FERRO CORP
Form 10-Q
November 08, 2007

Table of Contents

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

(**Mark One**)

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

For the quarterly period ended September 30, 2007

or

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

For the transition period from __________ to __________

Commission File Number 1-584
FERRO CORPORATION
(Exact name of registrant as specified in its charter)

Ohio	**34-0217820**
(State of Corporation)	(IRS Employer Identification No.)
1000 Lakeside Avenue	
Cleveland, OH	**44114**
(Address of Principal executive offices)	(Zip Code)

216-641-8580
(Telephone Number)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES þ NO o

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

Large accelerated filer þ Accelerated filer o Non-accelerated filer o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). YES o NO þ

At October 31, 2007, there were 43,515,015 shares of Ferro Common Stock, par value $1.00, outstanding.

TABLE OF CONTENTS

PART I

PART II

Table of Contents

PART I FINANCIAL INFORMATION

Item 1. Financial Statements (Unaudited)
Ferro Corporation and Consolidated Subsidiaries
Condensed Consolidated Statements of Income

	Three months ended September 30, 2007	Three months ended September 30, Adjusted 2006	Nine months ended September 30, 2007	Nine months ended September 30, Adjusted 2006
	(Dollars in thousands, except per share amounts)			
Net sales	$ 550,701	$ 500,573	$ 1,634,064	$ 1,544,218
Cost of sales	450,553	401,853	1,319,609	1,226,758
Gross profit	100,148	98,720	314,455	317,460
Selling, general and administrative expenses	71,069	74,116	234,212	231,955
Restructuring charges	5,826		7,689	
Other expense (income):				
Interest expense	14,488	16,818	46,220	48,155
Interest earned	(271)	(971)	(1,425)	(2,741)
Foreign currency transactions, net	(10)	166	924	706
Miscellaneous (income) expense, net	(13)	428	(399)	3,070
Income before income taxes	9,059	8,163	27,234	36,315
Income tax expense	3,472	2,694	10,814	11,938
Income from continuing operations	5,587	5,469	16,420	24,377
Loss (income) from discontinued operations, net of tax	2	(62)	216	405
Net income	5,585	5,531	16,204	23,972
Dividends on preferred stock	252	310	797	955
Net income available to common shareholders	$ 5,333	$ 5,221	$ 15,407	$ 23,017
Per common share data				
Basic earnings:				
From continuing operations	$ 0.12	$ 0.12	$ 0.36	$ 0.55
From discontinued operations	0.00	0.00	0.00	(0.01)
	$ 0.12	$ 0.12	$ 0.36	$ 0.54
Diluted earnings:				
From continuing operations	$ 0.12	$ 0.12	$ 0.36	$ 0.55
From discontinued operations	0.00	0.00	0.00	(0.01)
	$ 0.12	$ 0.12	$ 0.36	$ 0.54

Cash dividends declared	$ 0.145	$ 0.145	$ 0.435	$ 0.435

See accompanying notes to condensed consolidated financial statements.

Table of Contents

Ferro Corporation and Consolidated Subsidiaries
Condensed Consolidated Balance Sheets

	September 30, 2007	Adjusted December 31, 2006
	(Dollars in thousands)	
ASSETS		
Current assets		
Cash and cash equivalents	$ 25,821	$ 16,985
Accounts and trade notes receivable, net	236,362	220,899
Note receivable from Ferro Finance Corporation	22,887	16,083
Inventories	280,044	269,234
Deposits for precious metals		70,073
Deferred income taxes	12,086	12,291
Other current assets	40,189	25,877
Total current assets	617,389	631,442
Other assets		
Property, plant and equipment, net	535,713	526,802
Goodwill and other intangible assets, net	406,461	406,340
Deferred income taxes	93,791	94,490
Other non-current assets	107,110	82,528
Total assets	$ 1,760,464	$ 1,741,602
LIABILITIES and SHAREHOLDERS EQUITY		
Current liabilities		
Loans payable and current portion of long-term debt	$ 11,515	$ 10,764
Accounts payable	266,236	237,018
Income taxes		8,951
Accrued payrolls	32,073	33,164
Accrued expenses and other current liabilities	86,470	91,150
Total current liabilities	396,294	381,047
Other liabilities		
Long-term debt, less current portion	524,863	581,654
Postretirement and pension liabilities	185,770	194,427
Deferred income taxes	17,762	11,037
Other non-current liabilities	63,326	21,599
Total liabilities	1,188,015	1,189,764
Series A convertible preferred stock	14,198	16,787
Shareholders equity		
Common stock	52,323	52,323
Paid-in capital	163,074	158,504
Retained earnings	585,377	600,638

Accumulated other comprehensive loss	(41,838)	(65,138)
Common shares in treasury, at cost	(200,685)	(211,276)
Total shareholders equity	558,251	535,051
Total liabilities and shareholders equity	$ 1,760,464	$ 1,741,602

See accompanying notes to condensed consolidated financial statements.

Table of Contents

Ferro Corporation and Consolidated Subsidiaries
Condensed Consolidated Statement of Shareholders Equity and Comprehensive Income

	Common Shares in Treasury		Common	Paid-in	Retained	Accumulated Other Comprehensive Income	Total Share-holders
	Shares	Amount	Stock	Capital	Earnings	(Loss)	Equity
	(In thousands, except per share data)						
Balances at December 31, 2006 - Adjusted	9,458	$ (211,276)	$ 52,323	$ 158,504	$ 600,638	$ (65,138)	$ 535,051
Net income					16,204		16,204
Other comprehensive income (loss), net of tax:							
Foreign currency translation adjustment						28,183	28,183
Postemployment benefit liability adjustments						(140)	(140)
Raw material commodity swap adjustments						(1,903)	(1,903)
Interest rate swap adjustments						(2,840)	(2,840)
Total comprehensive income							39,504
Cash dividends:							
Common					(18,773)		(18,773)
Preferred					(797)		(797)
Income tax benefits					38		38
Transactions involving benefit plans	(644)	10,591		4,570			15,161
Adjustment to initially apply FIN No. 48 as of January 1, 2007					(11,933)		(11,933)
Balances at September 30, 2007	8,814	$ (200,685)	$ 52,323	$ 163,074	$ 585,377	$ (41,838)	$ 558,251

See accompanying notes to condensed consolidated financial statements.

Table of Contents

Ferro Corporation and Consolidated Subsidiaries
Condensed Consolidated Statements of Cash Flows

	Nine months ended September 30,	
	2007	Adjusted 2006
	(Dollars in thousands)	
Cash flows from operating activities		
Net income	$ 16,204	$ 23,972
Depreciation and amortization	63,825	59,030
Precious metals deposits	70,073	(74,250)
Accounts and trade notes receivable, inventories, and accounts payable	13,696	(75,233)
Note receivable from Ferro Finance Corportion	(6,804)	82,173
Other changes in current assets and liabilities, net	(27,964)	6,923
Other adjustments, net	(7,701)	(6,843)
Net cash provided by continuing operations	121,329	15,772
Net cash used for discontinued operations	(48)	(867)
Net cash provided by operating activities	121,281	14,905
Cash flows from investing activities		
Capital expenditures for property, plant and equipment	(43,247)	(33,602)
Proceeds from sale of assets and businesses	2,704	6,430
Cash investment in Ferro Finance Corporation		(25,000)
Other investing activities	551	(105)
Net cash used for investing activities	(39,992)	(52,277)
Cash flows from financing activities		
Net repayments under short-term credit facilities	(740)	(468)
Proceeds from revolving credit facility	592,167	966,200
Proceeds from term loan facility	55,000	250,000
Principal payments on revolving credit facility	(700,864)	(994,600)
Principal payments on term loan facility	(2,287)	
Extinguishment of debentures		(155,000)
Debt issue costs paid	(1,783)	(15,804)
Proceeds from exercise of stock options	9,217	2,196
Cash dividends paid	(19,570)	(19,439)
Other financing activities	(4,442)	(2,308)
Net cash (used for) provided by financing activities	(73,302)	30,777
Effect of exchange rate changes on cash and cash equivalents	849	(202)
Increase (decrease) in cash and cash equivalents	8,836	(6,797)
Cash and cash equivalents at beginning of period	16,985	17,413
Cash and cash equivalents at end of period	$ 25,821	$ 10,616

Cash paid during the period for:		
Interest	$ 46,925	$ 48,710
Income taxes	$ 11,387	$ 8,607

See accompanying notes to condensed consolidated financial statements.

Ferro Corporation and Consolidated Subsidiaries
Notes to Condensed Consolidated Financial Statements
1. Basis of Presentation

Ferro Corporation (Ferro, we, us or the Company) prepared these unaudited condensed consolidated financial statements of Ferro Corporation and its consolidated subsidiaries in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements and, therefore, should be read in conjunction with the consolidated financial statements and related notes included in our Annual Report on Form 10-K for the year ended December 31, 2006. The preparation of financial statements in conformity with U.S. GAAP requires us to make estimates and assumptions that affect the timing and amount of assets, liabilities, equity, revenues and expenses reported and disclosed. Actual amounts could differ from our estimates, resulting in changes in revenues or costs that could have a material impact on the Company s results of operations, financial position, or cash flows. In our opinion, we made all adjustments that are necessary for a fair presentation, and those adjustments are of a normal recurring nature unless otherwise noted. Due to differing business conditions, our various initiatives, and some seasonality, the results for the three and nine months ended September 30, 2007, are not necessarily indicative of the results expected in subsequent quarters or for the full year.

Interest earned in the three and nine months ended September 30, 2006, of $1.0 million and $2.7 million, respectively, was reclassified from miscellaneous expense (income), net, and is shown separately in the condensed consolidated statements of income.

2. Accounting Methods Adopted in the Nine Months Ended September 30, 2007

On January 1, 2007, we elected to change our costing method for our inventories not already costed under the lower of cost or market using the first-in, first-out (FIFO) method, while in prior years, these inventories were costed under the lower of cost or market using the last-in, first-out (LIFO) method. The percentage of inventories accounted for under the LIFO method at December 31, 2006, was 13.8% for U.S. inventories and 6.2% for consolidated inventories. We believe the FIFO method is preferable as it conforms the inventory costing methods for all of our inventories to a single method and improves comparability with our industry peers. The FIFO method also better reflects current acquisition cost of those inventories on our consolidated balance sheets and enhances the matching of future cost of sales with revenues. In accordance with Statement of Financial Accounting Standards No. 154, *Accounting Changes and Error Correction*, all prior periods presented have been adjusted to apply the new method retrospectively. The effect of the change in our inventory costing method includes the LIFO reserve and related impact on the obsolescence reserve. This change increased our inventory balance by $13.7 million and increased retained earnings, net of income tax effects, by $8.5 million as of January 1, 2006.

On January 1, 2007, we also changed our accounting method of accruing for major planned overhauls. Financial Accounting Standards Board (FASB) Staff Position No. AUG AIR-1, *Accounting for Planned Maintenance Activities,* (AUG AIR-1), prohibits our prior policy of accruing for major planned overhauls in advance of when the actual costs are incurred. Under our new policy, the costs of major planned overhauls are expensed when incurred. All prior periods presented have been adjusted to apply the new method retrospectively. Adoption of this accounting pronouncement decreased our accrued expenses and other current liabilities by $2.2 million and increased retained earnings, net of income tax effects, by $1.5 million as of January 1, 2006.

On January 1, 2007, we adopted FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes,* (FIN 48). FIN 48 clarifies what criteria must be met prior to recognition of the financial statement benefit of a position taken or expected to be taken in a tax return. This interpretation also provides guidance on de-recognition of income tax assets and liabilities, classification of current and deferred income tax assets and liabilities, accounting for interest and penalties associated with tax positions, accounting for income taxes in interim periods, and income tax disclosures. The adoption of this interpretation decreased the opening balance of retained earnings by $11.9 million as of January 1, 2007. We have elected to continue to report interest and penalties as income tax expense.

On January 1, 2007, we also adopted Statement of Financial Accounting Standards No. 156, *Accounting for Servicing of Financial Assets an amendment of FASB Statement No. 140*, (FAS No. 156). This statement requires an entity to recognize at fair value a servicing asset or liability each time it undertakes an obligation to service a financial asset by

Table of Contents

entering into a servicing contract. We provide collection agent services for our U.S. and certain international receivable sales programs. The collection agent fees received by the Company approximate adequate compensation. Therefore, the adoption of FAS No. 156 did not have an effect on our consolidated financial statements.

We have presented the effects of the changes in accounting principles for inventory costs and for major planned overhauls for 2007 and 2006 below. We have combined certain financial statement line items if they were not affected by the changes in accounting principles.

Condensed Consolidated Statements of Income

	Three months ended September 30, 2007		
	Computed under LIFO	Change to FIFO	Reported under FIFO
	(Dollars in thousands, except per share amounts)		
Net sales	$ 550,701	$	$ 550,701
Cost of sales	451,518	(965)	450,553
Gross profit	99,183	965	100,148
Selling, general and administrative expenses	71,069		71,069
Restructuring charges	5,826		5,826
Other expense	14,194		14,194
Income before income taxes	8,094	965	9,059
Income tax expense	3,282	190	3,472
Income from continuing operations	4,812	775	5,587
Loss from discontinued operations, net of tax	2		2
Net income	4,810	775	5,585
Dividends on preferred stock	252		252
Net income available to common shareholders	$ 4,558	$ 775	$ 5,333
Per common share data			
Basic earnings:			
From continuing operations	$ 0.10	$ 0.02	$ 0.12
From discontinued operations	0.00	0.00	0.00
	$ 0.10	$ 0.02	$ 0.12
Diluted earnings:			
From continuing operations	$ 0.10	$ 0.02	$ 0.12
From discontinued operations	0.00	0.00	0.00
	$ 0.10	$ 0.02	$ 0.12

8

Table of Contents

	Nine months ended September 30, 2007		
	Computed under LIFO	Change to FIFO	Reported under FIFO
	(Dollars in thousands, except per share amounts)		
Net sales	$ 1,634,064	$	$ 1,634,064
Cost of sales	1,321,205	(1,596)	1,319,609
Gross profit	312,859	1,596	314,455
Selling, general and administrative expenses	234,212		234,212
Restructuring charges	7,689		7,689
Other expense	45,320		45,320
Income before income taxes	25,638	1,596	27,234
Income tax expense	10,389	425	10,814
Income from continuing operations	15,249	1,171	16,420
Loss from discontinued operations, net of tax	216		216
Net income	15,033	1,171	16,204
Dividends on preferred stock	797		797
Net income available to common shareholders	$ 14,236	$ 1,171	$ 15,407
Per common share data			
Basic earnings:			
From continuing operations	$ 0.33	$ 0.03	$ 0.36
From discontinued operations	0.00	0.00	0.00
	$ 0.33	$ 0.03	$ 0.36
Diluted earnings:			
From continuing operations	$ 0.33	$ 0.03	$ 0.36
From discontinued operations	0.00	0.00	0.00
	$ 0.33	$ 0.03	$ 0.36

Table of Contents

	Three months ended September 30, 2006			
	Originally Reported	Change to FIFO	Adoption of AUG AIR-1	Adjusted
	(Dollars in thousands, except per share amounts)			
Net sales	$ 500,573	$	$	$ 500,573
Cost of sales	401,923	(168)	98	401,853
Gross profit	98,650	168	(98)	98,720
Selling, general and administrative expenses	74,116			74,116
Other expense	16,441			16,441
Income before income taxes	8,093	168	(98)	8,163
Income tax expense	2,663	62	(31)	2,694
Income from continuing operations	5,430	106	(67)	5,469
Income from discontinued operations, net of tax	(62)			(62)
Net income	5,492	106	(67)	5,531
Dividends on preferred stock	310			310
Net income available to common shareholders	$ 5,182	$ 106	$ (67)	$ 5,221
Per common share data				
Basic earnings:				
From continuing operations	$ 0.12	$ 0.00	$ 0.00	$ 0.12
From discontinued operations	0.00	0.00	0.00	0.00
	$ 0.12	$ 0.00	$ 0.00	$ 0.12
Diluted earnings:				
From continuing operations	$ 0.12	$ 0.00	$ 0.00	$ 0.12
From discontinued operations	0.00	0.00	0.00	0.00
	$ 0.12	$ 0.00	$ 0.00	$ 0.12

Table of Contents

	Nine months ended September 30, 2006			
	Originally Reported	Change to FIFO	Adoption of AUG AIR-1	Adjusted
	(Dollars in thousands, except per share amounts)			
Net sales	$ 1,544,218	$	$	$ 1,544,218
Cost of sales	1,226,771	66	(79)	1,226,758
Gross profit	317,447	(66)	79	317,460
Selling, general and administrative expenses	231,955			231,955
Other expense	49,190			49,190
Income before income taxes	36,302	(66)	79	36,315
Income tax expense	11,943	(25)	20	11,938
Income from continuing operations	24,359	(41)	59	24,377
Loss from discontinued operations, net of tax	405			405
Net income	23,954	(41)	59	23,972
Dividends on preferred stock	955			955
Net income available to common shareholders	$ 22,999	$ (41)	$ 59	$ 23,017
Per common share data				
Basic earnings:				
From continuing operations	$ 0.55	$ 0.00	$ 0.00	$ 0.55
From discontinued operations	(0.01)	0.00	0.00	(0.01)
	$ 0.54	$ 0.00	$ 0.00	$ 0.54
Diluted earnings:				
From continuing operations	$ 0.55	$ 0.00	$ 0.00	$ 0.55
From discontinued operations	(0.01)	0.00	0.00	(0.01)
	$ 0.54	$ 0.00	$ 0.00	$ 0.54

Table of Contents

Condensed Consolidated Balance Sheets

	September 30, 2007		
	Computed under LIFO	Change to FIFO	Reported under FIFO
	(Dollars in thousands)		
ASSETS			
Current assets			
Inventories	$ 263,727	$ 16,317	$ 280,044
Deferred income taxes	18,126	(6,040)	12,086
Other current assets	325,259		325,259
Total current assets	607,112	10,277	617,389
Other assets	1,143,075		1,143,075
Total assets	$ 1,750,187	$ 10,277	$ 1,760,464
LIABILITIES and SHAREHOLDERS EQUITY			
Current liabilities	$ 396,294	$	$ 396,294
Other liabilities	791,721		791,721
Total liabilities	1,188,015		1,188,015
Series A convertible preferred stock	14,198		14,198
Shareholders equity			
Retained earnings	575,100	10,277	585,377
Other shareholders equity	(27,126)		(27,126)
Total shareholders equity	547,974	10,277	558,251
Total liabilities and shareholders equity	$ 1,750,187	$ 10,277	$ 1,760,464

Table of Contents

	December 31, 2006			
	Originally Reported	Change to FIFO	Adoption of AUG AIR-1	Adjusted
	(Dollars in thousands)			
ASSETS				
Current assets				
Inventories	$ 254,513	$ 14,721	$	$ 269,234
Deferred income taxes	18,175	(5,615)	(269)	12,291
Other current assets	349,917			349,917
Total current assets	622,605	9,106	(269)	631,442
Other assets				
Deferred income taxes	94,662		(172)	94,490
Other non-current assets	1,015,670			1,015,670
Total assets	$ 1,732,937	$ 9,106	$ (441)	$ 1,741,602
LIABILITIES and SHAREHOLDERS EQUITY				
Current liabilities				
Income taxes	$ 8,732	$	$ 219	$ 8,951
Accrued expenses and other current liabilities	93,206		(2,056)	91,150
Other current liabilities	280,946			280,946
Total current liabilities	382,884		(1,837)	381,047
Other liabilities	808,717			808,717
Total liabilities	1,191,601		(1,837)	1,189,764
Series A convertible preferred stock	16,787			16,787
Shareholders equity				
Retained earnings	590,136	9,106	1,396	600,638
Other shareholders equity	(65,587)			(65,587)
Total shareholders equity	524,549	9,106	1,396	535,051
Total liabilities and shareholders equity	$ 1,732,937	$ 9,106	$ (441)	$ 1,741,602

Table of Contents

Condensed Consolidated Statements of Cash Flows

	Nine months ended September 30, 2007		
	Computed under LIFO	Change to FIFO	Reported under FIFO
	(Dollars in thousands)		
Cash flows from operating activities			
Net income	$ 15,033	$ 1,171	$ 16,204
Depreciation and amortization	63,825		63,825
Precious metals deposits	70,073		70,073
Accounts and trade notes receivable, inventories, and accounts payable	15,292	(1,596)	13,696
Note receivable from Ferro Finance Corporation	(6,804)		(6,804)
Other changes in current assets and liabilities, net	(27,964)		(27,964)
Other adjustments, net	(8,126)	425	(7,701)
Net cash provided by continuing operations	121,329		121,329
Net cash used for discontinued operations	(48)		(48)
Net cash provided by operating activities	121,281		121,281
Cash flows from investing activities	(39,992)		(39,992)
Cash flows from financing activities	(73,302)		(73,302)
Effect of exchange rate changes on cash and cash equivalents	849		849
Increase in cash and cash equivalents	8,836		8,836
Cash and cash equivalents at beginning of period	16,985		16,985
Cash and cash equivalents at end of period	$ 25,821	$	$ 25,821

	Nine months ended September 30, 2006			
	Originally Reported	Change to FIFO	Adoption of AUG AIR-1	Adjusted
	(Dollars in thousands)			
Cash flows from operating activities				
Net income	$ 23,954	$ (41)	$ 59	$ 23,972
Depreciation and amortization	59,030			59,030
Precious metals deposits	(74,250)			(74,250)
Accounts and trade notes receivable, inventories, and accounts payable	(75,299)	66		(75,233)
Note receivable from Ferro Finance Corporation	82,173			82,173
Other changes in current assets and liabilities, net	7,009		(86)	6,923
Other adjustments, net	(6,845)	(25)	27	(6,843)
Net cash provided by continuing operations	15,772			15,772

Net cash used for discontinued operations	(867)			(867)
Net cash provided by operating activities	14,905			14,905
Cash flows from investing activities	(52,277)			(52,277)
Cash flows from financing activities	30,777			30,777
Effect of exchange rate changes on cash and cash equivalents	(202)			(202)
Decrease in cash and cash equivalents	(6,797)			(6,797)
Cash and cash equivalents at beginning of period	17,413			17,413
Cash and cash equivalents at end of period	$ 10,616	$	$	$ 10,616

14

3. Newly Issued Accounting Pronouncements

In September 2006, the FASB issued Statement No. 157, *Fair Value Measurements*, (FAS No.157). FAS No. 157 defines fair value, establishes a framework and gives guidance regarding the methods used for measuring fair value, and expands disclosures about fair value measurements. Accordingly, FAS No. 157 does not require any new fair value measurements, but will change current practice for some entities. FAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. We will apply this standard prospectively, as permitted.

In September 2006, the FASB issued Statement No. 158, *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans an amendment of FASB Statements No. 87, 88, 106, and 132(R)*, (FAS No. 158). We are required to adopt the measurement provisions of FAS No. 158 as of December 31, 2008. The measurement provisions require companies to measure defined benefit plan assets and obligations as of the balance sheet date. Currently, we use September 30 as the measurement date for U.S. pension and other postretirement benefits. We are evaluating these requirements and have not yet determined the impact this may have on our consolidated financial statements.

In February 2007, the FASB issued Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities,* (FAS No. 159). This statement permits all entities to choose, at specified election dates, to measure eligible items at fair value (the fair value option). A business entity should report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date. Upfront costs and fees related to items for which the fair value option is elected shall be recognized in earnings as incurred and not deferred. FAS No. 159 is effective as of the beginning of the first fiscal year that begins after November 15, 2007. We are currently evaluating the impact of the adoption of this statement; at this time, we are uncertain as to the impact on our results of operations and financial position.

In June 2007, the Emerging Issues Task Force of the FASB reached a consensus on Issue No. 06-11, *Accounting for Income Tax Benefits of Dividends on Share-Based Payment Awards*, (EITF No. 06-11). EITF No. 06-11 requires that the income tax benefit from dividends that are charged to retained earnings and paid to employees for nonvested equity shares be recognized as an increase to paid-in capital. Currently, we recognize this income tax benefit as an increase to retained earnings. EITF No. 06-11 is to be applied prospectively in fiscal years beginning after December 15, 2007. Beginning in 2008, we will report this income tax benefit as an increase to paid-in capital.

4. Inventories

As noted in Note 2, effective January 1, 2007, we elected to change our costing method for selected inventories. We applied this change in accounting principle by adjusting all prior periods presented retrospectively. Inventories consisted of the following:

	September 30, 2007	Adjusted December 31, 2006
	(Dollars in thousands)	
Raw materials	$ 79,823	$ 74,160
Work in process	43,206	44,658
Finished goods	157,015	150,416
Total	$ 280,044	$ 269,234

In the production of some of our products, we use precious metals, some of which we obtain from financial institutions under consignment agreements with terms of one year or less. The financial institutions retain ownership of the precious metals and charge us fees based on the amounts we consign. These fees were $0.8 million and $0.8 million for the three months ended September 30, 2007 and 2006, respectively, and $2.8 million and $2.2 million for the nine months ended September 30, 2007 and 2006, respectively, and were charged to cost of sales. In November 2005, the financial institutions renewed their requirement for cash deposits from us to provide additional collateral beyond the value of the underlying precious metals. Outstanding collateral deposits were $70.1 million at December 31, 2006. These requirements were eliminated during the first six months of 2007. We had on hand $126.3 million at September 30, 2007, and $120.9 million at December 31, 2006, of precious metals owned by financial institutions, measured at fair value.

5. Property, Plant and Equipment

Property, plant and equipment is reported net of accumulated depreciation of $763.4 million at September 30, 2007, and $691.4 million at December 31, 2006.

6. Financing and Long-term Debt

Long-term debt consists of the following:

	September 30, 2007	December 31, 2006
	(Dollars in thousands)	
$200,000 Senior Notes, 9.125%, due January 2009 *	$ 199,545	$ 199,273
Revolving credit facility	19,256	127,953
Term loan facility	302,713	250,000
Capital lease obligations	6,965	6,744
Other notes	1,272	1,008
	529,751	584,978
Less current portion	(4,888)	(3,324)
Total	$ 524,863	$ 581,654

* Net of unamortized discounts.

Credit Rating

In May 2007, Moody s Investor Services, Inc. (Moody s) reassigned a senior credit rating to the Company after withdrawing its rating in March 2006 due to delays in the filing of financial statements for 2005 and quarterly statements for 2004 through 2006. At September 30, 2007, the Company s senior credit rating was B1, with a positive outlook, by Moody s and B+, with a stable outlook, by Standard & Poor s Rating Group (S&P).

Revolving Credit and Term Loan Facilities

In 2006, we entered into an agreement with a group of lenders for a $700 million credit facility. At that time, the credit facility consisted of a five-year, $250 million multi-currency senior revolving credit facility and a six-year, $450 million senior term loan facility.

In June 2007, we amended the credit facility (the Amended Credit Facility) primarily to increase the size of the revolving credit facility by $50 million to $300 million, reduce interest expense, and increase operating flexibility. We had $272.1 million at September 30, 2007, and $109.3 million at December 31, 2006, available under the revolving credit facility, after reductions for standby letters of credit secured by this facility. In addition, we can request an increase of $50 million in the revolving credit facility. With the amendment, we reduced the margins for borrowings under both the revolving credit and the term loan facilities as compared with the margins that were in effect prior to the amendment. For the revolving credit facility, as amended, the variable margin is based on the Company s leverage ratio. Previously, the variable margin was based on the Company s credit ratings as determined by S&P and Moody s. In addition, the amendment increased our operating flexibility by increasing the amount of restructuring and manufacturing rationalization programs permitted, relaxing restrictions on the use of proceeds from asset dispositions, and modifying covenants related to Ferro s leverage ratio and fixed charge coverage ratio.

In January 2007, we borrowed $55 million of our term loan facility and used the proceeds to reduce borrowings under our revolving credit facility. We also cancelled the remaining unused term loan commitment of $145 million, which was reserved to finance the potential accelerated payment of the senior notes, since the default under the senior notes was no longer continuing. As a result of canceling the remaining commitment, we wrote off to interest expense $2.0 million of deferred financing fees related to the term loan facility in the first quarter of 2007. In the second quarter of 2007, we began making periodic principal payments on the term loans. At September 30, 2007, we had borrowed $302.7 million in term loans. The Company is required to make quarterly principal payments of

$0.8 million from October 2007 to July 2011 and $72.6 million from October 2011 to April 2012 and a final payment of $72.6 million in June 2012.

The interest rates under the Amended Credit Facility are the sum of (A) either (1) LIBOR or (2) the higher of the Federal Funds Rate plus 0.5% or the Prime Rate and (B) for the revolving credit facility, a variable margin based on the Company s leverage, or for the term loan facility, a fixed margin. As part of the June 2007 amendments, $175 million of borrowings under the term loan facility were restricted to using three-month LIBOR in determining their interest rates. This change was made in connection with interest rate swap agreements executed in June 2007. These swap agreements effectively fixed the interest rate through June 2011 on $150 million of borrowings under the term loan facility. At September 30, 2007, the average interest rate for revolving credit borrowings was 7.4%, and the effective interest rate for term loan borrowings after adjusting for the interest rate swaps was 7.3%. At December 31, 2006, the average interest rate was 8.1% for revolving credit borrowings and 8.1% for term loan borrowings.

Senior Notes and Debentures

The senior notes are redeemable at our option at any time for the principal amount then outstanding plus the present value of unpaid interest through maturity. The senior notes are redeemable at the option of the holders only upon both a change in control of the Company and a rating by either Moody s or S&P below investment grade as defined in the indenture. Currently, the ratings by Moody s and S&P of the senior notes are below investment grade.

Receivable Sales Programs

We have several programs to sell, on an ongoing basis, pools of our trade accounts receivable. These programs accelerate cash collections at favorable financing costs and help us manage the Company s liquidity requirements. In our largest program, we sell substantially all of Ferro s U.S. trade accounts receivable to Ferro Finance Corporation (FFC), a wholly-owned unconsolidated qualified special purpose entity (QSPE). FFC finances its acquisition of trade receivable assets by issuing beneficial interests in (securitizing) the receivables to multi-seller receivables securitization companies (the Conduits) for proceeds of up to $100.0 million. FFC had received net proceeds of $65.5 million at September 30, 2007, and $60.6 million at December 31, 2006, for outstanding receivables. FFC and the Conduits have no recourse to Ferro s other assets for failure of debtors to pay when due, as the assets transferred are legally isolated in accordance with the U.S. bankruptcy laws. Ferro, on behalf of FFC and the Conduits, provides normal collection agent services with respect to the trade accounts receivable sold. In June 2007, we amended the program primarily to reduce its fees and to make Ferro s leverage ratio the basis for these fees.

Activity from this program for the nine months ended September 30 is detailed below:

	2007	**2006**
	(Dollars in thousands)	
Trade accounts receivable sold to FFC	$739,005	$769,580
Cash proceeds from FFC	731,454	852,019
Trade accounts receivable collected and remitted to FFC and the conduits	726,553	763,519

In addition, we maintain several international programs to sell trade accounts receivable, primarily without recourse. The commitments supporting these programs can be withdrawn at any time and totaled $85.8 million at September 30, 2007, and $49.2 million at December 31, 2006. The proceeds from outstanding receivables sold under the international programs were $51.2 million at September 30, 2007, and $33.7 million at December 31, 2006.

Other Financing Arrangements

In June 2007, we entered into two international variable-rate credit facilities secured by specific accounts receivable. Beginning in the third quarter, these underlying accounts receivable are treated as sold and, at September 30, 2007, were included in the above disclosures about our international programs to sell trade accounts receivable.

7. Financial Instruments

The carrying amounts of borrowings under the Amended Credit Facility approximate their fair values, due to their variable market interest rates. To reduce our exposure to interest rate changes on variable-rate debt, we entered into interest rate swap agreements. These swaps effectively converted $150 million of our variable-rate debt to a fixed rate.

Table of Contents

The carrying amount of the senior notes was $199.5 million at September 30, 2007, and $199.3 million at December 31, 2006. The fair value of the senior notes was $205.5 million at September 30, 2007, and $205.5 million at December 31, 2006. The fair value of Ferro s senior notes is based on a third party s estimated bid price.

We manage foreign currency risks principally by entering into forward contracts to mitigate the impact of currency fluctuations on transactions. We hedge a portion of our exposure to changes in the pricing of certain raw material commodities using swap arrangements that allow us to fix the price of the commodities for future purchases. When we enter into fixed price sales contracts for products with precious metal content, we also enter into a forward purchase arrangement with a precious metals supplier to cover the value of the fixed price sales contract. We also purchase portions of our natural gas requirements under fixed price contracts to reduce the volatility of cost changes. For gas contracts entered into prior to April 2006, we marked these contracts to fair value and recognized the resulting gains or losses as miscellaneous income or expense, respectively. Beginning April 2006, we designated new natural gas contracts as normal purchase contracts, which are not marked-to-market. Our purchase commitment for natural gas under normal purchase contracts was $6.2 million at September 30, 2007.

The notional amounts, carrying amounts of assets (liabilities), and fair values of these derivative instruments are presented below. Fair values are based on market quotations or third parties estimated bid prices.

	September 30, 2007	December 31, 2006
	(Dollars in thousands)	
Interest rate swaps:		
Notional amount	$150,000	$
Carrying amount and fair value	$ (4,656)	$
Foreign currency forward contracts:		
Notional amount	$169,454	$121,430
Carrying amount and fair value	$ (101)	$ (640)
Raw material commodity swaps:		
Notional amount (in metric tons of base metals)	1,595	2,004
Carrying amount and fair value	$ (1,043)	$ 1,939
Precious metals forward contracts:		
Notional amount (in troy ounces)	554,043	183,264
Carrying amount and fair value	$ 997	$ 192
Marked-to-market natural gas forward purchase contracts:		
Notional amount (in MBTUs)		120,000
Carrying amount and fair value	$	$ (442)

8. Income Taxes

Income tax expense was 39.7% of pre-tax income for the nine months ended September 30, 2007, and 32.9% of pre-tax income for the nine months ended September 30, 2006. The primary reasons for the increase in the effective tax rate were the tax effect of restructuring charges, a change in the mix of income and losses by country, and a relatively high tax cost on 2007 earnings repatriated from outside the United States.

On January 1, 2007, we adopted FIN 48. For further information regarding the adoption of FIN 48, refer to Note 2.

As of January 1, 2007, we had unrecognized tax benefits of $47.4 million, which, if recognized, would have a favorable impact of $23.5 million on income tax expense. We have recorded accrued interest and penalties related to unrecognized tax benefits totaling $3.7 million at January 1, 2007. During the first nine months of 2007, there were no significant changes in the amount of unrecognized tax benefits. We do not anticipate any significant increase or decrease in the amount of unrecognized tax benefits within the next twelve months.

The Company conducts business globally, and, as a result, the U.S. parent company or one of its subsidiaries files income tax returns in the U.S. federal jurisdiction and various state and foreign jurisdictions. In the normal course of business, the

18

U.S. parent company and its subsidiaries are subject to examination by taxing authorities. With few exceptions, we are not subject to federal, state, local or non-U.S. income tax examinations for years before 2000.

9. Contingent Liabilities

In February 2003, we were requested to produce documents in connection with an investigation by the United States Department of Justice into possible antitrust violations in the heat stabilizer industry. In April 2006, we were notified by the Department of Justice that the Government had closed its investigation and that the Company was relieved of any obligation to retain documents that were responsive to the Government s earlier document request. Before closing its investigation, the Department of Justice took no action against the Company or any of its current or former employees. The Company was previously named as a defendant in several lawsuits alleging civil damages and requesting injunctive relief relating to the conduct the Government was investigating. We entered into a verbal agreement in June 2007 and a definitive written settlement agreement in July 2007 with the direct purchasers in one of these class action civil lawsuits related to alleged antitrust violations in the heat stabilizer industry. Although the Company decided to bring this matter to a close through settlement, the Company did not admit to any of the alleged violations and continues to deny any wrongdoing. The settlement agreement must be approved by the United States District Court for the Eastern District of Pennsylvania. The Company is vigorously defending the remaining two civil actions alleging antitrust violations in the heat stabilizer industry, which are in their preliminary stages; therefore, we cannot determine the outcomes of these lawsuits at this time. We have asserted a claim against the former owner of our heat stabilizer business of indemnification for the defense of these lawsuits and any resulting payments by the Company, including the payments of approximately $6.3 million to the class of direct purchasers and a plaintiff that opted out of the class of direct purchasers and entered into a separate settlement agreement with the Company.

In a July 2004 press release, we announced that our Polymer Additives business performance in the second quarter of 2004 fell short of expectations and that our Audit Committee would investigate possible inappropriate accounting entries in the Polymer Additives business. We were later sued in a series of putative securities class action lawsuits related to this July 2004 announcement. Those lawsuits were consolidated into a single case in the United States District Court for the Northern District of Ohio against the Company, our deceased former Chief Executive Officer, our former Chief Financial Officer, and a former Operating Vice President of the Company. In June 2007, the United States District Court for the Northern District of Ohio dismissed the plaintiffs complaint, after which the plaintiffs appealed the District Court decision to the Sixth Circuit Court of Appeals. In September 2007, however, the plaintiffs filed a voluntary dismissal, with prejudice, of their appeal, thus ending this litigation.

Also following the July 2004 press release, four derivative lawsuits were filed and subsequently consolidated in the United States District Court for the Northern District of Ohio. These lawsuits alleged breach of fiduciary duties and mismanagement-related claims. In March 2006, the Court dismissed the consolidated derivative action without prejudice. In April 2006, the plaintiffs filed a motion seeking relief from the judgment that dismissed the derivative lawsuit and seeking to amend their complaint further following discovery. The plaintiffs motion was denied. Later in April 2006, plaintiffs filed a Notice of Appeal to the Sixth Circuit Court of Appeals. The Directors and named executives consider the allegations contained in the derivative actions to be unfounded, have vigorously defended this action and will defend against the new filing. We have notified Ferro s directors and officers liability insurer of the claim. This appeal is currently under consideration by the Sixth Circuit Court of Appeals; therefore, we cannot determine the outcome of this litigation at this time.

In June 2005, a putative class action lawsuit was filed against the Company and certain former and current employees alleging breach of fiduciary duty with respect to ERISA plans in connection with the matters announced in the July 2004 press release. In October 2006, the parties reached a settlement in principle that would result in the dismissal of the lawsuit, with prejudice, in exchange for a settlement amount of $4.0 million, of which $3.4 million was paid by the Company s liability insurer and $0.6 was paid by the Company. The Company and the individual defendants have expressly denied any wrongdoing. The United States District Court approved the settlement in September 2007, thus ending this lawsuit.

In September 2007, we entered into a settlement agreement with the U.S. Securities and Exchange Commission (SEC) related to the SEC s investigation of the inappropriate accounting entries in our Polymer Additives business. As part of the settlement, and without admitting or denying any wrongdoing, we agreed to the entry of an administrative order by the SEC directing the Company to cease and desist from committing or causing violations of certain of the reporting provisions of Federal securities laws and related SEC rules. The SEC s order contains no finding of securities fraud or violation of any antifraud provision of Federal securities laws or related SEC rules. The Company was not required to pay any monetary penalty or fine in connection with the resolution of this matter.

In October 2004, the Belgian Ministry of Economic Affairs Commercial Policy Division (the Ministry) served on our Belgian subsidiary a mandate requiring the production of certain documents related to an alleged cartel among producers of butyl benzyl phthalate (BBP) from 1983 to 2002. Subsequently, German and Hungarian authorities initiated their own national investigations related to the same allegations. Our Belgian subsidiary acquired its BBP business from Solutia Europe S.A./N.V. (SOLBR) in August 2000. We promptly notified SOLBR of the Ministry s actions and requested SOLBR to indemnify and defend the Company and its Belgian subsidiary with respect to these investigations. In response to our notice, SOLBR exercised its right under the 2000 acquisition agreement to take over the defense and settlement of these matters. In December 2005, the Hungarian authorities imposed a de minimis fine on our Belgian subsidiary and in October 2007, the German authorities imposed a fine of approximately 0.4 million. We expect the Belgian authorities also to assess fines for the alleged conduct. We cannot predict the amount of the Belgian fine that will ultimately be assessed and cannot predict the degree to which SOLBR will indemnify Ferro s Belgian subsidiary for these various fines.

In February 2007, we discovered that some of the values shown on certificates of analysis provided to customers by a plant in our Specialty Plastics segment were inaccurate. The faulty procedures and practices that resulted in the inaccurate values have been investigated and corrected. We have worked with the customers of the Specialty Plastics business to provide those customers with products that meet their performance requirements and are accurately described on the corresponding certificates of analysis. While it is possible some customers may assert claims relating to this issue, we cannot predict at this time the financial effect of any resulting claims.

There are various other lawsuits and claims pending against the Company and its consolidated subsidiaries. In our opinion, the ultimate liabilities, if any, and expenses resulting from such lawsuits and claims will not materially affect the consolidated financial position, results of operations, or cash flows of the Company.

The Company had bank guarantees and standby letters of credit issued by financial institutions, which totaled $17.1 million at September 30, 2007, and $20.8 million at December 31, 2006. These agreements primarily relate to Ferro s insurance programs, natural gas contracts, potential environmental remediation liabilities, and foreign tax payments. If the Company fails to perform its obligations, the guarantees and letters of credit may be drawn down by their holders, and we would be liable to the financial institutions for the amounts drawn.

10. Retirement Benefits

Information concerning net periodic benefit costs of our U.S. pension plans (including our unfunded nonqualified plans), non-U.S. pension plans, and postretirement health care and life insurance benefit plans for the three months ended September 30 is as follows:

	U.S. Pension Plans		Non-U.S. Pension Plans		Other Benefit Plans	
	2007	2006	2007	2006	2007	2006
	(Dollars in thousands)					
Components of net periodic cost:						
Service cost	$ 317	$ 461	$ 1,663	$ 1,724	$ 124	$ 140
Interest cost	5,026	4,973	2,359	1,891	836	807
Expected return on plan assets	(5,140)	(4,735)	(1,871)	(1,487)		
Amortization of prior service cost	39	46	27	36	(349)	(293)
Net amortization and deferral	1,456	1,249	148	238		
Curtailment and settlement effects		150			(814)	
Special termination benefits			2,189			
Net periodic benefit cost	$ 1,698	$ 2,144	$ 4,515	$ 2,402	$ (203)	$ 654

20

Information concerning net periodic benefit costs of our U.S. pension plans (including our unfunded nonqualified plans), non-U.S. pension plans, and postretirement health care and life insurance benefit plans for the nine months ended September 30 is as follows:

	U.S. Pension Plans		Non-U.S. Pension Plans		Other Benefit Plans	
	2007	2006	2007	2006	2007	2006
			(Dollars in thousands)			
Components of net periodic cost:						
Service cost	$ 948	$ 5,740	$ 4,888	$ 5,197	$ 428	$ 548
Interest cost	15,083	15,422	6,937	5,556	2,554	2,481
Expected return on plan assets	(15,392)	(14,497)	(5,499)	(4,366)		
Amortization of prior service cost	118	91	82	108	(935)	(542)
Net amortization and deferral	4,405	4,908	434	691		
Curtailment and settlement effects	250	2,565			(814)	(2,453)
Special termination benefits			2,189			
Net periodic benefit cost	$ 5,412	$ 14,229	$ 9,031	$ 7,186	$ 1,233	$ 34

The change in net periodic benefit cost is due primarily to the following factors:

A curtailment recognized in the second quarter of 2006 of retirement benefit accumulations for our largest defined benefit plan, which covers certain salaried and hourly employees in the United States. The affected employees now receive benefits in the Company s defined contribution plan that previously covered only U.S. salaried employees hired after 2003. These changes did not affect current retirees or former employees.

Settlements recognized in the second and third quarters of 2006 of certain obligations in our U.S. unfunded nonqualified defined benefit retirement plan, related primarily to a lump sum payment to the beneficiary of our deceased former Chief Executive Officer.

Restructuring activities that will result in closing the Company s Niagara Falls, New York, manufacturing facility by the end of 2007. In the first quarter of 2007, we recorded a net curtailment loss of $0.3 million for pension benefits related to this closing. In the third quarter of 2007, we recorded a net curtailment gain of $0.7 million for other benefits. In the fourth quarter of 2007, we expect to record additional curtailment gains of approximately $2.5 million for other benefits, based on the expected timing of employee terminations.

Restructuring activities that will result in closing one of the Company s Rotterdam, The Netherlands, manufacturing facilities by the end of the third quarter of 2008. In the third quarter of 2007, we recorded costs for special termination pension benefits of $2.2 million related to this closing. In the first half of 2008, we expect to record pension curtailment gains of approximately $0.1 million, based on the expected timing of employee terminations.

A curtailment recognized in the second quarter of 2006 of eligibility for retiree medical and life insurance coverage for nonunion employees. Only employees age 55 or older with 10 or more years of service as of December 31, 2006, will be eligible for postretirement medical and life insurance benefits. Moreover, these benefits will be available only to those employees who retire by December 31, 2007, after having advised the Company of their retirement plans by March 31, 2007.

11. Stock-based Compensation

On January 1, 2006, we adopted Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment*, (FAS 123R) and therefore measure and recognize compensation expense for all share-based payment awards made to employees and directors based on estimated fair values.

Deferred Stock Units

Under the 2006 Long-Term Incentive Plan (the Plan) we granted our directors 36,700 deferred stock units during the nine months ended September 30, 2007. Each deferred stock unit represents a forfeitable share of Ferro common stock. At the end of the deferral period, the deferred stock units will be converted into nonforfeitable shares of Ferro common stock based upon the recipients continued service with the Company. The recipients of the deferred stock units are not entitled to receive dividends during the deferral period. The deferred stock units granted in 2007 have a deferral period of one year.

Because the deferred stock units may only be paid in shares of Ferro common stock, we treated them as equity awards under the requirements of FAS 123R. We determined the fair value of the deferred stock units based upon the closing stock price on the date of the grant adjusted downward for the present value of the dividends that will not be paid to recipients of the deferred stock units. The related compensation expense is recognized evenly over the deferral period.

Compensation Expense Information

The following table contains the total stock-based compensation expense recorded in selling, general and administrative expense for the nine months ended September 30:

	2007	2006
	(Dollars in thousands)	
Stock options	$ 2,333	$ 2,267
Performance shares	794	776
Deferred stock units	505	
Total	$ 3,632	$ 3,043

Grant Information

The following table contains information regarding the stock-based compensation as of and for the nine months ended September 30, 2007:

	Number of Shares or Units Granted	Weighted -Average Grant Date Fair Value per Share or Unit	Aggregate Grant Date Fair Value of Shares or Units Granted (Dollars in thousands)	Remaining Service or Performance Period (In years)
Stock options	517,000	$ 6.24	$ 3,225	3.3
Performance shares	151,600	21.88	3,316	2.4
Deferred stock units	36,700	21.50	789	0.4

12. Restructuring and Cost Reduction Programs

During 2006, we developed and initiated several restructuring programs across a number of our business segments with the objectives of leveraging our global scale, realigning and lowering our cost structure, and optimizing capacity utilization. The programs are primarily associated with North America and Europe. Management continues to evaluate our business, and therefore, there may be supplemental provisions for new plan initiatives as well as changes in estimates to amounts previously recorded, as payments are made or actions are completed.

In July 2006, we announced that we were restructuring our European operations, including portions of our Performance Coatings segment and our Color and Glass Performance Materials segment. A portion of our Italian manufacturing operations and administrative functions was consolidated with Spain, where additional production capacity is being constructed. Additionally, we are consolidating our decorative colors production, primarily from Frankfurt, Germany, to Colditz, Germany. As a result of these activities, since July 2006, we have reduced our workforce by approximately 60 employees and are evaluating further workforce reductions. We expect these actions to significantly reduce the cost structure of our manufacturing operations. During the nine months ended September 30, 2007, we recorded charges of $1.9 million for our operations in Spain, Portugal, France and Germany, primarily relating to registration taxes paid and expected employee termination benefits. In March 2007, we reached an agreement with the Betriebsrat der Ferro GmbH (German Works Council) regarding employee termination benefits for employees included in the decorative colors consolidation plan. The agreement provides that a higher number of employees than previously anticipated will participate in a severance plan in accordance with German laws and regulations. As a result, the timing of the related expense recognition will occur ratably over future periods, and $1.1 million of the estimated amounts previously accrued were reversed during the first quarter. In total, 42 employees were terminated relating to the European consolidation during the first nine months of 2007.

In November 2006, we announced that we were restructuring the Electronic Materials segment due to excess capacity we had for the production of dielectric and industrial ceramic products. We will cease production at our Niagara Falls, New York, manufacturing facility by the end of 2007 and have transfered some of its production to facilities in Penn Yan, New York, and Uden, The Netherlands. The closure will impact approximately 150 employees. During the nine months ended September 30, 2007, we recorded $1.0 million of restructuring charges associated with termination benefits, and 62 employees were terminated.

In February 2007 and June 2007, we approved additional restructuring plans for our Specialty Plastics and Polymer Additives segments. As a result, we recorded $1.0 million of gross restructuring charges in the nine months ended September 30, 2007, primarily associated with termination benefits affecting 49 employees. We also reversed previously-accrued severance costs of $0.3 million due to changes in contractual benefits.

In May 2007, we initiated discussions with representatives of workers at our Rotterdam, The Netherlands, porcelain enamel manufacturing site regarding possible restructuring actions. In September 2007, we reached an agreement with the Rotterdam Works Council. As a result, the Company will discontinue porcelain enamel frit manufacturing at its Rotterdam, The Netherlands, facility in 2008 and will consolidate production at other European facilities. This consolidation will result in a reduction of the workforce by 84 employees. During the nine months ended September 30, 2007, we recorded $5.4 million in restructuring charges and an additional $0.5 million for inventory write downs in The Netherlands. These restructuring charges included $2.2 million of pension expense for accelerated benefits, $1.8 million for employee severance costs, and $1.4 million for asset impairments and other costs. Restructuring charges are expected to total $22.7 million with completion anticipated by the end of the third quarter of 2008. We plan to accrue from the fourth quarter of 2007 through the third quarter of 2008 an additional $12.8 million for employee severance costs and $4.5 million for future minimum operating lease obligations under a land rights lease.

Restructuring charges for the nine months ended September 30, 2007, also include $0.2 million in accrual reversals for other cost reduction and restructuring programs prior to 2006.

We have summarized the activities and balances related to our restructuring and cost reduction programs below:

	Employee Termination Benefits	Other Costs	Asset Writedowns	Total
		(Dollars in thousands)		
Balance, December 31, 2006	$ 6,730	$ 39	$ 15,795	$ 22,564
Gross charges	4,846	3,216	1,175	9,237
Cash payments	(5,528)	(895)		(6,423)
Reserve adjustments	(1,547)	34	30	(1,483)
Balance, September 30, 2007	$ 4,501	$ 2,394	$ 17,000	$ 23,895

We expect to make cash payments to settle the remaining liabilities for employee termination benefits and other costs primarily over the next twelve months, except where legal or contractual restrictions prevent us from doing so.

13. Discontinued Operations

Discontinued operations relate to the Powder Coatings, Petroleum Additives and Specialty Ceramics businesses that we sold in 2002 and 2003. There were no sales, cost of sales, or cash flows from investing or financing activities from discontinued operations in the nine months ended September 30, 2007 or 2006. The loss from discontinued operations includes ongoing legal and environmental costs directly related to discontinued operations.

Discontinued operations resulted in the following pre-tax losses (income) and related income tax benefits (expense):

	Three months ended September 30, 2007	Three months ended September 30, 2006	Nine months ended September 30, 2007	Nine months ended September 30, 2006
	(Dollars in thousands)			
Pre-tax losses (income)	$ 4	$ (96)	$ 355	$ 643
Tax benefits (expense)	2	(34)	139	238
Net of tax losses (income)	$ 2	$ (62)	$ 216	$ 405

We have continuing environmental remediation obligations that are related to these divestitures, and we have accrued $3.3 million as of September 30, 2007, and $3.1 million as of December 31, 2006, for these matters.

14. Earnings per Share

Details of the calculation of basic and diluted earnings per share are shown below:

	Three months ended September 30, 2007	Three months ended September 30, Adjusted 2006	Nine months ended September 30, 2007	Nine months ended September 30, Adjusted 2006
	(In thousands, except per share amounts)			
Basic earnings per share computation:				
Net income available to common shareholders	$ 5,333	$ 5,221	$ 15,407	$ 23,017
Add back: Loss (gain) from discontinued operations	2	(62)	216	405
	$ 5,335	$ 5,159	$ 15,623	$ 23,422
Weighted-average common shares outstanding	43,030	42,397	42,881	42,394
Basic earnings per share from continuing operations	$ 0.12	$ 0.12	$ 0.36	$ 0.55
Diluted earnings per share computation:				
Net income available to common shareholders	$ 5,333	$ 5,221	$ 15,407	$ 23,017
Add back: Loss (gain) from discontinued operations	2	(62)	216	405
Plus: Convertible preferred stock				
	$ 5,335	$ 5,159	$ 15,623	$ 23,422
Weighted-average common shares outstanding	43,030	42,397	42,881	42,394

Assumed conversion of convertible preferred stock				
Assumed satisfaction of performance share conditions	59	26	54	17
Assumed satisfaction of deferred stock unit conditions	24		14	
Assumed exercise of stock options				
Weighted-average diluted shares outstanding	43,113	42,423	42,949	42,411
Diluted earnings per share from continuing operations	$ 0.12	$ 0.12	$ 0.36	$ 0.55

Table of Contents

The convertible preferred shares and the stock options were anti-dilutive for the three and nine months ended September 30, 2007 and 2006, and thus not included in the diluted shares outstanding.

15. Reporting for Segments

The Company has six reportable segments: Performance Coatings, Electronic Materials, Color and Glass Performance Materials, Polymer Additives, Specialty Plastics and Other businesses. We have combined our Tile Coating Systems and Porcelain Enamel business units into one reportable segment, Performance Coatings, based on their similar economic and operating characteristics. We have also combined two of our segments, Pharmaceuticals and Fine Chemicals, into the Other businesses segment, because they do not meet the quantitative thresholds for separate disclosure.

The accounting policies of our segments are consistent with those described for our consolidated financial statements in the summary of significant accounting policies contained in our Annual Report on Form 10-K for the year ended December 31, 2006. We measure segment income for internal reporting purposes as net operating profit before interest and taxes. Segment income excludes unallocated corporate expenses and charges associated with restructuring and cost reduction programs.

Net sales to external customers by segment are presented in the table below. Sales between segments were not material.

	Three months ended September 30,		Nine months ended September 30,	
	2007	2006	2007	2006
	(Dollars in thousands)			
Performance Coatings	$ 153,742	$ 134,947	$ 451,058	$ 397,015
Electronic Materials	116,645	104,960	338,412	335,493
Color and Glass Performance Materials	113,575	94,916	329,195	292,515
Polymer Additives	85,230	79,815	252,903	245,057
Specialty Plastics	62,236	65,762	198,994	209,525
Other businesses	19,273	20,173	63,502	64,613
Total net sales	$ 550,701	$ 500,573	$ 1,634,064	$ 1,544,218

Table of Contents

Below are each segment s income and reconciliations to income before income taxes from continuing operations:

	Three months ended September 30,		Nine months ended September 30,	
	2007	Adjusted 2006	2007	Adjusted 2006
	(Dollars in thousands)			
Performance Coatings	$ 8,449	$ 11,527	$ 29,947	$ 31,937
Electronic Materials	8,522	7,261	19,534	25,895
Color and Glass Performance Materials	11,727	8,187	39,462	32,993
Polymer Additives	3,417	4,133	10,576	11,984
Specialty Plastics	3,586	2,087	10,961	11,937
Other businesses	593	754	7,982	4,002
Total segment income	36,294	33,949	118,462	118,748
Unallocated expenses	(7,215)	(9,345)	(38,219)	(33,243)
Restructuring charges	(5,826)		(7,689)	
Interest expense	(14,488)	(16,818)	(46,220)	(48,155)
Interest earned	271	971	1,425	2,741
Foreign currency transactions, net	10	(166)	(924)	(706)
Miscellaneous income (expense), net	13	(428)	399	(3,070)
Income before income taxes from continuing operations	$ 9,059	$ 8,163	$ 27,234	$ 36,315

We sell our products throughout the world, and we attribute sales to the country from which we generate the customer invoice. We have detailed net sales by geographic region in the table below:

	Three months ended September 30,		Nine months ended September 30,	
	2007	2006	2007	2006
	(Dollars in thousands)			
United States	$ 232,405	$ 231,531	$ 710,423	$ 738,060
International	318,296	269,042	923,641	806,158
Total net sales	$ 550,701	$ 500,573	$ 1,634,064	$ 1,544,218

Table of Contents

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

Overview

Net income for the three months ended September 30, 2007, was $5.6 million, up 1.0% from $5.5 million for the three months ended September 30, 2006. Earnings were little changed as restructuring charges related to the consolidation of certain of our manufacturing facilities in Europe and higher income tax expense were offset by lower selling, general and administrative expenses and lower interest expense.

During the third quarter, net sales increased by 10.0% compared with the prior-year quarter as a result of higher sales in the Performance Coatings, Color and Glass Performance Materials, Electronic Materials, and Polymer Additives segments. Sales in the Specialty Plastics and Other segments declined compared with the third quarter of 2006.

Unit costs for a number of raw materials used in the manufacture of our products, such as bismuth, cobalt, nickel, soybean oil, and tallow, continued to contribute to increased manufacturing costs compared with a year ago. In the aggregate, raw material costs per unit produced increased during the third quarter compared with the third quarter of 2006.

During the third quarter, selling, general and administrative expenses declined as a result of cost reduction efforts during previous quarters in a number of businesses including Polymer Additives and Specialty Plastics, lower incentive compensation accruals, and lower audit fees. Also during the third quarter, interest expense declined, partially due to lower borrowings, which resulted from the elimination of cash deposits that were required for precious metals during the third quarter of 2006. Income tax