CYTEC INDUSTRIES INC/DE/
Form 10-Q
May 04, 2004

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (d)
OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2004

Commission file number 1-12372

CYTEC INDUSTRIES INC.
(Exact name of registrant as specified in its charter)

Delaware	22-3268660
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

Five Garret Mountain Plaza
West Paterson, New Jersey 07424
(Address of principal executive offices)

973-357-3100
(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 |X| No |_|.

Indicate by check mark whether the Registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes |X| No |_|.

There were 38,881,148 shares of common stock outstanding at March 31, 2004.

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PART I - FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements

CYTEC INDUSTRIES INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)
(Millions of dollars, except per share amounts)

	Three Months Ended March 31, 2004	Three Months Ended March 31, 2003
Net sales	$ 415.2	$ 367.4
Manufacturing cost of sales	312.7	272.4
Selling and technical services	34.9	30.1
Research and process development	9.1	8.2
Administrative and general	13.3	11.8
Amortization of acquisition intangibles	1.4	0.8
Earnings from operations	43.8	44.1
Other income (expense), net	0.9	(1.2)
Equity in earnings of associated companies	0.3	2.5
Interest expense, net	3.8	4.1

Earnings before income taxes and cumulative effect of accounting change	41.2	41.3
Income tax provision	9.9	12.4
Earnings before cumulative effect of accounting change	31.3	28.9
Cumulative effect of accounting change, net of taxes of $7.3	-	(13.6)
Net earnings	$ 31.3	$ 15.3
Earnings before cumulative effect of accounting change per common share		
Basic	$ 0.80	$ 0.75
Diluted	$ 0.78	$ 0.73
Cumulative effect of accounting change per common share		
Basic	$ -	$ (0.35)
Diluted	$ -	$ (0.34)
Earnings per common share		
Basic	$ 0.80	$ 0.39
Diluted	$ 0.78	$ 0.38

See accompanying Notes to Consolidated Financial Statements.

CYTEC INDUSTRIES INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(Unaudited)
(Millions of dollars, except share and per share amounts)

	March 31, 2004	December 31, 2003
ASSETS		
Current Assets		
Cash and cash equivalents	$ 251.6	$ 251.1
Trade accounts receivable, less allowance for doubtful accounts of $7.2 and $7.6 in 2004 and 2003, respectively	242.1	217.1
Other accounts receivable	52.9	50.2
Inventories	183.6	176.0
Deferred income taxes	0.1	8.2

Other current assets	17.7	8.8
Total current assets	748.0	711.4
Investment in associated companies	81.5	82.1
Plants, equipment and facilities, at cost	1,542.5	1,538.3
Less: accumulated depreciation	(886.3)	(875.4)
Net plant investment	656.2	662.9
Acquisition intangibles, net of accumulated amortization	67.9	69.9
Goodwill	339.1	339.7
Deferred income taxes	86.5	85.7
Other assets	73.6	74.2
Total assets	$ 2,052.8	$ 2,025.9

LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities		
Short-term borrowings	$ 9.2	$ 9.3
Accounts payable	140.7	93.5
Accrued expenses	137.4	170.5
Income taxes payable	60.4	63.2
Total current liabilities	347.7	336.5
Long-term debt	418.6	416.2
Pension and other postretirement benefit liabilities	334.6	346.0
Other noncurrent liabilities	183.6	171.8
Stockholders' equity		
Preferred stock, 20,000,000 shares authorized; issued and outstanding 4,000 shares, Series C Cumulative, $.01 par value at liquidation value of $25 per share	0.1	0.1
Common stock, $.01 par value per share, 150,000,000 shares authorized; issued 48,132,640 shares	0.5	0.5
Additional paid-in capital	118.1	122.2
Retained earnings	1,010.1	982.9
Unearned compensation	(3.0)	(5.3)
Minimum pension liability	(96.8)	(96.8)
Unrealized gains on derivative instruments	0.5	0.3
Accumulated translation adjustments	29.8	38.0
Treasury stock, at cost, 9,251,492 shares in 2004, and 9,139,897 shares in 2003	(291.0)	(286.5)
Total stockholders' equity	768.3	755.4
Total liabilities and stockholders' equity	$ 2,052.8	$ 2,025.9

See accompanying Notes to Consolidated Financial Statements.

CYTEC INDUSTRIES INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(Millions of dollars)

	Three Months Ended March 31, 2004	Three Months Ended March 31, 2003
Cash flows provided by (used for) operating activities		
Net earnings	$ 31.3	$ 15.3
Noncash items included in net earnings:		
Dividends from associated companies greater than earnings	0.8	0.6
Depreciation	21.6	21.6
Amortization	2.7	1.2
Deferred income taxes	7.3	(10.3)
Gain on sale of assets	(0.6)	-
Cumulative effect of accounting change, net of tax	-	13.6
Other	(0.3)	-
Changes in operating assets and liabilities:		
Trade accounts receivable	(28.9)	(16.6)
Other receivables	(3.8)	(2.4)
Inventories	(9.0)	(19.5)
Accounts payable	44.0	12.3
Accrued expenses	(24.6)	(9.2)
Income taxes payable	-	17.7
Other assets	(8.0)	(2.7)
Other liabilities	(9.8)	(11.5)
Net cash flows provided by operating activities	22.7	10.1
Cash flows provided by (used for) investing activities		
Additions to plants, equipment and facilities	(16.9)	(18.9)
Proceeds received on sale of assets	0.7	0.1
Advance payment received on land lease	9.1	-
Net cash flows used for investing activities	(7.1)	(18.8)
Cash flows provided by (used for) financing activities		
Proceeds from the exercise of stock options	2.9	1.7
Purchase of treasury stock	(13.2)	(11.3)
Change in short-term borrowings	(0.1)	-
Change in long-term debt	-	(100.0)
Proceeds from termination of interest rate swap	2.7	-
Cash dividends	(3.9)	-
Net cash flows used for financing activities	(11.6)	(109.6)
Effect of currency rate changes on cash and cash equivalents	(3.5)	1.1
Increase (decrease) in cash and cash equivalents	0.5	(117.2)
Cash and cash equivalents, beginning of period	251.1	210.0

Cash and cash equivalents, end of period	$ 251.6	$ 92.8

See accompanying Notes to Consolidated Financial Statements

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
(Millions of dollars, except per share amounts, unless otherwise indicated)

(1) Basis of Presentation

The unaudited consolidated financial statements included herein have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission for reporting on Form 10-Q. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations. The statements should be read in conjunction with the Consolidated Financial Statements and Notes to the Consolidated Financial Statements contained in the Company's 2003 Annual Report on Form 10-K.

Certain reclassifications have been made to the prior year's financial statements in order to conform to the current year's presentation.

(2) Stock-Based Compensation

The Company accounts for its stock based compensation under the recognition and measurement principles of Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," ("APB No. 25") and related Interpretations. No stock-based compensation cost is reflected in net income for stock options, as all stock options granted had an exercise price equal to the market value of the underlying common stock on the date of the grant. Compensation cost for restricted stock is recorded based on the market value on the date of grant, and compensation cost for performance stock is recorded based on the quoted market price of the Company's common stock at the end of each period through the date of vesting. The fair value of restricted and performance stock is charged to unearned compensation in Stockholders' Equity and amortized to expense over the requisite vesting periods.

The Company reduced the amount of stock option grants in 2004 by approximately 40% compared to the 2003 grants. This was effected by reducing the average size of option grants and by replacing option grants to certain employees with stock appreciation rights (SARS). SARS are accounted for as a liability under APB No. 25 and are payable in cash. Compensation cost for SARS is recognized in the income statement over the period of the award based on changes in the current market price of the Company's common stock over the market price at the grant date. At March 31, 2004, the Company has not recorded a liability or any expense associated with the SARS as the market price at March 31, 2004 was less than the price at the grant date.

The following table illustrates the effect on net earnings and earnings per share if the Company had applied the fair value recognition provisions of Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" to all stock-based employee compensation for the three months ended March 31:

	2004	2003
Net earnings, as reported	$ 31.3	$ 15.3
Add :		
Stock-based employee compensation expense included in reported net earnings, net of related tax effects	0.3	-
Deduct:		
Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	1.8	1.9
Pro forma net earnings	$ 29.8	$ 13.4
Net earnings per share:		
Basic, as reported	$ 0.80	$ 0.39
Basic, pro forma	0.76	0.35
Diluted, as reported	$ 0.78	$ 0.38
Diluted, pro forma	0.74	0.34

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
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The fair value of each stock option grant is estimated on the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions:

	2004		2003	
Expected life (years)	5.7		5.6	
Expected volatility	46.7	%	47.3	%
Expected dividend yield	1.0	%	-	
Risk-free interest rate	3.4	%	2.9	%
Weighted average fair value of options granted during the year	$ 16.19		$ 12.52	

(3) Earnings Per Share (EPS)

Basic earnings per common share excludes dilution and is computed by dividing net earnings less preferred stock dividends by the weighted-average number of common shares outstanding (which includes shares outstanding, less performance and restricted shares for which vesting criteria have not been met) plus deferred stock awards, weighted for the period outstanding. Diluted earnings per common share is computed by dividing net earnings less preferred stock dividends by the sum of the weighted-average number of common shares outstanding for the period adjusted (i.e., increased) for all additional common shares that would have been outstanding if potentially dilutive common shares had been issued and any proceeds of the issuance had been used to repurchase common stock at the average market price during the period. The proceeds are assumed to be the sum of the amount to be paid to the Company upon exercise of options, the amount of compensation cost attributed to future services and not yet recognized and the amount of income taxes that would be credited to or deducted from capital upon exercise.

In calculating basic and diluted earnings per share, there are no adjustments to income (numerator). The following shows the reconciliation of weighted average shares (the denominator) used in the calculation of diluted earnings per share:

(Millions of dollars, except per share amounts, unless otherwise indicated)

March 31,	2004	2003
Weighted average shares outstanding:	39,098,953	38,734,611
Effect of dilutive shares:		
Options	914,323	912,603
Performance/Restricted Stock	86,690	116,808
Adjusted average shares outstanding	40,099,966	39,764,022

(4) Recently Issued Statements of Financial Accounting Standards

In December 2003, Congress passed the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (Medicare Act). In January 2004, the Financial Accounting Standards Board (FASB) issued Financial Staff Position No. 106-1 (FSP FAS 106-1), "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003" (FSP). The FASB is in the process of amending the FSP by issuing proposed FSP 106-b. The proposed FSP is effective for the first interim or annual period beginning after June 15, 2004. The FSP provides guidance on the accounting for the effects of the Medicare Act for employers that sponsor postretirement health care plans that provide prescription drug benefits. The Company is currently evaluating the effects of the Medicare Act on its existing postretirement health care plans and has not determined the amount of any subsidy that may be available to the Company from the Medicare Act. While the Company is evaluating the effects of the Medicare Act, the Company has elected under the provisions of the FSP to defer the recognition of any potential subsidy from the Medicare Act.

In March 2004, the FASB issued the exposure draft, "Share-Based Payment". The proposed Statement would require all equity-based awards to employees to be recognized in the income statement based on their fair value for fiscal years beginning after December 15, 2004. The new standard, if accepted in its present form, would apply to all awards granted, modified or settled after the effective date. The Company is in the process of analyzing the potential impact of this proposed standard on its consolidated results of operations and financial position.

(5) Inventories

The inventories consisted of the following:

	March 31 2004	December 31 2003
Finished goods	$ 120.8	$ 114.9
Work in process	21.8	21.5
Raw materials & supplies	74.6	73.2

	217.2	209.6
Less reduction to LIFO cost	(33.6)	(33.6)
Total inventories	$ 183.6	$ 176.0
LIFO inventories as a % of total inventories	56%	55%

(6) Equity in Earnings of Associated Companies

The Company has one associated company, CYRO Industries ("CYRO"), a 50% owned joint venture. The 2003 associated companies' information below includes the results of the former Mitsui-Cytec ("MCY") joint venture which was dissolved on September 30, 2003. The Company now owns 100% of MCY's coating resins product line and the associated assets and liabilities of the product line. Results are recorded as part of the Performance Products segment.

Summarized financial information for the Company's equity in earnings of associated companies for the three months ended March 31 is as follows:

	2004	2003
Net sales	$ 72.4	$ 79.5
Gross profit	9.7	15.6
Earnings before cumulative effect of accounting change	0.6	4.5
Cumulative effect of accounting change, net of tax	-	(0.2)
Net earnings	$ 0.6	$ 4.3
The Company's equity in earnings of associated companies	$ 0.3	$ 2.5
The Company's equity in cumulative effect of adoption of SFAS 143, net of tax, of associated companies	$ -	$ (0.1)

The Company sells certain products to CYRO and has determined that the sales and related profit are not material; therefore, no adjustments have been made to eliminate such profit or loss on sales to CYRO for inventory held at the balance sheet dates.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
(Millions of dollars, except per share amounts, unless otherwise indicated)

(7) Environmental Matters and Other Contingent Liabilities and Commitments

Environmental Matters

The Company is subject to substantial costs arising out of environmental laws and regulations, which include obligations to remove or limit the effects on the environment of the disposal or release of certain wastes or substances at various sites or to pay compensation to others for doing so.

As of March 31, 2004 and December 31, 2003, the aggregate environmental related accruals were $79.5 and $79.6, respectively. As of March 31, 2004 and December 31, 2003, $11.0 of the above amounts was included in accrued expenses, with the remainder included in other noncurrent liabilities. Environmental remediation spending for the three months ended March 31, 2004 and 2003 was $1.1 and $1.5, respectively.

These accruals can change substantially due to such factors as additional information on the nature or extent of contamination, methods of remediation required, changes in the apportionment of costs among responsible parties and other actions by governmental agencies or private parties.

A further discussion of environmental matters can be found in Note 10 of the Notes to the Consolidated Financial Statements contained in the Company's 2003 Annual Report on Form 10-K.

Other Contingent Liabilities

The Company is the subject of numerous lawsuits and claims incidental to the conduct of its or its predecessors' businesses, including lawsuits and claims relating to product liability, personal injury including asbestos, environmental, contractual, employment and intellectual property matters.

As of March 31, 2004 and December 31, 2003, the aggregate self-insured and insured contingent liability was $72.0 and $72.5, respectively. The asbestos liability included in the above amounts at March 31, 2004 and December 31, 2003 was $53.6 and $54.0, respectively, and the related insurance receivable was $28.9 at March 31, 2004 and $29.1 at December 31, 2003. The Company anticipates receiving a net tax benefit for payment of those claims to which full insurance recovery is not realized.

The following table presents information about the asbestos claims against the Company:

	Three Months Ended March 31, 2004	Year Ended December 31, 2003
Claims closed in period	156	7,601
Claims filed in period	1,734	7,648
Claims open at end of period	28,533	26,955

It should be noted that the ultimate liability and related insurance recovery for all pending and anticipated future claims cannot be determined with certainty due to the difficulty of forecasting the numerous variables that can affect the amount of the liability and insurance recovery. These variables include but are not limited to: (i) significant changes in the number of future claims; (ii) significant changes in the average cost of resolving claims; (iii) changes in the nature of claims received; (iv) changes in the laws applicable to these claims; and (v) financial viability of co-defendants and insurers.

The Company is among several defendants in approximately 35 cases in which plaintiffs assert claims for personal injury, property damage, and other claims for relief relating to lead pigment that was used as an ingredient decades ago in paint for the use in buildings. The different suits variously seek compensatory and punitive damages and/or injunctive relief, including funds for the cost of monitoring, detecting and removing lead based paint from buildings and for medical monitoring; for personal injuries allegedly caused by ingestion of lead based paint; and plaintiffs' attorneys' fees. The Company believes that the suits are without merit and is vigorously defending against all such claims. Accordingly, no loss contingency has been recorded. The Company has access to a substantial amount of primary and excess general liability insurance for property damage, and believes that these policies are available to cover a significant portion of both its defense costs and indemnity costs, if any, for lead pigment-related

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
(Millions of dollars, except per share amounts, unless otherwise indicated)

property damage claims. The Company has not recorded an insurance receivable relating to its defense costs although it continues to pursue an agreement with various of its insurers concerning coverage with respect to these matters. In the first quarter of 2004, the Company received a "good-faith" payment of $1.0 from one of its insurance carriers that it recorded in other income (expense) and expects to recognize additional recoveries in future periods as negotiations with its insurers proceed. However, until a cost-sharing arrangement with one or more of its insurers has been determined, the Company will continue to expense its lead defense costs as incurred without provision for potential insurance recoveries.

While it is not feasible to predict the outcome of all pending environmental matters, lawsuits and claims, it is reasonably possible that there will be a necessity for future provisions for costs for environmental matters and for other contingent liabilities that in management's opinion, will not have a material adverse effect on the consolidated financial position of the Company, but could be material to the consolidated results of operations of the Company in any one accounting period. The Company cannot estimate any additional amount of loss or range of loss in excess of the recorded amounts. Moreover, many of these liabilities are paid over an extended period, and the timing of such payments cannot be predicted with any certainty.

A further discussion of contingent liabilities can be found in Note 10 of the Notes to the Consolidated Financial Statements contained in the Company's 2003 Annual Report on Form 10-K.

Commitments

The Company frequently enters into long-term contracts with customers with terms that vary depending on specific industry practices. The Company's business is not substantially dependent on any single contract or any series of related contracts. Descriptions of the Company's significant sales contracts are set forth in Note 10 of the Notes to Consolidated Financial Statements contained in the Company's 2003 Annual Report on Form 10-K.

(8) Comprehensive Income

The components of comprehensive income, which represents the change in equity from non-owner sources, for the three months ended March 31 is as follows:

	2004	2003

(Millions of dollars, except per share amounts, unless otherwise indicated)

Net earnings	$ 31.3	$ 15.3
Other comprehensive income (loss):		
Unrealized gain (loss) on derivative instruments	0.2	(0.2)
Foreign currency translation adjustments	(8.2)	5.5
Comprehensive income	$ 23.3	$ 20.6

(9) Other Financial Information

On January 22, 2004 the Board of Directors approved the initiation of a common stock quarterly cash dividend program and declared a $0.10 per share cash dividend, paid on February 25, 2004 to shareholders of record as of February 10, 2004. Cash dividends paid in the first quarter of 2004 were $3.9.

Taxes paid for the three months ended March 31, 2004 and 2003 were $1.3 and $6.1, respectively. Interest paid for the three months ended March 31, 2004 and 2003 was $4.4 and $6.6, respectively.

During the first quarter of 2004 and 2003, the Company repurchased 388,300 and 384,100 shares of stock at a cost of $13.2 and $11.3, respectively.

During the quarter, the Company received, net of expenses, $9.1 as a prepayment for a long term lease on a certain property for future development by a third party with an option to purchase later. The net proceeds are being amortized over the life of the lease and the impact of amortization in any one period is not material.

Due to the liquidity provided by the Company's cash balances and the availability of $100.0 under an unsecured revolving credit agreement that expires April 11, 2005, the $100.0, 364-day unsecured revolving credit agreement was allowed to expire on its scheduled maturity date of April 9, 2004.

(10) Segment Information

Summarized segment information for the Company's four segments for the three months ended March 31, 2004 and 2003 is as follows:

	2004	2003
Net Sales:		
Water and Industrial Process Chemicals	$ 92.4	$ 85.8
Performance Products		
Sales to external customers	139.9	119.8
Intersegment sales	1.3	-
Specialty Materials	120.3	108.1
Building Block Chemicals		
Sales to external customers	62.6	53.7
Intersegment sales	19.3	16.4

Net sales from segments	435.8	383.8
Elimination of intersegment revenue	(20.6)	(16.4)
Total consolidated net sales	$ 415.2	$ 367.4

		% of Sales		% of Sales
Earnings (loss) from operations:				
Water and Industrial Process Chemicals	$ 3.6	4 %	$ 6.9	8 %
Performance Products	13.5	10 %	11.8	10 %
Specialty Materials	23.2	19 %	22.3	21 %
Building Block Chemi				