

STEELCASE INC
Form 10-Q
October 07, 2008

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549**

FORM 10-Q

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

For the quarterly period ended August 29, 2008

or

**o 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 1-13873

STEELCASE INC.
(Exact name of registrant as specified in its charter)

Michigan
(State or other jurisdiction
of incorporation or organization)
901 44th Street SE
Grand Rapids, Michigan
(Address of principal executive offices)

38-0819050
(I.R.S. employer identification no.)

49508
(Zip Code)

(Registrant's telephone number, including area code) (616) 247-2710

N/A

(Former name, former address and former fiscal year, if changed since last report)

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 þ No o

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

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Large accelerated filer ☒ Accelerated filer ☐ Non-accelerated filer ☐ Smaller reporting Company ☐
(Do not check if a smaller reporting company)

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

As of October 6, 2008, Steelcase Inc. had 78,573,663 shares of Class A Common Stock and 55,703,531 shares of Class B Common Stock outstanding.

**STEELCASE INC.
FORM 10-Q**

FOR THE QUARTER ENDED AUGUST 29, 2008

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Table of Contents**PART I FINANCIAL INFORMATION****Item 1. Financial Statements:****STEELCASE INC.****CONDENSED CONSOLIDATED STATEMENTS OF INCOME (Unaudited)****(in millions, except per share data)**

	Three Months Ended		Six Months Ended	
	August 29, 2008	August 24, 2007	August 29, 2008	August 24, 2007
Revenue	\$ 901.8	\$ 825.2	\$ 1,717.5	\$ 1,633.6
Cost of sales	615.1	549.1	1,159.7	1,091.7
Restructuring costs	8.7	(1.7)	13.5	
Gross profit	278.0	277.8	544.3	541.9
Operating expenses	231.7	222.8	458.8	438.6
Restructuring costs	0.3		2.7	
Operating income	46.0	55.0	82.8	103.3
Interest expense	(4.3)	(4.0)	(8.6)	(8.3)
Other income, net	4.3	10.8	5.8	18.2
Income before income tax expense	46.0	61.8	80.0	113.2
Income tax expense	14.6	24.1	26.4	41.9
Net income	\$ 31.4	\$ 37.7	\$ 53.6	\$ 71.3
Earnings per share:				
Basic	\$ 0.23	\$ 0.26	\$ 0.40	\$ 0.50
Diluted	\$ 0.23	\$ 0.26	\$ 0.39	\$ 0.49
Dividends declared and paid per common share	\$ 0.15	\$ 0.15	\$ 0.30	\$ 0.30

See accompanying notes to the condensed consolidated financial statements.

Table of Contents**STEELCASE INC.****CONDENSED CONSOLIDATED BALANCE SHEETS****(in millions)**

	(Unaudited) August 29, 2008	(Restated) February 29, 2008
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 70.8	\$ 213.9
Short-term investments	57.9	50.1
Accounts receivable, net	430.8	397.0
Inventories	159.0	146.7
Other current assets	126.2	127.0
Total current assets	844.7	934.7
Property and equipment, net	482.6	478.4
Company-owned life insurance	211.6	210.6
Goodwill and other intangible assets, net	285.9	301.0
Other assets	195.6	199.7
Total assets	\$ 2,020.4	\$ 2,124.4
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable	\$ 233.5	\$ 246.9
Short-term borrowings and current maturities of long-term debt	6.6	8.2
Accrued expenses:		
Employee compensation	148.9	181.3
Employee benefit plan obligations	26.3	39.0
Other	209.5	207.6
Total current liabilities	624.8	683.0
Long-term liabilities:		
Long-term debt less current maturities	251.3	250.5
Employee benefit plan obligations	184.1	183.4
Other long-term liabilities	85.8	96.6
Total long-term liabilities	521.2	530.5
Total liabilities	1,146.0	1,213.5
Shareholders' equity:		
Common stock	66.3	114.7

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Additional paid-in capital	6.2	5.0
Accumulated other comprehensive income	15.1	17.4
Retained earnings	786.8	773.8
Total shareholders' equity	874.4	910.9
Total liabilities and shareholders' equity	\$ 2,020.4	\$ 2,124.4

See accompanying notes to the condensed consolidated financial statements.

Table of Contents**STEELCASE INC.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)**
(in millions)

	Six Months Ended	
	August 29, 2008	August 24, 2007
OPERATING ACTIVITIES		
Net income	\$ 53.6	\$ 71.3
Depreciation and amortization	45.3	44.7
Changes in operating assets and liabilities	(146.9)	(59.4)
Other, net	14.1	5.8
Net cash (used in) provided by operating activities	(33.9)	62.4
INVESTING ACTIVITIES		
Capital expenditures	(44.9)	(31.2)
Net purchases of investments	(0.9)	(35.7)
Proceeds from disposal of fixed assets	4.0	14.8
Business divestitures	15.8	(3.0)
Other, net	10.1	9.3
Net cash used in investing activities	(15.9)	(45.8)
FINANCING ACTIVITIES		
Dividends paid	(40.5)	(43.7)
Common stock repurchases	(54.2)	(109.8)
Common stock issuances	0.3	10.5
Other, net	3.0	3.9
Net cash used in financing activities	(91.4)	(139.1)
Effect of exchange rate changes on cash and cash equivalents	(1.9)	5.2
Net decrease in cash and cash equivalents	(143.1)	(117.3)
Cash and cash equivalents, beginning of period	213.9	527.2
Cash and cash equivalents, end of period	\$ 70.8	\$ 409.9

See accompanying notes to the condensed consolidated financial statements.

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STEELCASE INC.

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)**

1. BASIS OF PRESENTATION

The accompanying condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information and with the instructions in Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals and adjustments) considered necessary for a fair presentation of the condensed consolidated financial statements have been included. Results for interim periods should not be considered indicative of results to be expected for a full year. Reference should be made to the consolidated financial statements contained in our Annual Report on Form 10-K for the fiscal year ended February 29, 2008 (Form 10-K).

The Condensed Consolidated Balance Sheet at February 29, 2008 was derived from the audited Consolidated Balance Sheet included in our Form 10-K. During Q2 2009, we determined that we had not appropriately recorded deferred tax liabilities on certain intangible assets acquired prior to February 29, 2008. Accordingly, we restated our February 29, 2008 balance sheet to correct goodwill and deferred tax liabilities related to prior acquisitions. These corrections increased goodwill by \$35.4 (\$32.8 in our Other category, \$1.4 in our North America segment and \$1.2 in our International segment) as reported in the Condensed Consolidated Balance Sheet as *Goodwill and other intangibles, net* and decreased deferred tax assets by a corresponding amount as reported in the Condensed Consolidated Balance Sheet as *Other assets*. We did not amend our February 29, 2008 Form 10-K or any other prior period filing, as these corrections were not considered material to the Consolidated Balance Sheet and had no impact on our Consolidated Statements of Income, earnings per share, retained earnings or our cash flows from operating, financing or investing activities.

As used in this Report, unless otherwise expressly stated or the content otherwise requires, all references to Steelcase, we, our, Company and similar references are to Steelcase Inc. and its majority-owned subsidiaries. In addition, reference to a year relates to the fiscal year, ended in February of the year indicated, rather than the calendar year. Additionally, Q1, Q2, Q3 and Q4 reference the first, second, third and fourth quarter, respectively, of the fiscal year indicated. All amounts are in millions, except share and per share data, data presented as a percentage or as otherwise indicated.

Certain amounts in the prior year's financial statements have been reclassified to conform to the current year presentation.

2. NEW ACCOUNTING STANDARDS

SFAS No. 141(R)

In December 2007, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 141(R), *Business Combinations* (SFAS No. 141(R)), to create greater consistency in the accounting and financial reporting of business combinations. SFAS No. 141(R) establishes principles and requirements for how the acquirer in a business combination (i) recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed and any controlling interest, (ii) recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase and (iii) determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the

business combination. SFAS No. 141(R) applies to fiscal years beginning after December 15, 2008. Earlier adoption is prohibited.

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STEELCASE INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

SFAS No. 160

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements an Amendment of ARB No. 51* (SFAS No. 160), to establish accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. SFAS No. 160 establishes accounting and reporting standards that require (i) the ownership interest in subsidiaries held by parties other than the parent to be clearly identified and presented on the balance sheet within equity, but separate from the parent's equity, (ii) the amount of net income attributable to the parent and the noncontrolling interest to be clearly identified and presented on the face of the statement of income and (iii) changes in a parent's ownership interest while the parent retains its controlling financial interest in its subsidiary to be accounted for consistently. SFAS No. 160 applies to fiscal years beginning after December 15, 2008. Earlier adoption is prohibited.

FSP No. 157-2

In February 2008, the FASB issued FASB Staff Position on Statement 157, *Effective Date of FASB Statement No. 157* (FSP No. 157-2). FSP No. 157-2 delays the effective date of SFAS No. 157, *Fair Value Measurements* (SFAS No. 157), for all nonfinancial assets and liabilities that are not remeasured at fair value on a recurring basis, to fiscal years beginning after November 15, 2008. Although we believe the adoption may impact the way in which we calculate fair value of goodwill, indefinite-lived intangible assets, and other long-lived assets, we do not believe the adoption of FSP No. 157-2 will have a material impact on our consolidated financial statements. We applied SFAS No. 157 to all other fair value measurements effective March 1, 2008. See Note 6 for additional information.

SFAS No. 161

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities an Amendment of FASB Statement No. 133* (SFAS No. 161), to improve financial reporting of derivative instruments and hedging activities by requiring enhanced disclosures to enable investors to better understand their effects on an entity's financial position, financial performance and cash flows. SFAS No. 161 applies to fiscal years and interim periods beginning after November 15, 2008. We have not determined the effect, if any, the adoption of this statement will have on our future disclosures.

3. BUSINESS DIVESTITURE

During Q2 2009, we sold Custom Cable Industries, Inc. (Custom Cable), a wholly-owned subsidiary in our North America segment. Total proceeds, including limited seller financing are expected to aggregate \$17.7. In connection with the sale, we recorded an operating loss of \$1.8 within our Corporate costs and also recorded net tax benefits of \$2.3. As a result, the net income impact of the sale was a gain of \$0.5. Our Condensed Consolidated Statement of Income for the six months ended August 29, 2008 includes \$11.2 of revenue, \$3.9 of gross profit, \$2.1 of operating expenses and \$1.8 of operating income related to Custom Cable.

Table of Contents**STEELCASE INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)****4. EARNINGS PER SHARE**

Basic earnings per share is based on the weighted-average number of shares of common stock outstanding during each period. Diluted earnings per share also includes the effects of shares and potential shares issued under our stock incentive plans. However, diluted earnings per share does not reflect the effects of 4.1 million options for 2009 and 1.1 million options for 2008 because those potential shares were not dilutive.

Computation of Earnings per Share	Three Months Ended		Six Months Ended	
	August 29, 2008	August 24, 2007	August 29, 2008	August 24, 2007
Net income	\$ 31.4	\$ 37.7	\$ 53.6	\$ 71.3
Weighted-average shares outstanding for basic earnings per share (in millions)	134.4	143.2	135.3	144.3
Effect of dilutive stock-based compensation (in millions)	0.4	1.1	0.4	1.2
Adjusted weighted-average shares outstanding for diluted earnings per share (in millions)	134.8	144.3	135.7	145.5
Earnings per share of common stock:				
Basic	\$ 0.23	\$ 0.26	\$ 0.40	\$ 0.50
Diluted	\$ 0.23	\$ 0.26	\$ 0.39	\$ 0.49
Total shares outstanding at period end (in millions)	134.3	142.2	134.3	142.2

5. COMPREHENSIVE INCOME

Comprehensive income is comprised of net income and all changes to shareholders' equity except those due to investments by, and distributions to, shareholders.

Components of Comprehensive Income	Three Months Ended	
	August 29, 2008	August 24, 2007
Net income	\$ 31.4	\$ 37.7
Other comprehensive (loss) income:		
Foreign currency translation	(10.4)	3.2
Derivative adjustments, net of tax of \$0.0 and \$0.1	(0.1)	(0.1)
Unrealized net loss on investments, net of tax of \$0.8	(1.3)	
Minimum pension liability, net of tax of \$0.7 and \$1.0	(1.1)	(1.5)

Total	(12.9)	1.6
Comprehensive income	\$ 18.5	\$ 39.3

Table of Contents**STEELCASE INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)**

Components of Comprehensive Income	Six Months Ended	
	August 29, 2008	August 24, 2007
Net income	\$ 53.6	\$ 71.3
Other comprehensive (loss) income:		
Foreign currency translation	(2.9)	13.2
Derivative adjustments, net of tax of \$0.0 and \$0.1	(0.1)	(0.2)
Unrealized net gain on investments, net of tax of \$(1.3)	2.9	
Minimum pension liability, net of tax of \$1.1 and \$1.6	(2.2)	(2.6)
Total	(2.3)	10.4
Comprehensive income	\$ 51.3	\$ 81.7

6. FAIR VALUE

We adopted SFAS No. 157 as of March 1, 2008. SFAS No. 157 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants. SFAS No. 157 also specifies a fair value hierarchy based upon the observability of inputs used in valuation techniques. Observable inputs (highest level) reflect market data obtained from independent sources, while unobservable inputs (lowest level) reflect internally developed market assumptions. In accordance with SFAS No. 157, fair value measurements are classified under the following hierarchy:

Level 1 Quoted prices for identical instruments in active markets.

Level 2 Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations in which all significant inputs or significant value-drivers are observable in active markets.

Level 3 Model-derived valuations in which one or more significant inputs or significant value-drivers are unobservable.

Fair value measurements are classified according to the lowest level input or value-driver that is significant to the valuation. A measurement may therefore be classified within Level 3 even though there may be other significant inputs that are readily observable.

Assets and liabilities measured at fair value in our Condensed Consolidated Balance Sheet as of August 29, 2008 are summarized below:

Fair Value of Financial Instruments	Level 1	Level 2	Level 3	Total
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Assets:

Managed investment portfolio	\$ 50.8	\$	\$	\$ 50.8
Auction rate securities			23.1	23.1
Available-for-sale securities	7.1			7.1
Canadian asset-backed commercial paper			3.9	3.9
Foreign exchange forward contracts		3.2		3.2
Privately-held equity investments			0.3	0.3
Total assets	\$ 57.9	\$ 3.2	\$ 27.3	\$ 88.4

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

Managed Investment Portfolio and Available-for-Sale Securities

Our managed investment portfolio consists of short-term investments, U.S. Government agency and corporate debt instruments. Fair values for investments in our managed investment portfolio and our available-for-sale securities are based upon valuations for identical instruments in active markets.

Auction Rate Securities

As of August 29, 2008, we held auction rate securities (ARS) totaling \$26.5 of par value for which the auction market remains effectively shut-down. We recorded unrealized losses of \$2.9 in previous quarters in *Accumulated other comprehensive income* on the Condensed Consolidated Balance Sheet, as we believe the impairment is temporary. During Q2 2009, we recorded an additional unrealized loss of \$0.5. We concluded no permanent impairment loss occurred as of the end of Q2 2009 as the decline in market value is due to general market conditions. We have the intent and ability to hold these securities until a recovery in market value occurs given our current liquidity and capital structure. We estimated the fair value of the ARS based on prices provided by the firm holding our investments, supported by our own analysis. Our estimates were based on assumptions we believe market participants would use in pricing the assets in a current transaction, which could change significantly over time based on market conditions.

Canadian Asset-Backed Commercial Paper

As of August 29, 2008, we held one investment in Canadian asset-backed commercial paper (ABCP) with an original cost of Canadian \$5.0. As a result of a lack of liquidity in the Canadian ABCP market, the ABCP did not settle on maturity and is considered to be in default. We recorded an impairment of our investment in Q4 2008 of \$0.9. A restructuring was effected in June 2008 which will result in the exchange of the ABCP currently held by investors for a variety of new long-term floating-rate notes. The restructuring is expected to close in October 2008. We expect the majority of our replacement notes to receive a AA credit rating by Dominion Bond Rating Service, the highest credit rating issued for Canadian commercial paper.

Using a discounted cash flow analysis, based on the types of securities we expect to receive from the restructuring plan, we evaluated our investment for impairment as of August 29, 2008. Our analysis concluded that no additional impairment was necessary.

Foreign Exchange Forward Contracts

From time to time, we enter into forward contracts to mitigate the risk of translation into U.S. dollars of certain foreign-denominated net income, assets and liabilities. We primarily hedge intercompany working capital loans and certain forecasted transactions. The fair value of foreign exchange forward contracts is based on a valuation model that discounts cash flows resulting from the differential between the contract price and the market-based forward rate.

Privately-Held Equity Investments

Privately-held equity investments are carried at the lower of cost or estimated fair value. For these non-quoted investments, we review the underlying performance of the privately-held companies to determine if potential declines in estimated fair value exist and are other than temporary.

Table of Contents**STEELCASE INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)**

Below is a roll-forward of assets and liabilities measured at fair value using Level 3 inputs for the six months ended August 29, 2008.

Rollforward of Fair Value Using Level 3 Inputs	Auction Rate Securities	Canadian Asset-Backed Commercial Paper	Privately- Held Equity Investments
Balance as of March 1, 2008	\$ 23.9	\$ 4.1	\$ 1.7
Reclassified to Level 1 available-for-sale securities			(1.3)
Unrealized loss on investments	(0.8)		(0.1)
Currency translation adjustment		(0.2)	
Balance as of August 29, 2008	\$ 23.1	\$ 3.9	\$ 0.3

7. INVENTORIES

Following is a summary of inventories as of August 29, 2008 and February 29, 2008:

Inventories	August 29, 2008	February 29, 2008
Finished goods	\$ 97.2	\$ 87.9
Work in process	21.8	20.9
Raw materials	73.9	67.5
	192.9	176.3
LIFO reserve	(33.9)	(29.6)
	\$ 159.0	\$ 146.7

The portion of inventories determined by the LIFO method aggregated \$59.8 as of August 29, 2008 and \$54.4 as of February 29, 2008.

8. EMPLOYEE BENEFIT PLAN OBLIGATIONS

Components of Expense	Three Months Ended			
	Pension Plans August 29, 2008	August 24, 2007	Post-Retirement Plans August 29, 2008	August 24, 2007

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Service cost	\$	0.5	\$	0.6	\$	0.2	\$	0.3
Interest cost		1.3		1.1		2.1		1.9
Amortization of prior year service gain						(1.8)		(1.8)
Expected return on plan assets		(0.9)		(0.9)				
Adjustment due to plan curtailment								(0.1)
Amortization of unrecognized net actuarial loss		0.1		0.1				
Net expense	\$	1.0	\$	0.9	\$	0.5	\$	0.3

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STEELCASE INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

Components of Expense	Six Months Ended			
	Pension Plans		Post-Retirement Plans	
	August 29, 2008	August 24, 2007	August 29, 2008	August 24, 2007
Service cost	\$ 1.0	\$ 1.1	\$ 0.5	\$ 0.6
Interest cost	2.6	2.3	4.1	3.8
Amortization of prior year service gain			(3.6)	(3.5)
Expected return on plan assets	(1.8)	(1.8)		
Adjustment due to plan curtailment				(0.5)
Amortization of unrecognized net actuarial loss	0.2	0.2		
Net expense	\$ 2.0	\$ 1.8	\$ 1.0	\$ 0.4

We expect to contribute approximately \$3 to our pension plans and \$12 to our post-retirement benefit plans during 2009. As of August 29, 2008, contributions of approximately \$1.6 and \$6.1 have been made to our pension and post-retirement plans, respectively.

We expect to receive approximately \$1.2 in Medicare Part D subsidy reimbursements during 2009. During the first two quarters of 2009, we received \$0.1 in Medicare Part D subsidy reimbursements.

9. PRODUCT WARRANTY

The accrued liability for warranty costs, included within *Accrued expenses: Other* on the Condensed Consolidated Balance Sheets, is based on an estimated amount needed to cover future warranty obligations for products sold as of the balance sheet date and is determined by historical product data and management's knowledge of current events and actions.

	Product Warranty	Amount
Balance as of February 29, 2008		\$ 21.6
Accruals for warranty charges		6.1
Settlements and adjustments		(7.8)
Balance as of August 29, 2008		\$ 19.9

10. REPORTABLE SEGMENTS

We operate within two reportable segments (North America and International), plus an *Other* category. Our *Other* category includes the Coalesse Group (formerly the Premium Group), PolyVision and IDEO subsidiaries.

Prior to Q1 2009, the Other category also included our Financial Services subsidiary. In recent years, we have significantly reduced the capital invested in, and related operations of, Financial Services. We now use third parties to provide lease funding to customers and have reduced the nature and level of financing services provided to our dealers. As a result, we integrated the remaining operations of Financial Services into the North America segment beginning in Q1 2009. Due to the change in the nature of the operations, we have not reclassified prior year financial results of Financial Services to North America; accordingly, the 2008 financial results remain in the Other category. Unallocated corporate expenses are reported as Corporate.

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STEELCASE INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

Revenue and operating income (loss) for the three and six months ended August 29, 2008 and August 24, 2007 and total assets as of August 29, 2008 and February 29, 2008 by segment are presented below:

	Three Months Ended		Six Months Ended	
	August 29,	August 24,	August 29,	August 24,
Reportable Segment Income Statement Data	2008	2007	2008	2007
Revenue				