

GRAFTECH INTERNATIONAL LTD

Form 10-Q

May 10, 2007

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

Washington, D.C. 20549

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**FORM 10-Q**

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(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, 2007

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

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**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)

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12900 Snow Road

Parma, OH  
(Address of principal executive offices)

44130  
(Zip code)

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

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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, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer  Accelerated Filer  Non-Accelerated Filer

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

As of April 30, 2007, 99,308,209 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)*

	At December 31, 2006	At March 31, 2007
<b>Current Assets:</b>		
Cash and cash equivalents	\$ 149,517	\$ 26,733
Accounts and notes receivable, net of allowance for doubtful accounts of \$3,186 at December 31, 2006 and \$2,964 at March 31, 2007	166,528	157,420
Inventories	239,129	241,336
Prepaid expenses and other current assets	14,071	12,703
<b>Total current assets</b>	<b>569,245</b>	<b>438,192</b>
Property, plant and equipment	889,389	895,266
Less: accumulated depreciation	599,636	604,473
<b>Net property, plant and equipment</b>	<b>289,753</b>	<b>290,793</b>
Deferred income taxes	6,326	5,529
Goodwill	9,822	9,533
Other assets	29,253	25,760
Assets held for sale	1,802	1,805
<b>Total assets</b>	<b>\$ 906,201</b>	<b>\$ 771,612</b>
<b>LIABILITIES AND STOCKHOLDERS DEFICIT</b>		
<b>Current liabilities:</b>		
Accounts payable	\$ 62,094	\$ 53,803
Interest payable	18,872	5,150
Short-term debt	458	206
Accrued income and other taxes	41,099	49,055
Other accrued liabilities	98,068	89,347
<b>Total current liabilities</b>	<b>220,591</b>	<b>197,561</b>
<b>Long-term debt:</b>		
Principal value	657,714	523,471
Fair value adjustments for hedge instruments	6,421	4,164
Unamortized bond premium	1,265	822
<b>Total long-term debt</b>	<b>665,400</b>	<b>528,457</b>

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Other long-term obligations	103,408	103,733
Deferred income taxes	27,000	28,043
Minority stockholders' equity in consolidated entities (see Contingencies Note 13)	3,722	3,797
Stockholders' deficit:		
Preferred stock, par value \$.01, 10,000,000 shares authorized, none issued		
Common stock, par value \$.01, 150,000,000 shares authorized, 101,433,949 shares issued at December 31, 2006 and 101,741,813 shares issued at March 31, 2007	1,026	1,026
Additional paid-in capital	950,023	953,445
Accumulated other comprehensive loss	(312,763)	(310,191)
Accumulated deficit	(660,153)	(642,265)
Less: cost of common stock held in treasury, 2,501,201 shares at December 31, 2006 and at March 31, 2007	(85,197)	(85,197)
Less: common stock held in employee benefit and compensation trusts, 472,566 shares at December 31, 2006 and 468,960 shares at March 31, 2007.	(6,856)	(6,797)
Total stockholders' deficit	(113,920)	(89,979)
Total liabilities and stockholders' deficit	\$ 906,201	\$ 771,612

*See accompanying Notes to Consolidated Financial Statements*

**Table of Contents****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>2006</b>	<b>2007</b>
Net sales	\$ 174,192	\$ 228,231
Cost of sales	124,743	151,949
<b>Gross profit</b>	<b>49,449</b>	<b>76,282</b>
Research and development	2,531	2,234
Selling and administrative expenses	24,808	22,308
Restructuring charges	2,946	884
Impairment loss on long-lived assets	8,151	
Other (income) expense, net	(380)	11,104
Interest expense	11,788	11,711
Interest income	(126)	(966)
	<b>49,718</b>	<b>47,275</b>
Income (loss) from continuing operations before provision for income taxes and minority stockholders' share of subsidiaries' income (loss)	(269)	29,007
Provision for income taxes	3,579	10,530
Income (loss) from continuing operations before minority interest	(3,848)	18,477
Minority stockholders' share of subsidiaries' income	3	33
Income (loss) from continuing operations	(3,851)	18,444
Loss from discontinued operations, net of tax	(795)	(589)
Net income (loss)	\$ (4,646)	\$ 17,855
<b>Basic income (loss) per common share:</b>		
Income (loss) per share from continuing operations	\$ (0.04)	\$ 0.19
Loss per share from discontinued operations	(0.01)	(0.01)
Net income (loss) per share	\$ (0.05)	\$ 0.18
Weighted average common shares outstanding	97,912	98,624
<b>Diluted income (loss) per common share:</b>		
Income (loss) per share from continuing operations	\$ (0.04)	\$ 0.17
Loss per share from discontinued operations	(0.01)	

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Net income (loss) per share	\$ (0.05)	\$ 0.17
Weighted average common shares outstanding	97,912	113,606
<i>See accompanying Notes to Consolidated Financial Statements</i>		

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

	<b>For the</b>	
	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2006</b>	<b>2007</b>
Cash flow from operating activities:		
Net income (loss)	\$ (4,646)	\$ 17,855
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Loss from discontinued operations, net of tax	795	589
Depreciation and amortization	9,246	7,874
Deferred income taxes	146	1,028
Restructuring charges	2,946	884
Impairment loss on long-lived assets	8,151	
Interest expense	797	1,082
Other charges, net	(1,379)	3,958
Increase in working capital *	(40,191)	(11,589)
Benefit obligation changes	(2,666)	(1,578)
Long-term assets and liabilities	(6,566)	(2,079)
Net cash (used in) provided by operating activities	(33,367)	18,024
Cash flow from investing activities:		
Capital expenditures	(10,942)	(7,671)
Patent capitalization	(124)	(236)
Proceeds from sale of assets	128	136
Net cash used in investing activities	(10,938)	(7,771)
Cash flow from financing activities:		
Short-term debt borrowings, net	15,656	158
Revolving Facility borrowings	62,255	45,645
Revolving Facility reductions	(18,347)	(45,052)
Long term debt reductions		(134,867)
Proceeds from exercise of stock options		1,374
Net cash (used in) provided by financing activities	59,564	(132,742)
Net (decrease) increase in cash and cash equivalents	15,259	(122,489)
Effect of exchange rate changes on cash and cash equivalents	74	(295)
Cash and cash equivalents at beginning of period	5,968	149,517
Cash and cash equivalents at end of period	\$ 21,301	\$ 26,733



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

(Increase) decrease in current assets:

Accounts and notes receivable	\$ 23,411	\$ (646)
Effect of factoring on accounts receivable	2,370	10,814
Inventories	(29,323)	(817)
Prepaid expenses and other current assets	6	1,296
Payments for antitrust investigations and related lawsuits and claims	(4,500)	(5,380)
Restructuring payments	(921)	(3,561)
Decrease in accounts payable and accruals	(19,408)	427
Decrease in interest payable	(11,826)	(13,722)
Increase in working capital	\$ (40,191)	\$ (11,589)

*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, 2006 (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, 2006 have been reclassified to conform with current period presentation.

**(2) New Accounting Standards**

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 and not to portions of instruments. SFAS 159 is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. We are currently in the process of assessing the impact of the adoption of SFAS 159 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, and expands disclosures about fair value measurements. SFAS No. 157 requires disclosure of information that enables users of the financial statements to assess the inputs used to develop fair value measurements and, for recurring fair value measurements using significant unobservable inputs, the effects of the measurements on earnings for the period. This statement is effective for fiscal years beginning after November 15, 2007. We are currently in the process of assessing the impact of the adoption of SFAS No. 157 on our consolidated results of operations and financial position.

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**GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

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

In June 2006, the FASB issued Interpretation No. 48 ( FIN 48 ), *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109*. FIN 48 clarifies the recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Under the guidelines of FIN 48, an entity should recognize a financial statement benefit for a tax position if it determines that it is more likely than not that the position will be sustained upon examination. We have adopted FIN 48 as of January 1, 2007. Additional information with respect to the adoption of this standard is set forth in Note 15 to the Consolidated Financial Statements.

In June 2006, the Emerging Issues Task Force ( EITF ) reached a consensus on Issue No. 06-03, *How Sales Tax Collected from Customers and Remitted to Governmental Authorities Should be Presented in the Income Statement (That is, Gross versus Net Presentation)* ( EITF 06-3 ). This EITF Issue clarifies that the presentation of taxes collected from customers and remitted to governmental authorities on a gross (included in revenues and costs) or net (excluded from revenues) basis is an accounting policy decision that should be disclosed pursuant to Accounting Principles Board (APB) Opinion No. 22, *Disclosure of Accounting Policies*. We adopted EITF 06-3 as of January 1, 2007. Our accounting policy is to collect such taxes from customers and account for them on a net basis. The adoption of EITF 06-03 did not have an impact on our consolidated results of operations or financial position.

**(3) Stock-Based Compensation**

In the three months ended March 31, 2007 and 2006, we recognized \$1.4 million and \$1.1 million, respectively, in stock-based compensation expense. A majority of the expense, \$1.3 million and \$1.0 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, 2007, the total compensation cost related to the non-vested restricted stock and stock options not yet recognized was \$5.7 million and will be recognized over the weighted average life of 1.76 years.

Restricted stock activity under the plans for the three months ended March 31, 2007 was as follows:

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	Number of Shares	Weighted- Average Grant Date Fair Value
Outstanding at January 1, 2007	1,630,725	\$ 6.29
Granted	58,274	7.51
Vested	(64,608)	7.18
Forfeited	(26,245)	4.18
Outstanding at March 31, 2007	1,598,146	\$ 6.35

Stock option activity under the plans for the three months ended March 31, 2007 was as follows:

	Number of Shares	Weighted- Average Grant Date Fair Value
Outstanding at January 1, 2007	9,424,864	\$ 12.01
Granted		
Vested		
Terminated	(1,719,944)	19.40
Exercised	(198,079)	6.61
Outstanding at March 31, 2007	7,506,841	\$ 10.46

**(4) Earnings Per Share**

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

	<b>For the Three Months</b>	
	<b>Ended March 31,</b>	
	<b>2006</b>	<b>2007</b>
	<i>(Dollars in thousands,</i>	
	<i>except option data)</i>	
Net income (loss), as reported	\$ (4,646)	\$ 17,855
Add: Interest on Debentures, net of tax benefit		898
Add: Amortization of Debentures issuance costs, net of tax benefit		422

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Net income (loss), as adjusted	\$ (4,646)	\$ 19,175
Weighted average common shares outstanding for basic calculation	97,912,499	98,623,569
Add: Effect of stock options and restricted stock		1,411,962
Add: Effect of Debentures		13,570,560
Weighted average common shares outstanding for diluted calculation	97,912,499	113,606,091

Basic earnings (loss) per common share are calculated by dividing net income (loss) by the weighted average number of common shares outstanding. Diluted earnings (loss) per share are calculated by dividing net income (loss), 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.

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**PART I (CONT D)**

**GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

The calculation of weighted average common shares outstanding for the diluted calculation excludes consideration of stock options covering 9,451,763 and 5,585,628 shares for the three months ended March 31, 2006 and 2007, respectively, because the exercise of these options would not have been dilutive for those periods due to the fact that the exercise prices were greater than the weighted average market price of our common stock for each of those periods.

The calculation of weighted average common shares outstanding for the diluted calculation also excludes the 13,570,560 shares underlying the Debentures for the three months ended March 31, 2006 and the effect of 428,743 stock options and restricted shares at March 31, 2006 as the effect would have been anti-dilutive due to the loss from continuing operations.

**(5) Segment Reporting**

Our businesses are reported in the following reportable segments:

**Graphite Electrode.** Our graphite electrode segment manufactures and delivers high quality graphite electrodes and related services. Electrodes are key components of the conductive power systems used to produce steel and other non-ferrous metals.

**Advanced Graphite Materials.** Advanced graphite materials include primary and specialty products for transportation, semiconductor and other markets.

**Other Businesses.** Other businesses include natural graphite products, refractories and carbon electrodes.

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

The following tables summarize financial information concerning our reportable segments.

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	<b>For the Three Months Ended March 31,</b>	
	<b>2006</b>	<b>2007</b>
	<i>(Dollars in thousands)</i>	
Net sales to external customers:		
Graphite electrode	\$ 128,792	\$ 180,064
Advanced graphite materials	25,162	26,507
Other businesses	20,238	21,660
<b>Total net sales</b>	<b>\$ 174,192</b>	<b>\$ 228,231</b>
Segment operating income (loss):		
Graphite electrode	\$ 13,095	\$ 47,677
Advanced graphite materials	2,106	3,287
Other businesses	(4,188)	(108)
<b>Total segment operating income</b>	<b>\$ 11,013</b>	<b>\$ 50,856</b>
Reconciliation of segment operating income to income (loss) from continuing operations before provision for income taxes and minority stockholders' share of subsidiaries' income (loss)		
Other (income) expense, net	(380)	11,104
Interest expense	11,788	11,711
Interest income	(126)	(966)
<b>Income (loss) from continuing operations before provision for income taxes and minority stockholders' share of subsidiaries' income (loss)</b>	<b>\$ (269)</b>	<b>\$ 29,007</b>

**(6) Restructuring Charges and Impairment Losses**

At March 31, 2007, the outstanding balance of our restructuring reserve was \$5.2 million. We expect the majority of the remaining payments to be paid by the end of 2007. The balance at March 31, 2007 consisted primarily of the following:

*Graphite Electrode Segment:*

\$1.3 million related to the restructuring of our manufacturing facilities, including those in France, and the cessation of operations of our facility in Russia.

\$1.8 million related to the closure of our graphite electrode manufacturing operations in Caserta, Italy.

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\$0.8 million related to the phase-out of our graphite electrode machining operations in Clarksville, Tennessee.

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



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\$0.8 million related to the shutdown of our carbon electrode production operations at our Columbia, Tennessee facility. In the three months ended March 31, 2007, we recorded a net restructuring charge of \$0.9 million. A majority of the net charge was comprised of severance and related costs associated with our Switzerland facility and similar costs related to rationalization of our graphite electrode facility in Clarksville, Tennessee.

The following table summarizes activity relating to the restructuring liability at March 31, 2007:

	<b>Severance and Related Costs</b>	<b>Plant Shutdown and Related Costs</b>	<b>Total</b>
	<i>(Dollars in thousands)</i>		
<b>Balance at January 1, 2007</b>	\$ 7,185	\$ 689	\$ 7,874
Restructuring charges	498	386	884
Change in estimates			
Payments and settlements	(3,167)	(394)	(3,561)
Effect of change in currency exchange rates	28	7	35
<b>Balance at March 31, 2007</b>	\$ 4,544	\$ 688	5,232

In the three months ended March 31, 2006, we abandoned long-lived fixed assets associated with costs capitalized for our enterprise resource planning system implementations due to an indefinite delay in the implementation of the remaining facilities. As a result, we recorded a \$6.6 million loss, including the write off of capitalized interest, in accordance with SFAS No. 144, *Accounting For the Impairment and Disposal of Long-Lived Assets*.

Also, in the three months ended March 31, 2006, management announced its intention to sell certain long-lived assets from our Etoy, Switzerland and Caserta, Italy facilities. As a result, we have classified these assets as held for sale in the Consolidated Balance Sheets in accordance with SFAS No. 144. In addition, we have recorded a \$1.4 million impairment loss that adjusts the carrying value of the assets in Switzerland to the estimated fair value less estimated selling costs. In the third quarter of 2006, we sold the long-lived assets at our Etoy, Switzerland facility for \$7.1 million.

**Table of Contents****PART I (CONT D)****GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited)****(7) Other (Income) Expense, Net**

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

	<b>For the Three</b>	
	<b>Months Ended</b>	
	<b>March 31,</b>	
	<b>2006</b>	<b>2007</b>
	<i>(Dollars in thousands)</i>	
Currency (gains) losses	\$ (2,386)	\$ 1,727
Loss on extinguishment of debt		7,523
Legal, environmental and other related costs	974	801
Loss on the disposal of fixed assets	405	706
Bank and other financing fees	358	666
Loss on the sale of accounts receivable	175	150
Other	94	(469)
 Total other (income) expense, net	 \$ (380)	 \$ 11,104

We have non-dollar-denominated intercompany loans between GrafTech Finance and some of our foreign subsidiaries. At December 31, 2006 and March 31, 2007, the aggregate principal amount of these loans was \$450.7 million and \$452.9 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' deficit section of the Consolidated Balance Sheets. The balance of these loans is deemed to be temporary and, as a result, remeasurement gains and losses on these loans are recorded as currency (gains) losses in other expense, net, on the Consolidated Statements of Operations. In the three months ended March 31, 2006, we had a net total of \$2.4 million of currency gains, including \$4.0 million of exchange gains due to the remeasurement of intercompany loans and translation of financial statements of foreign subsidiaries which use the dollar as their functional currency. In the three months ended March 31, 2007, we had a net total of \$1.7 million of currency losses, including \$1.5 million of exchange losses due to the remeasurement of intercompany loans and translation of financial statements of foreign subsidiaries that use the dollar as their functional currency.

In connection with the redemption of \$135.0 million of the outstanding principal of the Senior Notes, 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)****(8) 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,	
	2006	2007	2006	2007
	<i>(Dollars in thousands)</i>			
Service cost	\$ 294	\$ 244	\$ 103	\$ 122
Interest cost	3,038	2,827	505	207
Expected return on plan assets	(3,168)	(3,081)		
Amortization of transition obligation	(24)	(21)		
Amortization of prior service cost (benefit)	18	30	(5,280)	(2,832)
Amortization of unrecognized loss	729	576	1,333	1,120
Net cost (benefit)	\$ 887	\$ 575	\$ (3,339)	\$ (1,383)

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

The following table presents our long-term debt:

	At December 31, 2006	At March 31, 2007
	<i>(Dollars in thousands)</i>	
Revolving Facility	\$	\$
Senior Notes:		
Senior Notes due 2012	434,631	299,597
Fair value adjustments for terminated hedge instruments*	6,421	4,164
Unamortized bond premium	1,265	822
Total Senior Notes	442,317	304,583
Debentures	222,233	222,400
Other European debt	850	1,474
Total	\$ 665,400	\$ 528,457

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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, 2007, we redeemed a total of \$135.0 million of the outstanding principal amount of the 10 <sup>1</sup>/<sub>4</sub>% 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.

On April 23, 2007, we and certain of our subsidiaries requested U.S. Bank National Association, as trustee, to redeem an additional \$50 million of the outstanding principal amount of the 10 <sup>1</sup>/<sub>4</sub>% Senior Notes, due 2012, at 105.125% of the principal amount, plus accrued interest. This redemption is expected to occur in May 2007. In connection with this redemption, we expect to

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incur a \$2.7 million loss on the extinguishment of debt, which includes \$2.6 million related to the call premium and \$0.1 million of charges for accelerated amortization of the debt issuance fees, terminated interest rate swaps and the premium related to the Senior Notes.

**(10) Inventories**

Inventories are comprised of the following:

	<b>At December 31,</b>	
	<b>2006</b>	<b>At March 31, 2007</b>
	<i>(Dollars in thousands)</i>	
<b>Inventories:</b>		
Raw materials and supplies	\$ 79,277	\$ 70,614
Work in process	123,162	123,403
Finished goods	41,039	50,821
	243,478	244,838
Reserves	(4,349)	(3,502)
	\$ 239,129	\$ 241,336

**(11) Interest Expense**

The following table presents an analysis of interest expense:

	<b>For the Three Months Ended March 31,</b>	
	<b>2006</b>	<b>2007</b>
	<i>(Dollars in thousands)</i>	
Interest incurred on debt	10,815	10,749
Amortization of fair value adjustments for terminated hedge instruments	(239)	(203)
Amortization of debt issuance costs	912	875
Interest on DOJ antitrust fine	84	5
Amortization of premium on Senior Notes	(51)	(38)
Amortization of discount on Debentures	161	166
Interest incurred on other items	106	157
Total interest expense	\$ 11,788	\$ 11,711

**(12) Other Comprehensive Income**

Other comprehensive income consisted of the following:

	<b>For the Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2006</b>	<b>2007</b>
	<i>(Dollars in thousands)</i>	
Net income (loss)	\$ (4,646)	\$ 17,855
Other comprehensive income:		
Foreign currency translation adjustments	9,622	2,768
Total comprehensive income	\$ 4,976	\$ 20,623

**Table of Contents****PART I (CONT D)****GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited)****(13) Contingencies***Antitrust Investigations*

Beginning in 1997, the United States Department of Justice ( DOJ ) and other foreign antitrust authorities commenced investigations into alleged violations of the antitrust laws in connection with the sale of the graphite electrodes. These antitrust investigations and related lawsuits and claims have been resolved. Several of the investigations resulted in the imposition of fines against us which have been timely paid. At December 31, 2006, \$5.4 million remained in the reserve for liabilities and expenses in connection with these investigations representing the last scheduled installment of the fine imposed by the DOJ, which was paid in January 2007.

*Other Matters and Proceedings Against Us*

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

*Environmental Matters*

During 2006, we increased our reserve for environmentally related activities to be performed in connection with the closure and proposed sale of our Caserta, Italy facility by \$1.7 million. The increase in the reserve relates primarily to activities for closing the on-site solid waste landfill earlier than originally anticipated.

*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 \$0.9 million at December 31, 2006 and \$0.7 million at March 31, 2007. The following table presents the activity in this accrual for the three months ended March 31, 2007:

	<i>(Dollars in Thousands)</i>	
<b>Balance at January 1, 2007</b>	\$	920
Product warranty charges		5
Payments and settlements		(181)
<b>Balance at March 31, 2007</b>	\$	744

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**GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

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

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

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

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

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

Provisions in the Revolving Facility restrict the payment of dividends by our subsidiaries to the Parent. At March 31, 2007, retained earnings of our subsidiaries subject to such restrictions were approximately \$952 million. Investments in subsidiaries are recorded on the equity basis.



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**PART I (CONT D)**

**GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

The following table sets forth condensed consolidating balance sheets at December 31, 2006 and March 31, 2007, condensed consolidating statements of operations for the 2006 and 2007 first quarters, and condensed consolidating statements of cash flows for the 2006 and 2007 first quarters of the Parent, Finco, all other U.S. Guarantors and the Non-Guarantors.

**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, 2006**

	<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>
	<i>(Dollars in thousands)</i>					
<b>ASSETS</b>						
<b>Current assets:</b>						
Cash and cash equivalents	\$ 151	\$ 125,161	\$	\$ 24,335	\$ (130)	\$ 149,517
Intercompany loans	67,402	190,976		328,602	(586,980)	
Intercompany accounts receivable		12,071	38,065	17,939	(68,075)	
Accounts receivable - third party		130	23,376	143,022		166,528
Accounts and notes receivable, net	67,402	203,177	61,441	489,563	(655,055)	166,528
Inventories			51,220	187,948	(39)	239,129
Prepaid expenses and other current assets		16,430	1,444	18,417	(22,220)	14,071
Total current assets	67,553	344,768	114,105	720,263	(677,444)	569,245
Property, plant and equipment, net			43,567	250,834	(4,648)	289,753
Deferred income taxes			9,100	6,326	(9,100)	6,326
Intercompany loans		542,973			(542,973)	
Investments in affiliates						
Goodwill				9,822		9,822
Other assets	4,288	14,229	2,540	8,196		29,253
Assets held for sale				1,802		1,802
Total assets	\$ 71,841	\$ 901,970	\$ 169,312	\$ 997,243	\$ (1,234,165)	\$ 906,201
<b>LIABILITIES AND STOCKHOLDERS</b>						
<b>EQUITY (DEFICIT)</b>						
<b>Current liabilities:</b>						
Accounts payable	\$	\$	\$ 7,791	\$ 54,303	\$	\$ 62,094
Interest payable	1,676	17,195		1		18,872
Intercompany loans		330,540	242,132	82,487	(655,159)	
Third party loans				458		458

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Short-term debt		330,540	242,132	82,945	(655,159)	458
Accrued income and other taxes	1,939		27,309	34,065	(22,214)	41,099
Other accrued liabilities		184	30,160	67,724		98,068
Total current liabilities	3,615	347,919	307,392	239,038	(677,373)	220,591
Long-term debt	222,234	442,317		849		665,400
Intercompany loans				542,972	(542,972)	
Other long-term obligations			56,101	47,307		103,408
Payable to equity of investees	(40,088)		(593,631)		633,719	
Deferred income taxes				36,098	(9,098)	27,000
Minority stockholders' equity in consolidated entities				3,722		3,722
Stockholders' equity (deficit)	(113,920)	111,734	399,450	127,257	(638,441)	(113,920)
Total liabilities and stockholders' deficit	\$ 71,841	\$ 901,970	\$ 169,312	\$ 997,243	\$ (1,234,165)	\$ 906,201

**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, 2007**

	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	\$ 150	\$ 5,161	\$	\$ 21,568	\$ (146)	\$ 26,733
Intercompany loans	69,442	179,756		350,722	(599,920)	
Intercompany accounts receivable		7,787	41,745	34,213	(83,745)	
Accounts receivable third party			21,855	135,565		157,420
Accounts and notes receivable, net	69,442	187,543	63,600	520,500	(683,665)	157,420
Inventories			44,760	196,630	(54)	241,336
Prepaid expenses and other current assets	741	20,835	144	16,379	(25,396)	12,703
Total current assets	70,333	213,539	108,504	755,077	(709,261)	438,192
Property, plant and equipment, net			44,752	250,844	(4,803)	290,793
Deferred income taxes			10,160	3,770	(8,401)	5,529
Intercompany loans		545,181			(545,181)	
Goodwill				9,533		9,533
Other assets	4,020	10,561	2,648	8,531		25,760
Assets held for sale				1,805		1,805
Total assets	\$ 74,353	\$ 769,281	\$ 166,064	\$ 1,029,560	\$ (1,267,646)	\$ 771,612
<b>LIABILITIES AND STOCKHOLDERS</b>						
<b>EQUITY (DEFICIT)</b>						
<b>Current liabilities:</b>						
Accounts payable	\$	\$	\$ 6,297	\$ 47,506	\$	\$ 53,803
Interest payable	762	4,382		6		5,150
Intercompany loans		355,619	249,125	79,125	(683,869)	
Third party loans				206		206
Short-term debt		355,619	249,125	79,331	(683,869)	206
Accrued income and other taxes			33,123	41,020	(25,390)	49,055

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Other accrued liabilities		10	26,895	62,442		89,347
Total current liabilities	762	360,011	315,440	230,305	(709,259)	197,561
Long-term debt	222,400	304,583		1,474		528,457
Intercompany loans				545,180	(545,180)	
Other long-term obligations			54,169	49,564		103,733
Payable to equity of investees	(62,290)		(607,471)		669,761	
Deferred income taxes				36,444	(8,401)	28,043
Minority stockholders' equity in consolidated entities				3,797		3,797
Stockholders' equity (deficit)	(86,519)	104,687	403,926	162,796	(674,567)	(89,979)
Total liabilities and stockholders' deficit	\$ 74,353	\$ 769,281	\$ 166,064	\$ 1,029,560	\$ (1,267,646)	\$ 771,612











**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, 2006**

	Parent (Issuer of Debtures and Guarantor of Senior Notes)	Finco (Issuer of Senior Notes and Guarantor of Debtures)	All Other U.S. Guarantors (Dollars in thousands)	Non- Guarantors	Consolidation/ Eliminations	Consolidated
<b>Cash flow from operating activities:</b>						
Net income (loss)	\$ (6,880)	\$ (3,449)	\$ (2,173)	\$ 14,256	\$ (6,400)	\$ (4,646)
Adjustment to reconcile net income (loss) to net cash (used in) provided by operations:						
Loss from discontinued operations, net of tax				795		795
Depreciation and amortization			988	6,795	1,463	9,246
Deferred income taxes		193	823	(872)	2	146
Restructuring charges			1,642	1,304		2,946
Impairment loss on long-lived assets			6,768	1,383		8,151
Post retirement plan changes			(3,692)	1,026		(2,666)
Other (credits) charges, net	7,542	6,231	(8,841)	(9,915)	4,401	(582)
(Increase) decrease in working capital	(909)	(10,996)	(6,196)	(22,207)	117	(40,191)
Long-term assets and liabilities			(5,315)	(1,251)		(6,566)
<b>Net cash used in operating activities</b>	<b>(247)</b>	<b>(8,021)</b>	<b>(15,996)</b>	<b>(8,686)</b>	<b>(417)</b>	<b>(33,367)</b>
<b>Cash flow from investing activities:</b>						
Intercompany receivable/payable		(1,331)	(3,279)	5,758	(1,148)	
Intercompany debt, net	538	(33,014)	21,098	10,295	1,083	
Capital expenditures			(1,795)	(9,539)	392	(10,942)
Payments made for patents			(74)	(50)		(124)
Proceeds from sale of assets			10	118		128
Sale of interest rate swap						
<b>Net cash used in investing activities</b>	<b>538</b>	<b>(34,345)</b>	<b>15,960</b>	<b>6,582</b>	<b>327</b>	<b>(10,938)</b>
<b>Cash flow from financing activities:</b>						
Short-term debt borrowings (reductions), net	(212)			15,868		15,656
Revolving Facility borrowings		62,255				62,255
Revolving Facility reductions		(18,153)		(194)		(18,347)
Financing costs						
<b>Net cash provided by financing activities</b>	<b>(212)</b>	<b>44,102</b>		<b>15,674</b>		<b>59,564</b>

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Net increase (decrease) in cash and cash equivalents	79	1,736	(36)	13,570	(90)	15,259
Effect of exchange rate changes on cash and cash equivalents				74		74
Cash and cash equivalents at beginning of period	143		36	5,877	(88)	5,968
Cash and cash equivalents at end of period	\$ 222	\$ 1,736	\$	\$ 19,521	\$ (178)	\$ 21,301

**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, 2007**

	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>					
Cash flow from operating activities:						
Net income (loss)	\$ 17,492	\$ (7,521)	\$ 21,233	\$ 34,112	\$ (47,461)	\$ 17,855
Adjustment to reconcile net income (loss) to net cash (used in) provided by operations:						
Loss from discontinued operations, net of tax			589			589
Depreciation and amortization			1,312	6,562		7,874
Deferred income taxes	(2,394)	278	2,655	489		1,028
Restructuring charges			530	354		884
Interest expense	(175)	1,410	(153)			1,082
Other charges, net	(10,664)	(1,068)	(35,175)	3,223	47,642	3,958
Increase in working capital	(3,594)	(17,252)	9,774	(419)	(98)	(11,589)
Benefit obligation changes			(1,595)	17		(1,578)
Long-term assets and liabilities			(720)	(1,359)		(2,079)
Net cash used in operating activities	665	(24,153)	(1,550)	42,979	83	18,024
Cash flow from investing activities:						
Intercompany receivable/payable		7,242	10,969	(16,716)	(1,495)	
Intercompany debt, net	(2,040)	31,133	(7,656)	(22,833)	1,396	
Capital expenditures			(2,076)	(5,595)		(7,671)
Patent capitalization			(80)	(156)		(236)
Proceeds from sale of assets			57	79		136
Net cash (used in) investing activities	(2,040)	38,375	1,214	(45,221)	(99)	(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)	0	(45,052)
Long term debt reduction		(134,867)				(134,867)
Proceeds from exercise of stock options	1,374					1,374
Net cash (used in) provided by financing activities	1,374	(134,222)	336	(230)	0	(132,742)
Net (decrease) increase 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

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**PART I (CONT D)**

**GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**(15) Income Taxes**

We adopted FIN 48 on January 1, 2007, which requires financial statement benefits to be recognized for positions taken for tax return purposes when it is more likely than not that the position will be sustained. For additional information regarding FIN 48 refer to New Accounting Standards in Note 2.

The adoption of FIN 48 resulted in no net effect to the opening balance of retained earnings as of January 1, 2007.

As of January 1, 2007, we had unrecognized tax benefits of \$5.2 million, principally related to foreign tax uncertainties, of which \$5.2 million would have a favorable impact on our effective tax rate, if recognized. We have elected to report interest and penalties related to uncertain income tax positions as income tax expense. As of January 1, 2007, accrued interest and penalties were \$0.9 million.

In the United States, years 2003 and forward are open to examination. During the first quarter, the IRS commenced an audit of the 2004 year.

Generally, for the foreign countries in which we file tax returns, years beginning in 2003 or after are still open to examination by foreign taxing authorities; however, there are four countries for which the years 2002 or after are still open to tax examination. Revenue Canada is currently examining the 2002-2005 tax years.

It is expected that the amount of unrecognized tax benefits will change in the next 12 months; however, we do not expect that change to have a significant impact on our results of operations or our financial position.

**(16) 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

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

discontinued operation. We have reflected prior period results of the cathode business as a discontinued operation on the Consolidated Statements of Operations. Interest expense was allocated to discontinued operations based on the ratio of fixed assets included in the sale over total consolidated fixed assets in accordance with EITF 87-24, *Allocation of Interest to Discontinued Operations*.

The following table sets forth the results of the discontinued operation.

	<b>Three Months Ended March 31, 2006 (Dollars in thousands)</b>
Net sales	\$ 34,396
Cost of sales	29,222
<b>Gross profit</b>	<b>5,174</b>
Operating expenses	3,328
Other (income) expense, net	104
Interest expense	2,441
Interest income	(13)
Loss before provision for income taxes	(686)
Provision for income taxes	(92)
Less: Minority stockholders share of loss	201
<b>Loss from discontinued operations</b>	<b>\$ (795)</b>
Basic loss per common share	\$ (0.01)
Diluted loss per common share	\$ (0.01)

In the first quarter of 2007, we recorded a \$0.6 million charge, net of tax of \$0.3 million, related to the finalization of purchase price adjustments stated in the contract and other transaction related items.

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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 use 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. As a result, the financial information for AET and other non wholly-owned subsidiaries is consolidated on each line of the Consolidated Financial Statements and the equity of the other owners in those subsidiaries is reflected on the lines entitled minority stockholders equity in consolidated entities and minority stockholders share of income.

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 in the future; 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; future operational and financial performance; 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,



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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; and future asset sales, costs, working capital, revenues, business opportunities, debt levels, cash flows, cost savings and reductions, margins, earnings and growth. The words **will**, **may**, **plan**, **estimate**, **project**, **believe**, **anticipate**, **expect**, **intend**, **could**, **target**, **goal**, **continue to** and similar expressions, 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 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, specific consumption rates, 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 continued global consolidation of the world's largest 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 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;

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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;

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 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 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 or limitations on our ability 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;

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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;

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

the possibility that our high leverage, substantial debt and other obligations could limit our financial resources and ability to compete and may make us more vulnerable to adverse economic events;

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 complete planned asset sales for amounts or at times anticipated or at all or achieve increases in the amount or speed of cash generated through operations;

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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 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;

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;

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;

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.

Graphite electrode 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, 2007, global steel production and operating rates, excluding China, increased by 4% compared to the same period last year. China's steel production grew by 22% during the three months ended March 31, 2007, contributing to a global steel production increase of 10%.

Steel production in China and Russia is approximately 87% and 82% blast oxygen furnace related, respectively. However, these two countries provided the highest EAF capacity growth in 2007, due to new startups.

Overall, EAF steel production capacity continues to expand. During the three months ended March 31, 2007, EAF steel production increased approximately 4% compared to the three months ended March 31, 2006, due to new EAF start-ups and strong melt rates. We estimate that total EAF production will increase 2-3% during 2007. However, graphite electrode demand is expected to increase by approximately 1% due to continual improvements in specific consumption.

In 2007, we believe that the overall demand for advanced graphite materials 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 economy in the markets served has kept the demand high for our core products which are used in the industrial and chemical sectors. As a result of this high demand and decrease of approximately 5% in our advanced graphite materials capacity as a result of the December 2006 sale of our cathode business, we continue to anticipate operating at full capacity in 2007.

**Outlook**

In 2007, we expect:

Total company net sales to increase 12 to 14 percent

Net sales of graphite electrodes to increase approximately 18 percent

Net interest expense to be about \$40 to \$43 million

The effective book tax rate to be approximately 36 percent

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Capital expenditures to be approximately \$50 million

Depreciation expense of approximately \$35 million; and

Cash flow from operations to be about \$90 to 95 million.

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 \$228.2 million in the three months ended March 31, 2007 represented a \$54.0 million or 31.0% increase from net sales of \$174.2 million in the three months ended March 31, 2006. Net sales of graphite electrodes increased \$51.3 million, or 39.8%, primarily due to increased sales volumes and favorable price increases, offset slightly by an unfavorable product mix in the three months ended March 31, 2007 compared to the three months ended March 31, 2006. Advanced graphite materials net sales increased \$1.3 million, or 5.4%, due to favorable currency impacts and prices in the three months ended March 31, 2007 compared to the three months ended March 31, 2006, offset slightly by decreased volumes. Net sales of our other business increased \$1.4 million, or 7.0%, in the three months ended March 31, 2007 compared to the three months ended March 31, 2006.

Cost of sales of \$152.0 million in the three months ended March 31, 2007 represented a \$27.3 million, or 21.9%, increase from cost of sales of \$124.7 million in the three months ended March 31, 2006. Cost of sales increased primarily due to higher sales volumes and higher raw material and operating costs, particularly in our graphite electrode segment.

Gross profit of \$76.3 million in the three months ended March 31, 2007 represented a \$26.9 million, or 54.5%, increase from gross profit of \$49.4 million in the three months ended March 31, 2006. Gross margin increased to 33.4% of net sales.

Research and development expenses decreased \$0.3 million, or 12.0%, from \$2.5 million in the three months ended March 31, 2006 to \$2.2 million in the three months ended March 31, 2007.

Selling and administrative expenses decreased \$2.5 million, or 10.1%, from \$24.8 million in the three months ended March 31, 2006 to \$22.3 million in the three months ended March 31, 2007. This decrease was primarily due to lower administrative costs of \$2.1 million and decreased overhead costs of \$0.4 million. These decreases in costs are the result of a company-wide initiative to reduce administrative costs.

Other (income) expense, net was a charge of \$11.1 million in the three months ended March 31, 2007 compared to income of \$0.4 million in three months ended March 31, 2006. The increase was caused primarily by a \$7.5 million loss incurred on the

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extinguishment of debt. Currency losses increased \$4.1 million, from gains of \$2.4 million in the three months ended March 31, 2006 to losses of \$1.7 million in the three months ended March 31, 2007.

In the three months ended March 31, 2007 and March 31, 2006 restructuring charges were \$0.9 million, and \$2.9 million respectively. The following table summarizes activity relating to the accrued expense in connection with the restructuring charges. The restructuring accrual is included in other accrued liabilities and other long-term obligations on the Consolidated Balance Sheets.

	<b>Severance and Related Costs</b>	<b>Plant Shutdown and Related Costs</b>	<b>Total</b>
	<i>(Dollars in thousands)</i>		
<b>Balance at January 1, 2007</b>	\$ 7,185	\$ 689	\$ 7,874
Restructuring charges	498	386	884
Change in estimates			
Payments and settlements	(3,167)	(394)	(3,561)
Effect of change in currency exchange rates	28	7	35
<b>Balance at March 31, 2007</b>	\$ 4,544	\$ 688	5,232

At March 31, 2007, the outstanding balance of our restructuring reserve was \$5.2 million. We expect the majority of the remaining payments to be paid by the end of 2007. The balance at March 31, 2007 consisted primarily of the following:

*Graphite Electrode Segment:*

\$1.3 million related to the restructuring of our manufacturing facilities, including those in France, and the cessation of operations of our facility in Russia.

\$1.8 million related to the closure of our graphite electrode manufacturing operations in Caserta, Italy.

\$0.8 million related to the phase-out of our graphite electrode machining operations in Clarksville, Tennessee.

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

*Other Businesses:*

\$0.8 million related to the shutdown of our carbon electrode production operations at our Columbia, Tennessee facility.

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In the three months ended March 31, 2006, we abandoned long-lived fixed assets associated with costs capitalized for our enterprise resource planning system implementations due to an indefinite delay in the implementation of the remaining facilities. As a result, we recorded a \$6.6 million loss, including the write off of capitalized interest, in accordance with SFAS No. 144, *Accounting For the Impairment and Disposal of Long-Lived Assets* .

Also, in the three months ended March 31, 2006, management announced its intention to sell certain long-lived assets from our Etoy, Switzerland and Caserta, Italy facilities. As a result, we have classified these assets as held for sale in the Consolidated Balance Sheets in accordance with SFAS No. 144. In addition, we have recorded a \$1.4 million impairment loss that adjusts the carrying value of the assets in Switzerland to the estimated fair value less estimated selling costs. In the third quarter of 2006, we sold the long-lived assets at our Etoy, Switzerland facility for \$7.1 million.

The following table presents an analysis of interest expense:

	<b>For the Three Months Ended March 31, 2006                      2007 (Dollars in thousands)</b>	
Interest incurred on debt	\$ 10,815	10,749
Amortization of fair value adjustments for terminated hedge instruments	(239)	(203)
Amortization of debt issuance costs	912	875
Interest on DOJ antitrust fine	84	5
Amortization of premium on Senior Notes	(51)	(38)
Amortization of discount on Debentures	161	166
Interest incurred on other items	106	157
 Total interest expense	 \$ 11,788	 \$ 11,711

Average total debt outstanding was \$606.3 million in the three months ended March 31, 2007 as compared to \$741.9 million in the three months ended March 31, 2006. The average annual interest rate was 7.0% in the three months ended March 31, 2007 as compared to 7.2% in the three months ended March 31, 2006.

Provision for income taxes was a charge of \$10.5 million in the three months ended March 31, 2007 and \$3.5 million in the three months ended March 31, 2006. The actual income tax rate was approximately 36.0% in the three months ended March 31, 2007 as compared to approximately (1,330)% in the three months ended March 31, 2006. The effective income tax rate in the three months ended March 31, 2006 is negative due to jurisdictional profitability mix. We estimate that we will have an effective income tax rate of approximately 36% for 2007.

The loss from discontinued operations was \$0.8 million for the three months ended March 31, 2006 and \$0.6 million for the three months ended March 31, 2007.



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As a result of the matters described above, net income was \$17.9 million in the three months ended March 31, 2007 as compared to a net loss of \$4.6 million in the three months ended March 31, 2006.

*Segment net sales.* The following table represents our net sales by segment for the three months ended March 31, 2007 and 2006:

	<b>For the Three Months Ended March 31, 2006      2007 (Dollars in thousands)</b>	
Graphite electrode	\$ 128,792	\$ 180,064
Advanced graphite materials	25,162	26,507
Other businesses	20,238	21,660
 Total net sales	 \$ 174,192	 \$ 228,231

Our analysis of the percentage change in net sales for graphite electrode and advanced graphite materials is set forth in the following table:

	<b>Volume</b>	<b>Price</b>	<b>Mix</b>	<b>Currency</b>	<b>Net Change</b>
Graphite electrode	21%	16%	(2)%	5%	40%
Advanced graphite materials	(2)%	4%	%	3%	5%

Net sales for the graphite electrode segment increased primarily due to increased volumes, coupled with favorable price increases and currency fluctuations. These increases were offset slightly by an unfavorable product mix in the three months ended March 31, 2007 compared to the three months ended March 31, 2006. Advanced graphite materials net sales increased based on favorable price increases and currency impacts during the three months ended March 31, 2007 as compared to the three months ended March 31, 2006. These increases were offset slightly by an unfavorable change in volumes.

Net sales for our other businesses increased to \$21.7 million for the three months ended March 31, 2007, as compared to \$20.2 million for the three months ended March 31, 2006, primarily related to increased sales volumes of refractory products, offset by decreased sales volumes of carbon electrodes due to the planned exiting of this business.

*Segment operating net income.* Corporate expenses are allocated to segments based on each segment's percentage of consolidated sales. The following table represents our operating income by segment for the three months ended March 31, 2006 and 2007:

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	<b>For the Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2006</b>	<b>2007</b>
	<i>(Dollars in thousands)</i>	
Graphite electrode	\$ 13,095	\$ 47,677
Advanced graphite materials	2,106	3,287
Other businesses	(4,188)	(108)
 Total segment operating income	 \$ 11,013	 \$ 50,856

Our analysis of the percentage change in segment operating costs and expenses, including restructuring and impairment charges for graphite electrode and advanced graphite materials is set forth in the following table:

	<b>Operating Expenses</b>		
	<b>For the Three Months Ended</b>		
	<b>March 31,</b>		
	<i>(Percentage of sales)</i>		
	<b>2006</b>	<b>2007</b>	<b>Change</b>
Graphite electrode	90%	74%	(16%)
Advanced graphite materials	92%	88%	(4%)

Segment operating costs and expenses as a percentage of sales for graphite electrodes decreased 16% points to 74% in the three months ended March 31, 2007. However, total segment operating costs and expenses increased \$16.7 million for the three months ended March 31, 2007 compared to the three months ended March 31, 2006. This increase was due to higher raw material and product costs of \$9.9 million, higher volumes which increased total operating costs and expenses an additional \$9.7 million, and other operating costs and expenses offset by decreased selling and administrative costs, totaling \$4.7 million. Impairment costs decreased \$5.9 million, due to the impairment of the JD Edwards software during the three months ended March 31, 2006. There was no impairment charge during the three months ended March 31, 2007. Restructuring charges also decreased \$1.7 million for the three months ended March 31, 2007 compared to the three months ended March 31, 2006. This was primarily due to \$1.2 million of restructuring charges incurred during the three months ended March 31, 2006 related to the restructuring of our manufacturing facility in France which did not reoccur in the three months ended March 31, 2007.

Segment operating costs and expenses as a percentage of sales for advanced graphite materials decreased 4% points to 88% in the three months ended March 31, 2007. Total segment operating costs and expenses of \$23.2 million remained flat due primarily to higher operating costs and expenses of \$1.8 million, including the impact of changes in the Euro, which increased costs \$0.8 million. These increases were offset by a \$1.3 million decrease in restructuring and impairment charges. Selling, administrative, and research and development costs have decreased \$0.3 million for the three months ended March 31, 2007 compared to the three months ended March 31, 2006.

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Segment operating costs and expenses for other business decreased \$2.7 million. This decrease was due to a \$6.6 million improvement in operating costs and expenses related to carbon electrodes caused by lower production costs and selling and administrative expenses as the result of the planned exit of this business. Operating costs and expenses for our natural graphite products also decreased due to lower variable costs associated with decreased volumes. These decreases were offset by an increase in operating costs and expenses for refractories for the three months ended March 31, 2007 compared to the three months ended March 31, 2006 driven by production costs as a result of increased volumes.

**Effects of Changes in Currency Exchange Rates**

We incur costs in dollars and the currency of each of the five 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, 2007, the average exchange rate of the Brazilian Real and the Euro increased 5.5% and 9.9%, respectively, when compared to the average exchange rate for the three months ended March 31, 2006. During the three months ended March 31, 2007, the average exchange rate for the Mexican Peso and South African Rand decreased 4.6% and 14.2%, respectively, when compared to the average exchange rate for the three months ended March 31, 2006.

In the case of net sales of graphite electrodes, the impact of these events was an increase of about \$6.2 million in the three months ended March 31, 2007 as compared to the three months ended March 31, 2006. In the case of cost of sales of graphite electrodes, the impact of these events was a decrease of about \$2.4 million in the three months ended March 31, 2007 as compared to the three months ended March 31, 2006.

We have non-dollar denominated intercompany loans between GrafTech Finance and some of our foreign subsidiaries. At March 31, 2007, the aggregate principal amount of these loans was \$452.9 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' deficit section of the Consolidated Balance Sheets. The balance of these loans is deemed to be temporary and, as a result, remeasurement gains and losses on these loans are recorded as currency (gains) losses in other expense, net, on the

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Consolidated Statements of Operations. In the 2006 first quarter, we had a net total of \$2.4 million in currency gains, including \$4.0 million of exchange gains due to the remeasurement of intercompany loans and translation of financial statements of foreign subsidiaries that use the dollar as their functional currency. In the 2007 first quarter, we had a net total of \$1.7 million in currency losses, including \$1.5 million of exchange losses due to the remeasurement of intercompany loans and translation of financial statements of foreign subsidiaries which use the dollar as their functional currency. To manage certain exposures to specific financial market risks caused by changes in currency exchange rates, we 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 antitrust investigations, lawsuits and claims, payment of restructuring costs, pension and post-retirement contributions, debt reduction payments and other obligations.

We are significantly leveraged and have other substantial obligations. At March 31, 2007, we had total debt of \$528.5 million, cash and cash equivalents of \$26.7 million and a stockholders' deficit of \$90.0 million.

As part of our cash management activities, we periodically factor or discount (by selling) certain accounts receivable to third parties. In the 2007 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 receivables, our accounts receivable and our debt would have been about \$0.8 million higher at December 31, 2006 and about \$10.7 million higher at March 31, 2007. All receivables sold during 2006 and the 2007 first quarter were sold without recourse, and no amount of accounts receivable sold remained on the Consolidated Balance Sheets at December 31, 2006 and March 31, 2007.

We use cash and cash equivalents, 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, 2007, \$201.7 million was available (after consideration of outstanding letters of credit of \$13.3 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.

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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 and planned asset sales should allow us to reduce our debt and other obligations over the long term.

At March 31, 2007, 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, 2007, the Revolving Facility had an effective interest rate of 7.6%, our \$299.6 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, 2007, 0.3% (or \$1.7 million) of our total debt consists of variable rate obligations. We estimate that we will have interest expense of approximately \$40.0 to \$43.0 million for 2007.

At December 31, 2006, the Revolving Facility had an effective interest rate of 7.6%, our \$434.6 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 in the future 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.

**Cash Flow and Plans to Manage Liquidity.** As a result of our significant leverage and other substantial obligations, our business strategies include efforts to enhance our capital structure by further reducing our gross obligations. Accordingly, we have placed the highest priority on accelerating the amount and speed of cash generated every day. Our efforts include improved pricing initiatives in conjunction with our valued products, leveraging our unique 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. We also continue to evaluate other opportunities to reduce our obligations, including the obligations associated with our U.S. defined benefit plan, which was frozen in 2003.

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.

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We expect cash flow from operations to be positively impacted by the completion of our fines and penalties related to the antitrust and related lawsuits in the first quarter, reduced interest expense related to our reduced Senior Note obligations and decreases in cash outlay for planned overhead cost reductions. We expect our cash flow from operations to be negatively impacted by higher raw material prices, higher accounts receivable balances as a result of increased prices for graphite electrodes, increased taxes paid as a result of the sale of the cathodes business in 2006 and the realization of certain international deferred taxes, an incentive compensation payout in the second quarter of 2007, planned pension and post retirement contributions, and payments for severance under restructuring plans and workforce rationalization initiatives. We also expect to generate cash from our planned divestitures of assets and property, including our planned sale of our Vyazma, Russia interest and land in Caserta, Italy. Our cash flow will also be impacted from the loss of working capital and capital expenditures related to our former cathodes business, which was sold in the fourth quarter of 2006.

Our high leverage and other substantial 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 leverage 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 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, 2007 we redeemed \$135.0 million of our senior notes using proceeds from the sale of our cathode business. On April 23, 2007, we called an additional \$50.0 million of our Senior Notes. We expect this redemption to occur on or about May 23, 2007.

We have in the past entered into, and may in the future 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.

We believe that the long-term fundamentals of our business continue to be sound. Accordingly, although we cannot assure you that such will be the case, we believe that, based on our expected cash flow from operations, our existing capital resources, and taking into account our working capital needs and our efforts to reduce costs, improve efficiencies and product quality, and accelerate commercialization of new products and cash flow, we will be able to manage our liquidity to permit us to service our debt and meet our obligations when due.

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**PART I (CONT D)**

**GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES**

*Cash Flow Provided by Operating Activities.* Cash flow provided by operating activities was \$18.0 million in the three months ended March 31, 2007 as compared to a use of \$33.4 million in the three months ended March 31, 2006, an increase of \$51.4 million.

Cash provided by operating activities was \$18.0 million for the three months ended March 31, 2007. Cash provided by net income, after adding back the effect of non-cash items, was \$33.4 million. The non-cash items are related to depreciation and amortization charges of \$7.9 million, interest expense of \$1.1 million and other charges of \$6.5 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, and \$1.3 million related to decreases in prepaid and other current asset balances. Changes in benefit obligations and long term assets and liabilities used cash of \$1.6 million and \$2.1 million, respectively.

Cash provided by net income, after adding back the effect of non-cash items, was \$16.1 million for the three months ended March 31, 2006. Non-cash items included \$9.2 million of depreciation and amortization, \$2.9 million of restructuring charges, \$8.2 million of impairment losses for long-lived assets, and \$0.4 million net of other items. Changes in working capital decreased cash flow by \$40.2 million for the three months ended March 31, 2006, due primarily to a \$29.3 million increase in inventory, a decrease in accounts payable of \$19.4 million, a decrease in interest payable of \$11.8 million, and \$4.5 million of payments made for antitrust investigations and related lawsuits and claims. These uses of working capital were offset by changes in accounts and notes receivable, including the effect of factoring, provided \$25.8 million of cash flow. Changes in benefit obligations and long-term assets and liabilities used cash of \$2.7 million and \$6.6 million, respectively.

*Cash Flow Used in Investing Activities.* Cash flow used in investing activities was \$7.8 million in the three months ended March 31, 2007 and \$10.9 million in the three months ended March 31, 2006. Capital expenditures amounted to \$7.7 million for the three months ended March 31, 2007 and \$10.9 million of the three months ended March 31, 2006 and related primarily to graphite electrode productivity and production stability initiatives and other essential capital maintenance.

*Cash Flow Provided by Financing Activities.* Cash flow used in financing activities was \$132.7 million in the three months ended March 31, 2007 compared to cash provided by financing activities of \$59.6 million during three months ended March 31, 2006. The use of cash for the three months ended March 31, 2007 related primarily to \$135.0 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.

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**PART I (CONT D)**

**GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES**

During the three months ended March 31, 2006, we borrowed net \$43.9 million under the Revolving Facility. We used these borrowings primarily to pay our semi-annual interest payment on the Senior Notes, our scheduled payments to the DOJ, and to fund increases in working capital and capital expenditures.

**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.

**Antitrust Proceedings Against Us**

Beginning in 1997, the United States Department of Justice ( DOJ ) and other foreign antitrust authorities commenced investigations into alleged violations of the antitrust laws in connection with the sale of the graphite electrodes. These antitrust investigations and related lawsuits and claims have been resolved. Several of the investigations resulted in the imposition of fines against us which have been timely paid. At December 31, 2006, \$5.4 million remained in the reserve for liabilities and expenses in connection with these investigations representing the last scheduled installment of the fine imposed by the DOJ.

**Other Proceedings Against Us**

We are involved in various other investigations, lawsuits, claims demands, environmental compliance programs and other legal proceedings arising out of or incidental to the conduct of our business. While it is not possible to determine the ultimate disposition of each of 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 routinely 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 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 hedge 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 periodically enter into foreign currency instruments 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, 2006 and March 31, 2007, 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 December 31, 2006 were a payable of \$0.2 million. The outstanding contracts at March 31, 2007 were a nominal payable. 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, 2007, 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 2007 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 2007 first quarter by \$3.2 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, 2007. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer has concluded that these controls and procedures are effective at the reasonable assurance level as of March 31, 2007.

*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, 2007 that materially affected or is 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 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 10, 2007

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

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