GRAFTECH INTERNATIONAL LTD
Form 10-Q
November 07, 2006
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

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 September 30, 2006

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: 1-13888

GRAFTECH INTERNATIONAL LTD.

(Exact name of registrant as specified in its charter)

Delaware	**06-1385548**
(State or other jurisdiction of	**(I.R.S. Employer**
incorporation or organization)	**Identification Number)**

12900 Snow Road	
Parma, Ohio	**44130**
(Address of principal executive offices)	**(Zip code)**

Registrant s telephone number, including area code: (216) 676-2000

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 [ ]

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

Large Accelerated Filer [X]   Accelerated Filer [ ]   Non-Accelerated Filer [ ]
Indicate by check mark whether the registrant is a shell company (as defined in Exchange Act Rule 12b-2).

Yes [ ]   No [X]

As of October 31, 2006, 101,320,888 shares of common stock, par value $.01 per share, were outstanding.

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Item 1. Financial Statements

GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(Dollars in thousands, except share data)

(Unaudited)

	At December 31, 2005	At September 30, 2006
ASSETS		
Current assets:		
Cash and cash equivalents	$ 5,968	$ 18,710
Accounts and notes receivable, net of allowance for doubtful accounts of $3,132 at December 31, 2005 and $4,360 at September 30, 2006	184,580	144,357
Inventories	255,038	275,664
Prepaid expenses and other current assets	14,101	16,065
Total current assets	459,687	454,796
Property, plant and equipment	1,086,393	1,039,181
Less: accumulated depreciation	724,196	685,608
Net property, plant and equipment	362,197	353,573
Deferred income taxes	12,103	14,603
Goodwill	20,319	19,287
Other assets	32,514	31,451
Assets held for sale	-	1,807
Total assets	$ 886,820	$ 875,517
LIABILITIES AND STOCKHOLDERS' DEFICIT		
Current liabilities:		
Accounts payable	$ 73,363	$ 64,219
Interest payable	18,829	6,926
Short-term debt	405	603
Accrued income and other taxes	24,826	33,437
Other accrued liabilities	96,990	96,660
Total current liabilities	214,413	201,845
Long-term debt:		
Principal value	694,893	687,537
Fair value adjustments for hedge instruments	7,404	6,674
Unamortized bond premium	1,446	1,312
Total long-term debt	703,743	695,523
Other long-term obligations	107,704	89,259
Deferred income taxes	43,669	46,289
Minority stockholders' equity in consolidated entities	26,868	28,271
(see Contingencies - Note 13)		
Stockholders' deficit:		
Preferred stock, par value $.01, 10,000,000 shares authorized, none issued	-	-
Common stock, par value $.01, 150,000,000 shares authorized, 100,821,434 shares issued at December 31, 2005, 101,297,745 shares issued at September 30, 2006	1,023	1,023
Additional paid-in capital	944,581	948,498
Accumulated other comprehensive loss	(311,429)	(305,693)
Accumulated deficit	(751,487)	(737,445)
Less: cost of common stock held in treasury, 2,455,466 shares at December 31, 2005, 2,501,201 shares at September 30, 2006	(85,621)	(85,410)
Less: common stock held in employee benefit and compensation trusts, 518,301 shares at December 31, 2005, 472,566 shares at September 30, 2006	(6,644)	(6,643)

ASSETS	At December 31, 2005	At September 30, 2006
Total stockholders' deficit	(209,577)	(185,670)
Total liabilities and stockholders' deficit	$ 886,820	$ 875,517

See accompanying Notes to Consolidated Financial Statements

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GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

(Dollars in thousands, except per share data)

(Unaudited)

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2005	**2006**	**2005**	**2006**
Net sales	$ 208,195	$ 246,590	$ 639,437	$ 709,945
Cost of sales	149,993	175,748	475,319	516,936
Gross profit	58,202	70,842	164,118	193,009
Research and development	2,306	3,272	7,079	9,749
Selling and administrative	23,329	29,661	74,039	84,064
Other expense, net	1,706	4,056	13,911	4,458
Restructuring charges	-	1,871	451	7,694
Impairment loss on long-lived assets	-	-	-	8,788
Antitrust investigations and related lawsuits and claims	-	-	-	2,513
Interest expense	13,624	14,285	38,417	43,045
Interest income	$ (110)	$ (131)	$ (496)	$ (409)
	40,855	53,014	133,401	159,902
Income before provision for income taxes and minority stockholders' share of subsidiaries' income	17,347	17,828	30,717	33,107
Provision for income taxes	1,798	8,255	8,420	19,289
Minority stockholders' share of subsidiaries' income	(58)	(216)	(503)	(236)
Net income	$ 15,607	$ 9,789	$ 22,800	$ 14,054
Basic earnings per common share:				
Net income per share	$ 0.16	$ 0.10	$ 0.23	$ 0.14
Weighted average common shares outstanding (in thousands)	97,734	98,132	97,649	97,953
Diluted earnings per common share:				
Net income per share	$ 0.15	$ 0.09	$ 0.23	$ 0.14
Weighted average common shares outstanding (in thousands)	111,524	112,294	111,435	98,423

See accompanying Notes to Consolidated Financial Statements

PART I (CONT D)

GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in thousands)

(Unaudited)

	For the Nine Months Ended September 30, 2005	For the Nine Months Ended September 30, 2006
Cash flow from operating activities:		
Net income	$ 22,800	$ 14,054
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization	27,609	29,950
Deferred income taxes	5,191	3,683
Restructuring charges	451	7,694
Impairment loss on long-lived assets	-	8,788
Other charges, net	12,866	9,097
Increase in working capital*	(70,198)	(8,095)
Post retirement obligation changes	(10,869)	(10,693)
Long-term assets and liabilities	(7,878)	(9,884)
Net cash (used in) provided by operating activities	(20,028)	44,594
Cash flow from investing activities:		
Capital expenditures	(36,198)	(34,234)
Sale (purchase) of derivative instruments	1,796	(266)
Payments for patent costs	(566)	(695)
Proceeds from sale of assets	824	12,726
Termination of interest rate swaps	(8,691)	-
Net cash used in investing activities	(42,835)	(22,469)
Cash flow from financing activities:		
Short-term debt borrowings, net	1,065	-
Revolving Facility borrowings	122,490	449,269
Revolving Facility reductions	(72,152)	(458,989)
Financing costs	(4,767)	-
Net cash provided by (used in) financing activities	46,636	(9,720)
Net (decrease) increase in cash and cash equivalents	(16,227)	12,405
Effect of exchange rate changes on cash and cash equivalents	(1,445)	337

	For the Nine Months Ended September 30,	
Cash and cash equivalents at beginning of period	23,484	5,968
Cash and cash equivalents at end of period	$ 5,812	$ 18,710

*Net change in working capital due to the following components:

(Increase) decrease in current assets:		
Accounts and notes receivable	$ 21,760	$ 36,792
Effect of factoring on accounts receivable	4,587	8,883
Inventories	(41,879)	(13,483)
Prepaid expenses and other current assets	(1,021)	(1,818)
Payments for antitrust investigations and related lawsuits and claims	(12,400)	(17,671)
Restructuring payments	(4,746)	(9,472)
Increase (decrease) in accounts payable and accruals	(24,382)	577
Decrease in interest payable	(12,117)	(11,903)
Increase in working capital	$ (70,198)	$ (8,095)

See accompanying Notes to Consolidated Financial Statements

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GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(1) Interim Financial Presentation

These interim Consolidated Financial Statements are unaudited; however, in the opinion of management, they have been prepared in accordance with Rule 10-01 of Regulation S-X and reflect all adjustments (all of which are of a normal, recurring nature) which management considers necessary for a fair statement of financial position, results of operations and cash flows for the periods presented. These interim Consolidated Financial Statements should be read in conjunction with the audited Consolidated Financial Statements, including the accompanying Notes, contained in our Annual Report on Form 10-K for the year ended December 31, 2005 (the **Annual Report**). The year-end Consolidated Balance Sheet was derived from audited Consolidated Financial Statements, but does not include all disclosures required annually by accounting principles generally accepted in the United States of America.

We have revised our Consolidated Statements of Cash Flows to attribute payments made in connection with sales of interest rate swap derivatives as cash flows from investing activities. Previously, we reported these cash flows as part of cash flows from financing activities.

Certain amounts in the Consolidated Financial Statements for the three months and nine months ended September 30, 2005 and for the year ended December 31, 2005 have been reclassified to conform with current period presentation.

(2) New Accounting Standards

On November 24, 2004, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS") No. 151, *Inventory Costs - an amendment of APB No43*, Chapter 4, which is the result of its efforts to converge U.S. accounting standards for inventories with International Accounting Standards. SFAS No. 151 requires abnormal amounts of idle facility expense, freight, handling costs and wasted material (spoilage) to be recognized as current-period charges. It also requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. SFAS No. 151 is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. The adoption of SFAS No. 151 did not have a significant impact on our consolidated results of operations or financial position.

On November 10, 2005, the FASB Staff issued FASB Staff Position (FSP) No. SFAS 123(R)-3, *Transition Election Related to Accounting for the Tax Effects of Share-Based Payment Awards.* This FSP provides a practical transition election related to accounting for the tax effects of share-based payment awards to employees. SFAS No. 123(R), paragraph 81, indicates that, for purposes of calculating the pool of excess tax benefits available to absorb tax deficiencies recognized subsequent to the adoption of SFAS No. 123(R) (an APIC pool), an entity shall include the net excess tax benefits that would have qualified as such had the entity adopted SFAS No. 123 for recognition purposes. This FSP provides an elective alternative transition method. An entity may follow either the transition guidance for the APIC pool in paragraph 81 of SFAS No. 123(R) or the alternative transition method described in this

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

FSP. We may take up to one year from the initial adoption of SFAS No. 123(R) to evaluate our available transition alternatives and make our one-time election.

In May 2005, FASB issued SFAS No. 154, *Accounting Changes and Error Corrections, a replacement of APB Opinion No20 and FASB Statement No. 3,* which changes the requirements for the accounting for and reporting of a change in accounting principle. This Statement applies to all voluntary changes in accounting principle. It also applies to changes required by an accounting pronouncement in the unusual instance that the pronouncement does not include specific transition provisions. This Statement requires retrospective application to prior periods financial statements of changes in accounting principle, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. This Statement defines retrospective application as the application of a different accounting principle to prior accounting periods as if that principle had always been used or as the adjustment of previously issued financial statements to reflect a change in the reporting entity. This Statement also redefines restatement as the revising of previously issued financial statements to reflect the correction of an error. This Statement is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. We adopted this Statement effective January 1, 2006. The adoption of SFAS No. 154 did not have a significant impact on our consolidated results of operations or financial position.

In February 2006, the FASB issued SFAS No. 155, *Accounting for Certain Hybrid Financial Instruments an amendment of FASB Statements Nos. 133 and 140.* This Statement (1) permits fair value remeasurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation, (2) clarifies which interest-only strips and principal-only strips are not subject to the requirements of SFAS No. 133, (3) establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation and (4) clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives. SFAS No. 155 is effective for all financial instruments acquired or issued after the beginning of our first fiscal year that begins after September 15, 2006. The fair value election of SFAS No. 155 may also be applied upon adoption of SFAS No. 155 for hybrid financial instruments that had been bifurcated under paragraph 12 of SFAS No. 133, prior to the adoption of this Statement. We will be required to adopt SFAS No. 155 in the first quarter of 2007. We are currently in the process of assessing the impact of the adoption of SFAS No. 155 on our consolidated results of operations and financial position.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements.* This Statement defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. SFAS No. 157 requires disclosure of information that enables users of the financial statements to assess the inputs used to develop fair value measurements and, for recurring fair value measurements using significant unobservable inputs, the effects of the measurements on earnings for the period. This statement is effective for fiscal years beginning after November 15, 2007. We are currently in the process of assessing the

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impact of the adoption of SFAS No. 157 on our consolidated results of operations and financial position.

Also in September 2006, the FASB issued SFAS No. 158, *Employers Accounting For Defined Benefit Pension and Other Post Retirement Plans.* This Statement requires an employer to recognize the overfunded or underfunded status of a defined benefit postretirement plan as an asset or liability in its statement of financial position and to recognize changes in a funded status in the year in which the changes occur through comprehensive income of a business entity. This Statement is effective as of the end of the fiscal year ending after December 15, 2006. We are currently in the process of assessing the impact of the adoption of SFAS No. 158 on our consolidated results of operations and financial position.

If we were to record the effects of SFAS 158 using the results as of December 31, 2005, we would record a net liability of $5.3 million and a corresponding charge recorded to equity. However, based on economic developments over the year such as changes in the discount rate and rate of return on plan assets, these amounts may be different at the Company s December 31, 2006 measurement date.

In June 2006, the FASB issued Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109.* FIN 48 clarifies the recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. We are currently in the process of assessing the impact of the adoption of FIN 48 on our consolidated results of operations and financial position.

In September 2006, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin No. 108 (SAB 108). Due to diversity in practice among registrants, SAB 108 expresses SEC staff views regarding the process by which misstatements in financial statements are evaluated for purposes of determining whether financial statement restatement is necessary. SAB 108 is effective for fiscal years ending after November 15, 2006, and early application is encouraged. We are currently assessing the impact that SAB 108 will have on our financial position or results from operations.

(3) Stock-Based Compensation

We have historically maintained several stock incentive plans. The plans permitted options, restricted stock and other awards to be granted to employees and, in certain cases, also to non-employee directors. At December 31, 2005, the aggregate number of shares authorized under the plans since their initial adoption was 19,300,000.

Effective January 1, 2006, we adopted SFAS No. 123(R), which establishes accounting for stock-based awards exchanged for employee services, using the modified prospective transition method. Accordingly, stock-based compensation expense is measured at the grant

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GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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date, based on the fair market value of the award and recognized over the requisite service period. Also, in accordance with the modified prospective transition method, our condensed Consolidated Financial Statements for the periods prior to the first quarter of 2006 have not been restated to reflect this adoption.

Stock-Based Compensation under SFAS 123(R)

For the three and nine months ended September 30, 2006, we recognized $0.9 and $2.6 million, respectively, in stock-based compensation expense. A majority of the expense, $0.7 and $2.4 million, respectively, was recorded as selling and administrative in the Consolidated Statement of Operations, with the remaining expense included as cost of sales and research and development.

As of September 30, 2006, the total compensation expense related to non-vested restricted stock and stock options not yet recognized was $3.2 million which will be recognized over the weighted average life of 1.5 years.

Accounting for Stock-Based Compensation

Restricted Stock. The fair value of restricted stock is based on the trading price of our common stock on the date of grant, less required adjustments to reflect dividends paid and expected forfeitures or cancellations of awards throughout the vesting period, which ranges between one and three years. The weighted average grant date fair value of restricted stock was approximately $5.94 and $5.77 per share for the three months ended September 30, 2005 and 2006, respectively, and $5.28 and $6.79 per share for the nine months ended September 30, 2005 and 2006, respectively.

Restricted stock activity under the plans for the nine months ended September 30, 2006 was as follows:

	Number of Shares	Weighted-Average Grant Date Fair Value
Outstanding at January 1, 2006	1,315,229	$ 5.29
Granted	195,000	6.79
Vested	(257,996)	6.29
Forfeited	(195,345)	5.67
Outstanding at September 30, 2006	1,056,888	$ 6.41

For the nine months ended September 30, 2006, we granted 195,000 shares of restricted stock to certain directors, officers and employees at prices ranging from $4.71 to $7.82. Of these shares, 35,000 shares vest one year from the date of grant and 160,000 shares vest over a three-year period, with one-third of the shares vesting on the anniversary date of the grant in each of the next three years.

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GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES

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Stock Options. Our stock option compensation expense calculated under the fair value method is recognized over the weighted average remaining vesting period of 1.1 years. The weighted-average fair value of options granted was $4.33 and $7.34 for the nine months ended September 30, 2005. The fair values of options granted are estimated on the date of grant using the Black-Scholes option-pricing model. We did not issue stock option awards in the first nine months of 2006. The weighted average assumptions used in our Black-Scholes option-pricing model for awards issued during the nine months ended September 30, 2005 are as follows:

	For the Nine Months Ended September 30, 2005
Dividend yield	0.0%
Expected volatility	72.0%
Risk-free interest rate	4.0%
Expected term in years	7.5 years

Dividend Yield. We do not anticipate paying any cash dividends in the foreseeable future. Consequently, we use an expected dividend yield of zero.

Expected Volatility. We estimate the volatility of our common stock at the date of grant based on the historical volatility of our common stock. The volatility factor we use is based on our historical stock prices over the most recent period commensurate with the estimated expected life of the award.

Risk-Free Interest Rate. We base the risk-free interest rate used on the implied yield currently available on U.S. Treasury zero-coupon issues with an equivalent remaining term equal to the expected life of the award.

Expected Term In Years. The expected life of awards granted represents the period of time that they are expected to be outstanding. We determine the expected life based on historical experience with similar awards, giving consideration to the contractual terms, vesting schedules and pre-vesting and post-vesting forfeitures.

Stock options outstanding under our plans at September 30, 2006 are as follows:

	Options Outstanding (*Shares in thousands*)			Options Exercisable (*Shares in thousands*)	
Range of Exercise Prices	Number Outstanding	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Prices	Number Exercisable	Weighted-Average Exercise Prices
Time vesting options:					
$2.83 to $11.10	6,107	3 years	$ 7.53	5,984	$ 7.39

$11.60 to $19.06	2,233	2 years	16.62	2,224	16.66
$22.81 to $29.22	93	2 years	24.77	93	24.77
$30.59 to $40.44	784	1 year	33.48	784	33.48
	9,217		12.12	9,085	12.19
Performance vesting options:					
$7.60	242	1 year	$ 7.60	242	$ 7.60

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GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Options granted, exercised, canceled and expired under our plans are summarized as follows:

	Shares	Weighted-Average Exercise Prices	Weighted Average Remaining Contractual Life	Aggregate Intrinsic Value
	(Shares in thousands)			
Time vesting options:				
Outstanding at January 1, 2006	10,583	$ 13.28		
Granted at market price				
Exercised				
Forfeited/canceled	(592)	34.82		
Expired	(774)	10.45		
Outstanding at September 30, 2006	9,217	12.12	2.5 years	$ 137
Options exercisable at September 30, 2006	9,085	12.19	2.8 years	128
Weighted-average fair value of options granted during nine months ended September 30, 2006 at market				
Performance vesting options:				
Outstanding at January 1, 2006	242	$ 7.60		
Granted				
Exercised				
Forfeited/canceled				
Outstanding at September 30, 2006	242	7.60	1 year	
Exercisable at September 30, 2006	242	7.60	1 year	

Pro Forma Information

Previously, we applied APB Opinion No. 25 and related Interpretations, as permitted by SFAS No. 123. Compensation expense associated with our restricted stock and stock options granted to non-employees was recorded in the Consolidated Statements of Operations and in the stockholders deficit section of the Consolidated Balance Sheets based on the fair market value. However, no compensation expense was recognized for our time vesting options granted. If compensation expense for each of our stock-based compensation plans was determined by the fair value method prescribed by SFAS No. 123, our net income (loss) and net income (loss) per share would have been reduced to the pro forma amounts indicated below:

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GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

	For the Three Months Ended September 30, 2005	For the Nine Months Ended September 30, 2005
	(Dollars in thousands, except per share data)	
Net income as reported	$ 15,607	$ 22,800
Add: Total stock-based employee compensation expense, net of related tax effects included in the determination of net income as reported	526	751
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(972)	(2,193)
Pro forma net income	$ 15,161	$ 21,358
Earnings per share:		
Basic as reported	$ 0.16	$ 0.23
Basic pro forma	0.16	0.22
Diluted as reported	0.14	0.20
Diluted pro forma	0.14	0.19

(4) Earnings Per Share

Basic and diluted EPS are calculated based upon the provisions of SFAS No. 128, *Earnings Per Share*, and EITF No. 04-08, *Accounting Issues Related to Certain Features of Contingently Convertible Debt and the Effects on Diluted Earnings Per Share*, using the following data:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2005	2006	2005	2006
	(Dollars in thousands)			
Net income, as reported	$ 15,607	$ 9,789	$ 22,800	$ 14,054
Add: Interest on Debentures, net of tax benefit	694	600	2,078	-
Add: Amortization of Debentures issuance costs, net of tax benefit	266	175	802	-
Net income, as adjusted	$ 16,567	$ 10,564	$ 25,680	$ 14,054
Weighted average common shares outstanding for basic calculation	97,733,816	98,132,267	97,648,692	97,952,636

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
Add: Effect of stock options and restricted stock	219,524	590,868	215,427	470,218
Add: Effect of Debentures	13,570,560	13,570,560	13,570,560	-
Weighted average common shares outstanding for diluted calculation	111,523,900	112,293,695	111,434,679	98,422,854

Basic earnings per common share are calculated by dividing net income by the weighted average number of common shares outstanding. Diluted earnings per share are calculated by dividing net income by the sum of the weighted average number of common shares outstanding plus the additional common shares that would have been outstanding if potentially dilutive securities, including those underlying the Debentures, had been issued.

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GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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The calculation of weighted average common shares outstanding for the diluted calculation excludes consideration of stock options covering 3,616,367 and 9,259,629 shares in the third quarter of 2005 and 2006, respectively, and 9,538,959 and 9,264,346 shares in the nine months ended September 30, 2005 and 2006, respectively, because the exercise of these options would not have been dilutive for those periods due to the fact that the exercise prices were greater than the weighted average market price of our common stock for each of those periods.

The calculation of weighted average common shares outstanding for the diluted calculation also excludes the 13,570,560 shares underlying the debentures for the nine months ended September 30, 2006, as the effect would have been anti-dilutive.

(5) Segment Reporting

Our businesses are reported in the following reportable segments: synthetic graphite, which consists of graphite electrodes, advanced graphite materials, and cathodes and related services, and other, which consists of natural graphite, carbon electrodes and refractories and related services.

We evaluate the performance of our operating segments based on gross profit. Intersegment sales and transfers are not material. The accounting policies of the reportable segments are the same as those for our Consolidated Financial Statements as a whole.

The following tables summarize financial information concerning our reportable segments.

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2005	**2006**	**2005**	**2006**
	(Dollars in thousands)			
Net sales to external customers:				
Synthetic Graphite	$ 183,537	$ 227,678	$ 561,736	$ 645,655
Other	24,658	18,912	77,701	64,290
Net sales	$ 208,195	$ 246,590	$ 639,437	$ 709,945
Gross profit:				
Synthetic Graphite	$ 51,839	$ 67,309	$ 146,802	$ 188,033
Other	6,363	3,533	17,316	4,976
Gross profit	$ 58,202	$ 70,842	$ 164,118	$ 193,009
Reconciliation of gross profit to income before provision for income taxes and minority stockholders' share of income:				
Gross profit	$ 58,202	$ 70,842	$ 164,118	$ 193,009
Research and development	2,306	3,272	7,079	9,749
Selling and administrative	23,329	29,661	74,039	84,064
Other expense, net	1,706	4,056	13,911	4,458
Restructuring charges	-	1,871	451	7,694
Impairment loss on long-lived assets	-	-	-	8,788
Antitrust investigations and related lawsuits and claims	-	-	-	2,513

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
Interest expense	13,624	14,285	38,417	43,045
Interest income	(110)	(131)	(496)	(409)
Income before provision for income taxes and minority stockholders' share of loss	$ 17,347	$ 17,828	$ 30,717	$ 33,107

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GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(6) Restructuring Charges and Impairment Losses

At September 30, 2006, the outstanding balance of our restructuring reserve was $10.6 million. The components of the balance at September 30, 2006 consisted primarily of:

Synthetic Graphite Segment:

- $5.3 million related to the rationalization of our synthetic graphite facilities, including those in Brazil and France, and the closure of our facility in Russia.
- $3.3 million related to the closure of our graphite electrode manufacturing operations in Caserta, Italy.
- $0.7 million related to the closure of our graphite electrode machining and warehousing operations in Clarksville, Tennessee.

Other Segment and Corporate:

- $0.5 million related primarily to remaining lease payments on our former corporate headquarters.
- $0.8 million related to the shutdown of our carbon electrode production operations at our Columbia, Tennessee facility.

For the three and nine months ended September 30, 2006, we recorded net restructuring charges of $1.9 and $7.7 million, respectively. A majority of the net charges for the three and nine months ended September 30, 2006 were comprised of the following:

- $0.8 and $2.9 million, respectively, for severance and related costs related to rationalization at our synthetic graphite facility in France and Russia.
- $0.2 and $1.6 million, respectively, for severance and other closure costs associated with our former corporate headquarters.
- $0.4 and $2.1 million, respectively, for severance and costs related to the shutdown of our carbon electrode production operations at our Columbia, Tennessee facility.
- $0.3 and $0.9 million, respectively, for severance and costs related to the closure of our graphite electrode manufacturing operations in Caserta, Italy.

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GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES

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The following table summarizes activity relating to the restructuring liability at September 30, 2006.

	Severance and Related Costs	Plant Shutdown and Related Costs	Total
		(Dollars in thousands)	
Balance at January 1, 2006	$ 10,733	$ 794	$ 11,527
Restructuring charges	5,658	1,593	7,251
Change in estimates	443	-	443
Payments and settlements	(7,980)	(1,492)	(9,472)
Currency adjustments	826	6	832
Balance at September 30, 2006	$ 9,680	$ 901	$ 10,581

In the first quarter of 2006, we abandoned long-lived fixed assets associated with costs capitalized for our enterprise resource planning system implementations due to an indefinite delay in the implementation of the remaining facilities. As a result, we recorded a $6.6 million loss, including the write off of capitalized interest, in accordance with SFAS No. 144, *Accounting For the Impairment and Disposal of Long-Lived Assets.*

Also, in the first quarter of 2006, we announced our intention to sell certain long-lived assets from our Etoy, Switzerland and Caserta, Italy facilities. As a result, we have classified these assets as held for sale in the Consolidated Balance Sheet in accordance with SFAS No. 144. We recorded a $1.4 million impairment loss to adjust the carrying value of the assets in Switzerland to the estimated fair value less estimated selling costs. In the third quarter of 2006, we sold the long-lived assets at our Etoy, Switzerland facility for $7.1 million.

In the second quarter of 2006, we abandoned certain long-lived fixed assets associated with the accelerated closing of our carbon electrode facility in Columbia, Tennessee due to changes in our initial plan of restructuring the facility. As a result, we recorded a $0.6 million impairment loss in accordance with SFAS No. 144. Also in the second quarter, management established a plan to sell certain long-lived assets in Vyazma, Russia. We have classified these assets as held for sale in the Consolidated Balance Sheet in accordance with SFAS No. 144.

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GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(7) Other (Income) Expense, Net

The following table presents an analysis of other (income) expense, net:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2005	2006	2005	2006
	(Dollars in thousands)			
Currency (gains) losses	$ (181)	$ 3,449	$ 12,274	$ (778)
Brazil sales tax provision	-	-	-	(1,465)
Fair value adjustment on interest rate caps	(54)	-	521	-
Fair value adjustment on Debenture redemption make-whole option	913	-	(2,846)	-
Legal, environmental and other related costs	1,602	1,850	2,543	4,652
Loss (gain) on sale of fixed assets	(37)	(2,848)	(680)	(2,630)
Gain on sale of foreign exchange contracts	-	-	(1,268)	-
Bank and other financing fees	601	646	1,730	1,681
Write-off of capitalized bank fees	-	-	1,514	-
Relocation costs	343	567	750	1,976
Loss on sale of accounts receivable	30	140	30	545
Other	(1,511)	252	(657)	477
Total other expense, net	$ 1,706	$ 4,056	$ 13,911	$ 4,458

We have non-dollar-denominated intercompany loans between GrafTech Finance and some of our foreign subsidiaries. At December 31, 2005 and September 30, 2006, the aggregate principal amount of these loans was $414.6 million and $429.5 million, respectively. These loans are subject to remeasurement gains and losses due to changes in currency exchange rates. A portion of these loans are deemed to be essentially permanent and, as a result, remeasurement gains and losses on these loans are recorded as a component of accumulated other comprehensive loss in the stockholders deficit section of the Consolidated Balance Sheets. The balance of these loans is deemed to be temporary and, as a result, remeasurement gains and losses on these loans are recorded as currency (gains) losses in other income (expense), net, on the Consolidated Statements of Operations. In the nine months ended September 30, 2005, we had a net total of $12.3 million of currency losses, including $12.0 million of exchange losses due to the remeasurement of intercompany loans and translation of financial statements of foreign subsidiaries which use the dollar as their functional currency. In the nine months ended September 30, 2006, we had a net total of $0.8 million of currency gains, including $1.0 million of exchange gains due to the remeasurement of intercompany loans and translation of financial statements of foreign subsidiaries which use the dollar as their functional currency.

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GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(8) Benefit Plans

The components of our consolidated net pension and postretirement costs (benefits) are set forth in the following tables:

	Pension Benefits			
	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2005	2006	2005	2006
	(Dollars in thousands)			
Service cost	$ 272	$ 298	$ 993	$ 885
Interest cost	2,508	2,852	7,607	8,585
Expected return on plan assets	(2,642)	(2,966)	(8,243)	(8,913)
Amortization of transition obligation	(2)	(19)	(4)	(66)
Amortization of prior service cost	62	20	197	67
Amortization of unrecognized loss	323	698	924	2,113
Settlement loss	443	-	443	-
Cost for special termination benefits	-	-	279	-
Employee contributions	-	-	(94)	-
Net Cost	$ 964	$ 883	$ 2,102	$ 2,671

	Postretirement Benefits			
	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2005	2006	2005	2006
	(Dollars in thousands)			
Service cost	$ 62	$ 93	$ 209	$ 296
Interest cost	507	488	1,582	1,492
Amortization of prior service benefit	(5,453)	(5,278)	(16,392)	(15,835)
Amortization of unrecognized loss	1,290	1,333	3,901	3,997
Cost for special termination benefits	(57)	-	(180)	-
Net Cost	$ (3,651)	$ (3,364)	$ (10,880)	$ (10,050)

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GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(9) Long-Term Debt and Liquidity

The following table presents our long-term debt:

	At December 31, 2005	At September 30, 2006
	(Dollars in thousands)	
Revolving facility	$ 39,000	$ 30,000
Senior Notes:		
Senior Notes due 2012	434,631	434,631
Fair value adjustments for terminated hedge instruments*	7,404	6,674
Unamortized bond premium	1,446	1,312
Total Senior Notes	443,481	442,617
Debentures**	220,291	222,067
Other debt	971	839
Total	$ 703,743	$ 695,523

* Fair value adjustments for terminated hedge instruments will be amortized as a credit to interest expense over the remaining term of the Senior Notes.

** At December 31, 2005, the balance excludes the derivative liability relating to our debenture redemption feature with a make-whole provision, which amounts to $1.3 million. As of January 1, 2006, this derivative liability no longer requires separate accounting from the convertible debenture under Derivative Implementation Group Issue No. B39, *Embedded Derivatives: Application of Paragraph 13(b) to call options that are exercisable only by the debtor*.

(10) Inventories

Inventories are comprised of the following:

	At December 31, 2005	At September 30, 2006
	(Dollars in thousands)	
Raw material and supplies	$ 74,650	$ 75,110
Work in process	150,816	151,102
Finished goods	29,572	49,452
Total Inventories	$ 255,038	$ 275,664

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GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(11) Interest Expense

The following table presents an analysis of interest expense:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2005	2006	2005	2006
	(Dollars in thousands)			
Interest incurred on debt	$ 13,035	$ 13,480	$ 37,860	$ 40,237
Interest rate swap benefit	(310)	-	(2,042)	-
Amortization of fair value adjustments for terminated hedge instruments	(413)	(248)	(1,448)	(730)
Amortization of premium on Senior Notes	(41)	(45)	(120)	(132)
Amortization of discount on Debentures	222	165	663	489
Interest on DOJ antitrust fine	120	66	404	196
Amortization of debt issuance costs	881	930	2,673	2,764
Interest incurred on other items	130	(63)	427	221
Interest expense	$ 13,624	$ 14,285	$ 38,417	$ 43,045

(12) Comprehensive Income

Comprehensive income, net of tax, consists of the following:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2005	2006	2005	2006
	(Dollars in thousands)			
Net income	$ 15,607	$ 9,789	$ 22,800	$ 14,054
Other comprehensive income:				

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
Foreign currency translation adjustments, net of tax	7,289	(2,197)	(12,189)	5,705
Total comprehensive income	$ 22,896	$ 7,592	$ 10,611	$ 19,759

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GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(13) Contingencies

Antitrust Investigations

In 1997, the DOJ and the EU Competition Authority commenced investigations into alleged violations of the antitrust laws in connection with the sale of graphite electrodes. The antitrust authorities in Canada, Japan and Korea subsequently began similar investigations. The EU Competition Authority also commenced an investigation into alleged antitrust violations in connection with the sale of specialty graphite. These antitrust investigations have been resolved. Several of the investigations resulted in the imposition of fines against us. These fines, or payments in accordance with a payment schedule in the case of the DOJ antitrust fine, have been timely paid. At December 31, 2005 and September 30, 2006, $26.0 million and $10.8 million remained in the reserve for liabilities and expenses in connection with these antitrust investigations and related lawsuits and claims, respectively. The reserve is unfunded and represents the remaining DOJ antitrust fine obligation with quarterly payments scheduled through January 2007.

Between 1999 and March 2002, we and other producers of graphite electrodes were served with four complaints commencing separate civil antitrust lawsuits in the United States District Court for the Eastern District of Pennsylvania. These lawsuits are called the **foreign customer lawsuits**. By agreement dated as of June 21, 2006, all defendants agreed to settle the lawsuit titled *Arbed, S.A., et al. v. Mitsubishi Corporation, et al.* In addition, definitive agreements were executed settling the three remaining foreign customer lawsuits titled, *Ferromin International Trade Corporation, et al. v. UCAR International Inc., et al.*, *BHP New Zealand Ltd. et al. v. UCAR International Inc., et al.* and *Saudi Iron and Steel Company v. UCAR International Inc., et al*. In the second quarter of 2006, we recorded a $2.5 million charge for these settlements. In the 2006 third quarter, we made all payments related to the settlements.

Through September 30, 2006, we will have settled or obtained dismissal of all of the civil antitrust lawsuits (including class action lawsuits) previously pending against us, certain civil antitrust lawsuits threatened against us and certain possible civil antitrust claims against us arising out of alleged antitrust violations occurring prior to the date of the relevant settlements in connection with the sale of graphite electrodes, carbon electrodes and bulk graphite products. All payments due have been timely paid.

It is possible that additional antitrust investigations, lawsuits or claims could be commenced or asserted against us in the U.S. and in other jurisdictions. We are currently not reserved for any new potential matters.

Environmental Matters

In the second quarter of 2006, we increased our reserve for environmentally related activities to be performed in connection with the closure and proposed sale of our Caserta, Italy facility by $1.6 million. The increase in the reserve relates primarily to activities for closing the on-site solid waste landfill earlier than originally anticipated.

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GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES

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(Unaudited)

Other Matters and Proceedings Against Us

We are involved in various other investigations, lawsuits, claims, demands, environmental compliance programs, and other legal proceedings arising out of or incidental to the conduct of our business. While it is not possible to determine the ultimate disposition of each of these matters and proceedings, we do not believe that their ultimate disposition will have a material adverse effect on our financial position, results of operations or cash flows.

Product Warranties

We generally sell products with a limited warranty. We accrue for known warranty claims if a loss is probable and can be reasonably estimated. The following table presents the activity in this accrual for the nine months ended September 30, 2006 (dollars in thousands):

Balance at December 31, 2005	$	610
Product warranty charges		1,460
Payments and settlements		(1,168)
Balance at September 30, 2006	$	902

(14) Financial Information About the Issuers and Guarantors of Our Debt Securities and Subsidiaries Whose Securities Secure the Senior Notes and Related Guarantees

On February 15, 2002, GrafTech Finance (**Finco**), a direct subsidiary of GTI (the **Parent**), issued $400 million aggregate principal amount of Senior Notes and, on May 6, 2002, $150 million aggregate principal amount of additional Senior Notes. All of the Senior Notes have been issued under a single Indenture and constitute a single class of debt securities. The Senior Notes mature on February 15, 2012. The Senior Notes have been guaranteed on a senior basis by the Parent and the following wholly-owned direct and indirect subsidiaries of the Parent: GrafTech Global, UCAR Carbon, UCAR International Trading Inc., and UCAR Carbon Technology LLC. The Parent, Finco and these subsidiaries together hold a substantial majority of our U.S. assets.

On January 22, 2004, the Parent issued $225 million aggregate principal amount of Debentures. The guarantors of the Debentures are the same as the guarantors of the Senior Notes, except for Parent (which is the issuer of the Debentures but a guarantor of the Senior Notes) and Finco (which is a guarantor of the Debentures but the issuer of the Senior Notes). The Parent and Finco are both obligors on the Senior Notes and the Debentures, although in different capacities.

The guarantors of the Senior Notes and the Debentures, solely in their respective capacities as such, are collectively called the **U.S. Guarantors**. Our other subsidiaries, which are not guarantors of either the Senior Notes or the Debentures, are called the **Non-Guarantors**.

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GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES

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All of the guarantees are unsecured, except that the guarantee of the Senior Notes by UCAR Carbon has been secured by a junior pledge of all of the shares of capital stock (constituting 97.5% of the outstanding shares of capital stock) of AET held by UCAR Carbon (called the **AET Pledged Stock**), subject to the limitation that in no event will the value of the pledged portion of the AET Pledged Stock exceed 19.99% of the principal amount of the then outstanding Senior Notes. All of the guarantees are full, unconditional and joint and several. Finco and each of the other U.S. Guarantors (other than the Parent) are 100% owned, directly or indirectly, by the Parent. All of the guarantees of the Senior Notes continue until the Senior Notes have been paid in full, and payment under such guarantees could be required immediately upon the occurrence of an event of default under the Senior Notes. All of the guarantees of the Debentures continue until the Debentures have been paid in full, and payment under such guarantees could be required immediately upon the occurrence of an event of default under the Debentures. If a guarantor makes a payment under its guarantee of the Senior Notes or the Debentures, it would have the right under certain circumstances to seek contribution from the other guarantors of the Senior Notes or the Debentures, respectively.

Provisions in the Revolving Facility restrict the payment of dividends by our subsidiaries to the Parent. At September 30, 2006, retained earnings of our subsidiaries subject to such restrictions were approximately $806.9 million. Investments in subsidiaries are recorded on the equity basis.

The following table sets forth condensed consolidating balance sheets at December 31, 2005 and September 30, 2006, condensed consolidating statements of operations for the three and nine months ended September 30, 2005, and three and nine months ended September 30, 2006, as well as condensed consolidating statements of cash flows for the nine months ended September 30, 2005 and 2006 of the Parent, Finco, all other U.S. Guarantors and the Non-Guarantors.

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GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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Condensed Consolidating Balance Sheet

at December 31, 2005

	Parent (Issuer of Debentures and Guarantor of Senior Notes)	Finco (Issuer of Senior Notes and Guarantor of Debentures)	All Other U.S. Guarantors	Non-Guarantors	Consolidation/ Eliminations	Consolidated
			(Dollars in thousands)			
ASSETS						
Current assets:						
Cash and cash equivalents	$ 143	$ -	$ 36	$ 5,877	$ (88)	$ 5,968
Intercompany loans	51,315	166,292	-	108,716	(326,323)	-
Intercompany accounts receivable	-	2,676	27,689	31,079	(61,444)	-
Accounts receivable - third party	-	-	36,569	148,011	-	184,580
Accounts and notes receivable, net	51,315	168,968	64,258	287,806	(387,767)	184,580
Inventories	-	-	59,975	195,108	(45)	255,038
Prepaid expenses and other current assets	7	16,431	1,793	12,287	(16,417)	14,101
Total current assets	51,465	185,399	126,062	501,078	(404,317)	459,687
Property, plant and equipment, net	-	-	46,586	320,096	(4,485)	362,197
Deferred income taxes	-	-	8,980	4,067	(944)	12,103
Intercompany loans	-	506,887	-	-	(506,887)	-
Goodwill	-	-	-	20,319	-	20,319
Other assets	5,359	16,860	3,426	6,869	-	32,514
Total assets	$ 56,824	$ 709,146	$ 185,054	$ 852,429	$ (916,633)	$ 886,820
LIABILITIES AND STOCKHOLDERS EQUITY (DEFICIT)						
Current liabilities:						
Accounts payable	$ 161	$ 88	$ 12,392	$ 60,810	$ (88)	$ 73,363
Interest payable	1,675	17,154	-	-	-	18,829
Intercompany loans	-	109,284	217,009	61,655	(387,948)	-
Third party loans	-	-	-	405	-	405
Short-term debt	-	109,284	217,009	62,060	(387,948)	405
Accrued income and other taxes	1,939	-	20,963	18,341	(16,417)	24,826

	Parent (Issuer of Debentures and Guarantor of Senior Notes)	Finco (Issuer of Senior Notes and Guarantor of Debentures)	All Other U.S. Guarantors	Non-Guarantors	Consolidation/ Eliminations	Consolidated
Other accrued liabilities	-	-	34,644	62,346	-	96,990
Total current liabilities	3,775	126,526	285,008	203,557	(404,453)	214,413
Long-term debt	220,290	482,481	-	972	-	703,743
Intercompany loans	-	-	-	506,903	(506,903)	-
Other long-term obligations	1,284	37	59,051	47,332	-	107,704
Payable to equity of investees	41,045	-	(526,601)	-	485,556	-
Deferred income taxes	7	-	-	44,606	(944)	43,669
Commitments and Contingencies	-	-	-	-	-	-
Minority stockholders equity in consolidated entities	-	-	-	26,868	-	26,868
Stockholders equity (deficit)	(209,577)	100,102	367,596	22,191	(489,889)	(209,577)
Total liabilities and stockholders deficit	$ 56,824	$ 709,146	$ 185,054	$ 852,429	$ (916,633)	$ 886,820

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GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES

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Condensed Consolidating Balance Sheet

at September 30, 2006

	Parent (Issuer of Debentures and Guarantor of Senior Notes)	Finco (Issuer of Senior Notes and Guarantor of Debentures)	All Other U.S. Guarantors	Non-Guarantors	Consolidation/ Eliminations	Consolidated
			(Dollars in thousands)			
ASSETS						
Current assets:						
Cash and cash equivalents	$ 155	$ 9,416	$	$ 9,268	$ (129)	$ 18,710
Intercompany loans	51,734	212,868		207,164	(471,766)	
Intercompany accounts receivable		16,121	37,664	35,026	(88,811)	
Accounts receivable - third party			22,311	122,046		144,357
Accounts and notes receivable, net	51,734	228,989	59,975	364,236	(560,577)	144,357
Inventories			62,730	212,933	1	275,664
Prepaid expenses and other current assets		16,469	10	16,004	(16,418)	16,065
Total current assets	51,889	254,874	122,715	602,441	(577,123)	454,796
Property, plant and equipment			42,756	315,486	(4,669)	353,573
Deferred income taxes			7,621	14,256	(7,274)	14,603
Intercompany loans		521,729	(1)		(521,728)	
Goodwill				19,287		19,287
Other assets	4,556	14,898	2,493	9,504		31,451
Assets held for sale				1,807		1,807
Total assets	$ 56,445	$ 791,501	$			