

GRAFTECH INTERNATIONAL LTD

Form 10-Q

May 01, 2008

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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 10-Q**

(Mark One)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
for the quarterly period ended March 31, 2008

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)

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**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**06-1385548**  
(I.R.S. Employer  
Identification Number)

**12900 Snow Road**

**Parma, OH**  
(Address of principal executive offices)

**44130**  
(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  No

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.

Large Accelerated Filer  Accelerated Filer  Non-Accelerated Filer  Smaller Reporting Company

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

As of April 25, 2008, 103,215,991 shares of common stock, par value \$.01 per share, were outstanding.

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**Table of Contents****PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS***(Dollars in thousands, except share data)**(Unaudited)*

	<b>At December 31, 2007</b>	<b>At March 31, 2008</b>
<b>Current Assets:</b>		
Cash and cash equivalents	\$ 54,741	\$ 6,974
Accounts and notes receivable, net of allowance for doubtful accounts of \$2,971 at December 31, 2007 and \$1,912 at March 31, 2008	158,486	158,450
Inventories	285,433	289,420
Prepaid expenses and other current assets	10,133	8,929
<b>Total current assets</b>	<b>508,793</b>	<b>463,773</b>
Property, plant and equipment	881,067	900,285
Less: accumulated depreciation	564,613	577,466
<b>Net property, plant and equipment</b>	<b>316,454</b>	<b>322,819</b>
Deferred income taxes	7,144	6,301
Goodwill	9,683	8,245
Other assets	23,080	21,047
Restricted cash	1,547	1,723
<b>Total assets</b>	<b>\$ 866,701</b>	<b>\$ 823,908</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
<b>Current liabilities:</b>		
Accounts payable	\$ 58,975	\$ 64,565
Interest payable	9,633	1,983
Short-term debt	1,014	17,293
Accrued income and other taxes	29,996	40,009
Other accrued liabilities	104,066	92,423
<b>Total current liabilities</b>	<b>203,684</b>	<b>216,273</b>
<b>Long-term debt:</b>		
Principal value	423,234	302,584
Fair value adjustments for hedge instruments	2,421	861
Unamortized bond premium	481	171
<b>Total long-term debt</b>	<b>426,136</b>	<b>303,616</b>

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Other long-term obligations	94,010	95,047
Deferred income taxes	30,171	30,715
<i>(see Contingencies Note 14)</i>		
Stockholders' equity:		
Preferred stock, par value \$.01, 10,000,000 shares authorized, none issued		
Common stock, par value \$.01, 150,000,000 shares authorized, 105,169,507 shares issued at December 31, 2007 and 105,431,902 shares issued at March 31, 2008	1,052	1,054
Additional paid-in capital	988,662	991,489
Accumulated other comprehensive loss	(278,316)	(253,233)
Accumulated deficit	(506,666)	(468,018)
Less: cost of common stock held in treasury, 2,501,201 shares at December 31, 2007 and 2,992,551 shares at March 31, 2008	(85,197)	(92,426)
Less: common stock held in employee benefit and compensation trusts, 471,373 shares at December 31, 2007 and 42,419 shares at March 31, 2008.	(6,835)	(609)
Total stockholders' equity	112,700	178,257
Total liabilities and stockholders' equity	\$ 866,701	\$ 823,908

*See accompanying Notes to Consolidated Financial Statements*

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## PART I (CONT D)

## GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF OPERATIONS

*(Dollars in thousands, except per share data)**(Unaudited)*

	<b>For the</b>	
	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2007</b>	<b>2008</b>
Net sales	\$ 228,231	\$ 290,002
Cost of sales	152,943	181,901
Gross profit	75,288	108,101
Research and development	2,234	2,265
Selling and administrative expenses	22,394	22,591
Restructuring charges	884	152
Operating income	49,776	83,093
Other expense, net	10,024	21,035
Interest expense	11,711	5,686
Interest income	(966)	(372)
Income from continuing operations before provision for income taxes and minority stockholders' share of subsidiaries income	29,007	56,744
Provision for income taxes	10,530	18,096
Income from continuing operations before minority interest	18,477	38,648
Minority stockholders' share of subsidiaries' income	33	
Income from continuing operations	18,444	38,648
Loss from discontinued operations, net of tax	(3,117)	
Net income	\$ 15,327	\$ 38,648
<b>Basic income (loss) per common share:</b>		
Income per share from continuing operations	\$ 0.19	\$ 0.38
Loss per share from discontinued operations	(0.03)	
Net income per share	\$ 0.16	\$ 0.38
Weighted average common shares outstanding	98,624	102,274
<b>Diluted income (loss) per common share:</b>		
Income per share from continuing operations	\$ 0.18	\$ 0.34

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Loss per share from discontinued operations	(0.03)		
Net income per share	\$ 0.15	\$ 0.34	
Weighted average common shares outstanding	113,606	117,599	

*See accompanying Notes to Consolidated Financial Statements*

**Table of Contents****PART I (CONT D)****GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS***(Dollars in thousands)**(Unaudited)*

	<b>For the Three Months Ended March 31,</b>	
	<b>2007</b>	<b>2008</b>
<b>Cash flow from operating activities:</b>		
Net income	\$ 15,327	\$ 38,648
<b>Adjustments to reconcile net income to net cash used in operating activities:</b>		
Loss from discontinued operations, net of tax	3,117	
Depreciation and amortization	7,874	8,558
Deferred income taxes	1,028	887
Restructuring charges	884	152
Currency losses	1,113	16,235
Stock based compensation	1,265	1,161
Interest expense	1,082	1,070
Other charges, net	1,580	3,967
(Increase) decrease in working capital *	(11,589)	(5,754)
(Increase) decrease in long-term assets and liabilities	(3,657)	2,223
 Net cash provided by operating activities	 18,024	 67,147
 <b>Cash flow from investing activities:</b>		
Capital expenditures	(7,671)	(9,389)
Patent capitalization	(236)	
Proceeds from derivative instruments		224
Proceeds from sale of assets	136	51
Increase in restricted cash		(176)
 Net cash used in investing activities	 (7,771)	 (9,290)
 <b>Cash flow from financing activities:</b>		
Short-term debt borrowings, net	158	15,887
Revolving Facility borrowings	45,645	70,625
Revolving Facility reductions	(45,052)	(66,677)
Long term debt reductions	(134,867)	(124,663)
Excess tax benefit from stock-based compensation		53
Purchase of treasury shares		(1,003)
Proceeds from exercise of stock options	1,374	167
 Net cash used in financing activities	 (132,742)	 (105,611)



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Net decrease in cash and cash equivalents	(122,489)	(47,754)
Effect of exchange rate changes on cash and cash equivalents	(295)	(13)
Cash and cash equivalents at beginning of period	149,517	54,741
Cash and cash equivalents at end of period	\$ 26,733	\$ 6,974

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

(Increase) decrease in current assets:

Accounts and notes receivable	\$ (646)	\$ (25,953)
Effect of factoring on accounts receivable	10,814	30,618
Inventories	(817)	3,493
Prepaid expenses and other current assets	1,296	884
Payments for antitrust investigations and related lawsuits and claims	(5,380)	
Increase (decrease) in accounts payable and accruals	427	(7,013)
Decrease in interest payable	(13,722)	(7,650)
Restructuring payments	(3,561)	(133)
(Increase) decrease in working capital	\$ (11,589)	\$ (5,754)

*See accompanying Notes to Consolidated Financial Statements*

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**PART I (CONT D)**

**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, 2007 (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.

Certain amounts in the Consolidated Financial Statements for the three months ended March 31, 2007 have been reclassified to conform with the current period presentation.

As previously disclosed in our second quarter 2007 Form 10-Q, we identified and corrected an error in the 2007 second quarter for expenses associated with final price adjustments relating to the sale of our former cathodes business in 2006. By correcting the error in the 2007 second quarter, we understated income from discontinued operations in the 2007 second quarter by \$2.5 million and overstated income from discontinued operations by \$2.5 million in the 2007 first quarter. We determined that this adjustment was not material to our consolidated financial statements for any of the periods affected; therefore, no revisions were made to the 2007 quarterly financial statements included in our previously filed Form 10-Qs for this matter. However, consistent with Item 6, Selected Financial Data in our 2007 Annual Report, we have revised our results of operations for the three months ended March 31, 2007 to reflect the purchase price adjustments in 2007 in the appropriate reporting period.

During the three months ended March 31, 2008, we have revised our segment structure. Please refer to Note 6 for more information.

**(2) New Accounting Standards**

In March 2008, the FASB issued SFAS 161, *Disclosures about Derivative Instruments and Hedging Activities* (SFAS 161), which amends and expands the disclosure requirements of SFAS 133, *Accounting for Derivative Instruments and Hedging Activities* (SFAS 133), to provide an enhanced understanding of an entity's use of derivative instruments, how they are accounted for under SFAS 133 and their effect on the entity's financial position, financial performance and cash flows. The provisions of SFAS 161 are effective as of the beginning of our 2009 fiscal year. We are currently evaluating the impact of adopting SFAS 161 on our financial statements.

In December 2007, the FASB issued SFAS 141 (revised 2007), *Business Combinations* (SFAS 141R), and SFAS 160, *Noncontrolling Interests in Consolidated Financial Statements* (SFAS 160), to improve, simplify, and converge internationally the accounting for business combinations and the reporting of noncontrolling interests in consolidated financial statements. The provisions of SFAS 141R and SFAS 160 are effective as of the beginning of our 2009 fiscal year. We are currently evaluating the impact of adopting SFAS 141R and SFAS 160 on our financial statements.

In February 2007, the Financial Accounting Standards Board (FASB) issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities - Including an Amendment of FASB Statement No. 115*, (SFAS 159). This standard permits an entity to choose to measure many financial instruments and certain other items at fair value. Most of the provisions in SFAS 159 are elective; however, the amendment to FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, applies to all entities with available-for-sale and trading securities. The fair value option established by SFAS 159 permits all entities to choose to measure eligible items at fair value at specified election dates. A business entity will report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date. The fair value option: (a) may be applied instrument by instrument, with a few exceptions, such as investments otherwise accounted for by the equity method; (b) is irrevocable (unless a new election date occurs); and (c) is applied only to entire instruments

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and not to portions of instruments. We have adopted SFAS 159 as of January 1, 2008. The adoption of SFAS No. 159 did not have an impact on our consolidated results of operations and financial position.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*, ( SFAS 157 ). This Statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS No. 157 requires disclosure of information that enables users of the financial statements to assess the

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**PART I (CONT D)**

**GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

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. In February 2008, the FASB issued Staff Position 157-2, Effective Date of FASB Statement No. 157, which delays the effective date of SFAS No. 157 for non-financial assets and non-financial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). The delay is intended to allow the Board and constituents additional time to consider the effect of various implementation issues that have arisen, or that may arise, from the application of Statement 157.

In accordance with the Staff Position, we adopted SFAS No. 157 for financial assets and liabilities as of January 1, 2008. The adoption did not have an impact on our consolidated results of operations and financial position. Additional information with respect to the adoption of this standard is set forth in Note 4 to the Consolidated Financial Statements.

**(3) Stock-Based Compensation**

In the three months ended March 31, 2007 and 2008, we recognized \$1.3 million and \$1.2 million, respectively, in stock-based compensation expense. A majority of the expense, \$1.3 million and \$1.1 million respectively, was recorded as selling and administrative expenses in the Consolidated Statement of Operations, with the remaining expenses incurred as cost of sales and research and development.

As of March 31, 2008, the total compensation cost related to the non-vested restricted stock and stock options not yet recognized was \$4.7 million and will be recognized over the weighted average life of 1.48 years.

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Restricted stock activity under the plans for the three months ended March 31, 2008 was as follows:

	Number of Shares	Weighted- Average Grant Date Fair Value
Outstanding at January 1, 2008	1,077,300	\$ 7.32
Granted	19,002	15.25
Vested	(203,987)	6.13
Forfeited		
Outstanding at March 31, 2008	892,315	\$ 7.76

Stock option activity under the plans for the three months ended March 31, 2008 was as follows:

	Number of Shares	Weighted- Average Grant Date Fair Value
Outstanding at January 1, 2008	5,079,566	\$ 7.56
Granted		
Vested		
Terminated		
Exercised	(11,200)	4.12
Outstanding at March 31, 2008	5,068,366	\$ 7.57

**(4) Fair Value Measurements**

We enter into natural gas derivative contracts and short duration fixed rate purchase contracts to effectively fix some or all of our natural gas cost exposure. These contracts are treated as hedges under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities* and are required to be measured at fair value on a recurring basis. The outstanding contracts at January 1, 2008 were a payable of \$0.1 million. The outstanding contracts at March 31, 2008 were a receivable of \$0.1 million. With respect to the inputs used to determine the fair value, we use observable, quoted natural gas rates that are determined by active markets and therefore, classify the natural gas contracts as Level 2 in accordance with the definition in SFAS No. 157.

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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 share data:

	<b>For the Three Months Ended March 31,</b>	
	<b>2007</b>	<b>2008</b>
	<i>(Dollars in thousands, except share data)</i>	
Net income, as reported	\$ 15,327	\$ 38,648
Add: Interest on Debentures, net of tax benefit	898	916
Add: Amortization of Debentures issuance costs, net of tax benefit	422	431
Net income, as adjusted	\$ 16,647	\$ 39,995
Weighted average common shares outstanding for basic calculation	98,623,569	102,274,038
Add: Effect of stock options and restricted stock	1,411,962	1,754,328
Add: Effect of Debentures	13,570,560	13,570,560
Weighted average common shares outstanding for diluted calculation	113,606,091	117,598,926

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, as adjusted, 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.

The calculation of weighted average common shares outstanding for the diluted calculation excludes consideration of stock options covering 5,585,628 and 1,945,313 shares for the three months ended March 31, 2007 and 2008, 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.

**(6) Segment Reporting**

Previously, our businesses were reported in the following reportable segments: graphite electrode, advanced graphite materials, and other businesses, which consisted of natural graphite products, refractories and carbon electrodes.

During the fourth quarter of 2007 and first quarter of 2008, we made certain organizational changes and have realigned the management of our segment structure to better serve our customers in a cost effective manner. Information utilized by our chief operating decision maker to assess the performance and allocate resources was also changed so that it more closely aligned with the



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new operating structure of the company. With these changes, we evaluated our segments under SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information*.

**Industrial Materials.** Our industrial materials segment manufactures and delivers high quality graphite electrodes and refractories products. Electrodes are key components of the conductive power systems used to produce steel and other non-ferrous metals. Refractory products are used in blast furnaces and submerged arc furnaces due to their high thermal conductivity and the ease in which they can be machined to large or complex shapes.

**Engineered Solutions.** Engineered solutions include advanced graphite materials products for transportation, semiconductor and other markets, as well as natural graphite products.

We continue to evaluate the performance of our segments based on segment operating income. Intersegment sales and transfers are not material and the accounting policies of the reportable segments are the same as those for our Consolidated Financial Statements as a whole. Corporate expenses are allocated to segments based on each segment's percentage of consolidated sales.

Segment information for the three months ended March 31, 2007 has been restated to reflect the current presentation.

The following tables summarize financial information concerning our reportable segments.

	<b>For the Three Months Ended March 31,</b>	
	<b>2007</b>	<b>2008</b>
	<i>(Dollars in thousands)</i>	
Net sales to external customers:		
Industrial materials	\$ 194,512	\$ 248,289
Engineered solutions	33,719	41,713
Total net sales	\$ 228,231	\$ 290,002
Segment operating income:		
Industrial materials	\$ 48,117	\$ 74,665
Engineered solutions	1,659	8,428
Total operating income	\$ 49,776	\$ 83,093
Reconciliation of operating income to income from continuing operations before provision for income taxes and minority stockholders' share of subsidiaries' income		
Other expense, net	10,024	21,035
Interest expense	11,711	5,686
Interest income	(966)	(372)



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Income from continuing operations before provision for income taxes and minority stockholders share of subsidiaries income	\$ 29,007	\$ 56,744
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Assets by reportable segment are estimated based on the value of long-lived assets at each location and the sales mix to third party customers at that location.

	At December 31, 2007	At March 31, 2008
	<i>(Dollars in thousands)</i>	
Long-lived assets (a):		
Industrial materials.	\$ 275,115	\$ 279,966
Engineered solutions	51,022	51,098
Total long-lived assets	\$ 326,137	\$ 331,064

(a) Long-lived assets represent fixed assets, net of accumulated depreciation and goodwill.

**(7) Restructuring**

At March 31, 2008, the outstanding balance of our restructuring reserve was \$2.9 million. We expect approximately half of the remaining payments to be paid by the end of 2008, with the remaining payments made during 2009 and after. The balance at March 31, 2008 consisted of the following:

*Industrial Materials Segment:*

\$0.8 million related to the restructuring of our manufacturing facilities in France.

\$1.6 million related to the closure of our graphite electrode manufacturing operations in Caserta, Italy.

\$0.5 million related primarily to severance and related costs associated with our Switzerland facility.

In the three months ended March 31, 2008, we recorded a net restructuring charge of \$0.2 million. This charge related to severance and related costs associated with our Switzerland facility.

The following table summarizes activity relating to the restructuring liability at March 31, 2008:

**Total**

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	Severance and Related Costs	Plant Shutdown and Related Costs	
			<i>(Dollars in thousands)</i>
<b>Balance at January 1, 2008</b>	\$ 2,393	\$ 237	\$ 2,630
Restructuring charges	152		152
Payments and settlements	(20)	(113)	(133)
Effect of change in currency exchange rates	178	47	225
<b>Balance at March 31, 2008</b>	\$ 2,703	\$ 171	2,874

**Table of Contents****PART I (CONT D)****GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited)****(8) Other Expense, Net**

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

	<b>For the Three Months Ended March 31,</b>	
	<b>2007</b>	<b>2008</b>
	<i>(Dollars in thousands)</i>	
Currency losses	\$ 1,448	\$ 15,464
Loss on extinguishment of debt	7,523	4,725
Loss (gain) on the disposal of fixed assets	706	(48)
Bank and other financing fees	666	445
Loss on the sale of accounts receivable	150	340
Other	(469)	109
<b>Total other expense, net</b>	<b>\$ 10,024</b>	<b>\$ 21,035</b>

We have non-dollar-denominated intercompany loans between GrafTech Finance and some of our foreign subsidiaries. At December 31, 2007 and March 31, 2008, the aggregate principal amount of these loans was \$493.5 million and \$531.4 million, respectively (based on currency exchange rates in effect at such date). 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' equity 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 losses in other expense, net, on the Consolidated Statements of Operations. In the three months ended March 31, 2008, we had a net total of \$15.5 million of currency losses due primarily to the remeasurement of euro denominated intercompany loans and the effect of transaction losses related to foreign subsidiaries that use the dollar as their functional currency. In the three months ended March 31, 2007, we had a net total of \$1.5 million of currency losses due to the remeasurement of intercompany loans and transaction losses related to foreign subsidiaries that use the dollar as their functional currency.

In connection with the redemption of \$125 million of the outstanding principal of the Senior Notes in the three months ended March 31, 2008, we incurred a \$4.7 million loss on the extinguishment of debt, which includes \$4.3 million related to the call premium and \$0.4 million of charges for the accelerated amortization of the debt issuance fees, terminated interest rate swaps and the premium related to the Senior Notes.

In connection with the redemption of \$135 million of the outstanding principal of the Senior Notes in the three months ended March 31, 2007, we incurred a \$7.5 million loss on the extinguishment of debt, which includes \$6.9 million related to the call premium and \$0.6 million of charges for the accelerated amortization of the debt issuance fees, terminated interest rate swaps and the premium related to the Senior Notes.

**Table of Contents****PART I (CONT D)****GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited)****(9) Benefit Plans**

The components of our consolidated net pension and postretirement cost (benefit) are set forth in the following table:

	Pension Benefits For the Three Months Ended March 31,		Postretirement Benefits For the Three Months Ended March 31,	
	2007	2008	2007	2008
	<i>(Dollars in thousands)</i>			
Service cost	\$ 244	\$ 246	\$ 122	\$ 120
Interest cost	2,827	2,890	207	554
Expected return on plan assets	(3,081)	(3,254)		
Amortization of transition obligation	(21)	(22)		
Amortization of prior service cost (benefit)	30	34	(2,832)	(332)
Amortization of unrecognized loss	576	497	1,120	1,051
Settlement		171		
Net cost (benefit)	\$ 575	\$ 562	\$ (1,383)	\$ 1,393

**(10) Long-Term Debt and Liquidity**

The following table presents our long-term debt:

	At December 31, 2007	At March 31, 2008
	<i>(Dollars in thousands)</i>	
Revolving Facility	\$	\$ 4,100
Senior Notes:		
Senior Notes due 2012	199,649	74,816
Fair value adjustments for terminated hedge instruments*	2,421	861
Unamortized bond premium	481	171
Total Senior Notes	202,551	75,848
Debentures	222,905	223,075
Other European debt	680	593
Total	\$ 426,136	\$ 303,616

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

In the three months ended March 31, 2008, we redeemed a total of \$125 million of the outstanding principal amount of the 10 <sup>1</sup>/<sub>4</sub>% Senior Notes, due 2012, at 103.417% plus accrued interest. In connection with this redemption, we incurred a \$4.7 million loss on the extinguishment of debt.

**Table of Contents****PART I (CONT D)****GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited)**

In the three months ended March 31, 2007, we redeemed a total of \$135 million of the outstanding principal amount of the 10 1/4% Senior Notes, due 2012, at 105.125% plus accrued interest. In connection with this redemption, we incurred a \$7.5 million loss on the extinguishment of debt.

**(11) Inventories**

Inventories are comprised of the following:

	At December 31, 2007	At March 31, 2008
	<i>(Dollars in thousands)</i>	
Inventories:		
Raw materials and supplies	\$ 97,009	\$ 87,330
Work in process	132,709	150,617
Finished goods	57,183	53,046
	286,901	290,993
Reserves	(1,468)	(1,573)
	\$ 285,433	\$ 289,420

**(12) Interest Expense**

The following table presents an analysis of interest expense:

	For the Three Months Ended March 31,	
	2007	2008
	<i>(Dollars in thousands)</i>	
Interest incurred on debt	\$ 10,749	\$ 4,831
Amortization of fair value adjustments for terminated hedge instruments	(203)	(71)
Amortization of debt issuance costs	875	696
Amortization of premium on Senior Notes	(38)	(14)
Amortization of discount on Debentures	166	170
Interest incurred on other items	162	74
Total interest expense	\$ 11,711	\$ 5,686





**Table of Contents****PART I (CONT D)****GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited)****(13) Other Comprehensive Income**

Other comprehensive income consisted of the following:

	<b>For the Three Months Ended March 31,</b>	
	<b>2007</b>	<b>2008</b>
	<i>(Dollars in thousands)</i>	
Net income	\$ 15,327	\$ 38,648
Other comprehensive income:		
Foreign currency translation adjustments, net of tax	2,768	23,605
Amortization of prior service costs and unrecognized gains and losses	1,275	1,229
Natural gas derivatives and other		247
Total comprehensive income	\$ 19,370	\$ 63,729

**(14) Contingencies**

We are involved in various 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, 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. We also accrue for estimated warranty claims incurred based on a historical claims charge analysis. Claims accrued but not yet paid amounted to \$1.5 million at December 31, 2007 and \$1.7 million at March 31, 2008. The following table presents the activity in this accrual for the three months ended March 31, 2008:

	<i>(Dollars in Thousands)</i>	
<b>Balance at January 1, 2008</b>	\$	1,452
Product warranty charges		1,070
Payments and settlements		(782)
<b>Balance at March 31, 2008</b>	\$	1,740

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

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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

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**PART I (CONT D)**

**GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

and indirect subsidiaries of the Parent: GrafTech Global, GrafTech International Holdings Inc., GrafTech International Trading Inc. (formerly named UCAR International Trading Inc.), and GrafTech Technology LLC (formerly named 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**.

All of the guarantees are unsecured. 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 March 31, 2008, retained earnings of our subsidiaries subject to such restrictions were approximately \$1,136 million. Investments in subsidiaries are recorded on the equity basis.

The following table sets forth condensed consolidating balance sheets at December 31, 2007 and March 31, 2008 and condensed consolidating statements of operations and cash flows for each of the three months ended March 31, 2007 and 2008 of the Parent, Finco, all other U.S. Guarantors and the Non-Guarantors.

During the second quarter of 2007, the Company revised the presentation of the guarantor financial statements to reflect the equity (deficit) in earnings of all subsidiaries in the Parent condensed consolidating statement of operations. In addition, the Company reclassified the investment in affiliates from the payable to equity of investees for consistency with the presentation in the condensed consolidating statement of operations.

**Table of Contents****PART I (CONT D)****GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited)****Condensed Consolidating Balance Sheet****at December 31, 2007**

	<b>Parent (Issuer of Debentures and Guarantor of Senior Notes)</b>	<b>Finco (Issuer of Senior Notes and Guarantor of Debentures)</b>	<b>All Other U.S. Guarantors</b>	<b>Non- Guarantors</b>	<b>Consolidation/ Eliminations</b>	<b>Consolidated</b>
<b>ASSETS</b>						
<b>Current assets:</b>						
Cash and cash equivalents	\$ 168	\$ 31,021	\$	\$ 23,670	\$ (118)	\$ 54,741
Intercompany loans		155,568		495,849	(651,417)	
Intercompany accounts receivable		8,446		7,525	(15,971)	
Accounts receivable - third party			25,945	132,541		158,486
Accounts and notes receivable, net		164,014	25,945	635,915	(667,388)	158,486
Inventories			46,674	238,759		285,433
Prepaid expenses and other current assets		13	4,585	5,535		10,133
Total current assets	168	195,048	77,204	903,879	(667,506)	508,793
Property, plant and equipment, net			74,464	241,990		316,454
Deferred income taxes			850	6,404	(110)	7,144
Intercompany loans		585,739			(585,739)	
Investments in affiliates	333,897		330,848		(664,745)	
Goodwill				9,683		9,683
Other assets	3,216	7,013	5,197	7,654		23,080
Assets held for sale						
Restricted cash				1,547		1,547
Total assets	\$ 337,281	\$ 787,800	\$ 488,563	\$ 1,171,157	\$ (1,918,100)	\$ 866,701
<b>LIABILITIES AND STOCKHOLDERS EQUITY (DEFICIT)</b>						
<b>Current liabilities:</b>						
Accounts payable	\$	\$	\$ 10,709	\$ 48,384	\$ (118)	\$ 58,975
Interest payable	1,676	7,949		8		9,633
Intercompany loans		503,373	142,775	21,240	(667,388)	
Third party loans				1,014		1,014

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Short-term debt	503,373	142,775	22,254	(667,388)	1,014	
Accrued income and other taxes		2,780	27,216		29,996	
Other accrued liabilities	99	29,582	74,385		104,066	
<b>Total current liabilities</b>	<b>1,676</b>	<b>511,421</b>	<b>185,846</b>	<b>172,247</b>	<b>(667,506)</b>	<b>203,684</b>
Long-term debt	222,905	202,551		680		426,136
Intercompany loans				585,739	(585,739)	
Other long-term obligations			42,648	51,362		94,010
Payable to equity of investees						
Deferred income taxes				30,281	(110)	30,171
Minority stockholders' equity in consolidated entities						
Stockholders' equity (deficit)	112,700	73,828	260,069	330,848	(664,745)	112,700
<b>Total liabilities and stockholders' deficit</b>	<b>\$ 337,281</b>	<b>\$ 787,800</b>	<b>\$ 488,563</b>	<b>\$ 1,171,157</b>	<b>\$ (1,918,100)</b>	<b>\$ 866,701</b>

**Table of Contents****PART I (CONT D)****GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited)****Condensed Consolidating Balance Sheet****at March 31, 2008**

	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
	<i>(Dollars in thousands)</i>					
<b>ASSETS</b>						
<b>Current assets:</b>						
Cash and cash equivalents	\$ 197	\$ 492	\$	\$ 6,428	\$ (143)	\$ 6,974
Inter-company loans		150,896		641,817	(792,713)	
Inter-company accounts receivable		10,343	98	8,822	(19,263)	
Accounts receivable - third party			29,003	129,447		158,450
Accounts and notes receivable, net		161,239	29,101	780,086	(811,976)	158,450
Inventories			49,266	240,154		289,420
Prepaid expenses and other current assets		238	3,252	5,552	(113)	8,929
Total current assets	197	161,969	81,619	1,032,220	(812,232)	463,773
Property, plant and equipment, net			74,949	247,870		322,819
Deferred income taxes				6,789	(488)	6,301
Intercompany loans		623,668		(1)	(623,667)	
Investments in affiliates	398,949		403,369		(802,318)	
Goodwill				8,245		8,245
Other assets	2,948	4,342	5,174	8,583		21,047
Restricted cash				1,723		1,723
Total assets	\$ 402,094	\$ 789,979	\$ 565,111	\$ 1,305,429	\$ (2,238,705)	\$ 823,908
<b>LIABILITIES AND STOCKHOLDERS EQUITY (DEFICIT)</b>						
<b>Current liabilities:</b>						
Accounts payable	\$	\$	\$ 8,321	\$ 56,387	\$ (143)	\$ 64,565
Interest payable	762	1,210		11		1,983
Intercompany loans		650,800	137,280	23,896	(811,976)	
Third party loans				17,293		17,293
Short-term debt		650,800	137,280	41,189	(811,976)	17,293
Accrued income and other taxes			2,373	37,636		40,009
Other accrued liabilities			32,192	60,344	(113)	92,423

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Total current liabilities	762	652,010	180,166	195,567	(812,232)	216,273
Long-term debt	223,075	79,948		593		303,616
Intercompany loans				623,667	(623,667)	
Other long-term obligations			43,730	51,317		95,047
Payable to equity of investees						
Deferred income taxes			287	30,916	(488)	30,715
Stockholders equity	178,257	58,021	340,928	403,369	(802,318)	178,257
Total liabilities and stockholders deficit	\$ 402,094	\$ 789,979	\$ 565,111	\$ 1,305,429	\$ (2,238,705)	\$ 823,908

**Table of Contents****PART I (CONT D)****GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited)****Condensed Consolidating Statements of Operations****for the Three Months Ended March 31, 2007**

	<b>Parent (Issuer of Debentures and Guarantor of Senior Notes)</b>	<b>Finco (Issuer of Senior Guarantor of Notes and Debentures)</b>	<b>All Other U.S. Guarantors</b>	<b>Non- Guarantors</b>	<b>Consolidation/ Eliminations</b>	<b>Consolidated</b>
	\$	\$	\$	\$	\$	\$
	<i>(Dollars in thousands)</i>					
Net sales			52,329	175,902		228,231
Cost of sales			45,537	107,406		152,943
Gross profit			6,792	68,496		75,288
Research and development			2,234			2,234
Selling and administrative expenses			15,181	7,213		22,394
Restructuring charges			529	355		884
Operating income			(11,152)	60,928		49,776
Other (income) expense, net		(2,726)	323	(4,692)	17,119	10,024
Interest expense	1,348	14,972	2,808	9,702	(17,119)	11,711
Interest income		(710)		(256)		(966)
Income (loss) from continuing operations before provision for (benefit from) income taxes and minority stockholders share of subsidiaries income (loss)	(1,348)	(11,536)	(14,283)	56,174		29,007
Provision for (benefit from) income taxes	(2,680)	(4,014)	8,294	8,930		10,530
Income (loss) from continuing operations before minority interest	1,332	(7,522)	(22,577)	47,244		18,477
Minority stockholders share of subsidiaries income (loss)				33		33
Income (loss) from continuing operations	1,332	(7,522)	(22,577)	47,211		18,444
Loss from discontinued operations, net of tax			(3,117)			(3,117)
Equity (deficit) in earnings of subsidiaries	13,995		47,211		(61,206)	
Net income (loss)	\$ 15,327	\$ (7,522)	\$ 21,517	\$ 47,211	\$ (61,206)	\$ 15,327





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## PART I (CONT D)

## GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

## Condensed Consolidating Statements of Cash Flows

for the Three Months Ended March 31, 2007

	Parent (Issuer of Debentures and Guarantor of Senior Notes)	Finco (Issuer of Senior Notes and Guarantor of Debentures)	All Other U.S. Guarantors <i>(Dollars in thousands)</i>	Non- Guarantors	Consolidation/ Eliminations	Consolidated
Cash flow from operating activities:						
Net income	\$ 15,327	\$ (7,522)	\$ 21,517	\$ 47,211	\$ (61,206)	\$ 15,327
Adjustments to reconcile net income to net cash used in:						
Loss from discontinued operations, net of tax			3,117			3,117
Depreciation and amortization			1,831	6,043		7,874
Deferred income taxes	(2,394)	278	2,655	489		1,028
Restructuring charges			530	354		884
Foreign currency losses on inter-company loans		1,113				1,113
Stock-based compensation	1,265					1,265
Interest expense	(175)	1,410	(153)			1,082
Other charges, net	(11,804)	10,364	(30,404)	(27,864)	61,288	1,580
(Increase) decrease in working capital	(3,594)	(17,252)	9,774	(419)	(98)	(11,589)
Increase in long-term assets and liabilities			(2,315)	(1,342)		(3,657)
Net cash provided by operating activities	(1,375)	(11,609)	6,552	24,472	(16)	18,024
Cash flow from investing activities:						
Inter-company receivable/payable		25,831	(4,402)	(21,429)		
Capital expenditures			(2,307)	(5,364)		(7,671)
Patent capitalization			(236)			(236)
Proceeds from sale of assets			57	79		136
Net cash used in investing activities		25,831	(6,888)	(26,714)		(7,771)
Cash flow from financing activities:						
Short-term debt borrowings, net			336	(178)		158
Revolving Facility borrowings		45,645				45,645
Revolving Facility reductions		(45,000)		(52)		(45,052)
Long term debt reduction		(134,867)				(134,867)
Proceeds from exercise of stock options	1,374					1,374
Net cash used in financing activities	1,374	(134,222)	336	(230)		(132,742)
Net decrease in cash and cash equivalents	(1)	(120,000)		(2,472)	(16)	(122,489)
Effect of exchange rate changes on cash and cash equivalents				(295)		(295)

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Cash and cash equivalents at beginning of period	151	125,161	24,335	(130)	149,517
Cash and cash equivalents at end of period	\$ 150	\$ 5,161	\$ 21,568	\$ (146)	\$ 26,733

**Table of Contents****PART I (CONT D)****GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited)****Condensed Consolidating Statements of Cash Flows****for the Three Months Ended March 31, 2008**

	<b>Parent (Issuer of Debentures and Guarantor of Senior Notes)</b>	<b>Finco (Issuer of Senior Notes and Guarantor of Debentures)</b>	<b>All Other U.S. Guarantors (Dollars in thousands)</b>	<b>Non- Guarantors</b>	<b>Consolidation/ Eliminations</b>	<b>Consolidated</b>
<b>Cash flow from operating activities:</b>						
Net income (loss)	\$ 38,648	\$ (20,248)	\$ 60,248	\$ 95,168	\$ (135,168)	\$ 38,648
<b>Adjustments to reconcile net income (loss) to net cash (used in) provided by operations:</b>						
Depreciation and amortization			1,524	7,034		8,558
Deferred income taxes			1,918	(1,031)		887
Restructuring charges			(2)	154		152
Currency losses		16,235				16,235
Interest expense	(42)	1,112				1,070
Stock-based compensation	1,161					1,161
Other (credits) charges, net	86,622	(513,178)	(58,008)	385,957	102,574	3,967
(Increase) decrease in working capital	(914)	(4,402)	(7,396)	(137,754)	144,712	(5,754)
Long-term assets and liabilities			3,382	(1,159)		2,223
<b>Net cash provided by operating activities</b>	<b>125,475</b>	<b>(520,481)</b>	<b>1,666</b>	<b>348,369</b>	<b>112,118</b>	<b>67,147</b>
<b>Cash flow from investing activities:</b>						
Inter-company loans receivable/payable/debt		485,780		(373,637)	(112,143)	
Capital expenditures			(1,697)	(7,692)		(9,389)
Proceeds from sale of assets			31	20		51
Increase in restricted cash				(176)		(176)
Proceeds from derivative instruments		224				224
<b>Net cash used in investing activities</b>		<b>486,004</b>	<b>(1,666)</b>	<b>(381,485)</b>	<b>(112,143)</b>	<b>(9,290)</b>
<b>Cash flow from financing activities:</b>						
Short-term debt borrowings (reductions), net				15,887		15,887
Revolving Facility borrowings		70,625				70,625
Revolving Facility reductions		(66,677)				(66,677)
Long term debt reductions	(124,663)					(124,663)
Proceeds from exercise of stock options	167					167
Excess tax benefit from stock-based compensation	53					53
Purchase of treasury shares	(1,003)					(1,003)

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Net cash provided by financing activities	(125,446)	3,948	15,887	(105,611)
Net increase (decrease) in cash and cash equivalents	29	(30,529)	(17,229)	(25)
Effect of exchange rate changes on cash and cash equivalents			(13)	(13)
Cash and cash equivalents at beginning of period	168	31,021	23,670	(118)
Cash and cash equivalents at end of period	\$ 197	\$ 492	\$ 6,428	\$ (143)

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**PART I (CONT D)**

**GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**(16) Income Taxes**

Provision for income taxes was a charge of \$18.1 million for the three months ended March 31, 2008 and \$10.5 million for the three months ended March 31, 2007. The effective tax rate was 31.9% for the three months ended March 31, 2008 as compared to 36.0% for the three months ended March 31, 2007. The decrease in the effective tax rate was primarily due to the mix of income in lower tax jurisdictions and a net decrease in valuation allowances.

We adopted the provisions of Financial Accounting Standards Board Interpretation No. 48 ( FIN 48 ) on January 1, 2007. As a result of the adoption of FIN 48, we had an adjustment of approximately \$0.2 million to the opening balance of retained earnings on January 1, 2007. We recognize interest and penalties related to uncertain tax positions as a component of income tax expense.

Our unrecognized tax benefits have increased by \$1.5 million as a result of changes in tax positions taken in a prior year, which has an unfavorable impact on our effective tax rate. It is reasonably possible that a reduction in a range of \$3.0 million to \$3.5 million of unrecognized tax benefits may occur within 12 months as a result of the expiration of statutes of limitation.

The company files income tax returns in the U.S. federal jurisdiction, and various state and foreign jurisdictions. We are currently under federal audit by the Internal Revenue Service (IRS) for tax year 2004. All U.S. tax years prior to 2004 are closed by statute or have been audited and settled with the domestic tax authorities. Generally, tax years beginning after 2002 are still open to examination by foreign taxing authorities.

Our tax provision for the three months ended March 31, 2008 and 2007 was primarily for taxes on our international income. We continue to adjust the tax provision rate through the establishment, or release, of a non-cash valuation allowance attributable to several taxing jurisdictions, including foreign tax credit utilization. Statement of Financial Accounting Standards No. 109, *Accounting for Income Taxes*, requires us to weigh both positive and negative evidence in determining whether a valuation allowance is required. Positive evidence would include, for example, a strong earnings history, an event that will increase the Company's taxable income through a continuing reduction in expenses and tax planning strategies indicating an ability to realize deferred tax assets. While the performance of these tax jurisdictions has improved significantly in recent quarters, and our interest expense has been significantly reduced through debt repayment during 2007 and 2008, we have determined that the valuation allowances related to these jurisdictions' deferred tax assets should continue to be maintained as the balance of significant positive evidence does not yet outweigh the negative evidence in regards to whether or not a valuation allowance is required. However, as we have generated taxable income in 2007 and 2008, this has created a reversal of some of our valuation allowances, thereby reflecting a provision on pretax income in these jurisdictions.

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**PART I (CONT D)**

**GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**(17) Discontinued Operations**

On December 5, 2006, we completed the sale of our 70% equity interest in Carbone Savoie and other assets used in and liabilities related to our former cathode business to Alcan France, for approximately \$135.0 million less certain price adjustments and the purchaser's assumption of liabilities. As a result of this sale, under SFAS No. 144, the cathode business is reflected as a discontinued operation.

In the first quarter of 2007, we recorded a \$3.1 million charge, net of tax of \$1.6 million, related to the finalization of purchase price adjustments stated in the contract and other transaction related items. Please refer to Note 1 for more information.

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**PART I (CONT D)**

**GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES**

**Introduction to Part I, Item 2, and Part II, Item 1**

**Important Terms.** We define various terms to simplify the presentation of information in this Report. These terms, which definitions are incorporated herein by reference, are defined in the Annual Report.

**Presentation of Financial, Market and Legal Data.** We present our financial information on a consolidated basis.

Unless otherwise noted, when we refer to dollars, we mean U.S. dollars.

Unless otherwise specifically noted, market and market share data in this Report are our own estimates or derived from sources described in Part I Preliminary Notes Presentation of Financial, Market and Legal Data in the Annual Report, which description is incorporated herein by reference. Our estimates involve risks and uncertainties and are subject to change based on various factors, including those discussed under Forward Looking Statements and Risks in this Report and Forward Looking Statements and Risk Factors in the Annual Report. We cannot guarantee the accuracy or completeness of this market and market share data and have not independently verified it. None of the sources has consented to the disclosure or use of data in this Report.

Reference is made to the Annual Report for background information on various risks and contingencies and other matters related to circumstances affecting us and our industry.

Neither any statement made in this Report nor any charge taken by us relating to any legal proceedings constitutes an admission as to any wrongdoing.

**Forward Looking Statements and Risks.** This Report contains forward looking statements. In addition, we or our representatives have made or may make forward looking statements on telephone or conference calls, by webcasts or emails, in person, in presentations or written materials, or otherwise. These include statements about such matters as: expected future or targeted operational and financial performance; growth rates and future production and sales of products that incorporate or that are produced using our products; changes in production capacity in our operations and our customers operations; growth rates for, future prices and sales of, and demand for our products and our customers products; costs of materials and production, including anticipated increases therein; productivity, business process and operational initiatives, and their impact on us; our position in markets we serve; employment and contributions of key personnel; employee relations and collective bargaining agreements covering many of our operations; tax rates; capital expenditures and their impact on us; nature and timing of restructuring charges and payments; strategic plans and business projects; regional and global economic and industry market conditions, changes in such conditions and the impact thereof, interest rate management activities; currency rate management activities; deleveraging activities; rationalization, restructuring, realignment, strategic alliance, raw material and supply chain, technology development and collaboration, investment, acquisition, venture, operational, tax, financial and capital projects; legal proceedings, contingencies, and environmental compliance; consulting projects; potential offerings, sales and other actions regarding debt or equity securities of us or our subsidiaries; costs, working capital, revenues, business opportunities, debt levels, cash flows, cost savings and reductions, margins, earnings and growth.



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The words **will**, **may**, **plan**, **estimate**, **project**, **believe**, **anticipate**, **expect**, **intend**, **should**, **would**, **could**, **target**, or the negatives thereof, identify some of these statements.

Our expectations and targets are not predictors of actual performance and historically our performance has deviated, often significantly, from our expectations and targets. Actual future events and circumstances (including future results and trends) could differ materially, positively or negatively, from those set forth in these statements due to various factors. These factors include:

the possibility that additions to capacity for producing steel in electric arc furnaces (EAF), increases in overall EAF steel production capacity, and increases or other changes in steel production may not occur or may not occur at the rates that we anticipate or may not be as geographically dispersed as we anticipate;

possible failure of increased EAF steel production or stable graphite electrode production to result in stable or increased graphite electrode demand, prices or sales volume;

the possibility that increases in graphite electrode manufacturing capacity, competitive pressures, including growth by producers in developing countries and the mix, distribution, and pricing of their products, specific consumption rates, increases in customer inventory levels, or other changes in the graphite electrode markets may occur, which may impact demand for, prices or unit and dollar volume sales of graphite electrodes and growth or profitability of our graphite electrode business;

the possibility that, for all of our product lines, capital improvement and expansion in our customers' operations and increases in demand for their products may not occur or may not occur at the rates that we anticipate;

the possibility that global consolidation of the world's steel producers could impact our business or industry;

the possibility that average graphite electrode revenue per metric ton in the future may be different than current spot or market prices due to changes in product mix, changes in currency exchange rates, changes in competitive market conditions or other factors;

the possibility that price increases, adjustments or surcharges may not be realized;

the possibility that increases in prices for our raw materials and the magnitude of such increases, global events that influence energy pricing and availability, increases in our energy needs, or other developments may adversely impact or offset our productivity and cost containment initiatives;

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the possibility that increases in capacity, competitive pressures, or other changes in other markets we serve may occur, which may impact demand for, prices of or unit and dollar volume sales of our other products or growth or of profitability of our other product lines or change our position in such markets;

the possibility that we will not be able to hire and retain key personnel or to renew or extend our collective bargaining or similar agreements on reasonable terms as they expire or to do so without a work stoppage or strike;

the possibility of delays in or failure to achieve successful development and commercialization of new or improved electronic thermal management (ETM), or other products or that such products could be subsequently displaced by other products or technologies;

the possibility that we will fail to develop new customers or applications for our ETM products;

the possibility of delays in or failure to achieve widespread commercialization of fuel cells which use our natural graphite-based products or that manufacturers of PEM fuel cells may obtain those products from other sources;

the possibility that our manufacturing capabilities may not be sufficient or that we may experience delays in expanding or fail to expand our manufacturing capacity to meet demand for existing, new or improved products;

the possibility that the amount or timing of our anticipated capital expenditures may be limited by our financial resources or financing arrangements or that our ability to complete capital projects may not occur timely enough to adapt to changes in market conditions or changes in regulatory requirements;

the possibility that we may be unable to protect our intellectual property or may infringe the intellectual property rights of others, resulting in damages, limitations on our ability to produce or sell products or limitations on our ability to prevent others from using that intellectual property to produce or sell products;

the occurrence of unanticipated events or circumstances or changing interpretations and enforcement agendas relating to legal proceedings or compliance programs;

the occurrence of unanticipated events or circumstances or changing interpretations and enforcement agendas relating to health, safety or environmental compliance or remediation obligations or liabilities to third parties or relating to labor relations;

the possibility that our provision for income taxes and effective income tax rate or cash tax rate may fluctuate significantly due to changes in applicable tax rates, changes in the sources of our income, changes in tax planning, new or changing interpretations in applicable regulations, profitability, estimates of future ability to use foreign tax credits, tax laws, and other factors;



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the possibility that we may not achieve increases in the amount or speed of cash generated through operations;

the possibility of changes in interest or currency exchange rates, in competitive conditions, or in inflation;

the possibility that our outlook could be significantly impacted by, among other things, changes in interest rates by the U.S. Federal Reserve Board or other central banks, changes in fiscal policies by the U.S. and other governments, developments in the Middle East, North Korea, and other areas of concern, the occurrence of further terrorist acts and developments (including increases in security, insurance, data back-up, energy and transportation and other costs, transportation delays and continuing or increased economic uncertainty and weakness) resulting from terrorist acts and the war on terrorism;

the possibility that interruption in our major raw material, energy or utility supplies due to, among other things, natural disasters, process interruptions, actions by producers and capacity limitations, may adversely affect our ability to manufacture and supply our products or result in higher costs;

the possibility of interruptions in production at our facilities due to, among other things, critical equipment failure, which may adversely affect our ability to manufacture and supply our products or result in higher costs;

the possibility that the timing and amount of expenditures that we anticipate in connection with our restructuring and plant closing activities may vary significantly from our expectations;

the possibility that we may not achieve the earnings or other financial or operational metrics that we provide as guidance from time to time;

the possibility that the anticipated benefits from organizational and work process redesign, changes in our information systems, or other system changes, including operating efficiencies, production cost savings and improved operational performance, including leveraging infrastructure for greater productivity and contributions to our continued growth, may be delayed or may not occur or may result in unanticipated disruption;

the possibility that our disclosure or internal controls may become inadequate because of changes in conditions or personnel, that the degree of compliance with our policies and procedures related to those controls may deteriorate or that those controls may not operate effectively and may not prevent or detect misstatements or errors;

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the possibility that delays may occur in the financial statement closing process due to a change in our internal control environment or personnel;

the possibility of changes in performance that may affect financial covenant compliance or funds available for borrowing; and

other risks and uncertainties, including those described elsewhere in this Report or our other SEC filings, as well as future decisions by us.

Occurrence of any of the events or circumstances described above could also have a material adverse effect on our business, financial condition, results of operations, cash flows or the market price of our common stock, the Senior Notes or the Debentures.

No assurance can be given that any future transaction about which forward looking statements may be made will be completed or as to the timing or terms of any such transaction.

All subsequent written and oral forward looking statements by or attributable to us or persons acting on our behalf are expressly qualified in their entirety by these factors. Except as otherwise required to be disclosed in periodic reports required to be filed by public companies with the SEC pursuant to the SEC's rules, we have no duty to update these statements.

For a more complete discussion of these and other factors, see **Risk Factors** in the Annual Report.

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**GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES**

**Item 2. Management's Discussion and Analysis of Financial**

**Condition and Results of Operations**

**Global Economic Conditions**

We are impacted in varying degrees, both positively and negatively, by fluctuations in global, regional and country economic conditions.

Industrial material demand is primarily linked with the global production of steel in an electric arc furnace and, to a lesser extent, with the total production of steel and certain other metals. During the three months ended March 31, 2008, we estimate that global steel production and operating rates, excluding China, increased by 4% compared to the same period last year. China's steel production grew by approximately 6% during the three months ended March 31, 2008, contributing to an estimated global steel production increase of 5%.

Steel production in China and Russia is approximately 90% and 82% basic oxygen furnace related, respectively. However, these two countries provided some of the highest EAF capacity growth in 2008, due to new startups.

Overall, EAF steel production capacity continues to expand. During the three months ended March 31, 2008, EAF steel production increased approximately 3% compared to the three months ended March 31, 2007, due to new EAF start-ups and strong melt rates. We estimate that total EAF production will increase 2-3% during 2008. However, graphite electrode demand is expected to increase by approximately 1-2% due to continual improvements in specific consumption.

In 2008, we believe that the overall demand for our engineered solutions will remain at a high level, resulting from continued strength in the energy markets and defense and transportation industries. The continued overall strength of the markets served has kept the demand high for our core products which are used in the industrial and chemical sectors.

**Outlook**

If global economic conditions in 2008 are stable, we would expect:

Total company net sales to increase 16 to 18 percent

The effective book tax rate to be approximately 27 to 29 percent

Capital expenditures to be approximately \$70 - 75 million

Depreciation expense of approximately \$32 million; and

Cash flow from operations to be about \$180 million.

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Our outlook could be significantly impacted by, among other things, factors described under **Preliminary Notes**, **Forward Looking Statements** and **Risk Factors** in this Report. For a more complete discussion of these and other factors, see **Risk Factors** in the Annual Report.

**Results of Operations**

*Consolidated.* Net sales of \$290.0 million in the three months ended March 31, 2008 represented a \$61.8 million or 27.1% increase from net sales of \$228.2 million in the three months ended March 31, 2007. Net sales for both of our operating segments increased, primarily due to favorable pricing, along with currency impacts of \$11.9 million. High demand for most of our products, together with significant raw material cost increases, has resulted in increased prices, particularly related to graphite electrodes. Favorable currency exchange rates, particularly related to the euro, have also been a strong driver of our sales increase in the three months ended March 31, 2008 compared to the three months ended March 31, 2007. These increases in sales were offset by a \$3.7 million decrease in sales related to carbon electrodes, as we have completely exited this business.

Cost of sales of \$181.9 million in the three months ended March 31, 2008 represented a \$29.0 million, or 19.0%, increase from cost of sales of \$152.9 million in the three months ended March 31, 2007. Cost of sales increased primarily due to our industrial materials segment. This increase was driven primarily by increased raw material and production costs for the three months ended March 31, 2008 compared to March 31, 2007, including the effects of foreign currency exchange rates. The total cost of sales for our engineered solutions segment increased slightly due to the effects of foreign currency exchange rates.

Gross profit of \$108.1 million in the three months ended March 31, 2008 represented a \$32.8 million, or 43.6%, increase from gross profit of \$75.3 million in the three months ended March 31, 2007. Gross margin increased to 37.3% of net sales, from 33.0% in the three months ended March 31, 2007.

Research and development expenses increased \$0.1 million, or 4.5%, from \$2.2 million in the three months ended March 31, 2007 to \$2.3 million in the three months ended March 31, 2008.

Selling and administrative expenses was \$22.6 million for the three months ended March 31, 2008 compared to \$22.4 million for the three months ended March 31, 2007.

Restructuring charges decreased \$0.7 million to \$0.2 million for the three months ended March 31, 2008, as we continue to wind down previous restructuring activities.

Other (income) expense, net was a charge of \$21.0 million in the three months ended March 31, 2008 compared to \$10.0 million in three months ended March 31, 2007. The increase was caused primarily by a \$14.0 million increase in currency losses. These currency losses are primarily the result of our euro-denominated inter-company loans between GrafTech Finance and some of our foreign subsidiaries, caused by the negative impact of movements in the euro exchange rate in the quarter. This increase in currency losses was

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offset slightly by a \$2.8 million decrease in losses incurred on the extinguishment of debt. During the three months ended March 31, 2007, we redeemed \$135 million of our Senior Notes, compared to our redemption of \$125 million of Senior Notes in the three months ended March 31, 2008. For the three months ended March 31, 2008, the loss on extinguishment of debt was \$4.7 million, compared to a \$7.5 million loss for the three months ended March 31, 2007.

The following table presents an analysis of interest expense:

	<b>For the Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2007</b>	<b>2008</b>
	<i>(Dollars in thousands)</i>	
Interest incurred on debt	\$ 10,749	\$ 4,831
Amortization of fair value adjustments for terminated hedge instruments	(203)	(71)
Amortization of debt issuance costs	875	696
Amortization of premium on Senior Notes	(38)	(14)
Amortization of discount on Debentures	166	170
Interest incurred on other items	162	74
<b>Total interest expense</b>	<b>\$ 11,711</b>	<b>\$ 5,686</b>

Average total debt outstanding was \$381.6 million in the three months ended March 31, 2008 as compared to \$606.3 million in the three months ended March 31, 2007. The average annual interest rate was 5.0% in the three months ended March 31, 2008 as compared to 7.0% in the three months ended March 31, 2007.

Provision for income taxes was a charge of \$18.1 million for the three months ended March 31, 2008 and \$10.5 million for the three months ended March 31, 2007. The effective tax rate was 31.9% for the three months ended March 31, 2008 as compared to 36.0% for the three months ended March 31, 2007. The decrease in the effective tax rate was primarily due to the mix of income in lower tax jurisdictions and a net decrease in valuation allowances.

The loss from discontinued operations, net of tax, was \$3.1 million for the three months ended March 31, 2007.

As a result of the matters described above, net income was \$38.6 million in the three months ended March 31, 2008 as compared to \$15.3 million in the three months ended March 31, 2007.



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*Segment net sales.* The following table represents our net sales by segment for the three months ended March 31, 2007 and 2008:

	For the Three Months Ended March 31,	
	2007	2008
	<i>(Dollars in thousands)</i>	
Industrial materials	\$ 194,512	\$ 248,289
Engineered solutions	33,719	41,713
<b>Total net sales</b>	<b>\$ 228,231</b>	<b>\$ 290,002</b>

Our analysis of the percentage change in net sales for industrial materials and engineered solutions is set forth in the following table:

	Volume	Price	Mix	Currency	Other	Net Change
Industrial materials	1%	18%	1%	6%	2%	28%
Engineered solutions	4%	16%	%	4%		24%

Net sales for the industrial materials segment increased primarily due to favorable price increases as a result of increased demand, and raw material cost increases, particularly related to our graphite electrode products. Currency rate fluctuations also increased sales, driven by the strengthening of the euro. Sales volume for the segment increased slightly driven by volume increases for graphite electrodes, offset by volume decreases for our former carbon electrode products.

Net sales for engineered solutions increased primarily due to favorable price increases and favorable currency exchange rates, also related to the strengthening of the euro. Volumes for our engineered solutions increased 4% for the three months ended March 31, 2008 compared to the three months ended March 31, 2007.

*Segment operating net income.* The following table represents our operating income by segment for the three months ended March 31, 2007 and 2008:

	For the Three Months Ended March 31,	
	2007	2008
	<i>(Dollars in thousands)</i>	
Industrial materials	\$ 48,117	\$ 74,665
Engineered solutions	1,659	8,428
<b>Total operating income</b>	<b>\$ 49,776</b>	<b>\$ 83,093</b>

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Our analysis of the percentage change in segment operating costs and expenses for industrial materials and engineered solutions is set forth in the following table:

	Operating Expenses For the Three Months Ended March 31, (Percentage of sales)		
	2007	2008	Change
Industrial materials	75%	70%	(5%)
Engineered Solutions	95%	80%	(15%)

Segment operating costs and expenses as a percentage of sales for industrial materials decreased 5% points in the three months ended March 31, 2008. However, total segment operating costs and expenses increased \$27.2 million for the three months ended March 31, 2008 compared to the three months ended March 31, 2007. Operating expenses for this segment increased primarily due to a \$20.4 million increase in production costs, related primarily to raw material costs. The strengthening of certain currencies, primarily the euro increased production costs an additional \$9.7 million. Selling and administrative and other expenses increased \$1.0 million to support our increased sales levels. Changes in product mix and volume decreased production costs by \$3.9 million.

Segment operating costs and expenses as a percentage of sales for the engineered solutions segment decreased by 15% points to 80%. However, total segment operating costs and expenses increased by \$1.2 million. This increase was driven by increased production costs of \$1.8 million, driven primarily by foreign currency exchange rate fluctuations related to our advanced graphite materials products of \$1.2 million and increased costs driven by higher volumes of \$1.7 million, offset by decreased costs as a result of a favorable product mix of \$1.4 million related primarily to our natural graphite products. Overhead costs for the segment decreased by \$0.3 million as a result of our continued focus on reducing selling and administrative expenses.

**Effects of Changes in Currency Exchange Rates**

We incur costs in dollars and in the currency of each of the six non-U.S. countries in which we have a manufacturing facility, and we sell our products in multiple currencies. In general, our results of operations, cash flows and financial condition are affected by changes in currency exchange rates affecting these currencies relative to the dollar and, to a limited extent, each other.

Many of the non-U.S. countries in which we have a manufacturing facility have been subject to significant economic changes, which have significantly impacted currency exchange rates. We cannot predict changes in currency exchange rates in the future or whether those changes will have net positive or negative impacts on our net sales, cost of sales or net income. We cannot assure you that we would be able to mitigate any adverse effects of such changes.

During the three months ended March 31, 2008, the average exchange rate of the Brazilian Real, Mexican Peso and the euro increased 21%, 2% and 14%, respectively, when compared to the average exchange rate for the three months ended March 31, 2007.

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During the three months ended March 31, 2008, the average exchange rate for the South African Rand decreased 4% when compared to the average exchange rate for the three months ended March 31, 2007.

In the case of net sales of industrial materials, the impact of these events was an increase of about \$10.4 million in the three months ended March 31, 2008 as compared to the three months ended March 31, 2007. In the case of cost of sales of industrial materials the impact of these events was an increase of about \$9.7 million in the three months ended March 31, 2008 as compared to the three months ended March 31, 2007.

We have non-dollar denominated intercompany loans between GrafTech Finance and some of our foreign subsidiaries. At March 31, 2008, the aggregate principal amount of these loans was \$531.4 million. 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' equity 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 losses in other expense, net, on the Consolidated Statements of Operations. In the three months ended March 31, 2008, we had a net total of \$15.5 million in currency losses due primarily to the remeasurement of euro denominated inter-company loans and the effect of transaction losses related to foreign subsidiaries which use the dollar as their functional currency. In the three months ended March 31, 2007, we had a net total of \$1.5 million of currency losses due to the remeasurement of inter-company loans and transaction losses related to foreign subsidiaries that use the dollar as their financial currency. To manage certain exposures to specific financial market risks caused by changes in currency exchange rates, we may use various financial instruments as described under Item 3 Quantitative and Qualitative Disclosures about Market Risk.

**Liquidity and Capital Resources**

Our sources of funds have consisted principally of invested capital, cash flow from operations and debt and equity financings. Our uses of those funds (other than for operations) have consisted principally of capital expenditures, payment of fines, liabilities and expenses in connection with prior antitrust investigations, lawsuits and claims, payment of restructuring costs, pension and post-retirement contributions, debt reduction payments and other obligations.

At March 31, 2008, we had total long-term debt of \$303.6 million, cash and cash equivalents of \$7.0 million and a stockholders' equity of \$178.3 million.

As part of our cash management activities, we periodically factor or discount (by selling) certain accounts receivable to third parties. In the 2008 first quarter, certain subsidiaries sold receivables at a cost lower than the cost to borrow a comparable amount for a comparable period under the Revolving Facility. Proceeds of the sale of receivables were used to reduce debt. If we had not sold

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receivables, our accounts receivable and our debt would have been about \$0.3 million higher at December 31, 2007 and about \$30.6 million higher at March 31, 2008. All receivables sold during 2007 and the 2008 first quarter were sold without recourse, and no amount of accounts receivable sold remained on the Consolidated Balance Sheets at December 31, 2007 and March 31, 2008.

We use cash and cash equivalents, cash flow from operations, funds from factoring arrangements and funds available under the Revolving Facility (subject to continued compliance with the financial covenants and representations under the Revolving Facility), as well as cash flow from operations as our primary sources of liquidity. The Revolving Facility provides for maximum borrowings of up to \$215.0 million. At March 31, 2008, \$198.4 million was available (after consideration of outstanding revolving loans of \$4.1 million and outstanding letters of credit of \$12.5 million). It is possible that our future ability to borrow under the Revolving Facility may effectively be less because of the impact of additional borrowings upon our compliance with the maximum net senior secured debt leverage ratio permitted or minimum interest coverage ratio required under the Revolving Facility. The Revolving Facility matures in July 2010.

We believe that our business strategies will continue to improve the amount and speed of cash generated from operations under current economic conditions. Improvements in cash flow from operations resulting from these strategies are being partially offset by associated cash implementation costs while they are being implemented. We also believe that our improvements in cash flow from operations should allow us to continue to reduce our debt and other obligations over the long term.

At March 31, 2008, we were in compliance with all financial and other covenants contained in the Senior Notes, the Debentures and the Revolving Facility, as applicable. Based on expected operating results and expected cash flows, we expect to be in compliance with these covenants for the next twelve months. If we were to believe that we would not continue to comply with these covenants, we would seek an appropriate waiver or amendment from the lenders thereunder. We cannot assure you that we would be able to obtain such waiver or amendment on acceptable terms or at all.

At March 31, 2008, the Revolving Facility had an effective interest rate of 4.2%, our \$74.8 million principal amount of Senior Notes had a fixed rate of 10.25% and our \$225.0 million principal amount of Debentures had a fixed coupon rate of 1.625%. Also at March 31, 2008, 2% (or \$5.3 million) of our total debt consists of variable rate obligations.

At December 31, 2007, the Revolving Facility had an effective interest rate of 6.2%, our \$199.6 million principal amount of Senior Notes had a fixed rate of 10.25% and our \$225.0 million principal amount and Debentures had a fixed rate of 1.625%.

We may in the future implement interest rate management initiatives to seek to minimize interest expense and optimize the risk in our portfolio of fixed and variable interest rate obligations as described under **Item 3 Quantitative and Qualitative Disclosures about Market Risk** in this Report.

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***Cash Flow and Plans to Manage Liquidity.*** Our business strategies include efforts to enhance our capital structure by further reducing our gross obligations. Further, we have placed the highest priority on accelerating the amount and speed of cash generated every day. Our efforts include leveraging our global manufacturing network by driving higher utilization rates and more productivity from our existing assets, accelerating commercialization initiatives across all of our businesses and realizing other global efficiencies.

Typically, our cash flow from operations fluctuates significantly between quarters due to various factors. These factors include customer order patterns, fluctuations in working capital requirements, and other factors, including our incentive compensation program payout in the second quarter of 2008.

We expect cash flow from operations to be positively impacted by reduced interest expense of about \$17 million on an annual basis related to our reduced Senior Note obligations, decreases in cash outlay for planned overhead cost reductions and the positive impact of our last anti-trust payment made in January 2007. We expect our cash flow from operations to be negatively impacted by higher raw material prices, higher accounts receivable balances as a result of favorable pricing for industrial materials, the payment of certain international deferred taxes and planned pension and post retirement contributions.

Our debt and other obligations could have a material impact on our liquidity. Cash flow from operations services payment of our debt and other obligations, thereby reducing funds available to us for other purposes. Our debt and these obligations make us more vulnerable to economic downturns in the event that these obligations are greater or timing of payment is sooner than expected.

In order to seek to minimize our credit risks, we reduced our sales of, or refused to sell (except for cash on delivery), graphite electrodes and other products to some customers and potential customers in the U.S. and, to a limited extent, elsewhere. Our unrecovered trade receivables worldwide were only 0.1% of global net sales during the last 3 years. We cannot assure you that we will not be materially adversely affected by accounts receivable losses in the future. In addition, we have historically factored a portion of our accounts receivable and used the proceeds to reduce debt.

We may from time to time and at any time repurchase Senior Notes or Debentures in open market or privately negotiated transactions, opportunistically on terms that we believe to be favorable. In the three months ended March 31, 2008 we redeemed \$125 million of our Senior Notes.

In December 2007, our Board of Directors approved a share repurchase program authorizing the purchase of up to 3 million shares of our common stock. Share repurchases may take place from time to time in the open market, or through privately negotiated

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transactions, as market conditions warrant. We intend to fund any such share repurchases from available cash and cash flows. These share repurchases may be suspended or discontinued at any time.

We occasionally enter into natural gas derivative contracts and short duration fixed rate purchase contracts to effectively fix some or all of our natural gas cost exposure, as described under *Quantitative and Qualitative Disclosure about Market Risks* in this Report. At March 31, 2008, these contracts represented a receivable of \$0.1 million.

*Cash Flow Provided by Operating Activities.* Cash flow provided by operating activities was \$67.1 million in the three months ended March 31, 2008 as compared to \$18.0 million in the three months ended March 31, 2007, an increase of \$49.1 million.

Cash provided by net income, after adding back the effect of non-cash items, was \$70.7 million for the three months ended March 31, 2008. Non-cash items included \$8.6 million of depreciation and amortization, \$0.2 million of restructuring charges, \$16.2 million of foreign currency losses from inter-company loans, \$1.0 million in interest expense, \$1.2 million of stock based compensation expense, \$4.0 million net of other items, and a \$0.9 million change in deferred income taxes. Changes in working capital used cash flow of \$5.8 million for the three months ended March 31, 2008, due primarily to a \$4.7 million decrease in accounts receivable, including the effects of factoring, a \$3.5 million decrease in inventories, a \$0.9 million decrease in prepaid assets, and a \$7.0 million increase in accounts payable and accrued expenses. Restructuring payments used cash of \$0.1 million, and a decrease in interest payable represented a \$7.7 million use of cash.

For the three months ended March 31, 2007, cash provided by net income, after adding back the effect of non-cash items, was \$33.3 million, including the loss from discontinued operations of \$3.1 million. The non-cash items are related to depreciation and amortization charges of \$7.9 million, interest expense of \$1.1 million, \$1.1 million of foreign currency losses on inter-company transactions, restricted stock expense of \$1.3 million, and other items of \$3.5 million. Changes in working capital decreased cash flow by \$11.6 million for the three months ended March 31, 2007. Working capital uses related to a decrease in interest payable of \$13.7 million, \$5.4 million related to the final DOJ fine paid during January 2007, \$3.6 million for restructuring payments, and a \$0.8 million increase in inventories. These uses of working capital were partially offset by sources of cash generated from a decrease in accounts and notes receivable of \$10.2 million, including the effects of factoring, \$1.3 million related to decreases in prepaid and other current asset balances, and \$0.4 million related to increases in accounts payable and accruals. Changes in long term assets and liabilities used cash of \$3.7.

*Cash Flow Used in Investing Activities.* Cash flow used in investing activities was \$9.3 million in the three months ended March 31, 2008 and \$7.8 million in the three months ended March 31, 2007. Capital expenditures amounted to \$9.4 million for the three months ended March 31, 2008 and \$7.7 million of the three months ended March 31, 2007 and related primarily to industrial materials productivity and production stability initiatives and other essential capital maintenance.

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**GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES**

*Cash Flow Used in Financing Activities.* Cash flow used in financing activities was \$105.6 million in the three months ended March 31, 2008 compared to \$132.7 million during three months ended March 31, 2007. During the three months ended March 31, 2008, we redeemed \$125 million of our Senior Notes, and borrowed net \$4.1 million under the Revolving Facility. Other short-term borrowings, which related primarily to bank overdrafts at our international locations and amounts owed to our factoring principal related to collections from customers that were not yet remitted at March 31, 2008 under our current accounts receivable factoring arrangement, totaled \$15.9 million for the three months ended March 31, 2008. We used these borrowings primarily to fund increases in working capital and capital expenditures. The excess tax benefit from stock-based compensation was \$0.1 million for the three months ended March 31, 2008. We also purchased \$1.0 million of treasury shares during the three months ended March 31, 2008.

The use of cash for the three months ended March 31, 2007 related primarily to \$135 million associated with the redemption of our Senior Notes. We also made contributions to certain pension plans and had net borrowings under the Revolving Facility and European debt facilities of \$0.6 million for the three months ended March 31, 2007.

**Restrictions on Dividends and Stock Repurchases**

A description of the restrictions on our ability to pay dividends and our ability to repurchase common stock is set forth under **Item 5 Dividend Policies and Restrictions** in the Annual Report and such description is incorporated herein by reference. Such description contains all of the information required with respect thereto.

**Recent Accounting Pronouncements**

A description of recent accounting pronouncements is set forth under **New Accounting Standards** in Note 2 to the Notes to the Consolidated Financial Statements contained in this Report, and such description is incorporated herein by reference. Such description contains all of the information required with respect thereto.

**Description of Our Financing Structure**

A description of the Revolving Facility, the Senior Notes and the Debentures is set forth under **Long-Term Debt and Liquidity** in the Annual Report, and such description is incorporated herein by reference.

**Proceedings Against Us**

We are involved in various 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 them, we do not believe that their ultimate disposition will have a material adverse effect on our financial position, results of operations or cash flows.

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**PART I (CONT D)**

**GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES**

**Item 3. Quantitative and Qualitative Disclosures about Market Risk**

We are exposed to market risks primarily from changes in interest rates, currency exchange rates, and commercial energy rates. We from time to time enter into various transactions that have been authorized according to documented policies and procedures to manage these well-defined risks. These transactions relate primarily to financial instruments described below. Since the counterparties, if any, to these financial instruments are large commercial banks and similar financial institutions, we do not believe that we are exposed to material counterparty credit risk. We do not use financial instruments for trading purposes.

Our exposure to changes in interest rates results primarily from floating rate long-term debt tied to LIBOR or euro LIBOR. Our exposure to changes in currency exchange rates results primarily from:

sales made by our subsidiaries in currencies other than local currencies;

raw material purchases made by our foreign subsidiaries in currencies other than local currencies; and

investments in and intercompany loans to our foreign subsidiaries and our share of the earnings of those subsidiaries, to the extent denominated in currencies other than the dollar.

Our exposure to changes in energy costs results primarily from the purchase of natural gas and electricity for use in our manufacturing operations.

***Interest Rate Risk Management.*** We periodically implement interest rate management initiatives to seek to minimize our interest expense and optimize the risk in our portfolio of fixed and variable interest rate obligations.

When we sell a fair value swap, the gain or loss is amortized as a credit or charge to interest expense over the remaining term of the Senior Notes. When we effectively reduce the outstanding principal amount of the Senior Notes (through debt-for-equity exchanges, repurchases or otherwise), the related portion of such credit or charge is accelerated and recorded in the period in which such reduction occurs.

We periodically enter into agreements with financial institutions that are intended to limit, or cap, our exposure to incurrence of additional interest expense due to increases in variable interest rates. These instruments effectively cap our interest rate exposure.

***Currency Rate Management.*** We enter into foreign currency instruments from time to time to attempt to manage exposure to changes in currency exchange rates. These foreign currency instruments, which include, but are not limited to, forward exchange contracts and purchased currency options, attempt to hedge global currency exposures, net, relating to euro-denominated debt and identifiable foreign currency receivables, payables and commitments held by our foreign and domestic subsidiaries. Forward exchange contracts are agreements to exchange different currencies at a specified future date and at a specified rate. Purchased foreign currency options



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**PART I (CONT D)**

**GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES**

are instruments which give the holder the right, but not the obligation, to exchange different currencies at a specified rate at a specified date or over a range of specified dates. The result is the creation of a range in which a best and worst price is defined, while minimizing option cost. Forward exchange contracts and purchased currency options are carried at market value. As of December 31, 2007 and March 31, 2008, there were no outstanding contracts.

**Commercial Energy Rate Management.** We periodically enter into natural gas derivative contracts and short duration fixed rate purchase contracts to effectively fix some or all of our natural gas cost exposure. The outstanding contracts at March 31, 2008 were a receivable of \$0.1 million. We are required to provide cash collateral to certain counterparties to the extent that the fair market value of the natural gas derivative contracts exceeds a specific threshold. At March 31, 2008, we were not required to provide any cash collateral.

**Sensitivity Analysis.** We used a sensitivity analysis to assess the potential effect of changes in currency exchange rates and interest rates on results of operations for the 2008 first quarter. Based on this analysis, a hypothetical 10% weakening or strengthening in the dollar across all other currencies would have changed our reported gross margin for the 2008 first quarter by \$3.6 million. Also, a hypothetical increase in interest rates of 100 basis points for our variable interest rate obligations would have increased our interest expense by a nominal amount.

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**PART I (CONT D)**

**GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES**

***Item 4. Controls and Procedures***

*Evaluation of Disclosure Controls and Procedures.* Management is responsible for establishing and maintaining adequate disclosure controls and procedures at the reasonable assurance level. Disclosure controls and procedures are designed to ensure that information required to be disclosed by a reporting company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by it in the reports that it files under the Exchange Act is accumulated and communicated to management, including the chief executive officer and chief financial officer, as appropriate to allow timely decisions regarding required disclosure.

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we have evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of March 31, 2008. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that these controls and procedures are effective at the reasonable assurance level as of March 31, 2008.

*Changes in Internal Controls over Financial Reporting.* There have been no changes in our internal controls over financial reporting that occurred during the three months ended March 31, 2008 that materially affected or are reasonably likely to materially affect our internal controls over financial reporting.

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**PART II. OTHER INFORMATION**

**GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES**

**Item 1. Legal Proceedings**

This information required in response to this Item is set forth under *Contingencies* in Note 13 to the Notes to Consolidated Financial Statements contained in this Report, and such description is incorporated herein by reference.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

In December 2007, we announced that our Board of Directors had approved a share repurchase program authorizing the purchase of up to 3 million shares of our common stock. Purchases may take place from time to time in the open market, or through privately negotiated transactions, as market conditions warrant. During the first quarter of 2008, we did not repurchase any shares under this program.

In addition to the above repurchase program, we occasionally purchase vested restricted stock shares from employees to cover withholding taxes. During the first quarter of 2008, we purchased 64,950 shares at an average price of \$16.05.

**Item 6. Exhibits**

The exhibits listed in the following table have been filed as part of this Report.

<b>Exhibit Number</b>	<b>Description of Exhibit</b>
31.1	Certification pursuant to Rule 13a-14(a) under the Exchange Act by Craig S. Shular, Chief Executive Officer, President and Chairman of the Board.
31.2	Certification pursuant to Rule 13a-14(a) under the Exchange Act by Mark R. Widmar, Vice President and Chief Financial Officer.
32.1	Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 by Craig S. Shular, Chief Executive Officer, President and Chairman of the Board.
32.2	Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 by Mark R. Widmar, Vice President and Chief Financial Officer.

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**SIGNATURE**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this Report to be signed on its behalf by the undersigned thereunto duly authorized.

**GRAFTECH INTERNATIONAL LTD.**

Date: May 1, 2008

By: /s/ Mark R. Widmar  
Mark R. Widmar  
*Vice President and Chief Financial  
Officer (Principal Accounting Officer)*

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