ **Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the quarterly period ended November 30, 2006 or**

o **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 0-22496
SCHNITZER STEEL INDUSTRIES, INC.
(Exact name of registrant as specified in its charter)

OREGON	93-0341923
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
3200 N.W. Yeon Ave. P.O Box 10047 Portland, OR	97296-0047
(Address of principal executive offices)	(Zip Code)

(503) 224-9900
(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 þ No o

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.

Large accelerated filer o Accelerated filer þ Non-accelerated filer o

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

The Registrant had 22,856,081 shares of Class A common stock, par value of $1.00 per share, and 7,861,166 shares of Class B Common Stock, par value of $1.00 per share, outstanding at December 31, 2006.

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SCHNITZER STEEL INDUSTRIES, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except per share amounts)

	Nov. 30, 2006 (unaudited)	Aug. 31, 2006
Assets		
Current assets:		
Cash and cash equivalents	$ 24,818	$ 25,356
Restricted cash		7,725
Accounts receivable, less allowance for doubtful accounts of $1,510 and $1,270	124,738	118,820
Accounts receivable from related parties	79	19
Inventories	288,598	263,583
Deferred income taxes	7,580	7,285
Prepaid expenses and other	23,367	15,956
Total current assets	469,180	438,744
Property, plant and equipment, net	328,133	312,907
Other assets:		
Investment in and advances to joint venture partnerships	8,456	8,859
Goodwill	266,193	266,675
Intangibles	10,534	10,899
Other assets	6,563	6,640
Total assets	$ 1,089,059	$ 1,044,724
Liabilities and Shareholders Equity		
Current liabilities:		
Current portion of long-term debt	$ 11,061	$ 100
Accounts payable	71,357	64,506
Accrued payroll and related liabilities	26,399	36,809
Investigation reserve		15,225
Current portion of environmental liabilities	3,368	3,648
Accrued income taxes	60	4,265
Other accrued liabilities	28,211	26,585
Total current liabilities	140,456	151,138
Deferred income taxes	12,795	9,916
Long-term debt, less current portion	142,817	102,829
Environmental liabilities, net of current portion	36,524	37,754
Other long-term liabilities	4,932	3,855

Minority interests	4,552	5,133
Commitments and contingencies (Note 4)		
Shareholders equity:		
Preferred stock 20,000 shares authorized, none issued		
Class A common stock 75,000 shares $1.00 par value authorized, 22,688 and 22,793 shares issued and outstanding	22,688	22,793
Class B common stock 25,000 shares $1.00 par value authorized, 7,901 and 7,986 shares issued and outstanding	7,901	7,986
Additional paid-in capital	130,229	137,281
Retained earnings	584,799	564,165
Accumulated other comprehensive income:		
Foreign currency translation adjustment	1,366	1,874
Total shareholders equity	746,983	734,099
Total liabilities and shareholders equity	$ 1,089,059	$ 1,044,724

The accompanying notes to the unaudited condensed consolidated financial statements are an integral part of these statements.

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SCHNITZER STEEL INDUSTRIES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(Unaudited, in thousands, except per share amounts)

	For The Three Months Ended November 30,	
	2006	2005
Revenues	$ 509,854	$ 341,231
Operating Expenses:		
Cost of goods sold	434,706	285,106
Selling, general and administrative	42,858	40,344
Income from wholly-owned operations	32,290	15,781
Income from joint ventures	1,286	1,752
Operating income	33,576	17,533
Other income (expense):		
Interest expense	(1,061)	(435)
Other income	1,116	55,534
	55	55,099
Income before income tax and minority interests	33,631	72,632
Income tax provision	(12,071)	(31,135)
Income before minority interests	21,560	41,497
Minority interests, net of tax	(402)	(153)
Pre-acquisition interests, net of tax		186
Net income	$ 21,158	$ 41,530
Net income per share basic	$ 0.69	$ 1.36
Net income per share diluted	$ 0.69	$ 1.34

The accompanying notes to the unaudited condensed consolidated financial statements
are an integral part of these statements.

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SCHNITZER STEEL INDUSTRIES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited, in thousands)

	For The Three Months Ended November 30,	
	2006	2005
Cash flows from operating activities:		
Net income	$ 21,158	$ 41,530
Noncash items included in income:		
Depreciation and amortization	8,892	6,241
Minority interests	402	320
Deferred income tax	2,584	(10,206)
Distributed/(undistributed) equity in earnings of joint ventures	403	15,787
Stock-based compensation expense	1,410	494
Gain on disposition of joint venture assets		(54,618)
Excess tax benefit from stock options exercised	(537)	
Loss on disposal of assets	196	
Changes in assets and liabilities:		
Accounts receivable	(5,868)	21,321
Inventories	(24,876)	(7,753)
Prepaid expenses and other current assets	(7,736)	11,556
Other assets	951	1,630
Accounts payable	6,853	(12,684)
Accrued liabilities	(12,229)	21,409
Investigation reserve	(15,225)	
Environmental liabilities	(1,510)	(2,959)
Other liabilities	754	(767)
Net cash provided (used) by operating activities	(24,378)	31,301
Cash flows from investing activities:		
Capital expenditures	(23,808)	(15,823)
Acquisitions, net of cash acquired	(660)	(75,548)
Cash paid to joint ventures		(449)
Proceeds from sale of assets	123	12
Cash flows from non-hedge derivatives	(80)	
Restricted cash	7,725	
Net cash used in investing activities	(16,700)	(91,808)
Cash flows from financing activities:		
Proceeds from line of credit	85,500	43,000
Repayment of line of credit	(74,500)	(33,000)
Borrowings from long-term debt	215,500	140,184

Repayment of long-term debt		(175,551)		(72,000)
Issuance of Class A common stock		790		17
Excess tax benefit from stock options exercised		537		
Distributions to minority interests		(1,208)		(1,045)
Repurchase of Class A common stock		(9,979)		
Dividends declared and paid		(524)		(518)
Net cash provided by financing activities		40,565		76,638
Effect of exchange rate changes on cash		(25)		
Net increase (decrease) in cash and cash equivalents		(538)		16,131
Cash and cash equivalents at beginning of period		25,356		20,645
Cash and cash equivalents at end of period	$	24,818	$	36,776

The accompanying notes to the unaudited condensed consolidated financial statements are an integral part of these statements.

Note 1 Summary of Significant Accounting Policies:

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of Schnitzer Steel Industries, Inc. (the Company) have been prepared pursuant to generally accepted accounting principles and the rules and regulations of the Securities and Exchange Commission (SEC). The year-end condensed consolidated balance sheet was derived from audited financial statements, but does not include all disclosures required by U.S. generally accepted accounting principles. Certain information and note disclosures normally included in annual financial statements have been condensed or omitted pursuant to those rules and regulations. In the opinion of management, all normal, recurring adjustments considered necessary for a fair presentation have been included. Although management believes that the disclosures made are adequate to ensure that the information presented is not misleading, management suggests that these unaudited condensed consolidated financial statements be read in conjunction with the financial statements and notes thereto included in the Company s annual report for the fiscal year ended August 31, 2006. The results for the three months ended November 30, 2006 and 2005 are not necessarily indicative of the results of operations for the entire year.

Acquisitions that occurred during the first quarter of fiscal 2006 are described in Note 3 Business Combinations . Under Statement of Financial Accounting Standards No. 141, Business Combinations (SFAS 141) and Accounting Research Bulletin 51, Consolidated Financial Statements (ARB 51), the acquisition of Prolerized New England Company and Subsidiaries (PNE) and Hugo Neu Schnitzer Global Trade-Baltic Operations (HNSGT-Baltic), two of the three businesses acquired under the Hugo Neu Corporation (HNC) separation and termination agreement, were treated as step acquisitions because the Company had a joint venture interest in those two businesses. The Company did not have a prior interest in the third business acquired under the HNC separation and termination agreement, THS Recycling LLC, dba Hawaii Metal Recycling Company (HMR). Additionally, during the first quarter of fiscal 2006, the Company acquired the assets of Regional Recycling LLC (Regional) and purchased GreenLeaf Auto Recyclers, LLC (GreenLeaf), two businesses in which the Company did not have a previous interest. Since the PNE and HNSGT-Baltic acquisitions occurred early in the fiscal year, consolidation accounting allowed the Company to include PNE and HNSGT-Baltic in the consolidated results as though they had occurred at the beginning of fiscal 2006, with an adjustment to earnings for the pre-acquisition interest the Company did not own during the reporting period. As such, the unaudited condensed consolidated statements of income are presented as if the PNE and HNSGT-Baltic acquisitions had occurred on September 1, 2005.

Reclassifications

Certain prior year amounts have been reclassified to conform to the current year presentation. These changes had no impact on previously reported operating income, net income, shareholders equity or cash flow from operations.

Cash and Cash Equivalents

Cash and cash equivalents include short-term securities that are not restricted by third parties and have an original maturity date of 90 days or less. The Company funds its accounts as checks are presented and cleared at the bank, not when checks are written. As a result, the Company maintains no cash balances in its primary operating accounts and book overdrafts of $8 million and $13 million were reclassified out of cash and cash equivalents and included in accounts payable as of November 30, 2006 and August 31, 2006, respectively.

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Net Income and Dividends per Share

The following table sets forth the reconciliation from basic net income per share to diluted net income per share (in thousands, except per share amounts):

	For the Three Months Ended November 30,	
	2006	2005
Net Income	$ 21,158	$ 41,530
Computation of shares:		
Weighted average common shares outstanding	30,751	30,477
Effect of dilutive stock options and unvested share units	125	560
Diluted average common shares outstanding	30,876	31,037
Basic net income per share	$ 0.69	$ 1.36
Diluted net income per share	$ 0.69	$ 1.34
Dividend per share	$ 0.017	$ 0.017

Basic earnings per share is computed using net income and the weighted average number of common shares outstanding during the period. Diluted earnings per share is computed using net income and the weighted average number of common shares outstanding, assuming dilution. Weighted average common shares outstanding, assuming dilution, include potentially dilutive common shares outstanding during the period. Potentially dilutive common shares include the assumed exercise of stock options and assumed vesting of Long-Term Incentive Program (LTIP) performance share, deferred stock unit (DSU) and restricted stock unit (RSU) awards using the treasury stock method. Stock options and LTIP performance share, DSU and RSU awards totaling approximately 725,000 shares were excluded from the calculation of diluted earnings per share because they were antidilutive, although they could become dilutive in the future.

Goodwill

The changes in the carrying amount of goodwill resulting from business combinations (see Note 3 Business Combinations) during the three months ended November 30, 2006 were (in thousands):

	Metals Recycling Business	Auto Parts Business	Total
Balance as of August 31, 2006	$ 143,106	$ 123,569	$ 266,675
Translation adjustment		(482)	(482)
Balance as of November 30, 2006	$ 143,106	$ 123,087	$ 266,193

The Company performs impairment tests at least annually, during the second quarter of the fiscal year and whenever events and circumstances indicate that the value of goodwill might be impaired. The Company has determined that there were no events or circumstances indicating impairment during the first quarter of fiscal 2007.

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Comprehensive Income

The following table sets forth the reconciliation of comprehensive income (in thousands):

	For the Three Months Ended November 30,	
	2006	2005
Net Income	$ 21,158	$ 41,530
Foreign currency translation adjustment	(508)	(60)
Comprehensive income	$ 20,650	$ 41,470

Foreign Currency Translation

In accordance with Statement of Financial Accounting Standard No. 52, Foreign Currency Translation (SFAS 52), assets and liabilities of foreign operations are translated into U.S. dollars at the period-end exchange rate, revenues and expenses of foreign operations are translated into U.S. dollars at the average rate for the period. Translation adjustments are not included in determining net income for the period, but are recorded as a separate component of shareholders equity.

Foreign currency transaction gains and losses are generated from the effects of exchange rate changes on transactions denominated in a currency other than the functional currency of the Company, which is the U.S. dollar. SFAS 52 generally requires that gains and losses on foreign currency transactions be recognized in the determination of net income for the period. The aggregate amount of net realized and unrealized transaction gains was $753,000 in the first quarter of 2006, which was offset by $632,000 of net realized and unrealized losses recorded under Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities (SFAS 133) related to foreign currency contract settlements and mark-to-market adjustments on open foreign currency contracts. The net aggregate amount related to net realized and unrealized gains and losses is recorded in other income.

Changes in Shareholders Equity

In November 2006, the Company repurchased 250,000 common shares.

Derivative Financial Instruments

To manage the exposure to exchange risk associated with accounts receivable denominated in a foreign currency, the Company enters into foreign currency forward contracts to stabilize the U.S. dollar amount of the transaction at maturity. These contracts are not designated as hedging instruments under SFAS 133, Statement of Financial Accounting Standards No. 138, Accounting for Certain Derivative Instruments and Certain Hedging Activities an amendment of SFAS 133 or under Statement of Financial Accounting Standards No. 149, Amendment of Statement 133 on Derivative Instruments and Hedging Activities.

The Company held foreign currency forward contracts denominated in Euros with total notional amounts of 11 million at November 30, 2006. The fair value of these contracts was estimated based on quoted market prices as of November 30, 2006. The change in the exchange rate resulted in a liability of $565,000. The Company did not hold any foreign currency forward contracts during the first quarter of fiscal 2006.

New Accounting Pronouncements

In June 2005, FASB issued SFAS No. 154, Accounting Changes and Error Corrections a replacement of APB No. 20 and FASB Statement No. 3 (SFAS 154). SFAS 154 replaced APB No. 20, Accounting Changes and FASB Statement No. 3, Reporting Accounting Changes in Interim Financial Statements an amendment of APB Opinion No. 28. SFAS 154 provides guidance on the accounting for and reporting of accounting changes and error corrections. It requires retrospective application to prior period financial statements of changes in accounting principle, unless this would be impracticable. SFAS 154 also redefines the

term restatement to mean the correction of an error by revising previously issued financial statements. This statement is effective for fiscal years beginning after December 15, 2005. The Company adopted this pronouncement as of September 1, 2006. This statement had no impact on the consolidated financial statements at adoption.

In February 2006, FASB issued SFAS No. 155, Accounting for Certain Hybrid Financial Instruments, which is effective for all financial instruments acquired or issued after the beginning of an entity s first fiscal year that begins after September 15, 2006. This statement amends SFAS 133, Accounting for Derivative Instruments and Hedging Activities, and FASB Statement No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities (SFAS 140). The Company intends to adopt this pronouncement for fiscal year 2008 and does not anticipate this pronouncement to have a material impact on the consolidated financial statements.

In March 2006, FASB issued SFAS No. 156, Accounting for Servicing of Financial Assets (SFAS 156). This statement amends SFAS 140 with respect to the accounting for separately recognized servicing assets and servicing liabilities. This statement is effective for fiscal years beginning after September 15, 2006. The Company intends to adopt this pronouncement for fiscal year 2008 and does not anticipate this pronouncement to have a material impact on the consolidated financial statements.

In July 2006, FASB issued FASB Interpretation 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109 (FIN 48). This interpretation clarifies the accounting for uncertainty in income taxes recognized in an entity s financial statements in accordance with SFAS No. 109, Accounting for Income Taxes (SFAS 109). It prescribes a recognition threshold and measurement attribute for financial statement recognition and disclosure of tax positions taken or expected to be taken on a tax return. This interpretation is effective for fiscal years beginning after December 15, 2006. The Company will be required to adopt FIN 48 in the first quarter of fiscal year 2008. Management is currently evaluating the requirements of the interpretation and has not yet determined the impact on the consolidated financial statements.

In September 2006, FASB issued SFAS No. 157, Fair Value Measurements (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value in GAAP, and expands disclosures about fair value measurements. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. Earlier application is encouraged, provided that the reporting entity has not yet issued financial statements for that fiscal year, including financial statements for an interim period within that fiscal year. The Company will be required to adopt SFAS 157 in the first quarter of fiscal year 2009. Management is currently evaluating the requirements of SFAS 157 and has not yet determined the impact on the Company s consolidated financial statements.

In September 2006, the FASB issued SFAS No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans an amendment of FASB Statements No. 87, 88, 106, and 132(R) (SFAS 158), which requires employers to fully recognize the funded status of single-employer defined benefit pension, retiree healthcare and other postretirement plans in their financial statements and to recognize as a component of other comprehensive income, net of tax, the gains or losses and prior service costs or credits that arise during the period but are not recognized as components of net periodic costs. The requirement of SFAS 158 to recognize the funded status of a benefit plan and the disclosure requirements will be effective as of the end of the fiscal year ending August 31, 2007.

SFAS 158 also requires employers to measure defined benefit plan assets and obligations as of the date of the Company s fiscal year-end statement of financial position, and disclose in the notes to financial statements additional information about certain effects on net periodic benefit cost for the next fiscal year that arise from delayed recognition of the gains or losses, prior service costs or credits, and transition asset or obligation. The requirement to measure plan assets and benefit obligations as of the date of the employer s fiscal year-end statement of financial position will be effective for the fiscal year ending August 31, 2009. The Company is

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currently in compliance with the latter requirement of SFAS 158, using a measurement date of August 31 for all plans. Based on the postretirement obligations of the Company as of August 31, 2006, the adoption of SFAS 158 would increase total assets by approximately $1 million, increase total liabilities by approximately $3 million and reduce total stockholders equity by approximately $2 million. The adoption of SFAS 158 will not affect the results of the Company s operations. As a result of the June 2006 curtailment of the defined benefits plan, the Company does not expect the impact to be significantly different than the estimate at August 31, 2006.

In September 2006, the SEC staff issued Staff Accounting Bulletin No. 108, Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements (SAB 108). SAB 108 was issued in order to eliminate the diversity of practice surrounding how public companies quantify financial statement misstatements. Traditionally, there have been two widely-recognized methods for quantifying the effects of financial statement misstatements: the roll-over method and the iron curtain method. The roll-over method focuses primarily on the impact of a misstatement on the income statement including the reversing effect of prior year misstatements but its use can lead to the accumulation of misstatements in the balance sheet. The iron curtain method, on the other hand, focuses primarily on the effect of correcting the period-end balance sheet with less emphasis on the reversing effects of prior year errors on the income statement. Prior to the Company s application of the guidance in SAB 108, the Company used the iron curtain method for quantifying financial statement misstatements.

In SAB 108, the SEC staff established an approach that requires quantification of financial statement misstatements based on the effects of the misstatements on each of the company s financial statements and the related financial statement disclosures. This model is commonly referred to as a dual approach because it requires quantification of errors under both the iron curtain and the roll-over methods. SAB 108 is effective for the Company in its annual financial statements for the year ended August 31, 2007. The Company has evaluated the impact of applying the dual approach for quantifying financial statement misstatements and does not expect the cumulative effect adjustment in connection with its initial application to be material to its financial statements.

Note 2 Inventories:

Inventories consisted of the following (in thousands):

	November 30, 2006	August 31, 2006
Recycled metals	$ 184,166	$ 170,405
Work in process	18,014	15,093
Finished goods	68,669	62,151
Supplies	17,749	15,934
	$ 288,598	$ 263,583

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Note 3 Business Combinations:

On September 30, 2005, the Company and HNC and certain of their subsidiaries closed a transaction to separate and terminate their metal recycling joint venture relationships. Total consideration for the transaction was $165 million. Purchase accounting has been finalized and a dispute exists between the Company and HNC over post-closing adjustments. The Company believes it has adequately accrued for the disputed amounts.

In fiscal 2006, the Company also completed the following acquisitions:

On September 30, 2005, the Company acquired GreenLeaf, five store properties leased by GreenLeaf and certain GreenLeaf debt obligations. Total consideration for the acquisition was $45 million.

On October 31, 2005, the Company acquired substantially all of the assets of Regional, a metal recycling business with nine facilities located in Georgia and Alabama. The purchase price was $69 million in cash and the assumption of certain liabilities.

On March 21, 2006, the Company purchased the 40% minority interest in its Rhode Island metals recycling subsidiary. The purchase price of $25 million was paid in cash.

The following table is prepared on a pro forma basis for the three-month period ended November 30, 2005 as though all of the businesses acquired through the HNC separation and termination agreement and the GreenLeaf and Regional acquisitions had occurred on September 1, 2005 (in thousands, except per share amounts).

	For the Three Months Ended November 30, 2005 (pro forma)
Gross revenues	$ 388,673
Net Income	$ 49,475
Net Income per share:	
Basic	$ 1.62
Diluted	$ 1.60

The pro forma results are not necessarily indicative of what would have occurred if the acquisitions had been in effect for the full three-month period. In addition, the pro forma results are not intended to be a projection of future results and do not reflect any synergies that might be achieved from combining operations.

Note 4 Environmental Liabilities and Other Contingencies:

The Company considers various factors when estimating its environmental liabilities. Adjustments to the liabilities are made when additional information becomes available that affects the estimated costs to study or remediate any environmental issues. The factors which the Company considers in its recognition and measurement of environmental liabilities include the following:

Current regulations, both at the time the reserve is established and during the course of the clean-up, which specify standards for acceptable remediation;

Information about the site, which becomes available as the site is studied and remediated;

The professional judgment of both senior-level internal staff and external consultants, who take into account similar, recent instances of environmental remediation issues, among other considerations;

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Technologies available that can be used for remediation; and

The number and financial condition of other potentially responsible parties and the extent of their responsibility for the remediation.

Metals Recycling Business

In connection with acquisitions in the Metals Recycling Business in 1995, 1996 and 2006, the Company recorded in its financial statements reserves for environmental liabilities previously recorded by the acquired companies. Environmental reserves are evaluated quarterly according to Company policy. On November 30, 2006, environmental reserves for the Metals Recycling Business aggregated $22 million, which is primarily comprised of the reserves established during recent acquisitions and the Hylebos Waterway Remediation.

Hylebos Waterway Remediation. General Metals of Tacoma, Inc. (GMT), a subsidiary of the Company, owns and operates a metals recycling facility located in the State of Washington on the Hylebos Waterway, a part of Commencement Bay, which is the subject of an ongoing remediation project by the United States Environmental Protection Agency (EPA) under the Comprehensive Environmental Response, Compensation and Liability Act. GMT and more than 60 other parties were named potentially responsible parties (PRPs) for the investigation and clean-up of contaminated sediment along the Hylebos Waterway. On March 25, 2002, the EPA issued Unilateral Administrative Orders (UAOs) to GMT and another party (Other Party) to proceed with Remedial Design and Remedial Action (RD/RA) for the head of the Hylebos Waterway and to two other parties to proceed with the RD/RA for the balance of the waterway. The UAO for the head of the Hylebos Waterway was converted to a voluntary consent decree in 2004, pursuant to which GMT and the Other Party agreed to remediate the head of the Hylebos Waterway.

There are two phases to the remediation of the head of the Hylebos Waterway. The first phase was the intertidal and bank remediation, which was conducted in 2003 and early 2004. The second phase was dredging in the head of the Hylebos Waterway, which commenced in July 2004 and was completed in February 2006. During fiscal 2005, the Company paid remediation costs of $16 million related to Hylebos Waterway dredging, which resulted in a reduction of the recorded environmental liability. The Company s cost estimates were based on the assumption that dredge removal of contaminated sediments would be accomplished within one dredge season during July 2004 through February 2005. However, due to a variety of factors, including dredge contractor operational issues and other dredge related delays, the dredging was not completed during the first dredge season. As a result, the Company recorded environmental charges of $14 million in fiscal 2005, primarily to account for additional estimated costs to complete this work during a second dredging season. During fiscal 2006, the Company incurred remediation costs of $7 million, which were charged to the environmental reserves. The Company and the Other Party have filed a complaint in the United States District Court for the Western District of Washington at Tacoma against the dredge contractor to recover damages and a significant portion of cost over runs incurred in the second dredging season to complete the project; the case is scheduled to go to trial in January 2007.

GMT and the Other Party are pursuing settlement negotiations and legal actions against other non-settling, non-performing PRPs to recover additional amounts that may be applied against the head of the Hylebos Waterway remediation costs. This legal action is scheduled to go to trial in May 2007. During fiscal 2005, the Company recovered $1 million from four non-performing PRPs, and during the first quarter of fiscal 2006, the Company recovered an additional immaterial amount from two non-performing PRPs. This a