ALCAN INC
Form 10-Q
August 09, 2005

medium none; border-right: medium none; border-top: medium none; border-bottom: 1.5pt solid windowtext; padding-left: 5.4pt; padding-right: 5.4pt; padding-top: 0in; padding-bottom: 0in" align="right">

2005

2004

2005

2004

(*in millions of US$, except per share amounts)*

Sales and operating revenues

5,206

6,208

10,384

12,228

Costs and expenses

Cost of sales and operating expenses, excluding depreciation

and amortization noted below	**4,130**	4,918	**8,220**	9,890
Depreciation and amortization	**268**	324	**540**	660
Selling, administrative and general expenses	**345**	365	**725**	761
Research and development expenses	**49**	58	**98**	119
Interest	**90**	87	**175**	

180

Other expenses (income) - net (note 11)

73

54

97

51

4,955

5,806

9,855

11,661

Income from continuing operations before income taxes and

other items

251

402

529

567

Income taxes (note 9)

70

125

168

166

Income from continuing operations before other items

181

		277	**361**	401
Equity income	**28**	17	**57**	33
Minority interests	**(1)**	(9)	**(2)**	(15)
Income from continuing operations	**208**	285	**416**	419
Income (Loss) from discontinued operations (note 3)	**(17)**	46	**(7)**	18
Net income	**191**	331	**409**	437

Dividends on preference shares	**1**	1	**3**	3
Net income attributable to common shareholders	**190**	330	**406**	434
Earnings (Loss) per share (note 4)				
Basic and Diluted:				
Income from continuing operations	**0.56**	0.77	**1.11**	1.13
Income (Loss) from discontinued operations	**(0.04)**	0.12		

(0.02)

0.05

Net income per common share - basic and diluted

0.52

0.89

1.09

1.18

Dividends per common share

0.30

0.30

0.45

0.45

The accompanying notes are an integral part of the interim financial statements.

ALCAN INC.

INTERIM CONSOLIDATED BALANCE SHEET (unaudited)

(*in millions of US$)*	**June 30, 2005**	December 31, 2004
ASSETS		
Current assets		
Cash and time deposits	**222**	184
Trade receivables (net of allowances of $62 in 2005 and $99 in 2004)	**2,861**	3,247
Other receivables	**846**	936
Deferred income taxes	**110**	214
Inventories (note 12)	**2,863**	4,040
Current assets held for sale (note 3)	**172**	791
Total current assets	**7,074**	9,412
Deferred charges and other assets	**2,251**	2,877
Deferred income taxes	**969**	870
Property, plant and equipment		
Cost (excluding Construction work in progress)	**15,383**	21,956
Construction work in progress	**899**	816
Accumulated depreciation	**(5,479)**	(9,478)
	10,803	13,294
Intangible assets (net of accumulated amortization of $177 in 2005		

and $172 in 2004)	**1,028**	1,230
Goodwill	**4,992**	5,496
Long-term assets held for sale (note 3)	**30**	162
Total assets	**27,147**	33,341

The accompanying notes are an integral part of the interim financial statements.

INTERIM CONSOLIDATED BALANCE SHEET (cont'd) (unaudited)

(*in millions of US$*)	**June 30, 2005**	December 31, 2004
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Payables and accrued liabilities	**4,415**	5,843
Short-term borrowings	**339**	2,486
Debt maturing within one year	**854**	569
Deferred income taxes	**27**	23
Current liabilities of operations held for sale (note 3)	**104**	335
Total current liabilities	**5,739**	9,256
Debt not maturing within one year	**5,630**	6,345
Deferred credits and other liabilities	**4,270**	4,986
Deferred income taxes	**1,279**	1,543
Long-term liabilities of operations held for sale (note 3)	**9**	249
Minority interests	**91**	236
Shareholders' equity		
Redeemable non-retractable preference shares	**160**	160
Common shareholders' equity		
Common shares	**6,104**	6,670
Additional paid-in capital	**692**	112
Retained earnings	**3,322**	3,362
Common shares held by a subsidiary	**(31)**	(35)
Accumulated other comprehensive income (loss) (note 16)	**(118)**	457
	9,969	10,566
	10,129	10,726
Commitments and contingencies (note 15)		
Total liabilities and shareholders' equity	**27,147**	33,341

The accompanying notes are an integral part of the interim financial statements.

INTERIM CONSOLIDATED STATEMENT OF CASH FLOWS (unaudited)

	Second Quarter		Six Months	
Periods ended June 30	**2005**	2004	**2005**	2004
(in millions of US$)				
OPERATING ACTIVITIES				
Net income	**191**	331	**409**	437
Loss (Income) from discontinued operations	**17**	(46)	**7**	(18)
Income from continuing operations	**208**	285	**416**	419
Adjustments to determine cash from operating activities:				
Depreciation and amortization	**268**	324	**540**	660
Deferred income taxes	**(13)**	42	**42**	14
Equity income, net of dividends	**2**	(1)	**(25)**	(17)
Asset impairment provisions	**25**	2	**33**	10
Loss (Gain) on sale of businesses and investments - net	**17**	(42)	**16**	(42)
Stock option compensation	**5**	2	**10**	4
Change in operating working capital				
Change in receivables	**(157)**	(137)	**(353)**	(518)
Change in inventories	**(128)**	(11)	**(114)**	44
Change in payables and accrued liabilities	**(34)**	12	**(272)**	199
Change in deferred charges, other assets, deferred credits and other liabilities - net	**44**	(83)	**(72)**	(103)
Other - net	**5**	35	**(46)**	30
Cash from operating activities in continuing operations	**242**	428	**175**	700
Cash from (used for) operating activities in discontinued operations	**(18)**	33	**50**	51
Cash from operating activities	**224**	461	**225**	751
FINANCING ACTIVITIES				
Proceeds from issuance of new debt - net of issuance costs	**780**	177	**1,166**	718
Debt repayments	**(610)**	(234)	**(1,196)**	(454)
Short-term borrowings - net	**29**	(145)	**(1,993)**	(375)
Common shares issued	**6**	8	**10**	33
Dividends - Alcan shareholders (including preference)	**(56)**	(56)	**(114)**	(113)
- Minority interests	**(6)**	(2)	**(6)**	(4)
Cash from (used for) financing activities in continuing operations	**143**	(252)	**(2,133)**	(195)
Cash from (used for) financing activities in discontinued operations	**41**	(30)	**4**	(31)
Cash from (used for) financing activities	**184**	(282)	**(2,129)**	(226)

The accompanying notes are an integral part of the interim financial statements.

INTERIM CONSOLIDATED STATEMENT OF CASH FLOWS (cont'd) (unaudited)

	Second Quarter		Six Months	
Periods ended June 30	**2005**	2004	**2005**	2004
(in millions of US$)				

INVESTMENT ACTIVITIES

Purchase of property, plant and equipment	**(453)**	(265)	**(745)**	(517)
Business acquisitions and purchase of investments	**(39)**	(55)	**(42)**	(423)
Net proceeds from disposal of businesses, investments and other assets	**(9)**	(24)	**3**	20
Settlement of amounts due from Novelis - net (note 5)	**-**	-	**2,535**	-
Cash from (used for) investment activities in continuing operations	**(501)**	(344)	**1,751**	(920)
Cash from (used for) investment activities in discontinued operations	**121**	9	**64**	(4)
Cash from (used for) investment activities	**(380)**	(335)	**1,815**	(924)
Effect of exchange rate changes on cash and time deposits	**(11)**	(1)	**(29)**	(28)
Increase (Decrease) in cash and time deposits	**17**	(157)	**(118)**	(427)
Cash and time deposits - beginning of period	**205**	508	**340**	778
Cash and time deposit - end of period in continuing operations	**222**	235	**222**	235
Cash and time deposits - end of period in current assets held for sale	**-**	116	**-**	116
Cash and time deposits - end of period	**222**	351	**222**	351

The accompanying notes are an integral part of the interim financial statements.

ALCAN INC.

INTERIM CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY (unaudited)

(in millions of US$)	**Preference Shares - Series C and E**	**Common Shares**	**Additional Paid-In Capital**	**Retained Earnings**	**Common Shares Held by a Subsidiary**	**Accumulated Other Comprehen-sive Income (Loss)**	**Total Shareholders' Equity**
Balance at December 31, 2004	160	6,670	112	3,362	(35)	457	10,726
Spin-off of Novelis (note 5)		**(576)**	**572**	**(279)**		**(71)**	**(354)**
Net income - six months ended June 30, 2005				**409**			**409**
Other comprehensive loss (note 16)						**(504)**	**(504)**
Dividends:							
Preference				**(3)**			**(3)**
Common				**(167)**			**(167)**
Stock option expense			**10**				**10**
Exercise of stock options		**2**	**(2)**				**-**
Common shares held by a subsidiary					**4**		**4**
Common shares issued for cash:							
Executive share option plan		**8**					**8**
Dividend reinvestment and share purchase plans		**2**					**2**
Other		**(2)**					**(2)**
Balance at June 30, 2005	**160**	**6,104**	**692**	**3,322**	**(31)**	**(118)**	**10,129**

The accompanying notes are an integral part of the interim financial statements.

-7-

ALCAN INC.

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2005

(unaudited)

(in millions of US$, except per share amounts)

1. ACCOUNTING POLICIES

Basis of Presentation

The unaudited interim consolidated financial statements are based upon accounting policies and methods of their application consistent with those used and described in the Company's annual financial statements as contained in the most recent annual report. The interim financial statements do not include all of the financial statement disclosures included in the annual financial statements prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) and therefore should be read in conjunction with the Company's annual report.

In the opinion of management of the Company, the unaudited interim consolidated financial statements reflect all adjustments, which consist only of normal and recurring adjustments, necessary to present fairly the financial position and the results of operations and cash flows in accordance with U.S. GAAP, applied on a consistent basis. The results reported in these interim consolidated financial statements are not necessarily indicative of the results that may be expected for the entire year.

Spin-off of Rolled Products Businesses - Basis of Presentation

On January 6, 2005, Alcan completed the spin-off of Novelis Inc. (Novelis), as described in note 5 - Spin-off of Rolled Products Businesses. Prior to the spin-off, these businesses were owned by Alcan. Alcan's consolidated financial statements as at December 31, 2004 and for the second quarter and six months ended June 30, 2004 include the operations transferred to Novelis. Alcan's consolidated financial statements as at and for the second quarter and six months ended June 30, 2005 exclude the operations transferred to Novelis. Management concluded that all income earned and cash flows generated by Novelis entities from January 1 to 5, 2005, were insignificant, except as described in note 5 - Spin-off of Rolled Products Businesses.

2. RECENTLY ISSUED ACCOUNTING STANDARDS

Conditional Asset Retirement Obligations

In March 2005, the Financial Accounting Standards Board (FASB) issued Interpretation No. 47 (FIN 47), Accounting for Conditional Asset Retirement Obligations, an interpretation of FASB Statement No. 143. FIN 47 clarifies that the term *conditional asset retirement obligation* as used in FASB Statement (SFAS) No. 143, Accounting for Asset Retirement Obligations, refers to a legal obligation to perform an asset retirement activity in which the timing and/or method of settlement are conditional on a future event that may or may not be within the control of the entity. According to FIN 47, uncertainty about the timing and/or method of settlement of a conditional asset retirement obligation should be factored into the measurement of a liability when sufficient information exists. This interpretation is effective no later than the end of fiscal years ending after December 15, 2005. Retrospective application for interim financial information is permitted but not required. The Company does not anticipate that this interpretation will have a material impact on its financial statements.

-8-

2. RECENTLY ISSUED ACCOUNTING STANDARDS (cont'd)

Accounting Changes and Error Corrections

In June 2005, the FASB issued SFAS No. 154, Accounting Changes and Error Corrections, a replacement of APB Opinion No. 20 and FASB Statement No. 3. This statement applies to all voluntary changes in accounting principle and changes the requirements for accounting for and reporting of a change in accounting principle. The statement requires retrospective application to prior periods' financial statements of a voluntary change in accounting principle versus including the cumulative effect of changing to the new accounting principle in net income. SFAS No. 154 carries forward many provisions of APB Opinion No. 20 without change, including the provisions related to the reporting of a change in accounting estimate, a change in the reporting entity, and the correction of an error. SFAS No. 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005.

3. DISCONTINUED OPERATIONS AND ASSETS HELD FOR SALE

Bauxite and Alumina and Primary Metal

On December 29, 2004, the Company announced that, following an extensive evaluation of the Company's operations subsequent to the Pechiney acquisition, it had entered into a binding agreement for the sale of its controlling interest in Aluminium de Grèce S.A. (AdG), as well as the transfer of certain related contracts, to Mytilineos Holdings S.A. of Greece. The Company classified this business in discontinued operations and assets held for sale during the fourth quarter of 2004. The Company owned approximately 13 million shares in AdG, representing a 60.2% equity interest. The transaction was completed on March 15, 2005 at a value of $104. Under the terms of this agreement, Mytilineos Holdings and certain affiliated companies acquired from the Company a 53% equity position in AdG. The balance of the Company's interest in AdG, some 7.2%, may be sold by the Company to Mytilineos Holdings one year after closing pursuant to a three-month put option at a price equivalent to the selling price of the shares. Subsequently, Mytilineos Holdings will have a call option for six months to purchase any remaining interest, at a price equivalent to the selling price of the shares.

Primary Metal

On December 30, 2004, the Company announced that it had reached agreement on the principal terms of a sale of Pechiney Électrométallurgie (PEM) to Ferroatlántica, S.L., of Spain. The Company classified this business in discontinued operations and assets held for sale during the fourth quarter of 2004. The Company's decision to sell this business was based on an extensive evaluation of the Company's operations subsequent to the Pechiney acquisition and is consistent with the Company's strategy of divesting non-core activities. On June 1, 2005, the Company completed the sale of PEM for net proceeds of $150.

Engineered Products

In the first quarter of 2004, the Company committed to a plan to sell certain non-strategic assets that are not part of its core operations. The assets are used to supply castings and components to the automotive industry. The Company is actively pursuing potential purchasers. These assets are classified as held for sale and are included in discontinued operations.

Following a detailed assessment subsequent to the Pechiney acquisition, the Company began restructuring efforts at certain European sites in the fourth quarter of 2004. As a result of this restructuring, the Company committed to a plan to sell two high purity businesses, Mercus and Froges, in France. These businesses were classified in discontinued operations and assets held for sale during the fourth quarter of 2004. In the second quarter of 2005, the Company announced a change in its strategy of selling the businesses due to changes in market and economic conditions. The Company envisions suspending one of two activities at the Mercus high purity metal processing mill and closing the Froges rolling mill. As a result of the change in strategy, these two businesses no longer meet the criteria for discontinued operations and, accordingly, have been reclassified to assets held and used and are included in continuing operations.

Also in the fourth quarter of 2004, the Company committed to a plan to sell its service centres in France that are not part of its core operations. These assets were classified as held for sale and were included in discontinued operations. On April 20, 2005, the Company completed the sale of these service centres for net proceeds of $4 to Amari Metal France Ltd., which specializes in distributing aluminum, stainless steel and cuprous metal products.

3. DISCONTINUED OPERATIONS AND ASSETS HELD FOR SALE (cont'd)

Packaging

In the second quarter of 2003, the Company committed to a plan to sell certain non-strategic operations (Fibrenyle, Boxal Group, and Suner Cartons), as the businesses were not part of its core operations. These businesses were classified as held for sale and were included in discontinued operations. In the fourth quarter of 2003, the Company recorded the sale of Fibrenyle, in the U.K., for proceeds of $29. In the second quarter of 2004, the Company recorded the sale of the Boxal Group and Suner Cartons, for proceeds of $6 and $19, respectively. As at June 30, 2004, the Company had sold all of the assets of the non-strategic packaging businesses previously classified as held for sale in the second quarter of 2003.

Other

In the second quarter of 2004, the Company classified in discontinued operations its copper and ores and concentrates trading businesses. In the fourth quarter of 2004, the Company sold certain assets of its ores and concentrates trading division to its then current management team, and sold the assets of its zinc and lead metal trading business to Trafigura Ltd., an independent commodity trading company.

Fair values were determined based on either discounted cash flows or expected selling price. Certain financial information has been reclassified in the prior periods to present these businesses as discontinued operations on the statement of income, as assets held for sale and liabilities of operations held for sale on the balance sheet and as cash flows from (used for) discontinued operations on the statement of cash flows.

An impairment charge of nil for the second quarter and six months ended June 30, 2005 (2004: nil and $6) was recorded in discontinued operations to reduce the carrying values of these businesses to estimated fair values less costs to sell.

Selected financial information for the businesses included in discontinued operations is reported below:

	Second Quarter		Six Months	
Periods ended June 30	**2005**	2004	**2005**	2004
Sales	**78**	404	**276**	826
Income from operations	**-**	38	**4**	17
Gain (Loss) on disposal - net	**(19)**	27	**(10)**	27
Asset impairment provisions	**-**	-	**-**	(6)
Pre-tax income (loss)	**(19)**	65	**(6)**	38
Income tax recovered (expense)	**2**	(19)	**(1)**	(20)
Income (Loss) from discontinued operations	**(17)**	46	**(7)**	18

3. DISCONTINUED OPERATIONS AND ASSETS HELD FOR SALE (cont'd)

The major classes of Assets held for sale and Liabilities of operations held for sale are as follows:

	June 30, 2005	December 31, 2004
Current assets held for sale:		
Cash and time deposits	**-**	156
Trade receivables	**45**	308
Other receivables	**37**	40
Deferred income taxes	**-**	2
Inventories	**90**	285
	172	791
Long-term assets held for sale:		
Deferred charges and other assets	**14**	21
Deferred income taxes	**5**	6
Property, plant and equipment, net	**11**	85
Intangible assets, net	**-**	50
	30	162
Current liabilities of operations held for sale:		
Payables and accrued liabilities	**103**	330

Short-term borrowings	**1**	5
	104	335
Long-term liabilities of operations held for sale:		
Deferred credits and other liabilities	**6**	110
Deferred income taxes	**3**	4
Minority interests	**-**	135
	9	249

4. EARNINGS PER SHARE - BASIC AND DILUTED

Basic and diluted earnings per share are based on the weighted average number of shares outstanding during the period. The treasury stock method for calculating the dilutive impact of stock options is used. The following table outlines the calculation of basic and diluted earnings per share on income from continuing operations.

	Second Quarter		Six Months	
Periods ended June 30	**2005**	2004	**2005**	2004
Numerator:				
Income from continuing operations	**208**	285	**416**	419
Less: dividends on preference shares	**(1)**	(1)	**(3)**	(3)
Income from continuing operations attributable to common shareholders	**207**	284	**413**	416