

FERRO CORP  
Form 10-Q  
November 08, 2007

**Table of Contents**

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

**(Mark One)**

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

**For the quarterly period ended September 30, 2007**

**or**

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

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission File Number 1-584  
FERRO CORPORATION**

**(Exact name of registrant as specified in its charter)**

**Ohio**

**(State of Corporation)**

**34-0217820**

**(IRS Employer Identification No.)**

**1000 Lakeside Avenue**

**Cleveland, OH**

**(Address of Principal executive offices)**

**44114**

**(Zip Code)**

**216-641-8580**

**(Telephone Number)**

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

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

Large accelerated filer  Accelerated filer  Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). YES  NO   
At October 31, 2007, there were 43,515,015 shares of Ferro Common Stock, par value \$1.00, outstanding.

---

**TABLE OF CONTENTS**

**PART I**

|               |  |         |
|---------------|--|---------|
| <u>Item 1</u> | <u>Financial Statements (Unaudited)</u>  | Page 3  |
| <u>Item 2</u> | <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | Page 27 |
| <u>Item 3</u> | <u>Quantitative and Qualitative Disclosures about Market Risk</u>                            | Page 38 |
| <u>Item 4</u> | <u>Controls and Procedures</u>   | Page 40 |

**PART II**

|                |  |         |
|----------------|--|---------|
| <u>Item 1</u>  | <u>Legal Proceedings</u>   | Page 42 |
| <u>Item 1A</u> | <u>Risk Factors</u>  | Page 42 |
| <u>Item 2</u>  | <u>Unregistered Sales of Equity Securities and Use of Proceeds</u> | Page 42 |
| <u>Item 3</u>  | <u>Defaults Upon Senior Securities</u>                             | Page 42 |
| <u>Item 4</u>  | <u>Submission of Matters to a Vote of Security Holders</u>         | Page 42 |
| <u>Item 5</u>  | <u>Other Information</u>   | Page 42 |
| <u>Item 6</u>  | <u>Exhibits</u>  | Page 42 |
| <u>EX-31.1</u> |  |         |
| <u>EX-31.2</u> |  |         |
| <u>EX-32.1</u> |  |         |
| <u>EX-32.2</u> |  |         |

Table of Contents**PART I FINANCIAL INFORMATION****Item 1. Financial Statements (Unaudited)  
Ferro Corporation and Consolidated Subsidiaries  
Condensed Consolidated Statements of Income**

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

Edgar Filing: FERRO CORP - Form 10-Q

|                         |          |          |          |          |
|-------------------------|----------|----------|----------|----------|
| Cash dividends declared | \$ 0.145 | \$ 0.145 | \$ 0.435 | \$ 0.435 |
|-------------------------|----------|----------|----------|----------|

See accompanying notes to condensed consolidated financial statements.

3

---

**Table of Contents****Ferro Corporation and Consolidated Subsidiaries  
Condensed Consolidated Balance Sheets**

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

Edgar Filing: FERRO CORP - Form 10-Q

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

See accompanying notes to condensed consolidated financial statements.

4

---

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

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

See accompanying notes to condensed consolidated financial statements.



**Table of Contents****Ferro Corporation and Consolidated Subsidiaries  
Condensed Consolidated Statements of Cash Flows**

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

Cash paid during the period for:

|              |           |           |
|--------------|-----------|-----------|
| Interest     | \$ 46,925 | \$ 48,710 |
| Income taxes | \$ 11,387 | \$ 8,607  |

See accompanying notes to condensed consolidated financial statements.

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

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

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

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

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

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

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

On January 1, 2007, we also adopted Statement of Financial Accounting Standards No. 156, *Accounting for Servicing of Financial Assets – an amendment of FASB Statement No. 140*, ( FAS No. 156 ). This statement requires an

entity to recognize at fair value a servicing asset or liability each time it undertakes an obligation to service a financial asset by

**Table of Contents**

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

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

**Condensed Consolidated Statements of Income**

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



**Table of Contents**

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

**Table of Contents**

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



**Table of Contents****Nine months ended September 30, 2006**

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

**Table of Contents****Condensed Consolidated Balance Sheets**

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

**Table of Contents**

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

**Table of Contents****Condensed Consolidated Statements of Cash Flows**

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

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

Edgar Filing: FERRO CORP - Form 10-Q

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

14

---

**Table of Contents****3. Newly Issued Accounting Pronouncements**

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

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

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

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

**4. Inventories**

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

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

In the production of some of our products, we use precious metals, some of which we obtain from financial institutions under consignment agreements with terms of one year or less. The financial institutions retain ownership of the precious metals and charge us fees based on the amounts we consign. These fees were \$0.8 million and \$0.8 million for the three months ended September 30, 2007 and 2006, respectively, and \$2.8 million and \$2.2 million for the nine months ended September 30, 2007 and 2006, respectively, and were charged to cost of sales. In November 2005, the financial institutions renewed their requirement for cash deposits from us to provide additional collateral

beyond the value of the underlying precious metals. Outstanding collateral deposits were \$70.1 million at December 31, 2006. These requirements were eliminated during the first six months of 2007. We had on hand \$126.3 million at September 30, 2007, and \$120.9 million at December 31, 2006, of precious metals owned by financial institutions, measured at fair value.

**5. Property, Plant and Equipment**

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

**Table of Contents****6. Financing and Long-term Debt**

Long-term debt consists of the following:

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

\* Net of unamortized discounts.

**Credit Rating**

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

**Revolving Credit and Term Loan Facilities**

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

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

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



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

The interest rates under the Amended Credit Facility are the sum of (A) either (1) LIBOR or (2) the higher of the Federal Funds Rate plus 0.5% or the Prime Rate and (B) for the revolving credit facility, a variable margin based on the Company's leverage, or for the term loan facility, a fixed margin. As part of the June 2007 amendments, \$175 million of borrowings

**Table of Contents**

under the term loan facility were restricted to using three-month LIBOR in determining their interest rates. This change was made in connection with interest rate swap agreements executed in June 2007. These swap agreements effectively fixed the interest rate through June 2011 on \$150 million of borrowings under the term loan facility. At September 30, 2007, the average interest rate for revolving credit borrowings was 7.4%, and the effective interest rate for term loan borrowings after adjusting for the interest rate swaps was 7.3%. At December 31, 2006, the average interest rate was 8.1% for revolving credit borrowings and 8.1% for term loan borrowings.

**Senior Notes and Debentures**

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

**Receivable Sales Programs**

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

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

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

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

**Other Financing Arrangements**

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

**7. Financial Instruments**

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

**Table of Contents**

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

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

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

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

**8. Income Taxes**

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

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

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

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



**Table of Contents**

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

**9. Contingent Liabilities**

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

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

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

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

In September 2007, we entered into a settlement agreement with the U.S. Securities and Exchange Commission (SEC) related to the SEC's investigation of the inappropriate accounting entries in our Polymer Additives business. As part of the settlement, and without admitting or denying any wrongdoing, we agreed to the entry of an administrative

order by the SEC directing the Company to cease and desist from committing or causing violations of certain of the reporting provisions of Federal securities laws and related SEC rules. The SEC's order contains no finding of securities fraud or violation of any antifraud provision of Federal securities laws or related SEC rules. The Company was not required to pay any monetary penalty or fine in connection with the resolution of this matter.

**Table of Contents**

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

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

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

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

**10. Retirement Benefits**

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

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





**Table of Contents**

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

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

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

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

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

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

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

A curtailment recognized in the second quarter of 2006 of eligibility for retiree medical and life insurance coverage for nonunion employees. Only employees age 55 or older with 10 or more years of service as of December 31, 2006, will be eligible for postretirement medical and life insurance benefits. Moreover, these

benefits will be available only to those employees who retire by December 31, 2007, after having advised the Company of their retirement plans by March 31, 2007.

**11. Stock-based Compensation**

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

**Table of Contents****Deferred Stock Units**

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

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

**Compensation Expense Information**

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

|                      | <b>2007</b>                   | <b>2006</b> |
|----------------------|-------------------------------|-------------|
|                      | <b>(Dollars in thousands)</b> |             |
| Stock options        | \$ 2,333                      | \$ 2,267    |
| Performance shares   | 794                           | 776         |
| Deferred stock units | 505                           |             |
| Total                | \$ 3,632                      | \$ 3,043    |

**Grant Information**

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

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

**12. Restructuring and Cost Reduction Programs**

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

In July 2006, we announced that we were restructuring our European operations, including portions of our Performance Coatings segment and our Color and Glass Performance Materials segment. A portion of our Italian

manufacturing operations and administrative functions was consolidated with Spain, where additional production capacity is being constructed. Additionally, we are consolidating our decorative colors production, primarily from Frankfurt, Germany, to Colditz, Germany. As a result of these activities, since July 2006, we have reduced our workforce by approximately 60 employees and are evaluating further workforce reductions. We expect these actions to significantly reduce the cost structure

**Table of Contents**

of our manufacturing operations. During the nine months ended September 30, 2007, we recorded charges of \$1.9 million for our operations in Spain, Portugal, France and Germany, primarily relating to registration taxes paid and expected employee termination benefits. In March 2007, we reached an agreement with the Betriebsrat der Ferro GmbH (German Works Council) regarding employee termination benefits for employees included in the decorative colors consolidation plan. The agreement provides that a higher number of employees than previously anticipated will participate in a severance plan in accordance with German laws and regulations. As a result, the timing of the related expense recognition will occur ratably over future periods, and \$1.1 million of the estimated amounts previously accrued were reversed during the first quarter. In total, 42 employees were terminated relating to the European consolidation during the first nine months of 2007.

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

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

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

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

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

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

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



**Table of Contents****13. Discontinued Operations**

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

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

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

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

**14. Earnings per Share**

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

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

Edgar Filing: FERRO CORP - Form 10-Q

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

24

---



**Table of Contents**

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

**15. Reporting for Segments**

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

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

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

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

**Table of Contents**

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

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

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

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

**Table of Contents**

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

***Overview***

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

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

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

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

***Outlook***

General market conditions continue to be mixed. Markets in the United States that are related to residential housing, automobiles and appliances are expected to continue a pattern of weak demand that began in the second half of 2006. This market weakness is expected to affect sales volume in our Specialty Plastics, Polymer Additives, Color and Glass Performance Materials, and Performance Coatings segments. Markets outside of the United States are generally strong, and are expected to remain strong through the rest of 2007. We have seen a recovery in demand for our Electronic Materials products used by capacitor manufacturers, compared with a reduced level of demand in the first half 2007, and we expect demand to continue at this improved level for the remainder of 2007.

We expect to continue to record charges associated with our current and future restructuring programs, particularly related to our rationalization of the manufacturing assets in our European operations. Interest expense is expected to decline from prior-year periods, primarily as a result of lower deposit requirements on precious metals.

In February 2007, we discovered that some of the values shown on certificates of analysis provided to customers in our Specialty Plastics business were inaccurate. The faulty procedures and practices that resulted in the inaccurate values discovered at our Evansville, Indiana, manufacturing facility have been investigated and corrected. However, the corrective actions will require us to incur additional raw material and manufacturing costs of approximately \$0.5 million in the fourth quarter of 2007.

**Table of Contents****Results of Operations**

Comparison of the three months ended September 30, 2007 and 2006

|   | Three months ended<br>September 30,<br>Adjusted     |            | \$<br>Change | %<br>Change |
|---|---|------------|--------------|-------------|
|   | 2007  | 2006       |              |             |
|   | (Dollars in thousands,<br>except per share amounts) |            |              |             |
| <b>Net sales</b>  | \$ 550,701  | \$ 500,573 | \$ 50,128    | 10.0%       |
| Cost of sales   | 450,553   | 401,853    | 48,700       | 12.1%       |
| Gross profit  | 100,148   | 98,720     | 1,428        | 1.4%        |
| Gross profit percentage                                   | 18.2%   | 19.7%      |              |             |
| Selling, general and administrative expenses              | 71,069  | 74,116     | (3,047)      | (4.1)%      |
| Restructuring charges                                     | 5,826   |            | 5,826        |             |
| Other expense (income):                                   |   |            |              |             |
| Interest expense  | 14,488  | 16,818     | (2,330)      | (13.9)%     |
| Interest earned   | (271)   | (971)      | 700          | (72.1)%     |
| Foreign currency transactions, net                        | (10)  | 166        | (176)        | (106.0)%    |
| Miscellaneous (income) expense, net                       | (13)  | 428        | (441)        | (103.0)%    |
| <b>Income before income taxes</b>                         | 9,059   | 8,163      | 896          | 11.0%       |
| Income tax expense  | 3,472   | 2,694      | 778          | 28.9%       |
| <b>Income from continuing operations</b>                  | 5,587   | 5,469      | 118          | 2.2%        |
| Loss (income) from discontinued operations, net<br>of tax | 2   | (62)       | 64           | (103.2)%    |
| <b>Net income</b>   | \$ 5,585  | \$ 5,531   | \$ 54        | 1.0%        |
| <b>Diluted earnings per share</b>                         | \$ 0.12   | \$ 0.12    | \$           |             |

Net sales in the quarter ended September 30, 2007, increased by 10.0% from the same quarter in 2006. The sales increase was the result of higher sales in our Performance Coatings, Color and Glass Performance Materials, Electronic Materials, and Polymer Additives segments. Partially offsetting this growth was a sales decline in our Specialty Plastics and Other segments. The primary driver of the increased sales was the combined effect of improved product pricing and favorable changes in foreign currency exchange rates. Sales growth was the strongest in Europe, and sales also grew in Asia and Latin America. Sales in the United States increased slightly.

Gross profit increased slightly in the third quarter of 2007 compared with the third quarter of 2006. Gross profit was reduced by \$0.5 million in the third quarter of 2007 primarily as a result of charges for accelerated depreciation and other costs related to our manufacturing rationalization programs. Higher costs for raw materials, including higher precious metal prices, increased cost of sales and limited the increase in gross profit. Precious metal costs are generally passed through to customers with minimal gross profit contribution. Cost of sales was also increased by changes in foreign currency exchange rates and by the effects of natural gas supply disruptions in Asia and Latin America.

Selling, general and administrative ( SG&A ) expenses declined \$3.0 million during the third quarter, primarily as a result of previous expense reduction activities, particularly in our Specialty Plastics and Electronic Materials segments, lower incentive compensation accruals, and lower audit fees. During the third quarter of 2006, SG&A expense included charges of \$0.4 million related to organizational initiatives and an accounting investigation and restatement.

Restructuring charges of \$5.8 million were recorded in the third quarter of 2007, primarily related to our plan to discontinue manufacturing porcelain enamel frit at our Rotterdam, The Netherlands, facility in 2008.

**Table of Contents**

Interest expense declined during the three months ending September 30, 2007, compared to the third quarter of 2006, primarily as a result of lower borrowing levels. Our borrowing requirements were reduced by the elimination of cash deposits for the precious metals used in the manufacture of certain of our products. In addition, we have realized lower interest expense due to interest rate reductions on our revolving credit facility and term loans. Interest earned declined in the third quarter primarily as a result of the elimination of cash deposits for precious metals.

Income tax expense was 38.3% of pre-tax income for the three months ended September 30, 2007, compared with 33.0% of pre-tax income for the prior-year period. The primary reasons for the change in the effective tax rate were the tax effect resulting from restructuring charges recorded in the third quarter of 2007, a change in the mix of income and losses by country, and a relatively high tax cost on 2007 earnings repatriated from outside the United States.

There were no new businesses included in discontinued operations in the third quarter of 2007.

|                                       | <b>Three months ended<br/>September 30,<br/>Adjusted</b> |             |                  | <b>%<br/>Change</b> |
|---------------------------------------|--|-------------|------------------|---------------------|
|                                       | <b>2007</b>  | <b>2006</b> | <b>\$ Change</b> |                     |
|                                       | <b>(Dollars in thousands)</b>                            |             |                  |                     |
| <b>Segment Sales</b>                  |  |             |                  |                     |
| Performance Coatings                  | \$ 153,742   | \$ 134,947  | \$ 18,795        | 13.9%               |
| Electronic Materials                  | 116,645  | 104,960     | 11,685           | 11.1%               |
| Color and Glass Performance Materials | 113,575  | 94,916      | 18,659           | 19.7%               |
| Polymer Additives                     | 85,230   | 79,815      | 5,415            | 6.8%                |
| Specialty Plastics                    | 62,236   | 65,762      | (3,526)          | (5.4)%              |
| Other businesses                      | 19,273   | 20,173      | (900)            | (4.5)%              |
| Total                                 | \$ 550,701   | \$ 500,573  | \$ 50,128        | 10.0%               |
| <b>Segment Operating Income</b>       |  |             |                  |                     |
| Performance Coatings                  | \$ 8,449   | \$ 11,527   | \$ (3,078)       | (26.7)%             |
| Electronic Materials                  | 8,522  | 7,261       | 1,261            | 17.4%               |
| Color and Glass Performance Materials | 11,727   | 8,187       | 3,540            | 43.2%               |
| Polymer Additives                     | 3,417  | 4,133       | (716)            | (17.3)%             |
| Specialty Plastics                    | 3,586  | 2,087       | 1,499            | 71.8%               |
| Other businesses                      | 593  | 754         | (161)            | (21.4)%             |
| Total                                 | \$ 36,294  | \$ 33,949   | \$ 2,345         | 6.9%                |

*Performance Coatings Segment Results.* Sales increased in Performance Coatings due to higher sales of tile coatings and porcelain enamel products. The sales increase was driven by improved pricing, as well as favorable changes in foreign currency exchange rates. Regionally, sales growth was the strongest in Europe and Asia. Sales in North America were little changed from the prior-year period. Operating income declined during the third quarter of 2007 primarily as a result of lower manufacturing volume of porcelain enamel products, higher raw material costs, and manufacturing costs that were not fully offset by higher product pricing.

*Electronic Materials Segment Results.* Sales increased in the Electronic Materials segment primarily as a result of increased sales of our advanced materials, including our conductive materials for solar cells. Demand for our dielectric materials, which had been weak in the first half of 2007, recovered to more normal levels in the third quarter. Sales increased in Asia and Europe, driven primarily by increased sales of conductive pastes. Operating income increased during the quarter as a result of higher manufacturing volume and lower manufacturing costs, combined with lower

selling, general and administrative expenses, all of which more than offset higher raw material costs.

**Table of Contents**

*Color and Glass Performance Materials Segment Results.* Sales increased in Color and Glass Performance Materials due to the combination of the effects of higher volumes, improved product pricing and product mix, and favorable foreign currency exchange rates. Sales grew in Europe, North America, Asia and Latin America. Operating income grew primarily as a result of improved product pricing, partially offset by higher raw material costs.

*Polymer Additives Segment Results.* Sales increased in Polymer Additives as a result of improved product pricing and favorable changes in foreign currency exchange rates. Sales increased in both the United States and Europe. Weak demand from U.S. residential housing continued to negatively affect the volume of products sold, but this was offset by demand from customers serving other markets. Operating income declined from the prior year primarily due to raw materials cost increases, particularly tallow and soybean oil costs, which were not fully offset by product price increases.

*Specialty Plastics Segment Results.* Sales declined in Specialty Plastics during the third quarter of 2007, primarily as a result of lower volumes, which were only partially offset by improved product prices and by favorable foreign currency exchange rates. The lower sales were primarily the result of weaker demand from customers who manufacture products used in residential construction, appliance and automotive applications. Sales of reinforced plastic products declined while sales of plastic colorants increased. Sales declined in North America and increased in Europe. Operating income increased from the prior-year period primarily as the result of higher product pricing and restructuring activities in prior quarters that lowered selling, general and administrative expenses. The negative effects of lower manufacturing volume and higher raw material costs partially offset these improvements to operating income.

|                               | <b>Three months ended<br/>September 30,</b> |             |                  | <b>%<br/>Change</b> |
|-------------------------------|---|-------------|------------------|---------------------|
|                               | <b>2007</b>                                 | <b>2006</b> | <b>\$ Change</b> |                     |
| <b>(Dollars in thousands)</b> |   |             |                  |                     |
| <b>Geographic Revenues</b>    |   |             |                  |                     |
| United States                 | \$ 232,405                                  | \$ 231,531  | \$ 874           | 0.4%                |
| International                 | 318,296                                     | 269,042     | 49,254           | 18.3%               |
| Total                         | \$ 550,701                                  | \$ 500,573  | \$ 50,128        | 10.0%               |

Sales were flat in the United States, as higher sales in the Color and Glass Performance Materials and Polymer Additives segments were offset by lower U.S. sales for the Specialty Plastics segment. International sales increased the most in Europe, where sales increased due to a combination of the positive effects of improved price and product mix, and favorable changes in exchange rates. Sales also grew in Asia, primarily driven by increased sales in the Electronic Materials, Performance Coatings, and Color and Glass Performance Materials segments.



**Table of Contents**

*Comparison of the nine months ended September 30, 2007 and 2006*

|   | <b>Nine months ended<br/>September 30,<br/>Adjusted</b>     |              | <b>\$<br/>Change</b> | <b>%<br/>Change</b> |
|---|---|--------------|----------------------|---------------------|
|   | <b>2007</b>   | <b>2006</b>  |                      |                     |
|   | <b>(Dollars in thousands,<br/>except per share amounts)</b> |              |                      |                     |
| <b>Net sales</b>                              | \$ 1,634,064  | \$ 1,544,218 | \$ 89,846            | 5.8%                |
| Cost of sales                                 | 1,319,609   | 1,226,758    | 92,851               | 7.6%                |
| Gross profit                                  | 314,455   | 317,460      | (3,005)              | (0.9)%              |
| Gross profit percentage                       | 19.2%   | 20.6%        |                      |                     |
| Selling, general and administrative expenses  | 234,212   | 231,955      | 2,257                | 1.0%                |
| Restructuring charges                         | 7,689   |              | 7,689                |                     |
| Other expense (income):                       |   |              |                      |                     |
| Interest expense                              | 46,220  | 48,155       | (1,935)              | (4.0)%              |
| Interest earned                               | (1,425)   | (2,741)      | 1,316                | (48.0)%             |
| Foreign currency transactions, net            | 924   | 706          | 218                  | 30.9%               |
| Miscellaneous (income) expense, net           | (399)   | 3,070        | (3,469)              | (113.0)%            |
| <b>Income before income taxes</b>             | 27,234  | 36,315       | (9,081)              | (25.0)%             |
| Income tax expense                            | 10,814  | 11,938       | (1,124)              | (9.4)%              |
| <b>Income from continuing operations</b>      | 16,420  | 24,377       | (7,957)              | (32.6)%             |
| Loss from discontinued operations, net of tax | 216   | 405          | (189)                | (46.7)%             |
| <b>Net income</b>                             | \$ 16,204   | \$ 23,972    | \$ (7,768)           | (32.4)%             |
| <b>Diluted earnings per share</b>             | \$ 0.36   | \$ 0.54      | \$ (0.18)            | (33.3)%             |

Net sales increased in the nine months ended September 30, 2007, by 5.8% compared with the same period in 2006. The sales increase was driven by higher sales in the Performance Coatings and Color and Glass Performance Materials segments, partially offset by a decline in the Specialty Plastics segment. Improved product pricing, along with favorable foreign currency exchange rates, were primarily responsible for the increased sales. These factors were partially offset by the effects of lower manufacturing volume. Sales growth was strongest in Europe, and sales also grew in Asia and Latin America. Sales declined in the United States, largely as a result of weakness in demand from the residential housing, appliance and automotive markets.

Gross profit declined during the first nine months of 2007 compared with the first nine months of 2006. During the first three quarters of 2007, gross profit was reduced by \$4.7 million of charges primarily related to our manufacturing rationalization programs. Gross profit was also negatively impacted by the interruption of manufacturing operations at our South Plainfield, New Jersey, manufacturing location, where operations were temporarily suspended to address operational issues and safety concerns. In addition, gross profit was reduced by added costs that were required to address quality issues at our Evansville, Indiana, manufacturing facility. Higher precious metal prices reduced our gross margin, as a percentage of sales, because increases in precious metal costs are generally passed through to customers with minimal gross margin contribution.

Selling, general and administrative ( SG&A ) expenses increased by \$2.3 million during the first three quarters of 2007, primarily driven by a reserve established for settlement agreements with plaintiffs in civil lawsuits related to alleged antitrust violations in the heat stabilizer industry. (See Note 9 to the condensed consolidated financial statements.) The reserve increased SG&A expense in the first nine months of 2007 by \$6.3 million. Additional charges of \$2.2 million, primarily related to legal expenses connected with manufacturing issues at our Evansville, Indiana, plastics facility, business divestiture activities and executive severance expenses, were included in SG&A expense during the first nine months of 2007. These increases were partially offset by expense control initiatives. Charges of \$6.8 million were included in SG&A expense in the

**Table of Contents**

first nine months of 2006, mainly related to accounting investigation and restatement activities. As a percentage of sales, SG&A expense declined to 14.3% in the first nine months of 2007 from 15.0% in 2006.

Restructuring charges of \$7.7 million were recorded in the first nine months of 2007, primarily related to our European manufacturing rationalization programs in our Performance Coatings and Color and Glass Performance Materials segments and our restructuring programs in the Electronic Materials segment in the United States.

Interest expense declined in the first nine months of 2007, primarily as a result of lower borrowing levels in the second and third quarters. The lower borrowing levels were largely the result of renegotiating our consignment agreements for precious metals and elimination of requirements for cash deposits. During the first three quarters of 2007, interest expense included a \$2.0 million write-off of unamortized financing fees associated with the cancelled portion of our term loan arrangements. During the first three quarters of 2006, interest expense included a \$2.5 million write-off of fees and discounts from our debentures that were repaid in 2006 and previously unamortized fees related to our former revolving credit facility.

Miscellaneous income for the nine months ended September 30, 2007, was \$0.4 million compared with miscellaneous expense of \$3.1 million in the first nine months of 2006. The change in miscellaneous income (expense) was primarily due to a gain of \$0.4 million associated with marked-to-market supply contracts in the first nine months of 2007 compared with a loss of \$3.3 million in the first nine months of 2006.

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

There were no new businesses included in discontinued operations in the first nine months of 2007. We recorded a loss of \$0.2 million, net of taxes, in the first three quarters related to post-closing matters associated with businesses we sold in previous years.

|                                       | <b>Nine months ended<br/>September 30,<br/>Adjusted</b> |              |                  | <b>%<br/>Change</b> |
|---------------------------------------|---|--------------|------------------|---------------------|
|                                       | <b>2007</b>   | <b>2006</b>  | <b>\$ Change</b> |                     |
|                                       | <b>(Dollars in thousands)</b>                           |              |                  |                     |
| <b>Segment Sales</b>                  |   |              |                  |                     |
| Performance Coatings                  | \$ 451,058  | \$ 397,015   | \$ 54,043        | 13.6%               |
| Electronic Materials                  | 338,412   | 335,493      | 2,919            | 0.9%                |
| Color and Glass Performance Materials | 329,195   | 292,515      | 36,680           | 12.5%               |
| Polymer Additives                     | 252,903   | 245,057      | 7,846            | 3.2%                |
| Specialty Plastics                    | 198,994   | 209,525      | (10,531)         | (5.0)%              |
| Other businesses                      | 63,502  | 64,613       | (1,111)          | (1.7)%              |
| Total                                 | \$ 1,634,064  | \$ 1,544,218 | \$ 89,846        | 5.8%                |
| <b>Segment Operating Income</b>       |   |              |                  |                     |
| Performance Coatings                  | \$ 29,947   | \$ 31,937    | \$ (1,990)       | (6.2)%              |
| Electronic Materials                  | 19,534  | 25,895       | (6,361)          | (24.6)%             |
| Color and Glass Performance Materials | 39,462  | 32,993       | 6,469            | 19.6%               |
| Polymer Additives                     | 10,576  | 11,984       | (1,408)          | (11.7)%             |
| Specialty Plastics                    | 10,961  | 11,937       | (976)            | (8.2)%              |
| Other businesses                      | 7,982   | 4,002        | 3,980            | 99.5%               |

|       |            |            |          |        |
|-------|------------|------------|----------|--------|
| Total | \$ 118,462 | \$ 118,748 | \$ (286) | (0.2)% |
|-------|------------|------------|----------|--------|

*Performance Coatings Segment Results.* Sales increased in Performance Coatings due to increased sales of both tile coatings and porcelain enamel products. The sales increases were driven by increased product pricing and favorable changes in foreign exchange rates compared with the first nine months of 2006. The sales increases

**Table of Contents**

were partially offset by the effects of lower manufacturing volume. Sales growth was the greatest in Europe, although all regions recorded increased sales. In the United States, sales growth was slowed by weakness in demand from appliance and residential construction applications. Operating income declined during the first nine months of 2007 primarily as a result of increased costs of raw materials, the effects of lower manufacturing volumes, and higher manufacturing costs, partially offset by product price increases.

*Electronic Materials Segment Results.* Sales increased slightly in the first nine months of 2007 as lower sales in the beginning of the period were more than offset by improved sales in the third quarter. During the first half of the year, demand was weaker from customers who buy our dielectric powders to manufacture capacitors, however this demand has now recovered to more normal levels. Demand for conductive pastes used in the manufacture of solar cells continued to grow. Sales growth in Europe and Asia was nearly offset by sales declines in the United States during the first nine months of 2007. Operating income declined as a result of the impact of lower manufacturing volumes and as a result of a temporary interruption of manufacturing activities at our South Plainfield, New Jersey, manufacturing site. Operations at this site, which were suspended in April to address operational issues and safety concerns, have resumed.

*Color and Glass Performance Materials Segment Results.* Sales increased in Color and Glass Performance Materials as a result of a combination of favorable changes in foreign currency exchange rates, improved volume, and improved product pricing. Sales increased in all regions, with the largest sales increases coming from Europe. Operating income improved primarily as a result of improved product pricing partially offset by increased raw material costs.

*Polymer Additives Segment Results.* Sales increased in Polymer Additives during the first three quarters of 2007. Sales grew in the United States and Europe, but the growth in the United States was constrained somewhat by weak demand from residential housing and automotive applications. Sales growth was primarily from improved product pricing, partially offset by the effects of lower manufacturing volume. Operating income declined compared with the first nine months of 2006 as a result of lower manufacturing volume and higher raw material costs, partially offset by lower manufacturing costs, higher product pricing, and lower selling, general and administrative expenses.

*Specialty Plastics Segment Results.* Sales declined during the first nine months of 2007, primarily as a result of weak demand from U.S. customers who manufacture products used in residential construction, appliance and automotive applications. Sales declined in our filled and reinforced plastics and our liquid coatings and dispersions products. This decline was partially offset by growth in sales of our plastic colorants products. Operating income declined as a result of the effects of lower manufacturing volume and higher raw materials costs, partially offset by increased product pricing and lower selling, general and administrative expenses.

|                            | <b>Nine months ended</b>      |              |                  | <b>%<br/>Change</b> |
|----------------------------|-------------------------------|--------------|------------------|---------------------|
|                            | <b>September 30,</b>          |              |                  |                     |
|                            | <b>2007</b>                   | <b>2006</b>  | <b>\$ Change</b> |                     |
|                            | <b>(Dollars in thousands)</b> |              |                  |                     |
| <b>Geographic Revenues</b> |                               |              |                  |                     |
| United States              | \$ 710,423                    | \$ 738,060   | \$ (27,637)      | (3.7)%              |
| International              | 923,641                       | 806,158      | 117,483          | 14.6%               |
| Total                      | \$ 1,634,064                  | \$ 1,544,218 | \$ 89,846        | 5.8%                |

Sales declined in the United States, primarily driven by lower sales in the Specialty Plastics and Electronic Materials segments. These sales declines were partially offset by increased sales in the Polymer Additives, Color and Glass Performance Materials, and Performance Coatings segments. International sales increased in all regions, with the greatest growth in Europe, where sales increased due to a combination of the positive effects of improved price and product mix and favorable changes in exchange rates. The increase was the result of international sales growth in all segments, led by Performance Coatings and Color and Glass Performance Materials.



**Table of Contents**

|  | <b>Nine months ended<br/>September 30,</b> |             |                  | <b>%<br/>Change</b> |
|--|--|-------------|------------------|---------------------|
|  | <b>2007</b>                                | <b>2006</b> | <b>\$ Change</b> |                     |
|  | <b>(Dollars in thousands)</b>              |             |                  |                     |
| Net cash provided by operating activities            | \$ 121,281                                 | \$ 14,905   | \$ 106,376       | 713.7%              |
| Net cash used for investing activities               | (39,992)                                   | (52,277)    | 12,285           | (23.5)%             |
| Net cash (used for) provided by financing activities | (73,302)                                   | 30,777      | (104,079)        | (338.2)%            |
| Effect of exchange rate changes on cash              | 849  | (202)       | 1,051            | (520.3)%            |
| Increase (decrease) in cash and cash equivalents     | \$ 8,836                                   | \$ (6,797)  | \$ 15,633        | (230.0)%            |

Cash flows from operating activities improved by \$106.4 million in the first nine months of 2007 over the same period in 2006. Changes in deposits under our precious metals consignment program provided \$144.3 million of improvement. In the first nine months of 2007, we received \$70.1 million of these deposits from financial institutions, while in the first nine months of 2006, we placed \$74.2 million on deposit under this program. Cash flows were also improved \$88.9 million from net reductions in the working capital elements of accounts and trade notes receivable, inventories, and accounts payable. These improvements were offset by \$89.0 million from changes in the balance of the note receivable from FFC related to our asset securitization program.

Cash used for investing activities decreased by \$12.3 million. In June 2006, the Company invested an additional \$25.0 million in FFC in connection with the June 2006 amendment of the asset securitization agreement.

Cash flows used in financing activities increased by \$104.1 million, of which \$122.8 million related to changes in borrowing activity. In the first nine months of 2007, we used cash to reduce our debt by \$56.7 million. In the first nine months of 2006, we borrowed \$66.1 million in order to finance the deposits for precious metals noted above and other working capital needs such as accounts receivable and inventories.

**Capital Resources and Liquidity***Credit Rating*

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

*Revolving Credit and Term Loan Facility*

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

In June 2007, we amended the credit facility (the Amended Credit Facility) and increased the size of the revolving credit facility by \$50 million to \$300 million. At September 30, 2007, we had borrowed \$19.3 million of the revolving credit facility and had \$272.1 million available, after reductions for standby letters of credit secured by this facility. In addition, we can request an increase of \$50 million in the revolving credit facility.

In January 2007, we borrowed \$55 million of our term loan facility and used the proceeds to reduce borrowings under our revolving credit facility. At that time, we also cancelled the remaining unused term loan commitment of \$145 million, which was reserved to finance the potential accelerated payment of the senior notes, since the default under the senior notes was no longer continuing. In the second quarter of 2007, we began making periodic principal payments on the term loans. At September 30, 2007, we had borrowed \$302.7 million in term loans. The Company is required to make quarterly principal payments of \$0.8 million from October 2007 to July 2011 and \$72.6 million from October 2011 to April 2012 and a final payment of \$72.6 million in June 2012.

**Table of Contents**

At September 30, 2007, we were in compliance with the covenants of the Amended Credit Facility.

*Senior Notes and Debentures*

At September 30, 2007, we had \$200.0 million principal amount outstanding under senior notes, which are due in January 2009, and we were in compliance with the covenants under their indentures.

*Off Balance Sheet Arrangements*

*Receivable Sales Programs.* We sell, on an ongoing basis, substantially all of Ferro's U.S. trade accounts receivable under an asset securitization program. This program, which expires in 2009, accelerates cash collections at favorable financing costs and helps us manage the Company's liquidity requirements. We sell these trade accounts receivable to Ferro Finance Corporation (FFC), a wholly-owned unconsolidated qualified special purpose entity (QSPE). FFC finances its acquisition of trade receivable assets by issuing beneficial interests in (securitizing) the receivables to multi-seller receivables securitization companies (the Conduits) for proceeds of up to \$100.0 million. FFC and the Conduits have no recourse to Ferro's other assets for failure of debtors to pay when due as the assets transferred are legally isolated in accordance with the U.S. bankruptcy laws. Ferro's consolidated balance sheet does not include the trade receivables sold, but does include a note receivable from FFC to the extent that cash proceeds from the sales of accounts receivable to FFC have not yet been received by Ferro. At September 30, 2007, FFC had received net proceeds of \$65.5 million for outstanding receivables, and the balance of Ferro's note receivable from FFC was \$22.9 million.

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

*Consignment Arrangements for Precious Metals.* In the production of some of our products, we use precious metals, primarily silver for Electronic Materials products and gold for Color and Glass Performance Materials products. We obtain most precious metals from financial institutions under consignment agreements with terms of one year or less. The financial institutions retain ownership of the precious metals and charge us fees based on the amounts we consign. In November 2005, the financial institutions renewed their requirement for cash deposits from us to provide additional collateral beyond the value of the underlying precious metals. Outstanding collateral deposits were \$70.1 million at December 31, 2006. These requirements were eliminated during the first six months of 2007. At September 30, 2007, we had on hand \$126.3 million of precious metals owned by financial institutions, measured at fair value.

*Bank Guarantees and Standby Letters of Credit.* At September 30, 2007, the Company had bank guarantees and standby letters of credit issued by financial institutions, which totaled \$17.1 million. These agreements primarily relate to Ferro's insurance programs, potential environmental remediation liabilities, and foreign tax payments.

*Other Financing Arrangements*

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

In addition, the Company maintains other lines of credit to provide global flexibility for the Company's liquidity requirements. Most of these facilities are uncommitted lines for the Company's international operations.

*Uncertain Tax Positions*

Adoption of Financial Accounting Standards Board (FASB) Interpretation No. 48, Accounting for Uncertainty in Income Taxes, (FIN 48) as of January 1, 2007, did not materially impact the Company's liquidity. We do not have significant assets or liabilities related to uncertain tax positions that are expected to be settled in the next twelve months. However, at September 30, 2007, we had recognized approximately \$24.4 million of long-term tax assets and \$37.1 million of long-term tax liabilities, which could be settled more than one year in the future.



**Table of Contents***Liquidity Requirement*

Our liquidity requirements primarily include debt service, purchase commitments, working capital requirements, capital investments, postretirement obligations, and dividend payments. Ferro's level of debt and debt service requirements could have important consequences to its business operations and uses of cash flows. However, the liquidity available under our revolving credit agreement, along with liquidity from other financing arrangements, available cash flows from operations, and asset sales, should allow the Company to meet its funding requirements and other commitments.

*Critical Accounting Policies*

A detailed description of our critical accounting policies is contained in "Critical Accounting Policies" within Item 7 of the Company's Annual Report on Form 10-K for the year ended December 31, 2006.

As described below and elsewhere in this quarterly report, we changed our method of valuing selected inventories. Because of this change, the description of the accounting policy regarding our method of valuing our inventories contained in our Annual Report on Form 10-K for the year ended December 31, 2006, should now state the following:

*Inventories*

We value inventory at the lower of cost or market, with cost determined utilizing the first-in, first-out (FIFO) method.

We periodically evaluate the net realizable value of inventories based primarily upon their age, but also upon assumptions of future usage in production, customer demand and market conditions. Inventories have been reduced to the lower of cost or realizable value by allowances for slow moving or obsolete goods. If actual circumstances are less favorable than those projected by management in its evaluation of the net realizable value of inventories, additional write-downs may be required. Slow moving, excess or obsolete materials are specifically identified and may be physically separated from other materials, and we rework or dispose of these materials as time and manpower permit.

We maintain raw material on our premises that we do not own, including precious metals consigned from financial institutions and customers, and raw materials consigned from vendors. Although we have physical possession of the goods, their value is not reflected on our balance sheet because we do not have title.

Beginning in June 2007, we hedge a portion of our exposure to interest rate changes by entering into interest rate swap agreements. As a result, the description of the accounting policy regarding derivative financial instruments should include the following paragraph:

Our exposure to interest rate changes arises from our debt agreements with variable market interest rates. We hedge a portion of this exposure by entering into interest rate swap agreements. We mark these swaps to fair value and recognize the resulting gains or losses as other comprehensive income. These swaps are settled quarterly in cash, and the net interest paid or received is effectively recognized as interest expense.

*Newly Adopted Accounting Methods*

On January 1, 2007, we elected to change our costing method for our inventories not already costed under the lower of cost or market using the FIFO method, while in prior years, these inventories were costed under the lower of cost or market using the last-in, first-out (LIFO) method. The percentage of inventories accounted for under the LIFO method for U.S. inventories and consolidated inventories was 13.8% and 6.2%, respectively, at December 31, 2006. We adopted the new and preferable method of accounting for these inventories because the FIFO method conforms the inventory costing methods to a single method for all of our inventories and improves comparability with our industry peers. The FIFO method also better reflects current acquisition cost of those inventories on our consolidated balance sheets and enhances the matching of future revenues with cost of sales. All prior periods presented have been adjusted to reflect the new method retrospectively. The newly adopted accounting pronouncement increased our inventory balance by \$14.7 million and \$13.7 million and increased retained earnings, net of income tax effects, by \$9.1 million and \$8.5 million as of January 1, 2007 and 2006, respectively.

**Table of Contents**

Because of this change in accounting principle, inventory values at future balance sheet dates should reflect the most current prices we pay for the underlying inventory quantities.

On January 1, 2007, we also changed our accounting method of accruing for major planned overhauls. FASB Staff Position No. AUG AIR-1, *Accounting for Planned Maintenance Activities*, prohibits our prior policy of accruing for major planned overhauls in advance of when the actual costs are incurred. Under our new policy, the costs of major planned overhauls are expensed when incurred. All prior periods presented have been adjusted to reflect the new method retrospectively. Adoption of this accounting pronouncement decreased our accrued expenses and other current liabilities by \$2.1 million and \$2.2 million and increased retained earnings, net of income tax effects, by \$1.4 million and \$1.5 million as of January 1, 2007 and 2006, respectively.

On January 1, 2007, we adopted FIN 48, which clarifies what criteria must be met prior to recognition of the financial statement benefit of a position taken or expected to be taken in a tax return. This interpretation also provides guidance on de-recognition of income tax assets and liabilities, classification of current and deferred income tax assets and liabilities, accounting for interest and penalties associated with tax positions, accounting for income taxes in interim periods, and income tax disclosures. The adoption of this interpretation decreased the opening balance of retained earnings by \$11.9 million as of January 1, 2007. We have elected to continue to report interest and penalties as income tax expense.

On January 1, 2007, we also adopted Statement of Financial Accounting Standards No. 156, *Accounting for Servicing of Financial Assets – an amendment of FASB Statement No. 140*, ( FAS No. 156 ). This statement requires an entity to recognize at fair value a servicing asset or liability each time it undertakes an obligation to service a financial asset by entering into a servicing contract. We provide collection agent services for our U.S. and certain international receivable sales programs. The collection agent fees received by the Company approximate adequate compensation. Therefore, the adoption of FAS No. 156 did not have an affect on our consolidated financial statements.

***Newly Issued Accounting Pronouncements***

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

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

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

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

***Risk Factors***

Certain statements contained here and in future filings with the SEC reflect the Company's expectations with respect to future performance and constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These statements are subject to a variety of uncertainties, unknown risks and other factors concerning the Company's operations and business environment, which are difficult to predict and are beyond the control of the Company. A detailed description of such uncertainties, risks and other factors is contained under the heading "Risk Factors" of Item 1A in the Company's Annual Report on Form 10-K for the year ended December 31, 2006.

37

---

**Table of Contents**

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

Our exposure to market risks is generally limited to fluctuations in interest rates, foreign currency exchange rates, and costs of raw materials and natural gas.

Our exposure to interest rate risk arises from our debt portfolio. We manage this risk by controlling the mix of fixed versus variable-rate debt after considering the interest rate environment and expected future cash flows. To reduce our exposure to interest rate changes on variable-rate debt, we entered into interest rate swap agreements. These swaps effectively convert a portion of our variable-rate debt to a fixed rate. Our overall objective is to limit variability in earnings, cash flows and overall borrowing costs caused by changes in interest rates, while preserving operating flexibility.

We operate internationally and enter into transactions denominated in foreign currencies. These transactions expose us to gains and losses arising from exchange rate movements between the dates foreign currencies are recorded and the dates they are settled. We manage this risk by entering into forward currency contracts that offset these gains and losses.

We are subject to cost changes with respect to our raw materials and natural gas purchases. We attempt to mitigate raw materials cost increases through product reformulations, price increases, and other productivity improvements. We hedge a portion of our exposure to changes in the pricing of certain raw material commodities through swap arrangements that allow us to fix the pricing of the commodities for future purchases. When we enter into fixed price sales contracts for products with precious metal content, we also enter into a forward purchase arrangement with a precious metals supplier to cover the value of the fixed price sales contract. In addition, we purchase portions of our natural gas requirements under fixed price contracts to reduce the volatility of this cost. For gas contracts entered into prior to April 2006, we marked these contracts to fair value and recognized the resulting gains or losses as miscellaneous income or expense, respectively. Beginning April 2006, we designated new natural gas contracts as normal purchase contracts, which are not marked-to-market. Our purchase commitment for natural gas under normal purchase contracts was \$6.2 million at September 30, 2007.

**Table of Contents**

The notional amounts, carrying amounts of assets (liabilities), and fair values associated with our exposure to these market risks and sensitivity analyses about potential gains (losses) resulting from hypothetical changes in market rates are presented below:

|  | <b>September 30,<br/>2007</b> | <b>December 31,<br/>2006</b> |
|--|-------------------------------|------------------------------|
|  | <b>(Dollars in thousands)</b> |                              |
| Variable-rate debt and utilization of receivable sales programs:   |                               |                              |
| Change in annual interest expense from 1% change in interest rates | \$ 2,958                      | \$ 4,797                     |
| Fixed-rate debt:   |                               |                              |
| Carrying amount  | \$(200,934)                   | \$(200,281)                  |
| Fair value   | \$(206,739)                   | \$(206,399)                  |
| Change in fair value from 1% increase in interest rate             | \$ (2,406)                    | \$ (3,668)                   |
| Change in fair value from 1% decrease in interest rate             | \$ 2,446                      | \$ 3,755                     |
| Interest rate swaps:   |                               |                              |
| Notional amount  | \$ 150,000                    | \$                           |
| Carrying amount and fair value                                     | \$ (4,656)                    | \$                           |
| Change in fair value from 1% increase in interest rate             | \$ 5,196                      | \$                           |
| Change in fair value from 1% decrease in interest rate             | \$ (5,395)                    | \$                           |
| Foreign currency forward contracts:                                |                               |                              |
| Notional amount  | \$ 169,454                    | \$ 121,430                   |
| Carrying amount and fair value                                     | \$ (101)                      | \$ (640)                     |
| Change in fair value from 10% appreciation of U.S. dollar          | \$ (3,420)                    | \$ (1,142)                   |
| Change in fair value from 10% depreciation of U.S. dollar          | \$ 4,180                      | \$ 1,396                     |
| Raw material commodity swaps:                                      |                               |                              |
| Notional amount (in metric tons of base metals)                    | 1,595                         | 2,004                        |
| Carrying amount and fair value                                     | \$ (1,043)                    | \$ 1,939                     |
| Change in fair value from 10% change in forward prices             | \$ 814                        | \$ 1,003                     |
| Precious metals forward contracts:                                 |                               |                              |
| Notional amount (in troy ounces)                                   | 554,043                       | 183,264                      |
| Carrying amount and fair value                                     | \$ 997                        | \$ 192                       |
| Change in fair value from 10% change in forward prices             | \$ 1,064                      | \$ 465                       |
| Marked-to-market natural gas forward purchase contracts:           |                               |                              |
| Notional amount (in MBTUs)   |                               | 120,000                      |
| Carrying amount and fair value                                     | \$                            | \$ (442)                     |
| Change in fair value from 10% change in forward prices             | \$                            | \$ 78                        |

**Table of Contents**

**Item 4. Controls and Procedures**

*Evaluation of Disclosure Controls and Procedures*

Ferro is committed to maintaining disclosure controls and procedures that are designed to ensure that information required to be disclosed in its Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the U.S. Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to its management, including its Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

As required by Rule 13a-15(b) of the Exchange Act, Ferro has carried out an evaluation, under the supervision and with the participation of its management, including its Chief Executive Officer and its Chief Financial Officer, of the effectiveness of the design and operation of its disclosure controls and procedures. The evaluation examined those disclosure controls and procedures as of September 30, 2007, the end of the period covered by this report. As described below, we have taken measures to improve our internal controls and procedures; however, there has not been adequate time for us to conclude that the material weaknesses in the Company's internal control over financial reporting described below have been fully remediated. Therefore, Ferro's management, including its Chief Executive Officer and its Chief Financial Officer, has concluded that, as of September 30, 2007, Ferro's disclosure controls and procedures were not effective.

Additional procedures were performed in order for management to conclude with reasonable assurance that the Company's condensed consolidated financial statements contained in this Quarterly Report on Form 10-Q present fairly, in all material respects, the Company's financial position, results of operations and cash flows for the periods presented.

*Changes in Internal Control over Financial Reporting*

As of December 31, 2006, we identified the following material weaknesses in internal control over financial reporting:

The Company did not maintain a sufficient complement of personnel with an appropriate level of knowledge to consistently perform independent secondary reviews over complex and non-routine accounting matters.

The Company did not have in place adequate formal policies and procedures and also had a lack of sufficient resources with appropriate expertise in the Corporate tax function to effectively account for, oversee and review the Company's accounting for income taxes.

We have taken measures to improve the effectiveness of our internal control over financial reporting and to address the material weaknesses described above. The following process and control improvements are changes in our internal control over financial reporting during the three months ended September 30, 2007, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. We will continue to assess our disclosure controls and procedures and will take any further actions that we deem necessary.

The Company has hired additional experienced accounting professionals to increase the depth and experience of the Company's finance and accounting staff, thereby providing more expertise and knowledge to review accounting literature and other technical materials and providing the appropriate personnel to perform independent secondary reviews of complex and non-routine transactions.

The Company contracted with an independent accounting firm to provide additional expertise to the Corporate tax function, assist in the development of policies and procedures, and assist in the accounting for and review of the Company's income taxes.

The Company developed a comprehensive business information systems strategy intended to convert multiple legacy systems into one Enterprise Resource Planning ( ERP ) platform. The financial control environment benefits will include, but are not limited to, reducing the risks associated with multiple system interfaces, improving access controls within and between multiple systems, improving the integration of our sales, finance and accounting information systems, improving the accuracy of our revenue reporting, reducing the number of manual transactions, and increasing the transparency of financial information. As of

September 30, 2007, the

**Table of Contents**

Company has successfully upgraded its financial consolidation software and the parent-company general ledger system as part of this strategy.

41

---



**Table of Contents**

**PART II OTHER INFORMATION**

**Item 1. Legal Proceedings**

The information on legal proceedings contained in Note 9 to the condensed consolidated financial statements is incorporated here by reference.

On February 13, 2007, the New Jersey Department of Environmental Protection ( NJDEP ) issued an administrative order and notice of civil administrative penalty assessment to the Company for alleged violations at our Bridgeport, New Jersey, facility of the NJDEP laws and regulations regarding water discharge requirements pursuant to the New Jersey Water Pollution Control Act ( WPCA ). We have requested an adjudicatory hearing with NJDEP in order to negotiate a settlement, and we are currently awaiting a response from NJDEP. We cannot determine the outcome of these settlement negotiations at this time, but we do not expect the ultimate outcome of this penalty assessment and any associated expenses to have a material effect on the financial position, results of operations or cash flows of the Company.

In March 1997, the Company, as a potentially responsible party, filed a notice of intention to comply with the remediation of a federal Superfund site owned by Waste Disposal, Inc., located in Santa Fe Springs, California. The United States Environmental Protection Agency and the California Environmental Protection Agency oversaw the remediation of the site, which was completed in 2004, and are overseeing the continuing operation and maintenance of the site. There is a remaining liability to fund operations and maintenance costs through 2034. We have agreed to pay \$0.9 million to fully settle our liability associated with this site.

**Item 1A. Risk Factors**

There are no changes to the risk factors disclosed in the Company s Annual Report on Form 10-K for the year ended December 31, 2006.

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

No change.

**Item 3. Defaults Upon Senior Securities**

None.

**Item 4. Submission of Matters to a Vote of Security Holders**

None.

**Item 5. Other Information**

None.

**Item 6. Exhibits**

The exhibits listed in the attached Exhibit Index are filed pursuant to Item 6 of Form 10-Q.

**Table of Contents**

**SIGNATURES**

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

FERRO CORPORATION  
(Registrant)

Date: November 8, 2007

/s/ James F. Kirsch

James F. Kirsch  
Chairman, President and Chief Executive  
Officer  
(Principal Executive Officer)

Date: November 8, 2007

/s/ Sallie B. Bailey

Sallie B. Bailey  
Vice President and Chief Financial  
Officer  
(Principal Financial Officer)

43

---

**Table of Contents**

**EXHIBIT INDEX**

The following exhibits are filed with this report or are incorporated herein by reference to a prior filing in accordance with Rule 12b-32 under the Securities and Exchange Act of 1934.

Exhibit:

- 3 Articles of Incorporation and by-laws
  - 3.1 Eleventh Amended Articles of Incorporation. (Reference is made to Exhibit 3(a) to Ferro Corporation's Annual Report on Form 10-K for the year ended December 31, 2003, which Exhibit is incorporated here by reference.)
  - 3.2 Certificate of Amendment to the Eleventh Amended Articles of Incorporation of Ferro Corporation filed December 28, 1994. (Reference is made to Exhibit 3(b) to Ferro Corporation's Annual Report on Form 10-K for the year ended December 31, 2003, which Exhibit is incorporated here by reference.)
  - 3.3 Certificate of Amendment to the Eleventh Amended Articles of Incorporation of Ferro filed June 19, 1998. (Reference is made to Exhibit 3(c) to Ferro Corporation's Annual Report on Form 10-K for the year ended December 31, 2003, which Exhibit is incorporated here by reference.)
  - 3.4 Amended Code of Regulations. (Reference is made to Exhibit 10.01 to Ferro Corporation's Current Report on Form 8-K, filed November 8, 2006, which Exhibit is incorporated here by reference.)
- 4 Instruments defining rights of security holders, including indentures
  - 4.1 The rights of the holders of Ferro's Debt Securities issued and to be issued pursuant to an Indenture between Ferro and J. P. Morgan Trust Company, National Association (successor-in-interest to Chase Manhattan Trust Company, National Association) as Trustee, are described in the Indenture, dated March 25, 1998. (Reference is made to Exhibit 4(b) to Ferro Corporation's Annual Report on Form 10-K for the year ended December 31, 2003, which Exhibit is incorporated here by reference.)
    - 4.1.1 Pledge and Security Agreement, dated as of June 6, 2006, made by Ferro Corporation and each U.S. Subsidiary, as Grantors, in favor of J. P. Morgan Trust Company, National Association, as Trustee, for the benefit of the Trustee and the Holders under the Indentures. (Reference is made to Exhibit 10.3 to Ferro Corporation's Current Report on Form 8-K, filed June 12, 2006, which Exhibit is incorporated here by reference.)
    - 4.1.2 Collateral Sharing Agreement, dated as of June 6, 2006, among National City Bank, as Collateral Agent under the Credit Agreement, J.P. Morgan Trust Company, National Association, as Trustee under the Indentures, and Ferro Corporation and each other Person listed on the signature pages, as Obligors. (Reference is made to Exhibit 10.4 to Ferro Corporation's Current Report on Form 8-K, filed June 12, 2006, which Exhibit is incorporated here by reference.)
  - 4.2 Officers' Certificate dated December 20, 2001, pursuant to Section 301 of the Indenture dated as of March 25, 1998, between the Company and J. P. Morgan Trust Company, National Association (the successor-in-interest to Chase Manhattan Trust Company, National Association), as Trustee (excluding exhibits thereto). (Reference is made to Exhibit 4.2 to Ferro Corporation's Annual Report on Form 10-K for the year ended December 31, 2006, which Exhibit is incorporated here by reference.)
  - 4.3 Form of Global Note (9<sup>1</sup>/<sub>8</sub>% Senior Notes due 2009). (Reference is made to Exhibit 4.3 to Ferro Corporation's Annual Report on Form 10-K for the year ended December 31, 2006, which Exhibit is incorporated here by reference.)

The Company agrees, upon request, to furnish to the U.S. Securities and Exchange Commission a copy of any instrument authorizing long-term debt that does not authorize debt in excess of 10% of the total assets of the Company and its subsidiaries on a consolidated basis.



**Table of Contents**

10 Material Contracts

10.1 Ferro Corporation Deferred Compensation Plan for Executive Employees. (Reference is made to Exhibit 10.1 to Ferro Corporation's Current Report on Form 8-K, filed September 24, 2007, which Exhibit is incorporated here by reference.)

10.2 Ferro Corporation Deferred Compensation Plan for Non-Employee Directors. (Reference is made to Exhibit 10.2 to Ferro Corporation's Current Report on Form 8-K, filed September 24, 2007, which Exhibit is incorporated here by reference.)

10.3 Ferro Corporation Supplemental Defined Benefit Plan for Executive Employees. (Reference is made to Exhibit 10.3 to Ferro Corporation's Current Report on Form 8-K, filed September 24, 2007, which Exhibit is incorporated here by reference.)

10.4 Ferro Corporation Supplemental Defined Contribution Plan for Executive Employees. (Reference is made to Exhibit 10.4 to Ferro Corporation's Current Report on Form 8-K, filed September 24, 2007, which Exhibit is incorporated here by reference.)

31.1 Certification of Principal Executive Officer Pursuant to Rule 13a-14(a)/15d-14(a).

31.2 Certification of Principal Financial Officer Pursuant to Rule 13a-14(a)/15d-14(a).

32.1 Certification of Principal Executive Officer Pursuant to 18 U.S.C. 1350.

32.2 Certification of Principal Financial Officer Pursuant to 18 U.S.C. 1350.