Koppers Holdings Inc.
Form 10-Q
August 03, 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2017

Commission file number 1-32737

KOPPERS HOLDINGS INC.

(Exact name of registrant as specified in its charter)

Pennsylvania	20-1878963
(State of incorporation)	(IRS Employer Identification No.)

436 Seventh Avenue

Pittsburgh, Pennsylvania 15219

(Address of principal executive offices)

(412) 227-2001

(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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer   Accelerated filer   Non-accelerated filer   Smaller reporting company   Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes   No

Common Stock, par value $0.01 per share, outstanding at July 31, 2017 amounted to 20,745,461 shares.

PART I—FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

KOPPERS HOLDINGS INC.

CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS AND COMPREHENSIVE INCOME

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
(Dollars in millions, except per share amounts)	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)
Net sales	$378.0	$ 385.1	$724.6	$ 731.9
Cost of sales (excluding items below)	294.7	303.8	570.0	592.3
Depreciation and amortization	11.7	13.1	22.9	28.2
Impairment and restructuring charges	2.1	6.0	3.6	11.1
Selling, general and administrative expenses	31.9	30.2	62.9	60.5
Operating profit	37.6	32.0	65.2	39.8
Other income	0.7	0.4	2.7	2.0
Interest expense	10.8	14.3	21.4	26.6
Loss on extinguishment of debt	0.0	0.0	13.3	0.0
Income before income taxes	27.5	18.1	33.2	15.2
Income tax provision	6.6	6.8	7.6	6.3
Income from continuing operations	20.9	11.3	25.6	8.9
(Loss) income from discontinued operations, net of tax benefit (expense) of $0.6, $0.0, $0.6 and $(0.4)	(1.1)	0.0	(1.2)	0.6
Net income	19.8	11.3	24.4	9.5
Net income (loss) attributable to noncontrolling interests	0.1	(0.8)	0.3	(1.3)
Net income attributable to Koppers	$19.7	$ 12.1	$24.1	$ 10.8
Earnings (loss) per common share attributable to Koppers common shareholders:				
Basic -				
Continuing operations	$1.00	$ 0.58	$1.22	$ 0.49
Discontinued operations	(0.06)	0.00	(0.06)	0.03
Earnings per basic common share	$0.94	$ 0.58	$1.16	$ 0.52
Diluted -				
Continuing operations	$0.95	$ 0.57	$1.15	$ 0.49
Discontinued operations	(0.05)	0.00	(0.06)	0.03
Earnings per diluted common share	$0.90	$ 0.57	$1.09	$ 0.52
Comprehensive income	$24.7	$ 9.9	$36.9	$ 17.3
Comprehensive income (loss) attributable to noncontrolling interests	0.2	(1.0)	0.4	(1.5)
Comprehensive income attributable to Koppers	$24.5	$ 10.9	$36.5	$ 18.8
Weighted average shares outstanding (in thousands):				

Basic	20,782	20,640	20,752	20,611
Diluted	21,883	20,944	21,898	20,798

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

KOPPERS HOLDINGS INC.

CONDENSED CONSOLIDATED BALANCE SHEET

(Dollars in millions, except per share amounts)	June 30, 2017 (Unaudited)	December 31, 2016
Assets		
Cash and cash equivalents	$ 40.0	$ 20.8
Accounts receivable, net of allowance of $3.0 and $3.8	180.1	136.8
Income tax receivable	4.5	3.8
Inventories, net	229.7	228.7
Loan to related party	0.0	8.9
Other current assets	46.7	39.1
Total current assets	501.0	438.1
Property, plant and equipment, net	303.4	280.8
Goodwill	187.9	186.4
Intangible assets, net	136.2	141.9
Deferred tax assets	26.7	27.1
Other assets	13.2	13.2
Total assets	$ 1,168.4	$ 1,087.5
Liabilities		
Accounts payable	$ 148.4	$ 144.2
Accrued liabilities	116.4	106.3
Current maturities of long-term debt	12.5	42.6
Total current liabilities	277.3	293.1
Long-term debt	680.4	619.8
Accrued postretirement benefits	50.4	51.6
Deferred tax liabilities	6.7	6.3
Other long-term liabilities	80.1	82.1
Total liabilities	1,094.9	1,052.9
Commitments and contingent liabilities (Note 18)		
Equity		
Senior Convertible Preferred Stock, $0.01 par value per share; 10,000,000 shares authorized; no shares issued	0.0	0.0
Common Stock, $0.01 par value per share; 80,000,000 shares authorized; 22,350,838 and 22,140,680 shares issued	0.2	0.2
Additional paid-in capital	183.7	176.5
Accumulated deficit	(0.8)	(24.7)
Accumulated other comprehensive loss	(56.1)	(68.6)
Treasury stock, at cost, 1,605,377 and 1,475,792 shares	(58.1)	(53.0)
Total Koppers shareholders’ equity	68.9	30.4
Noncontrolling interests	4.6	4.2
Total equity	73.5	34.6

Total liabilities and equity	$ 1,168.4	$ 1,087.5

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

KOPPERS HOLDINGS INC.

CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS

(Dollars in millions)	Six Months Ended June 30, 2017 (Unaudited)	2016 (Unaudited)
Cash provided by (used in) operating activities:		
Net income	$24.4	$ 9.5
Adjustments to reconcile net cash provided by (used in) operating activities:		
Depreciation and amortization	22.9	28.2
Loss on extinguishment of debt	13.3	0.0
Gain on disposal of investment	(1.4)	0.0
Deferred income taxes	0.2	0.3
Equity loss, net of dividends received	0.0	0.7
Change in other liabilities	(6.7)	(5.2)
Non-cash interest expense	1.0	3.9
Stock-based compensation	5.0	3.4
Other - net	0.0	2.8
Changes in working capital:		
Accounts receivable	(39.2)	(19.5)
Inventories	4.6	6.0
Accounts payable	1.8	4.8
Accrued liabilities	8.3	3.3
Other working capital	(2.9)	(3.9)
Net cash provided by operating activities	31.3	34.3
Cash (used in) provided by investing activities:		
Capital expenditures	(34.2)	(21.3)
Repayments of loan	9.5	0.0
Net cash provided by divestitures and asset sales	0.8	0.6
Net cash used in investing activities	(23.9)	(20.7)
Cash provided by (used in) financing activities:		
Borrowings of revolving credit	523.3	290.3
Repayments of revolving credit	(455.9)	(288.2)
Borrowings of long-term debt	500.0	0.0
Repayments of long-term debt	(541.4)	(15.0)
Issuances of Common Stock	1.9	0.1
Repurchases of Common Stock	(5.2)	(0.3)
Payment of debt issuance costs	(11.0)	(1.4)
Net cash provided by (used in) financing activities	11.7	(14.5)
Effect of exchange rate changes on cash	0.1	(4.5)
Net increase (decrease) in cash and cash equivalents	19.2	(5.4)
Cash and cash equivalents at beginning of period	20.8	21.8
Cash and cash equivalents at end of period	$40.0	$ 16.4

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

KOPPERS HOLDINGS INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements and related disclosures have been prepared in accordance with accounting principles generally accepted in the United States applicable to interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation of Koppers Holdings Inc.'s and its subsidiaries' ("Koppers", "Koppers Holdings" or the "Company") financial position and interim results as of and for the periods presented have been included. All such adjustments are of a normal recurring nature unless disclosed otherwise. Because the Company's business is seasonal, results for interim periods are not necessarily indicative of those that may be expected for a full year. The Condensed Consolidated Balance Sheet for December 31, 2016 has been summarized from the audited balance sheet contained in the Annual Report on Form 10-K for the year ended December 31, 2016. Certain prior period amounts in the notes to the consolidated financial statements have been reclassified to conform to the current period's presentation.

The financial information included herein should be read in conjunction with the Company's audited consolidated financial statements and related notes included in its Annual Report on Form 10-K for the year ended December 31, 2016.

2. New Accounting Pronouncements

The Company adopted Financial Accounting Standards Board ("FASB") Accounting Standards Update ("ASU") No. 2016-09, "Improvements to Employee Share-Based Payment Accounting" effective January 1, 2017. This ASU makes several modifications related to the accounting for forfeitures of share-based awards, employer tax withholding on share-based compensation and the financial statement presentation of excess tax benefits or deficiencies. The Company elected to account for forfeitures when they occur. The impact of adoption was a decrease to retained earnings of $0.2 million, an increase to deferred tax assets of $0.1 million and an increase to additional paid in capital of $0.3 million.

In May 2014, the FASB issued ASU No. 2014-09, "Revenue from Contracts with Customers (Topic 606)." ASU 2014-09 requires an entity to recognize revenue in a manner that depicts the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Subsequent to the issuance of ASU 2014-09, the FASB issued multiple ASUs which either amended or clarified ASU 2014-09. Collectively, the revenue recognition ASUs are effective for annual reporting periods beginning after December 15, 2017 and allow for the use of either the full retrospective or modified retrospective transition method. The Company has decided to use the modified retrospective method for transition in which the cumulative effect will be recognized at the date of adoption with no restatement of comparative periods presented. The Company has a project team that has made substantial progress in analyzing significant contracts with customers across all major business units to determine the impact of the adoption of the ASUs on the Company's financial statements and disclosures. The Company will continue to assess the impact the ASU updates will have on its revenue arrangements with a final evaluation of the impact of adopting these ASU updates expected to be completed during the third quarter of 2017.

In February 2016, the FASB issued ASU No. 2016-02, "Leases (Topic 842)." ASU 2016-02 requires an entity to recognize a right-of-use asset and lease liability for all leases with terms of more than one year. Recognition, measurement and presentation of expenses will depend on classification as a finance or operating lease. The standard is effective January 1, 2019 and early adoption is permitted. The guidance requires a modified retrospective adoption. The Company is currently evaluating the impact the adoption of ASU 2016-02 will have on its consolidated financial statements.

In August 2016, the FASB issued ASU No. 2016-15, “Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments.” The update clarifies how entities should classify certain cash receipts and cash payments on the statement of cash flow. The amendments in this update are effective for periods beginning after December 15, 2017. The Company is in the process of assessing the impact the adoption of this ASU will have on its consolidated financial statements.

3. Plant Closures and Divestitures

Over the past three years, the Company has been restructuring its Carbon Materials and Chemicals (“CMC”) business unit in order to concentrate its facilities in regions where the Company believes it holds key competitive advantages to better serve its global customers. These closure activities include:

- In January 2017, the Company entered into an agreement to lease its Follansbee, West Virginia coal tar distillation facility to a third party. It is anticipated that the Company will cease naphthalene refining activities at the facility within the next nine to 12 months upon commissioning of a new naphthalene refining plant in Stickney, Illinois.

- In November 2016, the Company sold its 30-percent interest in Tangshan Kailuan Koppers Carbon Chemical Company Limited ("TKK") located in the Hebei Province in China.
- In July 2016, the Company discontinued coal tar distillation activities at its CMC plant located in Clairton, Pennsylvania.
- In March 2016, the Company discontinued production at its 60-percent owned CMC plant located in Tangshan, China.
- In February 2016, the Company announced plans to cease coal tar distillation and specialty pitch operations at both of its United Kingdom CMC facilities. In July 2016, the Company sold substantially all of its CMC tar distillation properties and assets in the United Kingdom. In exchange, the Company transferred cash to the buyer and the buyer assumed historical environmental and asset retirement obligations.
- In April 2014, the Company ceased its coal tar distillation activities at its CMC facility located in Uithoorn, the Netherlands.
- In 2011, the Company ceased carbon black production at its CMC facility located in Kurnell, Australia.

Other closure and divestiture activity relates to the Company's Railroad Utility Products and Services ("RUPS") business unit. These actions include:

- In October 2016, the Company agreed to a long-term lease of its wood treatment facility in Houston, Texas to a third party. The facility, owned by the Company's wholly-owned subsidiary, Wood Protection L.P., was engaged in the manufacturing and sale of pressure-treated dimensional lumber.
- In August 2015, the Company closed its RUPS plant located in Green Spring, West Virginia.
- In July 2015, the Company sold the assets of its 50-percent interest in KSA Limited Partnership, a concrete crosstie manufacturer.
- In January 2015, Koppers Inc. sold its RUPS North American utility pole business.

Details of the restructuring activities and related reserves are as follows:

(Dollars in millions)	Severance and employee benefits	Environmental remediation	Site demolition	Other	Total
Reserve at December 31, 2015	$ 2.0	$ 4.3	$ 21.9	$ 0.0	$ 28.2
Accrual	2.4	0.1	5.6	5.6	13.7
Cost charged against assets	0.0	0.0	0.0	(1.9)	(1.9)
Reversal of accrued charges	(1.9)	(0.5)	(8.7)	(0.1)	(11.2)
Cash paid	(1.0)	(2.4)	(8.1)	(0.2)	(11.7)
Currency translation	(0.1)	0.0	(0.7)	(0.2)	(1.0)
Reserve at December 31, 2016	$ 1.4	$ 1.5	$ 10.0	$ 3.2	$ 16.1
Accrual	0.1	2.1	0.0	3.5	5.7
Cost charged against assets	0.0	0.0	0.0	(3.2)	(3.2)
Reversal of accrued charges	(0.1)	0.0	(0.3)	0.0	(0.4)
Cash paid	(0.1)	(0.7)	(0.9)	(0.3)	(2.0)
Currency translation	0.0	0.1	0.0	0.0	0.1
Reserve at June 30, 2017	$ 1.3	$ 3.0	$ 8.8	$ 3.2	$ 16.3

4. Related Party Transactions

As of December 31, 2016 the Company had loaned $10.0 million, gross of accumulated equity losses of $1.1 million, to TKK, including interest. The Company had a 30-percent interest in TKK until its sale to TKK’s controlling shareholder in November 2016. The loan and interest has been fully repaid and the Company recorded a gain of $1.3 million in the six months ended June 30, 2017.

5. Fair Value Measurements

Carrying amounts and the related estimated fair values of the Company's financial instruments as of June 30, 2017 and December 31, 2016 are as follows:

	June 30, 2017		December 31, 2016	
	Fair Value	Carrying Value	Fair Value	Carrying Value
(Dollars in millions)				
Financial assets:				
Cash and cash equivalents, including restricted cash	$40.0	$ 40.0	$20.8	$ 20.8
Investments and other assets[(a)]	1.1	1.1	1.1	1.1
Financial liabilities:				
Long-term debt (including current portion)	$722.9	$ 692.9	$669.6	$ 662.4

(a) Excludes equity method investments.

Cash and cash equivalents – The carrying amount approximates fair value because of the short maturity of those instruments.

Investments and other assets – Represents the broker-quoted cash surrender value on universal life insurance policies. This asset is classified as Level 2 in the valuation hierarchy and is measured from values received from financial institutions.

Debt – The fair value of the Company's long-term debt is estimated based on the market prices for the same or similar issues or on the current rates offered to the Company for debt of the same remaining maturities (Level 2). The fair value of the Company's revolving credit facility approximates carrying value due to the variable rate nature of this instrument.

6. Comprehensive Income and Equity (Deficit)

Total comprehensive income for the three and six months ended June 30, 2017 and 2016 is summarized in the table below:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
(Dollars in millions)				
Net income	$19.8	$11.3	$24.4	$9.5

Other comprehensive income:				
Change in currency translation adjustment	4.9	(3.0)	10.9	3.4
Unrealized (losses) gains on cash flow hedges, net of tax (benefit) expense of $(0.3), $0.9, $0.6 and $2.5	(0.4)	1.3	0.9	3.7
Change in unrecognized pension net loss, net of tax expense of $0.2, $0.1, $0.4 and $0.3	0.4	0.3	0.7	0.7
Total comprehensive income	24.7	9.9	36.9	17.3
Less: Comprehensive income (loss) attributable to noncontrolling interests	0.2	(1.0)	0.4	(1.5)
Comprehensive income attributable to Koppers	$24.5	$10.9	$36.5	$18.8

Amounts reclassified from accumulated other comprehensive loss to net income consist of amounts shown for changes in unrecognized pension net loss and unrecognized prior service cost. These components of accumulated other comprehensive income are included in the computation of net periodic pension cost as disclosed in Note 13 – Pensions and Postretirement Benefit Plans. Other amounts reclassified from accumulated other comprehensive income include income related to derivative financial instruments, net of tax, of $1.3 million and $2.6 million for the three and six months ended June 30, 2017, respectively, and losses of $1.7 million and $3.2 million for the three and six months ended June 30, 2016, respectively.

The following tables present the change in equity (deficit) for the six months ended June 30, 2017 and 2016, respectively:

(Dollars in millions)	Total Koppers Shareholders' Equity	Noncontrolling Interests	Total Equity
Balance at December 31, 2016	$ 30.4	$ 4.2	$ 34.6
Net income	24.1	0.3	24.4
Issuance of common stock	1.9	0.0	1.9
Employee stock plans	5.3	0.0	5.3
Other comprehensive income	12.4	0.1	12.5
Repurchases of common stock	(5.2)	0.0	(5.2)
Balance at June 30, 2017	$ 68.9	$ 4.6	$ 73.5

(Dollars in millions)	Total Koppers Shareholders' Equity (Deficit)	Noncontrolling Interests	Total Equity (Deficit)
Balance at December 31, 2015	$ (18.5)	$ 6.1	$ (12.4)
Net income (loss)	10.8	(1.3)	9.5
Employee stock plans	3.4	0.0	3.4
Other comprehensive income (loss)	8.0	(0.2)	7.8
Repurchases of common stock	(0.3)	0.0	(0.3)
Balance at June 30, 2016	$ 3.4	$ 4.6	$ 8.0

7. Earnings per Common Share

The computation of basic earnings per common share for the periods presented is based upon the weighted average number of common shares outstanding during the periods. The computation of diluted earnings per common share includes the effect of non-vested nonqualified stock options and restricted stock units assuming such options and stock units were outstanding common shares at the beginning of the period. The effect of antidilutive securities is excluded from the computation of diluted loss per common share, if any.

The following table sets forth the computation of basic and diluted earnings per common share:

(Dollars in millions, except share amounts, in thousands, and per share amounts)	Three Months Ended June 30, 2017	2016	Six Months Ended June 30, 2017	2016
Net income attributable to Koppers	$19.7	$12.1	$24.1	$10.8
Less: (Loss) income from discontinued operations	(1.1)	0.0	(1.2)	0.6
Income from continuing operations attributable to Koppers	$20.8	$12.1	$25.3	$10.2
Weighted average common shares outstanding:				
Basic	20,782	20,640	20,752	20,611
Effect of dilutive securities	1,101	304	1,146	187
Diluted	21,883	20,944	21,898	20,798
Income per common share – continuing operations:				
Basic income per common share	$1.00	$0.58	$1.22	$0.49
Diluted income per common share	0.95	0.57	1.15	0.49
Other data:				
Antidilutive securities excluded from computation of diluted earnings per common share	509	424	344	572

8. Stock-based Compensation

The amended and restated 2005 Long-Term Incentive Plan (the “LTIP”) provides for the grant to eligible persons of stock options, stock appreciation rights, restricted stock, restricted stock units, performance shares, performance awards, dividend equivalents and other stock-based awards, which are collectively referred to as the awards.

Restricted Stock Units and Performance Stock Units

Under the LTIP, the board of directors grants restricted stock units and performance stock units to certain employee participants (collectively, the "stock units"). For grants to most employees in 2015 and thereafter, the restricted stock units vest in four equal annual installments. Restricted stock units that have one-year vesting periods are also issued under the LTIP to members of the board of directors in connection with annual director compensation and, from time to time, are issued to employees in connection with employee compensation with vesting periods of two years or less typically.

Compensation expense for non-vested stock units is recorded over the vesting period based on the fair value at the date of grant. The fair value of restricted stock units and performance stock units with a performance condition is the market price of the underlying common stock on the date of grant.

Performance stock units granted prior to 2016 have vesting based upon a performance condition. These performance stock units generally have three-year performance objectives and all performance stock units have a three-year period for vesting (if the applicable performance objective is achieved). For awards granted prior to 2016, the applicable performance objective is based upon a multi-year cumulative value creation calculation that considers the Company's financial performance commencing on the first day of each grant year. The number of performance stock units granted represents the target award and participants have the ability to earn between zero and 200 percent (depending on the grant date) of the target award based upon actual performance. If minimum performance criteria are not achieved, no performance stock units will vest. Performance stock units granted in 2014 did not meet the value creation threshold and were forfeited in February 2017.

Performance stock units granted in 2016 and 2017 have vesting based upon a market condition. These performance stock units have a three-year performance objective and a three-year period for vesting (if the applicable performance objective is achieved). The applicable performance objective is based on the Company's total shareholder return relative to the Standard & Poors SmallCap 600 Materials Index. The number of performance stock units granted represents the target award and participants have the ability to earn between zero and 200 percent of the target award based upon actual performance. If minimum performance criteria are not achieved, no performance stock units will vest. The Company has the discretion to settle the award in cash rather than shares, although the Company currently expects that all awards will be settled by the issuance of shares.

Compensation expense for non-vested performance stock units with a market condition is recorded over the vesting period based on the fair value at the date of grant. The Company calculated the fair value of the awards on the date of grant using the Monte Carlo valuation model and the assumptions listed below:

	March 2017 Grant	March 2016 Grant
Grant date price per share of performance award	$ 44.10	$18.11
Expected dividend yield per share	0.00 %	0.00 %
Expected volatility	43.50 %	40.86 %
Risk-free interest rate	1.54 %	0.96 %
Look-back period in years	2.83	2.84
Grant date fair value per share of performance award	$ 64.02	$23.70

Dividends declared, if any, on the Company's common stock during the period prior to vesting of the stock units are credited at equivalent value as additional stock units and become payable as additional common shares upon vesting. In the event of termination of employment, other than retirement, death or disability, any non-vested stock units are forfeited, including additional stock units credited from dividends. In the event of termination of employment due to retirement, death or disability, pro-rata vesting of the stock units over the service period will result. There are special vesting provisions for the stock units related to a change in control.

The following table shows a summary of the performance stock units as of June 30, 2017:

Performance Period	Minimum Shares	Target Shares	Maximum Shares
2015 – 2017	0	203,953	407,906
2016 – 2018	0	260,588	521,176
2017 – 2019	0	117,010	234,020

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The following table shows a summary of the status and activity of non-vested stock units for the six months ended June 30, 2017:

	Restricted Stock Units	Performance Stock Units	Total Stock Units	Weighted Average Grant Date Fair Value per Unit
Non-vested at December 31, 2016	279,807	554,388	834,195	$ 23.09
Granted	82,279	117,010	199,289	$ 55.32
Vested	(127,443)	0	(127,443)	$ 24.90
Forfeited	(138)	(89,847)	(89,985)	$ 37.80
Non-vested at June 30, 2017	234,505	581,551	816,056	$ 29.06

Stock Options

Prior to 2015, stock options to most executive officers vest and become exercisable upon the completion of a three-year service period commencing on the grant date. For grants in 2015 and thereafter, the stock options vest in four equal annual installments. The stock options have a term of ten years. In the event of termination of employment, other than retirement, death or disability, any non-vested options are forfeited. In the event of termination of employment due to retirement, death or disability, pro-rata vesting of the options over the service period will result. There are special vesting provisions for the stock options related to a change in control.

Compensation expense for non-vested stock options is recorded over the vesting period based on the fair value at the date of grant. The Company calculated the fair value of stock options on the date of grant using the Black-Scholes-Merton model and the assumptions listed below:

	March 2017 Grant	March 2016 Grant	March 2015 Grant
Grant date price per share of stock option award	$ 44.10	$ 18.11	$ 17.57
Expected dividend yield per share	0.00 %	0.00 %	3.40 %
Expected life in years	5.77	5.96	5.75
Expected volatility	39.70 %	40.86 %	42.27 %
Risk-free interest rate	2.13 %	1.45 %	1.73 %
Grant date fair value per share of option award	$ 17.90	$ 7.41	$ 5.20

The dividend yield is based on the Company’s current and prospective dividend rate which calculates a continuous dividend yield based upon the market price of the underlying common stock. The Company suspended its dividend in February 2015 and does not expect to declare any dividends for the foreseeable future. The expected life in years is based on historical exercise data of options previously granted by the Company. Expected volatility is based on the historical volatility of the Company’s common stock and the historical volatility of certain other similar public companies. The risk-free interest rate is based on U.S. Treasury bill rates for the expected life of the option.

The following table shows a summary of the status and activity of stock options for the six months ended June 30, 2017:

	Options	Weighted Average Exercise Price per Option	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (in millions)
Outstanding at December 31, 2016	935,454	$ 26.09		
Granted	97,403	$ 44.10		
Exercised	(69,365)	$ 27.52		
Outstanding at June 30, 2017	963,492	$ 27.81	6.58	$ 10.2
Exercisable at June 30, 2017	551,717	$ 30.62	5.13	$ 4.3

Stock Compensation Expense

Total stock-based compensation expense recognized for three and six months ended June 30, 2017 and 2016 is as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
(Dollars in millions)				
Stock-based compensation expense recognized:				
Selling, general and administrative expenses	$2.7	$2.3	$5.0	$3.4
Less related income tax benefit	0.7	1.0	1.2	1.4
	$2.0	$1.3	$3.8	$2.0

As of June 30, 2017, total future gross compensation expense related to non-vested stock-based compensation arrangements, which are expected to vest, totaled $19.9 million and the weighted-average period over which this cost is expected to be recognized is approximately 29 months.

9. Segment Information

The Company has three reportable segments: Railroad and Utility Products and Services, Performance Chemicals and Carbon Materials and Chemicals. The Company's reportable segments contain multiple aggregated business units since management believes the long-term financial performance of these business units is affected by similar economic conditions. The reportable segments are each managed separately because they manufacture and distribute distinct products with different production processes.

The Company's Railroad and Utility Products and Services segment sells treated and untreated wood products, manufactured products and services primarily to the railroad and public utility markets. Railroad products and services include procuring and treating items such as crossties, switch ties and various types of lumber used for railroad bridges and crossings and the manufacture of rail joint bars. The segment also operates a railroad services business that conducts engineering, design, repair and inspection services for railroad bridges. Utility products include the treating of transmission and distribution poles and pilings.

The Company's Performance Chemicals segment develops, manufactures, and markets wood preservation chemicals and wood treatment technologies and services a diverse range of end-markets including infrastructure, residential and commercial construction, and agriculture.

The Company's Carbon Materials and Chemicals segment is primarily a manufacturer of creosote, carbon pitch, naphthalene, phthalic anhydride and carbon black feedstock. Creosote is used in the treatment of wood and carbon black feedstock is used in the production of carbon black. Carbon pitch is a critical raw material used in the production of aluminum and for the production of steel in electric arc furnaces. Naphthalene is used for the production of phthalic anhydride and as a surfactant in the production of concrete. Phthalic anhydride is used in the production of plasticizers, polyester resins and alkyd paints.

The Company evaluates performance and determines resource allocations based on a number of factors, the primary measure being operating profit or loss from operations. Operating profit does not include equity in earnings of affiliates, other income, interest expense, income taxes or operating costs of Koppers Holdings Inc. The accounting policies of the reportable segments are the same as those described in the summary of significant accounting policies. Intersegment transactions are eliminated in consolidation.

The following table sets forth certain sales and operating data, net of all intersegment transactions, for the Company's segments for the periods indicated:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
(Dollars in millions)				

Revenues from external customers:				
Railroad and Utility Products and Services	$135.9	$164.4	$271.4	$315.8
Performance Chemicals	111.8	108.4	208.5	196.4
Carbon Materials and Chemicals	130.3	112.3	244.7	219.7
Total	$378.0	$385.1	$724.6	$731.9
Intersegment revenues:				
Performance Chemicals	$1.5	$1.9	$3.2	$3.9
Carbon Materials and Chemicals	19.0	21.0	37.9	41.9
Total	$20.5	$22.9	$41.1	$45.8
Depreciation and amortization expense:				
Railroad and Utility Products and Services	$2.9	$3.1	$5.9	$6.3
Performance Chemicals	4.5	4.8	8.9	9.6
Carbon Materials and Chemicals	4.3	5.2	8.1	12.3
Total	$11.7	$13.1	$22.9	$28.2
Operating profit (loss):				
Railroad and Utility Products and Services	$11.0	$18.5	$20.0	$32.0
Performance Chemicals	19.6	22.4	38.2	35.0
Carbon Materials and Chemicals	7.8	(8.3)	8.2	(25.9)
Corporate[(a)]	(0.8)	(0.6)	(1.2)	(1.3)
Total	$37.6	$32.0	$65.2	$39.8

(a) Operating loss for Corporate includes primarily general and administrative costs for Koppers Holdings Inc., the parent company of Koppers Inc.

The following table sets forth certain tangible and intangible assets allocated to each of the Company's segments as of the dates indicated:

(Dollars in millions)	June 30, 2017	December 31, 2016
Segment assets:		
Railroad and Utility Products and Services	$260.2	$ 264.2
Performance Chemicals	489.7	442.9
Carbon Materials and Chemicals	371.2	333.0
All other	47.3	47.4
Total	$1,168.4	$ 1,087.5
Goodwill:		
Railroad and Utility Products and Services	$10.4	$ 9.9
Performance Chemicals	177.5	176.5
Total	$187.9	$ 186.4

10. Income Taxes

Effective Tax Rate

The income tax provision for interim periods is comprised of an estimated annual effective income tax rate applied to current year ordinary income and tax associated with discrete items. These discrete items generally relate to adjustments to uncertain tax positions and changes of estimated tax to the actual liability determined upon filing tax returns. To determine the annual effective tax rate, management is required to make estimates of annual pretax income in each domestic and foreign jurisdiction in which the Company conducts business. Entities that have historical pre-tax losses and current year estimated pre-tax losses that are not projected to generate a future benefit are excluded from the estimated annual effective income tax rate.

The estimated annual effective income tax rate, excluding discrete items discussed above, was 24.6 percent and 31.1 percent for the six months ended June 30, 2017 and 2016, respectively. The estimated annual effective income tax rate differs from the U.S. federal statutory tax rate due to:

	June 30, 2017	June 30, 2016
Federal income tax rate	35.0 %	35.0 %

State income taxes, net of federal tax benefit	2.1	1.6
Foreign earnings taxed at different rates	(15.7)	(6.5)
Change in tax contingency reserves	0.3	0.5
Nondeductible expenses	2.1	0.9
Tax credits	(0.3)	(0.4)
Other	1.1	0.0
Estimated annual effective income tax rate	24.6 %	31.1 %

Income taxes as a percentage of pretax income were 24.0 percent and 37.6 percent for the three months ended June 30, 2017 and 2016, respectively, principally because the estimated annual effective income tax rate is applied to pre-tax earnings excluding the results of our Chinese subsidiaries that are not expected to generate a future tax benefit. These results are excluded from the determination of the annual effective income tax rate as discussed above. Discrete items included in income taxes for the three months ended June 30, 2017 and 2016, respectively, were not material.

Income taxes as a percentage of pretax income were 22.9 percent for the six months ended June 30, 2017. This is lower than the estimated annual effective tax rate principally due to discrete items, but also because the estimated annual effective income tax rate is applied to pre-tax earnings excluding the results of our Chinese subsidiaries that are not expected to generate a future tax benefit. Discrete items included in income taxes for the six months ended June 30, 2017 were a net benefit of $0.3 million, which includes excess tax benefits for stock-based compensation of $0.9 million offset by additional accruals for uncertain tax positions of $0.6 million.

Income taxes as a percentage of pretax income were 41.4 percent for the six months ended June 30, 2016. This is higher than the estimated annual effective tax rate principally because the estimated annual effective income tax rate is applied to pre-tax earnings excluding the results of our Chinese subsidiaries that are not expected to generate a future tax benefit. Discrete items included in income taxes for the six months ended June 30, 2016 were not material.

During the year, management regularly updates estimates of pre-tax income and income tax expense based on changes in pre-tax income projections by taxable jurisdiction, repatriation of foreign earnings, uncertain tax positions and other tax matters. To the extent that actual results vary from these estimates, the actual annual effective income tax rate at the end of the year could be materially different from the estimated annual effective income tax rate as of the end of the second quarter.

Uncertain Tax Positions

The Company and its subsidiaries file income tax returns in the U.S. federal jurisdiction, individual U.S. state jurisdictions and non-U.S. jurisdictions. With few exceptions, the Company is no longer subject to U.S. federal, state and local, or non-U.S. income tax examinations by tax authorities for years prior to 2012.

Unrecognized tax benefits totaled $7.0 million and $9.7 million as of June 30, 2017 and December 31, 2016, respectively. As of June 30, 2017 and December 31, 2016, the total amount of unrecognized tax benefits that, if recognized, would affect the effective tax rate, was approximately $3.0 million and $5.7 million, respectively. The Company recognizes interest expense and any related penalties from uncertain tax positions in income tax expense. As of June 30, 2017 and December 31, 2016, the Company had accrued approximately $3.4 million and $4.2 million for interest and penalties, respectively.

Unrecognized tax benefits decreased in the first six months of 2017 principally due to the settlement related to a transfer pricing matter. The Company does not anticipate significant increases or decreases to the amount of unrecognized tax benefits within the next twelve months.

11. Inventories

Net inventories as of June 30, 2017 and December 31, 2016 are summarized in the table below:

	June 30, 2017	December 31, 2016
(Dollars in millions)		
Raw materials	$ 161.7	$ 157.7
Work in process	11.3	14.2
Finished goods	102.3	103.6
	$ 275.3	$ 275.5
Less revaluation to LIFO		