

SIMPSON MANUFACTURING CO INC /CA/  
Form 10-Q  
November 08, 2005

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

(Mark One)

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

**For the quarterly period ended: September 30, 2005**

**OR**

**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: **0-23804**

**Simpson Manufacturing Co., Inc.**

(Exact name of registrant as specified in its charter)

**Delaware**  
(State or other jurisdiction of incorporation)

**94-3196943**  
(I.R.S. Employer)

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or organization)

Identification No.)

**4120 Dublin Boulevard, Suite 400, Dublin, CA 94568**

(Address of principal executive offices)

(Registrant's telephone number, including area code): **(925) 560-9000**

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

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

Yes  No

The number of shares of the Registrant's Common Stock outstanding as of September 30, 2005: 48,164,119

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## PART I FINANCIAL INFORMATION

## Item 1. Financial Statements.

## Simpson Manufacturing Co., Inc. and Subsidiaries

## Condensed Consolidated Balance Sheets

(In thousands, unaudited)

	2005	September 30, 2004	December 31, 2004
<b>ASSETS</b>			
Current assets			
Cash and cash equivalents	\$ 104,360	\$ 62,093	\$ 30,917
Short-term investments	6,303	21,395	17,032
Trade accounts receivable, net	129,590	113,723	89,807
Inventories	174,783	163,860	192,879
Deferred income taxes	10,160	8,325	8,809
Other current assets	3,598	5,400	7,667
Total current assets	428,794	374,796	347,111
Property, plant and equipment, net	151,724	125,881	137,609
Goodwill	42,901	24,451	44,379
Equity method investment	222		
Other noncurrent assets	16,952	7,105	16,038
Total assets	\$ 640,593	\$ 532,233	\$ 545,137
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>			
Current liabilities			
Line of credit and current portion of long-term debt	\$ 545	\$ 551	\$ 579
Trade accounts payable	41,290	44,592	32,031
Accrued liabilities	30,471	28,692	27,780
Income taxes payable	3,313		
Accrued profit sharing trust contributions	6,013	5,193	7,039
Accrued cash profit sharing and commissions	15,449	14,427	8,210
Accrued workers compensation	2,724	2,324	2,761
Total current liabilities	99,805	95,779	78,400
Long-term debt, net of current portion	1,874	2,455	2,397
Other long-term liabilities	1,352	1,716	1,415
Total liabilities	103,031	99,950	82,212
Commitments and contingencies (Note 7)			
Stockholders equity			
Common stock, at par value	482	501	479
Additional paid-in capital	89,383	72,192	79,877
Retained earnings	438,773	412,271	369,154
Accumulated other comprehensive income	8,924	8,020	13,415
Treasury stock		(60,701)	

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Total stockholders' equity		537,562		432,283		462,925
Total liabilities and stockholders' equity	\$	640,593	\$	532,233	\$	545,137

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

## Simpson Manufacturing Co., Inc. and Subsidiaries

## Condensed Consolidated Statements of Operations

(In thousands except per share amounts, unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Net sales	\$ 233,809	\$ 188,560	\$ 642,359	\$ 530,311
Cost of sales	144,126	110,959	399,362	313,681
Gross profit	89,683	77,601	242,997	216,630
Operating expenses (income):				
Selling	15,679	14,223	47,057	42,607
General and administrative	27,282	24,723	76,995	70,600
Loss (gain) on sale of assets	(2,027)	59	(2,124)	(103)
	40,934	39,005	121,928	113,104
Income from operations	48,749	38,596	121,069	103,526
Income in equity method investment, before tax	54		222	
Interest income, net	373	150	595	258
Income before income taxes	49,176	38,746	121,886	103,784
Provision for income taxes	17,569	14,562	45,057	39,836
Net income	\$ 31,607	\$ 24,184	\$ 76,829	\$ 63,948
Net income per common share				
Basic	\$ 0.66	\$ 0.51	\$ 1.60	\$ 1.33
Diluted	\$ 0.65	\$ 0.50	\$ 1.58	\$ 1.31
Cash dividends declared per common share	\$ 0.05	\$ 0.10	\$ 0.15	\$ 0.20
Number of shares outstanding				
Basic	48,091	47,644	48,024	48,116
Diluted	48,658	48,505	48,532	48,954

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

## Simpson Manufacturing Co., Inc. and Subsidiaries

## Condensed Consolidated Statements of Stockholders Equity

for the nine months ended September 30, 2004 and 2005 and three months ended December 31, 2004

(In thousands except per share amounts, unaudited)

	Common Stock		Additional	Retained	Accumulated	Treasury	Total
	Shares	Par Value	Paid-in	Earnings	Other	Stock	
			Capital		Income		
Balance, January 1, 2004	48,511	\$ 498	\$ 63,335	\$ 357,916	\$ 7,983	\$ (29,427)	\$ 400,305
Comprehensive income:							
Net income				63,948			63,948
Other comprehensive income:							
Change in net unrealized gains or losses on available- for-sale investments					(45)		(45)
Translation adjustment					82		82
Comprehensive income							63,985
Options exercised	303	3	2,952				2,955
Stock compensation expense			3,423				3,423
Tax benefit of options exercised			2,045				2,045
Repurchase of common stock	(1,151)					(31,274)	(31,274)
Cash dividends declared on Common stock (\$0.20 per share)				(9,593)			(9,593)
Common stock issued at \$25.43 per share	17		437				437
Balance, September 30, 2004	47,680	501	72,192	412,271	8,020	(60,701)	432,283
Comprehensive income:							
Net income				17,560			17,560
Other comprehensive income:							
Change in net unrealized gains or losses on available-for-sale investments					(17)		(17)
Translation adjustment					5,412		5,412
Comprehensive income							22,955
Options exercised	90	1	819				820
Stock compensation expense			1,026				1,026
Tax benefit of options exercised			841				841
Repurchase of common stock							
Retirement of treasury stock		(24)		(60,677)		60,701	
Common stock issued \$31.40 per share for acquisition	159	1	4,999				5,000
Balance, December 31, 2004	47,929	479	79,877	369,154	13,415		462,925
Comprehensive income:							
Net income				76,829			76,829
Other comprehensive income:							
Change in net unrealized gains or losses on available-for-sale investments					46		46
Translation adjustment					(4,537)		(4,537)
Comprehensive income							72,338
Options exercised	214	3	2,409				2,412
Stock compensation expense			4,414				4,414
Tax benefit of options exercised			1,976				1,976
Cash dividends declared on Common stock (\$0.15 per share)				(7,210)			(7,210)
Common stock issued at \$34.30 per share	21		707				707
Balance, September 30, 2005	48,164	\$ 482	\$ 89,383	\$ 438,773	\$ 8,924	\$	\$ 537,562

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

## Simpson Manufacturing Co., Inc. and Subsidiaries

## Condensed Consolidated Statements of Cash Flows

(In thousands, unaudited)

	Nine Months Ended September 30,	
	2005	2004
<b>Cash flows from operating activities</b>		
Net income	\$ 76,829	\$ 63,948
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Gain on sale of assets	(2,124)	(103)
Depreciation and amortization	17,850	14,693
Deferred income taxes	(3,794)	(1,278)
Noncash compensation related to stock plans	4,798	4,139
Income in equity method investment	(222)	
Tax benefit of options exercised	1,976	2,045
Provision for obsolete inventory	808	(321)
Provision for doubtful accounts	(143)	(3)
Changes in operating assets and liabilities, net of effects of acquisitions:		
Trade accounts receivable	(41,221)	(47,602)
Inventories	15,697	(57,273)
Trade accounts payable	7,340	19,191
Income taxes payable	8,493	(377)
Accrued profit sharing trust contributions	(1,006)	(829)
Accrued cash profit sharing and commissions	7,250	6,970
Other current assets	(667)	(1,432)
Accrued liabilities	4,015	8,584
Other long-term liabilities	(97)	1,214
Accrued workers compensation	(36)	(100)
Other noncurrent assets	(245)	(323)
Net cash provided by operating activities	95,501	11,143
<b>Cash flows from investing activities</b>		
Capital expenditures	(31,074)	(30,946)
Asset acquisitions, net of cash acquired		(582)
Proceeds from sale of capital assets	4,025	188
Purchases of available-for-sale investments		(41,397)
Maturities of available-for-sale investments	7,000	5,700
Sales of available-for-sale investments	3,500	58,995
Net cash used in investing activities	(16,549)	(8,042)
<b>Cash flows from financing activities</b>		
Line of credit borrowings	724	1,913
Repayment of debt and line of credit borrowings	(1,047)	(5,112)
Repurchase of common stock		(31,274)
Issuance of Company's common stock	2,412	2,955
Dividends paid	(7,198)	(4,810)
Net cash used in financing activities	(5,109)	(36,328)
Effect of exchange rate changes on cash	(400)	184
Net increase (decrease) in cash and cash equivalents	73,443	(33,043)
Cash and cash equivalents at beginning of period	30,917	95,136
Cash and cash equivalents at end of period	\$ 104,360	\$ 62,093

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Noncash capital expenditures	\$	2,376	\$	2,463
Dividends declared but not paid	\$	2,410	\$	4,783
Issuance of Company's common stock for compensation	\$	707	\$	437

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



**Simpson Manufacturing Co., Inc. and Subsidiaries**

**Notes to Condensed Consolidated Financial Statements**

**(Unaudited)**

1. Basis of Presentation

Except where otherwise indicated, dollar amounts and balances in the consolidated financial statements and the notes thereto are in thousands, except per share amounts.

*Principles of Consolidation*

The consolidated financial statements include the accounts of Simpson Manufacturing Co., Inc. and its subsidiaries. Investments in less than 50% owned affiliates are generally accounted for using either cost or the equity method. All significant intercompany transactions have been eliminated.

*Interim Period Reporting*

The accompanying unaudited interim condensed consolidated financial statements have been prepared pursuant to the rules and regulations for reporting on Form 10-Q. Accordingly, certain information and footnotes required by accounting principles generally accepted in the United States of America have been condensed or omitted. These interim statements should be read in conjunction with the consolidated financial statements and the notes thereto included in Simpson Manufacturing Co., Inc.'s (the Company's) 2004 Annual Report on Form 10-K (the 2004 Annual Report).

The unaudited quarterly condensed consolidated financial statements have been prepared on the same basis as the audited annual consolidated financial statements and, in the opinion of management, contain all adjustments (consisting of only normal recurring adjustments) necessary to state fairly the financial information set forth therein, in accordance with accounting principles generally accepted in the United States of America. The year-end condensed consolidated balance sheet data were derived from audited financial statements, but do not include all disclosures required by accounting principles generally accepted in the United States of America. The Company's quarterly results may be subject to fluctuations. As a result, the Company believes the results of operations for the interim periods are not necessarily indicative of the results to be expected for any future period.

*Revenue Recognition*

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The Company recognizes revenue when the earnings process is complete, net of applicable provision for discounts, returns and allowances, whether actual or estimated based on the Company's experience. This generally occurs when products are shipped to the customer in accordance with the sales agreement or purchase order, ownership and risk of loss pass to the customer, collectibility is reasonably assured and pricing is fixed and determinable. The Company's general shipping terms are F.O.B. shipping point, where title is transferred and revenue is recognized when the products are shipped to customers. When the Company sells F.O.B. destination point, title is transferred and the Company recognizes revenue on delivery. If the actual costs of sales returns, allowances, and discounts were to exceed the recorded estimated allowance, the Company's sales would be adversely affected. Accrued sales returns have not been material and have been within management's expectations. Service sales, representing aftermarket repair and maintenance and engineering activities, though significantly less than 1% of net sales and not material to the financial statements, are recognized as the services are completed.

### *Treasury Stock*

The Company records treasury stock purchases under the cost method whereby the entire cost of the acquired stock is recorded as treasury stock. Upon retirement, the resulting gains or losses are credited or charged to retained earnings.

### *Net Income Per Common Share*

Basic net income per common share is computed based upon the weighted average number of common shares outstanding. Potentially dilutive securities, using the treasury stock method, are included in the diluted per-share calculations for all periods when the effect of their inclusion is dilutive.

The following is a reconciliation of basic earnings per share ( EPS ) to diluted EPS:

	Three Months Ended September 30, 2005			Three Months Ended September 30, 2004		
	Income	Shares	Per Share	Income	Shares	Per Share
<b>Basic EPS</b>						
Income available to common stockholders	\$ 31,607	48,091	\$ 0.66	\$ 24,184	47,644	\$ 0.51
<b>Effect of Dilutive Securities</b>						
Stock options		567	(0.01)		861	(0.01)
<b>Diluted EPS</b>						
Income available to common stockholders	\$ 31,607	48,658	\$ 0.65	\$ 24,184	48,505	\$ 0.50
	Nine Months Ended September 30, 2005			Nine Months Ended September 30, 2004		
	Income	Shares	Per Share	Income	Shares	Per Share
<b>Basic EPS</b>						
Income available to common stockholders	\$ 76,829	48,024	\$ 1.60	\$ 63,948	48,116	\$ 1.33
<b>Effect of Dilutive Securities</b>						
Stock options		508	(0.02)		838	(0.02)
<b>Diluted EPS</b>						
Income available to common stockholders	\$ 76,829	48,532	\$ 1.58	\$ 63,948	48,954	\$ 1.31

For the three and nine months ended September 30, 2005, 125 thousand and 111 thousand shares attributable to outstanding stock options, respectively, were excluded from the calculation of diluted earnings per share because their inclusion would have been anti-dilutive.

#### *Accounting for Stock-Based Compensation*

The Company maintains two stock option plans under which the Company may grant incentive stock options and non-qualified stock options to employees, consultants and directors. Stock options have been granted with exercise prices at or above the fair market value on the date of grant. Options vest and expire according to terms established at the grant date.

As of January 1, 2003, the Company adopted Statement of Financial Accounting Standards ( SFAS ) No. 148, Accounting for Stock-Based Compensation Transition and Disclosure, and SFAS No. 123, Accounting for Stock Based Compensation, and used the prospective method of applying SFAS No. 123 for the transition. For stock options granted prior to January 1, 2003, the Company will continue to account for stock-based compensation using the intrinsic value method prescribed in Accounting Principles Board ( APB ) Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations. Accordingly, because the grant price equaled or exceeded the market price on the date of grant for options issued by the Company, no compensation expense has been recognized for stock options granted prior to January 1, 2003. For the three months ended September 30, 2005 and 2004, the Company has recognized after-tax stock option expense of approximately \$0.9 million and \$0.7 million, respectively. For the nine months ended September 30, 2005 and 2004, the Company has recognized after-tax stock option expense of approximately \$2.8 million and \$2.1 million, respectively. These amounts are included in general and administrative expenses.



Had compensation cost for the Company's stock options for all grants been recognized based upon the estimated fair value on the grant date under the fair value methodology prescribed by SFAS No. 123, as amended by SFAS No. 148, the Company's net income and earnings per share would have been as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Net income, as reported	\$ 31,607	\$ 24,184	\$ 76,829	\$ 63,948
Add: Stock-based employee compensation expense included in reported net income, net of related tax effects	903	652	2,781	2,109
Deduct: Total stock-based employee compensation expense determined under the fair value method for all awards, including those granted prior to January 1, 2003, net of related tax effects	910	664	2,803	2,146
Net income, pro forma	\$ 31,600	\$ 24,172	\$ 76,807	\$ 63,911
Earnings per share				
Basic, as reported	\$ 0.66	\$ 0.51	\$ 1.60	\$ 1.33
Basic, pro forma	0.66	0.51	1.60	1.33
Diluted, as reported				
Diluted, pro forma	0.65	0.50	1.58	1.31

The assumptions used to calculate the fair value of options granted are evaluated and revised, as necessary, to reflect market conditions and the Company's experience.

In December 2004, the Financial Accounting Standards Board ( FASB ) issued SFAS No. 123R, *Share Based Payment (Revised 2004)*, which revised SFAS No. 123 to require companies to record compensation cost for stock-based employee compensation plans based on the fair value of options granted. While the Company currently accounts for stock options on a fair value basis, additional changes will be required such as those affecting cash flow presentation. SFAS No. 123R will be adopted in the first quarter of 2006 and *management has not determined all of the effects on the Company's financial statements or the transition method that will be used.*

*Under the 1994 Stock Option plan, the Company allows for full vesting upon retirement if the employee becomes retirement eligible by reaching age sixty. Currently, stock-based employee compensation expense is recorded over the nominal vesting period and if a retirement eligible employee retires before the end of the vesting period, the Company records any unrecognized compensation cost at the date of retirement (the nominal vesting period approach). The nominal vesting period is four years of service subsequent to the grant date. The non-substantive vesting period approach specifies that awards, in substance, become vested when the employee's retention of the award is no longer contingent on providing service. Under this approach, the unrecorded compensation cost is expensed when that condition is met even if the employee continues providing service to the Company. This would be the case for existing grants when an employee becomes retirement eligible as well as when a retirement eligible employee is granted an award. Upon adoption of SFAS No. 123R in the first quarter of 2006, the Company will adopt the non-substantive vesting period approach for new grants that have retirement eligibility provisions. The after-tax effect on net income of applying the nominal vesting period approach versus the non-substantive vesting period approach is as follows:*

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Stock-based compensation expense:				

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<i>Nominal vesting period approach</i>	\$	903	\$	652	\$	2,781	\$	2,109
<i>Non-substantive vesting period approach</i>		815		644		2,935		2,538
Effect on net income	\$	88	\$	8	\$	(154)	\$	(429)

*Recently Issued Accounting Standards*

In May 2005, the FASB issued SFAS No. 154, Accounting Changes and Error Corrections, a replacement of APB Opinion 20 and FASB Statement No. 3. This Statement will be effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. *In the absence of explicit transition requirements specific to the newly adopted accounting principle, it establishes, unless not practicable, retrospective application as the required method for reporting a change in accounting principle. Management has not determined the effect, if any, of SFAS No. 154 on the Company's financial statements for its fiscal year ending December 31, 2006.*

*Reclassifications*

Certain prior period amounts have been reclassified to conform to the 2005 presentation with no effect on net income or retained earnings as previously reported. These reclassifications were primarily in relation to the presentation of deferred taxes and non-cash adjustments to reconcile net income to net cash in the statement of cash flows.

## 2. Trade Accounts Receivable, net

Trade accounts receivable consist of the following:

	At September 30,		At December 31,	
	2005	2004	2004	2004
Trade accounts receivable	\$ 133,799	\$ 116,834	\$ 93,515	
Allowance for doubtful accounts	(2,196)	(1,853)	(2,397)	
Allowance for sales discounts and returns	(2,013)	(1,258)	(1,311)	
	\$ 129,590	\$ 113,723	\$ 89,807	

## 3. Inventories

The components of inventories consist of the following:

	At September 30,		At December 31,	
	2005	2004	2004	2004
Raw materials	\$ 63,740	\$ 76,002	\$ 91,910	
In-process products	25,221	18,882	22,235	
Finished products	85,822	68,976	78,734	
	\$ 174,783	\$ 163,860	\$ 192,879	





## 4. Property, Plant and Equipment, net

Property, plant and equipment, net, consists of the following:

	At September 30,		At December 31,	
	2005	2004	2004	2004
Land	\$ 18,451	\$ 13,858	\$ 13,871	
Buildings and site improvements	88,045	65,498	67,215	
Leasehold improvements	5,921	5,735	6,838	
Machinery and equipment	159,819	134,797	147,442	
	272,236	219,888	235,366	
Less accumulated depreciation and amortization	(134,323)	(118,457)	(121,610)	
	137,913	101,431	113,756	
Capital projects in progress	13,811	24,450	23,853	
	\$ 151,724	\$ 125,881	\$ 137,609	

## 5. Investments

*Equity Method Investment*

The Company has a 35% equity interest in Keymark Enterprises, LLC ( Keymark ), for which it accounts using the equity method. Keymark develops software that assists in the design and engineering of residential structures. The Company's relationship with Keymark includes the specification of its products in the Keymark software. The Company has no obligation to make any additional future capital contributions, nor does it intend to provide additional funding, to Keymark. In 2001, after several quarters of losses, the Company concluded that the carrying value of its investment in Keymark exceeded its fair value and therefore wrote down the value of its investment to zero. After three consecutive quarters of profitability in 2004, however, the Company began recording its share of Keymark's 2005 profits, and as of September 30, 2005, the carrying value of this investment was \$222 thousand.

*Available-for-Sale Investments*

The Company's investments in debt securities are classified as either cash and cash equivalents or available-for-sale investments. As of September 30, 2005 and 2004, and December 31, 2004, the Company's investments were as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
<b>At September 30, 2005</b>				
Debt investments				
Municipal bonds	\$ 6,315	\$	\$ 12	\$ 6,303
<b>At September 30, 2004</b>				

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Debt investments								
Municipal bonds	\$	21,436	\$	3	\$	44	\$	21,395
<b>At December 31, 2004</b>								
Debt investments								
Municipal bonds	\$	17,090	\$		\$	58	\$	17,032

The debt securities were classified as short-term investments as of September 30, 2005 and 2004, and December 31, 2004.

As of September 30, 2005, contractual maturities of the Company's available-for-sale investments were as follows:

	Amortized Cost	Estimated Fair Value
Amounts maturing in less than 1 year	\$ 6,315	\$ 6,303

6. Debt

Outstanding debt at September 30, 2005 and 2004, and December 31, 2004, and the available credit at September 30, 2005, consisted of the following:

	Available Credit at	Debt Outstanding		
	September 30, 2005	at September 30, 2005	September 30, 2004	at December 31, 2004
Revolving line of credit, interest at bank's reference rate less 0.50% (at September 30, 2005, the bank's reference rate less 0.50% was 6.25%), expires November 2006	\$ 13,800	\$	\$	\$
Revolving term commitment, interest at bank's prime rate less 0.50% (at September 30, 2005, the bank's prime rate less 0.50% was 6.25%), expires June 2006	9,200			
Revolving line of credit, interest at the bank's base rate plus 2% (at September 30, 2005, the bank's base rate plus 2% was 6.75%), expires September 2006	1,220			
Revolving lines of credit, interest rates between 2.8665% and 4.50%, expirations through August 2006	5,088			
Term loan, interest at LIBOR plus 1.375% (at September 30, 2005, LIBOR plus 1.375% was 5.065%), matures June 2008		900	1,200	1,050
Term loans, interest rates between 2.94% and 5.60%, expirations between 2005 and 2018	29,308	1,519	1,806	1,926
Less line of credit and current portion of long-term debt		(545)	(551)	(579)
Long-term debt, net of current portion		\$ 1,874	\$ 2,455	\$ 2,397
Available credit	\$ 29,308			

7. Commitments and Contingencies

Note 9 to the consolidated financial statements in the Company's 2004 Annual Report provides information concerning commitments and contingencies. From time to time, the Company is involved in various legal proceedings and other matters arising in the normal course of business. The resolution of claims and litigation, however, is subject to inherent uncertainty and it is possible that such resolution could have a material adverse effect on the Company's financial condition, cash flows or results of operations.

The Company's policy with regard to environmental liabilities is to accrue for future environmental assessments and remediation costs when information becomes available that indicates that it is probable that the Company is liable for any related claims and assessments and the amount of the liability is reasonably estimable. The Company does not believe that these matters will have a material adverse effect on the Company's financial condition, cash flows or results of operations.

Corrosion, hydrogen embrittlement, cracking, material hardness, wood pressure-treating chemicals, misinstallations, environmental conditions or other factors can contribute to failure of fasteners, connectors, and tools. On occasion, some of the fasteners that the Company sells have failed, although the Company has not incurred any material liability resulting from those failures. The Company attempts to avoid such failures by establishing and monitoring appropriate product specifications, manufacturing quality control procedures, inspection procedures and information on appropriate installation methods and conditions. The Company subjects its products to extensive testing, with results and conclusions published in Company catalogues and on its website (see [www.strongtie.com/info](http://www.strongtie.com/info)). Based on test results to date, the Company believes that, generally, if its products are appropriately selected and installed in accordance with the Company's guidance, they may be reliably used in appropriate applications.

In May 2005, the Company completed the purchase, for approximately \$4.1 million, of the facility that it previously rented from a related party in Columbus, Ohio, and is expanding this facility on land adjacent to that property. The transaction was unanimously approved by the independent members of the Company's Board of Directors. The expansion is expected to be completed in April 2006 at a cost of \$14.6 million.

In July 2005, the Company entered into an agreement to purchase a building in Vacaville, California, from a related party for \$5.7 million. The building is 125 thousand square feet and is currently being leased by the Company's subsidiary, Simpson Dura-Vent. The Company has completed its due diligence and with the satisfaction of other customary conditions, the transaction is expected to close in January 2008. The transaction was unanimously approved by the independent members of the Company's Board of Directors.

In August 2005, the Company completed the purchase of property in Pleasanton, California, for \$9.3 million, which it plans to use as its administrative offices and its engineering laboratory. The Company anticipates additional expenditures of \$6.5 million to \$7.0 million to prepare the facility for use.

## 8. Segment Information

The Company is organized into two primary segments. The segments are defined by types of products manufactured, marketed and distributed to the Company's customers. The two product segments are connector products and venting products. These segments are differentiated in several ways, including the types of materials used, the production process, the distribution channels used and the applications in which the products are used. Transactions between the two segments were immaterial for each of the periods presented.

The following table illustrates certain measurements used by management to assess the performance of the segments described above as of or for the following periods:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
<i>Net Sales</i>				
Connector products	\$ 209,453	\$ 167,675	\$ 582,194	\$ 472,329
Venting products	24,356	20,885	60,165	57,982
Total	\$ 233,809	\$ 188,560	\$ 642,359	\$ 530,311
<i>Income from Operations</i>				
Connector products	\$ 45,839	\$ 35,571	\$ 117,891	\$ 97,384
Venting products	2,705	3,206	3,984	6,809
Administrative and all other	205	(181)	(806)	(667)
Total	\$ 48,749	\$ 38,596	\$ 121,069	\$ 103,526
	At September 30,		At December 31,	
	2005	2004	2004	2004
<i>Total Assets</i>				
Connector products	\$ 458,684	\$ 380,948	\$ 427,418	\$ 427,418
Venting products	66,506	58,019	56,188	56,188
Administrative and all other	115,403	93,266	61,531	61,531
Total	\$ 640,593	\$ 532,233	\$ 545,137	\$ 545,137

Cash collected by the Company's subsidiaries is routinely transferred into the Company's cash management accounts and, therefore, has been included in the total assets of the segment entitled Administrative and all other. Cash and cash equivalent and short-term investment balances in the Administrative and all other segment were approximately \$103.1 million, \$79.9 million, and \$47.0 million, as of September 30, 2005 and 2004, and December 31, 2004, respectively.

## 9. Subsequent Events

In October 2005, the Company received notification and payment of a refund, with interest, totaling \$0.7 million for state taxes paid related to the 1998 and 1999 tax years. The refund and interest will be recorded in the fourth quarter of 2005.



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

*Certain matters discussed below are forward-looking statements that involve risks and uncertainties, certain of which are discussed in this report and in other reports filed by the Company with the Securities and Exchange Commission. Actual results might differ materially from results suggested by any forward-looking statements in this report.*

The following is a discussion and analysis of the consolidated financial condition and results of operations for the Company for the three and nine months ended September 30, 2005 and 2004. The following should be read in conjunction with the interim Condensed Consolidated Financial Statements and related Notes appearing elsewhere herein.

Results of Operations for the Three Months Ended September 30, 2005, Compared

with the Three Months Ended September 30, 2004

Net sales increased 24.0% to \$233.8 million in the third quarter of 2005 as compared to net sales of \$188.6 million for the third quarter of 2004. Net income increased 30.7% to \$31.6 million for the third quarter of 2005 as compared to net income of \$24.2 million for the third quarter of 2004. Diluted net income per common share was \$0.65 for the third quarter of 2005 as compared to \$0.50 for the third quarter of 2004. Included in the third quarter 2005 results is a gain of \$2.0 million resulting from the sale, for \$4.0 million, of the Company's engineering laboratory in San Leandro, California. The laboratory is being relocated later this year to the property in Pleasanton, California, that the Company purchased in May of this year.

In the third quarter of 2005, sales growth occurred throughout North America and continental Europe. Sales were down slightly in the UK. The growth in the United States was strongest in the southern, western (excluding California) and northeastern regions. Simpson Strong-Tie's third quarter sales increased 24.9% over the same quarter last year, while Simpson Dura-Vent's sales increased 16.6%. Dealer distributors, lumber dealers and contractor distributors were the fastest growing Simpson Strong-Tie sales channels. The sales increase was broad based across most of Simpson Strong-Tie's major product lines. Sales of the Quik Drive product line, acquired in the fourth quarter of 2004, contributed significantly to the increase. Seismic and high wind products and engineered wood products had the highest percentage growth rates in sales. Anchor systems sales showed solid growth during the third quarter of 2005 compared to the third quarter in 2004. Sales of Simpson Strong-Tie's Strong-Wall product line, which were substantial in California, increased as compared to the third quarter of 2004. Sales of Simpson Dura-Vent's pellet vent and chimney product lines increased significantly in the third quarter of 2005. Sales of direct-vent products, designed for use with natural gas burning appliances, decreased compared to the third quarter of 2004, and sales of gas vent products were flat.

Income from operations increased 26.3% from \$38.6 million in the third quarter of 2004 to \$48.7 million in the third quarter of 2005, while gross margins decreased from 41.2% in the third quarter of 2004 to 38.4% in the third quarter of 2005. This decrease in gross margins was primarily due to increased material costs, mainly steel, which increased at a faster rate than the sales price increases that the Company put in place during 2004 and early 2005. The material cost increase was partially offset by improved absorption of the Company's fixed overhead costs, primarily due to the increased sales volume. The Company's raw material inventory continued to decrease, by 30.6% from balances as of December 31, 2004, while its in-process and finished goods inventory increased by 10.0% over the same period. As a result of high raw material and energy prices and increased demand in the aftermath of hurricane Katrina, the Company believes that steel prices are likely to increase in the near term and has increased its purchasing effort since the end of the third quarter. If steel prices do increase and the Company is not able to increase its prices, the Company's margins could deteriorate.

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Selling expenses increased 10.2% from \$14.2 million in the third quarter of 2004 to \$15.7 million in the third quarter of 2005. The increase was driven primarily by a \$0.5 million increase in costs associated with the addition of sales and marketing personnel, including those associated with the acquisition of the assets of Quik Drive, U.S.A., Inc. and Quik Drive Canada, Inc. and 100% of the equity of Quik Drive Australia Pty. Limited (collectively Quik Drive ) and a \$0.3 million increase in commissions paid to sales agents as a result of the increase in Simpson Dura-Vent's third quarter sales. General and administrative expenses increased 10.3% from \$24.7 million in the third quarter of 2004 to \$27.3 million in the third quarter of 2005. The increase was primarily due to an increase in cash profit sharing of \$1.2 million, as a result of increased operating profit, and a reserve in the amount of \$0.5 million related to a potential European tax liability. In addition, amortization of intangible assets increased by \$0.4 million, and costs associated with the addition of administrative personnel increased by \$0.2 million. The increases in



amortization and personnel costs were primarily associated with the Quik Drive acquisition. In addition, stock compensation costs were higher by \$0.2 million. Partially offsetting the increases was a decrease in legal expenses of \$0.4 million. The tax rate was 35.7% in the third quarter of 2005, down from 37.6% in the third quarter of 2004. The decrease was primarily due to lower taxable income as a result of the manufacturing deduction for qualified production activity income under the American Jobs Creation Act of 2004. In October 2005, the Company received a refund, with interest, totaling \$0.7 million for state taxes paid related to the 1998 and 1999 tax years. The refund and interest will be recorded in the fourth quarter of 2005.

Results of Operations for the Nine Months Ended September 30, 2005, Compared

with the Nine Months Ended September 30, 2004

Net sales increased 21.1% to \$642.4 million in the first nine months of 2005 as compared to net sales of \$530.3 million for the first nine months of 2004. Net income increased 20.1% to \$76.8 million for the first nine months of 2005 as compared to net income of \$63.9 million for the first nine months of 2004. Diluted net income per common share was \$1.58 for the first nine months of 2005 as compared to \$1.31 for the first nine months of 2004.

In the first nine months of 2005, sales growth occurred throughout North America and continental Europe. Sales in the UK were flat. The growth in the United States was strongest in the southern and western regions, excluding California. Sales in California continued to increase relative to the first quarter of 2005 when heavy rains, particularly in southern California, slowed construction activity. Simpson Strong-Tie's year-to-date sales for 2005 increased 23.3% over the same period last year, while Simpson Dura-Vent's sales increased 3.8%. Lumber dealers were the fastest growing Simpson Strong-Tie sales channel. The sales increase was broad based across most of Simpson Strong-Tie's major product lines. Sales of Quik Drive products contributed significantly to the increase. Seismic and high wind products, engineered wood products and anchor systems had the highest percentage growth rates in sales. Sales of Simpson Strong-Tie's Strong-Wall product line, which were substantial in California, decreased from the first nine months of 2004 primarily due to the slow sales in the first quarter of 2005. Sales of Simpson Dura-Vent's pellet vent and chimney products increased in the first nine months of 2005, primarily due to their performance in the third quarter. Sales of direct-vent products decreased compared to the third quarter of 2004 while sales of its gas vent products decreased slightly.

Income from operations increased 16.9% from \$103.5 million in the first nine months of 2004 to \$121.1 million in the first nine months of 2005 while gross margins decreased from 40.8% in the first nine months of 2004 to 37.8% in the first nine months of 2005. This decrease was primarily due to increased material costs, mainly steel, which increased at a faster rate than the sales price increases that the Company put in place during 2004 and early 2005. The material cost increase was offset slightly by improved absorption of the Company's fixed overhead costs, primarily due to the increased sales volume.

Selling expenses increased 10.4% from \$42.6 million in the first nine months of 2004 to \$47.1 million in the first nine months of 2005, primarily due to increased costs associated with the addition of sales and marketing personnel of \$2.6 million, including those associated with the acquisition of Quik Drive. General and administrative expenses increased 9.1% from \$70.6 million in the first nine months of 2004 to \$77.0 million in the first nine months of 2005. The increase was primarily due to increased costs associated with the addition of administrative personnel of \$1.6 million and an increase in amortization of intangible assets of \$1.3 million. The increases in personnel costs and amortization were primarily associated with the Quik Drive acquisition. In addition, cash profit sharing increased by \$1.5 million, as a result of increased operating profit, and stock compensation costs increased by \$0.7 million. The tax rate was 37.0% in the first nine months of 2005, down from 38.4% in the first nine months of 2004. The decrease was primarily due to lower taxable income as a result of the manufacturing deduction for qualified production activity income under the American Jobs Creation Act of 2004.

Liquidity and Sources of Capital

As of September 30, 2005, working capital was \$328.9 million as compared to \$279.0 million at September 30, 2004, and \$268.7 million at December 31, 2004. The increase in working capital from December 31, 2004, was primarily due to an increase in cash and cash equivalents of \$73.4 million from December 31, 2004. In addition, the Company's trade accounts receivable increased by \$39.8 million. Net accounts receivable increased 44.3% from December 31, 2004, primarily due to the increase in sales. Offsetting this increase in working capital were decreases in inventories and short-term investments of \$18.1 million and \$10.7 million, respectively, and increases in net trade accounts payable of \$9.3 million and accrued cash profit sharing and commissions, primarily as a result of higher operating income, of \$7.2 million. The balance of the change in working capital was due to the fluctuation of various

other asset and liability accounts. The working capital change and changes in noncurrent assets and liabilities, combined with net income of \$76.8 million and noncash expenses, primarily depreciation, amortization, and stock-based compensation charges, totaling approximately \$22.6 million, resulted in net cash provided by operating activities of \$95.5 million. As of September 30, 2005, the Company had unused credit facilities available of \$29.3 million.

The Company used \$16.5 million in its investing activities. Approximately \$31.1 million was used for capital expenditures, primarily for facilities in Columbus, Ohio, and Pleasanton, California, as well as for machinery and equipment for its facilities in McKinney, Texas, San Leandro and Vacaville, California, and Vicksburg, Mississippi. This was offset by the maturities and redemptions of available-for-sale securities of \$7.0 and \$3.5 million, respectively. The Company expects its total capital spending to be approximately \$47.0 million for 2005.

In May 2005, the Company completed the purchase, for \$4.1 million, of the facility that it previously leased from a related party in Columbus, Ohio, and is expanding this facility on land adjacent to that property. The transaction was unanimously approved by the independent members of the Company's Board of Directors. The expansion is expected to be completed in April 2006 at a cost of \$14.6 million. In August 2005, the Company completed the purchase of the property in Pleasanton, California, for \$9.3 million, which it plans to use as its administrative offices and its engineering laboratory. The Company anticipates additional expenditures of \$6.5 million to \$7.0 million to prepare the facility for use. The Company plans to move its administrative offices into the new building and vacate its leased property in Dublin, California, in mid-2006. The Company has not finalized its plans at this time, but anticipates a one-time charge to income in 2006 for the fair value of the remaining lease payments at the Dublin property, which it estimates will total approximately \$1.8 million. In July 2005, the Company entered into an agreement to purchase a building in Vacaville, California, from a related party for \$5.7 million. The building is 125 thousand square feet and is currently being leased by the Company's subsidiary, Simpson Dura-Vent. The Company has completed its due diligence and with the satisfaction of other customary conditions, the transaction is expected to close in January 2008. The transaction was unanimously approved by the independent members of the Company's Board of Directors. In September 2005, the Company sold one of its buildings in San Leandro, California, for \$4.0 million and realized a gain of \$2.0 million. The Company's subsidiary, Simpson Strong-Tie Company Inc., is currently renting the building from the buyers and using it primarily as its engineering laboratory until the new facility in Pleasanton, California, is ready for occupancy, anticipated to be late 2005.

The Company vacated and has listed its original McKinney, Texas, facility for sale but cannot estimate when it will be sold or the proceeds of such a sale. The Company has performed an analysis of the valuation of this property and does not believe that the asset is impaired at this time, although conditions may change in the future.

The Company's financing activities used net cash of \$5.1 million. Uses of cash for financing activities were primarily from the payments of cash dividends totaling \$7.2 million in January, April and July 2005, which were declared in September 2004 and January and May 2005, respectively. Cash provided by financing activities was primarily from borrowings on the Company's credit lines of its European subsidiaries of \$0.7 million and the issuance of the Company's stock through its stock option plan of \$2.4 million.

The Company believes that cash generated by operations and borrowings available under its existing credit agreements will be sufficient for the Company's working capital needs and planned capital expenditures over the next twelve months. Depending on the Company's future growth and possible acquisitions, it may become necessary to secure additional sources of financing.

There have been no other material changes to the contractual obligation table represented in Item 7 of the Company's 2004 Annual Report which provides information concerning the Company's commitments and obligations at December 31, 2004.

The Company believes that the effect of inflation on the Company has not been material in recent years, as general inflation rates have remained relatively low. The Company's main raw material, however, is steel, and increases in steel prices may adversely affect the Company's gross margins if it cannot recover the higher costs through price increases.

**Item 3. Quantitative and Qualitative Disclosures About Market Risk.**

The Company's short-term investments consisted of debt securities of approximately \$6.3 million as of September 30, 2005. These securities, like all fixed income instruments, are subject to interest rate risk and will vary in value as market interest rates fluctuate. If market interest rates were to increase immediately and uniformly by 10% from levels as of September 30, 2005, the decline in the fair value of the investments would not have a material effect on the Company's financial position as of September 30, 2005, or results of operations for the three or nine months then ended.

The Company has foreign exchange rate risk in its international operations, primarily Europe and Canada, and through purchases from foreign vendors. The Company does not currently hedge this risk. If the exchange rate were to change by 10% in any one country where the Company has operations, the change in net income would not be material to its operations taken as a whole. The translation adjustment resulted in an increase in accumulated other comprehensive income of \$1.1 million for the three months ended September 30, 2005, and a reduction in accumulated other comprehensive income of \$4.5 million for the nine months ended September 30, 2005, primarily due to the effect of the strengthening of the U.S. dollar in relation to European and Canadian currencies during the first six months of 2005 and a weakening of the U.S. dollar versus the Canadian dollar in the third quarter of 2005.

**Item 4. Controls and Procedures.**

*Disclosure Controls and Procedures.* As of September 30, 2005, an evaluation of the effectiveness of the design and operation of the Company's disclosure controls and procedures was performed under the supervision and with the participation of the Company's management, including the chief executive officer ( CEO ) and the chief financial officer ( CFO ). Based on that evaluation, the CEO and the CFO concluded that the Company's disclosure controls and procedures were effective as of that date.

*Changes in Internal Control over Financial Reporting.* During the three months ended September 30, 2005, the Company made no changes to its internal controls over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) that have materially affected, or are reasonably likely to materially affect, its internal controls over financial reporting.

PART II OTHER INFORMATION

**Item 1. Legal Proceedings.**

From time to time, the Company is involved in various legal proceedings and other matters arising in the normal course of business. The resolution of claims and litigation, however, is subject to inherent uncertainty and it is possible that such resolution could have a material adverse effect on the Company's financial condition, cash flows or results of operations.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.**

In December 2004, the Board of Directors authorized the Company to repurchase up to \$50.0 million of the Company's common stock. This replaces the \$50.0 million repurchase authorization from December 2003. The authorization will remain in effect through the end of 2005. There were no purchases by the Company during the third quarter of 2005.

Dividends are determined by the Company's Board of Directors, based on the Company's earnings, cash flow, financial condition and other factors deemed relevant by the Board of Directors. In addition, existing loan agreements require the Company to maintain tangible net worth of \$250.0 million plus 50% of net profit after taxes for each fiscal year. This requirement may limit the amount that the Company may pay out as dividends on the common stock. As of September 30, 2005, the Company had \$193.4 million available for the payment of dividends under these loan agreements.

**Item 3. Defaults Upon Senior Securities.**

None.

**Item 4. Submission of Matters to a Vote of Security Holders.**

None.

**Item 5. Other Information.**

None.

**Item 6. Exhibits.**

- 31. Rule 13a-14(a)/15d-14(a) Certifications.
- 32. Section 1350 Certifications.

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**Simpson Manufacturing Co., Inc.**  
(Registrant)

**DATE:** November 8, 2005

By /s/Michael J. Herbert

Michael J. Herbert  
Chief Financial Officer  
(principal accounting and financial officer)