

HERCULES INC
Form 10-Q/A
December 01, 2004
3:

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

FORM 10-Q/A

Quarterly Report
Pursuant to Section 13 or 15(d)
of the Securities Exchange Act of 1934

For the quarterly period ended June 30, 2004
Commission file number 1-496

HERCULES INCORPORATED

A Delaware corporation
I.R.S. Employer Identification No. 51-0023450
Hercules Plaza
1313 North Market Street
Wilmington, Delaware 19894-0001
Telephone: 302-594-5000

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 an accelerated filer (as defined in Rule 12b-2 of the Securities Exchange Act).

Yes: No:

As of July 30, 2004, 111,767,194 shares of registrant's common stock were outstanding.

EXPLANATORY NOTE

This Amendment No. 1 to the Form 10-Q of Hercules Incorporated (the "Company") for the period ended June 30, 2004 is being filed to restate its Balance Sheets, Statements of Stockholders' Equity and related notes to the Consolidated Financial Statements for income tax adjustments resulting from a review of the Company's GAAP accounting for income taxes for the tax years 1987 through 1995. The adjustments reflected in this Form 10-Q/A relate to the computation and application of foreign tax credits and reduce the tax deposit asset by \$65 million, increase deferred income tax assets by \$17 million, and, as a result of the cumulative additional income tax expense to be recorded for the restated periods, reduce retained earnings and stockholders' equity by \$48 million as of January 1, 1996 and for previously reported periods affected through June 30, 2004. The restatement does not affect the previously reported results of operations for any period subsequent to

Edgar Filing: HERCULES INC - Form 10-Q/A

December 31, 1995. The restatement, which was previously disclosed in a Form 8-K issued on November 9, 2004, is more fully described in Note 19 to the Consolidated Financial Statements.

This Form 10-Q/A includes amendments to the following items and exhibits as a result of the restatement:

Item 1.	Consolidated Financial Statements
Item 4.	Controls and Procedures
Exhibit 31.1	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
Exhibit 31.2	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
Exhibit 32.1	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
Exhibit 32.2.	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

PART I - FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements HERCULES INCORPORATED CONSOLIDATED STATEMENTS OF INCOME

<i>(Dollars in millions, except per share)</i>	(Unaudited)		(Unaudited)	
	Three Months Ended		Six Months	
	June 30,		Ended June 30,	
	2004	2003	2004	2003
Net sales	\$ 510	\$ 478	\$ 985	\$ 925
Cost of sales (Note 6)	325	298	630	582
Selling, general and administrative expenses	98	90	196	181
Research and development	11	10	22	20
Intangible asset amortization (Note 4)	2	2	4	4
Other operating expense, net (Note 7)	9	2	22	1
	<hr/>	<hr/>	<hr/>	<hr/>
Profit from operations	65	76	111	137
Interest and debt expense	30	33	60	67
Other expense, net (Note 8)	27	6	18	10
	<hr/>	<hr/>	<hr/>	<hr/>
Income before income taxes and equity income	8	37	33	60
Provision for income taxes (Note 17)	4	5	3	14
	<hr/>	<hr/>	<hr/>	<hr/>
Income before equity income	4	32	30	46
Equity income of affiliated companies, net of tax	-	-	-	-
	<hr/>	<hr/>	<hr/>	<hr/>
Net income from continuing operations before discontinued operations and cumulative effect of changes in accounting principle	4	32	30	46
Net income on discontinued operations, net of tax	-	2	-	2
	<hr/>	<hr/>	<hr/>	<hr/>
Net income before cumulative effect of changes in accounting principle	4	34	30	48
Cumulative effect of changes in accounting principle, net of tax	-	-	-	(28)
	<hr/>	<hr/>	<hr/>	<hr/>
Net income	\$ 4	\$ 34	\$ 30	\$ 20
	<hr/>	<hr/>	<hr/>	<hr/>
Basic and diluted earnings per share (Note 5)				
Continuing operations	\$ 0.04	\$ 0.30	\$ 0.28	\$ 0.43
Discontinued operations	-	0.02	-	0.02
Cumulative effect of changes in accounting principle	-	-	-	(0.26)
	<hr/>	<hr/>	<hr/>	<hr/>
Net income	\$ 0.04	\$ 0.32	\$ 0.28	\$ 0.19
	<hr/>	<hr/>	<hr/>	<hr/>

Edgar Filing: HERCULES INC - Form 10-Q/A

Weighted-average number of shares - basic (millions)	107.6	105.9	107.2	105.5
Weighted-average number of shares - diluted (millions)	108.4	107.0	108.1	106.5

See accompanying notes to consolidated financial statements.

HERCULES INCORPORATED
CONSOLIDATED BALANCE SHEETS

(Dollars in millions)

	(Unaudited) June 30, 2004	December 31, 2003
	As Restated (Note 19)	As Restated (Note 19)
ASSETS		
Current assets		
Cash and cash equivalents	\$ 93	\$ 125
Accounts and notes receivable (net of allowance for doubtful accounts of \$8 million and \$5 million, respectively)	430	415
Inventories		
Finished products	101	100
Raw materials, work-in-process and supplies	90	87
Deferred income taxes	121	93
Total current assets	835	820
Property, plant, and equipment	2,003	2,039
Accumulated depreciation and amortization	(1,342)	(1,362)
Net property, plant, and equipment	661	677
Intangible assets, net (Note 4)	187	187
Goodwill, net (Note 4)	515	518
Deferred income taxes	42	44
Other assets	436	465
Total assets	<u>\$ 2,676</u>	<u>\$ 2,711</u>

LIABILITIES AND STOCKHOLDERS' EQUITY

Current liabilities		
Accounts payable	\$ 193	\$ 192
Accrued expenses	230	243
Current maturities of long-term debt (Note 10)	24	22
Total current liabilities	447	457
Long-term debt (Note 10)	1,338	1,326
Deferred income taxes	78	78
Pension liability (Note 12)	229	249
Other postretirement benefits (Note 12)	90	96
Deferred credits and other liabilities	461	494
Commitments and contingencies (Note 14)		
Stockholders' equity		
Series preferred stock	-	-
Common stock, (shares issued and outstanding):		

Edgar Filing: HERCULES INC - Form 10-Q/A

2004 – 159,984,444; 2003 - 159,984,444)	83	83
Additional paid-in capital	578	603
Unearned compensation	(84)	(87)
Accumulated other comprehensive losses	(332)	(317)
Retained earnings	<u>1,525</u>	<u>1,495</u>
	1,770	1,777
Reacquired stock, at cost (shares: 2004 – 48,203,891; 2003 - 48,992,628)	<u>1,737</u>	<u>1,766</u>
Total stockholders' equity	<u>33</u>	<u>11</u>
Total liabilities and stockholders' equity	<u>\$ 2,676</u>	<u>\$ 2,711</u>

See accompanying notes to consolidated financial statements.

HERCULES INCORPORATED
CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in millions)

	(Unaudited)	
	Six Months Ended June 30,	
	2004	2003
Cash Flows from Operating Activities:		
Net income	\$ 30	\$ 20
Adjustments to reconcile net income to net cash used in operations:		
Depreciation	38	35
Amortization	13	13
Provision for deferred income taxes	7	(10)
Nonoperating gain on disposals	(26)	(1)
Impairment charges	7	-
Write-off of debt issuance costs	16	-
Other non-cash charges and credits	6	6
Accruals and deferrals of cash receipts and payments:		
Affiliates earnings in excess of dividends received	-	1
Accounts and notes receivable	(18)	(22)
Inventories	(4)	(7)
Accounts payable and accrued expenses	(7)	(35)
Income taxes payable	(33)	(11)
Pension and postretirement benefits	(26)	(31)
Asbestos settlement payments	(26)	(3)
Non-current assets and liabilities	(12)	26
Net cash used in operating activities	<u>(35)</u>	<u>(19)</u>
Cash Flow from Investing Activities:		
Capital expenditures	(30)	(19)
Proceeds from sale of minority interest in CP Kelco ApS	27	-
Proceeds of investment and fixed asset disposals	-	3
Decrease in restricted cash	-	125
Other, net	1	(4)
Net cash (used in) provided by investing activities	<u>(2)</u>	<u>105</u>
Cash Flow from Financing Activities:		
Long-term debt proceeds	650	-
Long-term debt repayments	(637)	(133)
Change in short-term debt	-	(1)
Payment of debt issuance costs and underwriting fees	(8)	-
Treasury stock issued	1	1
Net cash provided by (used in) financing activities	<u>6</u>	<u>(133)</u>
Effect of exchange rate changes on cash	(1)	9

Edgar Filing: HERCULES INC - Form 10-Q/A

Net decrease in cash and cash equivalents	(32)	(38)
Cash and cash equivalents - beginning of period	125	209
Cash and cash equivalents - end of period	<u>\$ 93</u>	<u>\$ 171</u>

Supplemental Disclosures of Cash Flow Information:

Cash paid during the period for:		
Interest and debt expense	\$ 52	\$ 63
Income taxes	29	20
Non-cash investing and financing activities:		
Incentive and other employee benefit stock plan issuances	12	16

See accompanying notes to consolidated financial statements.

HERCULES INCORPORATED
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Dollars in millions)

	(Unaudited)			
	Three Months Ended June 30		Six Months Ended June 30,	
	2004	2003	2004	2003
Net income	\$ 4	\$ 34	\$ 30	\$ 20
Foreign currency translation	(3)	50	(15)	70
Comprehensive income	\$ 1	\$ 84	\$ 15	\$ 90

See accompanying notes to consolidated financial statements

HERCULES INCORPORATED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Basis of Presentation

The interim condensed consolidated financial statements and the notes to the condensed consolidated financial statements of Hercules Incorporated ("Hercules" or the "Company") are unaudited as of and for the three and six months ended June 30, 2004 and 2003, but in the opinion of management include all adjustments (consisting only of normal recurring adjustments) necessary for a fair statement of Hercules' financial position and results of operations for the interim periods. These condensed consolidated financial statements should be read in conjunction with the accounting policies, financial statements and notes included in Hercules' Annual Report on Form 10-K/A, Amendment No. 2 for the year ended December 31, 2003. Certain prior period amounts have been reclassified to conform to the current period presentation.

2. Stock-based Compensation

The Company has adopted Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" ("SFAS 123"), as amended by Statement of Financial Accounting Standards No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure" ("SFAS 148"), effective January 1, 2003. SFAS 148 amends SFAS 123 by providing alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation and requiring enhanced disclosure regarding stock-based compensation. The Company elected to apply the fair value recognition provisions of SFAS 123 on a prospective basis to

Edgar Filing: HERCULES INC - Form 10-Q/A

all employee awards granted, modified or settled after January 1, 2003. Therefore, the cost related to stock-based employee compensation included in the determination of net income is less than that which would have been recognized if the fair value based method had been applied to all awards since the original effective date of SFAS 123. The Company did not grant any stock options pursuant to SFAS 123, as amended by SFAS 148, to employees in 2003 or 2004. The Company made grants of restricted stock to employees and non-employee directors in 2003 and 2004. Restricted stock awards under the Hercules Long-term Incentive Compensation Plan are valued at the quoted market price (fair value) of the Company's stock on the grant date (measurement date). Stock acquired through the Employee Stock Purchase Plan ("ESPP") and "above target" restricted stock awarded under the Hercules Management Incentive Compensation Plan ("MICP") for awards paid prior to 2004 is discounted 15% from market price as permitted by IRS regulations and the provisions of the Company's incentive compensation plans. "Above target" awards under the MICP for the 2003 plan year were paid in cash and "above target" awards, if any, for the 2004 plan year will be paid in either cash or restricted stock at fair market value. The value of the award and the discount, if any, is amortized into compensation expense over the applicable vesting period. Forfeitures are recorded as incurred. The ESPP was terminated effective March 31, 2004. The Company recognized expense of \$1 million and \$2 million during the three and six months ended June 30, 2004, respectively, in connection with restricted stock awards.

Pursuant to the disclosure requirements of SFAS 123, as amended by SFAS 148, the following table presents the pro forma effect on net income and earnings per share assuming the Company had applied the fair value recognition provisions of SFAS 123 to all stock-based employee compensation on a retroactive basis.

(Dollars in millions, except per share)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2004	2003	2004	2003
Net income, as reported	\$ 4	\$ 34	\$ 30	\$ 20
Add: Total stock-based employee compensation expense recognized in reported results	1	1	2	1
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of tax	1	3	3	5
Pro forma net income	\$ 4	\$ 32	\$ 29	\$ 16
Earnings per share:				
Basic - as reported	\$ 0.04	\$ 0.32	\$ 0.28	\$ 0.19
Basic - pro forma	\$ 0.04	\$ 0.30	\$ 0.27	\$ 0.15
Diluted - as reported	\$ 0.04	\$ 0.32	\$ 0.28	\$ 0.19
Diluted - pro forma	\$ 0.04	\$ 0.30	\$ 0.27	\$ 0.15

3. Recent Accounting Pronouncements

In May 2004, the FASB issued Staff Position FAS 106-2, "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003" ("FSP 106-2") which supersedes FASB Staff Position FAS 106-1 of the same name ("FSP 106-1"). The Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the "Medicare Act"), which triggered FSP 106-1, was signed by the President on December 8, 2003 and introduced a prescription drug benefit under Medicare (Medicare Part D) as well as a federal subsidy to sponsors of retiree health care benefit plans that provide a benefit that is at least actuarially equivalent to Medicare Part D. Pursuant to FSP 106-1, which was issued in January 2004, the Company had elected to defer current recognition of the effects of the Medicare Act in the accounting for its prescription drug plan until authoritative guidance on the accounting for the federal subsidy was issued.

FSP 106-2, which is effective for interim reporting periods beginning after June 15, 2005, provides authoritative guidance on accounting for the effects of the Medicare Act for those employers with prescription drug benefits that are actuarially equivalent to the drug benefits under Medicare Part D. Based upon the results of the Company's review of its prescription drug benefit plan under the currently issued regulations, the

Edgar Filing: HERCULES INC - Form 10-Q/A

Company has concluded that its current plan is not actuarially equivalent to the benefits provided under Medicare Part D. As such, the Company's prescription drug plan will not qualify for the federal subsidy and will not require any change in accounting to conform to the requirements of FSP 106-2. Any collateral effects that the availability of Medicare Part D program may have on the participation in the Company's prescription drug plan will be evaluated in conjunction with the Company's annual FAS 106 valuation.

4. Goodwill and Other Intangible Assets

The following table shows changes in the carrying amount of goodwill by operating segment for the six months ended June 30, 2004.

<i>(Dollars in millions)</i>	Performance Products	Engineered Materials & Additives	Total
Balance at December 31, 2003	\$ 433	\$ 85	\$ 518
Additions	2	-	2
Less: Foreign currency translation	5	-	5
Balance at June 30, 2004	<u>\$ 430</u>	<u>\$ 85</u>	<u>\$ 515</u>

The following table provides information regarding the Company's other intangible assets with finite lives:

<i>(Dollars in millions)</i>	Customer Relationships	Trademarks & Tradenames	Other Intangibles	Total
<u>Gross Carrying Amount</u>				
Balance, December 31, 2003	\$ 89	\$ 72	\$ 72	\$ 233
Balance, June 30, 2004	90	74	73	237
<u>Accumulated Amortization</u>				
Balance, December 31, 2003	\$ 12	\$ 9	\$ 25	\$ 46
Balance, June 30, 2004	13	10	27	50

Total amortization expense for other intangible assets was \$2 million for each of the three month periods ended June 30, 2004 and 2003. Total amortization expense for other intangible assets was \$4 million for each of the six month periods ended June 30, 2004 and 2003. Estimated amortization expense is \$8 million for 2004 and \$7 million per year for 2005 through 2008.

5. Earnings Per Share

The following table shows the amounts used in computing earnings per share and the effect on net income and the weighted-average number of shares of dilutive potential common stock:

(Dollars in millions, except per share)

	Three Months Ended June 30,			
	2004		2003	
	Income	Earnings per share	Income	Earnings per share
Basic and Diluted:				
Continuing operations	\$ 4	\$ 0.04	\$ 32	\$ 0.30
Discontinued operations	-	-	2	0.02
Cumulative effect of changes in accounting principle	-	-	-	-
Net income	<u>\$ 4</u>	<u>\$ 0.04</u>	<u>\$ 34</u>	<u>\$ 0.32</u>
Weighted-average number of shares - basic (millions)	107.6		105.9	
Weighted-average number of shares - diluted (millions)	108.4		107.0	

(Dollars in millions, except per share)

	Six Months Ended June 30,	
	2004	2003

Edgar Filing: HERCULES INC - Form 10-Q/A

	Income	Earnings per share	Income (loss)	Earnings (loss) per share
Basic and Diluted:				
Continuing operations	\$ 30	\$ 0.28	\$ 46	\$ 0.43
Discontinued operations	-	-	2	0.02
Cumulative effect of changes in accounting principle	-	-	(28)	(0.26)
Net income	<u>\$ 30</u>	<u>\$ 0.28</u>	<u>\$ 20</u>	<u>\$ 0.19</u>

Weighted-average number of shares - basic (millions)	107.2	105.5
Weighted-average number of shares - diluted (millions)	108.1	106.5

For the three months ended June 30, 2004 and 2003, the Company had convertible subordinated debentures, stock options and restricted stock that were convertible into approximately 0.8 and 1.1 million shares, respectively, of common stock. For the six months ended June 30, 2004 and 2003, the Company had convertible subordinated debentures, stock options and restricted stock that were convertible into approximately 0.9 and 1.0 million shares, respectively, of common stock. The related interest on the convertible subordinated debentures has an immaterial impact on the earnings per share calculations.

The following table shows the number of options and warrants that have been excluded from the computation of diluted earnings per share as their exercise price exceeded their current market value:

	Three Months Ended June 30,	Six Months Ended June 30,
<i>(In millions)</i>	<u>2004</u>	<u>2003</u>
Options to purchase common stock	15.7	17.4
Warrants to purchase common stock	7.1	8.2

6. Depreciation Expense

Cost of sales and selling, general and administrative expenses include depreciation expense related to continuing operations totaling \$19 million and \$18 million for the three months ended June 30, 2004 and 2003, respectively, and \$38 million and \$35 million for the six months ended June 30, 2004 and 2003, respectively.

7. Other Operating Expense, Net

Other operating expense, net, consists of the following for the three and six months ended June 30, 2004 and 2003, respectively:

<i>(Dollars in millions)</i>	Three Months Ended June 30,		Six Months Ended June 30,	
	2004	2003	2004	2003
Severance and restructuring costs (recoveries)	\$ 4	\$ (1)	\$ 6	\$ 1
Nitrocellulose facility shutdown costs	4	-	6	-
Asset impairment charges	-	-	7	-
Special executive pension adjustment	-	-	1	-
Other miscellaneous charges	1	3	2	-
	<u>\$ 9</u>	<u>\$ 2</u>	<u>\$ 22</u>	<u>\$ 1</u>

8. Other Expense, Net

Other expense, net, consists of the following for the three and six months ended June 30, 2004 and 2003, respectively:

<i>(Dollars in millions)</i>	Three Months ended June 30,	Six Months Ended June 30,
------------------------------	-----------------------------	---------------------------

Edgar Filing: HERCULES INC - Form 10-Q/A

	<u>2004</u>	<u>2003</u>	<u>2004</u>	<u>2003</u>
Write-off of unamortized debt issuance costs				
pursuant to refinancing	\$ 14	\$ -	\$ 14	\$ -
Loss on repurchases of 11.125% notes ⁽¹⁾	7	-	15	-
Asbestos-related litigation costs	5	1	7	2
Other litigation costs and legal settlements	-	3	6	3
Gain on disposals ⁽²⁾	-	-	(26)	(1)
Other miscellaneous expenses, net	<u>1</u>	<u>2</u>	<u>2</u>	<u>6</u>
	<u>\$ 27</u>	<u>\$ 6</u>	<u>\$ 18</u>	<u>\$ 10</u>

(1) Includes write-off of unamortized debt issuance costs of \$1 million and \$2 million for the three and six months ended June 30, 2004, respectively.

(2) In 2004, represents gain on the sale of CP Kelco ApS (see Note 18).

9. Severance and Other Exit Costs

The consolidated balance sheets reflect liabilities for employee severance benefits and other costs of \$8 million and \$6 million at June 30, 2004 and December 31, 2003, respectively. During 2001 and continuing through March 31, 2003, management authorized and committed to various plans to reduce the workforce as part of a comprehensive cost reduction and work process redesign program. During that period, the Company incurred \$78 million in employee severance benefits, exit costs and contract terminations. During 2003, the Company recognized an additional \$5 million for employee termination benefits in accordance with Statement of Financial Accounting Standards No. 112, "Employer's Accounting for Post-Employment Benefits" ("SFAS 112") under its Severance Pay Plan and Dismissal Wage Plans ("Dismissal Plans").

During the three and six months ended June 30, 2004, the Company recognized additional charges of \$4 million and \$6 million, respectively, for employee termination benefits under the Dismissal Plans in accordance with SFAS 112. As of June 30, 2004, the number of employees identified for dismissal had increased to 1,502, of which 1,409 had already left the Company. The Company terminated approximately 22 employees during the six months ended June 30, 2004. Approximately 93 employees remain to be terminated with the majority of the terminations anticipated to be finalized by September 30, 2004.

Total cash payments during the three and six months ended June 30, 2004, related to the above actions, were approximately \$2 million and \$4 million, respectively. Cash payments under the 2001 plan were negligible for the three months ended June 30, 2004 and were approximately \$1 million for the six months ended June 30, 2004. Payments under the Dismissal Plans were approximately \$2 million and \$3 million, respectively, for the three and six months ended June 30, 2004.

A reconciliation of activity with respect to the liabilities for these plans is as follows:

(Dollars in millions)

Balance at December 31, 2003	\$ 6
Additional termination costs	6
Cash payments	<u>(4)</u>
Balance at June 30, 2004	<u>\$ 8</u>

The balance at June 30, 2004 represents severance benefits and other exit costs of which \$2 million pertains to the continuing benefit payment streams under the 2001 restructuring plan and \$6 million pertains to other severance benefits accounted for under the Company's Dismissal Plans.

Effective January 1, 2003, the Company adopted Statement of Financial Accounting Standards No. 146, "Accounting for Costs Associated with Exit or Disposal Activities" ("SFAS 146"). The Company did not recognize any costs associated with exit or disposal activities pursuant to SFAS 146.

10. Debt

(Dollars in millions)

June 30, December 31,

Edgar Filing: HERCULES INC - Form 10-Q/A

	2004	2003
Long-term:		
Term B Loan due 2010	\$ 399	\$ -
Term B Loan due 2007	-	198
6.60% notes due 2027	100	100
Term notes at various rates from 2.84% to 7.90% due in varying amounts through 2014	34	42
11.125% senior subordinated notes due 2007	310	376
6.75% senior subordinated notes due 2029	250	-
8% convertible subordinated debentures due 2010	3	3
9.42% junior subordinated deferrable interest debentures due 2029	-	363
6.50% junior subordinated deferrable interest debentures due 2029	263	262
Other	3	4
	1,362	1,348
Less: Current maturities of long-term debt	24	22
Net long-term debt	\$ 1,338	\$ 1,326

On April 8, 2004, the Company completed the refinancing of its old Senior Credit Facility with a new Senior Credit Facility consisting of a \$400 million term loan (the new "Term B Loan") and a new \$150 million committed revolving credit facility (the "Revolving Facility"). The Company also has the ability under the new Senior Credit Facility, subject to lender approval, to borrow an additional \$250 million in the form of an incremental term note. The Term B Loan matures October 8, 2010 and the Revolving Facility matures April 9, 2009. Borrowings under the Term B Loan bear interest at LIBOR + 2.25% (weighted-average rate of 3.5% at June 30, 2004) with the Company holding the option to reset interest rates for one, two, three or six month periods. The new Senior Credit Facility is secured by liens on the Company's assets (including real, personal and intellectual properties) and is guaranteed by substantially all of the Company's current and future wholly owned domestic subsidiaries.

The Company also completed the private offering of \$250 million aggregate principal amount of 6.75% senior subordinated notes due 2029 during the quarter ended June 30, 2004. The 6.75% senior subordinated notes due 2029 were subject to a registration rights agreement that required Hercules to file an exchange offer registration statement with the Securities and Exchange Commission within 90 days (no later than July 7, 2004) and to use its best efforts to have the registration declared effective no later than October 5, 2004. On June 30, 2004, Hercules filed a Registration Statement on Form S-4 with the Securities and Exchange Commission pursuant to which the Company offered to exchange all of the \$250 million aggregate principal amount of the 6.75% senior subordinated notes due 2029 ("old notes") for \$250 million aggregate principal amount of 6.75% senior subordinated notes due 2029 ("new notes"). The Registration Statement on Form S-4 has not yet been declared effective. The form and terms of the new notes will be the same as the form and terms of the old notes except that, because the issuance of the new notes will be registered under the Securities Act, the new notes will not bear legends restricting their transfer and will not be entitled to certain registration rights under the registration rights agreement. The new notes will evidence the same debt as the old notes and the new notes and the old notes will be governed by the same indenture. Hercules will not receive any proceeds from the exchange offer.

Proceeds from the refinancing were used in part to fully repay the outstanding Term B loan. The Company dissolved Hercules Trust I (the "Trust") and caused the Company's 9.42% junior subordinated deferrable interest debentures due 2029 to be distributed to the holders of the Trust's 9.42% trust preferred securities. Proceeds of \$363 million from the refinancing were used to fully redeem the debentures on May 10, 2004. As a result of the debt repayment and redemption, the Company recognized approximately \$14 million of non-cash expense during the second quarter 2004 for the write-off of unamortized debt issuance costs.

The Board of Directors has authorized the Company, from time to time, subject to market conditions and provisions of the Company's credit agreement and indentures, to repurchase up to \$200 million of its outstanding indebtedness. The Company has repurchased a total of \$90 million (book value) of the 11.125% senior subordinated notes through June 30, 2004. During the six months ended June 30, 2004, the Company repurchased \$66 million (book value) of the 11.125% senior subordinated notes for \$79 million, recognizing a loss on the repurchase of \$13 million, which is included in Other expense, net. As a result of the repurchases, during the six months ended June 30, 2004 the Company recognized non-cash expenses of \$2 million for the amortization of related unamortized debt issuance costs.

As of June 30, 2004, \$73 million of the \$150 million Revolving Facility was available for use. The Company had \$77 million of outstanding letters of credit associated with the Revolving Facility at June 30, 2004.

The Company's Senior Credit Facility requires quarterly compliance with certain financial covenants, including a debt/EBITDA ratio ("leverage ratio") and an interest coverage ratio and established limitations on the permitted amount of annual capital expenditures.

11. Company-obligated Preferred Securities of Subsidiary Trusts

Edgar Filing: HERCULES INC - Form 10-Q/A

The Company determined that (i) Hercules Trust I and Hercules Trust II (the "Trusts") are variable interest entities and (ii) the Company is not the primary beneficiary of the Trusts pursuant to the provisions of FASB Interpretation No. 46 (revised December 2003), "Consolidation of Variable Interest Entities" ("FIN 46R"). Accordingly, the Company de-consolidated the Trusts effective December 31, 2003. Summarized below is the condensed financial information of the Trusts.

(Dollars in millions)

	June 30, 2004		December 31, 2003	
	Hercules Trust I	Hercules Trust II	Hercules Trust I	Hercules Trust II
	Non-current assets	\$ -	\$ 263	\$ 363
Non-current liabilities	-	263	363	262

The non-current assets for Hercules Trust II represents its investment in the 6.50% junior subordinated deferrable interest debentures of Hercules due June 30, 2029. As discussed in Note 10, the Company dissolved Hercules Trust I and redeemed the debentures distributed to the holders of the Trust's preferred securities on May 10, 2004.

12. Pension and Other Postretirement Benefits

The following tables set forth the consolidated net periodic pension and other postretirement benefit costs for the three and six months ended June 30, 2004 and 2003.

(Dollars in millions)

	Pension Benefits			
	Three Months Ended June 30,		Six Months Ended June 30,	
	2004	2003	2004	2003
Net periodic benefit cost:				
Service cost	\$ 5	\$ 5	\$ 10	\$ 9
Interest cost	27	25	51	50
Expected return on plan assets	(31)	(29)	(58)	(57)
Amortization and deferrals	1	1	2	2
Special benefits	-	-	1	-
Actuarial losses recognized	10	5	18	10
	\$ 12	\$ 7	\$ 24	\$ 14

(Dollars in millions)

	Other Postretirement Benefits			
	Three Months Ended June 30,		Six Months Ended June 30,	
	2004	2003	2004	2003
Net periodic benefit cost:				
Interest cost	\$ 3	\$ 3	\$ 6	\$ 7
Amortization and deferrals	(2)	(2)	(4)	(4)
Actuarial losses recognized	2	2	4	3
	\$ 3	\$ 3	\$ 6	\$ 6

The total expected contributions to be paid in 2004 to all pension plans globally is \$45 million, including \$40 million in voluntary contributions made to the U.S. defined benefit plan in January 2004.

In June 2004, the Board of Directors approved changing the U.S. defined benefits pension plan from a "final pay" plan to a "career average" pay plan effective January 1, 2005. In addition, new hires after December 31, 2004 will not be eligible to participate in the U.S. defined benefit plan. The effect of the amendment will be recognized beginning August 1, 2004. The Company estimates that this amendment will reduce 2004 net periodic pension expense by approximately \$2 million.

13. Asset Retirement Obligations

The following table provides a reconciliation of the changes in the asset retirement obligations during the period.

(Dollars in millions)

	Balance	Liabilities		Balance
	January 1,	Incurred	Accretion	June 30,
	2004	(Settled)		2004
Environmental Remediation Liabilities:				
SFAS 143 ARO sites	\$ 103	\$ (5)	\$ 1	\$ 99

(Dollars in millions)

Edgar Filing: HERCULES INC - Form 10-Q/A

Non-SFAS 143 sites	3	-	-	3
	\$ 106	\$ (5)	\$ 1	\$ 102

14. Commitments and Contingencies

Guarantees

In accordance with FASB Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" ("FIN 45"), disclosure about each group of guarantees is provided below:

Indemnifications

In connection with the sale of Company assets and businesses, the Company has indemnified respective buyers against certain liabilities that may arise in connection with the sale transactions and business activities prior to the ultimate closing of the sale. The terms of these indemnifications typically pertain to environmental, tax, employee and/or product related matters. If the indemnified party were to incur a liability or have a liability increase as a result of a successful claim, pursuant to the terms of the indemnification, the Company would be required to protect, defend, and/or indemnify the buyer. These indemnifications are generally subject to threshold amounts, specified claim periods and/or other restrictions. The carrying amount recorded for all indemnifications as of June 30, 2004 was \$77 million.

In addition, in connection with these transactions, the Company has generally provided indemnifications on general corporate matters such as ownership of the relevant assets, the power and corporate authority to enter into transactions and the satisfaction of liabilities not assumed by the buyer. These indemnifications generally have indefinite terms.

Although it is reasonably possible that future payments may exceed amounts accrued, due to the nature of indemnified items, it is not possible to make a reasonable estimate of the maximum potential loss or range of loss. Generally, there are no specific recourse provisions. At June 30, 2004, the Company had approximately \$1 million in cash held in escrow or collateral.

In addition, the Company provides certain indemnifications in the ordinary course of business such as product, patent and performance warranties in connection with the manufacture, distribution and sale of its products and services. Due to the nature of these indemnities, it is not possible to make a reasonable estimate of the maximum potential loss or range of loss.

Debt Obligations

The Company has directly guaranteed various debt obligations under agreements with third parties related to subsidiaries and affiliates, and/or other unaffiliated companies. At June 30, 2004, the Company had directly guaranteed \$18 million of such obligations. This represents the maximum principal amount of potential future payments that the Company could be required to make under the guarantees. Any applicable interest and expenses would generally be added to the amount of the obligations.

The Company's Consolidated Financial Statements include \$5 million of directly guaranteed obligations, including \$1 million recorded as debt and \$4 million recorded as a pension liability. The Company has also provided approximately \$3 million in collateral through a mortgage security related to the pension liability.

The Company guarantees the obligations of Hercules Trust II on the preferred securities (see Note 11).

Intercompany Guarantees

The Company and its subsidiaries have intercompany guarantees between and among themselves which aggregate approximately \$154 million as of June 30, 2004. These guarantees relate to intercompany loans used to facilitate normal business operations. All of the \$154 million has been eliminated from the Company's Consolidated Financial Statements.

Environmental

In the ordinary course of its business, the Company is subject to numerous environmental laws and regulations covering compliance matters or imposing liability for the costs of, and damages resulting from, cleaning up sites, past spills, disposals and other releases of hazardous substances. Changes in these laws and regulations may have a material adverse effect on the Company's financial position and results of operations. Any failure by the Company to adequately comply with such laws and regulations could subject the Company to significant future liabilities.

Edgar Filing: HERCULES INC - Form 10-Q/A

Hercules has been identified as a potentially responsible party ("PRP") by U.S. federal and state authorities, or by private parties seeking contribution, for the cost of environmental investigation and/or cleanup at numerous sites. The range of the reasonably possible share of costs for the investigation and cleanup of current and former operating sites, and other locations where the Company may have a known liability is between \$102 million and \$211 million. In accordance with generally accepted accounting principles, the Company has accrued a liability of \$102 million at June 30, 2004 representing the low end of the range, since no amount within the range is a better estimate than any other amount. The actual costs will depend upon numerous factors, including the number of parties found responsible at each environmental site and their ability to pay; the actual methods of remediation required or agreed to; outcomes of negotiations with regulatory authorities; outcomes of litigation; changes in environmental laws and regulations; technological developments; and the years of remedial activity required, which could range from 0 to 30 years.

Hercules becomes aware of sites in which it may be named a PRP in investigatory and/or remedial activities through correspondence from the U.S. Environmental Protection Agency ("EPA") or other government agencies or from previously named PRPs, who either request information or notify the Company of its potential liability. The Company has established procedures for identifying environmental issues at its plant sites. In addition to environmental audit programs, the Company has environmental coordinators who are familiar with environmental laws and regulations and act as a resource for identifying environmental issues.

United States, et al. v. Vertac Corporation, et al., USDC No. LR-C-80-109 and LR-C-80-110 (E.D. Ark.)

This case, a cost-recovery action based upon the Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA", or the Superfund statute), as well as other statutes, has been pending since 1980, and involves liability for costs in connection with the investigation and remediation of the Vertac Chemical Company ("Vertac") site in Jacksonville, Arkansas. Hercules owned and operated the site from December 1961 until 1971. The site was used for the manufacture of certain herbicides and, at the order of the United States, Agent Orange. In 1971, the site was leased to Vertac's predecessor. In 1976, Hercules sold the site to Vertac. The site was abandoned by Vertac in 1987, and Vertac was subsequently placed into receivership. Both prior to and following the abandonment of the site, the EPA and the Arkansas Department of Pollution Control and Ecology ("ADPC&E") were involved in the investigation and remediation of contamination at and around the site. Pursuant to several orders issued under CERCLA, Hercules actively participated in many of these activities. The cleanup is essentially complete, except for certain on-going maintenance and monitoring activities. This litigation primarily concerns the responsibility and allocation of liability for the costs incurred in connection with the activities undertaken by the EPA and the ADPC&E.

Although the case initially involved many parties, as a result of various United States District Court rulings and decisions, as well as a trial, Hercules and Uniroyal were held jointly and severally liable for the approximately \$100 million in costs allegedly incurred by the EPA and ADPC&E, as well as costs to be incurred in the future. That decision was made final by the District Court on September 13, 1999. Both Hercules and Uniroyal timely appealed that judgment to the United States Court of Appeals for the Eighth Circuit.

On February 8, 2000, the District Court issued a final judgment on the allocation between Hercules and Uniroyal finding Uniroyal liable for 2.6 percent and Hercules liable for 97.4 percent of the costs at issue. Hercules timely appealed that judgment. Oral argument on both appeals was held before the Eighth Circuit on June 12, 2000. On April 10, 2001, the United States Court of Appeals for the Eighth Circuit issued an opinion in the consolidated appeals described above. In that opinion, the Appeals Court reversed the District Court's decision which had held Hercules jointly and severally liable for costs incurred and to be incurred at the Jacksonville site, and remanded the case back to the District Court for several determinations, including a determination of whether the harms at the site giving rise to the government's claims were divisible. The Appeals Court also vacated the District Court's allocation decision holding Hercules liable for 97.4 percent of the costs at issue, ordering that these issues be revisited following further proceedings with respect to divisibility. Finally, the Appeals Court affirmed the judgment of liability against Uniroyal.

The trial on remand commenced on October 8, 2001, continued through October 19, 2001, resumed on December 11, 2001 and concluded on December 14, 2001. At the trial, the Company presented both facts and law to the District Court in support of its belief that the Company should not be liable under CERCLA for some or all of the costs incurred by the government in connection with the site because those harms are divisible. The District Court has not yet rendered its decision. Should the Company prevail on remand, any liability to the government will be either eliminated or reduced from the prior judgment.

Alleghany Ballistics Laboratory

The Alleghany Ballistics Laboratory ("ABL") is a government-owned facility, which was operated by Hercules from 1945 to 1995 under contract with the United States Department of the Navy. The Navy has notified Hercules that it would like to negotiate with Hercules with respect to certain environmental liabilities which, the Navy alleges, are attributable to Hercules' past operations at ABL. In recent discussions, the Navy has stated that, pursuant to CERCLA, it has spent a total of \$24.8 million and expects to spend an additional \$44 million over the next 10 years. The Company is currently investigating the Navy's allegations, including the basis of the Navy's claims, and whether the contracts with the government pursuant to which the Company operated ABL may provide the Company with a defense from some or all of the amounts sought. At this time, however, the Company cannot reasonably estimate its liability, if any, with respect to ABL and, accordingly, has not included this site in the range of its environmental liabilities reported above.

Kim Stan Landfill

Hercules is one of a limited number of industrial companies that have been identified by the EPA as a potentially responsible party (a "PRP") at the Kim Stan Landfill, near Covington, Virginia. The EPA seeks to have the PRPs undertake the remediation of the site at a currently estimated cost of \$12 million (including EPA oversight charges). Based on the investigation conducted to date, Hercules believes that parties not named by the EPA as PRPs may be responsible for the majority of the costs that have been and will be incurred at the site, and Hercules intends to seek contribution from those parties to the extent it is required to pay any monies in connection with the site. Hercules is continuing to evaluate the EPA's allegations and, pending further factual investigation, does not admit any liability with respect to this site.

At June 30, 2004, the Company's accrued liability for environmental remediation was \$102 million. The extent of liability is evaluated quarterly based on currently available information, including the progress of remedial investigations at each site and the current status of negotiations with regulatory authorities regarding the method and extent of apportionment of costs among other PRPs. While it is not feasible to predict the outcome of all pending suits and claims, the ultimate resolution of these environmental matters could have a material effect upon the results of operations and the financial position of Hercules, and the resolution of any of these matters during a specific period could have a material effect on the quarterly or annual results of that period.

Litigation

The Company is a defendant in numerous asbestos-related personal injury lawsuits and claims which typically arise from alleged exposure to asbestos fibers from resin encapsulated pipe and tank products which were sold by one of the Company's former subsidiaries to a limited industrial market ("products claims"). The Company is also a defendant in lawsuits alleging exposure to asbestos at facilities formerly or presently owned or operated by the Company ("premises claims"). Claims are received and settled or otherwise resolved on an on-going basis. In late December 1999, the Company entered into a settlement agreement to resolve the majority of the claims then pending. In connection with that settlement, the Company also entered into an agreement with several of the insurance carriers, which sold primary and first level excess insurance policies insuring that former subsidiary. Under the terms of that agreement, the majority of the amounts paid to resolve those products claims were insured, subject to the limits of the insurance coverage provided by those policies. The terms of both settlement agreements are confidential.

Since entering into the agreements referenced in the above paragraph, the Company has continued to receive and settle or otherwise resolve claims on an on-going basis. Between January 1, 2003 and December 31, 2003, the Company received approximately 18,330 new claims, over half of which were included in "consolidated" complaints naming anywhere from one hundred to thousands of plaintiffs and a large number of defendants, but providing little information connecting any specific plaintiff's alleged injuries to any specific defendant's products or premises. It is the Company's belief that a significant majority of these "consolidated" claims will be dismissed for no payment. During that same time period, the Company also received approximately 3,175 other new claims, all of which were included in "consolidated" complaints and which have either been dismissed without payment or are in the process of being dismissed without payment, but with plaintiffs retaining the right to re-file should they be able to establish exposure to an asbestos-containing product for which the Company bears liability. Between January 1, 2004 and June 30, 2004, the Company received approximately 3,890 new claims, of which approximately 1,825 were in "consolidated" complaints.

With respect to total claims pending, as of June 30, 2004, there were approximately 34,490 unresolved claims, of which approximately 1,040 were premises claims and the rest were products claims. There were also approximately 1,425 unpaid claims which have been settled or are subject to the terms of a settlement agreement. In addition, as of June 30, 2004, there were approximately 11,912 claims (an amount that includes the 3,175 claims noted above) which have either been dismissed without payment or are in the process of being dismissed without payment, but with plaintiffs retaining the right to re-file should they be able to establish exposure to an asbestos-containing product for which the Company bears liability.

In June and July 2003, the Company entered into several settlement agreements which will permanently resolve approximately 12,500 claims. Of those claims, approximately 3,000 are categorized as "unresolved" in the above paragraph, and approximately 8,900 are among those claims that have been dismissed without payment or are in the process of being dismissed without payment. The balance of those claims have been resolved. The terms of these settlement agreements are confidential. The Company believes that the vast majority of these claims will be permanently dismissed without payment.

The Company's primary and first level excess insurance policies that provided coverage for these asbestos-related matters have exhausted their limits. The Company has not yet reached agreement with its other insurance carriers to fund the cost of defending and resolving its asbestos-related matters. As a result, until the Company's other insurance carriers begin to fund the cost of defending and resolving these matters, the Company will have to fully fund the cost of defending and resolving these matters. The Company spent approximately \$33 million on these matters, including \$26 million in settlement payments and \$7 million for litigation during the six months ended June 30, 2004. Nonetheless, based on the current number of claims pending, the amounts the Company anticipates paying to resolve those claims which are not dismissed or otherwise resolved without payment and anticipated future claims, the Company believes that it and its former subsidiary together have sufficient additional insurance to cover the majority of its current and estimated future asbestos-related liabilities. However, there can be

no assurance that such liabilities will be sufficiently covered.

The foregoing is based on the Company's assumption that the number of future claims filed per year and claim resolution payments will vary considerably from year-to-year and by plaintiff, disease, venue and other circumstances, but will, when taken as a whole, remain relatively consistent with the Company's experience to date and will decline as the population of potential future claimants expires due to non-asbestos-related causes. It is also based on the results of the study discussed below, the Company's evaluation of potentially available insurance coverage and its review of the relevant case law. However, the Company recognizes that the number of future claims filed per year and claim resolution payments could greatly exceed those reflected by its past experience and contemplated by the study referenced below, that the Company's belief of the range of its reasonably possible financial exposure could change as the study referenced below is periodically updated, that its evaluation of potentially available insurance coverage may change depending upon numerous variables including risks inherent in litigation, potential legislation, and the risk that one or more insurance carriers may refuse or be unable to meet its obligations to the Company, and that conclusions resulting from its review of relevant case law may be impacted by future court decisions or legislative or other changes in the law.

The Company is seeking defense and indemnity payments or an agreement to pay from those carriers responsible for excess coverage whose levels of coverage have been or will soon be reached. Although those excess carriers have not yet agreed to defend or indemnify the Company, the Company believes that it is likely that they will ultimately agree to do so, and that the majority of its estimated future asbestos-related costs will ultimately be paid or reimbursed by those carriers. However, since the Company has not yet reached satisfactory agreements with those excess carriers, the Company will be required to completely fund these matters while it seeks reimbursement from those carriers. In order to maximize the likelihood of obtaining insurance payments for these asbestos-related costs, on November 27, 2002, the Company initiated litigation against its excess insurance carriers in a matter captioned Hercules Incorporated v. OneBeacon, et al., Civil Action No. 02C-11-237 (SCD), Superior Court of Delaware, New Castle County. That litigation is proceeding through discovery and motion practice, and trial is currently scheduled in October 2004. Notwithstanding the filing of this litigation, the Company is in settlement discussions with its insurers.

The Company commissioned a study of its asbestos-related liabilities by Professor Eric Stallard, who is a Research Professor of Demographic Studies at a major national university and a member of the American Academy of Actuaries. Professor Stallard is a consultant with broad experience in estimating such liabilities. Based on the results of the study undertaken by Professor Stallard, the Company estimated that its reasonably possible financial exposure for these matters (excluding approximately \$1 million for previously settled but unpaid claims) ranged from \$220 million to \$675 million at December 31, 2003. Due to inherent uncertainties in estimating the timing and amounts of future payments, this range does not include the effects of inflation and has not been discounted for the time value of money. In addition, the range of financial exposures set forth above does not include estimates for future legal costs. It is the Company's policy to expense these costs as incurred. As stated above, the Company presently believes that the majority of this range of financial exposures will ultimately be funded by insurance proceeds. Cash payments related to this exposure are expected to be made over an extended number of years and actual payments, when made, could be for amounts in excess of the range due to potential future changes in estimates as well as the effects of inflation.

Due to the dynamic nature of asbestos litigation and the present uncertainty concerning the participation of its excess insurance carriers, the Company's estimates are inherently uncertain, and these matters may present significantly greater financial exposures than presently anticipated. In addition, the Company intends to periodically update the asbestos study referenced in the above paragraph, and further analysis combined with new data received in the future could result in a material modification of the range of reasonably possible financial exposure set forth above. As a result of all of the foregoing, the Company's liability with respect to asbestos-related matters could exceed present estimates and may require a material change in the accrued liability for these matters within the next 12 months. If the Company's liability does exceed amounts recorded in the balance sheet, the Company presently believes that the majority of any additional liability it may reasonably anticipate will be paid or reimbursed by its insurance carriers. However, there can be no assurance that such liabilities will be reimbursed.

The findings of the study referenced above identify a range of the Company's reasonably possible financial exposure for these asbestos-related matters. The Company increased its accrual for present and future potential asbestos claims before anticipated insurance recoveries at December 31, 2003 to \$221 million, reflecting the low end of the range noted above in accordance with generally accepted accounting principles (since no amount within the range is a better estimate than any other amount) and \$1 million for previously settled but unpaid asbestos cases, resulting in a charge of \$55 million in the period related to these matters. At June 30, 2004, the Consolidated Balance Sheet reflects a current liability of \$44 million and a long-term liability of \$151 million. The Company believes that it is probable that \$169 million of the \$195 million accrual will be funded by or recovered from insurance carriers. That belief, which is subject to the various assumptions set forth herein, is based on many factors that have been evaluated by the Company, along with its outside insurance coverage counsel, including the indemnity and defense payments that have been made by its now exhausted insurers and by some of its other insurers, the limits of remaining potentially available insurance coverage, and the range of possible outcomes in the Company's insurance coverage litigation taking into account, among other considerations, the facts and status of that litigation and the relevant case law. At June 30, 2004, the Consolidated Balance Sheet reflects a current insurance receivable of \$7 million and a long-term insurance receivable of \$162 million. The Company does not offset estimated insurance receivables against its estimated liability.

The Company, in conjunction with outside advisors, will continue to study its asbestos-related matters, insurance recovery expectations and reserves on an on-going basis, and make adjustments as appropriate.

Edgar Filing: HERCULES INC - Form 10-Q/A

In August 1999, the Company was sued in an action styled as Cape Composites, Inc. v. Mitsubishi Rayon Co., Ltd., Case No. 99-08260 (U.S. District Court, Central District of California), one of a series of similar purported class action lawsuits brought on behalf of purchasers (excluding government purchasers) of carbon fiber and carbon prepreg in the United States from the named defendants from January 1, 1993 through January 31, 1999. The lawsuits were brought following published reports of a Los Angeles federal grand jury investigation of the carbon fiber and carbon prepreg industries. In these lawsuits, plaintiffs allege violations of Section 1 of the Sherman Antitrust Act for alleged price fixing. In September 1999, these lawsuits were consolidated by the Court into a case captioned Thomas & Thomas Rodmakers v. Newport Adhesives and Composites, Case No. CV-99-07796-GHK (CTx) (U.S. District Court, Central District of California), with all related cases ordered dismissed. This lawsuit is proceeding through discovery and motion practice. On May 2, 2002, the Court granted plaintiffs' Motion to Certify Class. The Company is named in connection with its former Composites Products Division, which was sold to Hexcel Corporation in 1996, denies liability and will vigorously defend this action.

Since September 2001, the Company, along with the other defendants in the Thomas & Thomas Rodmakers action referred to above, has been sued in nine California state court purported class actions brought on behalf of indirect purchasers of carbon fiber. In January 2002, these were consolidated into a case captioned Carbon Fiber Cases I, II, and III, Judicial Council Coordination Proceeding Nos. 4212, 4216 and 4222, Superior Court of California, County of San Francisco. These actions all allege violations of the California Business and Professions Code relating to alleged price fixing of carbon fiber and unfair competition. The Company denies liability and will vigorously defend each of these actions.

In June 2002, a purported class action was filed in Massachusetts under the caption Saul M. Ostroff, et al. v. Newport Adhesives, et al., Civil Action No. 02-2385, Superior Court of Middlesex County. This matter is a purported class action brought on behalf of consumers who purchased merchandise manufactured with carbon fiber, and alleges the same types of price fixing activities alleged in the actions described in the above two paragraphs. In October 2002, the Company was notified that Horizon Sports Technologies had "opted out" of the federal antitrust class action described above (Thomas & Thomas Rodmakers) and filed its own suit against Hercules and the other defendants in that action (Horizon Sports Technologies, Inc. v. Newport Adhesives and Composites, Inc., et al., Case No. CV02-8126 FMC (RNEX), U.S. District Court, Central District of California, Western Division).

Further, in April 2002, a related "Qui Tam" action was unsealed by the U.S. District Court for the Southern District of California. That action is captioned Randall M. Beck, et al. v. Boeing Defense and Space Group, Inc., et al., (Civil Action No. 99 CV 1557 JM JAH), was filed under seal in 1999, and is a "False Claims" action brought pursuant to the False Claims Act (31 U.S.C. Section 729 et seq.). In that action, the relators, in the name of the U.S. Government, allege the same price fixing activities which are the subject of the above-described actions. The relators then allege that those alleged price fixing activities resulted in inflated prices being charged by the defendant carbon fiber manufacturers to defense contractors, who, in turn, submitted claims for payment to the U.S. Government under various government contracts. It is alleged that those claims for payment were "false claims" because the prices charged for the carbon fiber and carbon prepreg were "fixed" contrary to the laws of the United States. By Order dated November 14, 2002, the Court dismissed the relators' complaint without prejudice because the complaint did not meet certain pleading requirements under the Federal Rules of Civil Procedure. The relators filed a First Amended Complaint on January 3, 2003. By Order dated July 29, 2003, the Court dismissed the First Amended Complaint without prejudice for similar reasons and provided the relators thirty days to re-file their complaint; that time period was subsequently extended by sixty days. The relators filed a Second Amended Complaint on or about October 30, 2003. The defendants filed a motion to have that complaint dismissed, but that motion was denied by Order dated June 9, 2004. The Company denies liability and will vigorously defend each of these actions.

In connection with the grand jury investigation noted above in the paragraph describing the Cape Composites litigation, in January 2000, the United States Department of Justice ("DOJ"), Antitrust Division, served a grand jury subpoena duces tecum upon Hercules. The Company has been advised that it is one of several manufacturers of carbon fiber and carbon prepreg that have been served with such a subpoena. In December 2003, the Company was advised that the grand jury investigation had been closed.

In November 2002, an action for declaratory judgment was filed in the U.S. District Court for the District of Delaware under the caption of Atofina Chemicals, Inc. and Atofina v. Hercules Incorporated (Civil Action No. 02-1613). In this action, Atofina seeks a declaratory judgment that Hercules cannot recover antitrust damages for purchases of monochloroacetic acid ("MCAA") that Hercules made outside of the United States or for purchases from producers of MCAA not alleged to have participated in any conspiracy to fix prices and allocate the market for MCAA. In response, Hercules has filed a counter-claim, seeking damages from and injunctive relief against Akzo Nobel Chemicals, Atofina Chemicals, Hoechst AG, Hoechst Celanese, Clariant and others related to the fixing of prices of MCAA and sodium monochloroacetate from approximately 1995 through 2000. The lawsuit is in pre-trial proceedings. Hercules has settled with some of the parties. The terms of the settlements are confidential.

By Order dated May 6, 2003, the U.S. District Court for the Middle District of Louisiana remanded to the 18th Judicial District Court for the Parish of Iberville, Louisiana, a total of nine consolidated lawsuits, including two lawsuits in which the Company is a defendant. These two lawsuits, Jerry Oldham, et al. v. The State of Louisiana, et al., Civil Action No. 55,160, 18th Judicial District Court, Parish of Iberville, Louisiana, and John Capone, et al. v. The State of Louisiana, et al., Civil Action No. 56,048C, 18th Judicial District Court, Parish of Iberville, Louisiana, were served on the Company in September 2002 and October 2002, respectively. The Oldham case is a purported class action comprised of as many as 4,000 plaintiffs, and the Capone case is a consolidated action by approximately 50 plaintiffs. Both actions assert claims against the State of Louisiana, the Company, American PetroFina, Inc., Hercofina, Ashland Oil, International Minerals and Chemicals,

Edgar Filing: HERCULES INC - Form 10-Q/A

Allemania Chemical, Ashland Chemical and the Parish of Iberville. The purported class members and plaintiffs, who claim to have worked or lived at or around the Georgia Gulf plant in Iberville Parish, allege injury and fear of future illness from the consumption of contaminated water and, specifically, elevated levels of arsenic in that water. As to the Company, plaintiffs allege that the Company itself and as part of a joint venture operated a nearby plant and, as part of those operations, used a groundwater injection well to dispose of various wastes, and that those wastes contaminated the potable water supply at Georgia Gulf. On October 17, 2002, the Company removed these matters to federal court. In January 2003, the U.S. District Court for the Middle District of Louisiana consolidated the Capone and Oldham matters with other lawsuits in which the Company is not a party. Plaintiffs sought remand which, as noted above, was granted by Order dated May 6, 2003. In March 2004, Atofina, successor to American PetroFina, Inc. was dismissed without prejudice. Discovery is continuing. The Company denies any liability and intends to vigorously defend these matters.

On January 31, 2003, the Court granted a Motion for Class Certification in a lawsuit captioned Douglas C. Smith, Individually and on Behalf of All Others Similarly Situated v. Hercules Incorporated and Thomas Gossage, CA No. 01C-08-291 WCC, Superior Court of Delaware, New Castle County. This lawsuit, which was filed on August 31, 2001, on behalf of Mr. Smith and a class of approximately 130 present and former Hercules employees, seeks payments under the "Integration Synergies Incentive Compensation Plan" (the "Plan"), a program put into place by the Company following its acquisition of BetzDearborn Inc. in October 1998. The goal of the Plan was to provide certain financial incentives to specific employees who were deemed to have significant impact on the integration of BetzDearborn Inc. into Hercules Incorporated. The amount to be paid under the Plan was tied to the successful achievement of "synergies," which were defined as the annualized reduction of expenses or improvement of profits realized as a result of the integration of BetzDearborn Inc. into Hercules. The lawsuit essentially alleges that the payments made under the Plan were not adequate and that the Company breached the terms of the Plan. The lawsuit originally sought payments of between \$25 million and \$30 million. In February 2003, plaintiffs agreed to dismiss Thomas Gossage from the lawsuit. In June 2003, potential members who had previously signed releases in favor of the Company were provided an opportunity to "opt in" to the class, and the remaining class members were provided an opportunity to "opt out" of the class. As a result of this process, the size of the class was reduced to approximately 87 members. In April 2004, the Company reached a tentative agreement to settle this matter for \$5.855 million. That settlement was approved by the Court on July 19, 2004 and an Order and Final Judgment has been entered. Under the settlement, individuals who previously opted-out of the litigation were permitted the opportunity to share in the agreed-upon settlement amount by opting-in to the class for purposes of settlement, and there is a cap on the amount payable to any individual class member. The settlement was agreed to by Hercules without any admission of liability to avoid the risks and uncertainties of litigation.

Agent Orange is a defoliant that was manufactured by several companies, including Hercules, at the direction of the U.S. Government, and used by the U.S. Government in military operations in both Korea and Vietnam from 1965 to 1970. In 1984, as part of a class action settlement, the Company and other defendants settled the claims of persons who were in the U.S., New Zealand and Australian Armed Forces who alleged injury due to exposure to Agent Orange. In Re "Agent Orange" Prod. Liab. Litig., 597 F. Supp. 740 (E.D.N.Y. 1984). Following that settlement, all claims for alleged injuries due to exposure to Agent Orange by persons who had served in the Armed Forces of those countries were treated as covered by that class action settlement.

On June 9, 2003, the United States Supreme Court affirmed the decision of the United States Court of Appeals for the Second Circuit in a case captioned Dow Chemical Company, et al. v. Daniel Raymond Stephenson, et al., 123 S. Ct. 2161 (2003), where plaintiffs Stephenson and Isaacson (in a separate but consolidated case) alleged that they were injured from exposure to Agent Orange and that such injury did not manifest until after exhaustion of the settlement fund created through the 1984 class action settlement. As a result of that decision, the claims of persons who allege injuries due to exposure to Agent Orange and whose injuries first manifest themselves after exhaustion of the settlement fund created through the 1984 class action settlement may no longer be barred by the 1984 class action settlement, and such persons may now be able to pursue claims against the Company and the other former manufacturers of Agent Orange.

At this time, the Company is a defendant in twenty lawsuits (including two purported class actions) where plaintiffs allege that exposure to Agent Orange caused them to sustain various personal injuries. In addition, in January 2004, the Company was sued in a class action filed in the United States District Court for the Eastern District of New York by The Vietnam Association for Victims of Agent Orange/Dioxin and several individuals who claim to represent between two and four million Vietnamese who allege that Agent Orange used by the United States during the Vietnam War caused them or their families to sustain personal injuries. (The Vietnam Association for Victims of Agent Orange/Dioxin, et al. v. The Dow Chemical Company, et al., Civil Action No. 04 CV 0400 (JBW).) That complaint alleges violations of international law and war crimes, as well as violations of the common law for products liability, negligence and international torts.

On February 9, 2004, the U.S. District Court for the Eastern District of New York issued a series of rulings granting several motions filed by defendants in the two cases that had been remanded to the U.S. District Court by the U.S. Court of Appeals for the Second Circuit on remand from the U.S. Supreme Court (In re: "Agent Orange" Product Liability Litigation: Joe Isaacson, et al v. Dow Chemical Company, et al. and Daniel Ray Stephenson, et al. v. Dow Chemical Company, et al. (MDL 381, CV 98-6383 (JBW), CV 99-3056 (JBW))). In relevant part, those rulings held that plaintiffs' claims against the defendant manufacturers of Agent Orange are properly removable to federal court under the "federal officer removal statute" and that such claims are subject to dismissal by application of the "government contractor defense." The Court then dismissed plaintiffs' claims, but stayed its decision until October 12, 2004, to permit plaintiffs time to pursue additional discovery to support their position that the government contractor defense should not apply to their claims, and to seek reconsideration of the Court's dismissal order.

Edgar Filing: HERCULES INC - Form 10-Q/A

The Company believes that it has substantial meritorious defenses to all of the Agent Orange-related claims described above and those that may yet be brought. To that end, the Company denies any liability to plaintiffs, and will vigorously defend all actions now pending or that may be brought in the future.

On October 6, 2003, the Company received a Notice of Deficiency with respect to the Company's 1996 through 1997 federal income tax returns wherein, among other issues, the IRS is disallowing a capital loss that the Company carried back to 1996 and 1997. The IRS has indicated that it will not settle that issue prior to a final decision after trial on the merits. The IRS has indicated that it is willing to address the other issues included in the Notice of Deficiency through standard IRS administrative appeals procedures without litigation. On December 23, 2003, the Company filed a Petition asking the U.S. Tax Court for a re-determination of the deficiency set forth in the October 6, 2003 Notice of Deficiency. The Company believes that it is remote that the ultimate disposition of these issues will have a material adverse impact on the Company's financial position in light of existing tax reserves and amounts already on deposit with the IRS.

On May 7, 2004, Ciba Specialty Chemicals Corporation ("Ciba") filed a Complaint against Hercules Incorporated and Cytec Industries, Inc. ("Cytec") in the United States District Court for the District of Delaware alleging infringement of two patents owned by Ciba. The two patents in question are U.S. Patent 5,167,766 (issued on December 1, 1992) entitled "Charged Organic Polymer Microbeads in Paper Making Process" and U.S. Patent 5,171,808 (issued on December 15, 1992) entitled "Cross-linked Anionic and Amphoteric Polymeric Microparticles." The alleged conduct relates to the manufacture, use, sale and offer to sell of certain products of the Company's Pulp and Paper business. Ciba seeks to enjoin alleged continued infringement, obtain a judgment that the defendants have infringed the patents, and obtain an award of damages and reasonable attorneys fees. The Company believes that there are substantial meritorious defenses to this action, and expects to deny any liability to Ciba and vigorously defend against this action. The Company has agreed to indemnify Cytec in this action.

On or about June 1, 2004, a Complaint captioned Charles Stepnowski v. Hercules Inc.; The Pension Plan of Hercules Inc.; The Hercules Inc. Finance Committee; and Edward V. Carrington, Hercules' Vice President Human Resources, Civil Action No. 04-cv-2296, was filed in the United States District Court, Eastern District of Pennsylvania. An Amended Complaint was filed on June 16, 2004. Styled as a class action, the Amended Complaint seeks benefits under the Pension Plan of Hercules Incorporated (the "Plan"), and alleges violations of the Employee Retirement Income Security Act, 29 U.S.C. §1100 et seq. ("ERISA"). Under the Plan, eligible retirees of the Company may opt to receive a single cash payment of 51% of the present value of their accrued benefit (with the remaining 49% payable as a monthly annuity). The Amended Complaint alleges that the Company's adoption of a new interest rate assumption used to determine the 51% cash payment constitutes a breach of fiduciary duty and a violation of the anti-cutback requirements of ERISA and the Internal Revenue Code. The Amended Complaint seeks the payment of additional benefits under ERISA (as well as costs and attorneys fees) and seeks to compel the Company to use an interest rate assumption that is more favorable to eligible retirees. The Amended Complaint seeks to establish a class comprised of all Plan participants who retired (or who will retire) on or after December 1, 2001. The Company denies all liability, and intends to vigorously defend this action.

At June 30, 2004, the consolidated balance sheet reflects a current liability of approximately \$55 million and a long-term liability of approximately \$151 million for litigation and claims, including asbestos-related claims. These amounts represent management's best estimate of the probable and reasonably estimable losses related to litigation or claims, including asbestos claims. The extent of the liability and recovery is evaluated quarterly. While it is not feasible to predict the outcome of all pending suits and claims, the ultimate resolution of these matters could have a material effect upon the financial position of Hercules, and the resolution of any of the matters during a specific period could have a material effect on the quarterly or annual operating results for that period.

15. Consolidation of Variable Interest Entities

In accordance with the provisions of the Financial Accounting Standards Board's ("FASB") Interpretation No. 46 "Consolidation of Variable Interest Entities" ("FIN 46") ("VIEs"), the financial statements of the Company reflect the consolidation of two joint venture VIEs, ES FiberVision Holdings A/S and ES FiberVisions L.P. These entities serve as global marketers of the Company's bicomponent fibers. As of June 30, 2004, the fair value of the assets in these joint ventures was approximately \$11 million and the fair value of the associated liabilities and non-controlling interests was approximately \$9 million. There are no assets of the Company that serve as collateral for the VIEs and the creditors of the VIEs have no recourse to the general credit of the Company.

16. Segment Information

The table below reflects Net sales and Profit from operations for the three and six months ended June 30, 2004 and 2003.

<i>(Dollars in millions)</i>	Three Months Ended June 30,		Six Months Ended June 30,	
	2004	2003	2004	2003
Net sales:				
Performance Products	\$ 412	\$ 383	\$ 798	\$ 739

(Dollars in millions)

Edgar Filing: HERCULES INC - Form 10-Q/A

Engineered Materials and Additives	98	95	187	186
Consolidated	<u>\$ 510</u>	<u>\$ 478</u>	<u>\$ 985</u>	<u>\$ 925</u>

Profit from operations:

Performance Products	\$ 68	\$ 74	\$ 119	\$ 132
Engineered Materials and Additives	(1)	3	(3)	5
Corporate Items (a)	(2)	(1)	(5)	-
Consolidated	<u>\$ 65</u>	<u>\$ 76</u>	<u>\$ 111</u>	<u>\$ 137</u>

(a) For the three and six months ended June 30, 2004, Corporate Items include charges related to previously divested businesses and other adjustments for executive pension. For the three and six months ended June 30, 2003, corporate includes income recognized as a result of a favorable legal settlement partially offset by severance charges.

17. Income Taxes

The effective tax rate for the quarter ended June 30, 2004 is 54%. This compares to 14% for the quarter ended June 30, 2003. The effective tax rate for the six months ended June 30, 2004 is 9%, versus 23% for the same period in 2003. The full year effective tax rate for 2004 is estimated to be approximately 41%. The effective tax rate for the six months ended June 30, 2004 reflects the tax benefit related to the CP Kelco gain, which was recognized in the first quarter of 2004. The 2004 estimated effective tax rate is higher than the U.S. statutory tax rate of 35% primarily due to an increase in state taxes related to tax planning initiatives. For the year, the tax benefit related to the CP Kelco gain is substantially offset by U.S. taxes on current year repatriations of foreign earnings in excess of amounts for which taxes had been provided.

18. Investment in CP Kelco ApS

On February 12, 2004, a subsidiary of the Company completed the sale of its minority ownership in CP Kelco ApS to a subsidiary of J. M. Huber Corporation for \$27 million. Summarized unaudited financial information for CP Kelco ApS is as follows:

	January 2004	Three Months Ended June 30, 2003	Six Months Ended June 30, 2003
Net sales	\$ 37	\$ 111	\$ 216
Gross profit	11	34	68
Profit from operations	5	13	29
Net (loss) income	(2)	57	60

19. Restatement

As a result of its June 24, 2004 settlement with the Internal Revenue Service ("IRS") for the tax years 1990 through 1992 that indicated additional tax liabilities for such audit cycle, the Company initiated a review of the GAAP accounting for income taxes for the tax years 1987 through 1995. In conjunction with this review, the Company undertook an effort to analyze and reconcile the various general ledger tax account balances relative to the tax years 1990 through 1992, which expanded to encompass the handling of adjustments that should have occurred relative to the previously settled tax years 1987 through 1989 and the open tax years 1993 through 1995. In addition, the Company also reviewed the tax years 1996 and forward to confirm that there were no further implications in years subsequent to 1995 with respect to issues identified as a result of the 1987 through 1995 analysis. The review indicated cumulative additional tax liabilities for the years 1987 through 1995 that had not been reconciled to the various general ledger tax account balances.

Based on this review, on November 9, 2004, the Company's Chief Financial Officer determined that previously issued financial statements cannot be relied upon and that restatement of such previously issued financial statements is required. The Audit Committee of the Board of Directors ("Audit Committee") concurred with this determination. The adjustments reflected in this Form 10-Q/A primarily relate to the computation and application of foreign tax credits and reduce the tax deposit asset by \$65 million, increase deferred income tax assets by \$17 million, and, as a result of the cumulative additional income tax expense to be recorded for the restated periods, reduce retained earnings and stockholders' equity by \$48 million as of January 1, 1996 and for previously reported periods affected through June 30, 2004. The restatement does not affect the previously reported results of operations for any period subsequent to December 31, 1995. The following table reflects the impact of the restatement adjustments on the Consolidated Balance Sheets as of December 31, 2003 and June 30, 2004:

(Dollars in millions)

Edgar Filing: HERCULES INC - Form 10-Q/A

<i>(Dollars in millions)</i>	Previously Reported	As Restated	Net Increase (Decrease)
As of December 31, 2003:			
Deferred income taxes (non-current asset)	\$ 27	\$ 44	\$ 17
Other assets (tax deposits)	530	465	(65)
Total assets	2,759	2,711	(48)
Retained earnings	1,543	1,495	(48)
Total stockholders equity	59	11	(48)
Total liabilities and stockholders' equity	\$ 2,759	\$ 2,711	\$ (48)
As of June 30, 2004:			
Deferred income taxes (non-current asset)	\$ 25	\$ 42	\$ 17
Other assets (tax deposits)	501	436	(65)
Total assets	2,724	2,676	(48)
Retained earnings	1,573	1,525	(48)
Total stockholders equity	81	33	(48)
Total liabilities and stockholders' equity	\$ 2,724	\$ 2,676	\$ (48)

20. Financial Information of Guarantor Subsidiaries

The following condensed consolidating financial information for the Company presents the financial information of Hercules, the guarantor subsidiaries and the non-guarantor subsidiaries based on the Company's understanding of the Securities and Exchange Commission's interpretation and application of Rule 3-10 under the Securities and Exchange Commission's Regulation S-X. The financial information may not necessarily be indicative of results of operations or financial position had the guarantor subsidiaries or non-guarantor subsidiaries operated as independent entities.

In this presentation, Hercules consists of the parent company's operations. Guarantor subsidiaries and non-guarantor subsidiaries of Hercules are reported on an equity basis. For companies acquired during 1998, the goodwill and fair values of the assets and liabilities acquired have been presented on a "push-down" accounting basis. Prior year information has been restated for the correction of an error related to deferred income taxes and tax deposit assets for periods prior to January 1, 1996. As described in Note 19, the restatement affects the amounts previously reported for deferred income taxes, other assets and retained earnings. Additionally, prior year information has been restated to conform to the current period presentation.

Condensed Consolidating Statement of
Income

Three Months Ended June 30, 2004

(Unaudited)

(Dollars in millions)

	Unconsolidated				Eliminations & Adjustments	Consolidated
	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries			
Net sales	\$ 137	\$ 130	\$ 288	\$ (45)	\$ 510	
Cost of sales	96	86	187	(44)	325	
Selling, general, and administrative expenses	26	32	40	-	98	
Research and development	5	5	1	-	11	
Intangible asset amortization	1	1	-	-	2	
Other operating expense, net	1	4	4	-	9	
Profit from operations	8	2	56	(1)	65	

(Dollars in millions)

Edgar Filing: HERCULES INC - Form 10-Q/A

Interest and debt expense (income), net	46	(14)	(2)	-	30
Other expense, net	26	1	-	-	27
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
Income (loss) before income taxes and equity income	(64)	15	58	(1)	8
Provision (benefit) for income taxes	(13)	(2)	20	(1)	4
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
Income (loss) before equity income	(51)	17	38	-	4
Equity income (loss) from consolidated subsidiaries	55	1	(1)	(55)	-
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
	\$ 4	\$ 18	\$ 37	\$ (55)	\$ 4

Condensed Consolidating Statement of Income
Three Months Ended June 30, 2003

(Unaudited)
(Dollars in millions)

	Unconsolidated				Consolidated
	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations & Adjustments	
Net sales	\$ 136	\$ 110	\$ 263	\$ (31)	\$ 478
Cost of sales	87	77	166	(32)	298
Selling, general, and administrative expenses	26	22	42	-	90
Research and development	5	4	1	-	10
Intangible asset amortization	1	1	-	-	2
Other operating expense, net	1	-	1	-	2
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
Profit from operations	16	6	53	1	76
Interest and debt expense (income), net	43	(14)	4	-	33
Other expense, net	6	-	-	-	6
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
Income (loss) before income taxes and equity income	(33)	20	49	1	37
Provision (benefit) for income taxes	(17)	9	13	-	5
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
Income (loss) before equity income	(16)	11	36	1	32
Equity income from consolidated subsidiaries	48	4	-	(52)	-
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>

(Dollars in millions)

Edgar Filing: HERCULES INC - Form 10-Q/A

Net income from continuing operations before discontinued operations	32	15	36	(51)	32
Net income on discontinued operations, net of tax	2	-	-	-	2
Net income	\$ 34	\$ 15	\$ 36	\$ (51)	\$ 34

Condensed Consolidating Statement of
Income
Six Months Ended June 30, 2004

(Unaudited)
(Dollars in millions)

	Parent	Unconsolidated Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations & Adjustments	Consolidated
Net sales	\$ 268	\$ 240	\$ 552	\$ (75)	\$ 985
Cost of sales	184	165	356	(75)	630
Selling, general, and administrative expenses	53	64	79	-	196
Research and development	10	9	3	-	22
Intangible asset amortization	3	1	-	-	4
Other operating expense, net	4	12	6	-	22
Profit (loss) from operations	14	(11)	108	-	111
Interest and debt expense (income), net	92	(28)	(4)	-	60
Other expense (income), net	44	1	(27)	-	18
Income (loss) before income taxes and equity income	(122)	16	139	-	33
Provision (benefit) for income taxes	(32)	(4)	39	-	3
Income (loss) before equity income	(90)	20	100	-	30
Equity income from consolidated subsidiaries	120	3	-	(123)	-
Net income	\$ 30	\$ 23	\$ 100	\$ (123)	\$ 30

Condensed Consolidating Statement of
Income
Six Months Ended June 30, 2003

(Unaudited)
(Dollars in millions)

	Parent	Unconsolidated Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations & Adjustments	Consolidated
--	--------	---	-------------------------------	-------------------------------	--------------

(Dollars in millions)

Edgar Filing: HERCULES INC - Form 10-Q/A

Net sales	\$ 271	\$ 217	\$ 497	\$ (60)	\$ 925
Cost of sales	173	153	315	(59)	582
Selling, general, and administrative expenses	55	37	89	-	181
Research and development	10	8	2	-	20
Intangible asset amortization	3	1	-	-	4
Other operating expense (income), net	(1)	-	2	-	1
Profit from operations	31	18	89	(1)	137
Interest and debt expense (income), net	88	(29)	8	-	67
Other expense, net	7	2	1	-	10
Income (loss) before income taxes and equity income	(64)	45	80	(1)	60
Provision (benefit) for income taxes	(27)	18	23	-	14
Income (loss) before equity income	(37)	27	57	(1)	46
Equity income from consolidated subsidiaries	83	7	1	(91)	-
Net income from continuing operations before discontinued operations and cumulative effect of changes in accounting principle	46	34	58	(92)	46
Net income on discontinued operations, net of tax	2	-	-	-	2
Net income before cumulative effect of changes in accounting principle	48	34	58	(92)	48
Cumulative effect of changes in accounting principle, net of tax	(28)	-	-	-	(28)
Net income	\$ 20	\$ 34	\$ 58	\$ (92)	\$ 20

Condensed Consolidating Balance Sheet

June 30, 2004

(Unaudited)

As Restated (Note 19)

(Dollars in millions)

Unconsolidated				
Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations & Adjustments	Consolidated

Assets

(Dollars in millions)

Edgar Filing: HERCULES INC - Form 10-Q/A

Current assets

Cash and cash equivalents	\$ 9	\$ 6	\$ 78	\$ -	\$ 93
Accounts and notes receivable, net	118	62	246	4	430
Intercompany receivables	74	19	22	(115)	-
Inventories	45	59	101	(14)	191
Deferred income taxes	123	-	9	(11)	121
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Total current assets	369	146	456	(136)	835
Property, plant, and equipment, net	164	160	338	(1)	661
Investments in subsidiaries	2,372	90	50	(2,512)	-
Goodwill and other intangible assets, net	220	89	393	-	702
Deferred income taxes	149	-	13	(120)	42
Other assets	371	12	53	-	436
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Total assets	\$ 3,645	\$ 497	\$ 1,303	\$ (2,769)	\$ 2,676

Liabilities and Stockholders' Equity

Current liabilities

Accounts payable	\$ 54	\$ 17	\$ 121	\$ 1	\$ 193
Accrued expenses	120	38	83	(11)	230
Intercompany payables	7	68	39	(114)	-
Current maturities of long-term debt	4	-	20	-	24
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Total current liabilities	185	123	263	(124)	447
Long-term debt	1,320	-	18	-	1,338
Deferred income taxes	-	120	79	(121)	78
Postretirement benefits and other liabilities	648	60	71	1	780
Intercompany notes payable (receivable)	1,459	(1,125)	(334)	-	-
Stockholders' equity	33	1,319	1,206	(2,525)	33
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Total liabilities and stockholders' equity	\$ 3,645	\$ 497	\$ 1,303	\$ (2,769)	\$ 2,676

Condensed Consolidating Statement of Cash Flows

Six Months Ended June 30, 2004

(Unaudited)
(Dollars in millions)

Unconsolidated

Guarantor Non-Guarantor Eliminations &

(Dollars in millions)

Edgar Filing: HERCULES INC - Form 10-Q/A

	Parent	Subsidiaries	Subsidiaries	Adjustments	Consolidated
Net Cash (Used In) Provided By Operations	\$ (22)	\$ 9	\$ 60	\$ (82)	\$ (35)
Cash Flow From Investing Activities:					
Capital expenditures	(10)	(5)	(15)	-	(30)
Proceeds from sale of minority interest in CP Kelco ApS	27	-	-	-	27
Contributions paid to affiliates	(1)	-	-	1	-
Contributions received from affiliates	-	-	1	(1)	-
Other, net	-	-	1	-	1
Net cash (used in) provided by investing activities	16	(5)	(13)	-	(2)
Cash Flow From Financing Activities:					
Long-term debt proceeds	650	-	-	-	650
Long-term debt repayments	(628)	-	(9)	-	(637)
Change in current maturities of long-term debt	-	-	-	-	-
Payment of debt issuance costs and underwriting fees	(8)	-	-	-	(8)
Change in intercompany, noncurrent	(9)	1	43	(35)	-
Dividends paid	-	-	(117)	117	-
Treasury stock issued	1	-	-	-	1
Net cash provided by (used in) financing activities	6	1	(83)	82	6
Effect of exchange rate changes on cash	-	-	(1)	-	(1)
Net (decrease) increase in cash and cash equivalents	-	5	(37)	-	(32)
Cash and cash equivalents - beginning of period	9	2	114	-	125
Cash and cash equivalents - end of period	\$ 9	\$ 7	\$ 77	\$ -	\$ 93

Condensed Consolidating Statement of Cash Flows
Six Months Ended June 30, 2004

(Unaudited)
(Dollars in millions)

	Unconsolidated				
	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Net Cash (Used In) Provided By Operations	\$ (28)	57	\$ 42	\$ (90)	\$
Cash Flow From Investing Activities:					
Capital expenditures	(5)	(6)	(8)	-	-
Proceeds of investment and fixed asset disposals	-	-	3	-	-
Decrease in restricted cash	125	-	-	-	-
Other, net	(1)	1	(4)	-	-

(Dollars in millions)

Net cash provided by (used in) investing activities	119	(5)	(9)	-
Cash Flow From Financing Activities:				
Long-term debt repayments	(126)	-	(7)	-
Change in current maturities of long-term debt	-	-	(1)	-
Change in intercompany, noncurrent	(49)	(53)	12	90
Treasury stock issued	1	-	-	-
Net cash (used in) provided by financing activities	(174)	(53)	4	90
Effect of exchange rate changes on cash	-	-	9	-
Net (decrease) increase in cash and cash equivalents	(83)	(1)	46	-
Cash and cash equivalents at beginning of period	131	7	71	-
Cash and cash equivalents at end of period	\$ 48	\$ 6	\$ 117	\$ -

Item 4. Controls and Procedures

(a) The Company maintains disclosure controls and procedures that are designed to provide reasonable assurance that information required to be disclosed in the Company's filings under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the periods specified in the rules and forms of the Securities and Exchange Commission (the "SEC") and that such information is accumulated and communicated to the Company's management, including its principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosure.

As a result of its June 24, 2004 settlement with the Internal Revenue Service ("IRS") for the tax years 1990 through 1992 that indicated additional tax liabilities for such audit cycle, the Company initiated a review of the GAAP accounting for income taxes for the tax years 1987 through 1995. In conjunction with this review, the Company undertook an effort to analyze and reconcile the various general ledger tax account balances relative to the tax years 1990 through 1992, which expanded to encompass the handling of adjustments that should have occurred relative to the previously settled tax years 1987 through 1989 and the open tax years 1993 through 1995. In addition, the Company also reviewed the tax years 1996 and forward to confirm that there were no further implications in years subsequent to 1995 with respect to issues identified as a result of the 1987 through 1995 analysis. The review indicated cumulative additional tax liabilities for the years 1987 through 1995 that had not been reconciled to the various general ledger tax account balances.

Based on this review, on November 9, 2004, the Company's Chief Financial Officer determined that previously issued financial statements cannot be relied upon and that restatement of such previously issued financial statements is required. The Audit Committee of the Board of Directors ("Audit Committee") concurred with this determination. The adjustments reflected in this Form 10-Q/A primarily relate to the computation and application of foreign tax credits and reduce the tax deposit asset by \$65 million, increase deferred income tax assets by \$17 million, and, as a result of the cumulative additional income tax expense to be recorded for the restated periods, reduce retained earnings and stockholders' equity by \$48 million as of January 1, 1996 and for previously reported periods affected through June 30, 2004. The restatement does not affect the previously reported results of operations for any period subsequent to December 31, 1995.

The Company believes that the errors were attributable to material weaknesses in internal control over financial reporting that (i) occurred (a) during the preparation and review of the U.S. federal income tax returns for the years

1987 through 1995, (b) prior and subsequent to entering into the settlement agreement with the IRS relative to the 1987 through 1989 tax years and (c) prior to and upon entering into the June 24, 2004 settlement agreement with the IRS for the tax years 1990 through 1992, (ii) concern (a) the computation by the Company of creditable foreign taxes and the utilization of such foreign tax credits and (b) the reconciliation of tax returns and settlements to the GAAP general ledger tax account balances. The material weaknesses, which existed through June 30, 2004, related to (i) review of the foreign tax credits, (ii) analysis prior to and after entering into settlements with tax authorities and (iii) analyses and reconciliations of general ledger tax account balances.

In order to remediate these material weaknesses in internal control over financial reporting, the Company is revising the procedures for collection and analysis of information used to calculate available foreign tax credits. The Company is also instituting new procedures over the tax settlement process. These procedures include (i) detailed review by the responsible area tax manager of the year-end tax reporting package for each foreign legal entity prior to finalization of the United States federal income tax return; (ii) detailed analysis and reconciliation of each legal entity's filed tax return to the general ledger tax account balances upon finalization of such returns; (iii) detailed reconciliation and analysis of proposed and settled tax adjustments by taxing authorities; and (iv) enhanced review and approval procedures to be used prior to entering into any final tax settlement and (v) enhanced Company-wide (including Tax) certification processes and procedures being implemented in connection with the Company's Sarbanes-Oxley Section 404 efforts discussed below.

(b) The Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's President and Chief Executive Officer and the Company's Vice President and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures pursuant to Exchange Act Rule 13a-15 as of June 30, 2004. Based upon that evaluation, the Company's President and Chief Executive Officer and the Company's Vice President and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective, with the exception of the items disclosed above. Disclosure controls and procedures are controls and procedures that are designed to ensure that information required to be disclosed in Company reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms.

There have been no significant changes in the Company's internal controls over financial reporting that occurred during the Company's third fiscal quarter that have materially affected, or are reasonably likely to materially affect the registrant's internal control over financial reporting. Since the end of third fiscal quarter, the changes described herein have been or are being implemented.

As a result of Section 404 of the Sarbanes-Oxley Act of 2002 and the rules issued thereunder ("SOX 404"), the Company will be required to include in its Annual Report on Form 10-K for the year ending December 31, 2004 a report on management's assessment of the effectiveness of the Company's internal controls over financial reporting. As part of the process for preparing for compliance with SOX 404, in 2003, the Company initiated a review of its internal controls over financial reporting. This review is being conducted under the direction of senior management. As a result, management has made improvements to the Company's internal controls through the date of the filing of this Form 10-Q/A as part of its normal process. Except for those change described above, the Company's management does not believe these changes have materially affected, or are likely to materially affect the Company's internal controls over financial reporting. The Company anticipates improvements will continue to be made as part of the ongoing SOX 404 preparation.

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be

(Dollars in millions)

signed on its behalf by the undersigned thereunto duly authorized.

HERCULES INCORPORATED

By:

/s/ Allen A. Spizzo

Allen A. Spizzo
Vice President and Chief Financial Officer
(Principal Accounting Officer and Duly
Authorized Signatory)
December 1, 2004

EXHIBIT INDEX

Number	Description
31.1*	Certification of President and Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2*	Certification of Vice President and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1*	Certification of President and Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2*	Certification of Vice President and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

* Filed herewith