

Edgar Filing: REUNION INDUSTRIES INC - Form 10-Q

REUNION INDUSTRIES INC
Form 10-Q
August 16, 2004

=====

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549-1004

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2004

OR

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

For the transition period from _____ to _____

Commission File Number 33-64325

REUNION INDUSTRIES, INC.

(Exact name of Registrant as specified in its charter)

DELAWARE

06-1439715

(State of Incorporation)

(I.R.S. Employer Identification No.)

11 STANWIX STREET, SUITE 1400
PITTSBURGH, PENNSYLVANIA 15222

(Address of principal executive offices, including zip code)

(412) 281-2111

(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 X No

At July 31, 2004, 16,278,579 shares of common stock, par value \$.01 per
share, were outstanding.

Page 1 of 44 pages.

=====

Edgar Filing: REUNION INDUSTRIES INC - Form 10-Q

FORWARD-LOOKING STATEMENTS AND ASSOCIATED RISKS

This report contains certain forward-looking statements within the meaning of Section 27A of the Securities Act and Section 21E of the Exchange Act which are intended to be covered by the safe harbors created thereby. The forward-looking statements contained in this report are enclosed in brackets [] for ease of identification. All forward-looking statements involve risks and uncertainties which could cause the future results and shareholder values to differ materially from those expressed in the forward-looking statements. Although the Company believes that the assumptions underlying the forward-looking statements contained in this report are reasonable, any of the assumptions could be inaccurate and, therefore, there can be no assurances that the forward-looking statements included or incorporated by reference in this report will prove to be accurate. Factors that could cause actual results to differ materially from those described in the forward-looking statements include, without limitation, the strengths/weaknesses of the Company's primary markets, the Company's ability to negotiate trade terms with its vendors, the continued forbearance of the Company's creditors with respect to indebtedness in default and the Company's ability to restructure and renegotiate the terms of the Company's indebtedness. In light of the significant uncertainties inherent in the forward-looking statements included or incorporated by reference herein, the inclusion of such information should not be regarded as a representation by the Company or any other person that the Company's objectives and plans will be achieved. In addition, the Company does not intend to, and is not obligated to update these forward-looking statements after filing and distribution of this report, even if new information, future events or other circumstances have made them incorrect or misleading as of any future date.

- 2 -

REUNION INDUSTRIES, INC.

INDEX

	Page No. -----
PART I. FINANCIAL INFORMATION	
Item 1. Financial Statements	
Condensed Consolidated Balance Sheet at June 30, 2004 (unaudited) and December 31, 2003	4
Condensed Consolidated Statement of Operations and Comprehensive Income (Loss) for the three and six months ended June 30, 2004 and 2003 (unaudited)	5
Condensed Consolidated Statement of Cash Flows for the six months ended June 30, 2004 and 2003 (unaudited)	6
Notes to Condensed Consolidated Financial Statements	7
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	21
Item 3. Quantitative and Qualitative Disclosures	

Edgar Filing: REUNION INDUSTRIES INC - Form 10-Q

About Market Risk	38
Item 4. Controls and Procedures	38
PART II. OTHER INFORMATION	
Item 1. Legal Proceedings	38
Item 6. Exhibits and Reports on Form 8-K	39
SIGNATURES	40
CERTIFICATIONS	41

- 3 -

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

REUNION INDUSTRIES, INC.
CONDENSED CONSOLIDATED BALANCE SHEET
AT JUNE 30, 2004 AND DECEMBER 31, 2003
(in thousands)

	At June 30, 2004 ----- (unaudited)	At December 31, 2003 -----
ASSETS:		
Cash and cash equivalents	\$ 1,601	\$ 755
Receivables (net of allowance of \$471 and \$485, respectively)	11,344	10,031
Advances to employees	41	56
Inventories, net	9,725	8,207
Other current assets	1,602	1,427
	-----	-----
Total current assets	24,313	20,476
Property, plant and equipment, net	13,539	14,197
Due from related parties	1,041	1,405
Goodwill, net	11,007	11,007
Other assets, net	4,352	4,438
	-----	-----
Total assets	\$ 54,252	\$ 51,523
	=====	=====
LIABILITIES AND STOCKHOLDERS' DEFICIT:		
Current maturities of debt	\$ 660	\$ 683
Trade payables	9,719	9,463
Accrued interest	3,718	2,119
Due to related parties	167	3,276
Other current liabilities	6,888	7,973
Notes payable	4,161	4,161
Notes payable - related parties	500	5,115
	-----	-----
Total current liabilities	25,813	32,790
Long-term debt	49,139	41,129

Edgar Filing: REUNION INDUSTRIES INC - Form 10-Q

Other liabilities	4,897	5,359
	-----	-----
Total liabilities	79,849	79,278
Minority interests	211	-
Commitments and contingent liabilities	-	-
Stockholders' deficit	(25,808)	(27,755)
	-----	-----
Total liabilities and stockholders' deficit	\$ 54,252	\$ 51,523
	=====	=====

See accompanying notes to condensed consolidated financial statements.

- 4 -

REUNION INDUSTRIES, INC. CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS) FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2004 AND 2003 (in thousands, except per share information) (unaudited)

	Three Months Ended		Six Months Ended	
	June 30,	June 30,	June 30,	June 30,
	2004	2003	2004	2003
	-----	-----	-----	-----
Sales	\$ 20,636	\$ 18,076	\$ 39,483	\$ 39,339
Cost of sales	17,021	14,858	32,106	31,930
	-----	-----	-----	-----
Gross profit	3,615	3,218	7,377	7,409
Selling, general & administrative	2,600	2,663	5,287	5,464
Gains on debt extinguishments	(470)	-	(3,540)	-
Other expense (income), net	(201)	(33)	(282)	(61)
	-----	-----	-----	-----
Operating profit	1,686	588	5,912	2,006
Interest expense, net	1,975	1,912	3,754	3,421
	-----	-----	-----	-----
Income (loss) from continuing operations before income taxes and minority interests	(289)	(1,324)	2,158	(1,415)
Provision for income taxes	-	-	-	-
	-----	-----	-----	-----
Income (loss) from continuing operations before minority interests	(289)	(1,324)	2,158	(1,415)
Minority interests	113	-	211	-
	-----	-----	-----	-----
Net and comprehensive income (loss)	\$ (402)	\$ (1,324)	\$ 1,947	\$ (1,415)
	=====	=====	=====	=====
Loss applicable to common stockholders	\$ (402)	\$ (1,324)	\$ 1,947	\$ (1,415)
	=====	=====	=====	=====
Income (loss) per common share - basic	\$ (0.02)	\$ (0.08)	\$ 0.12	\$ (0.09)
	=====	=====	=====	=====

Edgar Filing: REUNION INDUSTRIES INC - Form 10-Q

Income (loss) per common share - diluted	\$ (0.02)	\$ (0.08)	\$ 0.10	\$ (0.09)
	=====	=====	=====	=====
Weighted average shares outstanding - basic	16,279	16,279	16,279	16,279
	=====	=====	=====	=====
Weighted average shares outstanding - diluted	18,832	16,279	18,829	16,279
	=====	=====	=====	=====

See accompanying notes to condensed consolidated financial statements.

- 5 -

REUNION INDUSTRIES, INC. CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS FOR THE SIX MONTHS ENDED JUNE 30, 2004 AND 2003 (in thousands) (unaudited)

	Six Months Ended June 30, 2004	June 30, 2003
	-----	-----
Cash (used in) provided by operating activities	\$ (1,935)	\$ 850
	-----	-----
Cash flow from investing activities:		
Capital expenditures	(588)	(165)
	-----	-----
Cash used in investing activities	(588)	(133)
	-----	-----
Cash flow from financing activities:		
Net change in revolving credit facility	1,024	1,199
Issuance of debt	3,000	-
Repayments of debt	(345)	(1,782)
Payments of deferred financing costs	(310)	-
	-----	-----
Cash provided by (used in) financing activities	3,369	(583)
	-----	-----
Net increase in cash and cash equivalents	846	102
Cash and cash equivalents, beginning of period	755	807
	-----	-----
Cash and cash equivalents, end of period	\$ 1,601	\$ 909
	=====	=====
Interest paid	\$ 1,052	\$ 712
	=====	=====
Non-cash financing activity:		
Debt extinguishments	\$ 3,540	-
	=====	=====

See accompanying notes to condensed consolidated financial statements.

- 6 -

Edgar Filing: REUNION INDUSTRIES INC - Form 10-Q

REUNION INDUSTRIES, INC. NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2004

NOTE 1: CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all normal recurring adjustments considered necessary for a fair statement of the results of operations have been included. The results of operations for the three and six month periods ended June 30, 2004 are not necessarily indicative of the results of operations for the full year. When reading the financial information contained in this Quarterly Report, reference should be made to the financial statements, schedule and notes contained in Reunion's Annual Report on Form 10-K for the year ended December 31, 2003, as amended by Form 10-K/A Amendment No. 1 as filed on April 29, 2004.

Going Concern

These condensed consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. At June 30, 2004, the Company had a negative working capital position of \$0.8 million net of related party obligations and a deficiency in assets of \$25.8 million. These conditions raise substantial doubt about the Company's ability to continue as a going concern. These condensed consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

We successfully refinanced our bank debt, extinguished a significant portion of our obligations under the senior notes and removed all previously existing defaults on our debt. These steps were taken to improve liquidity and defer the principal maturities on a significant portion of our debt. The Company is investigating other recapitalization scenarios in an effort to provide additional liquidity and extinguishments or deferrals of debt obligations. Although we believe we can accomplish these plans, no assurances exist that we will. If we fail to accomplish these plans, it could have an adverse impact on the Company's liquidity, financial position and future operations.

Recent Accounting Pronouncements

In January 2004 and May 2004, the FASB issued FASB Staff Position Nos. 106-1 and 106-2, respectively, regarding accounting and disclosure requirements related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (Act). Recognition of the Act was permitted to be deferred under FASB Staff Position No. FAS 106-1, "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003." Under the provisions of the Act, companies that provide prescription drug coverage to retirees over age 65 will be entitled to a government subsidy beginning in 2006 if the benefits provided under the company plan are at least actuarially equivalent to those that will otherwise be offered by the government. The FASB issued final accounting guidance in May 2004 with FASB Staff Position No. 106-2, "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003", which requires that the effect of the Act to be

- 7 -

reflected in third quarter 2004 financial statements. We are evaluating the impact of the Act on our benefit plan accounting but do not expect the Act will have a significant effect on our financial position or results of operations.

In December 2003, the FASB revised and reissued SFAS No. 132 (revised 2003), "Employer's Disclosures about Pensions and Other Postretirement Benefits - an amendment of FASB Statements No. 87, 88 and 106." While requiring certain new disclosures, the revised Standard does not change the measurement or recognition of employee benefit plans. We adopted the provisions of the revised Standard effective December 2003, except for certain provisions regarding disclosure of information about estimated future benefit payments, which are not required until the fourth quarter of 2004. See NOTE 10: COMPONENTS OF BENEFIT COSTS for the required interim disclosures.

On December 17, 2003, the Staff of the Securities and Exchange Commission (SEC or the Staff) issued Staff Accounting Bulletin No. 104, "Revenue Recognition" (SAB 104), which supercedes Staff Accounting Bulletin No. 101 "Revenue Recognition in Financial Statements" (SAB 101). SAB 104 rescinds accounting guidance contained in SAB 101 related to multiple element revenue arrangements, superceded as a result of the issuance of Emerging Issues Task Force Issue No. 00-21 (EITF 00-21), "Accounting for Revenue Arrangements with Multiple Deliverables." Additionally, SAB 104 rescinds the SEC's Revenue Recognition in Financial Statements Frequently Asked Questions and Answers (the FAQ) issued with SAB 101 that had been codified in SEC topic 13, "Revenue Recognition". While the wording of SAB 104 has changed to reflect the issuance of EITF 00-21, the revenue recognition principles of SAB 101 remain largely unchanged by the issuance of SAB 104. The adoption of SAB 104 has not had, and is not expected to have, a material effect on Reunion's financial condition or results of operations.

Stock-Based Compensation

The Company has elected to follow Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" and related interpretations in accounting for stock options and awards. Accordingly, no compensation costs for stock options is included in operating results since all awards were made at exercise prices at or above their fair value on the dates of grants. The following table illustrates the effect on results of operations if the Company had applied fair value recognition provisions of SFAS No. 123 for the three and six month periods ended June 30, 2004 and 2003 (in thousands, except for per share amount) (unaudited):

- 8 -

	3-Mos. Ended		6-Mos. Ended	
	2004	2003	2004	2003
Net income (loss) as reported	\$ (402)	\$ (1,324)	\$ 1,947	\$ (1,415)
Deduct: Total stock-based employee compensation determined under fair value method for stock options, net of tax	-	-	-	-

Edgar Filing: REUNION INDUSTRIES INC - Form 10-Q

Pro forma loss applicable to common stockholders	\$ (402)	\$ (1,324)	\$ 1,947	\$ (1,415)
	=====	=====	=====	=====
Basic income (loss) per share, as reported	\$ (0.02)	\$ (0.08)	\$ 0.12	\$ (0.09)
	=====	=====	=====	=====
Basic income (loss) per share, pro forma	\$ (0.02)	\$ (0.08)	\$ 0.12	\$ (0.09)
	=====	=====	=====	=====
Diluted income (loss) per share, as reported	\$ (0.02)	\$ (0.08)	\$ 0.10	\$ (0.09)
	=====	=====	=====	=====
Diluted income (loss) per share, pro forma	\$ (0.02)	\$ (0.08)	\$ 0.10	\$ (0.09)
	=====	=====	=====	=====

NOTE 2: RECENT DEVELOPMENTS

Congress Financial Corporation Supplemental Revolving Credit Financing

The Company's loan agreement with Congress Financial Corporation (Congress) provides for a loan facility of up to \$25.0 million, collateralized by substantially all of the assets of the Company as described below. The amount which the Company may borrow at any time under such loan facility is based on a formula related to the value of the collateral securing the loan. In May 2004, two private capital funds invested \$1.5 million each to purchase from Congress junior participating interests in the revolving credit portion of the Congress loan facility. These investments increased by \$3.0 million the amount which the Company could borrow under the loan facility, subject to the overall borrowing limit of \$25.0 million, which did not change. The Company used the \$3.0 million in proceeds to pay trade payables and for other corporate purposes. In consideration of such investments, the Company has agreed in principle to grant warrants to such private capital funds allowing each to purchase 375,000 shares of the Company's common stock at an initial exercise price of \$0.01 per share and with registration rights, subject to the approval by the Company's stockholders to amend the Company's Articles of Incorporation to increase the authorized number of shares of common stock of the Company by 10,000,000.

Interest on the Congress supplemental revolving credit financing is payable monthly at a fixed rate of 15% per annum. The Congress supplemental revolving credit financing is collateralized by a continuing security interest and lien on substantially all of the current and after-acquired assets of Reunion including, without limitation, all accounts receivable, inventory, real property, equipment, chattel paper, documents, instruments, deposit accounts, contract rights and general intangibles.

- 9 -

The Congress supplemental revolving credit financing is subject to the same financial covenants and other covenants as the revolving credit and term loan facilities, including the minimum amount of earnings before interest, taxes, depreciation and amortization (EBITDA) and the minimum fixed charge coverage ratio. At June 30, 2004, the Company was in compliance with all financial and other covenants under the Congress financing facilities.

SFSC Litigation Settlement

The Company had been named as one of several defendants in fifteen

Edgar Filing: REUNION INDUSTRIES INC - Form 10-Q

consolidated lawsuits filed in December 2000 or early 2001 in the Superior Court for Los Angeles County, California. The plaintiffs in these suits, except one, are structured settlement payees to whom Stanwich Financial Services Corp. (SFSC) is indebted. The Company and SFSC were related parties. The plaintiffs alleged that the Company received loans from SFSC that have not been repaid. On May 25, 2001, SFSC filed a Chapter 11 Bankruptcy Petition in the U.S. Bankruptcy Court for the District of Connecticut.

A settlement was reached in the Superior Court action among the plaintiffs, Bankers Trust Co. and certain other financial institution defendants. In the settlement, Bankers Trust Co. and the other settling financial institution defendants paid the plaintiffs an amount specified in the settlement agreement, and Bankers Trust Co. received an assignment of the claims of the plaintiffs and such other settling defendants against the Company and other defendants. In the SFSC bankruptcy proceeding, the Company and certain other defendants entered into a settlement with SFSC and Bankers Trust Co. Under this settlement (1) the Company is obligated to pay SFSC a settlement amount by December 31, 2006 in the sum of \$4.29 million, plus interest at the rate of 10% per annum, in full satisfaction of the Company's indebtedness to SFSC under notes payable totaling \$4.6 million, plus interest, and for certain credit support fees payable, which settlement amount is net of an offset against SFSC's note payable to the Company in the amount of \$310,000 plus interest, and (2) provided it makes such settlement payment, the Company is released from all claims that have been or could have been asserted against the Company by the plaintiffs or the settling financial institution defendants in the California Superior Court suits or by SFSC in the bankruptcy proceeding. The settlement amount does not constitute a new liability of the Company, as it relates to indebtedness and a note receivable that had previously been recorded on the Company's balance sheet. The settlement resulted in a \$3.1 million gain on debt extinguishment calculated as follows (000's):

Description	Payable (Receivable)	Interest and Fee Accruals	Totals
SFSC note receivable	\$ (310)	\$ (155)	\$ (465)
Reserve for interest receivable	-	101	101
SFSC collateral fee	-	690	690
SFSC credit support fee	-	294	294
SFSC note payable	2,999	1,501	4,500
SFSC note payable	500	290	790
SFSC note payable	100	53	153
SFSC note payable by assignment	1,017	280	1,297
Totals	\$ 4,306	\$ 3,054	7,360
	=====	=====	
Less: Note payable under settlement agreement			(4,290)

Gain on SFSC litigation settlement first quarter 2004			\$ 3,070
			=====

- 10 -

The gain on debt extinguishment of \$3.1 million was recorded in the first quarter of 2004 as the settlement was reached in the Superior Court and the financial institution defendants paid the plaintiffs in January 2004. However, subsequent to the filing of our Form 10-Q for the quarter ended March 31, 2004, the parties to the settlement agreement set the effective date of the settlement as May 10, 2004. Accordingly, the Company recorded interest

Edgar Filing: REUNION INDUSTRIES INC - Form 10-Q

expense through May 10, 2004 under the terms of the prior SFSC notes payable and then recorded an additional gain on debt extinguishment of \$262,000 to reflect the effective date of the settlement as being May 10, 2004. The Company then adjusted interest expense under the terms of the new note payable as though it began accruing on May 10, 2004.

13% Senior Notes

In January 2004, we solicited our noteholders for the second time to consent to certain provisions and waivers of the indenture governing the 13% senior notes. In the first consent in November 2003, \$23,250,700 of the \$24,855,000 principal amount of senior notes, or 93.55%, had consented. The second consent solicitation period ended on April 28, 2004 at which time holders of an additional \$434,300 principal amount of senior notes had consented. The significant provisions of the solicitation requested that the noteholders consent to waive all then existing defaults under the indenture, cancel all accrued and unpaid interest, cancel 12% of the principal amount of senior notes and extend the maturity of the notes to December 2006. Accordingly, 12% of the \$434,300 principal amount of senior notes of noteholders that had consented to the various provisions and waivers in the second solicitation, or \$52,000, was extinguished pursuant to the provisions of the consent. As of April 28, 2004, accrued and unpaid interest related to the 13% senior notes consenting in the second solicitation totaled \$156,000. Such interest was extinguished pursuant to the provisions of the consent.

NOTE 3: LONG-TERM DEBT

Long-term debt consists of the following (in thousands):

	At June 30, 2004	At December 31, 2003
	----- (unaudited)	-----
Congress revolving credit facility	\$ 10,238	\$ 9,214
Congress supplemental revolving credit financing	3,000	-
Congress term loan	2,857	3,175
Note payable due December 1, 2006	4,200	4,200
Note payable due December 5, 2006 (net of warrant value of \$67 and \$83, respectively)	3,433	3,417
13% senior notes (net of warrant value of \$261 and \$315, respectively)	21,752	21,750
Notes payable	8,451	4,161
Notes payable - related parties	500	5,115
Capital leases and other	29	56
	-----	-----
Total long-term debt	54,460	51,088
Classified as current	(5,321)	(9,959)
	-----	-----
Long-term debt	\$ 49,139 =====	\$ 41,129 =====

- 11 -

In May 2004, the Company and Congress Financial entered an amendment to the loan and security agreement whereby Congress provided an additional \$3.0 million of supplemental revolving credit financing to the Company. Proceeds from the loan were used to pay trade payables and for other corporate

Edgar Filing: REUNION INDUSTRIES INC - Form 10-Q

purposes. See NOTE 2: RECENT DEVELOPMENTS, Congress Financial Corporation Supplemental Revolving Credit Facility."

Certain notes payable - related parties totaling \$4.6 million were settled in the first quarter of 2004, offset against a related party note receivable of \$364,000 and reclassified to a note payable totaling \$4.29 million. See NOTE 2: RECENT DEVELOPMENTS, "SFSC Litigation Settlement", above.

NOTE 4: INVENTORIES

Inventories are comprised of the following (in thousands):

	At June 30, 2004 ----- (unaudited)	At December 31, 2003 -----
Raw material	\$ 3,481	\$ 3,206
Work-in-process	3,697	2,077
Finished goods	2,547	2,924
	-----	-----
Inventories	\$ 9,725 =====	\$ 8,207 =====

NOTE 5: STOCKHOLDERS' DEFICIT AND EARNINGS PER SHARE

The following represents a reconciliation of the change in stockholders' deficit for the three month period ended June 30, 2004 (in thousands):

	Par Value of Common Stock -----	Capital in Excess of Par Value -----	Accum- ulated Deficit -----	Accum- ulated Other Compre- hensive Loss -----	Total -----
At January 1, 2004	\$163	\$25,609	\$ (51,548)	\$ (1,979)	\$ (27,755)
Activity (unaudited):					
Net income	-	-	1,947	-	1,947
	----	-----	-----	-----	-----
At June 30, 2004	\$163 =====	\$25,609 =====	\$ (49,601) =====	\$ (1,979) =====	\$ (25,808) =====

- 12 -

The computations of basic and diluted earnings (loss) per common share EPS (LPS) for the three and six month periods ended June 30, 2004 and 2003 are as follows (in thousands, except per share amounts) (unaudited):

	Net Income (Loss) -----	Shares -----	EPS (LPS) -----
Three months ended June 30, 2004:			
Loss applicable to common stockholders, weighted average shares outstanding and basic LPS	\$ (402)	16,279	\$ (0.02) =====

Edgar Filing: REUNION INDUSTRIES INC - Form 10-Q

Dilutive effect of stock options and warrants		2,553	
	-----	-----	
Income available to common stockholders, shares outstanding and diluted LPS	\$ (402)	18,832	\$ (0.02)
	=====	=====	=====
Three months ended June 30, 2003:			
Loss applicable to common stockholders, weighted average shares outstanding and basic and diluted LPS	\$ (1,324)	16,279	\$ (0.08)
	=====	=====	=====
Six months ended June 30, 2004:			
Income available to common stockholders, weighted average shares outstanding and basic LPS	\$ 1,947	16,279	\$ 0.12
			=====
Dilutive effect of stock options and warrants		2,550	
	-----	-----	
Income available to common stockholders, shares outstanding and diluted LPS	\$ 1,947	18,829	\$ 0.10
	=====	=====	=====
Six months ended June 30, 2003:			
Loss applicable to common stockholders, weighted average shares outstanding and basic and diluted LPS	\$ (1,415)	16,279	\$ (0.09)
	=====	=====	=====

At June 30, 2004, the Company's stock options outstanding totaled 614,000. Such options included a dilutive component of 183,577 shares for the three month period and 191,133 shares for the six month period ended June 30, 2004. At June 30, 2004, outstanding warrants to purchase the Company's common totaled 2,930,049. Such warrants included a dilutive component of 2,378,798 shares for the three month period and 2,379,787 shares for the six month period ended June 30, 2004. At June 30, 2003, the Company's stock options outstanding totaled 44,000, none of which were at exercise prices below the average market price of the underlying security during the second quarter or first half of 2003.

- 13 -

NOTE 6: COMMITMENTS AND CONTINGENT LIABILITIES

The Company is and has been involved in a number of lawsuits and administrative proceedings, which have arisen in the ordinary course of business of the Company and its subsidiaries. A summary of such legal proceedings follows.

Gambonini Environmental

On May 16, 2002, the Company, as the successor to Buttes Gas & Oil Company (BGO), received from the United States Environmental Protection Agency (USEPA) a notice of potential liability and demand for payment of \$3,909,614.37 for reimbursement of costs related to the USEPA's removal and environmental restoration efforts at the Gambonini Mine Site (Site) initiated in 1998 pursuant to the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA).

BGO, predecessor by merger to the Company, leased the Site for mining

Edgar Filing: REUNION INDUSTRIES INC - Form 10-Q

purposes and operated a mercury mine there from 1965 to 1970. BGO's mining operations were terminated in 1970. Subsequently, under the supervision of the environmental and planning representatives of Marin County, BGO completed closure and environmental restoration activities at the Site, including stabilization and re-vegetation of the Site. BGO then quitclaimed the mining lease to the Site owners, the Gambonini's, in 1973. Because of apparent overgrazing at the Site subsequent to BGO's restoration efforts, a storm in 1982 caused severe flooding, which resulted in the failure of a dam built to retain mining materials. Runoff from the flood released mining materials into the creek below and, ultimately, into the Tomales Bay, a local recreation and fishing area.

In March 2003, the Company and the USEPA reached an agreement in principle to settle the USEPA's claim for payment by the Company of \$100,000 plus interest at the Superfund rate (which is currently 1.27%), payable in three installments over a two-year period. On May 8, 2004, the United States District Court for the Northern District of California entered a Consent Decree in accordance with the settlement. The settlement amount was accrued by The Company in 2002. This settlement agreement will resolve the USEPA's claims for reimbursement of past environmental response costs under CERCLA, but does not resolve all possible claims the United States may have with respect to the Gambonini mine site, which could include, but not be limited to, claims for future costs or natural resource damages. The United States has given no indication as to whether or not it will pursue such claims. The Company has agreed to toll the statute of limitations with respect to any natural resource damages claims, if any, from August 30, 2002 to April 1, 2008.

Asbestos (Hanna)

During 2003, Reunion Industries was named as defendant in 32 actions in the state of Georgia and one action in the state of Alabama. Such actions claim that cylinders manufactured by the Hanna division of Reunion Industries contained asbestos that caused severe illness. Since most of the plaintiffs' exposure occurred prior to the purchase of the assets of this business by Reunion's predecessor in 1980, and since there is no evidence that asbestos was used in Hanna products after 1980, the Company's position is that it has

- 14 -

no liability in these suits. Upon motion made by plaintiff's attorney, in May 2004, the Court dismissed the Alabama suit against the Company with no liability. The plaintiffs' attorney has tentatively agreed to dismiss Reunion from the Georgia suits, subject to his review of certain information we have provided to him about our predecessor and if Reunion will assist the plaintiffs in their case against the pre-1980 owner of the business. Reunion has agreed to and is currently providing the requested assistance to plaintiffs' attorney.

SFSC Litigation

The settlement of the litigation involving or relating to Stanwich Financial Services Corp. (SFSC) as described in Item 3 of the Company's Annual Report on Form 10-K for the year ended December 31, 2003 as filed on March 30, 2004, has been settled as described in NOTE 2: RECENT DEVELOPMENTS, "SFSC Litigation Settlement."

Shareholder Suit

In December 1999, a stockholder of Reunion filed a purported class-action

Edgar Filing: REUNION INDUSTRIES INC - Form 10-Q

lawsuit in Delaware Chancery Court alleging, among other things, that Reunion's public stockholders would be unfairly diluted in the merger with Chatwins Group. The lawsuit sought to prevent completion of the merger and, the merger having been completed, sought rescission of the merger or awarding of damages. In the second quarter of 2004, the case was voluntarily dismissed by the plaintiff and, on July 14, 2004, a Stipulation and Order of Dismissal was filed in and approved by the Delaware Chancery Court.

Suit Against Paquet and Paquet Counterclaim

In the 2002 fourth quarter, the Company filed suit in the District Court for New Jersey against Paquet, a general contractor doing business in the state of New Jersey. The Company contends that it is owed approximately \$1.5 million in overdue payments and backcharges related to the supply of structural steel for the construction of a bridge in New Jersey. The defendant has asserted a counterclaim against the Company in the amount of \$2.5 million. Discovery is in process. The Company intends to vigorously pursue its suit against the defendant and defend against its counterclaim. No amount has been accrued for this matter in the Company's financial statements.

NAPTech Suit

On or about March 16, 2004, Shaw NAPTech, Inc. ("NAPTech"), as successor by merger to NAPTech, Inc. and NAPTech PS Corporation, filed a suit against the Company in state court in Baton Rouge, Louisiana, to collect payment on a subordinated note issued to NAPTech and assumed by the Company in a January 2001 acquisition. NAPTech claims the amounts due under this note are \$3,145,403 in principal plus \$1,207,875 in unpaid interest through November 30, 2003 plus interest at 15% per annum on the unpaid principal thereafter. Such amounts are approximately the same as amounts recorded as payable to NAPTech by the Company in the accompanying consolidated balance sheet. The Company has filed an answer to the complaint, in which the Company claims, among other things, that the suit is currently barred by a subordination agreement to which NAPTech is a party and that the Court lacks personal jurisdiction over the Company. Also named as defendants in the suit are Charles E. Bradley, Sr. (a director of the Company), as guarantor of the subordinated note, and KSB Acquisition Corp. and Hanna Investment Corp. (both of which are affiliates of Mr. Bradley), as pledgors of certain assets securing the note.

- 15 -

Product Warranties

The Company provides for warranty claims at its cylinders segment. Amounts accrued are estimates of future claims based on historical claims experience or a management estimate related to a specifically identified issue. The Company reevaluates its product warranty reserve quarterly and adjusts it based on changes in historical experience and identification of new or resolution of prior specifically identified issues. A tabular reconciliation of the product warranty reserve for the six-month periods ended June 30, 2004 and 2003 follows (in 000's):

Description	June 30, 2004	June 30, 2003
Beginning balance	\$ 211	\$ 379
Add: Provision for estimated future claims	72	45
Deduct: Cost of claims	(49)	(216)

Edgar Filing: REUNION INDUSTRIES INC - Form 10-Q

Ending balance	\$ 234	\$ 208
	=====	=====

NOTE 7: OPERATING SEGMENT DISCLOSURES

The following represents the disaggregation of financial data (in thousands) (unaudited):

	Net Sales	EBITDA(1)	Capital Spending	Total Assets(2)
	-----	-----	-----	-----
Three months ended and at June 30, 2004:				
-----				At 06/30
Metals:				-----
Pressure vessels and springs	\$ 6,620	\$ 1,141	\$ 200	\$ 14,655
Cylinders	4,402	188	119	8,472
Grating	2,582	325	-	645
	-----	-----	-----	-----
Subtotal Metals	13,604	1,654	319	23,772
Plastics	7,032	518	136	15,040
Corporate and other	-	(333)	-	15,440
	-----	-----	-----	-----
Totals	\$ 20,636	1,839	\$ 455	\$ 54,252
	=====		=====	=====
Gains on debt extinguishments		470		
Depreciation		(623)		
Interest expense, net		(1,975)		

Loss from continuing operations before income taxes and minority interests		\$ (289)		
		=====		

- 16 -

Three months ended June 30, 2003 and at December 31, 2003:				
-----				At 12/31
Metals:				-----
Pressure vessels and springs	\$ 6,250	\$ 1,360	\$ -	\$ 13,407
Cylinders	4,718	68	5	7,877
	-----	-----	-----	-----
Subtotal Metals	10,968	1,428	5	21,284
Plastics	7,108	646	27	14,516
Corporate and other	-	(813)	-	15,723
	-----	-----	-----	-----
Totals	\$ 18,076	1,261	\$ 32	\$ 51,523
	=====		=====	=====
Depreciation		(673)		
Interest expense, net		(1,912)		

Loss from continuing operations before income taxes		\$ (1,324)		
		=====		

Six months ended June 30, 2004:

Metals:

Edgar Filing: REUNION INDUSTRIES INC - Form 10-Q

Pressure vessels and springs	\$ 11,804	\$ 2,086	\$ 208
Cylinders	9,277	487	169
Grating	4,643	608	-
	-----	-----	-----
Subtotal Metals	25,724	3,181	377
Plastics	13,759	1,288	200
Corporate and other	-	(851)	11
	-----	-----	-----
Totals	\$ 39,483	3,618	\$ 588
	=====		=====
Gain on debt extinguishment		3,540	
Depreciation		(1,246)	
Interest expense, net		(3,754)	

Income from continuing operations before income taxes and minority interests		\$ 2,158	
		=====	

Six months ended June 30, 2003:

Metals:			
Pressure vessels and springs	\$ 13,780	\$ 3,123	\$ -
Cylinders	10,308	597	62
	-----	-----	-----
Subtotal Metals	24,088	3,720	62
Plastics	15,251	1,297	102
Corporate and other	-	(1,653)	1
	-----	-----	-----
Totals	\$ 39,339	3,364	\$ 165
	=====		=====
Depreciation		(1,358)	
Interest expense, net		(3,421)	

Loss from continuing operations before income taxes		\$ (1,415)	
		=====	

- 17 -

- (1) EBITDA is presented as it is the primary measurement used by management in assessing segment performance and not as an alternative measure of operating results or cash flow from operations as determined by accounting principles generally accepted in the United States, but because it is a widely accepted financial indicator of a company's ability to incur and service debt.
- (2) Corporate and other assets at June 30, 2004 and at December 31, 2003 includes \$8.0 million of goodwill that relates to the Company's pressure vessel and springs segment. For evaluation purposes under SFAS No. 142, this goodwill is included in the carrying value of the pressure vessels and springs segment. At June 30, 2004 and December 31, 2003, goodwill of \$1.5 million is recorded at each of pressure vessels and springs and cylinders.

NOTE 8: DISCONTINUED OPERATIONS - CHANGE IN PLAN

In December 1995, the Company entered into a joint venture agreement with

Edgar Filing: REUNION INDUSTRIES INC - Form 10-Q

China Metallurgical Import & Export Shanghai Company and Wanggang Township Economic Development Corporation. The Company has a 65% interest in the joint venture. During 1996, the Company capitalized its investment in the joint venture by contributing cash of \$150,000 and machinery and equipment with an estimated fair market value of \$1.9 million to the joint venture. The joint venture manufactures grating panels and is located in Wangang Township, Pudong New Area, Shanghai in the People's Republic of China.

In 1999, the Company adopted a plan to exit the grating manufacturing business through the disposition of its grating businesses, including its Chinese joint venture investment. Upon adoption of the plan, the grating businesses and assets were classified and accounted for as discontinued operations, including a provision for estimated loss on disposal of the Chinese joint venture of \$2.0 million, and ceased consolidating the joint venture as control of its daily operations was given to our joint venture partners and our then expatriate management was removed.

In the four years since adopting this plan, the Company has made several unsuccessful attempts to dispose of its investment in the joint venture but now perceives that a presence in China is consistent with its future plans for certain of its continuing operations. As a result and in connection with our Chinese partners' expressed desire to return control of the business to the Company for various reasons, the Company has decided to retain its investment in the Chinese joint venture and return it to continuing operations resulting in consolidation of the joint venture's results of operations. Certain information related to the joint venture's results of operations for the three and six month periods ended June 30, 2004 is as follows (in 000's):

Three months ended June 30, 2004		Six months ended June 30, 2004	
-----		-----	
Net sales	\$ 2,582	Net sales	\$ 4,643
Income before taxes	322	Income before taxes	602
EBITDA	325	EBITDA	608

- 18 -

NOTE 9: RESTRUCTURING

In the fourth quarter of 2001, we developed and adopted a restructure plan for our continuing businesses and certain other businesses were identified for disposal. By the end of 2002, this plan was substantially completed except for continuing commitments under leases for two idle facilities and certain equipment. The Company recorded restructuring costs, including lease termination costs, related to the plan. The following represents a summary of first half of 2004 cash activity of the remaining lease termination reserves (in thousands):

Description	At	Cash	At
	12/31/03	Activity	06/30/04
-----	-----	-----	-----
Lease termination costs	\$ 474	\$ (145)	\$ 329
	=====	=====	=====

Of the remaining lease termination costs, \$315,000 relates to idle manufacturing facilities in Milwaukee, Wisconsin and Clearfield, Utah. The remainder relates to lease commitments under idle machinery in the Plastics Group.

NOTE 10: COMPONENTS OF BENEFIT COSTS

Edgar Filing: REUNION INDUSTRIES INC - Form 10-Q

The following tables present the components of net periodic benefit costs for Metals pension and Metals and Corporate Executive Payroll other postretirement plans for the three- and six-month periods ended June 30, 2004 (000's):

	Pension		Postretirement	
	-----		-----	
	Three months ended		Three months ended	
	-----		-----	
	June 30,		June 30,	
	-----		-----	
	2004	2003	2004	2003
	-----	-----	-----	-----
Benefits earned during year	\$ 35	\$ 35	\$ 6	\$ 19
Interest cost	52	52	9	26
Amortization of:				
Prior service cost	5	5	-	-
Unrecognized net loss (gain)	11	11	2	6
Unrecognized net obligation	-	-	4	12
Expected return on plan assets	(45)	(45)	-	-
	-----	-----	-----	-----
Defined benefit pension and total other postretirement benefits costs	\$ 58	\$ 58	\$ 21	\$ 63
	=====	=====	=====	=====

- 19 -

	Pension		Postretirement	
	-----		-----	
	Six months ended		Six months ended	
	-----		-----	
	June 30,		June 30,	
	-----		-----	
	2004	2003	2004	2003
	-----	-----	-----	-----
Benefits earned during year	\$ 70	\$ 70	\$ 12	\$ 38
Interest cost	105	104	18	52
Amortization of:				
Prior service cost	10	10	-	-
Unrecognized net loss (gain)	22	22	4	12
Unrecognized net obligation	-	-	8	24
Expected return on plan assets	(90)	(90)	-	-
	-----	-----	-----	-----
Defined benefit pension and total other postretirement benefits costs	\$ 117	\$ 116	\$ 42	\$ 126
	=====	=====	=====	=====

In May 2004, the Company made a required payment of \$397,214 associated with the Metals pension plan.

The following tables present the components of net periodic benefit costs for Plastics pension and other postretirement plans for the three- and six-month periods ended June 30, 2004 (000's):

	Pension	Postretirement
	-----	-----
	Three months ended	Three months ended

Edgar Filing: REUNION INDUSTRIES INC - Form 10-Q

	June 30,		June 30,	
	2004	2003	2004	2003
Benefits earned during year	\$ -	\$ -	\$ 15	\$ 14
Interest cost	56	55	31	30
Amortization of:				
Unrecognized net loss (gain)	17	16	4	4
Expected return on plan assets	(43)	(43)	-	-
Defined benefit pension and total other postretirement benefits costs	\$ 30	\$ 28	\$ 50	\$ 48

- 20 -

	Pension		Postretirement	
	Six months ended		Six months ended	
	June 30,		June 30,	
	2004	2003	2004	2003
Benefits earned during year	\$ -	\$ -	\$ 30	\$ 28
Interest cost	112	110	62	60
Amortization of:				
Unrecognized net loss (gain)	34	32	8	8
Expected return on plan assets	(86)	(86)	-	-
Defined benefit pension and total other postretirement benefits costs	\$ 60	\$ 56	\$ 100	\$ 96

The Company is required to make a payment of \$497,000 in the third quarter of 2004 associated with the Plastics pension plan.

PART I. FINANCIAL INFORMATION

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

The following discussion and analysis is provided to assist readers in understanding financial performance during the periods presented and significant trends which may impact future performance. It should be read in conjunction with the consolidated financial statements and accompanying notes included elsewhere in this Form 10-Q and in conjunction with our annual report on Form 10-K for the year ended December 31, 2003, as amended by Form 10-K/A as filed on April 29, 2004.

GENERAL

The Company owns and operates industrial manufacturing operations that design and manufacture engineered, high-quality products for specific customer

Edgar Filing: REUNION INDUSTRIES INC - Form 10-Q

requirements, such as large-diameter seamless pressure vessels, hydraulic and pneumatic cylinders, grating, leaf springs and precision plastic components.

RESULTS OF OPERATIONS

Three Months Ended June 30, 2004 Compared to
Three Months Ended June 30, 2003

Net sales, gross margins and EBITDA percentages for the three months ended 2004 and 2003 are as follows. The percentages of EBITDA to net sales excludes corporate and other EBITDA. Including corporate and other EBITDA, the percentages of consolidated EBITDA to net sales for the three month periods ended June 30, 2004 and 2003 are 8.9% and 7.0%, respectively (\$'s in 000's):

- 21 -

	Net Sales		Gross Margin		EBITDA	
	2004	2003	2004	2003	2004	2003
Pressure vessels and springs	\$ 6,620	\$ 6,250	21.2%	26.5%	17.2%	21.8%
Cylinders	4,402	4,718	16.7%	12.8%	4.3%	1.4%
Grating	2,582	-	26.3%	-	12.6%	-
Plastics	7,032	7,108	12.6%	13.5%	7.4%	9.1%
Totals	\$ 20,636	\$ 18,076	17.5%	17.8%	10.5%	11.5%

Net sales for the second quarter of 2004 were up 14.2% from the second quarter of 2003. Such increase is the result of the inclusion of grating sales in the second quarter of 2004, which reflects the operations of the Company's 65% owned Chinese subsidiary. Such operation had been treated as a discontinued operation. See "Minority Interests" and "Discontinued Operations - Change in Plan" below. Excluding the \$2.6 million of grating sales, second quarter 2004 sales were about the same as the second quarter of 2003.

Pressure vessels and springs sales were \$0.4 million higher in the second quarter of 2004 compared to the second quarter of 2003 primarily as the result of the fact that this segment has experienced a 79% increase in its backlog since year-end 2003 to the end of the second quarter of 2004, from \$5.8 million to \$10.4 million, and such backlog increase is beginning to have an increasing effect on this segment's sales. Cylinder sales were \$0.3 million lower in the second quarter of 2004 compared to the second quarter of 2003. The Company completed the consolidation of its cylinder operations into a single facility in Libertyville, Illinois, in the 2004 second quarter, which caused some disruption in this segment's shipping activity but contributed to an increase in this segment's backlog. The cylinders' backlog increased 40% since year-end 2003 to the end of the second quarter 2004. Plastics sales decreased slightly in the second quarter of 2004 compared to the 2003 second quarter. The continued reluctance and lag in customers' decisions on newly quoted programs due to the uncertainty surrounding our financial condition was offset by some new customer programs and resulted in this segment's second quarter-to-quarter 2004 compared to 2003 sales being almost even. With Plastics' backlog having increased 35% since year-end 2003 to the end of the 2004 second quarter, from \$5.9 million to \$8.0 million, [management anticipates the declining trend in sales will reverse in the second half of 2004].

Edgar Filing: REUNION INDUSTRIES INC - Form 10-Q

Gross margin as a percentage of sales in the second quarter of 2004 compared to the 2003 second quarter was down slightly, to 17.5% from 17.8%. Excluding the sales and gross margin of the Chinese grating joint venture, the U.S. operations gross margin percentage decreased from 17.8% in the second quarter of 2003 to 16.8% in the second quarter of 2004. Even though pressure vessels and springs sales increased in the second quarter of 2004 compared to the 2003 second quarter, gross margin as a percentage of sales declined. This decrease is primarily the result of a week-long interruption in production caused by an electrical failure resulting in unanticipated costs and underabsorbed overheads. Cylinder gross margin increased in the second quarter of 2004 compared to the 2003 second quarter due primarily to the fact that, through the consolidation of cylinder operations into a single facility in Libertyville, Illinois in May 2004, we eliminated redundant expense and experienced other production efficiencies. Plastics gross margin was lower in the second quarter of 2004 compared to the 2003 second quarter primarily due to the decrease in sales and the fact that certain of the new customer programs discussed above carry lower profit margins than those they replaced.

- 22 -

Management evaluates the Company's segments based on EBITDA, a measure of cash generation, which is presented, not as an alternative measure of operating results or cash flow from operations as determined by accounting principles generally accepted in the United States, but because it is a widely accepted financial indicator of a company's ability to incur and service debt and due to the close relationship it bears to Reunion's financial covenants in its borrowing agreements. Excluding the Chinese grating subsidiary and corporate and other EBITDA, EBITDA and EBITDA as a percentage of sales decreased during the second quarter of 2004 compared to 2003 primarily due to the same factors affecting gross profit margin discussed above. A reconciliation of EBITDA to operating income for the three months ended June 30, 2004 and 2003 by segment and corporate and other is as follows (000's):

	Operating Profit	Deprec- iation	Amortiz- ation	EBITDA
	-----	-----	-----	-----
2004:				

Pressure vessels and springs	\$ 986	\$ 155	\$ -	\$ 1,141
Cylinders	138	50	-	188
Grating	325	-	-	325
Plastics	110	408	-	518
Corporate and other(1) (2)	(343)	10	-	(333)
	-----	-----	-----	-----
Totals	1,216	\$ 623	\$ -	\$ 1,839
		=====	=====	=====
Gain on debt extinguishment	470			

Operating profit	\$ 1,686			
	=====			
2003:				

Pressure vessels and springs	\$ 1,186	\$ 174	\$ -	\$ 1,360
Cylinders	(5)	73	-	68
Plastics	237	409	-	646
Corporate and other	(830)	17	-	(813)
	-----	-----	-----	-----
Totals	\$ 588	\$ 673	\$ -	\$ 1,261

Edgar Filing: REUNION INDUSTRIES INC - Form 10-Q

=====

(1) - Excludes gain on debt extinguishment of \$470,000. See "Gain on Debt Extinguishment" below.

(2) - Includes an environmental reserve adjustment of \$331,000. See "Other Income" below.

Selling, General and Administrative

Selling, general and administrative (SGA) expenses for the second quarter of 2004 were \$2.6 million, compared to \$2.7 million for the 2003 second quarter. SGA in the second quarter of 2004 includes \$0.3 million from the Chinese grating joint venture. Excluding this, SGA decreased to \$2.3 million domestically, or by \$0.4 million. This decrease in SGA is due to continued cost cutting measures and payroll reductions. Excluding the sales and SGA of the grating joint venture, SGA as a percentage of sales decreased to 13.0% for the second quarter of 2004 compared to 14.7% in the 2003 second quarter primarily due to the effects of the cost savings described above.

- 23 -

Gains on Debt Extinguishments

The Company had been named as one of several defendants in fifteen consolidated lawsuits filed in December 2000 or early 2001 in the Superior Court for Los Angeles County, California. The plaintiffs in these suits, except one, are structured settlement payees to whom Stanwich Financial Services Corp. (SFSC) is indebted. The Company and SFSC were related parties. The plaintiffs alleged that the Company received loans from SFSC that have not been repaid. On May 25, 2001, SFSC filed a Chapter 11 Bankruptcy Petition in the U.S. Bankruptcy Court for the District of Connecticut.

A settlement was reached in the Superior Court action among the plaintiffs, Bankers Trust Co. and certain other financial institution defendants. In the settlement, Bankers Trust Co. and the other settling financial institution defendants paid the plaintiffs an amount specified in the settlement agreement, and Bankers Trust Co. received an assignment of the claims of the plaintiffs and such other settling defendants against the Company and other defendants. In the SFSC bankruptcy proceeding, the Company and certain other defendants entered into a settlement with SFSC and Bankers Trust Co. Under this settlement (1) the Company is obligated to pay SFSC a settlement amount by December 31, 2006 in the sum of \$4.29 million, plus interest at the rate of 10% per annum, in full satisfaction of the Company's indebtedness to SFSC under notes payable totaling \$4.6 million, plus interest, and for certain credit support fees payable, which settlement amount is net of an offset against SFSC's note payable to the Company in the amount of \$310,000 plus interest, and (2) provided it makes such settlement payment, the Company is released from all claims that have been or could have been asserted against the Company by the plaintiffs or the settling financial institution defendants in the California Superior Court suits or by SFSC in the bankruptcy proceeding. The settlement amount does not constitute a new liability of the Company, as it relates to indebtedness and a note receivable that had previously been recorded on the Company's balance sheet.

The Company recorded a gain on debt extinguishment of \$3.1 million in the first quarter of 2004 effective January 1, 2004 as the settlement was reached in the Superior Court and the financial institution defendants paid the plaintiffs in January 2004. However, subsequent to the filing of our Form 10-Q for the quarter ended March 31, 2004, the parties to the settlement

Edgar Filing: REUNION INDUSTRIES INC - Form 10-Q

agreement set the effective date of the settlement as May 10, 2004. Accordingly, the Company recorded interest expense through May 10, 2004 under the terms of the prior SFSC notes payable and then recorded an additional gain on debt extinguishment of \$262,000 to reflect the effective date of the settlement as being May 10, 2004. The Company then adjusted interest expense under the terms of the new note payable as though it began accruing on May 10, 2004.

In January 2004, we solicited our noteholders for the second time to consent to certain provisions and waivers of the indenture governing the 13% senior notes. In the first consent in November 2003, \$23,250,700 of the \$24,855,000 principal amount of senior notes, or 93.55%, had consented. The second consent solicitation period ended on April 28, 2004 at which time holders of an additional \$434,300 principal amount of senior notes had consented. The significant provisions of the solicitation requested that the noteholders consent to waive all then existing defaults under the indenture, cancel all accrued and unpaid interest, cancel 12% of the principal amount of senior notes and extend the maturity of the notes to December 2006.

- 24 -

Accordingly, 12% of the \$434,300 principal amount of senior notes of noteholders that had consented to the various provisions and waivers in the second solicitation, or \$52,000, was extinguished pursuant to the provisions of the consent. As of April 28, 2004, accrued and unpaid interest related to the 13% senior notes consenting in the second solicitation totaled \$156,000. Such interest was extinguished pursuant to the provisions of the consent.

[The Company is currently investigating other recapitalization scenarios that include, among other things, the use of additional private capital fund financing to repurchase at discounts some portion or all of our senior and unsecured subordinated notes payable.]

Other Income

Other income for the second quarter of 2004 was \$201,000, compared to other income of \$33,000 for the second quarter of 2003. The components are as follows:

	2004	2003	Change
	-----	-----	-----
Costs to consolidate cylinder locations	\$ 171	\$ -	\$ 171
Adjustment of environmental reserve	(331)	-	(331)
Rental income on sublease	(37)	(10)	(27)
Other (income) expense, net	(4)	(23)	19
	-----	-----	-----
Total other income, net	\$ (201)	\$ (33)	\$ (168)
	=====	=====	=====

During May 2004, we completed the consolidation of our cylinder manufacturing operations into a single facility in Libertyville, Illinois. Costs totaling \$171,000 were incurred in the 2004 second quarter. The Company finalized the settlement of a Louisiana environmental litigation matter in the second quarter of 2004. Such settlement has resulted in a new estimate of the required reserve, resulting in a \$331,000 adjustment in the 2004 second quarter. In June 2003, the Company sublet its idle manufacturing facility in Clearfield, Utah. There were no other significant offsetting items of other income or expenses in either of the second quarters of 2004 and 2003.

Minority Interests

Edgar Filing: REUNION INDUSTRIES INC - Form 10-Q

Minority interests of \$0.1 million represents income during the second quarter of 2004 allocated to the minority ownerships of the Company's consolidated foreign grating joint venture. Minority interests are calculated based on the percentage of minority ownership. See "Discontinued Operations" below.

Interest Expense

Interest expense for the second quarter of 2004 was \$2.0 million compared to \$1.9 million for the second quarter of 2003. This increase is primarily due to the higher level of amortization of deferred financing costs and estimated warrant value in the 2004 second quarter than the 2003 second quarter.

- 25 -

Income Taxes

There was no tax provision from continuing operations in the first quarters of 2004 or 2003. The Company has net operating loss carryforwards for Federal tax return reporting purposes totaling \$115.2 million at December 31, 2003. The years in which such net operating losses expire are as follows (000's):

Year ending December 31:		Year ending December 31:	
-----		-----	
2004	\$ 53,099	2017	7,574
2006	6,067	2018	10,860
2007	609	2019	1,907
2008	3,231	2020	1,047
2009	2,526	2021	12,431
2011	1,069	2022	14,760

[The Company may be able to utilize its loss carryforwards against possible increased future profitability.] However, management has determined to fully reserve for the total amount of net deferred tax assets as of December 31, 2003 [and to continue to do so during 2004 until management can conclude that it is more likely than not that some or all of our loss carryforwards can be utilized.]

Discontinued Operations - Change in Plan

In December 1995, the Company entered into a joint venture agreement with China Metallurgical Import & Export Shanghai Company and Wanggang Township Economic Development Corporation. The Company has a 65% interest in the joint venture. During 1996, the Company capitalized its investment in the joint venture by contributing cash of \$150,000 and machinery and equipment with an estimated fair market value of \$1.9 million to the joint venture. The joint venture manufacturers grating panels and is located in Wanggang Township, Pudong New Area, Shanghai in the People's Republic of China.

In 1999, the Company adopted a plan to exit the grating manufacturing business through the disposition of its grating businesses, including its Chinese joint venture investment. Upon adoption of the plan, the grating businesses and assets were classified and accounted for as discontinued operations, including a provision for estimated loss on disposal of the Chinese joint venture of \$2.0 million, and ceased consolidating the joint venture as control of its daily operations was given to our joint venture partners and our then expatriate management was removed.

Edgar Filing: REUNION INDUSTRIES INC - Form 10-Q

In the four years since adopting this plan, the Company has made several unsuccessful attempts to dispose of its investment in the joint venture and now perceives that a presence in China is consistent with its future plans for certain of its continuing operations. As a result and in connection with our Chinese partners' expressed desire to return control of the business to the Company for various reasons, the Company has decided to retain its investment in the Chinese joint venture and returned it to continuing operations effective at the beginning of 2004 resulting in consolidation of the joint venture's results of operations for the quarter ended June 30, 2004.

- 26 -

Six Months Ended June 30, 2004 Compared to
Six Months Ended June 30, 2003

Net sales, gross margins and EBITDA percentages for the six months ended 2004 and 2003 are as follows. The percentages of EBITDA to net sales excludes corporate and other EBITDA. Including corporate and other EBITDA, the percentages of consolidated EBITDA to net sales for the six month periods ended June 30, 2004 and 2003 are 9.2% and 8.6%, respectively (\$'s in 000's):

	Net Sales		Gross Margin		EBITDA	
	2004	2003	2004	2003	2004	2003
Pressure vessels						
and springs	\$ 11,804	\$ 13,780	22.2%	27.5%	17.7%	22.7%
Cylinders	9,277	10,308	17.6%	16.0%	5.2%	5.8%
Grating	4,643	-	23.8%	-	13.1%	-
Plastics	13,759	15,251	14.7%	12.9%	9.4%	8.5%
Totals	\$ 39,483	\$ 39,339	18.7%	18.8%	11.3%	12.8%

Net sales for the first half of 2004 were almost equal to the first half of 2003. First half 2004 sales includes over \$4.6 million of sales from the consolidation of the Company's 65% owned Chinese grating manufacturing subsidiary. Such operation had been treated as a discontinued operation. See "Minority Interests" and "Discontinued Operations - Change in Plan" below. Excluding such grating sales, first half 2004 sales were down \$4.5 million, or 11.4%, when compared to the first half of 2003 due primarily to low order levels in later 2003 and early 2004. Such low orders were partially attributable to the Company's liquidity difficulties prior to its refinancing in December 2003 and partially attributable to the general economy and year-end holiday shut-downs at our customers.

Pressure vessels and springs sales were \$2.0 million lower and cylinder sales were \$1.0 million in the first half of 2004 compared to the first half of 2003 due primarily to the lower backlog at year-end 2003 compared to year-end 2002. However, the pressure vessel and springs segment has experienced a 79% increase in its backlog since year-end 2003 to the end of the second quarter of 2004, from \$5.8 million to \$10.4 million, and such backlog increase is beginning to have an increasing effect on this segment's sales. Cylinder sales were also affected by the consolidation of its cylinder operations into a single facility in Libertyville, Illinois, in the 2004 second quarter, which caused some disruption in this segment's shipping activity but contributed to an increase in this segment's backlog. The cylinders' backlog increased 40% since year-end 2003 to the end of the second quarter 2004. The \$1.5 million decrease in Plastics sales in the first half of 2004 compared to the 2003 first half is a continuation of a trend that began several years ago and is

Edgar Filing: REUNION INDUSTRIES INC - Form 10-Q

primarily the result of a continued reluctance and lag in customers' decisions on newly quoted programs due to the uncertainty surrounding our financial condition. Although the Plastics segment has recently been awarded some new customer programs, [this segment may continue to be affected by an overall lag in new program starts.] The continued reluctance and lag in customers' decisions on newly quoted programs due to the uncertainty surrounding our financial condition was more than offset by the effect on sales from new customer programs. However, with Plastics' backlog having increase 35% since year-end 2003 to the end of the 2004 second quarter, from \$5.9 million to \$8.0 million, [management anticipates the declining trend in sales will reverse in the second half of 2004].

- 27 -

Gross margin as a percentage of sales in the first half of 2004 compared to the 2003 first half was down slightly, to 18.7% from 18.8%. Excluding the sales and gross margin of the Chinese grating joint venture, the U.S. operations gross margin percentage decreased from 18.8% in the first half of 2003 to 18.0% in the first half of 2004. The decrease in pressure vessels and springs gross margin as a percentage of sales was due to the decrease in sales volume and a week-long interruption in June 2004 production caused by an electrical failure resulting in unanticipated costs and underabsorbed overheads. Cylinder gross margin increased in the first half of 2004 compared to the 2003 first half despite a decline in sales due primarily to the fact that, through the consolidation of cylinder operations into a single facility in Libertyville, Illinois in May 2004, we eliminated redundant expense and experienced other production efficiencies. The Plastics segment increased its gross profit margin percentage even with reduced sales as a result of increased productivity and a lower cost structure resulting from prior year cost reduction efforts.

Management evaluates the Company's segments based on EBITDA, a measure of cash generation, which is presented, not as an alternative measure of operating results or cash flow from operations as determined by accounting principles generally accepted in the United States, but because it is a widely accepted financial indicator of a company's ability to incur and service debt and due to the close relationship it bears to Reunion's financial covenants in its borrowing agreements. Excluding the Chinese grating subsidiary and corporate and other EBITDA, EBITDA and EBITDA as a percentage of sales decreased during the first quarter of 2004 compared to 2003 primarily due to the same factors affecting gross profit margin discussed above. A reconciliation of EBITDA to operating income for the six months ended June 30, 2004 and 2003 by segment and corporate and other is as follows (000's):

	Operating Profit	Deprec- iation	Amortiz- ation	EBITDA
	-----	-----	-----	-----
2004:				

Pressure vessels and springs	\$ 1,775	\$ 311	\$ -	\$ 2,086
Cylinders	388	99	-	487
Grating	608	-	-	608
Plastics	473	815	-	1,288
Corporate and other(1) (2)	(872)	21	-	(851)
	-----	-----	-----	-----
Totals	2,372	\$ 1,246	\$ -	\$ 3,618
		=====	=====	=====
Gain on debt extinguishment	3,540			

Edgar Filing: REUNION INDUSTRIES INC - Form 10-Q

Operating profit	\$ 5,912
------------------	----------

2003:

Pressure vessels and springs	\$ 2,770	\$ 353	\$ -	\$ 3,123
Cylinders	453	144	-	597
Plastics	471	826	-	1,297
Corporate and other	(1,688)	35	-	(1,653)
	-----	-----	-----	-----
Totals	\$ 2,006	\$ 1,358	\$ -	\$ 3,364
	=====	=====	=====	=====

- 28 -

(1) - Excludes gain on debt extinguishment of \$3,540,000. See "Gain on Debt Extinguishment" below.

(2) - Includes an environmental reserve adjustment of \$331,000. See "Other Income" below.

Selling, General and Administrative

Selling, general and administrative (SGA) expenses for the first half of 2004 were \$5.3 million, compared to \$5.5 million for the 2003 first half. SGA in the first half of 2004 includes \$0.5 million from the Chinese grating joint venture. Excluding this, SGA decreased to \$4.8 million domestically, or by \$0.7 million. This decrease in SGA is due to continued cost cutting measures and payroll reductions. Excluding the sales and SGA of the grating joint venture, SGA as a percentage of sales decreased to 13.7% for the first half of 2004 compared to 13.9% in the 2003 first half primarily due to the effects of the cost savings described above.

Gains on Debt Extinguishments

The Company had been named as one of several defendants in fifteen consolidated lawsuits filed in December 2000 or early 2001 in the Superior Court for Los Angeles County, California. The plaintiffs in these suits, except one, are structured settlement payees to whom Stanwich Financial Services Corp. (SFSC) is indebted. The Company and SFSC were related parties. The plaintiffs alleged that the Company received loans from SFSC that have not been repaid. On May 25, 2001, SFSC filed a Chapter 11 Bankruptcy Petition in the U.S. Bankruptcy Court for the District of Connecticut.

A settlement was reached in the Superior Court action among the plaintiffs, Bankers Trust Co. and certain other financial institution defendants. In the settlement, Bankers Trust Co. and the other settling financial institution defendants paid the plaintiffs an amount specified in the settlement agreement, and Bankers Trust Co. received an assignment of the claims of the plaintiffs and such other settling defendants against the Company and other defendants. In the SFSC bankruptcy proceeding, the Company and certain other defendants entered into a settlement with SFSC and Bankers Trust Co. Under this settlement (1) the Company is obligated to pay SFSC a settlement amount by December 31, 2006 in the sum of \$4.29 million, plus interest at the rate of 10% per annum, in full satisfaction of the Company's indebtedness to SFSC under notes payable totaling \$4.6 million, plus interest, and for certain credit support fees payable, which settlement amount is net of an offset against SFSC's note payable to the Company in the amount of \$310,000 plus interest, and (2) provided it makes such settlement payment, the Company is released from all claims that have been or could have been asserted against

Edgar Filing: REUNION INDUSTRIES INC - Form 10-Q

the Company by the plaintiffs or the settling financial institution defendants in the California Superior Court suits or by SFSC in the bankruptcy proceeding. The settlement amount does not constitute a new liability of the Company, as it relates to indebtedness and a note receivable that had previously been recorded on the Company's balance sheet. The settlement resulted in a \$3.1 million gain on debt extinguishment calculated as follows (000's):

- 29 -

Description	Payable (Receivable)	Interest and Fee Accruals	Totals
SFSC note receivable	\$ (310)	\$ (155)	\$ (465)
Reserve for interest receivable	-	101	101
SFSC collateral fee	-	690	690
SFSC credit support fee	-	294	294
SFSC note payable	2,999	1,501	4,500
SFSC note payable	500	290	790
SFSC note payable	100	53	153
SFSC note payable by assignment	1,017	280	1,297
	-----	-----	-----
Totals	\$ 4,306	\$ 3,054	7,360
	=====	=====	
Less: Note payable under settlement agreement			(4,290)

Gain on SFSC litigation settlement first quarter 2004			\$ 3,070
			=====

The gain on debt extinguishment of \$3.1 million was recorded in the first quarter of 2004 as the settlement was reached in the Superior Court and the financial institution defendants paid the plaintiffs in January 2004. However, subsequent to the filing of our Form 10-Q for the quarter ended March 31, 2004, the parties to the settlement agreement set the effective date of the settlement as May 10, 2004. Accordingly, the Company recorded interest expense through May 10, 2004 under the terms of the prior SFSC notes payable and then recorded an additional gain on debt extinguishment of \$262,000 to reflect the effective date of the settlement as being May 10, 2004. The Company then adjusted interest expense under the terms of the new note payable as though it began accruing on May 10, 2004.

In January 2004, we solicited our noteholders for the second time to consent to certain provisions and waivers of the indenture governing the 13% senior notes. In the first consent in November 2003, \$23,250,700 of the \$24,855,000 principal amount of senior notes, or 93.55%, had consented. The second consent solicitation period ended on April 28, 2004 at which time holders of an additional \$434,300 principal amount of senior notes had consented. The significant provisions of the solicitation requested that the noteholders consent to waive all then existing defaults under the indenture, cancel all accrued and unpaid interest, cancel 12% of the principal amount of senior notes and extend the maturity of the notes to December 2006. Accordingly, 12% of the \$434,300 principal amount of senior notes of noteholders that had consented to the various provisions and waivers in the second solicitation, or \$52,000, was extinguished pursuant to the provisions of the consent. As of April 28, 2004, accrued and unpaid interest related to the 13% senior notes consenting in the second solicitation totaled \$156,000. Such interest was extinguished pursuant to the provisions of the consent.

Edgar Filing: REUNION INDUSTRIES INC - Form 10-Q

[The Company is currently investigating other recapitalization scenarios that include, among other things, the use of additional private capital fund financing to repurchase at discounts some portion or all of our senior and unsecured subordinated notes payable.]

- 30 -

Other Income

Other income for the first half of 2004 was \$282,000, compared to other income of \$61,000 for the first half of 2003. The components are as follows:

	2004	2003	Change
	-----	-----	-----
Costs to consolidate cylinder locations	\$ 288	\$ -	\$ 288
Adjustment of environmental reserve	(331)	-	(331)
Rental income on sublease	(73)	(10)	(63)
Other (income) expense, net	(166)	(51)	(115)
	-----	-----	-----
Total other income, net	\$ (282)	\$ (61)	\$ (221)
	=====	=====	=====

During May 2004, we completed the consolidation of our cylinder manufacturing operations into a single facility in Libertyville, Illinois. Costs totaling \$171,000 were incurred in the 2004 second quarter. The Company finalized the settlement of a Louisiana environmental litigation matter in the second quarter of 2004. Such settlement has resulted in a new estimated of the required reserve, resulting in a \$331,000 adjustment in the 2004 second quarter. In June 2003, the Company sublet its idle manufacturing facility in Clearfield, Utah. There were no other individually significant or offsetting items of other income or expenses in either of the first halves of 2004 and 2003.

Minority Interests

Minority interests of \$0.2 million represents income during the first half of 2004 allocated to the minority ownerships of the Company's consolidated foreign grating joint venture. Minority interests are calculated based on the percentage of minority ownership. See "Discontinued Operations" below.

Interest Expense

Interest expense for the first half of 2004 was \$3.8 million compared to \$3.4 million for the first half of 2003. This increase is primarily due to the higher level of amortization of deferred financing costs and estimated warrant value in the 2004 first half than the 2003 first half.

Income Taxes

There was no tax provision from continuing operations in the first halves of 2004 or 2003. The Company has net operating loss carryforwards for Federal tax return reporting purposes totaling \$115.2 million at December 31, 2003. The years in which such net operating losses expire are as follows (000's):

Year ending December 31:		Year ending December 31:	
-----		-----	
2004	\$ 53,099	2017	7,574
2006	6,067	2018	10,860
2007	609	2019	1,907

Edgar Filing: REUNION INDUSTRIES INC - Form 10-Q

2008	3,231	2020	1,047
2009	2,526	2021	12,431
2011	1,069	2022	14,760

- 31 -

[The Company may be able to utilize its loss carryforwards against possible increased future profitability.] However, management has determined to fully reserve for the total amount of net deferred tax assets as of December 31, 2003 [and to continue to do so during 2004 until management can conclude that it is more likely than not that some or all of our loss carryforwards can be utilized.]

Discontinued Operations - Change in Plan

In December 1995, the Company entered into a joint venture agreement with China Metallurgical Import & Export Shanghai Company and Wanggang Township Economic Development Corporation. The Company has a 65% interest in the joint venture. During 1996, the Company capitalized its investment in the joint venture by contributing cash of \$150,000 and machinery and equipment with an estimated fair market value of \$1.9 million to the joint venture. The joint venture manufactures grating panels and is located in Wangang Township, Pudong New Area, Shanghai in the People's Republic of China.

In 1999, the Company adopted a plan to exit the grating manufacturing business through the disposition of its grating businesses, including its Chinese joint venture investment. Upon adoption of the plan, the grating businesses and assets were classified and accounted for as discontinued operations, including a provision for estimated loss on disposal of the Chinese joint venture of \$2.0 million, and ceased consolidating the joint venture as control of its daily operations was given to our joint venture partners and our then expatriate management was removed.

In the four years since adopting this plan, the Company has made several unsuccessful attempts to dispose of its investment in the joint venture and now perceives that a presence in China is consistent with its future plans for certain of its continuing operations. As a result and in connection with our Chinese partners' expressed desire to return control of the business to the Company for various reasons, the Company has decided to retain its investment in the Chinese joint venture and returned it to continuing operations effective at the beginning of 2004 resulting in consolidation of the joint venture's results of operations for the six months ended June 30, 2004.

LIQUIDITY AND CAPITAL RESOURCES

General

The Company manages its liquidity as a consolidated enterprise. The operating groups of the Company carry minimal cash balances. Cash generated from group operating activities generally is used to repay borrowings under revolving credit arrangements, as well as other uses (e.g. corporate headquarters expenses, debt service, capital expenditures, etc.). Conversely, cash required for group operating activities generally is provided from funds available under the same revolving credit arrangements.

- 32 -

Edgar Filing: REUNION INDUSTRIES INC - Form 10-Q

Recent Events

Congress Financial Corporation Supplemental Revolving Credit Financing

The Company's loan agreement with Congress Financial Corporation (Congress) provides for a loan facility of up to \$25.0 million, collateralized by substantially all of the assets of the Company as described below. The amount which the Company may borrow at any time under such loan facility is based on a formula related to the value of the collateral securing the loan. In May 2004, two private capital funds invested \$1.5 million each to purchase from Congress junior participating interests in the revolving credit portion of the Congress loan facility. These investments increased by \$3.0 million the amount which the Company could borrow under the loan facility, subject to the overall borrowing limit of \$25.0 million, which did not change. The Company used the \$3.0 million in proceeds to pay trade payables and for other corporate purposes. In consideration of such investments, the Company has agreed to grant warrants to such private capital funds allowing each to purchase 375,000 shares of the Company's common stock at an initial exercise price of \$0.01 per share and with registration rights, subject to the approval by the Company's stockholders to amend the Company's Articles of Incorporation to increase the authorized number of shares of common stock of the Company by 10,000,000.

Interest on the Congress supplemental revolving credit financing is payable monthly at a fixed rate of 15% per annum. The Congress supplemental revolving credit financing is collateralized by a continuing security interest and lien on substantially all of the current and after-acquired assets of Reunion including, without limitation, all accounts receivable, inventory, real property, equipment, chattel paper, documents, instruments, deposit accounts, contract rights and general intangibles.

The Congress supplemental revolving credit financing is subject to the same financial covenants and other covenants as the revolving credit and term loan facilities, including the minimum amount of earnings before interest, taxes, depreciation and amortization (EBITDA) and the minimum fixed charge coverage ratio.

Congress Financial Corporation Revolving and Term Loan Credit Facility

On December 3, 2003, the Company entered into a new revolving and term loan bank credit facility with Congress Financial Corporation. This credit facility consists of revolving credit, term loan and letter of credit accommodations up to a maximum credit of \$25.0 million. At June 30, 2004, the Company had outstanding borrowings under this facility totaling \$13.1 million, including \$10.2 million of revolving credit and a term loan of \$2.9 million. The term loan amortizes to the revolving credit availability at a rate of \$53,000 per month which began on January 31, 2004 and continues until fully paid. This facility has a three-year initial term and automatically renews for additional one-year increments unless either party gives the other notice of termination at least 90 days prior to the beginning of the next one-year term.

The Congress facility requires Reunion to comply with financial covenants and other covenants, including a minimum amount of earnings before interest, taxes, depreciation and amortization (EBITDA) and a minimum fixed charge coverage ratio. The minimum EBITDA covenant began in 2004 and requires the Company to maintain minimum monthly amounts of EBITDA ranging from \$450,000 in January 2004 to \$600,000 in December 2004 with \$50,000 to \$100,000 increments or decrements occurring during the year. There are also minimum monthly

Edgar Filing: REUNION INDUSTRIES INC - Form 10-Q

EBITDA amounts required during 2005 and 2006. Through June 2004, the Company achieved the minimum monthly EBITDA required for compliance with this covenant. The minimum fixed charge coverage ratio covenant requires the Company to maintain a minimum fixed charge coverage ratio to be tested as of the last day of each fiscal quarter beginning with the quarter ended March 31, 2004, for the year-to-date period starting on January 1, 2004. For quarters ended on and after December 31, 2004, the components of the calculation are on a rolling, twelve-month basis. The ratio is defined as EBITDA divided by fixed charges (defined as interest expense, capital expenditures, regularly scheduled or required principal payments on debt and taxes paid). For the ratio calculation period ended March 31, 2004 and for each year-to-date period during 2004 ended on quarters thereafter, the required minimum fixed charge coverage ratio is 0.65:1, 0.77:1, 0.77:1 and 0.80:1, respectively. There are also minimum fixed charge coverage ratio amounts required during 2005 and 2006. The Company was in compliance with the minimum fixed charge coverage ratio covenant for the period ended June 30, 2004.

In addition, the facilities contain various other affirmative and negative covenants. As of the date of this report, the Company was in compliance with all other covenants. The facilities require Reunion to pay the reasonable expenses incurred by Congress in connection with the facilities. Available borrowings under the revolving credit portion are based upon a percentage of eligible receivables and inventories.

13% Senior Notes

In January 2004, we solicited our noteholders for the second time to consent to certain provisions and waivers of the indenture governing the 13% senior notes. In the first consent in November 2003, \$23,250,700 of the \$24,855,000 principal amount of senior notes, or 93.55%, had consented. The second consent solicitation period ended on April 28, 2004 at which time holders of an additional \$434,300 principal amount of senior notes had consented. The significant provisions of the solicitation requested that the noteholders consent to waive all then existing defaults under the indenture, cancel all accrued and unpaid interest, cancel 12% of the principal amount of senior notes and extend the maturity of the notes to December 2006. Accordingly, 12% of the \$434,300 principal amount of senior notes of noteholders that had consented to the various provisions and waivers in the second solicitation, or \$52,000, was extinguished pursuant to the provisions of the consent. As of April 28, 2004, accrued and unpaid interest related to the 13% senior notes consenting in the second solicitation totaled \$156,000. Such interest was extinguished pursuant to the provisions of the consent.

SFSC Litigation Settlement

The Company had been named as one of several defendants in fifteen consolidated lawsuits filed in December 2000 or early 2001 in the Superior Court for Los Angeles County, California. The plaintiffs in these suits, except one, are structured settlement payees to whom Stanwich Financial Services Corp. (SFSC) is indebted. The Company and SFSC were related parties. The plaintiffs alleged that the Company received loans from SFSC that have not been repaid. On May 25, 2001, SFSC filed a Chapter 11 Bankruptcy Petition in the U.S. Bankruptcy Court for the District of Connecticut.

- 34 -

A settlement was reached in the Superior Court action among the plaintiffs, Bankers Trust Co. and certain other financial institution defendants. In the settlement, Bankers Trust Co. and the other settling

Edgar Filing: REUNION INDUSTRIES INC - Form 10-Q

financial institution defendants paid the plaintiffs an amount specified in the settlement agreement, and Bankers Trust Co. received an assignment of the claims of the plaintiffs and such other settling defendants against the Company and other defendants. In the SFSC bankruptcy proceeding, the Company and certain other defendants entered into a settlement with SFSC and Bankers Trust Co. Under this settlement (1) the Company is obligated to pay SFSC a settlement amount by December 31, 2006 in the sum of \$4.29 million, plus interest at the rate of 10% per annum, in full satisfaction of the Company's indebtedness to SFSC under notes payable totaling \$4.6 million, plus interest, and for certain credit support fees payable, which settlement amount is net of an offset against SFSC's note payable to the Company in the amount of \$310,000 plus interest, and (2) provided it makes such settlement payment, the Company is released from all claims that have been or could have been asserted against the Company by the plaintiffs or the settling financial institution defendants in the California Superior Court suits or by SFSC in the bankruptcy proceeding. The settlement amount does not constitute a new liability of the Company, as it relates to indebtedness and a note receivable that had previously been recorded on the Company's balance sheet. The settlement resulted in a \$3.1 million gain on debt extinguishment calculated as follows (000's):

Description	Payable (Receivable)	and Fee Accruals	Totals
SFSC note receivable	\$ (310)	\$ (155)	\$ (465)
Reserve for interest receivable	-	101	101
SFSC collateral fee	-	690	690
SFSC credit support fee	-	294	294
SFSC note payable	2,999	1,501	4,500
SFSC note payable	500	290	790
SFSC note payable	100	53	153
SFSC note payable by assignment	1,017	280	1,297
	-----	-----	-----
Totals	\$ 4,306	\$ 3,054	7,360
	=====	=====	
Less: Note payable under settlement agreement			(4,290)

Gain on SFSC litigation settlement first quarter 2004			\$ 3,070
			=====

The gain on debt extinguishment of \$3.1 million was recorded in the first quarter of 2004 as the settlement was reached in the Superior Court and the financial institution defendants paid the plaintiffs in January 2004. However, subsequent to the filing of our Form 10-Q for the quarter ended March 31, 2004, the parties to the settlement agreement set the effective date of the settlement as May 10, 2004. Accordingly, the Company recorded interest expense through May 10, 2004 under the terms of the prior SFSC notes payable and then recorded an additional gain on debt extinguishment of \$262,000 to reflect the effective date of the settlement as being May 10, 2004. The Company then adjusted interest expense under the terms of the new note payable as though it began accruing on May 10, 2004.

- 35 -

SUMMARY OF 2004 ACTIVITIES

Cash and cash equivalents totaled \$1.6 million at June 30, 2004, compared to \$0.8 million at December 31, 2003, an increase of \$0.8 million. This resulted from \$1.9 million of cash used in operating activities and \$0.6 million used in investing activities being more than offset by almost \$3.4

Edgar Filing: REUNION INDUSTRIES INC - Form 10-Q

million provided by financing activities. Cash and cash equivalents at the end of a period generally represents lockbox receipts from customers to be applied to our Congress revolving credit facility in the following one to two business days.

Operating Activities

Operating activities used \$1.9 million in cash in the first half of 2004 as increases of \$2.8 million in receivables and inventories were only partially funded by an increase in trade payables and other liabilities.

Investing Activities

Capital expenditures were \$0.6 million.

Financing Activities

The Company made scheduled repayments of the Congress term loan totaling \$318,000 and paid an additional \$310,000 in costs related to the December 2003 refinancing. Revolving credit facility borrowings increased \$1.0 million during the first half of 2004. The Company and Congress entered into a supplemental revolving credit financing for \$3.0 million. See "Recent Developments - Congress Financial Corporation Supplemental Revolving Credit Financing" above. Other debt repayments totaling \$27,000 represent payments on capital lease obligations and other debt.

Lease Termination Reserves

In the fourth quarter of 2001, we developed and adopted a restructure plan for our continuing businesses and certain other businesses were identified for disposal. By the end of 2002, this plan was substantially completed except for continuing commitments under leases for two idle facilities and certain equipment. The Company recorded restructuring costs, including lease termination costs, related to the plan. The following represents a summary of first half 2004 cash activity of the remaining lease termination reserves (in thousands):

Description	At 12/31/03	Cash Activity	At 06/30/04
-----	-----	-----	-----
Lease termination costs	\$ 474	\$ (145)	\$ 329
	=====	=====	=====

Of the remaining lease termination costs, \$315 relates to idle manufacturing facilities in Milwaukee, Wisconsin and Clearfield, Utah. The remainder relates to lease commitments under idle machinery in the Plastics Group.

- 36 -

FACTORS THAT COULD AFFECT FUTURE RESULTS

Reunion's vendors may restrict credit terms

We have corrected many vendor-related problems with liquidity generated from the refinancing and from asset sales. However, another period of tight liquidity could result in key vendors restricting or eliminating the extension of credit terms to us. If this would happen, our ability to obtain raw materials would be strained significantly and our ability to manufacture products would be reduced.

Edgar Filing: REUNION INDUSTRIES INC - Form 10-Q

Reunion's bank financing is subject to financial covenants

We have removed all defaults on our bank financing and senior notes. However, our new bank financing is subject to monthly financial and other covenants. If our operations do not improve during 2004, we may fail to meet one or more financial or other covenants. If this would happen, we would be in default on our bank obligations and, subject to the terms of the loan and security agreement, all of our bank loans would be due and payable. Although it may be possible to negotiate waivers of defaults, no assurances can be given that we would be able to do so.

Reunion is exposed to the risks of litigation and environmental matters

We have made significant progress in settling major exposures to litigation and environmental claims during 2003 and in the first half of 2004. However, we are still exposed to certain undecided litigation and environmental matters. An adverse outcome in one or more of these matters could have a significant negative effect on our financial position and results of operations.

Reunion operates in highly competitive mature, niche markets

Our products are sold in highly competitive mature, niche markets and we compete with companies of varying size, including divisions and subsidiaries of larger companies that have financial resources that exceed ours. This combination of competitive and financial pressures could cause us to lose market share or erode prices, which could negatively impact our financial position and results of operations.

Reunion's past performance could impact future prospects

Our past performance has been poor. Because of this, potential or current customers may decide not to do business with us. If this were to happen, our sales may not increase or may decline. If sales do not increase or we experience a further decline in sales, our ability to cover costs would be further reduced, which could negatively impact our financial position and results of operations.

Going concern

The financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. At June 30, 2004, the Company has a deficiency in working capital of \$0.8 million net of related party obligations and a deficiency in assets of \$25.8 million. These conditions raise substantial doubt about the Company's ability to continue as a going concern. The financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classifications of liabilities that may result from the outcome of this uncertainty.

- 37 -

We successfully refinanced our bank debt, extinguished a significant portion of our obligations under the senior notes and removed all previously existing defaults on our debt. These steps were taken to improve liquidity and defer the principal maturities on a significant portion of our debt. The Company is investigating other recapitalization scenarios in an effort to provide additional liquidity and extinguishments or deferrals of debt

Edgar Filing: REUNION INDUSTRIES INC - Form 10-Q

obligations. The Company will also consider sales of assets as part of its plan to continue in existence. Although we believe we can accomplish these plans, no assurances exist that we will. Failure to accomplish these plans could have an adverse impact on the Company's liquidity, financial position and future operations.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

There have been no significant changes in the market risk factors which affect the Company since the end of the preceding fiscal year.

Item 4. Controls and Procedures

As required by Rule 13a-15(b) of the Securities Exchange Act of 1934, as amended, Reunion's management, including its Chief Executive Officer and Chief Financial Officer, conducted an evaluation as of the end of the period covered by this report, of the effectiveness of Reunion's disclosure controls and procedures as defined in Rule 13a-15(e). Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that Reunion's disclosure controls and procedures were effective as of the end of the period covered by this report. As required by Rule 13a-15(d), Reunion's management, including its Chief Executive Officer and Chief Financial Officer, also conducted an evaluation of Reunion's internal control over financial reporting to determine whether any changes occurred during the quarter that have materially affected, or are reasonably likely to materially affect, Reunion's internal control over financial reporting. Based on that evaluation, there has been no such change during the quarter.

It should be noted that any system of controls, however well designed and operated, can provide only reasonable, and not absolute, assurance that the objectives of the system will be met. In addition, the design of any control system is based in part upon certain assumptions about the likelihood of future events.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

The Company is involved in various legal proceedings and environmental matters. See "Item 1. Financial Statements, Note 6: Commitments and Contingent Liabilities."

- 38 -

Item 6. Exhibits and Reports on Form 8-K

(b) Reports on Form 8-K

The Company filed a Current Report on Form 8-K dated May 4, 2004 on May 5, 2004 to set the record date of those shareholders entitled to vote at and to announce the time and place of the Company's 2004 annual meeting of the Company's stockholders.

The Company filed a Current Report on Form 8-K/A dated May 4, 2004 on May 28, 2004 to change the date of the

Edgar Filing: REUNION INDUSTRIES INC - Form 10-Q

Company's 2004 annual meeting of the Company's stockholders.

The Company filed a Current Report on Form 8-K dated May 18, 2004 on May 28, 2004 to file, as an exhibit, the Company's press release regarding its results of operations for the quarter ended March 31, 2004.

(c) Exhibits

Exhibit No.	Exhibit Description
-----	-----
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

- 39 -

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, thereto duly authorized.

Date: August 16, 2004

REUNION INDUSTRIES, INC.
(Registrant)

By: /s/ Charles E. Bradley, Sr.

Charles E. Bradley, Sr.
Chairman and Chief
Executive Officer

By: /s/ John M. Froehlich

John M. Froehlich
Executive Vice President, Finance
and Chief Financial Officer
(chief financial and accounting officer)

- 40 -

EXHIBIT 31.1

Edgar Filing: REUNION INDUSTRIES INC - Form 10-Q

CERTIFICATION

I, Charles E. Bradley, Sr., certify that:

1. I have reviewed this quarterly report on Form 10-Q of Reunion Industries, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 16, 2004

/s/ Charles E. Bradley, Sr.

Chief Executive Officer

- 41 -

CERTIFICATION

EXHIBIT 31.2

Edgar Filing: REUNION INDUSTRIES INC - Form 10-Q

I, John M. Froehlich, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Reunion Industries, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - (a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 16, 2004

/s/ John M. Froehlich

Chief Financial Officer

- 42 -

EXHIBIT 32.1

REUNION INDUSTRIES, INC.
SARBANES-OXLEY ACT SECTION 906 CERTIFICATION

Edgar Filing: REUNION INDUSTRIES INC - Form 10-Q

In connection with this quarterly report on Form 10-Q of Reunion Industries, Inc. for the quarter ended June 30, 2004, I, Charles E. Bradley, Sr., Chief Executive Officer of Reunion Industries, Inc., hereby certify pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 Of the Sarbanes-Oxley Act of 2002, that:

1. this Form 10-Q for the quarter ended June 30, 2004 fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. the information contained in this Form 10-Q for the quarter ended June 30, 2004 fairly presents, in all material respects, the financial condition and results of operations of Reunion Industries, Inc. for the periods presented therein.

Date: August 16, 2004

/s/ Charles E. Bradley, Sr.

Chief Executive Officer

- 43 -

EXHIBIT 32.2

REUNION INDUSTRIES, INC. SARBANES-OXLEY ACT SECTION 906 CERTIFICATION

In connection with this quarterly report on Form 10-Q of Reunion Industries, Inc. for the quarter ended June 30, 2004, I, John M. Froehlich, Chief Financial Officer of Reunion Industries, Inc., hereby certify pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 Of the Sarbanes-Oxley Act of 2002, that:

1. this Form 10-Q for the quarter ended June 30, 2004 fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. the information contained in this Form 10-Q for the quarter ended June 30, 2004 fairly presents, in all material respects, the financial condition and results of operations of Reunion Industries, Inc. for the periods presented therein.

Date: August 16, 2004

/s/ John M. Froehlich

Chief Financial Officer

- 44 -