

ALCAN INC
 Form 10-Q
 August 14, 2003

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2003

Commission file number 1-3677

ALCAN INC.

(Exact name of registrant as specified in its charter)

	CANADA	Inapplicable	
	(State or Other Jurisdiction of	(I.R.S. Employer Identification No.)	
	Incorporation or Organization)		

	1188 Sherbrooke Street West, Montreal, Quebec, Canada H3A 3G2	
	(Address of Principal Executive Offices and Postal Code)	

	(514) 848-8000	
	(Registrant's Telephone Number, including Area Code)	

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes No

At June 30, 2003, the registrant had 321,739,502 shares of common stock (without nominal or par value) outstanding.

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PART I – FINANCIAL INFORMATION

In this report, all dollar amounts are stated in U.S. dollars and all quantities in metric tons, or tonnes, unless indicated otherwise. A tonne is 1,000 kilograms, or 2,204.6 pounds. The word "Company" refers to Alcan Inc. and, where applicable, one or more of its consolidated subsidiaries.

Item 1. Financial Statements

ALCAN INC.

INTERIM CONSOLIDATED STATEMENT OF INCOME

(unaudited)

Periods ended June 30 (in millions of US\$, except per <i>share amounts</i>)	Second Quarter		Six Months	
	2003	2002	2003	2002
Sales and operating revenues	3,468	3,146	6,681	6,034
Costs and expenses				
Cost of sales and operating expenses	2,751	2,473	5,286	4,760
Depreciation and amortization	231	212	455	411
Selling, administrative and general expenses	176	142	339	280
Research and development expenses	32	27	61	55

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Interest (note 12)	56	49	104	99
Restructuring, impairment and other special charges (note 6)	(16)	6	(14)	20
Other expenses - net	52	43	109	50
	3,282	2,952	6,340	5,675
Income from continuing operations before income taxes and other items	186	194	341	359
Income taxes (note 9)	151	122	292	201
Income from continuing operations before other items	35	72	49	158
Equity income	1	2	1	3
Minority interests	(12)	(2)	(13)	(2)
Income from continuing operations	24	72	37	159
Loss from discontinued operations (note 3)	(113)	(1)	(113)	(2)
Net income (Loss)	(89)	71	(76)	157
Dividends on preference shares	1	1	3	2
Net income (Loss) attributable to common shareholders	(90)	70	(79)	155
Net income (Loss) per common share - basic and diluted (note 4)				
Income from continuing operations	0.07	0.22	0.10	0.49
Loss from discontinued operations	(0.35)	-	(0.35)	(0.01)
Net Income (Loss)	(0.28)	0.22	(0.25)	0.48
Dividends per common share	0.30	0.15	0.45	0.30

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

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ALCAN INC.

INTERIM CONSOLIDATED STATEMENT OF RETAINED EARNINGS
(unaudited)

Six months ended June 30 (in millions of US\$)	2003	2002
Retained earnings - beginning of year - as reported	3,503	4,074
Accounting change - Impairment of goodwill as at January 1, 2002		
(note 2)	-	(748)
As restated	3,503	3,326
Net income (Loss)	(76)	157

Dividends

- Common	(145)	(96)
- Preference	(3)	(2)
Retained earnings - end of period	3,279	3,385

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

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ALCAN INC.

INTERIM CONSOLIDATED BALANCE SHEET

(unaudited for 2003)

(in millions of US\$)

June 30, 2003

December 31, 2002

ASSETS

Current assets

Cash and time deposits	127	109
Trade receivables		
(net of allowances of \$61 in 2003 and \$58 in 2002)	1,550	1,264
Other receivables	432	542
Inventories		
• Aluminum operating segments		
. Aluminum	964	905
. Raw materials	432	390
. Other supplies	305	296
	1,701	1,591
• Packaging operating segment	519	368
	2,220	1,959
Current assets held for sale (note 3)	83	76
	4,412	3,950
Deferred charges and other assets	665	666
Property, plant and equipment		
• Cost (excluding Construction work in progress)	18,402	17,630
• Construction work in progress	704	570
• Accumulated depreciation	(8,654)	(8,107)
	10,452	10,093
Intangible assets, net of accumulated amortization of \$69 in 2003 and \$53 in 2002	319	318
Goodwill	2,353	2,303
Long-term assets held for sale (note 3)	72	208
Total assets	18,273	17,538

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

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ALCAN INC.

INTERIM CONSOLIDATED BALANCE SHEET (cont'd)

(unaudited for 2003)

(in millions of US\$) June 30, 2003 December 31, 2002

LIABILITIES AND SHAREHOLDERS' EQUITY

Current liabilities

Payables and accrued liabilities	2,509	2,294
Short-term borrowings	348	381
Debt maturing within one year	235	295
Current liabilities of operations held for sale (note 3)	41	47
	3,133	3,017
Debt not maturing within one year (note 13)	3,517	3,186
Deferred credits and other liabilities	1,631	1,418
Deferred income taxes	1,198	1,120
Long-term liabilities of operations held for sale (note 3)	8	22
Minority interests	195	150
Shareholders' equity		
Redeemable non-retractable preference shares	160	160
Common shareholders' equity		
• Common shares	4,711	4,703
• Retained earnings	3,279	3,503
• Deferred translation adjustments	441	259
	8,431	8,465
	8,591	8,625

Commitments and contingencies (note 11)

Total liabilities and shareholders' equity 18,273 17,538

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

ALCAN INC.

INTERIM CONSOLIDATED STATEMENT OF CASH FLOWS

(unaudited)

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Periods ended June 30	Second Quarter		Six Months	
<i>(in millions of US\$)</i>	2003	2002	2003	2002
OPERATING ACTIVITIES				
Income from continuing operations	24	72	37	159
Adjustments to determine cash from operating activities:				
Depreciation and amortization	231	212	455	411
Deferred income taxes	44	36	69	40
Asset impairment provisions	8	9	8	9
Gain on sales of businesses and investment - net	(51)	-	(51)	-
Change in operating working capital:				
• Change in receivables	112	38	71	51
• Change in inventories	(40)	(10)	(60)	23
• Change in payables	(47)	(2)	(36)	(91)
• Total change in operating working capital	25	26	(25)	(17)
Change in deferred charges, other assets, deferred credits and other liabilities - net	33	40	106	65
Other - net	19	(2)	24	(8)
Cash from operating activities in continuing operations	333	393	623	659
Cash from (used for) operating activities in discontinued operations (note 3)	3	7	7	(1)
Cash from operating activities	336	400	630	658

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

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ALCAN INC.

INTERIM CONSOLIDATED STATEMENT OF CASH FLOWS (cont'd)

(unaudited)

Periods ended June 30	Second Quarter		Six Months	
<i>(in millions of US\$)</i>	2003	2002	2003	2002

FINANCING ACTIVITIES

New debt	501	51	505	182
Debt repayments	(261)	(21)	(346)	(192)
	240	30	159	(10)

Short-term borrowings - net	(40)	(49)	(64)	(175)
Common shares issued	3	4	8	10
Dividends				
• Alcan shareholders (including preference)	(50)	(49)	(100)	(98)
• Minority interests	(1)	(2)	(10)	(3)
Cash from (used for) financing activities in continuing operations	152	(66)	(7)	(276)
Cash used for financing activities in discontinued operations (note 3)	(1)	-	(4)	(1)
Cash from (used for) financing activities	151	(66)	(11)	(277)
INVESTMENT ACTIVITIES				
Property, plant and equipment	(206)	(152)	(337)	(257)
Business acquisitions (note 14)	(343)	(172)	(348)	(172)
	(549)	(324)	(685)	(429)
Net proceeds from disposal of businesses, investments and other assets	47	11	53	47
Cash used for investment activities in continuing operations	(502)	(313)	(632)	(382)
Cash used for investment activities in discontinued operations (note 3)	(2)	(3)	(4)	(5)
Cash used for investment activities	(504)	(316)	(636)	(387)
Effect of exchange rate changes on cash and time deposits	3	7	4	8
Increase (Decrease) in cash and time deposits	(14)	25	(13)	2
Cash of subsidiaries consolidated - net	30	-	30	-
Cash and time deposits - beginning of period	111	96	110	119
Cash and time deposits - end of period	127	121	127	121

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

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ALCAN INC.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2003

(Unaudited)

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

1. **ACCOUNTING POLICIES**

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, except for the recently adopted accounting policies described below. The interim financial statements do not include all of the financial statement disclosures included in the annual financial statements prepared in accordance with Canadian generally accepted accounting principles (GAAP) and therefore should be read in conjunction with the most recent annual financial statements.

Recently Adopted Accounting Policies

Impairment of Long-lived Assets

On January 1, 2003, the Company elected to early adopt the Canadian Institute of Chartered Accountants (CICA) section 3063, Impairment of Long-lived Assets. Under this standard, an impairment loss is recognized when the carrying amount of a long-lived asset held for use is not recoverable and exceeds its fair value. An impairment loss of \$8 relating to the packaging operations was recorded in the second quarter of 2003.

Disposal of Long-lived Assets and Discontinued Operations

On January 1, 2003, the Company elected to early adopt the CICA section 3475, Disposal of Long-lived Assets and Discontinued Operations. Under this standard, a long-lived asset to be disposed of by sale is measured at the lower of its carrying amount or fair value less cost to sell, and is not amortized while classified as held for sale. Assets and liabilities classified as held for sale are reported as assets held for sale and liabilities of operations held for sale on the balance sheet. A long-lived asset to be disposed of other than by sale, such as by abandonment, before the end of its previously estimated useful life, is classified as held for use until it is disposed of and depreciation estimates revised to reflect the use of the asset over its shortened useful life. Also, the standard requires that the results of operations of a component of an enterprise, that has been disposed of either by sale or abandonment or is classified as held for sale, be reported as discontinued operations if the operations and cash flows of the component have been, or will be, eliminated from the ongoing operations as a result of the disposal transaction and the Company will not have any significant continuing involvement in the operations of the component after the disposal transaction. A component of an enterprise comprises operations and cash flows that can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the enterprise. Disposal activities relating to long-lived assets initiated by the Company in the second quarter of 2003 are described in note 3 - Discontinued Operations and Assets Held for Sale.

1. ACCOUNTING POLICIES (cont'd)
Recently Issued Accounting Policies

Guarantees

Asset Retirement Obligations

The CICA issued section 3110, Asset Retirement Obligations, which will be effective for the Company's fiscal year beginning on January 1, 2003, 2003. This standard established CICA accounting standards for the recognition, measurement and disclosure of liabilities associated with a guarantor or cost for a legal obligation. According to the commitments and tangibles related asset. Under this standard, a liability would generally be recognized for such an obligation at its fair value when incurred and a corresponding asset retirement cost would be added to the carrying amount of the related asset.

The CICA issued accounting guideline AcG-15, Consolidation of variable interest entities, which will be effective for the Company's fiscal year beginning on January 1, 2004. The Guideline provides guidance as to when to apply consolidation principles to certain entities that are subject to control on a basis other than ownership of voting shares and thus determining when an enterprise includes the assets, liabilities and results of activities of such an entity (a variable interest entity) in its consolidated financial statements.

2.

ACCOUNTING CHANGE

Goodwill and Other Intangible Assets

On January 1, 2002, the Company adopted the CICA standard concerning goodwill and other intangible assets. Under this standard, goodwill and other intangible assets with an indefinite life are no longer amortized but are carried at the lower of carrying value and fair value. Goodwill and other intangible assets with an indefinite life are tested for impairment on an annual basis. An impairment of \$748 was identified in the goodwill balance as at January 1, 2002, and was charged to opening retained earnings in 2002 upon adoption of the accounting standard. Any further impairment arising subsequent to January 1, 2002, will be taken as a charge against income. As a result of the new standard, the Company no longer amortizes goodwill.

3.

DISCONTINUED OPERATIONS AND ASSETS HELD FOR SALE

In the second quarter of 2003, the Company committed to a plan to sell certain non-strategic Packaging operations. These businesses are classified as held for sale and are included in discontinued operations. An impairment charge of \$113, after tax, was recorded in discontinued operations to reduce the carrying values of these businesses to estimated fair values less costs to sell. Accepted valuation techniques were used to estimate fair values. Certain financial information has been reclassified in the prior periods to present these businesses as discontinued operations on the income statement, 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. All of these divestments are expected to

be completed within one year.

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

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

Periods ended June 30	Second Quarter		Six Months	
	2003	2002	2003	2002
Sales	62	53	122	102
Loss from operations	-	(1)	-	(3)
Loss from impairment	(136)	-	(136)	-
Pre-tax loss	(136)	(1)	(136)	(3)
Income taxes	23	-	23	1
Loss from discontinued operations	(113)	(1)	(113)	(2)

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

	June 30, 2003	December 31, 2002
Current assets held for sale:		
Cash and time deposits	1	1
Trade receivables	41	36
Other receivables	9	11
Inventories	32	28
	83	76
Long-term assets held for sale:		
Deferred charges and other assets	1	1
Property, plant and equipment, net	5	140
Intangible assets, net	10	14
Goodwill, net	56	53
	72	208
Current liabilities of operations held for sale:		
Payables and accrued liabilities	41	43
Short-term borrowings	-	4
	41	47

	Long-term liabilities of operations held for sale:		
	Debt not maturing within one year	-	1
	Deferred credits and other liabilities	1	1
	Deferred income taxes	7	20
		8	22

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4. NET INCOME PER COMMON SHARE - BASIC AND DILUTED

Basic and diluted net income per common 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 net income per common share.

Periods ended June 30	Second Quarter		Six Months	
	2003	2002	2003	2002
Numerator for basic and diluted net income per common share:				
Net income (Loss) attributable to common shareholders	(90)	70	(79)	155
Denominator (number of common shares in millions):				
Denominator for basic net income (loss) per common share - weighted average of outstanding shares	322	321	322	321
Effect of dilutive stock options	-	2	-	2
Denominator for diluted net income (loss) per common share - adjusted weighted average of outstanding shares	322	323	322	323
Net income (Loss) per common share - basic and diluted	(0.28)	0.22	(0.25)	0.48

In the second quarter and six months of 2003, options to purchase 6,242,883 and 6,222,883 common shares, respectively (2002: 932,000 and 353,000) at a weighted average price of CAN\$48.78 and CAN\$48.79 per share, respectively (2002: CAN\$61.21 and CAN\$64.25) were outstanding during the periods but were not included in the computation of diluted earnings per share because the options' exercise price was greater than the average price of the common shares.

As at June 30, 2003, there were 321,739,502 (2002: 321,256,890) common shares outstanding.

5. DIFFERENCES BETWEEN CANADIAN AND UNITED STATES GENERALLY ACCEPTED ACCOUNTING PRINCIPLES

Significant differences between Canadian and United States GAAP are described below: of the FASB Statements Nos. 133 and 138, Accounting for Derivative Instruments and Hedging Activities. Accordingly, for U.S. GAAP Derivatives purposes only, beginning in 2001, unrealized gains and losses resulting from the valuation of derivatives at fair value are recognized in net income as the gains and losses arise and not concurrently with the recognition of the transactions being hedged. On January 1, 2003, the Company adopted, for certain transactions, the optional hedge accounting provisions; see "Recently Adopted Accounting Standards" below. In its primary Canadian GAAP financial statements, the Company continues to recognize the gains and losses on derivative contracts in income concurrently with the recognition of the transactions being hedged, except for certain foreign currency forward

contracts and swaps that are used to hedge certain foreign currency denominated debt and foreign currency denominated loans and oil put options, which are recorded at fair value.

For the period ended	<u>June 30, 2003</u>	(pro forma) <u>December 31, 2002</u>	
Balance - beginning of period	389		363
Liabilities incurred	6		12
Liabilities settled	(13)		(12)
Accretion expense	10		17
Exchange	67		9
Balance - end of period	459		389

On January 1, 2003, the Company prospectively adopted the FASB Statement No. 146, Accounting for Costs Associated with Exit or Disposal Activities. This standard requires that a liability associated with an exit or disposal activity be recognized when the liability is incurred rather than at the date of the Company's commitment to an exit plan.

On January 1, 2003, the Company adopted the recognition and measurement provisions of the FASB Interpretation No. 45, Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others. The provisions are applied on a prospective basis to guarantees issued or modified after December 31, 2002. There were no significant guarantees issued or modified after December 31, 2002. See note 11 - Commitments and Contingencies.

Recently Issued Accounting Standards

In January 2003, the FASB issued Interpretation No. 46, Consolidation of Variable Interest Entities, which applies in the first fiscal year or interim period beginning after June 15, 2003, to variable interest entities in which the Company holds a variable interest that it acquired before February 1, 2003. This Interpretation requires existing unconsolidated variable interest entities to be consolidated by their primary beneficiaries if the entities do not effectively disperse risks among parties involved. An entity that holds a significant variable interest but is not the primary beneficiary is subject to specific disclosure requirements. The Company is studying the accounting requirements of this Interpretation and is preparing for its implementation.

Periods ended June 30 (in millions of US\$, except per share amounts)	Reference	Second Quarter		Six Months	
		2003	2002	2003	2002
Income from continuing operations - as reported		24	72	37	159
Differences due to:					
- Valuation of derivatives	(a)	12	(20)	28	79
- Currency translation	(b)	1	-	1	-
- Asset retirement obligations	(f)	(13)	-	(24)	-
- Deferred tax effect on the above		(2)	7	(6)	(25)
Income from continuing operations before cumulative effect of accounting changes - U.S. GAAP		22	59	36	213
Cumulative effect of accounting changes - net of taxes					
- Impairment of goodwill	(e)	-	-	-	(748)
- Asset retirement obligations	(f)	-	-	(39)	-
Income (Loss) from continuing operations					

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- U.S. GAAP	22	59	(3)	(535)
Loss from discontinued operations	(113)	(1)	(113)	(2)
Net income (Loss) - U.S. GAAP	(91)	58	(116)	(537)
Dividends on preference shares	1	1	3	2
Net income (Loss) attributable to common shareholders - U.S. GAAP	(92)	57	(119)	(539)
Net income (Loss) per common share - basic - U.S. GAAP				
Income (Loss) from continuing operations	0.06	0.18	(0.02)	(1.68)
Loss from discontinued operations	(0.35)	-	(0.35)	-
Net income (Loss)	(0.29)	0.18	(0.37)	(1.68)
Net income (Loss) per common share - diluted - U.S. GAAP				
Income (Loss) from continuing operations	0.06	0.17	(0.02)	(1.68)
Loss from discontinued operations	(0.35)	-	(0.35)	-
Net income (Loss)	(0.29)	0.17	(0.37)	(1.68)
Income attributable to common shareholders from continuing operations before cumulative effect of accounting changes - U.S. GAAP	21	58	33	211
Income from continuing operations before cumulative effect of accounting changes per common share - basic - U.S. GAAP	0.06	0.18	0.10	0.65
Income from continuing operations before cumulative effect of accounting changes per common share - diluted - U.S. GAAP	0.06	0.17	0.10	0.65

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5. DIFFERENCES BETWEEN CANADIAN AND UNITED STATES GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (cont'd)

Reconciliation of Canadian and U.S. GAAP (cont'd)