

COMMERCIAL METALS CO

Form 10-Q

January 09, 2007

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

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

**For the quarterly period ended November 30, 2006
Commission File Number 1-4304
COMMERCIAL METALS COMPANY**

(Exact Name of registrant as specified in its charter)

Delaware

75-0725338

(State or other Jurisdiction of
incorporation of organization)

(I.R.S. Employer
Identification Number)

6565 N. MacArthur Blvd.
Irving, Texas 75039

(Address of principal executive offices)
(Zip Code)

(214) 689-4300

(Registrant's telephone number, including area code)

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

Yes No

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

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-Accelerated filer
As of January 5, 2007, there were 118,211,276 shares of the Company's common stock issued and outstanding excluding 10,849,388 shares held in the Company's treasury.

**COMMERCIAL METALS COMPANY AND SUBSIDIARIES
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COMMERCIAL METALS COMPANY AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)
ASSETS

| (in thousands) | November 30, 2006 | August 31, 2006 |
|---|----------------------|--------------------|
| Current assets: | | |
| Cash and cash equivalents | \$ 157,351 | \$ 180,719 |
| Accounts receivable (less allowance for collection losses of \$16,634 and \$16,075) | 994,635 | 1,134,823 |
| Inventories | 859,202 | 762,635 |
| Other | 65,377 | 66,615 |
| Total current assets | 2,076,565 | 2,144,792 |
| Property, plant and equipment: | | |
| Land | 45,102 | 44,702 |
| Buildings and improvements | 275,540 | 268,755 |
| Equipment | 983,977 | 970,973 |
| Construction in process | 67,257 | 51,184 |
| | 1,371,876 | 1,335,614 |
| Less accumulated depreciation and amortization | (773,494) | (746,928) |
| | 598,382 | 588,686 |
| Goodwill | 35,799 | 35,749 |
| Other assets | 141,371 | 129,641 |
| | \$2,852,117 | \$2,898,868 |

See notes to unaudited condensed consolidated financial statements.

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COMMERCIAL METALS COMPANY AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)
LIABILITIES AND STOCKHOLDERS EQUITY

| (in thousands except share data) | November 30, 2006 | August 31, 2006 |
|--|----------------------|--------------------|
| Current liabilities: | | |
| Accounts payable-trade | \$ 493,710 | \$ 526,408 |
| Accounts payable-documentary letters of credit | 134,706 | 141,713 |
| Accrued expenses and other payables | 247,973 | 379,764 |
| Income taxes payable and deferred income taxes | 40,858 | 14,258 |
| Notes payable CMC International | 49,102 | 60,000 |
| Current maturities of long-term debt | 54,630 | 60,162 |
| Total current liabilities | 1,020,979 | 1,182,305 |
| Deferred income taxes | 35,293 | 34,550 |
| Other long-term liabilities | 97,437 | 78,789 |
| Long-term debt | 309,712 | 322,086 |
| Total liabilities | 1,463,421 | 1,617,730 |
| Minority interests | 69,198 | 61,034 |
| Commitments and contingencies | | |
| Stockholders' equity: | | |
| Capital stock: | | |
| Preferred stock | | |
| Common stock, par value \$0.01 per share: authorized 200,000,000 shares; issued 129,060,664 shares; outstanding 118,350,644 and 117,881,160 shares | 1,290 | 1,290 |
| Additional paid-in capital | 347,963 | 346,994 |
| Accumulated other comprehensive income | 47,782 | 33,239 |
| Retained earnings | 1,058,729 | 980,454 |
| | 1,455,764 | 1,361,977 |
| Less treasury stock: 10,710,020 and 11,179,504 shares at cost | (136,266) | (141,873) |
| Total stockholders' equity | 1,319,498 | 1,220,104 |
| | \$2,852,117 | \$2,898,868 |

See notes to unaudited condensed consolidated financial statements.

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COMMERCIAL METALS COMPANY AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS (UNAUDITED)

| (in thousands, except share data) | Three Months Ended November 30, | |
|---|------------------------------------|--------------|
| | 2006 | 2005 |
| Net sales | \$ 1,986,544 | \$ 1,645,698 |
| Costs and expenses: | | |
| Cost of goods sold | 1,703,390 | 1,424,730 |
| Selling, general and administrative expenses | 135,179 | 106,734 |
| Interest expense | 8,228 | 6,924 |
| | 1,846,797 | 1,538,388 |
| Earnings before income taxes and minority interests | 139,747 | 107,310 |
| Income taxes | 49,769 | 37,441 |
| Earnings before minority interests | 89,978 | 69,869 |
| Minority interests | 4,628 | 245 |
| Net earnings | \$ 85,350 | \$ 69,624 |
| Basic earnings per share | \$ 0.73 | \$ 0.60 |
| Diluted earnings per share | \$ 0.71 | \$ 0.57 |
| Cash dividends per share | \$ 0.06 | \$ 0.03 |
| Average basic shares outstanding | 117,430,858 | 115,935,616 |
| Average diluted shares outstanding | 121,037,332 | 122,106,880 |

See notes to unaudited condensed consolidated financial statements.

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COMMERCIAL METALS COMPANY AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

| (in thousands) | Three Months Ended November 30, | |
|--|------------------------------------|-----------------|
| | 2006 | 2005 |
| Cash Flows From (Used By) Operating Activities: | | |
| Net earnings | \$ 85,350 | \$ 69,624 |
| Adjustments to reconcile net earnings to cash from (used by) operating activities: | | |
| Depreciation and amortization | 25,166 | 19,270 |
| Minority interests | 4,628 | 245 |
| Provision for losses on receivables | 633 | 682 |
| Share-based compensation | 2,299 | 1,933 |
| Net gain on sale of assets and other | (3) | (1,032) |
| Changes in operating assets and liabilities, net of effect of acquisitions: | | |
| Accounts receivable | 138,412 | 12,102 |
| Accounts receivable sold | 12,546 | |
| Inventories | (90,778) | 47,457 |
| Other assets | (8,927) | (4,559) |
| Accounts payable, accrued expenses, other payables and income taxes | (145,808) | (82,481) |
| Deferred income taxes | 326 | 650 |
| Other long-term liabilities | 18,200 | 7,772 |
| Net Cash Flows From Operating Activities | 42,044 | 71,663 |
| Cash Flows From (Used By) Investing Activities: | | |
| Purchases of property, plant and equipment | (26,831) | (27,105) |
| Purchase of interests in CMC Zawiercie subsidiary | (61) | |
| Sales of property, plant and equipment | 224 | 3,108 |
| Acquisitions of fabrication businesses | | (5,117) |
| Net Cash Used By Investing Activities | (26,668) | (29,114) |
| Cash Flows From (Used By) Financing Activities: | | |
| Increase (Decrease) in documentary letters of credit | (7,007) | (37,889) |
| Payments on trade financing arrangements | | (1,612) |
| Short-term borrowings, net change | (10,898) | |
| Payments on long-term debt | (18,512) | (240) |
| Proceeds from issuance of long-term debt | | 11,406 |
| Stock issued under incentive and purchase plans | 1,290 | 1,663 |
| Dividends paid | (7,075) | (3,492) |
| Tax benefits from stock plans | 2,987 | 2,043 |
| Net Cash Used By Financing Activities | (39,215) | (28,121) |
| Effect of Exchange Rate Changes on Cash | 471 | (354) |
| Increase (Decrease) in Cash and Cash Equivalents | (23,368) | 14,074 |

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| | | |
|--|------------|-----------|
| Cash and Cash Equivalents at Beginning of Year | 180,719 | 119,404 |
| Cash and Cash Equivalents at End of Period | \$ 157,351 | \$133,478 |

See notes to unaudited condensed consolidated financial statements.

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**COMMERCIAL METALS COMPANY AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENT OF
STOCKHOLDERS EQUITY (UNAUDITED)**

| in thousands, except share data) | Common Stock | | Additional Paid-In Capital | Accumulated | | Retained Earnings | Treasury Stock | | Total |
|---|---------------------|----------|----------------------------------|----------------------------------|-----------------------------------|----------------------|---------------------|--------------|--------------|
| | Number of Shares | Amount | | Other Comprehensive Income | Unearned Stock Compensation | | Number of Shares | Amount | |
| Balance, September 1, 2006 | 129,060,664 | \$ 1,290 | \$ 346,994 | \$ 33,239 | \$ | \$ 980,454 | (11,179,504) | \$ (141,873) | \$ 1,220,100 |
| Comprehensive income: | | | | | | | | | |
| Net earnings for three months ended November 30, 2006 | | | | | | 85,350 | | | 85,350 |
| Other comprehensive income (loss): | | | | | | | | | |
| Foreign currency translation adjustment, net of taxes of \$(765) | | | | 13,188 | | | | | 13,188 |
| Unrealized gain on hedges, net of taxes of \$741 | | | | 1,355 | | | | | 1,355 |
| Comprehensive income | | | | | | | | | 99,893 |
| Cash dividends | | | | | | (7,075) | | | (7,075) |
| Stock issued under incentive and purchase plans | | | (4,319) | | | | 469,684 | 5,609 | 1,290 |
| Stock-based compensation | | | 2,301 | | | | (200) | (2) | 2,299 |
| Tax benefits from stock plans | | | 2,987 | | | | | | 2,987 |
| Balance, November 30, 2006 | 129,060,664 | \$ 1,290 | \$ 347,963 | \$ 47,782 | \$ | \$ 1,058,729 | (10,710,020) | \$ (136,266) | \$ 1,319,498 |

See notes to unaudited condensed consolidated financial statements.

Table of Contents**COMMERCIAL METALS COMPANY AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)****NOTE A QUARTERLY FINANCIAL DATA**

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (GAAP) on a basis consistent with that used in the Company's Annual Report on Form 10-K filed with the Securities and Exchange Commission (SEC) for the year ended August 31, 2006, and include all normal recurring adjustments necessary to present fairly the condensed consolidated balance sheets and statements of earnings, cash flows and stockholders' equity for the periods indicated. These Notes should be read in conjunction with such Form 10-K. The results of operations for the three month period are not necessarily indicative of the results to be expected for a full year.

NOTE B ACCOUNTING POLICIES**Stock-Based Compensation**

See Note 9, Capital Stock, to the Company's consolidated financial statements for the year ended August 31, 2006 filed on Form 10-K with the SEC for a description of the Company's stock incentive plans.

The Company adopted 123(R) effective September 1, 2005 using the modified prospective method. As a result, compensation expense has been and will be recorded for the unvested portion of previously issued awards that were outstanding at September 1, 2005. No share-based awards were granted during the three months ended November 30, 2006 or 2005. The Black-Scholes pricing model was used to calculate total compensation cost which is amortized on a straight-line basis over the remaining vesting period of previously issued awards. (See Note 1, Summary of Significant Accounting Policies, to the Company's consolidated financial statements for the year ended August 31, 2006 for the assumptions used to estimate the fair value and the weighted average grant date fair value. The Company developed its volatility assumption based on historical data). The Company recognized after-tax stock-based compensation expense of \$1.5 million (\$0.01 per diluted share) and \$1.3 million (\$0.01 per diluted share) as a component of selling, general and administrative expenses for the three months ended November 30, 2006 and 2005, respectively. The cumulative effect of adoption (primarily arising from the recognition of anticipated forfeitures) was not material. At November 30, 2006, the Company had \$8.8 million of total unrecognized compensation cost related to non-vested share-based compensation arrangements. This cost is expected to be recognized over the next 31 months.

Combined information for shares subject to options and SARs for the three months ended November 30, 2006 was as follows:

| | Number | Weighted Average Exercise Price | Price Range Per Share |
|-------------------|-----------|--|-----------------------------|
| August 31, 2006 | | | |
| Outstanding | 7,485,348 | \$8.06 | \$2.75-\$24.71 |
| Exercisable | 6,178,200 | 5.90 | 2.75- 13.58 |
| Granted | | | |
| Exercised | 504,742 | 4.22 | 2.75- 12.31 |
| Forfeited | | | |
| November 30, 2006 | | | |
| Outstanding | 6,980,606 | 8.34 | 2.94-24.71 |
| Exercisable | 5,673,458 | 6.05 | 2.94-13.58 |

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Share information for options and SARs at November 30, 2006:

| Range of Exercise Price | Outstanding | | | Exercisable | | |
|-------------------------|--------------------|--|---------------------------------|--------------------|---------------------------------|---------------------------------|
| | Number Outstanding | Weighted Average Remaining Contractual Life (Yrs.) | Weighted Average Exercise Price | Number Outstanding | Weighted Average Exercise Price | Weighted Average Exercise Price |
| \$ 2.94 - 3.78 | 1,756,488 | 2.7 | \$ 3.47 | 1,756,488 | \$ 3.47 | \$ 3.47 |
| 4.29 - 5.36 | 1,117,788 | 2.2 | 4.33 | 1,117,788 | 4.33 | 4.33 |
| 7.53 - 7.78 | 2,445,242 | 4.3 | 7.77 | 2,445,242 | 7.77 | 7.77 |
| 12.31 - 13.58 | 1,022,058 | 5.6 | 12.33 | 353,940 | 12.37 | 12.37 |
| 21.81 - 24.71 | 639,030 | 6.5 | 24.53 | | | |
| \$ 2.94 - 24.71 | 6,980,606 | 3.9 | \$ 8.34 | 5,673,458 | \$ 6.05 | \$ 6.05 |

None of the Company's previously granted restricted stock awards vested during the three months ended November 30, 2006.

Intangible Assets

The total gross carrying amounts of the Company's intangible assets that were subject to amortization were \$21.8 million and \$22.0 million at November 30, 2006 and August 31, 2006, respectively. There were no significant changes in either the components or the lives of intangible assets during the three months ended November 30, 2006. Aggregate amortization expense for the three months ended November 30, 2006 and 2005 was \$0.8 million and \$0.5 million, respectively.

Staff Accounting Bulletin No. 108

In September 2006, the SEC released SAB No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements* which is effective for fiscal years ending after December 31, 2006. The Standard requires registrants to consider the effects of the carryover or reversal of prior year misstatements in quantifying a current year misstatement and to quantify errors using both a balance sheet and an income statement approach and evaluate whether either approach results in quantifying a misstatement that, when all relevant quantitative and qualitative factors are considered, is material. The Company does not expect the adoption of this Standard to have a material impact on its financial statements.

FASB Staff Position (FSP) No. AUG AIR-1

In September 2006, the FASB issued FASB Staff Position (FSP) No. AUG AIR-1, *Accounting for Planned Major Maintenance Activities* which is effective for fiscal years beginning after December 15, 2006. The Staff Position prohibits the use of the accrue-in-advance method of accounting for planned major maintenance activities in annual and interim financial reporting periods. The Company does not expect the adoption of this Standard to have a material impact on its financial statements.

Reclassifications

Certain immaterial reclassifications have been made to the prior period financial statements to conform to the classifications used in the current period.

NOTE C ACQUISITIONS

On December 28, 2006 the Company closed a purchase agreement with Bruhler Stahlhandel GmbH acquiring the operating assets and inventory of its steel fabrication business in Rosslau/Saxony-Anhalt in eastern Germany. The acquisition was made by CMC's subsidiary Commercial Metals Deutschland GmbH; the purchase price was not significant to the Company's results of operations and financial position.

NOTE D SALES OF ACCOUNTS RECEIVABLE

The Company has an accounts receivable securitization program which it utilizes as a cost-effective, short-term financing alternative. Under this program, the Company and several of its subsidiaries periodically sell certain eligible trade accounts receivable to the Company's wholly-owned consolidated special purpose subsidiary

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(CMCRV). CMCRV is structured to be a bankruptcy-remote entity. CMCRV, in turn, sells undivided percentage ownership interests in the pool of receivables to affiliates of two third-party financial institutions. CMCRV may sell undivided interests of up to \$130 million, depending on the Company's level of financing needs.

At November 30, 2006 and August 31, 2006, accounts receivable of \$331 million and \$351 million, respectively, had been sold to CMCRV. The Company's undivided interest in these receivables (representing the Company's retained interest) was 100% at November 30 and August 31, 2006. The Company did not sell any undivided interests in the pool of receivables to the financial institution buyers during the three months ended November 30, 2006 and 2005, respectively.

In addition to the securitization program described above, the Company's international subsidiaries periodically sell accounts receivable without recourse. Uncollected accounts receivable that had been sold under these arrangements and removed from the condensed consolidated balance sheets were \$74.4 million and \$61.9 million at November 30 and August 31, 2006, respectively. The average monthly amounts of outstanding international accounts receivable sold were \$69.5 million and \$60.6 million for the three months ended November 30, 2006 and 2005, respectively. Discounts (losses) on domestic and international sales of accounts receivable were \$959 thousand and \$776 thousand for the three months ended November 30, 2006 and 2005, respectively. These losses primarily represented the costs of funds and were included in selling, general and administrative expenses.

NOTE E INVENTORIES

Before deduction of last-in, first-out (LIFO) inventory valuation reserves of \$199.5 million and \$189.3 million at November 30 and August 31, 2006, respectively, inventories valued under the first-in, first-out method approximated replacement cost. The majority of the Company's inventories are in finished goods, with minimal work in process. Approximately \$48.6 million and \$54.6 million were in raw materials at November 30 and August 31, 2006, respectively.

NOTE F CREDIT ARRANGEMENTS

At November 30 and August 31, 2006, no borrowings were outstanding under the Company's commercial paper program or the related revolving credit agreement. The Company was in compliance with all covenants at November 30, 2006.

The Company has numerous informal credit facilities available from domestic and international banks. These credit facilities are available to support documentary letters of credit (including those with extended terms), foreign exchange transactions and, in certain instances, short-term working capital loans and are priced at bankers' acceptance rates or on a cost of funds basis. Amounts outstanding on these facilities relate to accounts payable settled under documentary letters of credit.

Long-term debt was as follows:

| (in thousands) | November 30, 2006 | August 31, 2006 |
|----------------------------------|----------------------|--------------------|
| 6.80% notes due August 2007 | \$ 50,000 | \$ 50,000 |
| 6.75% notes due February 2009 | 100,000 | 100,000 |
| CMCZ term note due March 2009 | | 18,322 |
| 5.625% notes due November 2013 | 200,000 | 200,000 |
| Other, including equipment notes | 14,342 | 13,926 |
| | 364,342 | 382,248 |
| Less current maturities | 54,630 | 60,162 |
| | \$ 309,712 | \$ 322,086 |

CMCZ has a revolving credit facility with maximum borrowings of 100 million PLN (\$34.5 million) bearing interest at the Warsaw Interbank Offered Rate (WIBOR) plus 0.55% and collateralized by CMCZ's accounts receivable. This

facility expires May 11, 2007. At November 30, 2006, no amounts were outstanding under this facility. The revolving credit facility contains certain financial covenants for CMCZ. CMCZ was in compliance with these

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covenants at November 30, 2006. There are no guarantees by the Company or any of its subsidiaries for any of CMCZ's debt.

CMC Poland, a wholly-owned subsidiary of the Company, owns and operates equipment at the CMCZ mill site. In connection with the equipment purchase, CMC Poland issued equipment notes under a term agreement dated September 2005 with 33.9 million PLN (\$11.7 million) outstanding at November 30, 2006. Installment payments under these notes are due from 2006 through 2010. Interest rates are variable based on the Poland Monetary Policy Council's rediscount rate, plus any applicable margin. The weighted average rate as of November 30, 2006 was 4.25%. The notes are substantially secured by the equipment.

At November 30, 2006, CMC International, a subsidiary of CMC, had \$49.1 million outstanding under four short-term notes maturing in December 2006. The interest on the notes ranges from 5.9% to 6.0%. The notes are not collateralized and do not contain any financial covenants.

Interest of \$8.6 million and \$7.7 million was paid in the three months ended November 30, 2006 and 2005, respectively.

NOTE G INCOME TAXES

The Company paid \$20 million in income taxes during the three months ended November 30, 2006. No significant income taxes were paid during the three months ended November 30, 2005.

Reconciliations of the United States statutory rates to the Company's effective tax rates were as follows:

| | Three Months Ended November 30, | |
|---|------------------------------------|-------|
| | 2006 | 2005 |
| Statutory rate | 35.0% | 35.0% |
| State and local taxes | 2.4 | 1.2 |
| Extraterritorial Income Exclusion (ETI) | (0.1) | (0.2) |
| Foreign rate differential | (1.4) | (0.9) |
| Domestic production activity deduction | (0.7) | (0.6) |
| Other | 0.4 | 0.4 |
| Effective rate | 35.6% | 34.9% |

In June 2006, the FASB issued FIN 48, "Accounting for Uncertainty in Income Taxes" an interpretation of FASB Statement 109, which clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FAS No. 109, "Accounting for Income Taxes." FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company is currently evaluating the impact of FIN 48 on the Company's consolidated financial statements.

NOTE H STOCKHOLDERS EQUITY AND EARNINGS PER SHARE

On April 24, 2006, the Company declared a two-for-one stock split in the form of a 100% stock dividend on the Company's common stock payable May 22, 2006 to shareholders of record on May 8, 2006. The stock dividend resulted in the issuance of 64,530,332 additional shares of common stock. All per share and weighted average share amounts in the accompanying condensed consolidated financial statements for the three months ended November 30, 2005 have been restated to reflect the stock split.

In calculating earnings per share, there were no adjustments to net earnings to arrive at earnings for the three months ended November 30, 2006 or 2005. The reconciliation of the denominators of the earnings per share calculations is as follows:

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| | Three Months Ended November 30, | |
|--|------------------------------------|-------------|
| | 2006 | 2005 |
| Average shares outstanding for basic earnings per share | 117,430,858 | 115,935,616 |
| Effect of dilutive securities-stock based incentive/purchase plans | 3,606,474 | 6,171,264 |
| Average shares outstanding for diluted earnings per share | 121,037,332 | 122,106,880 |

Stock Appreciation Rights (SARs) with total share commitments of 628,630 were antidilutive at November 30, 2006 based on the average share price of \$24.40. All of the Company's outstanding stock options, restricted stock and SARs with total share commitments of 11,207,494 at November 30, 2005 were dilutive based on the average share price for the quarter then ended of \$16.32. All stock options and SARs expire by 2013.

The Company's restricted stock is included in the number of shares of common stock issued and outstanding, but omitted from the basic earnings per share calculation until the shares vest.

At November 30, 2006, the Company had authorization to purchase 3,341,760 of its common shares.

NOTE I DERIVATIVES AND RISK MANAGEMENT

The Company's worldwide operations and product lines expose it to risks from fluctuations in foreign currency exchange rates and metals commodity prices. The objective of the Company's risk management program is to mitigate these risks using futures or forward contracts (derivative instruments). The Company enters into metal commodity forward contracts to mitigate the risk of unanticipated changes in gross margin due to the volatility of the commodities prices, and enters into foreign currency forward contracts, which match the expected settlements for purchases and sales denominated in foreign currencies. Also, when its sales commitments to customers include a fixed price freight component, the Company occasionally enters into freight forward contracts to minimize the effect of the volatility of ocean freight rates. Forward contracts on natural gas may also be entered to reduce the price volatility of gas used in production. The Company designates only those contracts which closely match the terms of the underlying transaction as hedges for accounting purposes. These hedges resulted in an immaterial amount of ineffectiveness in the statements of earnings and there were no components excluded from the assessment of hedge effectiveness for the three months ended November 30, 2006 and 2005. Certain of the foreign currency and commodity contracts were not designated as hedges for accounting purposes, although management believes they are essential economic hedges.

The following chart shows the impact on the condensed consolidated statements of earnings of the changes in fair value of these economic hedges:

| | Three Months Ended November 30, | |
|--|------------------------------------|---------|
| (in thousands) | 2006 | 2005 |
| | Earnings (Expense) | |
| Net sales (foreign currency instruments) | \$ 111 | \$ 93 |
| Cost of goods sold (commodity instruments) | (2,206) | (1,877) |

The Company's derivative instruments were recorded as follows on the condensed consolidated balance sheets:

| | November 30, 2006 | August 31, 2006 |
|--|-------------------------|--------------------|
| (in thousands) | | |
| Derivative assets (other current assets) | \$ 7,341 | \$5,633 |
| Derivative liabilities (other payables) | 8,392 | 8,323 |

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The following table summarizes activities in other comprehensive income (losses) related to derivatives classified as cash flow hedges held by the Company during the three months ended November 30, 2006 (in thousands):

| | |
|---|---------|
| Change in market value (net of taxes) | \$1,310 |
| (Gain) losses reclassified into net earnings, net | 45 |
| Other comprehensive gain (loss) unrealized Gain (loss) on derivatives | \$1,355 |

During the twelve months following November 30, 2006, \$2.9 million in losses related to commodity hedges and capital expenditures are anticipated to be reclassified into net earnings as the related transactions mature and the assets are placed into service, respectively. Also, an additional \$112 thousand in gains will be reclassified as interest expense related to an interest rate lock.

All of the instruments are highly liquid, and none are entered into for trading purposes.

NOTE J CONTINGENCIES

See Note 11, Commitments and Contingencies, to the consolidated financial statements for the year ended August 31, 2006 relating to environmental and other matters. There have been no significant changes to the matters noted therein. In the ordinary course of conducting its business, the Company becomes involved in litigation, administrative proceedings and governmental investigations, including environmental matters. Management believes that adequate provision has been made in the condensed consolidated financial statements for the potential impact of these issues, and that the outcomes will not significantly impact the results of operations or the financial position of the Company, although they may have a material impact on earnings for a particular quarter.

NOTE K BUSINESS SEGMENTS

The Company's reportable segments are based on strategic business areas, which offer different products and services. These segments have different lines of management responsibility as each business requires different marketing strategies and management expertise.

The Company has five reportable segments: domestic mills, CMCZ, domestic fabrication, recycling and marketing and distribution.

The following is a summary of certain financial information by reportable segment:

| (in thousands) | Three Months Ended November 30, 2006 | | | | | | Eliminations | Consolidated |
|----------------------------------|--------------------------------------|-----------|----------------------|-----------|----------------------------|-----------|--------------|--------------|
| | Domestic Mills | CMCZ | Domestic Fabrication | Recycling | Marketing and Distribution | Corporate | | |
| Net sales unaffiliated customers | \$249,794 | \$162,914 | \$448,010 | \$359,676 | \$761,018 | \$ 5,132 | \$ | \$1,986,544 |
| Intersegment sales | 107,761 | 33 | 776 | 23,385 | 36,792 | (540) | (168,207) | |
| Net sales | 357,555 | 162,947 | 448,786 | 383,061 | 797,810 | 4,592 | (168,207) | 1,986,544 |
| Adjusted operating profit (loss) | 72,639 | 25,794 | 31,496 | 17,608 | 7,908 | (6,511) | | 148,934 |
| Goodwill November 30, 2006 | 306 | | 27,006 | 6,669 | 1,818 | | | 35,799 |

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| Total assets | | | | | | | | |
|--------------------------------------|-----------|-----------|-------------|-----------|-----------|--------------|-----------|---------------------------|
| November 30, 2006 | | | | | | | | |
| | 493,641 | 315,452 | 696,289 | 263,705 | 890,996 | 192,034 | | 2,852,117 |
| Three Months Ended November 30, 2005 | | | | | | | | |
| | Domestic | | Domestic | | Marketing | | | |
| (in thousands) | Mills | CMCZ | Fabrication | Recycling | and | Distribution | Corporate | Eliminations Consolidated |
| Net sales unaffiliated customers | \$268,672 | \$106,880 | \$400,069 | \$213,206 | \$655,169 | \$1,702 | \$ | \$1,645,698 |
| Intersegment sales | 101,107 | 452 | 454 | 23,193 | 29,389 | | (154,595) | |
| Net sales | 369,779 | 107,332 | 400,523 | 236,399 | 684,558 | 1,702 | (154,595) | 1,645,698 |
| Adjusted operating profit (loss) | 64,919 | 1,532 | 18,197 | 13,834 | 23,055 | (6,527) | | 115,010 |
| Goodwill | | | | | | | | |
| November 30, 2005 | 306 | | 27,006 | 3,230 | | | | 30,542 |
| Total assets | | | | | | | | |
| November 30, 2005 | 445,483 | 251,595 | 619,138 | 164,155 | 688,012 | 128,068 | | 2,296,451 |

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The following table provides a reconciliation of consolidated adjusted operating profit to net earnings:

| (in thousands) | Three Months Ended November 30, | |
|---|------------------------------------|------------|
| | 2006 | 2005 |
| Net earnings | \$ 85,350 | \$ 69,624 |
| Minority interests | 4,628 | 245 |
| Income taxes | 49,769 | 37,441 |
| Interest expense | 8,228 | 6,924 |
| Discounts on sales of accounts receivable | 959 | 776 |
| Adjusted operating profit | \$ 148,934 | \$ 115,010 |

The following presents external net sales by major product and geographic area for the Company:

| (in thousands) | Three Months Ended November 30, | |
|----------------------------|------------------------------------|--------------|
| | 2006 | 2005 |
| Major product information: | | |
| Steel products | \$ 1,158,751 | \$ 999,288 |
| Nonferrous scrap | 242,977 | 131,366 |
| Industrial materials | 211,941 | 244,197 |
| Non-ferrous products | 137,209 | 85,420 |
| Ferrous scrap | 115,521 | 80,369 |
| Construction materials | 106,065 | 92,015 |
| Other | 14,080 | 13,043 |
| Net sales | \$ 1,986,544 | \$ 1,645,698 |

| (in thousands) | Three Months Ended November 30, | |
|-----------------------|------------------------------------|--------------|
| | 2006 | 2005 |
| Geographic area: | | |
| United States | \$ 1,193,910 | \$ 1,041,382 |
| Europe | 397,854 | 214,233 |
| Asia | 204,286 | 210,541 |
| Australia/New Zealand | 108,670 | 124,199 |
| Other | 81,824 | 55,343 |
| Net sales | \$ 1,986,544 | \$ 1,645,698 |

NOTE L RELATED PARTY TRANSACTIONS

One of the Company's international subsidiaries has an agreement for steel purchases with a key supplier of which the Company owns an 11% interest. The total amounts of purchases from this supplier were \$79.5 million and \$57.0 million for the three months ended November 30, 2006 and 2005, respectively.

NOTE M SUBSEQUENT EVENTS

On December 18, 2006 the Company announced the purchase of a new wire rod block line in our Polish Steel mill operations in Zawiercie, Poland, that will augment the production of its current bar mill. Installation should take approximately 18 months with an expected investment of \$40 million.

Also on December 20, 2006 the Company announced plans to construct a steel manufacturing facility, a micro mill, in the greater Phoenix, Arizona area at an estimated cost of \$130 million with production anticipated to commence in early 2009.

Table of Contents**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

This Management's Discussion and Analysis should be read in conjunction with our Form 10-K filed with the Securities and Exchange Commission (SEC) for the year ended August 31, 2006.

CRITICAL ACCOUNTING POLICIES

Our critical accounting policies are not different from the information set forth in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, included in our Form 10-K filed with the SEC for the year ended August 31, 2006 and are, therefore, not presented herein.

CONSOLIDATED RESULTS OF OPERATIONS

| (in millions) | Three Months Ended November 30, | | Increase % |
|---------------|------------------------------------|------------|---------------|
| | 2006 | 2005 | |
| Net sales | \$ 1,986.5 | \$ 1,645.7 | 21% |
| Net earnings | 85.4 | 69.6 | 23% |
| EBITDA | 168.5 | 133.3 | 26% |

In the table above, we have included a financial statement measure that was not derived in accordance with GAAP. We use EBITDA (earnings before interest expense, income taxes, depreciation and amortization) as a non-GAAP performance measure. In calculating EBITDA, we exclude our largest recurring non-cash charge, depreciation and amortization. EBITDA provides a core operational performance measurement that compares results without the need to adjust for federal, state and local taxes which have considerable variation between domestic jurisdictions. Tax regulations in international operations add additional complexity. Also, we exclude interest cost in our calculation of EBITDA. The results are, therefore, without consideration of financing alternatives of capital employed. We use EBITDA as one guideline to assess our unleveraged performance return on our investments. EBITDA is also the target benchmark for our long-term cash incentive performance plan for management. Reconciliations to net earnings are provided below:

| (in millions) | Three Months Ended November 30, | | Increase % |
|-------------------------------|------------------------------------|----------|---------------|
| | 2006 | 2005 | |
| Net earnings | \$ 85.4 | \$ 69.6 | 23% |
| Interest expense | 8.2 | 6.9 | 19% |
| Income taxes | 49.8 | 37.5 | 33% |
| Depreciation and amortization | 25.1 | 19.3 | 30% |
| EBITDA | \$ 168.5 | \$ 133.3 | 26% |

Our EBITDA does not include interest expense, income taxes and depreciation and amortization. Because we have borrowed money in order to finance our operations, interest expense is a necessary element of our costs and our ability to generate revenues. Because we use capital assets, depreciation and amortization are also necessary elements of our costs. Also, the payment of income taxes is a necessary element of our operations. Therefore, any measures that exclude these elements have material limitations. To compensate for these limitations, we believe that it is appropriate to consider both net earnings determined under GAAP, as well as EBITDA, to evaluate our performance. Also, we separately analyze any significant fluctuations in interest expense, depreciation and amortization and income taxes. **Overview** Reported net earnings and EBITDA increased by 23% to \$85.4 and 26% to \$168.5 million, respectively, for the three months ended November 30, 2006 as compared to 2005. Quarterly earnings rose on solid demand from nonresidential construction markets and improved margins from the prior year first quarter. The following financial

events were significant during our first quarter ended November 30, 2006:

Net earnings were a record for a first quarter with our Domestic Mills and Recycling segments achieving record first quarter adjusted operating profits.

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Metal margins for the Domestic Steel Mills increased 21% due to higher selling prices and slightly lower scrap and energy costs.

Net sales of the Recycling segment increased 62% due primarily to increased volume of 12% and a 60% increase in the nonferrous selling price.

Our Polish (CMCZ) operations rebounded strongly with an adjusted operating profit of \$25.8 million as compared to \$1.5 million for last year's first quarter. Net sales of our Polish segment increased 52% over last year's first quarter and metal margins were up 21%.

Adjusted operating profit of our Domestic Fabrication segment increased \$13.3 million to \$31.5 million for the quarter due primarily to a \$23 million swing from LIFO expense to a LIFO credit. Shipments from our Domestic Fabrication segment increased 11% over last year's first quarter.

Our Marketing and Distribution segment had a 17% sales increase over the first quarter of 2005 but adjusted operating profit was down \$15.2 million (66%) as a result of absorbing \$14.3 million of LIFO expense as compared to a LIFO credit of \$3.3 million in 2005.

In December 2006 the Company announced the future purchase of a new wire rod block line in our Polish Steel mill operations at an estimated investment of \$40 million and the construction of a steel micro mill in the Phoenix, Arizona area with an estimated cost of \$130 million. Installation of the wire rod block line is expected to take about 18 months and production at the continuous continuous micro mill is expected to commence in early 2009.

SEGMENT OPERATING DATA

See Note K Business Segments, to the condensed consolidated financial statements.

We use adjusted operating profit (loss) to compare and evaluate the financial performance of our segments. Adjusted operating profit is the sum of our earnings before income taxes, minority interests and financing costs. The following tables show our net sales and adjusted operating profit (loss) by business segment:

| (in thousands) | Three Months Ended November 30, | |
|----------------------------|------------------------------------|-------------|
| | 2006 | 2005 |
| NET SALES: | | |
| Domestic mills | \$ 357,555 | \$ 369,779 |
| CMCZ* | 162,947 | 107,332 |
| Domestic fabrication | 448,786 | 400,523 |
| Recycling | 383,061 | 236,399 |
| Marketing and distribution | 797,810 | 684,558 |
| Corporate and eliminations | (163,615) | (152,893) |
| | \$1,986,544 | \$1,645,698 |

* Before minority interests

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| (in thousands) | Three Months Ended November 30, | |
|--|------------------------------------|----------|
| | 2006 | 2005 |
| ADJUSTED OPERATING PROFIT (LOSS): | | |
| Domestic mills | \$72,639 | \$64,919 |
| CMCZ* | 25,794 | 1,532 |
| Domestic fabrication | 31,496 | 18,197 |
| Recycling | 17,608 | 13,834 |
| Marketing and distribution | 7,908 | 23,055 |
| Corporate and eliminations | (6,511) | (6,527) |

* Before minority interests

LIFO Impact on Adjusted Operating Profit LIFO is an inventory costing method that assumes the most recent inventory purchases or goods manufactured are sold first. This results in current sales prices offset against current inventory costs. In periods of rising prices it has the effect of eliminating inflationary profits from net income. In periods of declining prices it has the effect of eliminating deflationary losses from net income. In either case the goal is to reflect economic profit. The table below reflects LIFO income or (expense) representing decreases or (increases) in the LIFO inventory reserve. CMCZ is not included in this table as it uses FIFO valuation exclusively for its inventory:

| (in thousands) | Three Months Ended November 30, | |
|---|------------------------------------|----------|
| | 2006 | 2005 |
| Domestic mills | (3,971) | (9,671) |
| Domestic fabrication | 9,320 | (13,916) |
| Recycling | (1,197) | (1,397) |
| Marketing and Distribution | (14,299) | 3,320 |
| Consolidated (decrease) to adjusted profit before tax | (10,147) | (21,664) |

Domestic Mills We include our four domestic steel and our copper tube minimills in our domestic mills segment. Our domestic mills segment's adjusted operating profit for the three month ended November 30, 2006 increased by \$7.7 million (12%) as compared to prior year's first quarter despite a slight drop in net sales of \$12.2 million. Adjusted operating profit for the quarter just ended was higher than last year's first quarter as a result of improved selling prices and relatively stable scrap prices which resulted in increased metal margins offset by a 2% increase in scrap production costs and a 16% decline in tons shipped.

Selling prices for our domestic steel minimills increased for the months ended November 30, 2006 as compared to 2005 due to strong domestic demand for steel including public works and nonresidential construction markets. Our average total mill selling price for the first quarter was \$67 per ton above last year's level.

The table below reflects steel and ferrous scrap prices per ton:

| Three Months Ended November 30, | | Increase (Decrease) | |
|------------------------------------|------|------------------------|---|
| 2006 | 2005 | \$ | % |

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| | | | | |
|---|-------|-------|------|------|
| Average mill selling price (finished goods) | \$571 | \$510 | \$61 | 12% |
| Average mill selling price (total sales) | 557 | 490 | 67 | 14% |
| Average ferrous scrap production cost | 208 | 203 | 5 | 2% |
| Average metal margin | 349 | 287 | 62 | 21% |
| Average ferrous scrap purchase price | 183 | 187 | (4) | (2)% |

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Overall, our mills' shipments were down by 16% for the three months ended November 30, 2006 as compared to 2005 as customers who were understocked last year had better balanced inventory this quarter. The table below reflects our domestic steel minimills' operating statistics (short tons in thousands):

| | Three Months Ended | | Increase (Decrease) | |
|--------------|--------------------|------|---------------------|-------|
| | 2006 | 2005 | Amount | % |
| Tons melted | 532 | 573 | (41) | (7)% |
| Tons rolled | 531 | 522 | 9 | 2% |
| Tons shipped | 526 | 624 | (98) | (16)% |

All four of our domestic steel minimills were profitable during the first quarter of fiscal 2007. Two of our domestic steel minimills, Texas and Alabama, were more profitable for the quarter as compared to the prior year first quarter as a result of higher selling prices offset by a decrease in tons shipped for the quarter. CMC Steel Arkansas' adjusted operating profit for the quarter was down 25% from last year's first quarter as a result of higher conversion costs offset by a relative improvement in tons shipped. Our South Carolina steel minimill's adjusted operating profit was down by 20% from prior year's first quarter as a result of lower shipments.

Overall our domestic steel mills had pretax LIFO expense of \$3.9 million during the three months just ended as compared to \$8.2 million LIFO expense for the quarter ended November 30, 2005. In addition, planned melt shop shutdowns for maintenance and project work at South Carolina and Alabama contributed to a decrease of 7% in tons melted for the quarter just ended as compared to last year's first quarter. Our total utility costs declined by \$3.7 million or 15% over the same quarter last year as a direct result on lower usage offset by an increased in price, while natural gas costs were down by \$4.3 million or 42% from last year's first quarter because of lower prices. Our ferroalloys costs remained constant, but electrode costs increased by 13% to \$3.9 million in the first quarter 2006 as compared to 2005. The table below reflects our copper tube minimill's prices per pound and operating statistics:

| | Three Months Ended | | Increase (Decrease) | |
|--------------------------------------|--------------------|--------|---------------------|-------|
| | 2006 | 2005 | Amount | % |
| Pounds shipped (in millions) | 10.4 | 16.2 | (5.8) | (36)% |
| Pounds produced (in millions) | 10.1 | 15.9 | (5.8) | (36)% |
| Average selling price | \$4.17 | \$2.44 | \$1.73 | 71% |
| Average copper scrap production cost | \$3.05 | \$1.60 | \$1.45 | 91% |
| Average metal margin | \$1.12 | \$0.83 | \$.29 | 35% |
| Average copper scrap purchase price | \$3.26 | \$1.70 | \$1.56 | 92% |

Our copper tube minimill's adjusted operating profit was \$3.4 million for the quarter ended November 30, 2006, as compared to \$4.2 million in 2005. Our shipments and production for the three months ended November 30, 2006 decreased each by 36% as compared to 2005 due to the demand from our commercial and residential end-users declining as a direct result of the softening in housing construction. First quarter metal margin improved by 35% or \$0.29 over last year's first quarter as a result of our ability to increase our copper tube selling prices to more than compensate for increases in our copper scrap production costs. For the quarter just ended there was no significant LIFO expense as compared to \$1.5 million LIFO expense for the first quarter of 2005.

CMCZ Our combined Polish operations generated net sales of \$163 million and adjusted operating profit of \$25.8 million for the three months ended November 30, 2006 as compared with \$107 million and \$1.5 million, respectively, for 2005. In addition, our operating levels and results of operations improved significantly as a result of better market conditions in the region, the positive growth of the German economy and the impact of our mega-shredder which resulted in improved melt yields and a decrease of melt shop operating costs. Also the new fab shop operations were profitable. The change in foreign currency exchange rates had minimal impact on the reported

sales and adjusted operating profit for the quarter just ended. The following table reflects CMCZ's operating statistics and average prices per short ton:

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| | Three Months Ended | | Increase (Decrease) | |
|--|--------------------|----------------------|---------------------|---------|
| | 2006 | November 30, 2005 | Amount | % |
| Tons melted (thousands) | 358 | 284 | 74 | 26% |
| Ton rolled (thousands) | 296 | 237 | 59 | 25% |
| Tons shipped (thousands) | 312 | 257 | 55 | 21% |
| Average mill selling price (total sales) | 1529 | PLN 1304 | PLN 225 | PLN 17% |
| Average ferrous scrap production cost | 816 | PLN 673 | PLN 143 | PLN 21% |
| Average metal margin | 714 | PLN 631 | PLN 83 | PLN 13% |
| Average ferrous scrap purchase price | 725 | PLN 569 | PLN 156 | PLN 27% |
| Average mill selling price (total sales) | \$ 496 | \$ 398 | \$ 98 | 25% |
| Average ferrous scrap production cost | \$ 264 | \$ 206 | \$ 58 | 28% |
| Average metal margin | \$ 232 | \$ 192 | \$ 40 | 21% |
| Average ferrous scrap purchase price | \$ 235 | \$ 173 | \$ 62 | 36% |

Domestic Fabrication For the quarter just ended our domestic fabrication businesses reported net sales and adjusted operating profit of \$449 million and \$31.5 million, an increase of \$48 million and \$13.3 million, respectively, over last year's first quarter because of the strong and solid nonresidential construction markets that resulted in improved average selling prices and product shipments. The adjusted operating profit was also impacted by a LIFO credit of \$9.3 million as compared to a LIFO expense of \$13.9 million for the prior year's first quarter. Among the segment's product mix, rebar fabrication, construction-related products, and steel fence posts had increased profits offset by a decline in sales in the steel joist manufacturing and structural steel fabrication product group. Shipments from our fabrication plants totaled 404 thousand tons, 11% above the prior year's first quarter, with rebar fabrication showing the largest increase. Our domestic fabrication plant's shipments and average selling prices per ton were as follows:

| | Three Months Ended | | Increase (Decrease) | |
|-------------------------|--------------------|----------------------|---------------------|-----|
| | 2006 | November 30, 2005 | Amount | % |
| Average selling prices* | | | | |
| Rebar | \$ 796 | \$ 742 | \$ 54 | 7% |
| Joist | 1,136 | 1,104 | 32 | 3% |
| Structural | 2,438 | 2,087 | 351 | 17% |
| Post | 713 | 696 | 17 | 2% |

* excludes stock and buyout sales

| Tons shipped (in Thousands) | | | | |
|-----------------------------|-----|-----|-----|-------|
| Rebar | 284 | 233 | 51 | 22% |
| Joist | 79 | 84 | (5) | (6)% |
| Structural | 18 | 20 | (2) | (10)% |
| Post | 23 | 27 | (4) | (15)% |

Recycling The Recycling segment had net sales of \$383 million an increase of 62% from prior year's first quarter as a result of relatively stable ferrous scrap prices and higher nonferrous prices, including aluminum, copper, and nickel. Adjusted operating profit increased by 28% to \$17.6 million compared with \$13.8 million in the prior year, primarily due to higher volumes including material from our Yonack acquisition. LIFO expense for the quarter was \$1.2 million

versus \$1.4 million for the quarter ended November 30, 2005. The segment's profitability was more balanced between ferrous and nonferrous product lines compared to the prior year's quarter, heavily influenced by relative pricing. Our strategy in volatile or steady markets remains the same; focus on rapid inventory turnover. As compared to last year's first quarter, the average ferrous scrap sales price decreased by 6% to \$184 per ton while ferrous shipments increased 22% to 573 thousand tons. The average nonferrous scrap sales price for the quarter was 60% above last year's first quarter and nonferrous shipments were 21% higher at 85 thousand tons. The total volume of scrap processed, including all our domestic processing operations, equaled 937 thousand tons against 839 thousand tons in last year's first quarter.

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The following table reflects our recycling segment's average selling prices per ton and tons shipped (in thousands):

| | Three Months Ended | | Increase | |
|-------------------------------------|--------------------|---------|----------|------|
| | 2006 | 2005 | Amount | % |
| Ferrous sales price | \$ 184 | \$ 195 | \$ (11) | (6)% |
| Nonferrous sales price | \$2,903 | \$1,819 | \$1,084 | 60% |
| Ferrous tons shipped | 573 | 468 | 105 | 22% |
| Nonferrous tons shipped | 85 | 70 | 15 | 21% |
| Total volume processed and shipped* | 937 | 839 | 98 | 12% |

* Includes our processing plants affiliated with our domestic steel mills.

Marketing and Distribution Our marketing and distribution segment's net sales increased by 17% to \$798 million while adjusted operating profit decreased by 66% to \$7.9 million for the three months ended November 30, 2006 as compared to 2005 sales and results. LIFO expense of \$14.3 million in the quarter is a major swing from last year's first quarter LIFO credit of \$3.3 million. The LIFO expense resulted from nonferrous price increases and large increases in inventory, substantially in transit, which is an indicator of upcoming strong sales activity. The segment's sales and results were impacted by an increase in Chinese exports that gave the Company additional sourcing opportunities in inter-Asian carbon steel products, and improved margins by our domestic steel import business and European imports. Our sales of aluminum, copper, brass and stainless steel semis were steady while sales, margins and profits for our industrial materials and products remained strong in the quarter just ended. Our value-added downstream processing businesses, primarily in Australia, continued to generate good profits. In addition, the results of operations for the segment were negatively impacted by a weaker U.S. dollar and higher freight rates.

Corporate and Eliminations Our corporate expenses for the three months ended November 30, 2006 were comparable to 2005.

CONSOLIDATED DATA

On a consolidated basis, the LIFO method of inventory valuation decreased our net earnings on a pre-tax basis by \$10.1 million and by \$21.7 million (5 cents and 12 cents per diluted share) for the three months ended November 30, 2006 and 2005, respectively.

Our overall selling, general and administrative expenses increased by \$28.4 million (27%) for the three months ended November 30, 2006 as compared to 2005 primarily from increases in salary and other compensation related costs due to growth and higher profitability, and expenses related to the planned implementation of a new Enterprise Resource Planning (ERP) system. Foreign currency fluctuations had minimal impact on selling, general and administrative expenses for the three months ended November 30 2006 as compared to 2005.

Interest expense for the three months ended November 30, 2006 was slightly higher than 2005 due primarily to higher interest rates on short-term borrowings outstanding.

Our overall effective tax rate for the three months ended November 30, 2006 increased to 35.6% as compared to 34.9% in 2005 due mainly to a shift in profitability to those domestic jurisdictions subject to state taxes.

CONTINGENCIES

See Note J Contingencies, to the condensed consolidated financial statements.

In the ordinary course of conducting our business, we become involved in litigation, administrative proceedings, governmental investigations including environmental matters, and contract disputes. We may incur settlements, fines, penalties or judgments and otherwise become subject to liability because of some of these matters. While we are unable to estimate precisely the ultimate dollar amount of exposure to loss in connection with these matters, we make accruals as amounts become probable and estimable. The amounts we accrue could vary substantially from amounts

we pay due to several factors including the following: evolving remediation technology, changing regulations, possible third-party contributions, the inherent shortcomings of the estimation process and the uncertainties involved in litigation. Accordingly, we cannot always estimate a meaningful range of possible exposure. We believe that we have adequately provided in our financial statements for the estimable potential

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impact of these contingencies. We also believe that the outcomes will not significantly affect the long-term results of operations, our financial position or cash flows. However, they may have a material impact on earnings for a particular period.

We are subject to federal, state and local pollution control laws and regulations in all locations where we have operating facilities. We anticipate that compliance with these laws and regulations will involve continuing capital expenditures and operating costs.

OUTLOOK

The Company's outlook remains positive for the remainder of the fiscal year ending August 31, 2007. Although our second quarter (winter months) is traditionally our weakest quarter we anticipate a second quarter LIFO diluted net earnings per share of between \$0.57 and \$0.67 compared to last year's second quarter of \$0.65. Destocking will continue at service centers and to a lesser extent at fabrication facilities. Rebar imports will continue to decline significantly.

The Company is poised to reaccelerate in the third quarter (spring months) and fourth quarter (summer months). The fundamentals remain very good with strong demand in non-residential construction markets both in the U.S. and globally. The demand for long products in the U. S. will remain solid, and the continued strength of the non-residential construction markets, including infrastructure, is expected to further benefit our domestic fabrication business profitability. Commodity prices will remain at high levels, although copper is expected to retreat slowly. Our Polish operations are expected to remain strong for the remainder of the year.

In addition, international steel prices appear to be at or near the bottom of the current cycle and are likely to increase early in calendar 2007. Ferrous scrap prices will trend upwards based on good international demand as well as U.S. mills rebuilding inventory of scrap.

We anticipate that our domestic steel mills will enjoy excellent metal margins and shipments to match seasonal demand. The discipline of mill outages will balance supply and demand and, with significantly reduced steel imports, steel prices should firm.

CMC Howell Metal, our copper tube mill, will continue to ship at lower levels due to the weaker housing market. Our Fabrication segment overall will continue to benefit from stable steel prices.

CMCZ our Polish mill operations faces the usual slowdown in demand during the winter period and with a very strong Zloty (2.88 to the U.S. dollar), exports are limited. However, we expect that CMCZ will bounce back strongly in the spring of 2007.

CMC Recycling will benefit from higher ferrous scrap prices although there is some margin squeeze due to buying pressures on unprepared scrap. Flows will improve with higher prices and better demand from the mills. Nonferrous will remain volatile with spreads (to Comex) narrowing.

Our Marketing and Distribution segment will have a steady second quarter; however, the impact of LIFO is difficult to predict.

In summary, 2007 is shaping up to be similar to 2006. Our diversification provides a good balance in the current global market conditions.

LIQUIDITY AND CAPITAL RESOURCES

See Note F – Credit Arrangements, to the condensed consolidated financial statements.

Our sources, facilities and availability of liquidity and capital resources as of November 30, 2006 (dollars in thousands):

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| Source | Total Facility | Availability |
|--|----------------|--------------|
| Net cash flows from operating activities | \$ 42,044 | \$ N/A |
| Commercial paper program* | 400,000 | 373,925 |
| Domestic accounts receivable securitization | 130,000 | 130,000 |
| International accounts receivable sales facilities | 162,155 | 87,706 |
| Bank credit facilities uncommitted | 1,017,000 | 431,060 |
| Notes due from 2007 to 2013 | 350,000 | ** |
| Trade financing arrangements | ** | As required |
| CMCZ revolving credit facility | 34,483 | 34,483 |
| CMCZ & CMC Poland equipment notes | 12,536 | |
| CMC International short-term credit facility | 112,000 | 62,897 |

* The commercial paper program is supported by our \$400 million unsecured revolving credit agreement. The availability under the revolving credit agreement is reduced by \$26.1 million of stand-by letters of credit issued as of November 30, 2006.

** With our investment grade credit ratings and current industry conditions we believe we have access to cost-effective public markets for potential refinancing or the issuance of additional long-term debt.

Certain of our financing agreements, both domestically and at CMCZ, include various covenants, of which we were in compliance at November 30, 2006. There are no guarantees by the Company or any of its subsidiaries for any of CMCZ's debt.

Off-Balance Sheet Arrangements For added flexibility, we may secure financing through securitization and sales of certain accounts receivable both in the U.S. and internationally. See Note D Sales of Accounts Receivable, to the condensed consolidated financial statements. We may continually sell accounts receivable on an ongoing basis to replace those receivables that have been collected from our customers. Our domestic securitization program contains certain cross-default provisions whereby a termination event could occur should we default under another credit arrangement, and contains covenants that conform to the same requirements contained in our revolving credit agreement.

Cash Flows Our cash flows from operating activities primarily result from sales of steel and related products, and to a lesser extent, sales of nonferrous metal products. We have a diverse and generally stable customer base.

During the quarter ended November 30, 2006, we generated \$42 million of net cash flows from operating activities as compared to \$72 million for the prior year's quarter 2005. Significant fluctuations in working capital were as follows:

Increased inventories more in transit inventory and higher inventory costs in some divisions.

Decreased accounts receivable lower sales volume across all segments compared to the fourth quarter of fiscal 2006, in addition to faster turnover in the Marketing and Distribution and CMCZ segments.

Decreased accrued expenses annual incentive and discretionary compensation payments made in the first quarter.

We expect our total capital spending for fiscal year 2007 to be approximately \$230 million, including \$28 million to commence the construction of the greenfield micro mill in Phoenix, Arizona and \$20 million to start the installation of a new wire block mill in CMCZ. We invested \$27 million in property, plant and equipment during the first quarter just ended. We continuously assess our capital spending and reevaluate our requirements based upon current and expected results.

We are also undertaking a 5-year Enterprise Resource Planning (ERP) system implementation program to improve our operating systems and the Company is anticipating spending approximately \$26 million during the current fiscal year. We did not purchase any of our common shares for our treasury during the three months ended November 30, 2006. Our contractual obligations for the next twelve months of \$1.3 billion are typically expenditures with normal

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revenue processing activities. We believe our cash flows from operating activities and debt facilities are adequate to fund our ongoing operations and planned capital expenditures.

CONTRACTUAL OBLIGATIONS

The following table represents our contractual obligations as of November 30, 2006:

| (dollars in thousands) | Total | Payments Due By Period* | | | |
|---|--------------------|-------------------------|------------------|------------------|----------------------|
| | | Less than 1 Year | 1-3 Years | 3-5 Years | More than 5 Years |
| Contractual Obligations: | | | | | |
| Long-term debt ⁽¹⁾ | \$ 364,342 | \$ 54,630 | \$106,647 | \$ 3,015 | \$200,050 |
| Notes payable | 49,103 | 49,103 | | | |
| Interest ⁽²⁾ | 96,944 | 21,058 | 31,245 | 22,595 | 22,046 |
| Operating leases ⁽³⁾ | 102,880 | 26,787 | 39,722 | 22,081 | 14,290 |
| Purchase obligations ⁽⁴⁾ | 1,571,362 | 1,196,775 | 297,824 | 57,762 | 19,001 |
| Total contractual cash obligations | \$2,184,631 | \$1,348,353 | \$475,438 | \$105,453 | \$255,387 |

* We have not discounted the cash obligations in this table.

- (1) Total amounts are included in the November 30, 2006 condensed consolidated balance sheet. See Note F, Credit Arrangements, to the condensed consolidated financial statements.
- (2) Interest payments related to our short-term debt are not included in the table as they do not represent a significant obligation as of November 30, 2006.
- (3) Includes minimum lease payment obligations for non-cancelable equipment and real estate leases in effect as of November 30, 2006.
- (4) About 93% of these purchase obligations are for inventory items to be sold in the ordinary course of business. Purchase obligations include all enforceable, legally binding agreements to purchase goods or services that specify all significant terms, regardless of the duration of the agreement. Agreements with variable terms are excluded because we are unable to estimate the minimum amounts.

Other Commercial Commitments We maintain stand-by letters of credit to provide support for certain transactions that our insurance providers and suppliers request. At November 30, 2006, we had committed \$34.3 million under these arrangements. All of the commitments expire within one year.

See Note J Contingencies, to the condensed consolidated financial statements regarding our guarantees.

FORWARD-LOOKING STATEMENTS

This Form 10-Q contains forward-looking statements regarding the outlook for our financial results including net earnings, product pricing and demand, currency valuation, production rates, inventory levels, new capital investments, and general market conditions. These forward-looking statements generally can be identified by phrases such as we expect, anticipate believe, ought, should, likely, appear, , project, forecast, or other similar words or impact. There is inherent risk and uncertainty in any forward-looking statements. Variances will occur and some could be materially different from our current opinion. Developments that could impact our expectations include the following:

interest rate changes,

construction activity,

metals pricing over which we exert little influence,

increased capacity and product availability from competing steel minimills and other steel suppliers including import quantities and pricing,

court decisions,

industry consolidation or changes in production capacity or utilization,

global factors including political and military uncertainties,

credit availability,

currency fluctuations,

energy prices,

cost of construction,

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successful implementation of new technology,
successful integration of acquisitions,
decisions by governments impacting the level of steel imports, and
pace of overall economic activity, particularly China.

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The information required hereunder for the Company is not materially different from the information set forth in Item 7a. Quantitative and Qualitative Disclosures about Market Risk included in the Company's Annual Report on Form 10-K for the year ended August 31, 2006, filed with the Securities Exchange Commission and is, therefore, not presented herein.

Also, see Note I Derivatives and Risk Management, to the condensed consolidated financial statements.

ITEM 4. CONTROLS AND PROCEDURES

The term disclosure controls and procedures is defined in Rules 13a-15(e) of the Securities Exchange Act of 1934, or the Exchange Act. This term refers to the controls and procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files under the Exchange Act is recorded, processed, summarized and reported within required time periods. Our Chief Executive Officer and our Chief Financial Officer have evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this quarterly report, and they have concluded that as of that date, our disclosure controls and procedures were effective.

No change to our internal control over financial reporting occurred during our last fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Reference is made to the information incorporated by reference from Item 3. Legal Proceedings in the Company's Annual Report on Form 10-K for the year ended August 31, 2006, filed November 8, 2006, with the Securities and Exchange Commission.

ITEM 1A. RISK FACTORS

Not Applicable.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Issuer Purchases of Equity Securities

| | Total Number of Shares Purchased | Average Price Paid Per Share | Total Number of Shares Purchased As Part of Publicly Announced Plans or Programs | Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs |
|--|---|------------------------------------|--|---|
| As of September 1, 2006 | | | | 3,341,760(1) |
| September 1- September 30, 2006 | \$ 0 | \$ 0 | | |
| October 1 - October 31, 2006 | 8,009(2) | \$22.71 | | |
| November 1 - November 30, 2006 | 5,615(2) | \$26.97 | | |
| As of November 30, 2006 | 13,624(2) | \$24.47 | | 3,341,760(1) |
| (1) Shares available to be purchased under the Company's Share Repurchase Program publicly announced July 19, 2006. | | | | |
| (2) Shares tendered to the Company by employee stock option holders in payment of the option purchase price due upon exercise. | | | | |

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ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not Applicable

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

Not Applicable

ITEM 5. OTHER INFORMATION

Not Applicable

ITEM 6. EXHIBITS

Exhibits required by Item 601 of Regulation S-K.

- 31.1 Certification of Murray R. McClean, President and Chief Executive Officer of Commercial Metals Company, pursuant to Section 302 to the Sarbanes-Oxley Act of 2002 (filed herewith).
- 31.2 Certification of William B. Larson, Vice President and Chief Financial Officer of Commercial Metals Company, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith).
- 32.1 Certification of Murray R. McClean, President and Chief Executive Officer of Commercial Metals Company, pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (filed herewith).
- 32.2 Certification of William B. Larson, Vice President and Chief Financial Officer of Commercial Metals Company, pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (filed herewith).

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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.

COMMERCIAL METALS COMPANY

January 9, 2007

/s/ William B. Larson
William B. Larson
Vice President
& Chief Financial Officer

January 9, 2007

/s/ Leon K. Rusch
Leon K. Rusch
Controller

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INDEX TO EXHIBITS

| Exhibit No. | Description of Exhibit |
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