BUCKEYE TECHNOLOGIES INC
Form 10-Q
October 25, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2007

¨ **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: 33-60032

Buckeye Technologies Inc.
Delaware
(state or other jurisdiction of incorporation)

Internal Revenue Service — Employer Identification No. 62-1518973

1001 Tillman Street, Memphis, TN 38112
901-320-8100

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 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” or “large accelerated filer” in Rule 12b-2 of the Exchange Act. (Check one).

Large accelerated filer ¨ Accelerated filer x Non-accelerated filer ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes ¨ No x

As of October 24, 2007, there were outstanding 39,083,682 Common Shares of the Registrant.

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BUCKEYE TECHNOLOGIES INC.

Item 1. Financial Statements

PART I - FINANCIAL INFORMATION

BUCKEYE TECHNOLOGIES INC.
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

(In thousands, except per share data)

	Three Months Ended September 30	
	2007	2006
Net sales	$ 197,399	$ 191,406
Cost of goods sold	156,744	162,071
Gross margin	40,655	29,335
Selling, research and administrative expenses	11,474	11,204
Amortization of intangibles and other	561	631
Restructuring costs	96	13
Operating income	28,524	17,487
Net interest expense and amortization of debt costs	(9,157)	(10,751)
Gain on sale of assets held for sale	-	355
Loss on early extinguishment of debt	(786)	(556)
Foreign exchange and other	(168)	6
Income before income taxes	18,413	6,541
Income tax expense	4,916	2,734
Net income	$ 13,497	$ 3,807
Earnings per share		
Basic	$ 0.35	$ 0.10
Diluted	$ 0.34	$ 0.10
Weighted average shares for earnings per share		
Basic	38,743	37,661
Effect of diluted shares	517	31
Diluted	39,260	37,692

See accompanying notes.

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BUCKEYE TECHNOLOGIES INC.
CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands)

	September 30 2007 (Unaudited)	June 30 2007
Assets		
Current assets:		
Cash and cash equivalents	$ 14,003	$ 14,790
Accounts receivable – net	120,199	116,865
Inventories – net	94,050	86,777
Deferred income taxes and other	9,514	9,452
Total current assets	237,766	227,884
Property, plant and equipment	1,038,757	1,016,299
Less accumulated depreciation	(497,175)	(478,644)
	541,582	537,655
Goodwill	162,116	155,937
Intellectual property and other, net	30,439	30,346
Total assets	$ 971,903	$ 951,822
Liabilities and stockholders' equity		
Current liabilities:		
Trade accounts payable	$ 42,032	$ 41,030
Accrued expenses	58,861	49,532
Current portion of capital lease obligation	407	399
Short-term debt	505	-
Total current liabilities	101,805	90,961
Long-term debt	418,917	445,138
Accrued postretirement benefits	24,622	24,509
Deferred income taxes	47,019	41,761
Capital lease obligation	251	356
Other liabilities	1,493	1,943
Stockholders' equity	377,796	347,154
Total liabilities and stockholders' equity	$ 971,903	$ 951,822

See accompanying notes.

BUCKEYE TECHNOLOGIES INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(In thousands)

	Three Months Ended September 30 2007	Three Months Ended September 30 2006
Operating activities		
Net income	$ 13,497	$ 3,807
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	12,629	12,146
Amortization	502	937
Loss on early extinguishment of debt	786	556
Deferred income taxes and other	4,915	1,276
Gain on sale of assets held for sale	-	(355)
Excess tax benefit from stock based compensation	(15)	-
Changes in operating assets and liabilities:		
Accounts receivable	(1,726)	2,745
Inventories	(5,571)	6,681
Other assets	(219)	(1,294)
Accounts payable and other current liabilities	6,955	13,465
Net cash provided by operating activities	31,753	39,964
Investing activities		
Purchases of property, plant and equipment	(8,990)	(6,605)
Proceeds from sale of assets	-	521
Other	(46)	(124)
Net cash used in investing activities	(9,036)	(6,208)
Financing activities		
Net borrowings (payments) under lines of credit	88,267	(3,000)
Payments for debt issuance costs	(1,289)	-
Payments on long-term debt and other	(113,719)	(21,429)
Net proceeds from sale of equity interests	2,705	-
Excess tax benefit from stock based compensation	15	-
Net cash used in financing activities	(24,021)	(24,429)
Effect of foreign currency rate fluctuations on cash	517	(3)
Increase (decrease) in cash and cash equivalents	(787)	9,324
Cash and cash equivalents at beginning of period	14,790	8,734
Cash and cash equivalents at end of period	$ 14,003	$ 18,058

See accompanying notes.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

(In thousands)

NOTE 1: BASIS OF PRESENTATION

Our accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (including normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three months ended September 30, 2007 are not necessarily indicative of the results that may be expected for the fiscal year ending June 30, 2008. All significant intercompany accounts and transactions have been eliminated in consolidation. For further information and a listing of our significant accounting policies, refer to the financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended June 30, 2007, which was filed with the Securities and Exchange Commission on September 7, 2007 (“Annual Report”). Except as otherwise specified, references to years indicate our fiscal year ending June 30, 2008 or ended June 30 of the year referenced and comparisons are to the corresponding period of the prior year.

Translation adjustment

Management has determined that the local currency of our German, Canadian, and Brazilian subsidiaries is the functional currency, and accordingly European euro, Canadian dollar, and Brazilian real denominated balance sheet accounts are translated into U.S. dollars at the rate of exchange in effect at the balance sheet date. Income and expense activity for the period is translated at the weighted average exchange rate during the period. Translation adjustments are included as a separate component of stockholders' equity.

Use of estimates

The preparation of the consolidated financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from the estimates and assumptions used.

Changes in estimates are recognized in accordance with the accounting rules for the estimate, which is typically in the period when new information becomes available to management. Areas where the nature of the estimate makes it reasonably possible that actual results could materially differ from amounts estimated include: impairment assessments on long-lived assets (including goodwill), allowance for doubtful accounts, inventory reserves, income tax liabilities and contingent liabilities.

NOTE 2: SEGMENT INFORMATION

We report results for two segments, specialty fibers and nonwoven materials. The specialty fiber segment is an aggregation of cellulosic fibers based on both wood and cotton. Management makes financial decisions and allocates resources based on the sales and operating income of each segment. We allocate selling, research and administrative expenses to each segment, and management uses the resulting operating income to measure the performance of the segments. The financial information attributed to these segments is included in the following table:

Three Months Ended September 30		Specialty Fibers	Nonwoven Materials	Corporate	Total
Net sales	2007	$ 135,701	$ 71,630	$ (9,932)	$ 197,399
	2006	134,875	64,967	(8,436)	191,406
Operating income (loss)	2007	22,066	7,954	(1,496)	28,524
	2006	12,288	5,979	(780)	17,487
Depreciation and amortization of intangibles	2007	8,015	4,232	944	13,191
	2006	7,698	4,171	954	12,823
Capital expenditures	2007	7,920	707	363	8,990
	2006	5,573	417	615	6,605

Management evaluates operating performance of the specialty fibers and nonwoven materials segments excluding amortization of intangibles, the impact of impairment of long-lived assets and charges related to restructuring. Therefore, the corporate segment includes operating elements such as segment eliminations, amortization of intangibles, non-allocated administrative costs, impairment of long-lived assets and charges related to restructuring. Corporate net sales represent the elimination of intersegment sales included in the specialty fibers reporting segment. Intersegment sales are at current market prices.

NOTE 3: RESTRUCTURING COSTS AND ASSETS HELD FOR SALE

During fiscal 2007, we entered into a restructuring program that complements our operations' consolidations and involves consolidation in our European sales offices, product and market development and corporate overhead. The total cost of this program was $1,358 and was completed during the three months ended September 30, 2007. The remaining accrual of $204 will be paid over the next six months. As a result of this restructuring, 22 positions have been eliminated which will provide annual savings over $2,000.

	Period Ended September 30, 2007					
	Accrual Balance as of June 30, 2007	Additional Charges	Impact of Foreign Currency	Payments	Accrual Balance as of September 30, 2007	Program Charges to Date
2007 Restructuring Program						
Severance and employee benefits						
Specialty fibers	$ -	$ 26	$ -	$ (26)	$ -	$ 791
Corporate	199	68	-	(169)	98	432
Other miscellaneous expenses						
Specialty fibers	128	2	5	(29)	106	135
Total 2007 Program	$ 327	$ 96	$ 5	$ (224)	$ 204	$ 1,358

In September 2006, the remaining assets located at our Glueckstadt facility were sold for $520. Since we previously had written the value of these assets down to $165, we recorded a gain on sale of assets held for sale of $355 during the three months ended September 30, 2006. For the three months ending September 30, 2006, $13 in restructuring costs were recorded.

NOTE 4: INVENTORIES

Inventories are valued at the lower of cost or market. The costs of manufactured cotton-based specialty fibers and costs for nonwoven raw materials are generally determined on the first-in, first-out basis. Other manufactured products and raw materials are generally valued on an average cost basis. Manufactured inventory costs include material, labor and manufacturing overhead. Slash pine timber, cotton fibers and chemicals are the principal raw materials used in the manufacture of our specialty fiber products. Fluff pulp is the principal raw material used in our nonwoven materials products. We take physical counts of inventories at least annually, and we review periodically the provision for potential losses from obsolete, excess or slow-moving inventories.

The components of inventory consist of the following:

	September 30 2007	June 30 2007
Raw materials	$ 25,551	$ 25,816
Finished goods	46,461	39,335
Storeroom and other supplies	22,038	21,626
	$ 94,050	$ 86,777

NOTE 5: DEBT

The components of long-term debt consist of the following:

	September 30 2007	June 30 2007
Senior Notes due:		
2013	$ 200,000	$ 200,000
Senior Subordinated Notes due:		
2008	-	59,948
2010	131,254	151,568
Credit facility	87,663	33,622
	$ 418,917	$ 445,138

Senior Notes - During September 2003, we placed privately $200,000 in aggregate principal amount of 8.5% Senior Notes due October 1, 2013. In fiscal year 2004, we exchanged these outstanding notes for public notes with the same terms. The notes are unsecured obligations and are senior to any of our subordinated debt. The notes are guaranteed by our direct and indirect domestic subsidiaries that are also guarantors on our senior secured indebtedness. The senior notes are redeemable at our option, in whole or part, at any time on or after October 1, 2008, at redemption prices varying from 104.25% of principal amount to 100% of principal amount on or after October 1, 2011, together with accrued and unpaid interest to the date of redemption.

Senior Subordinated Notes - During July 1996, we completed a public offering of $100,000 in aggregate principal amount of 9.25% unsecured Senior Subordinated Notes due September 15, 2008 (the “2008 Notes”). These notes have been redeemable at our option, in whole or in part, at any time since September 15, 2004, at a redemption price of 100% of principal amount together with accrued and unpaid interest to the date of redemption.

Through fiscal year 2007, we redeemed $40,000 of the 2008 Notes. As a result of these redemptions, we wrote off a portion of the deferred financing costs and unamortized discount related to the redeemed bonds.

On September 17, 2007, we redeemed the remaining $60,000 of the 2008 Notes. As a result of this redemption, we wrote off the remaining balance of deferred financing costs and unamortized discount related to the 2008 Notes. During the three months ended September 30, 2007, we recorded non-cash expenses of $206 related to the early extinguishment of this debt.

During June 1998, we completed a private placement of $150,000 principal amount of 8% unsecured Senior Subordinated Notes due October 15, 2010. In fiscal year 1999, we exchanged these outstanding notes for public notes with the same terms. These notes have been redeemable at our option, in whole or in part, at any time since October 15, 2006, at a redemption price of 100% of principal amount together with accrued and unpaid interest to the date of redemption.

On September 24, 2007, we redeemed $20,000 of the 2010 Notes. As a result of this redemption, we wrote off a portion of the deferred financing costs and unamortized discount related to the 2010 Notes. During the three months ended September 30, 2007, we recorded non-cash expenses of $153 related to the early extinguishment of this debt.

Revolving Credit Facility - On July 25, 2007, we established a $200,000 senior secured revolving credit facility with a maturity date of July 25, 2012. This facility amends and restates the Company's existing credit facility. Initially, we used proceeds from this new credit facility and cash from operations to pay the outstanding balance on the former credit facility plus fees and expenses. The interest rate applicable to borrowings under the revolver is the agent’s prime rate plus 0.25% to 1.00% or a LIBOR-based rate ranging from LIBOR plus 1.25% to LIBOR plus 2.00%. We used proceeds from this facility to redeem the remaining $60,000 of our 2008 notes and to redeem $20,000 of the 2010 notes in mid-September 2007. The credit facility is secured by substantially all of our assets located in the United States.

The credit facility contains covenants customary for financing of this type. The financial covenants include: maximum total leverage ratio of consolidated total debt to consolidated earnings before interest, taxes, depreciation and amortization (“EBITDA”), and minimum ratio of consolidated EBITDA to consolidated interest expense. As of September 30, 2007, we are in compliance with the financial covenants under the new credit facility.

As of September 30, 2007, we had $107,271 available on the revolving credit facility. The commitment fee, on the unused portion of the revolving credit facility, ranges from 0.25% to 0.40% per annum based on a grid related to our leverage ratio. Total costs for the issuance of the facility were approximately $1,300 and are being amortized to interest expense using the effective interest method over the life of the facility. During the three months ended September 30, 2007, $427 was expensed as early extinguishment of debt related to the write-off of deferred financing costs for the former credit facility.

On September 17, 2007, we entered into an interest rate swap agreement for $30,000 maturing on September 17, 2009. The swap involves the exchange of interest payments from a floating-rate three month LIBOR plus the applicable margin on the revolving credit facility to a fixed rate of 4.79% plus the same applicable margin. This arrangement qualifies as a cash flow hedge under SFAS 133 and, therefore, the net effect from the interest rate swap is being recorded as part of interest expense. During the three months ended September 30, 2007, the swap reduced our interest expense by $10.

NOTE 6: COMPREHENSIVE INCOME

The components of comprehensive income consist of the following:

	Three Months Ended September 30	
	2007	2006
Net income	$ 13,497	$ 3,807
Foreign currency translation adjustments – net	14,909	(975)
Comprehensive income	$ 28,406	$ 2,832

For the three months ended September 30, 2007, the change in the foreign currency translation adjustment is due to fluctuations in the exchange rate of the U.S. dollar against the euro of $3,718, the Brazilian real of $2,493 and the Canadian dollar of $8,698.

For the three months ended September 30, 2006, the change in the foreign currency translation adjustment was primarily due to fluctuations in the exchange rate of the U.S. dollar against the euro of $(233), the Brazilian real of $(291) and the Canadian dollar of $(630).

NOTE 7: INCOME TAXES

On July 1, 2007, we adopted the provisions of FASB Interpretation No. (“FIN”) 48, “*Accounting for Uncertainty in Income Taxes.*” FIN 48 clarifies the accounting for income taxes by prescribing the minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. As a result of the adoption, we recorded an adjustment of approximately $878 to reduce the opening balance of retained earnings. At adoption, our unrecognized tax benefits totaled $1,806. Cumulative potential interest and penalties accrued related to unrecognized tax benefits at the date of adoption totaled $164. We include interest and penalties related to income tax matters as a component of net income before income tax expense. All unrecognized tax benefits at adoption would affect the effective tax rate, if recognized.

We file income tax returns with federal, state, local and foreign jurisdictions. As of September 30, 2007, we remain subject to examinations of our U.S. federal income tax returns for the years 2003 through 2006, state income tax returns for the years 2002 through 2006 and German tax filings for the years 2003 through 2006.

Our effective tax rate for the three month period ended September 30, 2007 was 26.7%. Our effective tax rate for the same period of 2006 was 41.8%. The rate decrease for the three month period ended September 30, 2007 resulted from a recently enacted German tax rate reduction. Our income tax expense differs from the amount computed by applying the statutory federal income tax rate of 35% to income before income taxes due to the following:

	Three Months Ended September 30	
	2007	2006
Expected tax expense at 35%	$ 6,444	$ 2,289
German tax rate change	(2,245)	-
Effect of foreign operations	762	849
Other	(45)	(404)
Income tax expense	$ 4,916	$ 2,734

NOTE 8: EMPLOYEE BENEFIT PLANS

We provide medical, dental and life insurance postretirement plans covering certain U.S. employees who meet specified age and service requirements. Pursuant to an amendment, effective January 1, 2006, Medicare eligible retirees age 65 or older are no longer covered under the self-funded plan. Instead they are provided a subsidy towards the purchase of supplemental insurance. The components of net periodic benefit costs are as follows:

	Three Months Ended September 30	
	2007	2006
Service cost for benefits earned	$ 151	$ 149
Interest cost on benefit obligation	350	352
Amortization of unrecognized prior service cost	(251)	(250)
Actuarial loss	146	142
Total cost	$ 396	$ 393

NOTE 9: CONDENSED CONSOLIDATING FINANCIAL STATEMENTS

The guarantor subsidiaries presented below represent our subsidiaries that are subject to the terms and conditions outlined in the indenture governing the senior notes and that guarantee the notes, jointly and severally, on a senior unsecured basis. The non-guarantor subsidiaries presented below represent the foreign subsidiaries that do not guarantee the senior notes. Each subsidiary guarantor is 100% owned directly or indirectly by us and all guarantees are full and unconditional.

Our supplemental financial information and our guarantor subsidiaries and non-guarantor subsidiaries for the senior notes are presented in the following tables.

CONDENSED CONSOLIDATING STATEMENTS OF OPERATIONS
Three Months Ended September 30, 2007

	Buckeye Technologies Inc.	Guarantors US Subsidiaries	Non-Guarantor Subsidiaries	Consolidating Adjustments	Consolidated
Net sales	$ 27,603	$ 127,727	$ 53,228	$ (11,159)	$ 197,399
Cost of goods sold	23,033	98,686	46,139	(11,114)	156,744
Gross margin	4,570				