

ALCOA INC
Form 10-Q
July 24, 2008

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the Quarterly Period Ended June 30, 2008

OR

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

Commission File Number 1-3610

ALCOA INC.

(Exact name of registrant as specified in its charter)

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PENNSYLVANIA
(State of incorporation)

25-0317820
(I.R.S. Employer Identification No.)

390 Park Avenue, New York, New York
(Address of principal executive offices)

10022-4608
(Zip code)

Investor Relations 212-836-2674

Office of the Secretary 212-836-2732

(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, and (2) has been subject to such filing requirements for the past 90 days. Yes No

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

Large accelerated filer Accelerated filer
Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company

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

As of July 21, 2008, 813,395,070 shares of common stock, par value \$1.00 per share, of the registrant were outstanding.

PART I FINANCIAL INFORMATION**Item 1. Financial Statements.****Alcoa and subsidiaries****Statement of Consolidated Income (unaudited)**

(in millions, except per-share amounts)

	Second quarter ended		Six months ended	
	June 30,		June 30,	
	2008	2007	2008	2007
Sales (L)	\$ 7,620	\$ 8,066	\$ 14,995	\$ 15,974
Cost of goods sold (exclusive of expenses below)	6,090	6,178	11,982	12,185
Selling, general administrative, and other expenses	306	367	634	724
Research and development expenses	64	55	130	107
Provision for depreciation, depletion, and amortization (B)	321	317	640	621
Restructuring and other charges (E)	2	(57)	40	(31)
Interest expense	87	86	186	169
Other income, net (K)	(97)	(60)	(39)	(104)
Total costs and expenses	6,773	6,886	13,573	13,671
Income from continuing operations before taxes on income	847	1,180	1,422	2,303
Provision for taxes on income (N)	231	354	436	689
Income from continuing operations before minority interests share	616	826	986	1,614
Less: Minority interests share	70	110	137	225
Income from continuing operations	546	716	849	1,389
Loss from discontinued operations (D)		(1)		(12)
NET INCOME	\$ 546	\$ 715	\$ 849	\$ 1,377
EARNINGS (LOSS) PER COMMON SHARE (M)				
Basic:				
Income from continuing operations	\$ 0.67	\$ 0.82	\$ 1.04	\$ 1.59
Loss from discontinued operations				(0.01)
Net income	\$ 0.67	\$ 0.82	\$ 1.04	\$ 1.58
Diluted:				
Income from continuing operations	\$ 0.66	\$ 0.81	\$ 1.03	\$ 1.58
Loss from discontinued operations				(0.02)
Net income	\$ 0.66	\$ 0.81	\$ 1.03	\$ 1.56
Dividends paid per common share	\$.17	\$.17	\$.34	\$.34

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

Alcoa and subsidiaries

Consolidated Balance Sheet (unaudited)

(in millions)

	June 30, 2008	December 31, 2007
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 815	\$ 483
Receivables from customers, less allowances of \$65 in 2008 and \$72 in 2007	3,063	2,602
Other receivables	458	451
Inventories (G)	3,813	3,326
Prepaid expenses and other current assets	1,393	1,224
Total current assets	9,542	8,086
Properties, plants, and equipment	33,953	31,601
Less: accumulated depreciation, depletion, and amortization	15,576	14,722
Properties, plants, and equipment, net	18,377	16,879
Goodwill	5,184	4,806
Investments (H)	3,353	2,038
Other assets	4,251	4,046
Assets held for sale (D)	19	2,948
Total assets	\$ 40,726	\$ 38,803
LIABILITIES		
Current liabilities:		
Short-term borrowings	\$ 609	\$ 569
Commercial paper	1,199	856
Accounts payable, trade	3,121	2,787
Accrued compensation and retirement costs	909	943
Taxes, including taxes on income	489	644
Other current liabilities	1,268	1,165
Long-term debt due within one year	47	202
Total current liabilities	7,642	7,166
Long-term debt, less amount due within one year	6,782	6,371
Accrued pension benefits	1,271	1,098
Accrued postretirement benefits	2,695	2,753
Other noncurrent liabilities and deferred credits	2,123	1,943
Deferred income taxes	635	545
Liabilities of operations held for sale (D)	17	451
Total liabilities	21,165	20,327

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MINORITY INTERESTS	2,859	2,460
COMMITMENTS AND CONTINGENCIES (J)		
SHAREHOLDERS EQUITY		
Preferred stock	55	55
Common stock	925	925
Additional capital	5,827	5,774
Retained earnings	13,607	13,039
Treasury stock, at cost	(3,852)	(3,440)
Accumulated other comprehensive income (loss)	140	(337)
Total shareholders equity	16,702	16,016
Total liabilities and equity	\$ 40,726	\$ 38,803

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

Alcoa and subsidiaries**Statement of Consolidated Cash Flows (unaudited)****(in millions)**

	Six months ended June 30,	
	2008	2007
CASH FROM OPERATIONS		
Net income	\$ 849	\$ 1,377
Adjustments to reconcile net income to cash from operations:		
Depreciation, depletion, and amortization (B)	640	621
Deferred income taxes	(188)	46
Equity income, net of dividends	(46)	(72)
Restructuring and other charges (E)	40	(31)
Gains from investing activities – asset sales (K)	(9)	(1)
Provision for doubtful accounts	4	1
Loss from discontinued operations (D)		12
Minority interests	137	225
Stock-based compensation	70	51
Excess tax benefits from stock-based payment arrangements	(15)	(36)
Other	(18)	(68)
Changes in assets and liabilities, excluding effects of acquisitions, divestitures, and foreign currency translation adjustments:		
(Increase) in receivables	(102)	(51)
(Increase) decrease in inventories	(336)	218
(Increase) in prepaid expenses and other current assets	(126)	(102)
Increase (decrease) in accounts payable, trade	205	(76)
(Decrease) in accrued expenses	(219)	(35)
Increase (decrease) in taxes, including taxes on income	52	(92)
Cash received on long-term aluminum supply contract		93
Pension contributions	(67)	(91)
Net change in noncurrent assets and liabilities	(168)	(40)
Decrease (increase) in net assets held for sale	16	(72)
CASH PROVIDED FROM CONTINUING OPERATIONS	719	1,877
CASH USED FOR DISCONTINUED OPERATIONS		(1)
CASH PROVIDED FROM OPERATIONS	719	1,876
FINANCING ACTIVITIES		
Net change in short-term borrowings	30	67
Net change in commercial paper	343	(1,034)
Additions to long-term debt	432	2,035
Debt issuance costs (I)	(6)	(126)
Payments on long-term debt (I)	(190)	(387)
Common stock issued for stock compensation plans	176	428
Excess tax benefits from stock-based payment arrangements	15	36
Repurchase of common stock	(605)	(253)
Dividends paid to shareholders	(280)	(297)
Dividends paid to minority interests	(117)	(204)
Contributions from minority interests	299	217
CASH PROVIDED FROM FINANCING ACTIVITIES	97	482

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INVESTING ACTIVITIES

Capital expenditures	(1,544)	(1,674)
Acquisitions, net of cash acquired (F)	(276)	(15)
Acquisitions of minority interests (F)	(94)	
Proceeds from the sale of assets and businesses (F)	2,636	
Additions to investments (H)	(1,237)	(56)
Sales of investments	5	27
Net change in short-term investments and restricted cash	(3)	3
Other	(17)	1

CASH USED FOR INVESTING ACTIVITIES	(530)	(1,714)
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EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS	46	18
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Net change in cash and cash equivalents	332	662
Cash and cash equivalents at beginning of year	483	506

CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 815	\$ 1,168
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The accompanying notes are an integral part of the consolidated financial statements.

Alcoa and subsidiaries

Statement of Shareholders' Equity (unaudited)

(in millions, except per-share amounts)

	Preferred stock	Common stock	Additional capital	Retained earnings	Treasury stock	Accumulated other comprehensive (loss) income	Total shareholders equity
Balance at March 31, 2007	\$ 55	\$ 925	\$ 5,790	\$ 11,579	\$ (1,953)	\$ (974)	\$ 15,422
Net income				715			715
Other comprehensive income (P)						607	607
Cash dividends:							
Common @ \$0.17 per share				(148)			(148)
Stock-based compensation			27				27
Common stock issued: compensation plans			(101)		475		374
Repurchase common stock					(165)		(165)
Balance at June 30, 2007	\$ 55	\$ 925	\$ 5,716	\$ 12,146	\$ (1,643)	\$ (367)	\$ 16,832
Balance at March 31, 2008	\$ 55	\$ 925	\$ 5,782	\$ 13,063	\$ (3,823)	\$ (189)	\$ 15,813
Net income				546			546
Other comprehensive income (P)						329	329
Cash dividends:							
Adjustment to common dividends declared				(2)			(2)
Stock-based compensation			33				33
Common stock issued: compensation plans			12		146		158
Repurchase common stock					(175)		(175)
Balance at June 30, 2008	\$ 55	\$ 925	\$ 5,827	\$ 13,607	\$ (3,852)	\$ 140	\$ 16,702
Balance at December 31, 2006	\$ 55	\$ 925	\$ 5,817	\$ 11,066	\$ (1,999)	\$ (1,233)	\$ 14,631
Net income				1,377			1,377
Other comprehensive income (P)						866	866
Cash dividends:							
Preferred @ \$1.875 per share				(1)			(1)
Common @ \$0.34 per share				(296)			(296)
Stock-based compensation			51				51
Common stock issued: compensation plans			(152)		609		457
Repurchase common stock					(253)		(253)
Balance at June 30, 2007	\$ 55	\$ 925	\$ 5,716	\$ 12,146	\$ (1,643)	\$ (367)	\$ 16,832
Balance at December 31, 2007	\$ 55	\$ 925	\$ 5,774	\$ 13,039	\$ (3,440)	\$ (337)	\$ 16,016
Net income				849			849
Other comprehensive income (P)						477	477
Cash dividends:							
Preferred @ \$1.875 per share				(1)			(1)
Common @ \$0.34 per share				(280)			(280)
Stock-based compensation			70				70
Common stock issued: compensation plans			(17)		193		176
Repurchase common stock					(605)		(605)

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Balance at June 30, 2008	\$	55	\$	925	\$	5,827	\$	13,607	\$	(3,852)	\$	140	\$	16,702
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The accompanying notes are an integral part of the consolidated financial statements.

Alcoa and subsidiaries**Notes to the Consolidated Financial Statements (unaudited)**

(dollars in millions, except per-share amounts)

A. Basis of Presentation The Consolidated Financial Statements (the Financial Statements) of Alcoa Inc. and its subsidiaries (Alcoa or the company) are unaudited. The Financial Statements include all adjustments, consisting of normal recurring adjustments, considered necessary by management to fairly state the results of operations, financial position, and cash flows. The results reported in these Financial Statements are not necessarily indicative of the results that may be expected for the entire year. The 2007 year-end balance sheet data was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America. This Form 10-Q report should be read in conjunction with Alcoa's Annual Report on Form 10-K for the year ended December 31, 2007, which includes all disclosures required by accounting principles generally accepted in the United States of America. Certain amounts in the prior period Statement of Consolidated Cash Flows have been reclassified to conform to the current period presentation.

B. Properties, Plants, and Equipment During the first quarter of 2008, Alcoa completed a review of the estimated useful lives of its alumina refining and aluminum smelting facilities. Such a review was performed because considerable engineering data and other information (readily available due to the recent construction of the Iceland smelter as well as various expansions and other growth projects in-process or completed over the past two years) indicated that the useful lives of many of the assets in these businesses were no longer appropriate. As a result of this review, for the majority of its refining and smelting locations, Alcoa extended the useful lives of structures to an average of 26 and 32 years (previously 23 and 29 years), respectively, and machinery and equipment to an average of 27 and 20 years (previously 17 and 19 years), respectively. The extension of depreciable lives qualifies as a change in accounting estimate and was made on a prospective basis effective January 1, 2008. For the 2008 second quarter and six-month period, Depreciation, depletion, and amortization expense was \$8 (after-tax and minority interests) and \$11 (after-tax and minority interests), respectively, less than it would have been had the depreciable lives not been extended. The effect of this change on basic and diluted earnings per share for both periods was \$0.01. Alcoa is performing a similar study related to its facilities in the Flat-Rolled Products and Engineered Products and Solutions segments and expects to complete this analysis late in 2008.

C. Recently Adopted and Recently Issued Accounting Standards On January 1, 2008, Alcoa adopted Statement of Financial Accounting Standards (SFAS) No. 159, The Fair Value Option for Financial Assets and Financial Liabilities including an amendment of FASB Statement No. 115, (SFAS 159). SFAS 159 permits entities to choose to measure many financial instruments and certain other assets and liabilities at fair value on an instrument-by-instrument basis (the fair value option) with changes in fair value reported in earnings. Alcoa already records marketable securities at fair value in accordance with SFAS No. 115, Accounting for Certain Investments in Debt and Equity Securities, and derivative contracts and hedging activities at fair value in accordance with SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, as amended (SFAS 133). The adoption of SFAS 159 had no impact on the Financial Statements as management did not elect the fair value option for any other financial instruments or certain other assets and liabilities.

On January 1, 2008, Alcoa adopted SFAS No. 157, Fair Value Measurements, (SFAS 157) as it relates to financial assets and financial liabilities. In February 2008, the Financial Accounting Standards Board (FASB) issued FASB Staff Position (FSP) No. FAS 157-2, Effective Date of FASB Statement No. 157, which delayed the effective date of SFAS 157 for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on at least an annual basis, until January 1, 2009 for calendar year-end entities. Also in February 2008, the FASB issued FSP No. FAS 157-1, Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement under Statement 13, which states that SFAS No. 13, Accounting for Leases, (SFAS 13) and other accounting pronouncements that address fair value measurements for purposes of lease classification or measurement under SFAS 13 are excluded from the provisions of SFAS 157, except for assets and liabilities related to leases assumed in a business combination that are required to be measured at fair value under SFAS No. 141, Business Combinations, (SFAS 141) or SFAS No. 141 (revised 2007), Business Combinations, (SFAS 141(R)).

SFAS 157 defines fair value, establishes a framework for measuring fair value in accounting principles generally accepted in the United States of America (GAAP), and expands disclosures about fair value measurements. The provisions of this standard apply to other accounting pronouncements that

require or permit fair value measurements and are to be applied prospectively with limited exceptions. The adoption of SFAS 157, as it relates to financial assets, except for pension plan assets in regards to the funded status of pension plans recorded on the Consolidated Balance Sheet, and financial liabilities, had no impact on the Financial Statements. Management is currently evaluating the potential impact of SFAS 157, as it relates to pension plan assets, nonfinancial assets, and nonfinancial liabilities, on the Financial Statements.

SFAS 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. This standard is now the single source in GAAP for the definition of fair value, except for the fair value of leased property as defined in SFAS 13. SFAS 157 establishes a fair value hierarchy that distinguishes between (1) market participant assumptions developed based on market data obtained from independent sources (observable inputs) and (2) an entity's own assumptions about market participant assumptions developed based on the best information available in the circumstances (unobservable inputs). The fair value hierarchy consists of three broad levels, which gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). The three levels of the fair value hierarchy under SFAS 157 are described below:

Level 1 - Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.

Level 2 - Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly, including quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in markets that are not active; inputs other than quoted prices that are observable for the asset or liability (e.g., interest rates); and inputs that are derived principally from or corroborated by observable market data by correlation or other means.

Level 3 - Inputs that are both significant to the fair value measurement and unobservable.

The following sections describe the valuation methodologies used by Alcoa to measure different financial instruments at fair value, including an indication of the level in the fair value hierarchy in which each instrument is generally classified. Where appropriate the description includes details of the valuation models, the key inputs to those models, and any significant assumptions.

Available-for-sale securities. Alcoa uses quoted market prices to determine the fair value of available-for-sale securities. These financial instruments consist of exchange-traded fixed income and equity securities, and are classified in Level 1 of the fair value hierarchy.

Derivative contracts. Derivative contracts are valued using quoted market prices and significant other observable and unobservable inputs. Such financial instruments consist of aluminum, interest rate, commodity (principally energy-related), and foreign currency contracts. The fair values for the majority of these derivative contracts are based upon current quoted market prices. These financial instruments are typically exchange-traded and are generally classified within Level 1 or Level 2 of the fair value hierarchy depending on whether the exchange is deemed to be an active market or not.

For certain derivative contracts whose fair values are based upon trades in liquid markets, such as aluminum options, valuation model inputs can generally be verified and valuation techniques do not involve significant management judgment. The fair values of such financial instruments are generally classified within Level 2 of the fair value hierarchy.

Alcoa has other derivative contracts that do not have observable market quotes. For these financial instruments, management uses significant other observable inputs (i.e., information concerning time premiums and volatilities for certain option type embedded derivatives and regional premiums for swaps). For periods beyond the term of quoted market prices for aluminum, Alcoa uses a macroeconomic model that estimates the long-term price of aluminum based on anticipated changes in worldwide supply and demand. Where appropriate, valuations are adjusted for various factors such as liquidity, bid/offer spreads, and credit considerations. Such adjustments are generally based on available market evidence (Level 2). In the absence of such evidence, management's best estimate is used (Level 3).

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The following table presents Alcoa's assets and liabilities that are measured and recognized at fair value on a recurring basis classified under the appropriate level of the fair value hierarchy as of June 30, 2008:

	Level 1	Level 2	Level 3	Collateral*	Total
Assets:					
Available-for-sale securities	\$ 78	\$	\$	\$	\$ 78
Derivative contracts	99	33	124	(59)	197
 Total assets	 \$ 177	 \$ 33	 \$ 124	 \$ (59)	