FERRO CORP
Form 10-Q
August 01, 2011

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

(**Mark One**)

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

For the quarterly period ended June 30, 2011

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 1-584

FERRO CORPORATION

(Exact name of registrant as specified in its charter)

Ohio	**34-0217820**
(State of Corporation)	(IRS Employer Identification No.)
1000 Lakeside Avenue	**44114**
Cleveland, OH	(Zip Code)
(Address of Principal executive offices)	

216-641-8580

(Telephone Number)

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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES þ NO o

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

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

At June 30, 2011, there were 86,569,287 shares of Ferro Common Stock, par value $1.00, outstanding.

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements (Unaudited)
Ferro Corporation and Subsidiaries
Condensed Consolidated Statements of Income

	Three months ended June 30,		Six months ended June 30,	
	2011	2010	2011	2010
	(Dollars in thousands, except per share amounts)			
Net sales	$ 593,974	$ 543,485	$ 1,166,983	$ 1,036,350
Cost of sales	479,627	421,155	932,310	807,086
Gross profit	114,347	122,330	234,673	229,264
Selling, general and administrative expenses	73,548	69,852	150,366	140,800
Restructuring and impairment charges	1,545	21,205	3,175	34,537
Other expense (income):				
Interest expense	7,352	13,766	14,178	26,677
Interest earned	(69)	(133)	(143)	(464)
Foreign currency losses (gains), net	1,013	(302)	2,323	3,246
Miscellaneous (income) expense, net	(124)	(3,571)	394	(4,822)
Income before income taxes	31,082	21,513	64,380	29,290
Income tax expense	11,461	13,919	21,568	22,508
Net income	19,621	7,594	42,812	6,782
Less: Net income (loss) attributable to noncontrolling interests	232	494	533	(250)
Net income attributable to Ferro Corporation	19,389	7,100	42,279	7,032
Dividends on preferred stock		(165)	(165)	(330)
Net income attributable to Ferro Corporation common shareholders	$ 19,389	$ 6,935	$ 42,114	$ 6,702
Earnings per share attributable to Ferro Corporation common shareholders:				
Basic earnings per share	$ 0.23	$ 0.08	$ 0.49	$ 0.08
Diluted earnings per share	0.22	0.08	0.48	0.08
Dividends per share of common stock				

See accompanying notes to condensed consolidated financial statements.

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Ferro Corporation and Subsidiaries
Condensed Consolidated Balance Sheets

	June 30, 2011	December 31, 2010
	(Dollars in thousands)	
ASSETS		
Current assets		
Cash and cash equivalents	$ 27,368	$ 29,035
Accounts receivable, net	383,026	302,448
Inventories	253,107	202,067
Deposits for precious metals		28,086
Deferred income taxes	26,413	24,924
Other receivables	32,151	27,762
Other current assets	14,157	7,432
Total current assets	736,222	621,754
Other assets		
Property, plant and equipment, net	393,729	391,496
Goodwill	219,842	219,716
Amortizable intangible assets, net	11,767	11,869
Deferred income taxes	123,370	121,640
Other non-current assets	84,289	67,880
Total assets	$ 1,569,219	$ 1,434,355
LIABILITIES AND EQUITY		
Current liabilities		
Loans payable and current portion of long-term debt	$ 61,270	$ 3,580
Accounts payable	240,378	207,770
Income taxes	18,026	8,823
Accrued payrolls	35,908	49,590
Accrued expenses and other current liabilities	77,836	75,912
Total current liabilities	433,418	345,675
Other liabilities		
Long-term debt, less current portion	291,324	290,971
Postretirement and pension liabilities	184,292	189,058
Deferred income taxes	2,459	2,211
Other non-current liabilities	23,078	22,833
Total liabilities	934,571	850,748
Series A convertible preferred stock (approximates redemption value)		9,427
Equity		
Ferro Corporation shareholders equity:		
Common stock	93,436	93,436
Paid-in capital	317,522	323,015
Retained earnings	404,278	362,164

Accumulated other comprehensive loss	(37,646)	(50,949)
Common shares in treasury, at cost	(153,674)	(164,257)
Total Ferro Corporation shareholders equity	623,916	563,409
Noncontrolling interests	10,732	10,771
Total equity	634,648	574,180
Total liabilities and equity	$ 1,569,219	$ 1,434,355

See accompanying notes to condensed consolidated financial statements.

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Ferro Corporation and Subsidiaries
Condensed Consolidated Statements of Equity

	Ferro Corporation Shareholders							
	Common Shares in Treasury		Common	Paid-in	Retained	Accumulated Other Comprehensive Income	Non-controlling	Total
	Shares	Amount	Stock	Capital	Earnings	(Loss)	Interests	Equity
				(In thousands)				
Balances at December 31, 2009	7,375	$ (171,567)	$ 93,436	$ 331,376	$ 357,128	$ (60,147)	$ 10,269	$ 560,495
Net income (loss)					7,032		(250)	6,782
Other comprehensive income (loss), net of tax:								
Foreign currency translation						(25,726)	31	(25,695)
Postretirement benefit liabilities						(3,035)		(3,035)
Raw material commodity swaps						(107)		(107)
Interest rate swaps						1,930		1,930
Total comprehensive loss								(20,125)
Cash dividends: Preferred					(330)			(330)
Stock-based compensation transactions	(70)	2,838		(988)				1,850
Distributions to noncontrolling interests							(527)	(527)
Balances at June 30, 2010	7,305	$ (168,729)	$ 93,436	$ 330,388	$ 363,830	$ (87,085)	$ 9,523	$ 541,363
Balances at December 31, 2010	7,242	$ (164,257)	$ 93,436	$ 323,015	$ 362,164	$ (50,949)	$ 10,771	$ 574,180
Net income					42,279		533	42,812
Other comprehensive income (loss), net								

of tax:								
Foreign currency translation						10,335	116	10,451
Postretirement benefit liabilities						2,968		2,968
Total comprehensive income								56,231
Cash dividends:								
Preferred					(165)			(165)
Stock-based compensation transactions	(376)	10,583		(5,493)				5,090
Distributions to noncontrolling interests							(688)	(688)
Balances at June 30, 2011	6,866	$ (153,674)	$ 93,436	$ 317,522	$ 404,278	$ (37,646)	$ 10,732	$ 634,648

See accompanying notes to condensed consolidated financial statements.

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Ferro Corporation and Subsidiaries
Condensed Consolidated Statements of Cash Flows

	Six months ended June 30, 2011	2010
	(Dollars in thousands)	
Cash flows from operating activities		
Net cash (used for) provided by operating activities	$ (20,758)	$ 91,772
Cash flows from investing activities		
Capital expenditures for property, plant and equipment	(31,817)	(16,298)
Proceeds from sale of businesses		5,887
Proceeds from sale of assets	2,374	317
Other investing activities	193	
Net cash used for investing activities	(29,250)	(10,094)
Cash flows from financing activities		
Net borrowings (repayments) under loans payable	57,570	(18,787)
Proceeds from long-term debt	382,219	205,140
Principal payments on long-term debt	(381,771)	(256,840)
Redemption of convertible preferred stock	(9,427)	
Cash dividends paid	(165)	(330)
Other financing activities	(856)	974
Net cash provided by (used for) financing activities	47,570	(69,843)
Effect of exchange rate changes on cash and cash equivalents	771	(610)
(Decrease) increase in cash and cash equivalents	(1,667)	11,225
Cash and cash equivalents at beginning of period	29,035	18,507
Cash and cash equivalents at end of period	$ 27,368	$ 29,732
Cash paid during the period for:		
Interest	$ 12,575	$ 20,766
Income taxes	14,715	9,830

See accompanying notes to condensed consolidated financial statements.

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Ferro Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements

1. Basis of Presentation

Ferro Corporation (Ferro, we, us or the Company) prepared these unaudited condensed consolidated financial statements of Ferro Corporation and subsidiaries in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements and, therefore, should be read in conjunction with the consolidated financial statements and related notes included in our Annual Report on Form 10-K for the year ended December 31, 2010. The preparation of financial statements in conformity with U.S. GAAP requires us to make estimates and assumptions that affect the timing and amount of assets, liabilities, equity, revenues and expenses reported and disclosed. Actual amounts could differ from our estimates. In our opinion, we made all adjustments that are necessary for a fair presentation, and those adjustments are of a normal recurring nature unless otherwise noted. Due to differing business conditions, our various initiatives, and some seasonality, the results for the three and six months ended June 30, 2011, are not necessarily indicative of the results expected in subsequent quarters or for the full year. We combined the captions for impairment charges and restructuring charges in the prior-period statements of income to conform the presentation to the current period.

2. Recent Accounting Pronouncements

Accounting Standards Adopted in the Six Months Ended June 30, 2011

On January 1, 2011, we prospectively adopted Financial Accounting Standards Board (FASB) Accounting Standards Update (ASU) 2009-13, *Multiple Deliverable Revenue Arrangements*, (ASU 2009-13) and ASU 2010-17, *Revenue Recognition Milestone Method*, (ASU 2010-17). ASU 2009-13 applies to all deliverables in contractual arrangements in which a vendor will perform multiple revenue-generating activities. ASU 2010-17 defines a milestone and determines when it may be appropriate to apply the milestone method of revenue recognition for research or development transactions. These pronouncements are codified in *FASB Accounting Standards Codification™* (ASC) Topic 605, Revenue Recognition. Adoption of these pronouncements did not have a material effect on our consolidated financial statements.

New Accounting Pronouncements Not Yet Adopted

In May 2011, the FASB issued ASU 2011-04, *Fair Value Measurement: Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*, (ASU 2011-04), which is codified in ASC Topic 820, Fair Value Measurement. This pronouncement changes certain fair value measurement guidance and expands certain disclosure requirements. ASU 2011-04 will be effective for our fiscal year that begins January 1, 2012, and is to be applied prospectively. We do not expect that adoption of this pronouncement on January 1, 2012, will have a material effect on our consolidated financial statements.

In June 2011, the FASB issued ASU 2011-05, *Presentation of Comprehensive Income*, (ASU 2011-05), which is codified in ASC Topic 220, Comprehensive Income. This pronouncement requires companies to present items of net income, items of other comprehensive income and total comprehensive income in one continuous statement or two separate but consecutive statements and will be effective for our fiscal year that begins January 1, 2012. ASU 2011-05 is to be applied retrospectively, and early adoption is permitted. Adoption of this pronouncement will not have a material effect on our consolidated financial statements.

3. Inventories

Inventories consisted of the following:

	June 30, 2011	December 31, 2010
	(Dollars in thousands)	
Raw materials	$ 86,548	$ 63,856
Work in process	48,069	38,684
Finished goods	118,490	99,527

Total inventories	$ 253,107	$ 202,067

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In the production of some of our products, we use precious metals, some of which we obtain from financial institutions under consignment agreements with terms of one year or less. The financial institutions retain ownership of the precious metals and charge us fees based on the amounts we consign. These fees were $2.7 million and $1.3 million for the three months ended June 30, 2011 and 2010, respectively, and $4.7 million and $2.4 million for the six months ended June 30, 2011 and 2010, respectively, and were charged to cost of sales. We had on hand precious metals owned by participants in our precious metals consignment program of $269.1 million at June 30, 2011, and $205.7 million at December 31, 2010, measured at fair value based on market prices for identical assets. At December 31, 2010, we had delivered $28.1 million in cash collateral as a result of the market value of the precious metals under consignment exceeding the credit lines provided by some of the financial institutions. At June 30, 2011, no cash collateral was outstanding.

4. Property, Plant and Equipment

Property, plant and equipment is reported net of accumulated depreciation of $622.4 million at June 30, 2011, and $594.3 million at December 31, 2010. Unpaid capital expenditure liabilities, which are noncash investing activities, were $7.3 million at June 30, 2011, and $6.1 million at June 30, 2010.

5. Financing and Long-term Debt

Loans payable and current portion of long-term debt consisted of the following:

	June 30, 2011	December 31, 2010
	(Dollars in thousands)	
Loans payable to banks	$ 2,313	$ 709
Domestic accounts receivable asset securitization program	45,000	
International accounts receivable sales programs	11,003	
Current portion of long-term debt	2,954	2,871
Total loans payable and current portion of long-term debt	$ 61,270	$ 3,580

Long-term debt consisted of the following:

	June 30, 2011	December 31, 2010
	(Dollars in thousands)	
7.875% Senior Notes	$ 250,000	$ 250,000
6.50% Convertible Senior Notes, net of unamortized discounts	33,789	33,368
Revolving credit facility	448	
Capitalized lease obligations	5,721	6,177
Other notes	4,320	4,297
Total long-term debt	294,278	293,842
Less current portion	(2,954)	(2,871)
Total long-term debt, less current portion	$ 291,324	$ 290,971

Receivable Sales Programs

We have an asset securitization program for Ferro s U.S. trade accounts receivable. In May 2011, we made certain modifications to and extended the maturity of this $50.0 million facility through May 2012. We sell interests in our domestic receivables to various purchasers, and we may obtain up to $50.0 million in the form of cash or, under the current program, letters of credit. Advances received under this program are accounted for as borrowings secured by the receivables and included in net cash provided by financing activities. At June 30, 2011, advances received of

$45.0 million were secured by $114.5 million of accounts receivable. The interest rate under this program is the sum of (A) either (1) commercial paper rates, (2) LIBOR rates, or (3) the federal funds rate plus 0.5% or the prime rate and (B) a fixed margin. At June 30, 2011, the interest rate was 0.6%. We had no borrowings under this program at December 31, 2010.

In the first half of 2011, we entered into several international programs to sell with recourse trade accounts receivable to financial institutions. Advances received under these programs are accounted for as borrowings secured by the receivables and included in net cash provided by financing activities. At June 30, 2011, the commitments supporting these programs totaled $20.3 million, the advances received were secured by $13.3 million of accounts receivable, and no additional borrowings were available under the programs. The interest rates under these programs are based on EURIBOR rates plus 1.75%. At June 30, 2011, the weighted-average interest rate was 3.1%.

Prior to 2011, we maintained several international programs to sell without recourse trade accounts receivable to financial institutions. Advances received under these programs were accounted for as proceeds from the sales of receivables and included in net cash provided by operating activities. In the first quarter of 2011, these programs expired or were terminated. Ferro had received net proceeds under these programs of $3.4 million at December 31, 2010, for outstanding receivables.

7.875% Senior Notes

The Senior Notes were issued in 2010 at par, bear interest at a rate of 7.875% per year, payable semi-annually in arrears on February 15 and August 15 of each year, beginning February 15, 2011, and mature on August 15, 2018. We may redeem some or all of the Senior Notes beginning August 15, 2014, at prices ranging from 100% to 103.938% of the principal amount. In addition, through August 15, 2013, we may redeem up to 35% of the Senior Notes at a price equal to 107.875% of the principal amount using proceeds of certain equity offerings. We may also redeem some or all of the Senior Notes prior to August 15, 2014, at a price equal to the principal amount plus a defined applicable premium. The applicable premium on any redemption date is the greater of 1.0% of the principal amount of the note or the excess of (1) the present value at such redemption date of the redemption price of the note at August 15, 2014, plus all required interest payments due on the note through August 15, 2014, computed using a discount rate equal to the Treasury Rate as of the redemption date plus 50 basis points; over (2) the principal amount of the note.

The Senior Notes are unsecured obligations and rank equally in right of payment with any other unsecured, unsubordinated obligations. The Senior Notes contain certain affirmative and negative covenants customary for high-yield debt securities, including, but not limited to, restrictions on our ability to incur additional debt, create liens, pay dividends or make other distributions or repurchase our common stock and sell assets outside the ordinary course of business. At June 30, 2011, we were in compliance with the covenants under the Senior Notes indenture.

6.50% Convertible Senior Notes

The Convertible Notes were issued in 2008, bear interest at a rate of 6.5% per year, payable semi-annually in arrears on February 15th and August 15th of each year, and mature on August 15, 2013. We separately account for the liability and equity components of the Convertible Notes in a manner that, when interest cost is recognized in subsequent periods, will reflect our nonconvertible debt borrowing rate at the time the Convertible Notes were issued. The effective interest rate on the liability component is 9.5%. Under certain circumstances, holders of the Convertible Notes may convert their notes prior to maturity. The Convertible Notes are unsecured obligations and rank equally in right of payment with any other unsecured, unsubordinated obligations. The principal amount outstanding was $35.8 million at June 30, 2011, and $35.8 million at December 31, 2010. At June 30, 2011, we were in compliance with the covenants under the Convertible Notes indenture.

2010 Credit Facility

In 2010, we entered into the Third Amended and Restated Credit Agreement with a group of lenders for a five-year, $350 million multi-currency senior revolving credit facility (the 2010 Credit Facility). The interest rate under the 2010 Credit Facility is the sum of (A) either (1) LIBOR or (2) the higher of the Federal Funds Rate plus 0.5%, the Prime Rate, or LIBOR plus 1.0% and (B) a variable margin based on the Company s leverage. At June 30, 2011, the interest rate was 2.7%. We had no borrowings under this facility at December 31, 2010. The 2010 Credit Facility matures on August 24, 2015, and is secured by substantially all of Ferro s assets.

We are subject to a number of financial covenants under our 2010 Credit Facility, which are discussed in Note 6 within Item 8 of the Company s Annual Report on Form 10-K for the year ended December 31, 2010. At June 30, 2011, we were in compliance with the covenants of the 2010 Credit Facility.

Our ability to pay common stock dividends is limited by certain covenants in our 2010 Credit Facility and the bond indenture governing the Senior Notes. The covenant in our 2010 Credit Facility is the more limiting of the two covenants and is described in Note 6 within Item 8 of the Company s Annual Report on Form 10-K for the year ended December 31, 2010.

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6. Financial Instruments

The carrying amounts of the following assets and liabilities meeting the definition of a financial instrument approximate their fair values due to the short period to maturity of the instruments:

- Cash and cash equivalents;
- Notes receivable;
- Deposits;
- Miscellaneous receivables; and
- Short-term loans payable.

Long-term Debt

The following financial instruments are measured at fair value for disclosure purposes:

	June 30, 2011		December 31, 2010	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
	(Dollars in thousands)			
7.875% Senior Notes	$ 250,000	$ 260,625	$ 250,000	$ 266,563
6.50% Convertible Senior Notes, net of unamortized discounts	33,789	36,181	33,368	36,379
Revolving credit facility	448	448		
Other notes	4,320	3,619	4,297	3,600

The fair values of the Senior Notes and the Convertible Notes are based on a third party s estimated bid prices. The fair values of the revolving credit facility and the other long-term notes are based on the present value of expected future cash flows and assumptions about current interest rates and the creditworthiness of the Company that market participants would use in pricing the debt.

Derivative Instruments

All derivative instruments are recognized as either assets or liabilities at fair value. For derivative instruments that are designated and qualify as cash flow hedges, the gain or loss on the derivative is reported as a component of other comprehensive income (OCI) and reclassified from accumulated other comprehensive income (AOCI) into earnings when the hedged transaction affects earnings. For derivatives that are not designated as hedges, the gain or loss on the derivative is recognized in current earnings.

Interest rate swaps. To reduce our exposure to interest rate changes on variable-rate debt, we entered into interest rate swap agreements in 2007. These swaps effectively converted $150 million of a former variable-rate term loan facility to a fixed rate through June 2011. These swaps were designated and qualified as cash flow hedges. The fair value of these swaps was based on the present value of expected future cash flows, which reflected assumptions about current interest rates and the creditworthiness of the Company that market participants would use in pricing the swaps. In the third quarter of 2010, in conjunction with repayment of our remaining outstanding term loans, we settled these swaps and reclassified $6.8 million from accumulated other comprehensive income to miscellaneous expense.

Foreign currency forward contracts. We manage foreign currency risks principally by entering into forward contracts to mitigate the impact of currency fluctuations on transactions. These forward contracts are not designated as hedging instruments. The fair value of these contracts is based on market prices for comparable contracts. We had foreign currency forward contracts with a notional amount of $277.6 million at June 30, 2011, and $187.3 million at December 31, 2010.

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The following table presents the fair value on our consolidated balance sheets of our foreign currency forward contracts, which are not designated as hedging instruments:

	June 30, 2011	December 31, 2010	Balance Sheet Location
	(Dollars in thousands)		
Asset derivatives:			
Foreign currency forward contracts	$ 1,372	$ 1,261	Accrued expenses and other current liabilities
Liability derivatives:			
Foreign currency forward contracts	(2,288)	(1,501)	Accrued expenses and other current liabilities

The inputs to the valuation techniques used to measure fair value are classified into the following categories:
Level 1: Quoted market prices in active markets for identical assets or liabilities.
Level 2: Observable market-based inputs or unobservable inputs that are corroborated by market data.
Level 3: Unobservable inputs that are not corroborated by market data.
The classifications within the fair value hierarchy of these financial instruments were as follows:

	June 30, 2011				December 31, 2010
	Level 1	Level 2	Level 3	Total	
	(Dollars in thousands)				
Liabilities:					
Foreign currency forward contracts, net	$	$ (916)	$	$ (916)	$ (240)

The following table presents the effect of derivative instruments on our consolidated financial performance for the six months ended June 30:

	Amount of Gain (Loss) Recognized in OCI		Amount of Gain (Loss) Reclassified from AOCI into Income		Location of Gain (Loss) Reclassified from AOCI into Income
	2011	2010	2011	2010	
	(Dollars in thousands)				
Derivatives in Cash Flow Hedging Relationships:					
Interest rate swaps	$	$ (996)	$	$ (3,985)	Interest expense

	Amount of Gain (Loss) Recognized in Income		Location of Gain (Loss) in Income
	2011	2010	
	(Dollars in thousands)		
Derivatives Not Designated as Hedging Instruments:			
Foreign currency forward contracts	$ (13,422)	$ 14,684	Foreign currency losses, net

7. Income Taxes

During the first half of 2011, income tax expense was $21.6 million, or 33.5% of pre-tax income. In the first six months of 2010, we recorded income tax expense of $22.5 million, or 76.9% of pre-tax income. The reduction in the effective tax rate primarily resulted from a decrease in losses in jurisdictions with full valuation allowances, which resulted in unrecognized tax benefits of $9.0 million in the prior-year period as compared to $3.0 million in the first six months of 2011. In addition, the effective tax rate in the prior-year period was impacted by $3.3 million of tax charges, which resulted from the elimination of future tax deductions related to Medicare Part D subsidies and the recording of valuation allowances on certain deferred tax assets.

8. Contingent Liabilities

There are various lawsuits and claims pending against the Company and its subsidiaries. We do not currently expect the ultimate liabilities, if any, and expenses related to such lawsuits and claims to materially affect the consolidated financial position, results of operations, or cash flows of the Company.

The Company has a non-operating facility in Brazil that is environmentally contaminated. We have recorded an undiscounted remediation liability because we believe the liability is incurred and the amount of contingent loss is reasonably estimable. The recorded liability associated with this facility was $10.4 million at June 30, 2011, and $9.8 million at December 31, 2010. The ultimate loss will depend on the extent of contamination found as the project progresses and acceptance by local authorities of remediation activities, including the time frame of monitoring involved.

On January 4, 2011, the Company received an administrative subpoena from the U.S. Department of the Treasury s Office of Foreign Assets Control (OFAC). OFAC has requested that the Company provide documents and information related to the possibility of direct or indirect transactions with or to a prohibited country. The Company is cooperating with OFAC in connection with the administrative subpoena. The Company cannot predict the length, scope or results of the inquiry from OFAC, or the impact, if any, on its business activities or results of operations.

9. Retirement Benefits

Information concerning net periodic benefit costs of our U.S. pension plans (including our unfunded nonqualified plans), non-U.S. pension plans, and postretirement health care and life insurance benefit plans for the three months ended June 30 follows:

	U.S. Pension Plans		Non-U.S. Pension Plans		Other Benefit Plans	
	2011	2010	2011	2010	2011	2010
	(Dollars in thousands)					
Components of net periodic cost:						
Service cost	$ 8	$ 7	$ 562	$ 834	$	$
Interest cost	5,120	5,156	1,492	2,517	483	607
Expected return on plan assets	(5,165)	(4,491)	(837)	(1,759)		
Amortization of prior service cost	19	24	(34)	(121)	(101)	(399)
Net amortization and deferral	2,739	3,456	164	193	(160)	(43)
Curtailment and settlement effects				(3,839)		
Net periodic benefit cost	$ 2,721	$ 4,152	$ 1,347	$ (2,175)	$ 222	$ 165

Information concerning net periodic benefit costs of our U.S. pension plans (including our unfunded nonqualified plans), non-U.S. pension plans, and postretirement health care and life insurance benefit plans for the six months ended June 30 follows:

	U.S. Pension Plans		Non-U.S. Pension Plans		Other Benefit Plans	
	2011	2010	2011	2010	2011	2010
	(Dollars in thousands)					
Components of net periodic cost:						
Service cost	$ 8	$ 14	$ 1,101	$ 1,716	$	$
Interest cost	10,234	10,312	2,924	5,252	965	1,214
Expected return on plan assets	(10,301)	(8,982)	(1,647)	(3,658)		
	37	48	(67)	(253)	(201)	(798)

Amortization of prior service cost						
Net amortization and deferral	5,974	6,912	325	340	(320)	(86)
Curtailment and settlement effects				(4,565)		
Net periodic benefit cost	$ 5,952	$ 8,304	$ 2,636	$ (1,168)	$ 444	$ 330

In our U.S. plans, improvement through December 2010 in the valuation of pension investments increased our 2011 expected return on plan assets, and a longer amortization period due to changes in the pattern of retirements decreased our 2011 net amortization and deferral costs. In our non-U.S. plans, various curtailments and settlements recorded in 2010 decreased our benefit obligations and plan assets, which in turn reduced our 2011 interest cost and expected return on plan assets. In the second quarter of 2010, we recognized $4.0 million of curtailment and settlement gains related to our restructuring activities in the Netherlands and France and a $0.2 million settlement loss related to the transfer of some pension obligations to another company in Germany. In the first quarter of 2010, we recognized a $0.7 million gain from the settlement of certain pension obligations in Japan.

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10. Serial Convertible Preferred Stock

We are authorized to issue up to 2,000,000 shares of serial convertible preferred stock without par value. In 1989, Ferro issued 1,520,215 shares of 7% Series A ESOP Convertible Preferred Stock (Series A Preferred Stock) to the Trustee of the Ferro Employee Stock Ownership Plan (ESOP) at a price of $46.375 per share for a total consideration of $70.5 million. Subsequently, all shares of the Series A Preferred Stock were allocated to participating individual employee accounts, and most of the shares were redeemed or converted by the Trustee to provide for distributions to, loans to, or withdrawals by participants or to satisfy an investment election provided to participants. At December 31, 2010, there were 203,282 shares of Series A Preferred Stock outstanding. In the first quarter of 2011, we redeemed in cash all outstanding Series A Preferred Stock for $9.4 million plus earned but unpaid dividends.

11. Stock-Based Compensation

In April 2010, our shareholders approved the 2010 Long-Term Incentive Plan (the Plan). The Plan s purpose is to promote the Company s and the shareholders long-term financial interests by attracting, retaining and motivating high-quality, key employees and directors and aligning their interests with those of the Company s shareholders. The Plan reserves 5,000,000 shares of common stock to be issued for grants of several different types of long-term incentives including stock options, stock appreciation rights, deferred stock units, restricted shares, performance shares, other common-stock-based awards, and dividend equivalent rights. No future grants may be made under previous incentive plans. However, any outstanding awards or grants made under these plans will continue until the end of their specified terms.

The stock-based compensation transactions in equity consisted of the following for the six months ended June 30, 2011:

	Common Shares in Treasury		Paid-in
	Shares	Amount	Capital
	(In thousands)		
Stock options	(205)	$ 5,099	$ (1,208)
Deferred stock units	(80)	2,013	(1,709)
Restricted shares	(128)	3,445	(2,475)
Performance shares	37	(537)	462
Directors deferred compensation, net		563	(563)
Preferred stock conversions			
Total	(376)	$ 10,583	$ (5,493)

12. Restructuring and Cost Reduction Programs

During the first half of 2011, we continued to wind down our restructuring programs. Current period charges primarily relate to facility closing and exit costs in Limoges, France; Casiglie, Italy; and Castanheira do Ribatejo, Portugal.

For the six months ended June 30, 2011 and 2010, total charges resulting from these activities were $3.6 million and $36.4 million, respectively, of which $0.4 million and $1.9 million, respectively, were recorded in cost of sales as they related to accelerated depreciation on assets to be disposed, and the remaining $3.2 million and $34.5 million, respectively, were reported as restructuring and impairment charges. For the six months ended June 30, 2011, restructuring and impairment charges of $3.2 million consisted of gross charges of $5.7 million, partially offset by a gain on the sale of a building of $1.1 million and a reduction of accrued rent previously included in restructuring charges of $1.4 million.

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We have summarized the activities and accruals related to our restructuring and cost reduction programs below:

	Employee Severance	Other Costs	Asset Impairment	Total
	(Dollars in thousands)			
Balance at December 31, 2010	$ 2,429	$ 5,863	$	$ 8,292
Restructuring charges	1,814	1,358	3	3,175
Cash payments	(3,384)	(2,967)		(6,351)
Currency translation adjustment	136	417		553
Non-cash items	(27)	(109)	(3)	(139)
Balance at June 30, 2011	$ 968	$ 4,562	$	$ 5,530

We expect to make cash payments to settle the remaining liability for employee termination benefits and other costs over the next twelve months, except where legal or contractual restrictions prevent us from doing so.

13. Earnings Per Share

Details of the calculation of basic and diluted earnings per share attributable to Ferro Corporation common shareholders are shown below:

	Three months ended June 30,		Six months ended June 30,	
	2011	2010	2011	2010
	(In thousands, except per share amounts)			
Basic earnings per share computation:				
Net income attributable to Ferro Corporation common shareholders	$ 19,389	$ 6,935	$ 42,114	$ 6,702
Weighted-average common shares outstanding	86,159	85,783	86,067	85,809
Basic earnings per share attributable to Ferro Corporation common shareholders	$ 0.23	$ 0.08	$ 0.49	$ 0.08
Diluted earnings per share computation:				
Net income attributable to Ferro Corporation common shareholders	$ 19,389	$ 6,935	$ 42,114	$ 6,702
Plus: Convertible preferred stock dividends, net of tax			103	
Total	$ 19,389	$ 6,935	$ 42,217	$ 6,702
Weighted-average common shares outstanding	86,159	85,783	86,067	85,809
Assumed exercise of stock options	268	212	293	225
Assumed satisfaction of deferred stock unit conditions	38	88	51	71
Assumed satisfaction of restricted share conditions	403	347	383	325
Assumed conversion of convertible notes				
Assumed conversion of convertible preferred stock			264	
Weighted-average diluted shares outstanding	86,868	86,430	87,058	86,430

Diluted earnings per share attributable to Ferro Corporation common shareholders	$	0.22	$	0.08	$	0.48	$	0.08

Securities that could potentially dilute basic earnings per share in the future but were not included in the computation of diluted earnings per share because to do so would have been antidilutive represented 5.3 million common shares for the three and six months ended June 30, 2011, and 13.0 million common shares for the three and six months ended June 30, 2010.

14. Comprehensive Income (Loss)

The components of comprehensive income (loss) were as follows:

	Three months ended June 30,		Six months ended June 30,	
	2011	2010	2011	2010
	(Dollars in thousands)			
Net income	$ 19,621	$ 7,594	$ 42,812	$ 6,782
Other comprehensive income (loss), net of tax:				
Foreign currency translation	4,872	(14,685)	10,451	(25,695)
Postretirement benefit liabilities	3,459	(3,203)	2,968	(3,035)
Raw material commodity swaps				(107)
Interest rate swaps		1,206		1,930
Total comprehensive income (loss)	27,952	(9,088)	56,231	(20,125)
Less: Comprehensive income (loss) attributable to noncontrolling interests	301	524	649	(219)
Comprehensive income (loss) attributable to Ferro Corporation	$ 27,651	$ (9,612)	$ 55,582	$ (19,906)

15. Reporting for Segments

The Company has six reportable segments: Electronic Materials, Performance Coatings, Color and Glass Performance Materials, Polymer Additives, Specialty Plastics, and Pharmaceuticals. We have aggregated our Tile Coating Systems and Porcelain Enamel operating segments into one reportable segment, Performance Coatings, based on their similar economic and operating characteristics.

The accounting policies of our segments are consistent with those described for our consolidated financial statements in the summary of significant accounting policies contained in our Annual Report on Form 10-K for the year ended December 31, 2010. We measure segment income for internal reporting purposes by excluding unallocated corporate expenses, restructuring and impairment charges, other expenses, net, and income taxes. Unallocated corporate expenses consist primarily of corporate employment costs and professional services.

Net sales to external customers by segment are presented in the table below. Sales between segments were not material.

	Three months ended June 30,		Six months ended June 30,	
	2011	2010	2011	2010
	(Dollars in thousands)			
Electronic Materials	$ 180,362	$ 174,528	$ 382,709	$ 321,761
Performance Coatings	163,481	142,137	300,181	270,328
Color and Glass Performance Materials	106,476	97,697	206,281	197,029
Polymer Additives	91,271	79,664	177,133	154,140
Specialty Plastics	46,510	43,359	89,139	81,732
Pharmaceuticals	5,874	6,100	11,540	11,360
Total net sales	$ 593,974	$ 543,485	$ 1,166,983	$ 1,036,350

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Each segment s income (loss) and reconciliations to income before taxes follow:

	Three months ended June 30,		Six months ended June 30,	
	2011	2010	2011	2010
	(Dollars in thousands)			
Electronic Materials	$ 23,914	$ 37,397	$ 56,503	$ 65,879
Performance Coatings	11,329	14,422	18,734	23,904
Color and Glass Performance Materials	11,201	9,982	21,031	17,265
Polymer Additives	4,331	2,836	10,782	6,827
Specialty Plastics	2,810	3,503	4,719	5,322
Pharmaceuticals	759	(271)	1,915	(146)
Total segment income	54,344	67,869	113,684	119,051
Unallocated corporate expenses	13,545	15,391	29,377	30,587
Restructuring and impairment charges	1,545	21,205	3,175	34,537
Other expense, net	8,172	9,760	16,752	24,637
Income before income taxes	$ 31,082	$ 21,513	$ 64,380	$ 29,290

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Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

Overview

Overall sales grew during the quarter, driven primarily by changes in product pricing. Aggregate customer demand was relatively stable, although demand for conductive pastes from customers who manufacture solar cells declined. Net sales increased by 9% in the three months ended June 30, 2011, compared with the prior-year quarter. Increased precious metal costs, which are passed through to customers with little gross margin contribution, were one driver of the increased sales. Sales increased in all business segments except Pharmaceuticals, where sales declined slightly. In aggregate, changes in product prices and mix contributed approximately 11 percentage points to the growth in net sales compared to the second quarter of 2010. Changes in foreign currency exchange rates contributed an additional 5 percentage points to sales growth. Lower sales volumes, primarily driven by lower sales of conductive pastes and the effects of products that we no longer sell, reduced sales growth by approximately 7 percentage points.

Raw material costs, in aggregate, increased during the quarter by approximately $45 million compared with the prior-year quarter, reflecting widespread commodity cost increases in the global economy. A number of raw materials ended the quarter higher than in the prior-year period but below the peak levels that were reached during the quarter. Changes in product pricing kept pace with increasing raw material costs across the business as a whole. Increasing prices to fully cover raw materials cost increases was the most challenging in the Performance Coatings and Specialty Plastics businesses.

Gross profit declined in the quarter compared with the second quarter of 2010. The reduction was driven by declines in sales of conductive pastes for solar cells in our Electronic Materials business. Higher sales of precious metals did not add significantly to gross profit during the quarter because precious metal costs are passed through to customers with little gross profit contribution. In addition, higher sales due to product price increases that reflected rising raw material costs did not result in significant incremental gross profit during the quarter.

Selling, general and administrative (SG&A) expenses increased compared with the prior-year period. The increased SG&A spending included expenses associated with our initiative to standardize business processes and improve management information systems and the effects of changes in foreign currency exchange rates.

Restructuring and impairment charges decreased significantly compared with the second quarter of 2010. The major operational activities related to our restructuring initiatives, initiated in 2006, were completed during 2010. The current restructuring charges are primarily related to residual costs at manufacturing sites where production activities have ended.

Interest expense declined in the second quarter as a result of lower borrowing levels and reduced amortization of debt issuance costs.

We recorded increased net income in the 2011 second quarter compared with the second quarter of 2010. The increased income was driven by lower restructuring and impairment charges and reduced interest expense, partially offset by reduced gross profit and increased SG&A expenses.

Outlook

We expect normal seasonality across our businesses during the second half of 2011. Many of our businesses provide materials that are used in, or are influenced by, commercial and residential construction activities. The construction markets are generally more active in the spring and summer months, leading to strong demand for our products in the first half of the year.

However, sales of conductive pastes used in solar cells are subject to a variety of non-seasonal economic influences, including public policy decisions in various jurisdictions around the world, interest rates, and the prices and inventory levels of completed solar power modules. We believe that increased inventories of solar power modules are likely to continue to negatively affect demand for our conductive pastes in the near term. The time required for the solar power market to absorb the excess inventory of modules is difficult to forecast, but we expect a gradual recovery in demand for our products by late 2011. We continue to believe that there are attractive long-term growth opportunities for our metal pastes as a result of growth in the solar power market during the next several years.

Factors that could adversely affect our future financial performance are described under the heading Risk Factors in Item 1A of Part I of our Annual Report on Form 10-K for the year ended December 31, 2010.

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Results of Operations

Comparison of the three months ended June 30, 2011 and 2010

	Three months ended June 30, 2011	Three months ended June 30, 2010	$ Change	% Change
	(Dollars in thousands, except per share amounts)			
Net sales	$ 593,974	$ 543,485	$ 50,489	9.3%
Cost of sales	479,627	421,155	58,472	13.9%
Gross profit	114,347	122,330	(7,983)	(6.5)%
Gross profit percentage	19.3%	22.5%		
Selling, general and administrative expenses	73,548	69,852	3,696	5.3%
Restructuring and impairment charges	1,545	21,205	(19,660)	
Other expense (income):				
Interest expense	7,352	13,766	(6,414)	
Interest earned	(69)	(133)	64	
Foreign currency losses (gains), net	1,013	(302)	1,315	
Miscellaneous (income) expense, net	(124)	(3,571)	3,447	
Income before income taxes	31,082	21,513	9,569	
Income tax expense	11,461	13,919	(2,458)	
Net income	$ 19,621	$ 7,594	$ 12,027	