TreeHouse Foods, Inc.
Form 10-Q
November 05, 2008

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 and Exchange Act of 1934
For the Quarterly Period Ended September 30, 2008.

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 001-32504

TreeHouse Foods, Inc.
(Exact name of the registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	20-2311383 (I.R.S. employer identification no.)
Two Westbrook Corporate Center, Suite 1070 Westchester, IL (Address of principal executive offices)	60154 (Zip Code)

(Registrant's telephone number, including area code) (708) 483-1300

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 is a large accelerated filer, an accelerated filer or 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	þ	Accelerated filer	o
Non-accelerated filer	o	Smaller reporting Company	o
(Do not check if a 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 o No þ

There were 31,533,853 shares of Common Stock, par value $0.01 per share, outstanding as of October 31, 2008.

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Part I — Financial Information

Item 1. Financial Statements

TREEHOUSE FOODS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except share and per share data)

	September 30, 2008 (Unaudited)	December 31, 2007
Assets		
Current assets:		
Cash and cash equivalents	$ 1,874	$ 9,230
Receivables, net	92,594	76,951
Inventories	288,287	297,692
Deferred income taxes	3,115	2,790
Prepaid expenses and other current assets	14,345	7,068
Assets held for sale	4,081	—
Net assets of discontinued operations	425	544
Total current assets	404,721	394,275
Property, plant and equipment, net	266,423	265,007
Goodwill	583,264	590,791
Deferred income taxes	—	3,504
Identifiable intangible and other assets, net	185,347	202,381
Total assets	$ 1,439,755	$ 1,455,958
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable and accrued expenses	$ 176,064	$ 144,090
Current portion of long-term debt	370	677
Total current liabilities	176,434	144,767
Long-term debt	551,474	620,452
Deferred income taxes	31,000	27,517
Other long-term liabilities	29,307	33,913
Commitments and contingencies (Note 15)		
Stockholders' equity:		
Preferred stock, par value $0.01 per share, 10,000,000 shares authorized, none issued		
Common stock, par value $0.01 per share, 40,000,000 shares authorized, 31,463,853 and 31,204,305 shares issued and outstanding, respectively	315	312
Additional paid-in capital	564,122	550,370
Retained earnings	107,099	85,724
Accumulated other comprehensive loss	(19,996)	(7,097)
Total stockholders' equity	651,540	629,309
Total liabilities and stockholders' equity	$ 1,439,755	$ 1,455,958

See Notes to Condensed Consolidated Financial Statements.

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TREEHOUSE FOODS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(In thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
	(Unaudited)		(Unaudited)	
Net sales	$ 374,576	$ 271,951	$ 1,102,568	$ 786,966
Cost of sales	301,416	213,219	890,390	622,538
Gross profit	73,160	58,732	212,178	164,428
Operating expenses:				
Selling and distribution	29,060	21,459	86,672	64,408
General and administrative	15,959	13,716	46,961	39,338
Other operating expense (income), net	722	2	12,572	(309)
Amortization expense	3,331	1,616	10,346	3,926
Total operating expenses	49,072	36,793	156,551	107,363
Operating income	24,088	21,939	55,627	57,065
Other (income) expense:				
Interest expense	6,493	4,998	21,785	12,850
Interest income	—	(7)	(107)	(58)
Loss on foreign currency exchange	1,869	—	3,724	—
Other income, net	(87)	—	(268)	—
Total other expense	8,275	4,991	25,134	12,792
Income from continuing operations, before income taxes	15,813	16,948	30,493	44,273
Income taxes	4,733	6,380	9,060	16,899
Income from continuing operations	11,080	10,568	21,433	27,374
Loss from discontinued operations, net of tax	—	—	—	30
Net income	$ 11,080	$ 10,568	$ 21,433	$ 27,344
Weighted average common shares:				
Basic	31,397	31,202	31,281	31,202
Diluted	31,514	31,290	31,399	31,305
Basic earnings per common share:				
Income from continuing operations	$ .35	$ .34	$ .69	$ .88
Loss from discontinued operations, net of tax	—	—	—	—
Net income	$ .35	$ .34	$ .69	$ .88
Diluted earnings per common share:		—		—
Income from continuing operations	$ .35	$ .34	$ .68	$ .87
Loss from discontinued operations, net of tax	—	—	—	—
Net income	$ .35	$ .34	$ .68	$ .87

See Notes to Condensed Consolidated Financial Statements.

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TREEHOUSE FOODS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	Nine Months Ended September 30, 2008	2007
	(Unaudited)	
Cash flows from operating activities:		
Net income	$ 21,433	$ 27,344
Loss from discontinued operations	—	30
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	25,160	20,366
Amortization	10,346	3,926
Gain on derivative	(62)	—
Loss on foreign currency exchange	3,107	—
Stock-based compensation	8,795	10,221
Write down of impaired assets	5,173	—
Gain on disposition of assets	(652)	(448)
Deferred income taxes	7,165	5,478
Interest rate swap amortization	120	121
Excess tax benefits from share-based payment arrangements	(325)	—
Other	335	—
Changes in operating assets and liabilities, net of acquisitions:		
Receivables	(16,630)	(3,643)
Inventories	6,535	(46,287)
Prepaid expenses and other current assets	(6,358)	815
Accounts payable, accrued expenses and other current liabilities	28,550	22,139
Net cash provided by continuing operations	92,692	40,062
Net cash used in discontinued operations	—	(30)
Net cash provided by operating activities	92,692	40,032
Cash flows from investing activities:		
Additions to property, plant and equipment	(40,799)	(14,344)
Insurance proceeds	4,800	—
Acquisitions of businesses	(251)	(100,102)
Acquisition of equity investment	—	(4,471)
Proceeds from sale of fixed assets	1,659	1,376
Net cash used in continuing operations	(34,591)	(117,541)
Net cash provided by discontinued operations	—	467
Net cash used in investing activities	(34,591)	(117,074)
Cash flows from financing activities:		
Proceeds from issuance of debt	—	100,132
Net repayment of debt	(69,460)	(22,865)
Payment of deferred financing debt	—	(225)
Proceeds from stock option exercises	3,965	—
Excess tax benefits from share-based payment arrangements	325	—
Net cash provided (used in) financing activities	(65,170)	77,042
Effect of exchange rate changes on cash and cash equivalents	(287)	—
Net (decrease) increase in cash and cash equivalents	(7,356)	—

Cash and cash equivalents, beginning of period		9,230		6
Cash and cash equivalents, end of period	$	1,874	$	6

See Notes to Condensed Consolidated Financial Statements.

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TREEHOUSE FOODS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
As of and for the nine months ended September 30, 2008
(Unaudited)

1. General

TreeHouse is a food manufacturer servicing primarily the retail grocery and foodservice channels. Its products include non-dairy powdered coffee creamer; canned soup, salad dressings and sauces; salsa and Mexican sauces; jams and pie fillings under the E.D. Smith brand name; pickles and related products; infant feeding products; and other food products including aseptic sauces, refrigerated salad dressings, and liquid non-dairy creamer. TreeHouse believes it is the largest manufacturer of pickles and non-dairy powdered creamer in the United States and the largest manufacturer of private label salad dressings in the United States and Canada based on sales volume.

Effective January 1, 2008, we realigned the manner in which the business is managed and now focus on operating results based on channels of distribution, which has resulted in a change to the operating and reportable segments. Previously, we managed our business based on product categories. Our change in operating and reportable segments from product categories to channel based is consistent with management's long-term growth strategy and was necessary due to the acquisitions that occurred during 2007. Our new reportable segments are North American Retail Grocery, Food Away From Home, and Industrial and Export. Accordingly, prior year segment data has been restated to reflect the new segment structure.

2. Basis of Presentation

The Condensed Consolidated Financial Statements included herein have been prepared by TreeHouse Foods, Inc. without audit, pursuant to the rules and regulations of the Securities and Exchange Commission applicable to quarterly reporting on Form 10-Q. In our opinion, these statements include all adjustments necessary for a fair presentation of the results of all interim periods reported herein. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted as permitted by such rules and regulations. The Condensed Consolidated Financial Statements and related notes should be read in conjunction with the consolidated financial statements and related notes included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2007. Results of operations for interim periods are not necessarily indicative of annual results.

The preparation of our condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States of America ("GAAP") requires us to use our judgment to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosures of contingent assets and liabilities at the date of the Condensed Consolidated Financial Statements, and the reported amounts of net sales and expenses during the reporting period. Actual results could differ from these estimates under different assumptions or conditions.

A detailed description of the Company's significant accounting policies can be found in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2007.

3. Recent Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) 157 Fair Value Measurement, which defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. The provisions of SFAS 157 are effective for fiscal years beginning after November 15, 2007. In February 2008, the FASB issued FASB Staff Position (FSP) FAS 157-2, which delays the effective date of Statement 157 for all nonrecurring fair value measurements of nonfinancial assets and nonfinancial liabilities until fiscal years beginning after November 15, 2008. We adopted the provisions of SFAS 157 that were not deferred. We will continue to assess the impact of the deferred provisions of SFAS 157, which will be effective for the Company beginning January 1, 2009.

In February 2007, the FASB issued SFAS 159, The Fair Value Option for Financial Assets and Financial Liabilities — Including an Amendment of FASB Statement 115, that permits measurement of financial instruments and other certain items at fair value. SFAS 159 does not require any new fair value measurements. SFAS 159 is effective for financial statements issued for fiscal years beginning after November 15, 2007. Adoption of SFAS 159 did not have an impact on our financial statements.

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In December 2007, the FASB issued SFAS 141(R), Business Combinations, a replacement of SFAS 141, Business Combinations. The provisions of SFAS 141(R) establish principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any non-controlling interest acquired and the goodwill acquired. SFAS 141(R) also establishes disclosure requirements that will enable users to evaluate the nature and financial effects of the business combination, and applies to business combinations for which the acquisition date is on or after December 15, 2008, and may not be early adopted. The Company will adopt SFAS 141(R) for acquisitions after the effective date.

In December 2007, FASB issued SFAS 160, Non-controlling Interests in Consolidated Financial Statements – an Amendment of ARB 51. The provisions of SFAS 160 outline the accounting and reporting for ownership interests in a subsidiary held by parties other than the parent. SFAS 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. Earlier application is prohibited. SFAS 160 is to be applied prospectively as of the beginning of the fiscal year in which it is initially adopted, except for the presentation and disclosure requirements, which are to be applied retrospectively for all periods presented. We are currently assessing the impact SFAS 160 will have on our financial statements.

In March 2008, FASB issued SFAS 161, Disclosures about Derivative Instruments and Hedging Activities, SFAS 161 requires increased qualitative, and credit-risk disclosures. This Statement is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. Early adoption is permitted. Further, entities are encouraged, but not required to provide comparative disclosures for earlier periods. We are currently assessing the impact SFAS 161 will have on our financial statements.

In May 2008, FASB issued SFAS 162, The Hierarchy of Generally Accepted Accounting Principles. SFAS 162 identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements presented in conformity with generally accepted accounting principles in the United States. It does not change current practice. This Statement is effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board amendments to AU Section 411, The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles. The Company does not believe this Statement will have an impact on our financial statements.

EITF 08-3, Accounting by Lessees for Nonrefundable Maintenance Deposits, was issued in June 2008 and requires that all nonrefundable maintenance deposits that are contractually and substantively related to maintenance of a particular asset be recorded as deposit assets. These deposit assets are either capitalized or expensed when the underlying maintenance is performed. This EITF is effective for fiscal years beginning after December 15, 2008. The Company is currently assessing the impact this EITF will have on our financial statements.

4. Income Taxes

The Company was formed on January 25, 2005 and is subject to federal and state income tax examinations beginning in 2005. The Internal Revenue Service (IRS) completed an examination of the Company's 2005 and 2006 federal returns in the second quarter of 2008. The Company paid tax adjustments of approximately $0.3 million which are primarily temporary items, the impact of which will reverse in future years.

The Company's wholly owned consolidated subsidiary, E.D. Smith, and its affiliates are subject to Canadian, U.S., and state tax examinations from 2003 forward. The IRS is currently conducting an examination of E.D. Smith U.S. affiliates for 2005. The outcome of this examination is unknown and is expected to be completed during 2008.

The Company adopted the provisions of FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes – an Interpretation of FASB Statement No. 109 (FIN 48), on January 1, 2007. The adoption of FIN 48 did not have a material effect on the financial position or results of operations of the Company.

During the first quarter of 2008, the Company entered into an intercompany financing structure that results in the recognition of foreign earnings subject to a low effective tax rate. As the foreign earnings are permanently reinvested, U.S. income taxes have not been provided. For the three and nine months ended September 30, 2008, the Company recognized a tax benefit of approximately $1.4 million and $4.2 million, respectively, related to this item.

5. Other Operating Expense

The Company incurred Other operating expense of $0.7 million and $12.6 million for the three and nine months ended September 30, 2008, respectively. For the nine months ended September 30, 2008, this expense consisted of $12.1 million relating to the closing of our pickle plant located in Portland, Oregon (See Note 6) and $0.5 million relating to a fire at our non-dairy powdered creamer facility located in New Hampton, Iowa.

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6. Facility Closing

On February 13, 2008, the Company announced plans to close its pickle plant in Portland, Oregon. The Portland plant was the Company's highest cost and least utilized pickle facility. Operations in the plant ceased during the second quarter of 2008. Costs associated with the plant closure are estimated to be approximately $14.0 million, of which $8.0 million is expected to be in cash, net of estimated proceeds from the sale of assets.

The principal components of the plans include workforce reductions (approximately $0.9 million) as a result of the facility closing and reorganization; shutdown costs (approximately $2.7 million), including those costs that are necessary to clean and prepare the facility for closure; contract termination costs (approximately $4.8 million); and fixed asset impairment charges of $5.2 million.

During the nine months ended September 30, 2008, the Company recorded $12.1 million of costs, (included in Other operating expense in our Condensed Consolidated Statements of Income), related to the closure of the Portland plant, which included a fixed asset impairment charge of $5.2 million to reduce the carrying value of the Portland facility to its net realizable value, $6.0 million for contract terminations and other costs, as well as $0.9 million for severance. The following is a summary of the liabilities recorded by the Company as of and during the nine months ended September 30, 2008:

	Accrued Charges at December 31, 2007	Accruals	Payments	Accrued Charges at September 30, 2008
		(In thousands)		
Contract terminations	$ —	$ 3,092	$ (3,092)	$ —
Work force reductions	—	869	(800)	69
Capital lease and service contract buyout	5,681	1,694	(7,375)	—
Total	$ 5,681	$ 5,655	$ (11,267)	$ 69

We expect the closure plan for the facility to be completed by the end of 2008.

7. Inventories

	September 30, 2008	December 31, 2007
	(In thousands)	
Finished goods	$ 206,312	$ 222,452
Raw materials and supplies	99,663	89,328
LIFO reserve	(17,688)	(14,088)
Total	$ 288,287	$ 297,692

Approximately $103.0 million and $92.4 million of our inventory was accounted for under the LIFO method of accounting at September 30, 2008 and December 31, 2007, respectively.

8. Intangible Assets

Changes in the carrying amount of goodwill for the nine months ended September 30, 2008 are as follows:

	North American Retail Grocery	Food Away From Home	Industrial and Export	Total
		(In thousands)		
Balance at December 31, 2007	$ 370,688	$ 86,521	$ 133,582	$ 590,791
Purchase price adjustment	497	68	—	565
Currency exchange adjustment	(7,347)	(745)	—	(8,092)
Balance at September 30, 2008	$ 363,838	$ 85,844	$ 133,582	$ 583,264

The Company finalized its purchase price allocation related to the E.D. Smith acquisition as of October 15, 2008 resulting in minor changes to goodwill for the period October 1, 2008 through October 15, 2008.

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The gross carrying amount and accumulated amortization of our intangible assets other than goodwill as of September 30, 2008 and December 31, 2007 are as follows:

	September 30, 2008			December 31, 2007		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
	(In thousands)					
Intangible assets with indefinite lives:						
Trademarks	$ 42,824	$ —	$ 42,824	$44,367	$ —	$ 44,367
Intangible assets with finite lives:						
Customer-related	148,825	(22,148)	126,677	152,812	(13,607)	139,205
Non-compete agreement	2,646	(1,263)	1,383	2,646	(708)	1,938
Trademarks	8,500	(1,281)	7,219	8,500	(970)	7,530
Formulas/recipes	1,776	(340)	1,436	1,849	(87)	1,762
Total	$ 204,571	$ (25,032)	$ 179,539	$210,174	$ (15,372)	$ 194,802

Amortization expense on intangible assets for the three months ended September 30, 2008 and 2007 was $3.3 million and $1.6 million, respectively, and $10.3 million and $3.9 million for the nine months ended September 30, 2008 and 2007, respectively. Estimated aggregate intangible asset amortization expense for the next five years is as follows:

2009	$ 13.3 million
2010	$ 12.9 million
2011	$ 11.0 million
2012	$ 10.7 million
2013	$ 10.4 million

9. Long-Term Debt

	September 30, 2008	December 31, 2007
	(In thousands)	
Revolving credit facility	$ 448,000	$ 511,500
Senior notes	100,000	100,000
Tax increment financing and other	3,844	9,629
	551,844	621,129
Less current portion	(370)	(677)
Total	$ 551,474	$ 620,452

Revolving Credit Facility — On August 30, 2007, the Company entered into Amendment No. 2 to our unsecured revolving Credit Agreement, as amended (the “Credit Agreement”), dated June 27, 2005, with a group of participating financial institutions. Among other things, Amendment No. 2 reduces the available liquidity requirement with respect to permitted acquisitions and reduces the required consolidated interest coverage ratio at the end of each fiscal quarter. The Company also exercised its option under the Credit Agreement to increase the aggregate commitments under the revolving credit facility from $500 million to $600 million. The Credit Agreement also provides for a $75 million letter of credit sublimit, against which $8.6 million in letters of credit have been issued but undrawn. Proceeds from the credit facility may be used for working capital and general corporate purposes, including acquisition financing. The credit facility contains various financial and other restrictive covenants and requires that we maintain certain financial ratios, including a leverage and interest coverage ratio. We are in compliance with all applicable covenants as of September 30, 2008. We believe that, given our cash flow from operating activities and our available credit capacity, we can comply with the current terms of the credit facility and meet foreseeable financial requirements.

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Interest is payable quarterly or at the end of the applicable interest period in arrears on any outstanding borrowings at a customary Eurodollar rate plus the applicable margin, or at a customary base rate. The underlying rate is defined as the rate equal to the British Bankers Association LIBOR Rate for Eurodollar Rate Loans, or the higher of the prime lending rate of the administrative agent or federal funds rate plus 0.5% for Base Rate Committed Loans. The applicable margin for Eurodollar loans is based on our consolidated leverage ratio and ranges from 0.295% to 0.90%. In addition, a facility fee based on our consolidated leverage ratio and ranging from 0.08% to 0.225% is due quarterly on all commitments under the credit facility. Our average interest rate on debt outstanding under our Credit Agreement at September 30, 2008 was 4.05%.

Senior Notes — On September 22, 2006, we completed a private placement of $100 million in aggregate principal of 6.03% senior notes due September 30, 2013, pursuant to a Note Purchase Agreement among the Company and a group of purchasers. All of the Company's obligations under the senior notes are fully and unconditionally guaranteed by Bay Valley Foods, LLC, a wholly-owned subsidiary of the Company. The senior notes have not been registered under the Securities Act of 1933, as amended, and may not be offered or sold in the United States, absent registration or an applicable exemption. Interest is paid semi-annually in arrears on March 31 and September 30 of each year.

The Note Purchase Agreement contains covenants that will limit the ability of the Company and its subsidiaries to, among other things, merge with other entities, change the nature of the business, create liens, incur additional indebtedness or sell assets. The Note Purchase Agreement also requires the Company to maintain certain financial ratios. We are in compliance with the applicable covenants as of September 30, 2008.

Swap Agreements — The Company entered into a $200 million long term interest rate swap agreement with a forward starting effective date of November 19, 2008 to lock into a fixed LIBOR interest rate base. Under the terms of agreement, $200 million in floating rate debt will be swapped for a fixed 2.9% interest base rate for a period of 24 months, amortizing to $50 million for an additional nine months at the same 2.9% interest rate. Under the terms of the Company's revolving credit agreement, this will result in an all in borrowing cost on the swapped principal being no more than 3.8% during the life of the swap agreement.

In July 2006, we entered into a forward interest rate swap transaction for a notional amount of $100 million as a hedge of the forecasted private placement of $100 million senior notes. The interest rate swap transaction was terminated on August 31, 2006, which resulted in a pre-tax loss of $1.8 million. The unamortized loss is reflected, net of tax, in Accumulated other comprehensive loss in our Condensed Consolidated Balance Sheets. The total loss will be reclassified ratably to our Condensed Consolidated Statements of Income as an increase to Interest expense over the term of the senior notes, providing an effective interest rate of 6.29% over the term of our senior notes. In the nine months ended September 30, 2008, $0.2 million of the loss was taken into interest expense. We anticipate that $0.3 million of the loss will be reclassified to interest expense in 2008.

Tax Increment Financing — On December 15, 2001, the Urban Redevelopment Authority of Pittsburgh ("URA") issued $4.0 million of redevelopment bonds, pursuant to a Tax Increment Financing Plan to assist with certain aspects of the development and construction of the Company's Pittsburgh, Pennsylvania facilities. The agreement was transferred to the Company as part of the acquisition of the soup and infant feeding business. The Company has agreed to make certain payments with respect to the principal amount of the URA's redevelopment bonds through May 2019. As of September 30, 2008, $2.9 million remains outstanding.

10. Earnings Per Share

In accordance with SFAS 128 Earnings Per Share, basic earnings per share is computed by dividing net income by the number of weighted average common shares outstanding during the reporting period. The weighted average number of common shares used in the diluted earnings per share calculation is determined using the treasury stock method and includes the incremental effect related to outstanding options and restricted stock. Certain restricted stock units and restricted stock awards outstanding are subject to market conditions for vesting, which were not met as of September 30, 2008 or 2007, so these awards are excluded from the diluted earnings per share calculation. During the second quarter of 2008, the Company issued performance unit awards that contain both service and performance criteria. As of September 30, 2008, none of the criteria were met and these awards were excluded from the diluted earnings per share calculation.

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The following table summarizes the effect of the share-based compensation awards on the weighted average number of shares outstanding used in calculating diluted earnings per share:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Weighted average common shares outstanding	31,396,886	31,202,473	31,281,338	31,202,473
Assumed exercise of stock options (1)	116,854	87,639	117,446	102,504
Weighted average diluted common shares outstanding	31,513,740	31,290,112	31,398,784	31,304,977

(1) The assumed exercise of stock options excludes 2,225,111 options outstanding, which were anti-dilutive for the three and nine months ended September 30, 2008, and 2,117,973 options outstanding, which were anti-dilutive for the three and nine months ended September 30, 2007.

11. Stock-Based Compensation

For the quarter beginning July 1, 2005, we adopted the requirements of SFAS 123(R), Share Based Payments. The Company elected to use the modified prospective application of SFAS 123(R) for awards issued prior to July 1, 2005. Income from continuing operations before income taxes, for the three and nine month periods ended September 30, 2008 and 2007 includes share-based compensation expense of $3.4 million, $8.8 million, $3.4 million and $10.2 million, respectively. The tax benefit recognized related to the compensation cost of these share-based awards was approximately $1.3 million and $3.5 million for the three and nine month periods ended September 30, 2008, and $1.3 million and $3.9 million for the three and nine month periods ended September 30, 2007, respectively.

During the second quarter of 2008, the Company issued its annual equity compensation awards that consisted of stock options, restricted stock, restricted stock units and performance units. In previous years, the Company issued stock options to all eligible employees on an annual basis. The Company changed its equity compensation methodology and now awards eligible employees stock options, restricted stock or restricted stock units, or a combination of the awards. Performance units were also issued to certain senior management employees, the vesting of which is contingent upon service and performance criteria. These awards are more fully described below. Restricted stock and restricted stock unit awards previously granted are fully described in the Company’s annual report on Form 10-K filed on February 28, 2008.

The following table summarizes stock option activity during the nine months ended September 30, 2008. Options are granted under our long-term incentive plan, and have a three year vesting schedule, which vest one-third on each of the first three anniversaries of the grant date. Options expire 10 years from the grant date.