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MATERIAL SCIENCES CORP
Form 10-Q
January 08, 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 November 30, 2002
Commission File Number 1-8803

MATERIAL SCIENCES CORPORATION
(Exact name of Registrant as specified in its charter)

Delaware 95-2673173
(State or other jurisdiction (IRS employer identification number)
of incorporation or organization)

2200 East Pratt Boulevard 60007
Elk Grove Village, Illinois (Address of principal executive offices)
(Zip code)

Registrant's telephone number, including area code: (847) 439-8270

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

As of January 2, 2003, there were 14,032,268 outstanding shares of common stock, \$.02 par value.

MATERIAL SCIENCES CORPORATION

FORM 10-Q

For The Quarter Ended November 30, 2002
(In thousands, except per share data)

PART I. FINANCIAL INFORMATION

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Item 1. Financial Statements

(a) Financial statements of Material Sciences Corporation and Subsidiaries

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Consolidated Statements of Income (Loss) (Unaudited) Material Sciences Corporation and Subsidiaries

| (In thousands, except per share data) | Three Months November 2002 |
|--|---|
| <hr style="border-top: 1px dashed black;"/> | |
| Net Sales (1) | \$ 67,401 |
| Cost of Sales | 55,593 |
| | <hr style="border-top: 1px dashed black;"/> |
| Gross Profit | \$ 11,808 |
| Selling, General and Administrative Expenses | 10,390 |
| Restructuring Expenses (10) | 855 |
| | <hr style="border-top: 1px dashed black;"/> |
| Income (Loss) from Operations | \$ 563 |
| | <hr style="border-top: 1px dashed black;"/> |
| Other (Income) and Expense: | |
| Interest (Income) Expense, Net (14) | \$ 747 |
| Equity in Results of Joint Ventures | 363 |
| Other, Net | 32 |
| | <hr style="border-top: 1px dashed black;"/> |
| Total Other Expense, Net | \$ 1,142 |
| | <hr style="border-top: 1px dashed black;"/> |
| Income (Loss) from Continuing Operations Before Provision | |
| (Benefit) for Income Taxes | \$ (579) |
| Provision (Benefit) for Income Taxes | (281) |
| | <hr style="border-top: 1px dashed black;"/> |
| Income (Loss) from Continuing Operations | \$ (298) |
| Discontinued Operations: (7) (13) | |
| Income from Discontinued Operation - Specialty Films (Net of Provision for Income Taxes of \$0, \$0, \$0 and \$1,009, Respectively) | - |
| Loss from Discontinued Operation - Pinole Point Steel (Net of Benefit for Income Taxes of \$0, \$0, \$0 and \$5,261, Respectively) | - |
| Gain (Loss) on Sale of Discontinued Operation - Specialty Films (Net of Benefit for Income Taxes of \$0, \$0, \$70 and Provision for Income Taxes of \$31,445, Respectively) | - |
| Gain (Loss) on Discontinued Operation - Pinole Point Steel (Net of Benefit for Income Taxes of \$102, Provision for Income Taxes of \$0 and \$2,032 and Benefit for Income Taxes of \$7,588, Respectively) | (145) |
| Extraordinary Loss on Early Retirement of Debt (Net of Benefit for Income Taxes of \$1,546) (15) | - |
| | <hr style="border-top: 1px dashed black;"/> |
| Net Income (Loss) | \$ (443) |
| | <hr style="border-top: 3px double black;"/> |
| Basic Net Income (Loss) Per Share: | |
| Income (Loss) from Continuing Operations | \$ (0.02) |
| Income from Discontinued Operation - Specialty Films | - |
| Loss from Discontinued Operation - Pinole Point Steel | - |
| Gain (Loss) on Sale of Discontinued Operation - Specialty Films | - |
| Gain (Loss) on Discontinued Operation - Pinole Point Steel | (0.01) |

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| | |
|---|-----------|
| Extraordinary Loss on Early Retirement of Debt | - |
| | ----- |
| Basic Net Income (Loss) Per Share | \$ (0.03) |
| | ===== |
| Diluted Net Income (Loss) Per Share: | |
| Income (Loss) from Continuing Operations | \$ (0.02) |
| Income from Discontinued Operation - Specialty Films | - |
| Loss from Discontinued Operation - Pinole Point Steel | - |
| Gain (Loss) on Sale of Discontinued Operation - Specialty Films | - |
| Gain (Loss) on Discontinued Operation - Pinole Point Steel | (0.01) |
| Extraordinary Loss on Early Retirement of Debt | - |
| | ----- |
| Diluted Net Income (Loss) Per Share | \$ (0.03) |
| | ===== |
| Weighted Average Number of Common Shares Outstanding | |
| Used for Basic Net Income (Loss) Per Share | 13,656 |
| Dilutive Shares | - |
| | ----- |
| Weighted Average Number of Common Shares Outstanding | |
| Plus Dilutive Shares | 13,656 |
| | ===== |
| Outstanding Common Stock Options Having No Dilutive Effect | 747 |
| | ===== |

The accompanying notes are an integral part of these statements.

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Consolidated Balance Sheets (Unaudited)
Material Sciences Corporation and Subsidiaries

| | |
|--|----------------------|
| (In thousands) | November 30, 2002 |
| | ----- |
| Assets: | |
| Current Assets: | |
| Cash and Cash Equivalents | \$ 44,505 |
| Restricted Cash (8) | 2,630 |
| | ----- |
| Total Cash and Cash Equivalents | \$ 47,135 |
| Marketable Securities (11) | 3,030 |
| Receivables, Less Reserves of \$4,581 and \$4,754, Respectively (2) | 27,583 |
| Income Taxes Receivable | 3,526 |
| Prepaid Expenses | 2,458 |
| Inventories: | |
| Raw Materials | 10,755 |
| Finished Goods | 14,402 |
| Prepaid Taxes | 2,451 |
| Current Assets of Discontinued Operation, Net - Pinole Point Steel (7) | 13,597 |
| | ----- |
| Total Current Assets | \$ 124,937 |
| | ----- |

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| | |
|--|------------|
| Property, Plant and Equipment | \$ 248,915 |
| Accumulated Depreciation and Amortization | (153,990) |
| | ----- |
| Net Property, Plant and Equipment | \$ 94,925 |
| | ----- |
| Other Assets: | |
| Investment in Joint Ventures (12) | \$ 13,475 |
| Intangible Assets, Net (9) | 6,557 |
| Other | 1,138 |
| | ----- |
| Total Other Assets | \$ 21,170 |
| | ----- |
| Total Assets | \$ 241,032 |
| | ===== |
| Liabilities: | |
| Current Liabilities: | |
| Current Portion of Long-Term Debt (15) | \$ 11,721 |
| Accounts Payable | 23,646 |
| Accrued Payroll Related Expenses | 12,006 |
| Accrued Expenses | 8,177 |
| Accrued Future Operating Losses - Pinole Point Steel (7) | - |
| | ----- |
| Total Current Liabilities | \$ 55,550 |
| | ----- |
| Long-Term Liabilities: | |
| Deferred Income Taxes | \$ 6,802 |
| Long-Term Debt, Less Current Portion (15) | 43,944 |
| Other | 10,949 |
| | ----- |
| Total Long-Term Liabilities | \$ 61,695 |
| | ----- |
| Shareowners' Equity: | |
| Preferred Stock (3) | \$ - |
| Common Stock (4) | 365 |
| Additional Paid-In Capital | 69,607 |
| Treasury Stock at Cost (5) | (46,528) |
| Retained Earnings | 99,572 |
| Accumulated Other Comprehensive Income (Loss) (6) (11) | 771 |
| | ----- |
| Total Shareowners' Equity | \$ 123,787 |
| | ----- |
| Total Liabilities and Shareowners' Equity | \$ 241,032 |
| | ===== |

The accompanying notes are an integral part of these statements.

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| (In thousands) | 2002 | |
|--|----------|-------|
| ----- | | |
| Cash Flows From: | | |
| Operating Activities: | | |
| Net Income (Loss) | \$ (443) | \$ |
| Adjustments to Reconcile Net Income (Loss) to Net Cash Provided by | | |
| (Used in) Operating Activities: | | |
| Discontinued Operation, Net - Specialty Films (13) | - | |
| Discontinued Operation, Net - Pinole Point Steel (7) | 725 | |
| Gain on Sale of Discontinued Operation - Specialty Films (13) | - | |
| Loss on Discontinued Operation - Pinole Point Steel (7) | 145 | |
| Depreciation and Amortization | 4,052 | |
| Benefit for Deferred Income Taxes | (164) | |
| Compensatory Effect of Stock Plans | 342 | |
| Other, Net | 355 | |
| Changes in Assets and Liabilities: | | |
| Receivables | 841 | |
| Income Taxes Receivable | (279) | |
| Prepaid Expenses | 491 | |
| Inventories | (73) | |
| Accounts Payable | 631 | |
| Accrued Expenses | 2,231 | |
| Income Taxes Payable | - | (|
| Other, Net | 155 | |
| | ----- | ----- |
| Net Cash Provided by (Used in) Operating Activities | \$ 9,009 | \$ (|
| | ----- | ----- |
| Investing Activities: | | |
| Discontinued Operation, Net - Specialty Films (13) | \$ - | \$ |
| Discontinued Operation, Net - Pinole Point Steel (7) | - | |
| Cash Received from Sale of Specialty Films, Net (13) | - | |
| Cash Received from Sale of Pinole Point Steel, Net (7) | - | |
| Capital Expenditures | (1,131) | |
| Acquisition, Net of Cash Acquired | - | |
| Investment in Joint Ventures (12) | (108) | |
| Purchases of Marketable Securities (11) | - | (|
| Proceeds from Sale of Marketable Securities (11) | 1,037 | |
| Other | 43 | |
| | ----- | ----- |
| Net Cash Provided by (Used in) Investing Activities | \$ (159) | \$ (|
| | ----- | ----- |
| Financing Activities: | | |
| Discontinued Operation, Net - Specialty Films (13) | \$ - | \$ |
| Proceeds Under Line of Credit | - | |
| Payments Under Line of Credit | - | |
| Payments of Debt | (158) | |
| Cash from Cancellation of Letter of Credit (8) | 28 | |
| Purchase of Treasury Stock (5) | - | |
| Issuance of Common Stock | 267 | |
| | ----- | ----- |
| Net Cash Provided by (Used in) Financing Activities | \$ 137 | \$ |
| | ----- | ----- |
| Net Increase (Decrease) in Cash | \$ 8,987 | \$ (|
| Cash and Cash Equivalents at Beginning of Period | 35,518 | |
| | ----- | ----- |
| Cash and Cash Equivalents at End of Period | \$44,505 | \$ |
| | ===== | ===== |

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Supplemental Cash Flow Disclosures:

| | | | |
|-------------------|----|-----|----|
| Interest Paid | \$ | 203 | \$ |
| Income Taxes Paid | | 182 | |

The accompanying notes are an integral part of these statements.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)
MATERIAL SCIENCES CORPORATION
(In thousands)

The data for the three and nine months ended November 30, 2002 and 2001 have not been audited by our independent public accountants but, in the opinion of Material Sciences Corporation (the "Company" or "MSC"), reflect all adjustments (consisting of only normal, recurring adjustments) necessary for a fair presentation of the information at those dates and for those periods. The financial information contained in this report should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended February 28, 2002. Certain prior year amounts have been reclassified to conform with the fiscal 2003 presentation.

- (1) During the nine months ended November 30, 2002 and 2001, the Company derived approximately 22% and 21%, respectively, of its sales from fees billed by a subsidiary of the Company to Walbridge Coatings (the "Partnership") for operating the Walbridge, Ohio facility. Summarized financial information for the Partnership is presented below:

| Income Statement Information | Three Months Ended | | Nine Months Ended | |
|------------------------------|---------------------------|----------|-------------------|-----------|
| | November 30, | | November 30, | |
| | 2002 | 2001 | 2002 | 2001 |
| Net Sales | \$ 11,577 | \$ 4,153 | \$ 42,182 | \$ 32,663 |
| Loss from Operations | (624) | (207) | (1,847) | (1,453) |
| Net Loss | (568) | (207) | (1,774) | (1,439) |
| | | | | |
| Balance Sheet Information | November 30, February 28, | | | |
| | 2002 | | | |
| | 2002 | 2002 | | |
| Current Assets | \$ 6,324 | \$ 7,949 | | |
| Total Assets | 17,575 | 20,632 | | |
| Total Liabilities | 122 | 1,627 | | |
| Partners' Capital | 17,453 | 19,005 | | |

- (2) Includes trade receivables due from the Partnership of \$2,399 as of November 30, 2002 and \$1,621 as of February 28, 2002.
- (3) Preferred Stock, \$1.00 Par Value; 10,000,000 Shares Authorized; 1,000,000 Designated Series B Junior Participating Preferred; None Issued.
- (4) Common Stock, \$.02 Par Value; 40,000,000 Shares Authorized; 18,225,175

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Shares Issued and 14,036,527 Shares Outstanding as of November 30, 2002 and 18,115,624 Shares Issued and 14,731,188 Shares Outstanding as of February 28, 2002.

- (5) Treasury Stock at Cost: 4,188,648 Shares as of November 30, 2002 and 3,384,436 Shares as of February 28, 2002. On June 22, 2000, MSC's Board of Directors authorized the repurchase of up to one million shares of the Company's common stock. In the third quarter of fiscal 2001, the Company suspended the program after having purchased 709,381 shares.

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On March 1, 2002, the Company purchased 13,593 of its shares from certain employees based on the closing price on February 28, 2002 in connection with the vesting of shares granted under the Company's 1999 Long-Term Incentive/Leverage Stock Awards Program ("1999 Program"). The Compensation Committee of the Board of Directors approved the share repurchase under the provisions of the Material Sciences Corporation 1992 Omnibus Awards Plan for Key Employees to cover a portion of the participants' tax withholding liability for the vesting of these shares under the 1999 Program.

On June 20, 2002, the Company resumed the previously approved repurchase program and by August 31, 2002, the Company had completed this share repurchase program by purchasing the remaining 290,619 shares with an average purchase price of \$14.89 per share. On June 20, 2002, MSC's Board of Directors also authorized a new program to repurchase up to an additional 500,000 shares of the Company's common stock. The repurchase of 500,000 shares was complete at August 31, 2002 with an average purchase price of \$14.50 per share. No further share repurchases have been approved by the Company's Board of Directors.

- (6) Comprehensive Income (Loss):

| | Three Months Ended | | Nine Months Ended | |
|--|--------------------|----------|-------------------|------------|
| | November 30, | | November 30, | |
| | 2002 | 2001 | 2002 | 2001 |
| | ----- | ----- | ----- | ----- |
| Net Income (Loss) | \$ (443) | \$ (319) | \$ 3,770 | \$ (7,586) |
| Other Comprehensive Income: | | | | |
| Foreign Currency Translation Adjustments | 12 | 181 | 850 | 181 |
| Unrealized Gain on Marketable Securities | 1 | 62 | 90 | 62 |
| | ----- | ----- | ----- | ----- |
| Comprehensive Income (Loss) | \$ (430) | \$ (76) | \$ 4,710 | \$ (7,343) |
| | ===== | ===== | ===== | ===== |

The decrease in foreign currency translation adjustments was due to higher exchange rates used to translate the Company's international operations to U.S. dollars in the third quarter of fiscal 2003. The Accumulated Other Comprehensive Income (Loss) included in Shareowners' Equity as of November 30, 2002 of \$771 included foreign currency translation adjustments of \$765 and unrealized gains on marketable securities of \$6.

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- (7) On May 31, 2002, the Company completed the sale of substantially all of the assets of its Pinole Point Steel business. The Company is in the process of liquidating the remaining assets and liabilities of the business. As of November 30, 2002, the Company has received \$51,243 related to the disposition and liquidation of the business, consisting of \$31,221 of sale proceeds from Grupo IMSA S.A. de C.V. and \$20,022 from liquidating the Pinole Point Steel operations. In addition, as of November 30, 2002, there is \$13,597 in net assets remaining to be liquidated. The net assets consist primarily of the expected tax refund due to a loss carryback offsetting a portion of the gain on sale of its Specialty Films business in the prior year. The remaining net assets include accounts receivable, offset, in part, by severance expenses and other liabilities not assumed by Grupo IMSA S.A. de C.V. Pinole Point Steel has been reported as a discontinued operation, and the consolidated financial

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statements have been reclassified to segregate the net assets and operating results of the business.

As of February 28, 2002, the Company recorded a provision for loss on discontinued operation, net of income taxes, of \$53,287. The loss on discontinued operation, net of income taxes, included the allocation of consolidated interest expense of \$5,391 incurred from September 1, 2001 through May 31, 2002. The allocations were based on the debt associated with the original purchase of Pinole Point Steel in December 1997 and Pinole Point Steel's subsequent cash flow. During the first quarter of fiscal 2003, the Company recorded an adjustment on sale of discontinued operation, net of income taxes, of \$3,683 to reduce the previously provided loss on discontinued operation. The adjustment consisted of a reduction for estimated operating losses of \$1,247 due to higher plant utilization and customers' willingness to accelerate product deliveries prior to the closing of the transaction. In addition, MSC recorded a favorable change in the estimated proceeds of the sale of \$2,436. During the second quarter of fiscal 2003, the Company recorded an additional loss on sale of discontinued operation, net of income taxes, of \$610 related to increases in previously estimated bad debt expense and product claims expense, and employee expenses related to the collection of accounts receivable and settlement of certain retained liabilities. During the third quarter of fiscal 2003, the Company recorded an additional loss on sale of discontinued operation, net of income taxes, of \$145 related to increases in previously estimated workers compensation expense, product claims expense and bad debt expense.

Net sales and loss from discontinued operation of Pinole Point Steel were as follows:

| | Three Months Ended | | Nine Months Ended | |
|--|--------------------|----------|-------------------|-----------|
| | November 30, | | November 30, | |
| | 2002 | 2001 | 2002 | 2001 |
| | ---- | ---- | ---- | ---- |
| Net Sales | \$ — | \$34,267 | \$48,050 | \$102,191 |
| Loss from Discontinued Operation, Net of Income Taxes | — | (3,591) | (2,136) | (11,152) |

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No consolidated interest expense was allocated to Pinole Point Steel in the three months ended November 30, 2002. The loss from discontinued operation, net of income taxes, for the three months ended November 30, 2001 includes the allocation of consolidated interest expense of \$1,797. For the nine-months ended November 30, 2002 and 2001, the loss from discontinued operation, net of income taxes, includes the allocation of interest expense of \$1,797 and \$6,303, respectively.

- (8) In April 2002, one of the Company's letters of credit for \$3,235 was canceled and the related cash collateral was released to the Company. During the third quarter of fiscal 2003, a \$28 commercial letter of credit expired. As of November 30, 2002, the Company's outstanding letters of credit continue to be cash collateralized. Other than \$2,630 and \$5,315 that were classified as restricted cash in the consolidated balance sheets as of November 30, 2002 and February 28, 2002, respectively, there are no other restrictions on the use of the Company's cash and cash equivalents under the Company's line of credit facility at times when no borrowings are outstanding. The line of credit is secured by accounts receivable of the Company.

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- (9) In June 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 141, "Business Combinations" and SFAS No. 142, "Goodwill and Other Intangible Assets." SFAS No. 141 requires that all business combinations initiated after June 30, 2001, be accounted for using the purchase method of accounting. With the adoption of SFAS No. 142 on March 1, 2002, goodwill is no longer subject to amortization over its estimated useful life. Goodwill will be subject to at least an annual assessment of impairment by applying a fair-value based test, beginning on the date of adoption of the new accounting standard. The Company completed its initial impairment assessment as of August 31, 2002 as required under the impairment requirements of SFAS No. 142 and no impairment was deemed necessary. MSC will complete the required annual impairment assessment in the fourth quarter of fiscal 2003.

As of November 30, 2002, the Company's net intangibles consisted of \$6,516 for goodwill and \$41 for a non-compete agreement.

The Company adopted SFAS No. 144, "Impairment or Disposal of Long-Lived Assets" on March 1, 2002. This statement further refines the rules for accounting for long-lived assets and long-lived assets to be disposed of. MSC has assessed the impairment requirements of SFAS No. 144 and believes that no adjustment is deemed necessary.

In April 2002, the FASB issued SFAS No. 145, "Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13 and Technical Corrections." SFAS No. 145 makes changes to several areas, including the classification of gains and losses from extinguishment of debt and accounting for certain lease modifications. The statement is effective for fiscal years beginning after May 15, 2002. With the adoption of SFAS No. 145 on March 1, 2003, the extraordinary loss on early retirement of debt will no longer be classified as an extraordinary item and will be reflected as a component of income from continuing operations in the consolidated statements of income (loss).

In June 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities" which addresses financial

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accounting and reporting for costs associated with exit or disposal activities. This statement requires that a liability be recognized at fair value for costs associated with exit or disposal activities only when the liability is incurred as opposed to at the time the Company commits to an exit plan as permitted under EITF Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." SFAS No. 146 is effective for exit or disposal activities that are initiated after December 31, 2002. The Company does not expect that the adoption of this statement will have a material impact on the Company's financial position, results of operations or cash flows.

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- (10) During the nine months of fiscal 2003, cash of \$459 was paid in conjunction with the restructuring program announced on November 15, 2001.

On November 20, 2002, the Company announced it implemented a program to reduce overhead and improve efficiencies. The program involves restructuring MSC's manufacturing organization, including terminations of 14 salaried personnel. The Company recorded a restructuring charge of \$855 for severance and other related costs in the third quarter of fiscal 2003. As of November 30, 2002, cash of \$16 was paid in conjunction with the restructuring program. As presented in the chart below, the restructuring reserve was \$918 at November 30, 2002.

| | Severance ----- | Other ----- | Total ----- |
|---|--------------------|----------------|----------------|
| Restructuring Reserve as of February 28, 2002 | \$ 434 | \$ 104 | \$ 538 |
| Restructuring Reserve as of November 20, 2002 | 677 | 178 | 855 |
| Total Cash Payments | (389) | (86) | (475) |
| | ----- | ----- | ----- |
| Total Restructuring Reserve as of November 30, 2002 | \$ 722 | \$ 196 | \$ 918 |
| | ===== | ===== | ===== |

- (11) During fiscal 2003, the Company made investments in marketable securities. These marketable securities are available for sale and consist primarily of investments in U.S. agency and corporate notes. These investments are expected to be held less than twelve months and are classified as marketable securities in the consolidated balance sheets. The Company recorded unrealized gains and losses on its investments in marketable securities to adjust the carrying value of these investments to fair value. Unrealized gains were \$6 as of November 30, 2002. The unrealized gains were classified as a component of Accumulated Other Comprehensive Income (Loss).
- (12) On May 13, 2002, MSC completed the purchase of LTV Corporation's ownership interests in the Partnership for \$3,137. As a result, MSC's ownership interest in the Partnership increased to 66.5% and it gained access to an additional 33% of the facility's available line time. Under the terms of the Partnership agreements, all significant operating actions require the consent of the management committee. MSC and Bethlehem Steel Company are each represented by two members on the four-member management committee. As a result, the Company does not have a controlling voting interest in the Partnership and, accordingly, continues to account for the Partnership under the equity method.

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- (13) On June 29, 2001, the Company completed the sale of substantially all of the assets of its Specialty Films segment, including its interest in Innovative Specialty Films, LLC, to Bekaert pursuant to the terms of the Purchase Agreement by and among MSC, MSC Specialty Films, Inc. ("MSC/SFI"), Bekaert and N.V. Bekaert S.A., dated June 10, 2001. As a result of the sale, Specialty Films is being reported as a discontinued operation in the prior year.

During the second quarter of fiscal 2003, the Company recorded an after-tax charge of \$101 related to a decrease in the previously estimated insurance premium refund for the Specialty Films business.

- (14) The table presented below analyzes the components of interest (income) expense, net.

| | Three Months Ended | | Nine Months Ended | |
|--|--------------------|----------|-------------------|---------|
| | November 30, | | November 30, | |
| | 2002 | 2001 | 2002 | 2001 |
| Interest (Income) Expense, Net: | | | | |
| Interest Expense | \$ 966 | \$ 1,829 | \$ 4,179 | \$ 6,49 |
| Interest Income | (219) | (528) | (777) | (1,04 |
| Interest Expense Allocated to Pinole Point Steel | - | (1,797) | (1,797) | (6,30 |
| Interest (Income) Expense, Net | \$ 747 | \$ (496) | \$ 1,605 | \$ (85 |

As a result of the sale of Pinole Point Steel, the Company no longer allocates interest expense to Pinole Point Steel.

- (15) On July 31, 2002, the Company made a debt payment of \$39,852 to the holders of the 1997 Senior Notes. The debt payment consisted of principal of \$35,714, interest of \$420 and a contractual prepayment penalty of \$3,718 (pretax basis). The extraordinary loss on early retirement of debt, net of income taxes, includes the prepayment penalty of \$2,257 and a \$131 write-off of debt issuance costs.

The estimated fair value of the Company's remaining debt, based on discounted cash flows, was less than the carrying value by \$6,387 as of November 30, 2002.

The 1998 Senior Note agreements require the Company to adhere to certain covenants. The most significant of these covenants include maintenance of consolidated cumulative adjusted net worth of \$118,341. This covenant may limit the Company's ability to repurchase its common stock from time to time. Other covenants include a consolidated senior debt ratio (maximum of 55.0% until agreement expiration) and a total indebtedness ratio (maximum of 60.0% until agreement expiration). MSC was in compliance with the financial covenants related to the 1998 Senior Notes for the period ended November 30, 2002.

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- (16) MSC is a party to various legal proceedings in connection with the remediation of certain environmental matters. The most significant proceedings relate to the Company's involvement in Superfund sites in Kingsbury and Gary, Indiana. MSC has been named as a potentially responsible party ("PRP") for the surface, soil and ground water contamination at these sites.

The United States District Court for the Northern District of Indiana has entered a Consent Decree between the government and certain PRPs on the scope of its remediation work at the Kingsbury site. The participating PRPs account for approximately 75% of the waste volume sent to this site. In December 2001, the PRPs established and funded a trust that has contracted with a remediation contractor to undertake all foreseeable activities necessary to achieve cleanup of the site pursuant to the decree. The trust has purchased an annuity that will pay the remediation contractor the anticipated expenses and oversight costs, including the purchase of stop-loss insurance coverage to reimburse the trust in the event of unforeseen cleanup expenses. The Company contributed \$2,047 to the trust in December 2001, with no impact to income (loss) before income taxes, and expects that this payment will conclude its financial obligations with respect to the Kingsbury site. Upon the conclusion of litigation against a PRP that elected not to participate in the trust, the Company will be entitled to receive its pro rata share of any funds remaining in the site group litigation account and any periodic payments by the non-participating PRP equal to its share of the trust's ongoing remediation expenses. Moreover, should site closure be achieved ahead of schedule, the Company will be entitled to receive its pro rata share of the commuted value of the annuity less a 25% early closure incentive bonus payable to the remediation contractor.

The United States District Court for the Northern District of Indiana also has entered a Consent Decree between the government and certain PRPs on the scope of the remediation work at the Gary site. The estimate of the Company's liability for this site is \$1,100. This work has begun, and MSC has maintained a letter of credit for approximately \$1,200 to secure its obligation to pay its currently estimated share of the remediation expenses at this site.

On February 27, 2002, the Company received a notice of alleged violations of environmental laws, regulations or permits from the Illinois EPA related to volatile organic matter ("VOM") air emissions and other permitting issues at its Elk Grove Village facility. The Company has filed a response and performed stack testing for one of its production lines under the supervision of the Illinois EPA. Those recent stack test results, when considered with stack test results from the facility's other production lines taken in the past, indicate the Company's Elk Grove Village facility is in compliance with the overall VOM emission limitations in its Clean Air Act permit. However, the Company's VOM coating application volume on one of its production lines is in excess of the permit limit. To address that issue, the Company has filed a permit modification request to reflect the current VOM application rates on the facility's production lines, which the Illinois EPA recently granted. The Illinois EPA has indicated that resolution of the matters alleged in the February 27, 2002 Notice of Violation may require referral to the office of the Illinois Attorney General for potential enforcement action, which could lead to the imposition of penalties on the Company.

MSC believes its range of exposure for all known environmental matters, based on allocations of liability among PRPs, the most recent estimate of remedial work and other factors is \$1,100 to \$1,700. The Company's environmental reserves were approximately \$1,400 as of November 30, 2002.

The Company believes that the ultimate outcome of its environmental legal proceedings will not have a material adverse effect on the Company's financial condition or results of operations, given the reserves recorded as of November 30, 2002 and, where applicable, taking into account contributions from other PRPs. However, there can be no assurance that the Company's environmental legal proceedings, individually or in the aggregate, will not have a material adverse effect on the Company's financial condition or results of operations due to a number of uncertainties, including without limitation, the costs of site cleanup, the discretionary authority of the Illinois Attorney General in bringing enforcement actions and other factors.

The Company is also party to various legal actions arising in the ordinary course of its business. These legal actions cover a broad variety of claims spanning the Company's entire business. The Company believes that the resolution of these legal actions will not, individually or in the aggregate, have a material adverse effect on the Company's financial condition or results of operations.

MATERIAL SCIENCES CORPORATION

FORM 10-Q

For The Quarter Ended November 30, 2002

PART I. FINANCIAL INFORMATION

(In thousands)

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

The following management's discussion and analysis of financial condition and results of operations ("MD&A") should be read in conjunction with the February 28, 2002 Financial Statements and notes thereto, the MD&A included in the Company's Annual Report on Form 10-K and the Company's other filings with the Securities and Exchange Commission. Certain prior year amounts have been reclassified to conform with the fiscal 2003 presentation.

As a result of the sale of substantially all of the assets of the Company's Specialty Films segment, including MSC Specialty Films, Inc. ("MSC/SFI"), to Bekaert Corporation and its affiliates ("Bekaert") in the second quarter of fiscal 2002, and the sale of substantially all of the assets of the Company's Pinole Point Steel business, including MSC Pinole Point Steel Inc. and MSC Pre Finish Metals (PP) Inc., to Grupo IMSA S.A. de C.V. ("IMSA") and other third parties in the first quarter of fiscal 2003, both Specialty Films and Pinole Point Steel are reported as discontinued operations for all periods presented.

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RESULTS OF OPERATIONS

Net Sales

Net sales from continuing operations in the third quarter of fiscal 2003 were \$67,401, 6.6% higher than \$63,249 in the third quarter of fiscal 2002. For the nine months ended November 30, 2002, net sales from continuing operations increased 5.4% to \$207,212 from \$196,610 in the same period last year.

Sales of electronic-based materials decreased 7.6% to \$6,176 in the third quarter of fiscal 2003 from \$6,686 in the prior year period. For the nine months ended November 30, 2002, electronic-based materials sales increased 1.7% to \$16,729 compared with \$16,452 for the same period last year. For both periods, an unfavorable change in mix from stainless steel to aluminum disk drive sales and lower electronic cabinetry material sales were offset, in part, by higher set-top box and printer cartridge material shipments. For the third quarter and nine months of fiscal 2003, the Company has reported sales of \$102 and \$122 related to the switch and sensor business, respectively.

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Acoustical/thermal materials sales declined 6.3% in the third quarter of fiscal 2003 to \$14,916 as compared with \$15,921 in the third quarter of fiscal 2002, due mainly to decreased sales of disc brake noise damping materials as well as lower shipments of Specular+(R) to the lighting market offset, in part, by higher engine and body panel material shipments. For the nine months ended November 30, 2002 and 2001, acoustical/thermal materials sales decreased 7.1% to \$46,091 compared with \$49,633 for the same period last year. The change was due mainly to decreased sales to the automotive market and Specular+(R), somewhat offset by higher shipments to the appliance market.

Sales of coated metal materials increased 13.9% to \$46,309 during the third quarter of fiscal 2003, from \$40,642 in the third quarter of fiscal 2002. Coated metal materials sales increased to \$144,392 for the nine-month period ended November 30, 2002 as compared to \$130,525 for the same period last year, a 10.6% increase. The main contributors to the increase, for both periods, were higher electrogalvanizing sales as well as higher shipments of coated metal to the transportation and appliance markets, offset slightly by a decline in shipments to the building and construction and lighting markets. For the nine-month period ended November 30, 2002, the Company's electrogalvanizing sales primarily benefited from supplying a portion of Double Eagle Steel Coating Company's ("DESCO") requirements, whose coating line capabilities were interrupted by a major fire at the DESCO facility in December 2001.

Gross Profit

The Company's gross profit margin for the third quarter of fiscal 2003 was 17.5%, or \$11,808, as compared with 18.6%, or \$11,754, in the third quarter of fiscal 2002. The decrease in gross profit margin for the third quarter was due mainly to an unfavorable product mix partially offset by higher capacity utilization. For the nine months of fiscal 2003, gross profit margin was 18.8%, or \$39,005, as compared with 18.6%, or \$36,639, in the nine months of fiscal 2002. Higher capacity utilization was offset by a less favorable product mix and additional resources being focused at the manufacturing facilities as a result of the Company's November 15, 2001 restructuring program.

Selling, General and Administrative Expenses

Selling, general and administrative ("SG&A") expenses of \$10,390 were 15.4% of net sales in the third quarter of fiscal 2003 as compared with \$11,131, or

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17.6%, of net sales in the same period last year. The decrease in SG&A percentage was due to the increase in net sales somewhat offset by investments in marketing and research and development in the switch and sensor products business and professional services. For the nine-months ended November 30, 2002, SG&A expenses of \$30,074 were 14.5% of net sales as compared with \$32,059, or 16.3%, of net sales in fiscal 2002. The decrease in SG&A percentage was due to the increase in net sales offset by increased spending in marketing and research and development, higher variable compensation expense and professional services. The Company's year-to-date spending on its marketing and research and development spending related to the switch and sensor business in fiscal 2003 was approximately \$2,500. The Company anticipates marketing and research and development spending related to the switch and sensor business to be approximately \$3,700 for fiscal 2003.

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Restructuring Expenses

On November 20, 2002, the Company announced it implemented a program to reduce overhead and improve efficiencies. The program involves restructuring MSC's manufacturing organization, including terminations of 14 salaried personnel. The Company recorded a restructuring charge of \$855 for severance and other related costs in the third quarter of fiscal 2003. During the third quarter of fiscal 2002, the Company recorded a \$1,385 restructuring charge related to a reorganization and cost reduction program that combined the Company's previous three continuing operations into a single business unit. Total cash paid related to the restructuring programs in the third quarter and nine months of fiscal 2003 was \$102 and \$475, respectively. The remaining restructuring reserve for this program and the program initiated in 2001 was \$918 as of November 30, 2002.

Total Other (Income) and Expense, Net and Income Taxes

Total other expense, net was \$1,142 in the third quarter of fiscal 2003 as compared with \$66 in the third quarter of fiscal 2002. For the nine months ended November 30, 2002, total other expense, net was \$2,801 compared to \$469 in the prior year period. The variance was primarily due to interest expense not allocated to the Pinole Point Steel business in the third quarter. Equity in Results of Joint Ventures was flat with the prior year third quarter. For the nine months of fiscal 2003 and 2002, Equity in Results of Joint Ventures was a net loss of \$1,120 and \$1,014, respectively. The change in net loss was due to the increased ownership in Walbridge Coatings (the "Partnership") as a result of the Company purchasing LTV Corporation's ("LTV") interest in the first quarter. MSC's effective tax rate for continuing operations was 48.5% (benefit) for the third quarter of fiscal 2003 versus 61.5% (benefit) for the same period last year. For the nine months of fiscal 2003, the Company's effective income tax rate was 36.9% as compared with 27.8% in the nine months of fiscal 2002. The variance in the effective tax rate for both periods was due to tax credits and other permanent items relative to income before income taxes.

General

MSC serves the electrogalvanizing market through its 66.5% ownership interest in the Partnership. Under the terms of the Partnership agreements, all significant operating actions require the consent of the management committee. Bethlehem Steel Corporation ("BSC") continues to maintain a 33.5% ownership interest and has access to 63% of the available line time. MSC has the right to utilize available line time to the extent BSC does not order Partnership services. In the third quarter of fiscal 2003, MSC utilized 31% of the available line time. MSC and BSC are each represented by two members on the four-member management committee. The Company does not have a controlling voting interest in the

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Partnership and, accordingly, continues to account for the Partnership under the equity method. The Partnership term expires on December 31, 2004.

As previously reported, BSC filed for protection under Chapter 11 of the U.S. Bankruptcy Code on October 15, 2001. The Partnership is being treated as a critical vendor under BSC's proceedings. As of November 30, 2002, the Partnership had no BSC pre-petition receivables outstanding and \$2,940 of BSC post-petition receivables outstanding. The BSC post-petition receivables are judged to be collectible in full and, therefore, no reserve was recorded as of November 30, 2002. Sales to BSC through the Partnership were \$9,149 in the third quarter of fiscal 2003. BSC continues to participate in the Partnership and to furnish electrogalvanized coatings to the automotive industry. The Company believes that the Partnership's processing services are valuable to the BSC estate, however, there can be no assurance that the BSC bankruptcy will not result in further disruption of the business.

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On December 15, 2001, a major fire destroyed an electrogalvanizing facility owned by DESCO, a joint venture between U.S. Steel Corporation and Rouge Steel Company. The DESCO facility resumed production in September 2002 and MSC anticipates that sales to U.S. Steel Corporation and Rouge Steel Company will be significantly less than in the first two quarters of fiscal 2003. For the third quarter of fiscal 2003, U.S. Steel Corporation and Rouge Steel Company utilized 3% of the Partnership's available line time compared with 31% in the first two fiscal quarters. Due to uncertainty in the economy and bankruptcies in the steel industry, no assurance can be made as to the Partnership's future production levels.

On February 27, 2002, the Company received a notice of alleged violations of environmental laws, regulations or permits from the Illinois EPA related to volatile organic matter ("VOM") air emissions and other permitting issues at its Elk Grove Village facility. The Company has filed a response and performed stack testing for one of its production lines under the supervision of the Illinois EPA. Those recent stack test results, when considered with stack test results from the facility's other production lines taken in the past, indicate the Company's Elk Grove Village facility is in compliance with the overall VOM emission limitations in its Clean Air Act permit. However, the Company's VOM coating application volume on one of its production lines is in excess of the permit limit. To address that issue, the Company has filed a permit modification request to reflect the current VOM application rates on the facility's production lines, which the Illinois EPA recently granted. The Illinois EPA has indicated that resolution of the matters alleged in the February 27, 2002 Notice of Violation may require referral to the office of the Illinois Attorney General for potential enforcement action, which could lead to the imposition of penalties on the Company.

The Company believes that the ultimate outcome of its environmental legal proceedings will not have a material adverse effect on the Company's financial condition or results of operations, given the reserves recorded as of November 30, 2002 and, where applicable, taking into account contributions from other PRPs. However, there can be no assurance that the Company's environmental legal proceedings, individually or in the aggregate, will not have a material adverse effect on the Company's financial condition or results of operations due to a number of uncertainties, including without limitation, the costs of site cleanup, the discretionary authority of the Illinois Attorney General in bringing enforcement actions and other factors.

The Company is also party to various legal actions arising in the ordinary course of its business. These legal actions cover a broad variety of claims

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spanning the Company's entire business. The Company believes that the resolution of these legal actions will not, individually or in the aggregate, have a material adverse effect on the Company's financial condition or results of operations.

RESULTS OF DISCONTINUED OPERATIONS

Pinole Point Steel

On May 31, 2002, the Company completed the sale of substantially all of the assets of its Pinole Point Steel business. The Company is in the process of liquidating the remaining assets and liabilities of the business. As of November 30, 2002, the Company has received \$51,243 related to the disposition and liquidation of the business, consisting of \$31,221 of sale proceeds from Grupo IMSA S.A. de C.V. and \$20,022 from liquidating the Pinole Point Steel operations. In addition, as of November 30, 2002, there is \$13,597 in net assets remaining to

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be liquidated. The net assets consist primarily of the expected tax refund due to a loss carryback offsetting a portion of the gain on sale of its Specialty Films business in the prior year. The remaining net assets include accounts receivable, offset, in part, by severance expenses and other liabilities not assumed by Grupo IMSA S.A. de C.V. Pinole Point Steel has been reported as a discontinued operation, and the consolidated financial statements have been reclassified to segregate the net assets and operating results of the business.

As of February 28, 2002, the Company recorded a provision for loss on discontinued operation, net of income taxes, of \$53,287. The loss on discontinued operation, net of income taxes, included the allocation of consolidated interest expense of \$5,391 incurred from September 1, 2001 through May 31, 2002. The allocations were based on the debt associated with the original purchase of Pinole Point Steel in December 1997 and Pinole Point Steel's subsequent cash flow. During the first quarter of fiscal 2003, the Company recorded an adjustment on sale of discontinued operation, net of income taxes, of \$3,683 to reduce the previously provided loss on discontinued operation. The adjustment consisted of a reduction for estimated operating losses of \$1,247 due to higher plant utilization and customers' willingness to accelerate product deliveries prior to the closing of the transaction. In addition, MSC recorded a favorable change in the estimated proceeds of the sale of \$2,436. During the second quarter of fiscal 2003, the Company recorded an additional loss on sale of discontinued operation, net of income taxes, of \$610 related to increases in previously estimated bad debt expense and product claims expense, and employee expenses related to the collection of accounts receivable and settlement of certain retained liabilities. During the third quarter of fiscal 2003, the Company recorded an additional loss on sale of discontinued operation, net of income taxes, of \$145 related to increases in previously estimated workers compensation expense, product claims expense and bad debt expense.

Specialty Films

On June 29, 2001, the Company completed the sale of substantially all of the assets of its Specialty Films segment, including its interest in Innovative Specialty Films, LLC, to Bekaert pursuant to the terms of the Purchase Agreement by and among MSC, MSC/SFI, Bekaert and N.V. Bekaert S.A., dated June 10, 2001. As a result of the sale, Specialty Films has been reported as a discontinued operation for the prior fiscal year.

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During the second quarter of fiscal 2003, the Company recorded an after-tax charge of \$101 related to a decrease in the previously estimated insurance premium refund for the Specialty Films business.

LIQUIDITY AND CAPITAL RESOURCES

The Company has historically financed its operations with funds generated from operating activities, sales of various businesses and borrowings under its credit facilities or long-term debt instruments.

During the third quarter of fiscal 2003, MSC generated \$9,009 of cash from operating activities as compared with utilizing \$26,852 in the third quarter last year. The change in cash generation for the third quarter was primarily due to higher accounts payable and accrued expenses as well as the payment of income taxes related to the gain on the sale of Specialty Films in the third quarter of fiscal 2002. For the nine months ended November 30, 2002, the Company generated \$33,944 of cash as compared with utilizing \$24,235 in the same period

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last year. The change in cash generation was due to higher net income and cash generated from liquidating the Pinole Point Steel business, offset in part by the previously mentioned tax payment.

In the third quarter and nine months of fiscal 2003, MSC invested \$1,131 and \$3,679 in capital improvement projects, respectively, compared to \$1,135 and \$3,355 in the same periods last year, respectively. There was no capital spending related to discontinued operations for the third quarter of fiscal 2003 and \$179 of capital spending for discontinued operations for the third quarter of fiscal 2002. Capital spending related to discontinued operations for the nine months of fiscal 2003 and 2002 was \$176 and \$2,840, respectively. Investments in joint ventures were \$108 in the third quarter of fiscal 2003, compared with \$28 during the same period last fiscal year. For the year-to-date period, investments in joint ventures were \$3,562, which relates to the Company's purchase of LTV's ownership interest in the Partnership in the first quarter of fiscal 2003 compared to investments of \$9 during the same period last fiscal year. There were no investments in joint ventures related to discontinued operations in the third quarter of fiscal 2003 and 2002. There were no investments in joint ventures related to discontinued operations for the nine months of fiscal 2003 compared with \$5,114 in the nine months of fiscal 2002 due to the investment in the joint venture with Bekaert Corporation prior to the disposition of the Company's Specialty Films segment.

MSC's total debt decreased to \$55,665 as of November 30, 2002 from \$105,262 as of February 28, 2002. The Company made principal debt payments of \$13,421 and interest payments of \$3,594 on May 31, 2002 related to the 1998 Senior Notes and the 1997 Senior Notes. In addition, on July 31, 2002, the Company made a debt payment of \$39,852 to the holders of the 1997 Senior Notes. The debt payment consisted of principal of \$35,714, interest of \$420 and a contractual prepayment penalty of \$3,718 (pretax basis). The extraordinary loss on early retirement of debt, net of income taxes, includes the prepayment penalty of \$2,257 and a \$131 write-off of debt issuance costs. On December 2, 2002, the Company made interest payments of \$1,870 for interest accrued from June 1, 2002 to November 30, 2002 related to the 1998 Senior Notes.

During the third quarter of fiscal 2003, a \$28 commercial letter of credit expired. The Company's outstanding letters of credit continue to be cash collateralized as of November 30, 2002. Other than \$2,630 that was classified as restricted cash in the consolidated balance sheets, there are no other restrictions on the Company's use of its cash and cash equivalents under the

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Company's line of credit facility at times when no borrowings are outstanding. The line of credit is secured by accounts receivable of the Company.

On June 3, 2002, the Company made a minimum annual royalty payment of \$417 for amounts accrued from January 31, 2002 through May 31, 2002 related to the license agreement with TouchSensor Technologies, LLC ("TST"). On September 3, 2002, the Company paid a second minimum annual royalty payment of \$250 for amounts accrued from June 1, 2002 through August 31, 2002. On December 2, 2002, the Company paid a third minimum annual royalty payment of \$250 for amounts accrued from September 1, 2002 through November 30, 2002.

On June 22, 2000, MSC's Board of Directors authorized the repurchase of up to one million shares of the Company's common stock. In the third quarter of fiscal 2001, the Company suspended the program after having purchased 709,381 shares.

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On March 1, 2002, the Company purchased 13,593 of its shares from certain employees based on the closing price on February 28, 2002 in connection with the vesting of shares granted under the Company's 1999 Long-Term Incentive/Leverage Stock Awards Program ("1999 Program"). The Compensation Committee of the Board of Directors approved the share repurchase under the provisions of the Material Sciences Corporation 1992 Omnibus Awards Plan for Key Employees to cover a portion of the participants' tax withholding liability for the vesting of these shares under the 1999 Program.

On June 20, 2002, the Company resumed the previously approved repurchase program and by August 31, 2002, the Company had completed this share repurchase program by purchasing the remaining 290,619 shares with an average purchase price of \$14.89 per share. On June 20, 2002, MSC's Board of Directors also authorized a new program to repurchase up to an additional 500,000 shares of the Company's common stock. The repurchase of 500,000 shares was complete at August 31, 2002 with an average purchase price of \$14.50 per share. No further share repurchases have been approved by the Company's Board of Directors.

Accounting Pronouncements

In June 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 141, "Business Combinations" and SFAS No. 142, "Goodwill and Other Intangible Assets." SFAS No. 141 requires that all business combinations initiated after June 30, 2001, be accounted for using the purchase method of accounting. With the adoption of SFAS No. 142 on March 1, 2002, goodwill is no longer subject to amortization over its estimated useful life. Goodwill will be subject to at least an annual assessment of impairment by applying a fair-value based test, beginning on the date of adoption of the new accounting standard. The Company completed its initial impairment assessment as of August 31, 2002 as required under the impairment requirements of SFAS No. 142 and no impairment was deemed necessary. MSC will complete the required annual impairment assessment in the fourth quarter of fiscal 2003.

The Company adopted SFAS No. 144, "Impairment or Disposal of Long-Lived Assets" on March 1, 2002. This statement further refines the rules for accounting for long-lived assets and long-lived assets to be disposed of. MSC has assessed the impairment requirements of SFAS No. 144 and believes that no adjustment is deemed necessary.

In April 2002, the FASB issued SFAS No. 145, "Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13 and Technical Corrections." SFAS No. 145 makes changes to several areas, including the classification of gains and losses from extinguishment of debt and accounting for certain lease

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modifications. The statement is effective for fiscal years beginning after May 15, 2002. With the adoption of SFAS No. 145 on March 1, 2003, the extraordinary loss on early retirement of debt will no longer be classified as an extraordinary item and will be reflected as a component of income from continuing operations in the consolidated statements of income (loss).

In June 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities" which addresses financial accounting and reporting for costs associated with exit or disposal activities. This statement requires that a liability be recognized at fair value for costs associated with exit or disposal activities only when the liability is incurred as opposed to at the time the Company commits to an exit plan as permitted under EITF Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to

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Exit an Activity (including Certain Costs Incurred in a Restructuring)." SFAS No. 146 is effective for exit or disposal activities that are initiated after December 31, 2002. The Company does not expect that the adoption of this statement will have a material impact on the Company's financial position, results of operations or cash flows.

Critical Accounting Policies

The Company has identified significant accounting policies that, as a result of the judgments, uncertainties, uniqueness and complexities of the underlying accounting standards and operations involved, could result in material changes to its financial condition or results of operations under different conditions or using different assumptions. The Company's most critical accounting policies are related to the following areas: revenue recognition, long-lived assets and concentrations of credit risks. Details regarding the Company's use of these policies and the related estimates are described in MSC's Annual Report on Form 10-K for the fiscal year ended February 28, 2002 filed with the Securities and Exchange Commission. There have been no material changes to the Company's critical accounting policies that impacted MSC's financial condition or results of operations in the third quarter of fiscal 2003 or the nine months of fiscal 2003.

Cautionary Statement Concerning Forward-Looking Statements

Certain statements contained in this report, including, without limitation, the estimated loss and estimated proceeds from the disposition of discontinued operation set forth in the financial statements, are forward-looking, based on current expectations, forecasts and assumptions. MSC cautions the reader that the following factors could cause MSC's actual outcomes and results to differ materially from those stated or implied in the forward-looking statements: the risk of the successful development, introduction and marketing of new products and technologies, including products based on the touch-sensory technology we have licensed from TouchSensor Technologies, LLC; competitive factors; changes in the business environment, including the transportation, building and construction, electronics and durable goods industries; the ability of the Company to successfully implement its reorganization plans and to achieve the benefits the Company expects from such plans; final realization of proceeds on the sale of Pinole Point Steel; changes in laws, regulations, policies or other activities of governments, agencies and similar organizations (including the ruling under Section 201 of the Trade Act of 1974); continuation of the favorable environment to make acquisitions, including regulatory requirements and market values of candidates; the stability of governments and business conditions inside and outside the U.S., which may affect a successful

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penetration of the Company's products; impact of changes in the overall economy; increases in the prices of raw and other material inputs used by the Company; the loss, or changes in the operations, financial condition or results of operation of one or more significant customers of the Company; environmental risks, costs and penalties associated with the Company's past and present manufacturing operations, including any risks, costs and penalties arising out of an enforcement action by the Illinois EPA and Attorney General related to the Company's Elk Grove Village facility; risks associated with the termination of the Partnership in December 2004 or the termination of the joint venture partnership with Tekno in December 2003; facility utilization and product mix at Walbridge Coatings; acts of war or terrorism; and the other factors identified in Part II, Item 7 of the Company's 2002 Annual Report on Form 10-K filed with the Securities and Exchange Commission. We undertake no obligation to publicly update forward-looking statements, whether as a result of new information, future events or otherwise.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

There has been a material change in the Company's assessment of its sensitivity to market risk since its presentation set forth in Item 7A, "Quantitative and Qualitative Disclosures About Market Risk," in its Annual Report on Form 10-K for the year ended February 28, 2002.

On July 31, 2002, the Company made a debt payment of \$39,852 to the holders of the 1997 Senior Notes. The debt payment consisted of principal of \$35,714, interest of \$420 and a contractual prepayment penalty of \$3,718 (pretax basis). The table below provides information about the Company's remaining outstanding debt that is sensitive to changes in interest rates.

As of November 30, 2002, the fair value of the Company's debt was \$49,278.

(Dollars in Thousands)

| | Expected Maturity Date (Fiscal Year) | | | | | | Total |
|-----------------------|--------------------------------------|----------|----------|----------|----------|------------|----------|
| | 2003* | 2004 | 2005 | 2006 | 2007 | Thereafter | |
| Total Debt: | | | | | | | |
| ----- | | | | | | | |
| Fixed Rate: | | | | | | | |
| Principal Amount | \$ 6,902 | \$11,559 | \$ 6,278 | \$ 6,278 | \$ 6,278 | \$25,110 | \$62,405 |
| Average Interest Rate | 7.2% | 6.8% | 6.8% | 6.8% | 6.8% | 6.8% | 6.8% |
| Variable Rate: | | | | | | | |
| Principal Amount | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - |
| Average Interest Rate | N/A | N/A | N/A | N/A | N/A | N/A | N/A |

* During the nine months ended November 30, 2002, the Company paid \$6,740 of the 2003 principal amount.

Item 4. Controls and Procedures

Evaluation of disclosure controls and procedures. Our chief executive officer

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and our chief financial officer, after evaluating the effectiveness of the Company's "disclosure controls and procedures" (as defined in the Rules 13a-14(c) and 15d-14(c) of the Securities Exchange Act of 1934) as of a date (the "Evaluation Date") within 90 days before the filing date of this quarterly report, have concluded that as of the Evaluation Date, the Company's disclosure controls and procedures were adequate and designed to ensure that material information relating to the Company and its consolidated subsidiaries would be made known to them by others within those entities.

Changes in internal controls. There were no significant changes in the Company's internal controls or in other factors that could significantly affect the Company's disclosure controls and procedures subsequent to the Evaluation Date.

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MATERIAL SCIENCES CORPORATION

FORM 10-Q

For the Quarter Ended November 30, 2002

PART II. OTHER INFORMATION

Item 6. Exhibits and Reports on Form 8-K

- (a) Exhibits. Reference is made to the attached Index to Exhibits.
- (b) Reports on Form 8-K. On October 3, 2002, the Company filed a Current Report on Form 8-K, pursuant to Items 7 and 9, to file a copy of a presentation to investors.

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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, in Elk Grove Village, State of Illinois, on the 8th day of January 2003.

MATERIAL SCIENCES CORPORATION

By: /s/ Gerald G. Nadig

Gerald G. Nadig
Chairman, President
and Chief Executive Officer

By: /s/ James J. Waclawik, Sr.

James J. Waclawik, Sr.
Vice President,
Chief Financial Officer
and Secretary

CERTIFICATIONS

I, Gerald G. Nadig, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Material Sciences Corporation;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
 - a.) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
 - b.) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
 - c.) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent function):
 - a.) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
 - b.) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

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6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Dated: January 8, 2003

By: /s/ Gerald G. Nadig

Gerald G. Nadig
Chairman, President
and Chief Executive Officer

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I, James J. Waclawik, Sr., certify that:

1. I have reviewed this quarterly report on Form 10-Q of Material Sciences Corporation;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
 - a.) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
 - b.) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
 - c.) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent function):

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- a.) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
 - b.) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Dated: January 8, 2003

By: /s/ James J. Waclawik, Sr.

James J. Waclawik, Sr.
Vice President,
Chief Financial Officer
and Secretary

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MATERIAL SCIENCES CORPORATION

Quarterly Report on Form 10-Q

Index to Exhibits

| Exhibit Number | Description of Exhibit |
|----------------|--|
| 99.1 | Certifications of the registrant's Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

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