

GRAFTECH INTERNATIONAL LTD

Form 10-Q

October 29, 2009

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

Washington, D.C. 20549

**FORM 10-Q**

(Mark One)

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

for the quarterly period ended September 30, 2009

OR

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

for the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number: 1-13888

# GRAFTECH INTERNATIONAL LTD.

(Exact name of registrant as specified in its charter)

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

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

**12900 Snow Road**

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

**44130**  
(Zip code)

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

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

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Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act.

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

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

As of October 16, 2009, 120,406,896 shares of common stock, par value \$.01 per share, were outstanding.

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	<b>At December 31, 2008</b>	<b>At September 30, 2009</b>
	<i>(as adjusted see Note 4)</i>	
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents	\$ 11,664	\$ 8,665
Accounts and notes receivable, net of allowance for doubtful accounts of \$4,110 at December 31, 2008 and \$5,061 at September 30, 2009	146,986	104,450
Inventories	290,397	251,802
Loan to non-consolidated affiliate		6,000
Prepaid expenses and other current assets	14,376	19,044
<b>Total current assets</b>	<b>463,423</b>	<b>389,961</b>
Property, plant and equipment	873,932	957,015
Less: accumulated depreciation	536,562	591,672
<b>Net property, plant and equipment</b>	<b>337,370</b>	<b>365,343</b>
Deferred income taxes	1,907	6,516
Goodwill	7,166	8,784
Other assets	12,887	12,089
Investment in non-consolidated affiliate	118,925	64,460
Restricted cash	1,451	2,450
<b>Total assets</b>	<b>\$ 943,129</b>	<b>\$ 849,603</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 55,132	\$ 41,248
Interest payable	953	7
Short-term debt	9,347	10,256
Accrued income and other taxes	34,861	33,134
Other accrued liabilities	140,330	64,814
<b>Total current liabilities</b>	<b>240,623</b>	<b>149,459</b>
Long-term debt:		
Principal	50,328	2,145
Fair value adjustments for hedge instruments	191	

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Unamortized premium (discount)	38	(651)
Total long-term debt	50,557	1,494
Other long-term obligations	118,272	121,723
Deferred income taxes (see Contingencies Note 14)	29,087	30,012
Stockholders' equity:		
Preferred stock, par value \$.01, 10,000,000 shares authorized, none issued		
Common stock, par value \$.01, 150,000,000 shares authorized at December 31, 2008 and 225,000,000 authorized at September 30, 2009, 122,634,854 shares issued at December 31, 2008 and 123,945,414 shares issued at September 30, 2009	1,226	1,239
Additional paid-in capital	1,290,381	1,298,108
Accumulated other comprehensive loss	(355,960)	(299,557)
Accumulated deficit	(317,752)	(339,510)
Less: cost of common stock held in treasury, 3,974,345 shares at December 31, 2008 and September 30, 2009	(112,511)	(112,511)
Less: common stock held in employee benefit and compensation trusts, 55,728 shares at December 31, 2008 and 69,661 shares at September 30, 2009	(794)	(854)
Total stockholders' equity	504,590	546,915
Total liabilities and stockholders' equity	\$ 943,129	\$ 849,603

*See accompanying Notes to Consolidated Financial Statements*

**Table of Contents****PART I (CONT D)****GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF OPERATIONS***(Dollars in thousands, except per share data)**(Unaudited)*

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2008 <i>(as adjusted see Note 4)</i>	2009	2008 <i>(as adjusted see Note 4)</i>	2009
Net sales	\$ 315,748	\$ 164,879	\$ 925,288	\$ 456,679
Cost of sales	201,795	118,226	588,884	332,244
Gross profit	113,953	46,653	336,404	124,435
Research and development	2,479	2,871	6,579	8,048
Selling and administrative	24,754	18,589	71,033	63,319
Restructuring charges	7	120	349	88
Operating income	86,713	25,073	258,443	52,980
Equity in losses of and write-down of investment in non-consolidated affiliate		953		54,343
Other (income) expense, net	(16,919)	10,710	7,035	8,446
Interest expense	3,427	1,168	16,859	4,236
Interest income	(204)	(251)	(782)	(552)
Income (loss) before provision for income taxes	100,409	12,493	235,331	(13,493)
Provision for income taxes	17,009	5,629	69,392	8,265
Net income (loss)	\$ 83,400	\$ 6,864	\$ 165,939	\$ (21,758)
<b><u>Basic income (loss) per common share:</u></b>				
Net income (loss) per share	\$ 0.70	\$ 0.06	\$ 1.52	\$ (0.18)
Weighted average common shares outstanding	118,764	119,928	109,063	119,596
<b><u>Diluted earnings (loss) per common share:</u></b>				
Net income (loss) per share	\$ 0.70	\$ 0.06	\$ 1.45	\$ (0.18)
Weighted average common shares outstanding	119,965	120,716	118,920	119,596

*See accompanying Notes to Consolidated Financial Statements*

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

	<b>For the</b>	
	<b>Nine Months Ended</b>	
	<b>September 30,</b>	
	<b>2008</b>	<b>2009</b>
	<i>(as adjusted see Note 4)</i>	
Cash flow from operating activities		
Net income (loss)	\$ 165,939	\$ (21,758)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	26,748	23,905
Deferred income tax provision	10,212	(10,829)
Equity in losses of and write-down of investment in non-consolidated affiliate		54,343
Gain on redemption of Debentures	(4,060)	
Currency (gains) losses	(7,752)	5,135
Post retirement obligation, severance and pension plan changes	6,679	6,688
Stock based compensation, including incentive compensation paid in company stock	3,861	5,957
Interest expense	7,488	1,040
Other (credits) charges, net	(7,298)	14,666
Dividends from non-consolidated affiliate		122
(Increase) decrease in working capital *	(29,560)	47,693
Long-term assets and liabilities	(2,978)	(5,259)
 Net cash provided by operating activities	 169,279	 121,703
Cash flow from investing activities:		
Capital expenditures	(47,610)	(40,544)
Proceeds from derivative instruments	311	433
Investment in and loan to non-consolidated affiliate	(136,390)	(6,000)
Proceeds from sale of assets	319	112
Decrease (increase) in restricted cash	91	(999)
 Net cash (used in) investing activities	 (183,279)	 (46,998)
Cash flow from financing activities:		
Short-term debt borrowings	11,625	773
Revolving Facility borrowings	180,661	124,715
Revolving Facility reductions	(70,877)	(155,231)
Long-term debt additions		1,837
Long-term debt reductions	(179,418)	(20,035)
Excess tax benefit from stock-based compensation	14,273	10
Supply chain financing		(30,115)
Long-term financing obligations	(296)	(815)
Purchase of treasury shares	(21,250)	
Proceeds from exercise of stock options	36,910	89



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Net cash (used in) financing activities	(28,372)	(78,772)
Net (decrease) in cash and cash equivalents	(42,372)	(4,067)
Effect of exchange rate changes on cash and cash equivalents	(1,237)	1,068
Cash and cash equivalents at beginning of period	54,741	11,664
Cash and cash equivalents at end of period	\$ 11,132	\$ 8,665

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

(Increase) decrease in current assets:		
Accounts and notes receivable	\$ (60,596)	\$ 64,187
Effect of factoring on accounts receivable	24,096	(15,993)
Inventories	(11,009)	62,819
Prepaid expenses and other current assets	(735)	(596)
Restructuring payments	(873)	(12)
Increase (decrease) in accounts payable and accruals	10,540	(62,672)
Increase in accrued income taxes	17,837	906
(Decrease) in interest payable	(8,820)	(946)
(Increase) decrease in working capital	\$ (29,560)	\$ 47,693

*See accompanying Notes to Consolidated Financial Statements*

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**PART I (CONT D)**

**GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**(1) Interim Financial Presentation**

These interim Consolidated Financial Statements are unaudited; however, in the opinion of management, they have been prepared in accordance with Rule 10-01 of Regulation S-X and in accordance with accounting principles generally accepted in the United States of America ( GAAP ). Certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been omitted or condensed. These interim Consolidated Financial Statements should be read in conjunction with the audited Consolidated Financial Statements, including the accompanying Notes, contained in our Annual Report on Form 10-K for the year ended December 31, 2008 (the **Annual Report** ). The year-end Consolidated Balance Sheet was derived from audited Consolidated Financial Statements, and has been adjusted to reflect the change in accounting as described in Note 4.

The unaudited consolidated financial statements reflect all adjustments (all of which are of a normal, recurring nature) which management considers necessary for a fair statement of financial position, results of operations and cash flows for the interim periods presented. The results for interim periods are not necessarily indicative of results which may be expected for any other interim period or for the full year.

**(2) New Accounting Standards**

On September 15, 2009, the Financial Accounting Standards Board Accounting Standards Codification system ( ASC or the Codification ) became the official authoritative source of nongovernmental GAAP. Rules and interpretations of the U.S. Securities and Exchange Commission ( SEC ) also remain sources of GAAP for us.

The Codification does not change GAAP; instead, it introduces a structure arranged within Topics, Subtopics, Sections, and Paragraphs. Codification Sections, which include the actual guidance, are based on the nature of the content (e.g., scope, recognition, measurement, etc.) and are standardized throughout the Codification. New authoritative GAAP will be communicated via an Accounting Standards Update ( ASU ), a new FASB document.

References to legacy GAAP citations (e.g., SFAS, EITF, FIN, etc.) now refer to the Codification topic numbers.

*Recently Adopted Accounting Standards*

**Convertible Debentures**

In January 2009, we adopted ASU 470-20, *Debt with Conversion and Other Options*, which applies to convertible debt instruments that, by their stated terms, may be settled in cash (or other assets) upon conversion, including partial cash settlement of the conversion option. As described in Note 4, even though our Debentures were extinguished in June 2008, we were required to apply ASU 470-20 retrospectively to our previously issued financial statements for the periods in which the Debentures were outstanding.

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**GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**Earnings Per Share**

Beginning in 2009 we began to use the two-class method of computing earnings per share for our instruments granted in share-based payment transactions that are determined to be participating securities prior to vesting as required by ASC 260, *Earnings Per Share*. Under this new guidance there was no material impact on our consolidated financial statements and we were not required to adjust our prior period earnings per share calculations.

**Derivative Instruments**

Effective January 1, 2009, we provide the disclosure information required by ASC 815, *Derivatives and Hedging*. The amended and expanded disclosures did not have a material impact on our financial position or results of operation.

**Business Combinations**

Effective January 2009, we adopted the new guidance for accounting for and reporting of business combinations found in ASC 805, *Business Combinations*. The requirements of ASC 805 substantially changed prior accounting for and reporting of business combinations guidance by (i) expanding the definition of a business and a business combination; (ii) requiring all assets and liabilities of the acquired business, including goodwill, contingent assets and liabilities, and contingent consideration be recorded at fair value on the acquisition date; (iii) requiring acquisition-related transaction and restructuring costs be expensed rather than accounted for as acquisition costs; and (iv) requiring reversal of valuation allowances related to deferred tax assets and changes to acquired income tax uncertainties be recognized in earnings.

We shall apply the guidance in ASC 805 for all future business combinations.

**Fair Value Measurements and Disclosures**

As of January 1, 2008, we adopted the guidance in ASC 820, *Fair Value Measurements and Disclosures*, which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. In February 2008 the FASB issued guidance that permitted companies to partially defer the effective date for nonfinancial assets and nonfinancial liabilities that are recognized or disclosed at fair value in the financial statements on a nonrecurring basis until fiscal years beginning after November 15, 2008; however, companies were not permitted to defer recognition and disclosure requirements for financial assets and financial liabilities or for nonfinancial assets and nonfinancial liabilities that are remeasured at least annually. We applied the guidance of ASC 820 to our nonfinancial assets and nonfinancial liabilities on January 1, 2009. The adoption of this guidance did not have a material impact on our consolidated financial statements.

The FASB also amended the guidance in ASC 825, *Financial Instruments* to require disclosures about the fair value of financial instruments in the interim period financial statements, including the summarized financial information, of publicly traded companies. We were required to adopt this guidance for our interim and annual reporting periods ending after June 15, 2009. At initial adoption we were not required to provide disclosures for periods presented for comparative purposes; comparative disclosures are required only for periods ending after initial adoption. The adoption of this guidance did not have a material impact on our consolidated financial statements.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**Subsequent Events**

Beginning with our June 30, 2009 Quarterly Report on Form 10-Q, we evaluate events that occur after the balance sheet date but before financial statements are issued to determine if a material event requires our amending the financial statements or disclosing the event. We are also required to disclose the date through which we evaluated subsequent events which is the date the financial statements are issued. These requirements are found in ASC 855, *Subsequent Events*.

We evaluated subsequent events through October 29, 2009, the date we issued these financial statements.

*Recently Issued Accounting Standards*

**Benefit Plans**

In December 2008, the FASB amended the requirements for our disclosures about the plan assets of our defined benefit pension or other postretirement plan. These disclosures include (a) how we make investment allocation decisions; (b) information about major categories of plan assets; (c) significant concentrations of risks within plan assets; and (d) fair value measurements of plan assets. Our effective date is December 31, 2009, and we are not required to present the disclosures for prior periods. We do not expect the adoption of these additional disclosures, found in ASC 715, *Compensation - Retirement Benefits*, to have a material impact on our financial statements.

**Consolidation**

In June 2009, the FASB amended ASC 810, *Consolidation*. We are now required to qualitatively assess the determination of our being the primary beneficiary ( consolidator ) of a variable interest entity ( VIE ) on whether we (1) have the power to direct matters that most significantly impact the activities of the VIE, and (2) have the obligation to absorb losses or the right to receive benefits of the VIE that could potentially be significant to the VIE. It also requires an ongoing reconsideration of the primary beneficiary and amends events that trigger a reassessment of whether an entity is a VIE. The new model is applicable to all new and existing VIE s. We are required to adopt this guidance beginning January 2010 and are currently assessing its impact on our consolidated financial statements.

**Transfers of Financial Assets**

In June 2009 the FASB amended ASC 860, *Transfers and Servicing* to clarify guidance for determining whether a transfer of a financial asset qualifies for sale accounting. The amendment also provides four broad disclosure objectives designed to provide users of the financial statements with an understanding of:

1. The transferor s continuing involvement with the transferred assets.
2. The nature of any restrictions on the transferor s assets that relate to a transferred financial asset, including the carrying amount of those assets.
3. How servicing assets and servicing liabilities are reported by the transferor.

4. How a transfer of financial assets affects the company's balance sheet, earnings, and cash flows.

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**GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

We are required to adopt this guidance prospectively to new transfers of financial assets beginning January 2010 and are currently assessing its impact on our consolidated financial statements.

**Fair Value Measurements and Disclosure**

In August 2009 the FASB issued ASU 2009-05 to provide clarification on measuring the fair value of liabilities under ASC 820, *Fair Value Measurements and Disclosure*. In circumstances in which a quoted price in an active market for the identical liability is not available we are required to measure fair value using one or more of the following techniques:

1. A valuation that uses:
  - a. The quoted price of the identical liability when traded as an asset.
  - b. Quoted market prices for similar liabilities or similar liabilities when traded as assets.
  
2. Another valuation technique that is consistent with the principles of ASC 820.

We are required to adopt the guidance on October 1, 2009. We do not expect the adoption to have a material impact on our financial statements.

**(3) Stock-Based Compensation**

In the three months ended September 30, 2008 and 2009, we recognized \$1.2 million and \$1.0 million, respectively, in stock-based compensation expense. A majority of the expense, \$1.1 million and \$0.9 million respectively, was recorded as selling and administrative expenses in the Consolidated Statement of Operations, with the remaining expenses incurred as cost of sales and research and development.

In the nine months ended September 30, 2008 and 2009, we recognized \$3.9 million and \$2.3 million, respectively, in stock-based compensation expense. A majority of the expense, \$3.6 million and \$2.2 million, respectively, was recorded as selling and administrative expenses in the Consolidated Statement of Operations, with the remaining expenses incurred as cost of sales and research and development.

As of September 30, 2009, the total compensation cost related to non-vested restricted stock and stock options not yet recognized was \$3.2 million, which will be recognized over the weighted average life of 1.0 years.

During 2008, we approved a performance share award program under our long-term incentive plan. Under this program, a maximum of 597,000 shares of performance shares, which represent the right to receive shares contingent upon the achievement of one or more performance measures, will be issued to eligible employees. These new awards are both service and performance based. Eligible employees must remain employed with the company for a three year period, which began in the first quarter of 2009, and also meet specific performance targets established for each year for the awards to vest. If performance targets are not met at a defined minimum level of 50% , the employees forfeit their awards for that specific annual grant. Employees are eligible to earn up to 150% of a specific annual grant based on actual performance compared to the performance targets applicable to that grant. The performance targets for 2009 were established in February 2009. We recognized expense of \$0.3 million in the nine months ended September 30, 2009 related to these awards, which assumes the 2009 targets will

be met at a 150% target level.

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Restricted stock activity under the plans for the nine months ended September 30, 2009 was as follows:

	Number of Shares	Weighted- Average Grant Date Fair Value
Outstanding unvested at January 1, 2009	640,152	\$ 9.05
Granted	418,290	8.71
Vested	(388,119)	9.18
Forfeited	(21,701)	11.70
Outstanding at September 30, 2009	648,622	\$ 8.67

Stock option activity under the plans for the nine months ended September 30, 2009 was as follows:

	Number of Shares	Weighted- Average Exercise Price
Outstanding at January 1, 2009	1,359,238	\$ 8.84
Granted	5,000	9.52
Vested		
Exercised	(14,200)	6.30
Forfeited	(14,000)	15.80
Outstanding at September 30, 2009	1,336,038	\$ 8.79

During the nine months ended September 30, 2009, we made payments under our 2008 employee incentive compensation plan to eligible employees. Our executive officers and certain members of senior management received 50% of their award in company stock. This resulted in the issuance of 592,536 shares of common stock.

**(4) Change in Accounting for Debentures**

As mentioned in Note 2, we were required to retrospectively change our method of accounting for the Debentures during the period they were outstanding to comply with ASC 470-20 which required us to separate the proceeds from the Debentures into two accounting components at issuance:

1. a debt component, representing the fair value of the Debentures as if they had no conversion rights, and



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2. an equity component, representing the difference between the proceeds from the issuance of the Debentures and the fair value of the debt component.

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**GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

*Initial Measurement Accounting*

We used an interest rate of 6.3531% to determine the fair value of the Debentures as if they had no conversion rights, which resulted in a fair value of \$165.6 million. The remaining \$59.4 million was recorded as additional paid-in capital and debt discount in our balance sheet. We also allocated the transaction costs to the liability and equity components in proportion to the allocation of proceeds and accounted for them as debt issuance costs and equity issuance costs, respectively.

The debt discount and debt issuance costs not allocated to equity were amortized over the period to the first conversion date (7 years) using the interest method and recorded as interest expense. Because the amounts allocated to equity were not deductible for income tax purposes, we recorded the tax effects as adjustments to additional paid-in capital.

*Redemption Accounting*

On May 30, 2008, we called for the redemption of the \$225.0 million outstanding principal amount of the Debentures. On June 13, 2008, the redemption date, the Debenture holders who exercised their conversion rights received 60.3136 shares of our common stock for each \$1,000 principal amount of Debentures on conversion, together with a make-whole payment totaling \$9.0 million, which represented the present value of all remaining scheduled payments of interest on the redeemed Debentures from the date of conversion through January 15, 2011.

We also made payment of \$0.2 million to the Debenture holders who did not exercise their conversion rights and opted to receive a redemption price in cash equal to 100% of the principal plus accrued but unpaid interest until the redemption date. These Debenture holders received the make-whole value in shares.

In accordance with ASC 470-20, we allocated the fair value (determined using an interest rate of 7.5178%) of the consideration transferred (13.6 million shares of common stock with an aggregate value of \$366.4 million) to the fair values of the debt component (\$194.7 million) and the equity component (\$171.7 million) immediately prior to the redemption. A \$4.1 million gain was recognized for the difference between the amount allocated to the debt component and the sum of the carrying amount of the debt, unamortized debt discount, and issuance costs at conversion. At redemption, we recorded additional valuation allowance of \$9.9 million as a result of the reduction of the deferred tax liability for the difference in debt discount and debt issuance costs expense recognized for financial and tax reporting.

*Effect of Restatement*

The effect of adopting this new guidance on our balance sheet at December 31, 2008, and our statement of operations for the nine months ended September 30, 2008 follows (dollars in thousands except per share data). There is no impact for the three months ended September 30, 2008, because the Debentures were extinguished on June 13, 2008.

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

	Previously reported	Retrospectively Adjusted
<b>Balance Sheet as of December 31, 2008</b>		
Additional paid-in capital	\$ 1,268,980	\$ 1,290,381
Accumulated deficit	(296,351)	(317,752)
<b>Statement of Operations for the nine months ended September 30, 2008</b>		
Gain on redemption		4,060
Interest expense	12,903	16,859
Income from continuing operations	235,227	235,331
Income taxes	59,489	69,392
Net income	175,738	165,939
Basic income per common share	1.61	1.52
Diluted income per common share	1.50	1.45

**(5) Earnings Per Share**

Basic and diluted EPS are calculated using the following data:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2008	2009	2008	2009
	<i>(In thousands, except share data)</i>			
Net income (loss) as reported	\$ 83,400	\$ 6,864	\$ 165,939	\$ (21,758)
Interest on Debentures, net of tax benefit			1,718	
Amortization of Debentures issuance costs, net of tax benefit			4,772	
Net income (loss), as adjusted	\$ 83,400	\$ 6,864	\$ 172,429	\$ (21,758)
Weighted average common shares outstanding for basic calculation	118,764,332	119,928,599	109,062,582	119,595,663
Add: Effect of stock options and restricted stock	1,200,796	787,656	1,497,424	
Add: Effect of Debentures			8,359,677	
Weighted average common shares outstanding for diluted calculation	119,965,128	120,716,255	118,919,683	119,595,663

Basic earnings per common share are calculated by dividing net income by the weighted average number of common shares outstanding. Diluted earnings per share are calculated by dividing net income, as adjusted, by the sum of the weighted average number of common shares outstanding plus the additional common shares that would have been outstanding if potentially dilutive securities had been issued.



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The calculation of weighted average common shares outstanding for the diluted calculation excludes consideration of stock options covering 64,451 in the three months ended September 30, 2009 and 49,566 in the three and nine months ended September 30, 2008, respectively, because the exercise of these options would not have been dilutive for those periods due to the fact that the exercise prices were greater than the weighted average market price of our common stock for each of those periods. There is no dilution for the nine months ended September 30, 2009 as we are in a net loss position for the period.

**(6) Segment Reporting**

Our businesses are reported in the following reportable segments:

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

**Engineered Solutions.** Engineered solutions include advanced graphite materials products for the transportation, solar, and oil and gas exploration industries, as well as natural graphite products.

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

The following tables summarize financial information concerning our reportable segments:

	<b>For the</b>		<b>For the</b>	
	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2008</b>	<b>2009</b>	<b>2008</b>	<b>2009</b>
	<i>(Dollars in thousands)</i>			
<b>Net sales to external customers:</b>				
Industrial materials	\$ 266,046	\$ 136,721	\$ 789,456	\$ 371,076
Engineered solutions	49,702	28,158	135,832	85,603
Total net sales	\$ 315,748	\$ 164,879	\$ 925,288	\$ 456,679
<b>Segment operating income:</b>				
Industrial materials	\$ 74,180	\$ 23,828	\$ 228,491	\$ 46,986
Engineered solutions	12,533	1,245	29,952	5,994
Total segment operating income	\$ 86,713	\$ 25,073	\$ 258,443	\$ 52,980
<b>Reconciliation of segment operating income to income (loss) before provision for income taxes:</b>				

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Equity in loss and write-down of investment in non-consolidated affiliate		953		54,343
Other expense (income), net	(16,919)	10,710	7,035	8,446
Interest expense	3,427	1,168	16,859	4,236
Interest income	(204)	(251)	(782)	(552)
Income (loss) before provision for income taxes	\$ 100,409	\$ 12,493	\$ 235,331	\$ (13,493)

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**GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**(7) Investment in and Loan to Non-Consolidated Affiliate**

*Acquisition*

On June 30, 2008, we acquired 100% of the common stock of Falcon-Seadrift Holding Corp., now named GrafTech Seadrift Holding Corp. ( GTSD ). The principal asset of GTSD is limited partnership units constituting approximately 18.9% of the equity interests of Seadrift Coke L.P. ( Seadrift ); a privately-held producer of needle coke, the primary raw material used in the manufacture of graphite electrodes. The substance of the transaction was the acquisition of an asset, the limited partnership units. The cost of our acquisition was \$136.5 million (net of \$0.4 million cash received) of which \$135.0 million was paid in cash.

*Write-down of Investment to Its Fair Value*

We perform an assessment of our investment in Seadrift for impairment whenever changes in the facts and circumstances indicate that a loss in value has occurred, which is other than temporary. Because Seadrift is privately-held, we determine the fair value using an income approach (based upon the present value of expected future cash flows using discount rates commensurate with the risks of the investment), Level 3 in accordance with the definition in ASC 820, *Fair Value Measurements and Disclosures*.

At December 31, 2008, we determined that the fair value of the investment was less than our carrying value and that the loss in value is other than temporary. We recorded a \$34.5 million noncash impairment to recognize this other than temporary loss in value. The fair value of Seadrift reflected reductions in the estimated future cash flows based on a lower expectation of tons shipped and reduced growth and profitability resulting primarily from the downturn in the economy.

At June 30, 2009, we determined that Seadrift's reported and projected operating losses were triggering events requiring us to assess if there was a loss in value that is other than temporary. The fair value of Seadrift reflected reductions in the estimated future cash flows based on a lower expectation of volume and reduced growth and profitability resulting primarily from the continued downturn in the economy. We determined that the fair value was less than our carrying value and that the loss in value was other than temporary. We recorded a \$52.8 million noncash impairment to recognize this other than temporary loss in value. Because the impairment reduced the difference between the carrying amount of our investment and its tax basis, we recorded a net tax benefit of \$7.4 million representing the net change of the deferred tax liability and the restoration of the valuation allowance recognized at the acquisition.

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**GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES**

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**(Unaudited)**

Given the current economic environment and the uncertainties regarding the impact on steel producers and their suppliers, including Seadrift, there can be no assurances that our estimates and assumptions regarding the fair value of Seadrift will prove to be accurate. If the assumptions regarding forecasted revenue, growth rates, and expected profitability are not achieved, we may be required to record additional impairment charges in future periods.

*Equity in Earnings (Losses) and Summarized Financial Information*

Our equity earnings are based on Seadrift's results of operations with a one-month lag because its accounting close cycle and preparation of financial statements occurs subsequent to our reporting deadline. We include an estimate for the effect of Seadrift's LIFO inventory accounting on interim periods. Seadrift reported net sales and net loss for the three months ended August 31, 2009 of \$12.8 million and \$2.4 million, respectively; and net sales and net income, adjusted for the LIFO impact recognized by the company in 2008, for the nine months ended August 31, 2009 of \$65.5 million and \$8.8 million, respectively.

Our statement of operations for the three months ended September 30, 2009 includes our equity in the losses of Seadrift on a one-month lag basis of \$0.5 million and the amortization of the difference between our cost of the investment and the net assets of Seadrift assigned to the long-lived assets of \$0.5 million. Our statement of operations for the nine months ended September 30, 2009 includes our equity in the income of Seadrift on a one-month lag basis of \$1.6 million and the amortization of the difference between our cost of the investment and the net assets of Seadrift assigned to the long-lived assets of \$3.2 million.

*Loan to Seadrift*

In late June and early July 2009, Seadrift entered into agreements to borrow up to \$17.0 million from certain of its shareholders, which includes GrafTech. We agreed to loan up to \$8.5 million and on July 2, 2009, we loaned Seadrift \$6.0 million. We recorded the loan at its face amount, which reasonably approximated the present value of the note. Seadrift has borrowed \$6.0 million from the other shareholders.

Borrowings under these agreements are evidenced by Senior Subordinated Non-Negotiable Demand Notes that are subordinate to Seadrift's revolving credit agreement. The Demand Notes cannot be repaid until all indebtedness under Seadrift's revolving credit agreement have been paid in full and the obligation to make any further loans or advances have ceased and terminated. The Demand Notes bear interest at 10%, payable quarterly in arrears commencing September 30, 2009. Seadrift also pays a 1% servicing fee to the lender at the time of a borrowing.



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

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

	For the		For the	
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2009	2008	2009
	<i>(Dollars in thousands)</i>			
Currency (gains) losses	\$ (18,522)	\$ 9,887	\$ (5,830)	\$ 6,509
Loss on extinguishment of debt	2,060	390	6,785	390
Gain on derecognition of Debentures			(4,060)	
Debenture make-whole payment			9,034	
(Gain) on sale of assets	(271)	(43)	(279)	(107)
Bank and other financing fees	560	445	1,543	1,381
Loss on the sale of accounts receivable	261	62	836	209
Other (income) expense	(1,007)	(31)	(994)	64
<b>Total other expense (income), net</b>	<b>\$ (16,919)</b>	<b>\$ 10,710</b>	<b>\$ 7,035</b>	<b>\$ 8,446</b>

We have non-dollar-denominated intercompany loans between GrafTech Finance and certain of our foreign subsidiaries. At December 31, 2008 and September 30, 2009, the aggregate principal amount of these loans was \$558.4 million and \$589.3 million, respectively (based on currency exchange rates in effect at such dates). These loans are subject to remeasurement gains and losses due to changes in currency exchange rates. Certain of these loans had been deemed to be essentially permanent prior to settlement and, as a result, remeasurement gains and losses on these loans were recorded as a component of accumulated other comprehensive loss in the stockholders' equity section of the Consolidated Balance Sheets. The loans remaining are deemed to be temporary and, as a result, remeasurement gains and losses on these loans are recorded as currency gains / losses in other income (expense), net, on the Consolidated Statements of Operations. For the three months ended September 30, 2008 and 2009, we had a net total of \$18.5 million of currency gains and \$9.9 million of currency losses, respectively, due to the remeasurement of intercompany loans and the effect of transaction gains and losses related to foreign subsidiaries whose functional currency is the US dollar. For the nine months ended September 30, 2008 and 2009, we had a net total of \$5.8 million of currency gains and \$6.5 million of currency losses, respectively, due to the remeasurement of intercompany loans and the effect of transaction gains and losses related to foreign subsidiaries whose functional currency is the US dollar.

In connection with the redemption of \$180 million of the outstanding principal of the Senior Notes during the nine months ended September 30, 2008, we incurred a \$6.8 million loss on the extinguishment of debt, which includes \$6.2 million related to the call premium and \$0.6 million of charges for the accelerated amortization of the debt issuance fees, terminated interest rate swaps and the premium related to the Senior Notes.

On September 28, 2009, we redeemed the remaining outstanding Senior Notes totaling \$19.9 million. We incurred a \$0.4 million loss on the extinguishment of the debt, which includes \$0.3 million related to the call premium and \$0.1 million of charges for the accelerated amortization of the debt issuance fees, terminated interest rate swaps, and premium related to the Senior Notes.

In connection with the conversion of our \$225.0 million of Convertible Senior Debentures in June 2008, we incurred a \$9.0 million charge related to the make-whole provision. This charge represented the present value of all remaining scheduled interest payments from the date of conversion through January 15, 2011. We also recorded a gain of \$4.1 million upon derecognition, as discussed in Note 4.



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

	<b>Pension Benefits</b>			
	<b>For the Three Months Ended September 30,</b>		<b>For the Nine Months Ended September 30,</b>	
	<b>2008</b>	<b>2009</b>	<b>2008</b>	<b>2009</b>
	<i>(Dollars in thousands)</i>			
Service cost	\$ 245	\$ 157	\$ 737	\$ 470
Interest cost	2,890	2,619	8,670	7,858
Expected return on plan assets	(3,254)	(2,909)	(9,763)	(8,728)
Amortization of transition obligation	(22)	2	(65)	5
Amortization of prior service cost	327	11	395	32
Amortization of unrecognized loss	497	319	1,492	957
Settlements			171	
Net cost	\$ 683	\$ 199	\$ 1,637	\$ 594

	<b>Post Retirement Benefits</b>			
	<b>For the Three Months Ended September 30,</b>		<b>For the Nine Months Ended September 30,</b>	
	<b>2008</b>	<b>2009</b>	<b>2008</b>	<b>2009</b>
	<i>(Dollars in thousands)</i>			
Service cost	\$ 120	\$ 86	\$ 360	\$ 272
Interest cost	553	537	1,661	1,644
Amortization of prior service benefit	785	(47)	121	(686)
Amortization of unrecognized loss	1,050	602	3,152	2,538
Curtailement gain		(644)		(644)
Net cost	\$ 2,508	\$ 534	\$ 5,294	\$ 3,124

We provide postretirement benefits for eligible retired employees – pooled participants, a closed group of retirees that existed under the former parent company; and non-pooled participants, GrafTech employees who began working prior to 2001 and remain working for us until retirement. Effective July 1, 2009, we amended our plan to eliminate the life insurance benefit for certain non-pooled participants. The effect of this amendment was to reduce our accumulated plan benefit by \$0.8 million, \$0.6 million of which was recognized as a reduction of the plan benefit cost in the three months ended September 30, 2009. The remaining \$0.2 million will be recognized as a reduction of net plan benefit cost over the actuarially determined remaining life expectancy of non-pooled participants.



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The following table presents our long-term debt:

	At December 31, 2008	At September 30, 2009
	<i>(Dollars in thousands)</i>	
Revolving Facility	\$ 30,000	\$
Senior Notes:		
Senior Notes due 2012	19,906	
Fair value adjustments for terminated hedge instruments	191	
Unamortized premium	38	
Total Senior Notes	20,135	
Other European debt:		
Principal	422	2,145
Unamortized debt discount		(651)
Total Other European debt	422	1,494
Total	\$ 50,557	\$ 1,494

Our \$215 million Revolving Facility matures in July 2010. The outstanding balance of \$5.0 million, which consists of borrowings with a maturity of less than 10 days, is classified as short-term debt in our Consolidated Balance Sheet at September 30, 2009.

During the nine months ended September 30, 2008, we redeemed a total of \$180 million of the outstanding principal amount of the 10<sup>1</sup>/<sub>4</sub>% Senior Notes, due 2012, at 103.417% plus accrued interest. On September 28, 2009, we redeemed all of the remaining outstanding Senior Notes, \$19.9 million, at 101.708% plus accrued interest. Total cash to redeem the Senior Notes approximated \$20.2 million. The expenses related to each redemption are discussed in Note 8.

On September 30, 2009, our Spanish subsidiary received a \$1.8 million economic stimulus loan from the Ministry of Industry, Government of Spain. The loan is non-interest bearing and matures in October 2024. Repayment in 10 annual installments commences in October 2015. The loan is to be used for costs associated with a capital project. We must return a proportionate amount of the loan if we do not spend the amount budgeted for the capital project prior to December 31, 2009. Since we have spent approximately 50% of the required amount as of September 30, 2009, the remaining 50% of the cash received is reported as restricted cash in our consolidated balance sheet. Because the loan is non-interest bearing, we are required to record the loan at its present value of \$1.1 million (determined using an interest rate of 4.33%). The difference between the proceeds received and the present value of the debt is recorded as debt discount and deferred expense. The discount will be amortized to income using the interest method; the deferred charge will be amortized to income using the same basis and over the same period as the capital project assets are depreciated.



**Table of Contents****PART I (CONT D)****GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited)****(11) Inventories**

Inventories are comprised of the following:

	At December 31, 2008	At September 30, 2009
	<i>(Dollars in thousands)</i>	
Inventories:		
Raw materials and supplies	\$ 130,615	\$ 97,285
Work in process	111,995	105,345
Finished goods	49,895	51,391
	292,505	254,021
Reserves	(2,108)	(2,219)
	\$ 290,397	\$ 251,802

ASC 330, *Inventory* requires us to recognize abnormal amounts of idle facility expense, freight, handling costs, and wasted materials (spoilage) as current period charges. ASC 330 also requires that we allocate fixed production overheads to the costs of conversion based on normal capacity of the production facilities. The unabsorbed costs were attributable to adjustments of fixed production overheads to the costs of conversion based on normal capacity versus actual levels, due to production levels being below normal capacity for each of the three quarters in 2009. Costs in excess of normal absorption at September 30, 2009 were \$7.1 million.

**(12) Interest Expense**

The following table presents an analysis of interest expense:

	For the Three Months Ended September 30, 2008		For the Nine Months Ended September 30, 2009	
	2008	2009	2008	2009
	<i>(Dollars in thousands)</i>			
Interest incurred on debt	\$ 3,052	\$ 778	\$ 10,883	\$ 3,080
Amortization of fair value adjustments for terminated hedge instruments	(28)	(13)	(144)	(39)
Amortization of premium on Senior Notes	(6)	(3)	(29)	(9)
Amortization of discount on Debentures			4,409	
Amortization of debt issuance costs	367	347	1,558	1,037
Interest incurred on other items	42	59	182	167
Total interest expense	\$ 3,427	\$ 1,168	\$ 16,859	\$ 4,236





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

Other comprehensive income consisted of the following:

	<b>For the Three Months Ended September 30,</b>		<b>For the Nine Months Ended September 30,</b>	
	<b>2008</b>	<b>2009</b>	<b>2008</b>	<b>2009</b>
	<i>(Dollars in thousands)</i>			
Net income (loss)	\$ 83,400	\$ 6,864	\$ 165,939	\$ (21,758)
Other comprehensive income:				
Foreign currency translation adjustments	(4,098)	(26,921)	(33,711)	(52,008)
Amortization of prior service costs and unrecognized gains and losses, net of tax \$0, \$616, \$0, and \$1,598, respectively	1,037	(1,305)	(1,405)	(3,105)
Natural gas derivatives and other, net of tax of \$0, \$535, \$0, \$565, respectively	(2,406)	283	(2,537)	(1,290)
Total comprehensive income	\$ 77,933	\$ (21,079)	\$ 128,286	\$ (78,161)

**(14) Contingencies**

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

*Product Warranties*

We generally sell products with a limited warranty. We accrue for known warranty claims if a loss is probable and can be reasonably estimated. We also accrue for estimated warranty claims incurred based on a historical claims charge analysis. The following table presents the activity in this accrual for the nine months ended September 30, 2009:

	<i>(Dollars in Thousands)</i>	
<b>Balance at January 1, 2009</b>	\$	913
Product warranty charges		1,533
Payments and settlements		(717)
<b>Balance at September 30, 2009</b>	\$	1,729

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**PART I (CONT D)**

**GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

*Brazil Federal Excise Tax*

Brazil has a federal excise tax (Imposto sobre Produtos Industrializados (IPI)) that applies for manufactured goods. The Brazilian Constitution provides a general basis for recognizing tax credits on the purchase of raw material used in production (IPI tax credit). Based on legal precedent, we recognized IPI tax credits in the aggregate amount of \$3.1 million. The Brazilian tax authority challenged the recording of IPI tax credits based on this legal precedent, litigated the issue, and the Federal Superior Court of Justice decided in their favor.

In May 2009, the Brazilian government announced a special program providing for extended payment terms and reductions in penalties and interest to encourage taxpayers to resolve disputed IPI tax credit amounts. During the third quarter 2009, we revised our estimate of the accrual based on the provisions of the law adopted to implement the program and recorded a credit of \$0.8 million in our Consolidated Statement of Operations. Our September 30, 2009 consolidated balance sheet includes an accrued liability of \$6.8 million which is the aggregate of the tax due, interest, penalty, and legal costs.

On October 13, 2009, the Brazilian government announced a special program providing for reductions in the tax due, penalty, interest, and legal costs if we elect a payment program of 12 months. We estimate that our liability could decrease up to \$3.0 million if we elect to participate. We have not made a decision about participation; we have until November 30, 2009, to decide.

**(15) Income Taxes**

We compute an estimated annual effective tax rate on a quarterly basis, considering ordinary income and related income tax expense. Ordinary income refers to income (loss) before income tax expense excluding significant, unusual, or infrequently occurring items. The tax effect of an unusual or infrequently occurring item is recorded in the interim period in which it occurs. These items may include the cumulative effect of changes in tax laws or rates, foreign exchange gains and losses, impairment charges, adjustments to prior period uncertain tax positions, and adjustments to our valuation allowance due to changes in judgment of the realizability of deferred tax assets.

The provision for income taxes for the three months ended September 30, 2009 and 2008 was a tax expense of \$5.6 million on pretax income of \$12.5 million, and a tax expense of \$17.0 million on pretax income of \$100.4 million. The effective tax rates were 44.8% and 16.9% for the three months ended September 30, 2009 and 2008, respectively. The increase in the effective tax rate is primarily due to jurisdictional shifts of income, currency fluctuations, withholding taxes on planned cash repatriation, and changes in the utilization of attributes and related valuation allowances.

The provision for income taxes for the nine months ended September 30, 2009 and 2008 was a tax expense of \$8.3 million on pretax loss of \$13.5 million and a tax expense of \$69.4 million on pretax income of \$235.2 million. The effective tax rates were 61.5% and 29.5% for the nine months ended September 30, 2009 and 2008, respectively. The effective tax rate for the nine months ended September 30, 2009 results from not fully realizing the benefit of the \$52.8 million Seadrift impairment charge, as described in note 7 above, due to the reestablishment of valuation allowances against tax attributes in the U.S.

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**PART I (CONT D)**

**GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

Our cumulative year-to-date unrecognized tax benefits have increased by \$8.4 million, primarily as a result of tax positions taken in a prior period. This would have an unfavorable impact on our effective tax rate, except for the fact that we are able to utilize attributes and release related valuation allowances to offset this amount. As of September 30, 2009, we had unrecognized tax benefits of \$19.2 million, which would have a favorable impact on our effective tax rate. It is reasonably possible that a reduction in a range of \$.5 million to \$1.0 million of unrecognized tax benefits may occur within 12 months as a result of the expiration of statutes of limitation.

We file income tax returns in the U.S. federal and state jurisdictions and various non-U.S. jurisdictions. We are currently under federal audit by the Internal Revenue Service for tax year 2007. All U.S. tax years prior to 2006 are closed by statute or have been audited and settled with the U.S. tax authorities. We are also under audit in Italy for our 2006 tax year. All other jurisdictions are still open to examination beginning after 2003.

Our tax provisions for the nine months ended September 30, 2009 and 2008 were primarily for taxes on our international income. We continue to adjust the tax provision rate through the establishment, or release, of non-cash valuation allowances attributable to the U.S. and certain non-U.S. taxing jurisdictions, including U.S. foreign tax credit utilization. We weigh both positive and negative evidence in determining whether a valuation allowance is required. Examples of positive evidence would include a strong earnings history, an event or events that would increase our taxable income through a continued reduction of expenses, and tax planning strategies that would indicate an ability to realize deferred tax assets. The balance of significant positive evidence does not yet outweigh the negative evidence in regards to whether or not a valuation allowance is required.

**(16) Derivative Instruments**

We use derivative instruments as part of our overall foreign currency and commodity risk management strategies to manage the risk of exchange rate movements that would reduce the value of our foreign cash flows and to minimize commodity price volatility. Foreign currency exchange rate movements create a degree of risk by affecting the value of sales made and costs incurred in currencies other than the US Dollar.

None of our derivative contracts contain provisions that would require us to provide collateral. Derivative contracts that we may enter into in the future may contain such provisions. Since the counterparties to these financial instruments are large commercial banks and similar financial institutions, we do not believe that we are exposed to material counterparty credit risk, despite the current worldwide economic situation. We do not anticipate nonperformance by any of the counter-parties to our instruments.

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## PART I (CONT D)

## GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

The fair value of all derivatives is recorded as assets or liabilities on a gross basis in our Consolidated Balance Sheets. At September 30, 2009 and December 31, 2008, the fair values of our derivatives and their respective balance sheet locations are presented in the following table:

	Asset Derivatives		Liability Derivatives	
	Location	Fair Value	Location	Fair Value
		<i>(Dollars in thousands)</i>		
<b>As of December 31, 2008</b>				
Derivatives designated as cash flow hedges:				
Foreign currency contracts	Other current assets	\$ 203		
Commodity forward contracts			Other current liabilities	\$ 1,511
Total fair value		\$ 203		\$ 1,511
<b>As of September 30, 2009</b>				
Derivatives designated as cash flow hedges:				
Foreign currency contracts	Other current assets	\$ 384		
Commodity forward contracts	Other current assets	96		
Total fair value		\$ 480		
Derivatives not designated as hedges:				
Foreign currency contracts			Other current liabilities	\$ 69
Total fair value				\$ 69

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## PART I (CONT D)

## GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

The location and amount of realized (gains) losses recognized in the Statement of Operations for derivatives are as follows for the three and nine months September 30, 2008 and 2009:

	Location of (Gain)/Loss Reclassified	Amount of (gain) Loss Recognized (Dollars in thousands)	
		2008	2009
<b>Three months ended September 30, 2009</b>	<b>from Other Comprehensive Income</b>		
Derivatives designated as cash flow hedges:			
Foreign currency contracts	Cost of goods sold / Other		
	(income)/expense	\$	\$ (621)
Commodity forward contracts	Cost of goods sold	562	405
	<b>Location of (Gain)/Loss Reclassified</b>		
<b>Nine months ended September 30, 2009</b>	<b>from Other Comprehensive Income</b>	<b>2008</b>	<b>2009</b>
Derivatives designated as cash flow hedges			
Foreign currency contracts	Cost of goods sold / Other		
	(income)/expense	\$	\$ (2,951)
Commodity forward contracts	Cost of goods sold	311	2,471

In 2008 and 2009, we entered into foreign exchange contracts as economic hedges of anticipated cash flows denominated in the Mexican peso and Brazilian real. These contracts were entered into to protect the risk that the eventual cash flows resulting from such transactions will be adversely affected by changes in exchange rates between the US Dollar and either the Mexican peso or Brazilian real. As of September 30, 2009, we had outstanding Mexican peso and Brazilian real forward exchange contracts, with aggregate notional amounts of \$4.0 million. The forward exchange contracts outstanding as of September 30, 2009 have several maturity dates ranging from October to December 2009.

Certain of our foreign currency contract and all of our commodity contracts are treated as hedges under ASC 815, *Derivatives and Hedging* and are required to be measured at fair value on a recurring basis. With respect to the inputs used to determine the fair value, we use observable, quoted rates that are determined by active markets and therefore, classify the contracts as Level 2 in accordance with the definition in ASC 820, *Fair Value Measurements and Disclosures*.

At September 30, 2009, we also had Euro-denominated contracts (4.5 million Euro) outstanding that were not accounted for as hedges. These contracts had a notional amount of \$6.5 million.

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**GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

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

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

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

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

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

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

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

**Forward Looking Statements and Risks.** This Report contains forward looking statements. In addition, we or our representatives have made or may make forward looking statements on telephone or conference calls, by webcasts or emails, in person, in presentations or written materials, or otherwise. These include statements about such matters as: expected future or targeted operational and financial performance; growth rates and future production and sales of products that incorporate or that are produced using our products; changes in production capacity in our operations and our competitors' or customers' operations and the utilization rates of that capacity; growth rates for, future prices and sales of, and demand for our products and our customers products; costs of materials and production, including anticipated increases or decreases therein, our ability to pass on any such increases in our product prices or surcharges thereon, or customer or market demand to reduce our prices due to such decreases; changes in customer order patterns due to changes in economic conditions; productivity, business process and operational initiatives, and their impact on us; our position in markets we serve; financing and refinancing activities; investments and acquisitions that we have made or may make in the future and the performance of the businesses underlying such acquisitions and investments; employment and contributions of key personnel; employee relations and collective bargaining agreements covering many of our operations; tax rates; capital expenditures and their impact on us; nature and timing of restructuring charges and payments; strategic plans and business projects; regional and global economic and industry market conditions, the timing and magnitude of changes in such conditions and the impact thereof; interest rate management activities; currency rate management activities; deleveraging activities; rationalization, restructuring, realignment, strategic alliance, raw material and supply chain, technology development and collaboration, investment, acquisition, venture, operational, tax, financial and capital projects; legal proceedings, contingencies, and environmental compliance;

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consulting projects; potential offerings, sales and other actions regarding debt or equity securities of us or our subsidiaries; and costs, working capital, revenues, business opportunities, debt levels, cash flows, cost savings and reductions, margins, earnings and growth. The words **will, may, plan, estimate, project, believe, anticipate, expect, intend, should, would, could, target, goal, continue** to the negatives thereof, identify some of these statements.

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

the possibility that the challenging global economic conditions which continue to prevail may continue to depress or further decrease the demand for electric arc furnace ( EAF ) steel which may, in turn, further decrease demand for our graphite electrodes;

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

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

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

the possibility that increases or decreases in manufacturing capacity (including growth by producers in developing countries) for our engineered solutions segment s products, competitive pressures (including changes in and the mix, distribution, and pricing of competitive products), technological development and changes in performance characteristics, increases or decreases in customer inventory levels, or other changes in the markets may occur, which may impact demand for, prices or unit and dollar volume sales of our engineered solutions products and growth or profitability of our engineered solutions business;

the possibility that, for all of our product lines, capital improvement and expansion in our customers operations and increases in demand for their products may not occur or may not occur at the rates that we anticipate or the demand for their products may decline, or may result in an increase in demand for the products we sell or supply to them;

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

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

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

the possibility that current challenging economic conditions and economic demand reduction may continue to impact our revenues and costs;

the possibility that decreases in prices for energy and raw materials may lead to downward pressure on prices for our products and delays in customer orders for our products as customers anticipate possible future lower prices;

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

the possibility that current economic disruptions may result in idling or closing of blast furnace capacity or delay of blast furnace capacity additions which may affect demand and prices for our refractory products;

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

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

the possibility of delays in or failure to achieve successful development and commercialization of new or improved engineered solutions or that such solutions could be subsequently displaced by other products or technologies;

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



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

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the possibility that the investments and acquisitions that we make or may make in the future may not be successfully integrated into our business or provide the performance or returns expected; the possibility that current global economic conditions and changes in the economy may materially impact the businesses underlying our acquisitions and investments, including their cash flow, liquidity, and sources of financing; the possibility that our investments and reported results may be materially impacted by the effect of such events on our acquisitions and investments; and that there may be further impairment of our investments;

the possibility that challenging conditions or changes in the capital markets will limit our ability to obtain capital or financing, including the renewal of our Revolving Facility which matures in July 2010, for growth and other initiatives, on acceptable terms or at all;

the possibility that conditions or changes in the global equity markets may have a material impact on our future pension funding obligations and liabilities on our balance sheet;

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

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

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

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

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

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

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the possibility that our outlook could be significantly impacted by, among other things, changes in United States or other monetary or fiscal policies or regulations in response to the capital markets crisis and its impact on global economic conditions, developments in the Middle East, North Korea, and other areas of concern, the occurrence of further terrorist acts and developments (including increases in security, insurance, data back-up, energy and transportation and other costs, transportation delays and continuing or increased economic uncertainty and weakness) resulting from terrorist acts and the war on terrorism;

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the possibility that our outlook could be significantly impacted by changes in demand as a result of the effect on customers of the volatility in global credit and equity markets;

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

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

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

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

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

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

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

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

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

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

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

For a more complete discussion of these and other factors, see [Risk Factors](#) in the Annual Report.

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

**Global Economic Conditions**

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

Global and regional economic conditions remained relatively stable in the first half of 2008. In September 2008 it became apparent that the global economy was entering into difficult times due to the financial industry crisis, which have continued into 2009. Credit markets became frozen, liquidity diminished, and business activity slowed at an extreme pace leading the global economy into its worst recession in 60 years.

Economists are forecasting that the worldwide recession has begun to ease as a result of wide-ranging government stimulus programs and intervention. Consensus among economists is that the pace of recovery will be slow as high unemployment continues.

As of September 2009, signs of a slow recovery in the steel industry began to emerge. Government stimulus programs around the world resulted in modest growth in several economies resulting in customers replenishing, rather than destocking their graphite electrode inventories in order to meet slightly higher utilization rates for steel production.

Compared to the same period last year, global utilization rates remain low. In the third quarter of 2009, steel mills restarted some idled capacity and utilization rates increased from the low levels of second quarter 2009. However, the utilization rates for 2009 remain considerably lower than for 2008.

Based on company market information and published reports, the year-to-date global steel capacity utilization is approximately 71% compared to 87% for the same period last year. The year-to-date global capacity utilization, excluding China, is approximately 62% compared to 90% for the same period last year. According to published reports, the United States steel industry operated at approximately 54% and 47% capacity utilization for the three and nine months ended September 30, 2009 compared to 88% utilization for both the three and nine months ended September 30, 2008.

Demand for our Industrial materials products is primarily linked with the global production of steel in an electric arc furnace and, to a lesser extent, with the total production of steel and certain other metals. Estimates are that during the three and nine months ended September 30, 2009, that global steel production, excluding China, decreased by 23% and 31% compared to the same periods last year. China's steel production increased by an estimated 20% and 7% during the three and nine months ended September 30, 2009. It is estimated that global steel production decreased by an estimated 7% and 17% for the three and nine months ended September 30, 2009 compared to the three and nine months ended September 30, 2008. The company projects that total steel production for the year 2009 will be approximately 1.1 billion metric tons, a reduction of approximately 12%.

EAF steel production has followed a similar trend as overall steel production. During the three and nine months ended September 30, 2009, it is estimated that EAF steel production, excluding China, decreased by 21% and 28% compared to the same periods last year. China's estimated EAF steel production increased by 20% and 7% during the three and nine months ended September 30, 2009. It is estimated that global EAF steel production decreased by 16% and 24%, for the three and six months ended September 30, 2009 compared to the three and nine months ended September 30, 2008. The company projects that total EAF steel production for the year 2009 will be approximately 325 million metric tons, a reduction of 20%.

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Generally, changes in graphite electrode demand have tracked changes in EAF steel production. Because there has been significant inventory destocking by EAF steel manufacturers, the recent reduction in graphite electrode demand has generally preceded the EAF steel production cuts. As a result, we believe that graphite electrode industry operating rates will be significantly lower than EAF steel industry operating rates during periods of inventory destocking. During the first half of 2009, many EAF steel customers delayed making new purchases in an effort to work down existing graphite electrode inventory levels. Based on recent market indicators, there are emerging signs that graphite electrode inventory destocking will be completed by the end of the year.

Because our engineered solutions business crosses many markets, the negative global economy impacts each market in varying degrees. We believe our engineered solutions products will be faced with reduced demand throughout 2009.

**Outlook**

Based on International Monetary Fund ( IMF ) projections and other economic forecasts, the global recession has begun to ease, driven by strength in Asian economies and unprecedented global government intervention. While stabilization has begun, end market demand remains far below pre-crisis levels and the pace of recovery is anticipated to be slow. As a result, steel producers continue to operate at low rates in order to match current market demand.

Third quarter results came in better than expected due to stronger than anticipated European steel operating rates as well as continued increases in steel operating rates in several other geographies. As a result, we believe customers in several geographies have completed their graphite electrode destocking activities earlier than initially expected and began reordering in the third quarter of 2009. Accordingly, we are increasing our 2009 full year operating guidance to reflect the improved third quarter of 2009 performance and anticipation of a solid fourth quarter of 2009.

While the global economy remains fragile; we continue to expect and improvement in the fourth quarter as customers will have largely completed inventory destocking initiatives and continue restocking.

Given global economic conditions, which have been and may continue to be volatile and uncertain, we expect the following full year 2009 results:

Operating income targeted to be in the range of \$80 million to \$85 million (previous guidance was \$60 million to \$70 million);

Capital expenditures approximate \$50 - \$55 million;

Depreciation expense to be in the range of \$32 million to \$34 million (previous guidance was approximately \$35 million); and

Cash flow from operations targeted to be approximately \$150 million.

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

**Results of Operations**

**Three Months Ended September 30, 2009 as Compared to Three Months Ended September 30, 2008.**

*Consolidated.* Net sales of \$164.9 million for the three months ended September 30, 2009 represented a \$150.8 million, or 47.8%, decrease from net sales of \$315.7 million for the three months ended September 30, 2008. Net sales for both of our operating segments decreased significantly, primarily due to reduced demand across all of our product lines. Volume decreases for our industrial materials segment accounted for \$149.2 million of this decrease, primarily due to our customers destocking their inventories in response to the significantly reduced demand for steel as compared to 2008. Our engineered solutions segment also had significant volume decreases, which totaled \$22.7 million. These decreases were slightly offset by favorable price/mix and other increases of \$21.7 million in the third quarter of 2009 compared to the third quarter of 2008. For the three months ended September 30, 2008, net sales for both of our operating segments had been favorably impacted by increased pricing and volumes. Most of our products, in particular our electrode and natural graphite product lines, experienced high demand and increased prices in the third quarter of 2008.

Cost of sales of \$118.2 million for the three months ended September 30, 2009 represented an \$83.6 million, or 41.4%, decrease from cost of sales of \$201.8 million for the three months ended September 30, 2008. Lower sales volumes drove \$84.0 million of this decrease across both of our segments in the three months ended September 30, 2009 compared to the three months ended September 30, 2008. Lower production costs and other operating costs, offset by unfavorable product mix, resulted in increased operating expenses \$0.4 million for the third quarter of 2009 compared to the third quarter of 2008. In 2008, cost of sales for both segments increased as a result of our higher sales volumes. We also experienced significant rising raw material prices, particularly our industrial materials segment, in the third quarter of 2008.

Gross profit of \$46.7 million for the three months ended September 30, 2009 represented a \$67.3 million, or 59.0%, decrease from gross profit of \$114.0 million for the three months ended September 30, 2008. Gross margin decreased to 28.3% of net sales, from 36.1% in the three months ended September 30, 2008 as a result of decreased sales and utilization of our factories.

Research and development expenses increased slightly to \$2.9 million for the three months ended September 30, 2009 compared to \$2.5 million for the three months ended September 30, 2008.

Selling and administrative expenses decreased \$6.2 million, or 25.0%, to \$18.6 million for the three months ended September 30, 2009 compared to \$24.8 million for the three months ended September 30, 2008. This decrease was caused by lower sales commissions as a result of lower sales and the impact of cost-saving measures enacted by the company, offset by slightly higher bad debt costs. We also reduced our liabilities for certain taxes in Brazil land taxes related to property sold and excise taxes on manufactured goods. In 2008 we had higher costs related to variable employee incentive plans as a result of our strong cash flow performance against established goal targets as well as for travel expenses due to increased travel by certain teams to analyze and implement cost-saving and lean initiatives world-wide.



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For the three months ended September 30, 2009, we recorded a \$1.0 million charge, which represents our equity in the losses of our non-consolidated affiliate.

Other expense was \$10.7 million for the three months ended September 30, 2009 compared to other income of \$16.9 million for three months ended September 30, 2008. For the three months ended September 30, 2009, we recognized \$9.9 million of currency losses compared to currency gains of \$18.5 in 2008. The currency gains and losses are primarily the result of our euro-denominated inter-company loans between GrafTech Finance and some of our foreign subsidiaries. During the three months ended September 30, 2009, we recognized a \$0.4 million loss on the redemption of the remaining \$19.9 million of our Senior Notes, and had miscellaneous other expenses of \$0.4 million. During the three months ended September 30, 2008, we recognized a loss of \$2.1 on the redemption of \$55 million of Senior Notes and had miscellaneous other income of \$0.5 million.

The following table presents an analysis of interest expense:

	<b>For the Three Months Ended September 30, 2008                      2009</b>	
	<i>(Dollars in thousands)</i>	
Interest incurred on debt	\$ 3,052	\$ 778
Amortization of fair value adjustments for terminated hedge instruments	(28)	(13)
Amortization of premium on Senior Notes	(6)	(3)
Amortization of debt issuance costs	367	347
Interest incurred on other items	42	59
 Total interest expense	 \$ 3,427	 \$ 1,168

Average debt outstanding (long-term debt and the outstanding Revolver) was \$40.7 million in the three months ended September 30, 2009 as compared to \$163.9 million in the three months ended September 30, 2008. The average annual interest rate for these instruments, excluding amortization of issuance costs and other similar non-cash charges, was 6.3% for the three months ended September 30, 2009 and 6.5% for the three months ended September 30, 2008. The average debt outstanding decreased in the three months ended September 30, 2009 compared to the three months ended September 30, 2008 due to the redemption of the \$19.9 million of outstanding Senior Notes on September 28, 2009 and by lower average Revolver Facility balances during the three months ended September 30, 2009.

The provision for income taxes for the three months ended September 30, 2009 and 2008 was a tax expense of \$5.6 million on pretax income of \$12.5 million, and a tax expense of \$17.0 million on pretax income of \$100.4 million. The effective tax rates were 44.8% and 16.9% for the three months ended September 30, 2009 and 2008, respectively. The increase in the effective tax rate is primarily due to jurisdictional shifts of income, currency fluctuations, withholding taxes on planned cash repatriation, and changes in the utilization of attributes and related valuation allowances.

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As a result of the matters described above, net income was \$6.9 million for the three months ended September 30, 2009 as compared to net income of \$83.4 million for the three months ended September 30, 2008.

*Segment net sales.* The following table represents our net sales by segment for the three months ended September 30, 2008 and 2009:

	<b>For the Three Months Ended September 30, 2008                      2009 (Dollars in thousands)</b>	
Industrial materials	\$ 266,046	\$ 136,721
Engineered solutions	49,702	28,158
<b>Total net sales</b>	<b>\$ 315,748</b>	<b>\$ 164,879</b>

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

	<b>Volume</b>	<b>Price/Mix</b>	<b>Currency</b>	<b>Net Change</b>
Industrial materials	(57)%	8%	0%	(49)%
Engineered solutions	(45)%	3%	(1)%	(43)%

Net sales for the industrial materials segment decreased significantly in the three months ended September 30, 2009 compared to the three months ended September 30, 2008, due to the sharp fall in demand for steel resulting from the global economic crisis and destocking of inventories by our steel customers. Our industrial materials net sales were not impacted by currency even though the US dollar weakened compared to the Euro. For the three months ended September 30, 2008, net sales for industrial materials segment were favorably impacted as a result of strong demand, particularly related to our graphite electrode products and the strengthening of the Euro. The weighted average selling price of our graphite electrodes has increased by approximately 15% in the three months ended September 30, 2009 compared to the three months ended September 30, 2008.

Net sales for engineered solutions decreased in the three months ended September 30, 2009 compared to the three months ended September 30, 2008, due to lower volumes across virtually all of our engineered solutions products. Currency rate fluctuations also had a slightly negative impact on sales, driven by the weakening of the US dollar compared to the Euro.

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*Segment operating net income.* The following table represents our operating income by segment for the three months ended September 30, 2008 and 2009:

	<b>For the Three Months Ended September 30, 2008      2009</b>	
	<i>(Dollars in thousands)</i>	
Industrial materials	\$ 74,180	\$ 23,828
Engineered solutions	12,533	1,245
<b>Total operating income</b>	<b>\$ 86,713</b>	<b>\$ 25,073</b>

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

	<b>Operating Costs and Expenses</b>		
	<b>For the Three Months Ended</b>		
	<b>September 30,</b>		
	<i>(Percentage of sales)</i>		
	<b>2008</b>	<b>2009</b>	<b>Change</b>
Industrial materials	72%	83%	11%
Engineered solutions	75%	96%	21%

Segment operating costs and expenses as a percentage of sales for industrial materials increased 11% percentage points in the three months ended September 30, 2009. However, in total, segment operating costs and expenses decreased \$79.0 million for the three months ended September 30, 2009 compared to the three months ended September 30, 2008. Operating expenses for this segment declined primarily due to lower sales volumes, which decreased costs by \$70.5 million for the entire segment. Selling and administration expenses, including allocated corporate costs, decreased \$4.8 million due to lower sales volumes and the continued impact of cost cutting measures. Other production costs, coupled with product mix changes, resulted in an additional \$3.7 million decrease to operating expenses in the three months ended September 30, 2009 compared to the three months ended September 30, 2008.

Segment operating costs and expenses as a percentage of sales for engineered solutions increased by 21% percentage points to 96%. However, total segment operating costs and expenses decreased by \$10.3 million. This decline was primarily the result of lower sales volumes, which decreased operating costs by \$13.5 million in the three months ended September 30, 2009 compared to the three months ended September 30, 2008. Selling and administration expenses, including allocated corporate costs, decreased \$0.9 million, driven primarily by a decrease in incentive costs for the segment in the three months ended September 30, 2009 compared to September 30, 2008. These decreases in costs were partially offset by raw material and production costs increases, coupled with product mix changes, which resulted in a \$4.1 million increase to operating expenses.

**Nine Months Ended September 30, 2009 as Compared to Nine Months Ended September 30, 2008.**

*Consolidated.* Net sales of \$456.7 million for the nine months ended September 30, 2009 represented a \$468.6 million, or 50.6%, decrease from net sales of \$925.3 million for the nine months ended September 30, 2008. Net sales for both of our operating segments decreased significantly, primarily due to lower demand resulting in lower volumes across all of our product lines. Volume decreases for our industrial materials segment accounted for \$466.1 million of this decrease, caused by the drastic declines in demand for steel in the nine months of 2009 compared to the nine months of 2008, due in part to inventory destocking by our steel customers. Our engineered solutions segment also had significant volume decreases, which totaled \$53.9 million. The strengthening of the US dollar compared to the Euro caused a further decrease in sales of \$9.3 million across both segments. These declines were offset in part by a net increase in price, change of mix and other of \$60.7 million for the nine months ended September 30, 2009, compared to the nine months ended September 30, 2008. For the nine months ended September 30, 2008, we experienced high demand for most of our products. We also were able to increase our graphite electrode selling prices to offset increases in raw material costs. Volumes increased in both our operating segments, with natural graphite products producing the largest percentage volume increase of all of our products.

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Cost of sales of \$332.2 million for the nine months ended September 30, 2009 represented a \$256.7 million, or 43.6%, decrease from cost of sales of \$588.9 million for the nine months ended September 30, 2008. Lower sales volumes drove \$257.4 million of this decrease across both of our segments, while currency impacts decreased cost of sales by \$18.8 million in the nine months ended September 30, 2009 compared to the nine months ended September 30, 2008. These costs of sales decreases were offset by a \$6.3 million charge recorded under the guidance of ASC 330, which was attributable to adjustments of fixed production overheads to the costs of conversion based on normal capacity versus actual levels, due to production levels well below normal capacity for the nine months ended September 30, 2009. Offsetting these decreases were unfavorable changes in product mix and operating expenses totaling \$13.2 million for the nine months ended September 30, 2009 compared to the nine months ended September 30, 2008. In addition to the increased volume experienced for the nine months ended September 30, 2008, we also experienced increased raw material and production costs.

Gross profit of \$124.4 million for the nine months ended September 30, 2009 represented a \$212.0 million, or 63.0%, decrease from gross profit of \$336.4 million for the nine months ended September 30, 2008. Gross margin decreased to 27.2% of net sales, from 36.4% for the nine months ended September 30, 2008.

Research and development expenses increased \$1.4 million to \$8.0 million for the nine months ended September 30, 2009 from \$6.6 million for the nine months ended September 30, 2008. This increase was primarily due to the write off of costs incurred on projects that we determined could not be billed or collected.

Selling and administrative expenses decreased \$7.7 million, or 10.8%, to \$63.3 million for the nine months ended September 30, 2009 compared to \$71.0 million for the nine months ended September 30, 2008. This decrease was caused by lower sales commissions as a result of lower sales and the impact of cost-saving measures enacted by the company, offset by higher bad debt costs of \$2.6 million. We also reduced our liabilities for certain taxes in Brazil – land taxes related to property sold and contested excise taxes on manufactured goods as a result of Brazilian government incentives. For the nine months ended September 30, 2008, we also had higher costs related to variable employee incentive plans due to our strong cash flow performance compared to established targets. Travel expenses were also higher due to increased travel by certain teams to analyze and implement cost-saving and lean initiatives world-wide.

During the nine months ended September 30, 2009, we recorded a \$54.3 million charge, which included an impairment charge of \$52.8 million, for our equity in losses related to our investment in a non-consolidated affiliate.

We recorded other expense of \$8.5 million for the nine months ended September 30, 2009 compared to other expense of \$7.0 million for nine months ended September 30, 2008. For the nine months ended September 30, 2009, we recognized \$6.5 million of currency losses compared to currency gains of \$5.8 for the same period in 2008. We also recognized a \$0.4 million loss on the redemption of the remaining \$19.9 million of Senior Notes, and miscellaneous other expenses of \$1.5 million in 2009. During the nine months ended September 30, 2008, we incurred a \$9.0 million charge for the Debenture make-whole payment and a \$4.0 million gain on the conversion. During the nine months ended September 30, 2008, we redeemed \$180 million of the outstanding principal of our Senior Notes, which resulted in a \$6.8 million loss on the extinguishment of debt.

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The following table presents an analysis of interest expense:

	<b>For the Nine Months Ended September 30, 2008                      2009</b>	
	<i>(Dollars in thousands)</i>	
Interest incurred on debt	\$ 10,883	\$ 3,080
Amortization of fair value adjustments for terminated hedge instruments	(144)	(39)
Amortization of premium on Senior Notes	(29)	(9)
Amortization of discount on Debentures	4,409	
Amortization of debt issuance costs	1,558	1,037
Interest incurred on other items	182	167
<b>Total interest expense</b>	<b>\$ 16,859</b>	<b>\$ 4,236</b>

Average debt outstanding (long-term debt and the outstanding Revolver) was \$60.4 million in the nine months ended September 30, 2009 as compared to \$275.5 million in the nine months ended September 30, 2008. The average annual interest rate for these instruments, excluding amortization of issuance costs and other similar non-cash charges, was 5.1% for the nine months ended September 30, 2009 and 5.2% for the nine months ended September 30, 2008. The average debt outstanding decreased in the nine months ended September 30, 2009 compared to the nine months ended September 30, 2008 due to the redemption of the \$19.9 million of outstanding Senior Notes on September 28, 2009, and the lower average Revolver Facility balances.

The provision for income taxes for the nine months ended September 30, 2009 and 2008 was a tax expense of \$8.3 million on pretax loss of \$13.5 million and a tax expense of \$69.4 million on pretax income of \$235.3 million. The effective tax rates were 61.5% and 29.5% for the nine months ended September 30, 2009 and 2008, respectively. The effective tax rate for the nine months ended September 30, 2009 results from not fully realizing the benefit of the \$52.8 million Seadrift impairment charge due to the reestablishment of valuation allowances against tax attributes in the U.S.

As a result of the matters described above, we had a net loss was \$21.8 million for the nine months ended September 30, 2009 as compared to net income of \$165.9 million for the nine months ended September 30, 2008.

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*Segment net sales.* The following table represents our net sales by segment for the nine months ended September 30, 2008 and 2009:

	<b>For the Nine Months Ended September 30, 2008                      2009 (Dollars in thousands)</b>	
Industrial materials	\$ 789,456	\$ 371,076
Engineered solutions	135,832	85,603
<b>Total net sales</b>	<b>\$ 925,288</b>	<b>\$ 456,679</b>

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

	<b>Volume</b>	<b>Price/Mix</b>	<b>Currency</b>	<b>Net Change</b>
Industrial materials	(59)%	7%	(1)%	(53)%
Engineered solutions	(40)%	5%	(2)%	(37)%

Net sales for the industrial materials segment decreased significantly in the nine months ended September 30, 2009 compared to the nine months ended September 30, 2008, due to the sharp fall in demand for steel resulting from the global economic crisis and destocking of inventories by our steel customers. Currency rate fluctuations also had a negative impact on sales, driven by the strengthening of the US dollar compared to the Euro. These decreases were offset slightly by an increase in price/mix. The weighted average selling price of our graphite electrodes has increased by approximately 12% in the nine months ended September 30, 2009 compared to the nine months ended September 30, 2008.

Net sales for engineered solutions decreased in the nine months ended September 30, 2009 compared to the nine months ended September 30, 2008, due to lower volumes across virtually all of our engineered solutions products. Currency rate fluctuations also had a negative impact on sales, driven by the strengthening of the US dollar compared to the Euro. These decreases were offset slightly by an increase in price/mix, primarily related to our advanced graphite materials products.

*Segment operating net income.* The following table represents our operating income by segment for the six months ended September 30, 2008 and 2009:

	<b>For the Nine Months Ended September 30, 2008                      2009 (Dollars in thousands)</b>	
Industrial materials	\$ 228,491	\$ 46,986
Engineered solutions	29,952	5,994
<b>Total operating income</b>	<b>\$ 258,443</b>	<b>\$ 52,980</b>





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

	<b>Operating Costs and Expenses</b>		
	<b>For the Nine Months Ended</b>		
	<b>September 30,</b>		
	<i>(Percentage of sales)</i>		
	<b>2008</b>	<b>2009</b>	<b>Change</b>
Industrial materials	71%	87%	16%
Engineered solutions	78%	93%	15%

Segment operating costs and expenses as a percentage of sales for industrial materials increased 16% percentage points in the nine months ended September 30, 2009. However, total segment operating costs and expenses decreased \$236.9 million for the nine months ended September 30, 2009 compared to the nine months ended September 30, 2008. Operating expenses for this segment declined primarily due to lower sales volumes, which decreased costs by \$224.8 million for the entire segment. The strengthening of the US Dollar across certain currencies, decreased costs an additional \$16.7 million. These cost decreases were partially offset by a \$6.3 million charge required by ASC 330, which was attributable to adjustments of fixed production overheads to the costs of conversion based on normal capacity versus actual levels, due to production levels well below normal capacity. Increased raw material and production costs, coupled with product mix changes, resulted in an additional \$1.7 million increase to operating expenses in the nine months ended September 30, 2009 compared to the nine months ended September 30, 2008.

Segment operating costs and expenses as a percentage of sales for engineered solutions increased by 15% percentage points to 93%. However, total segment operating costs and expenses decreased by \$26.3 million. This decline was primarily the result of lower sales volumes, which decreased operating costs by \$32.6 million in the nine months ended September 30, 2009 compared to the nine months ended September 30, 2008. Selling and general expenses, including allocated corporate costs, decreased by \$0.8 million, driven primarily due to lower employee incentive costs for the nine months ended September 30, 2009 compared to September 30, 2008. These decreases in costs were partially offset by material and production costs increases, coupled with product mix changes, which resulted in a \$7.1 million increase to operating expenses.

**Effects of Changes in Currency Exchange Rates**

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

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

During the nine months ended September 30, 2009, the average exchange rate of the Brazilian real, the euro, Mexican peso and South African rand weakened compared to the US dollar approximately 18.6%, 10.2%, 23.0% and 10.8% respectively, when compared to the average exchange rate for the same period in 2008.

In the case of net sales of industrial materials, the impact of these events was a decrease of about \$6.7 million in the nine months ended September 30, 2009 as compared to the same period in 2008. In the case of cost of sales of industrial materials, the impact of these events was a decrease of about \$16.7 million in the nine months ended September 30, 2009 as compared to the same period in 2008.

We have non-dollar-denominated intercompany loans between GrafTech Finance and certain of our foreign subsidiaries. At December 31, 2008 and September 30, 2009, the aggregate principal amount of these loans was \$558.4 million and \$589.3 million, respectively (based on currency exchange rates in effect at such dates). These loans are subject to remeasurement gains and losses due to changes in currency exchange rates. Certain of these loans had been deemed to be essentially permanent prior to settlement and, as a result, remeasurement gains and losses on these loans were recorded as a component of accumulated other comprehensive loss in the stockholders' equity section of the Consolidated Balance Sheets. The loans remaining are deemed to be temporary and, as a result, remeasurement gains and losses on these loans are recorded as currency gains / losses in other income (expense), net, on the Consolidated Statements of Operations. For the three months ended September 30, 2008 and 2009, we had a net total of \$18.5 million of currency gains and \$9.9 million of currency losses, respectively, due to the remeasurement of intercompany loans and the effect of transaction gains and losses related to foreign subsidiaries whose functional currency is the US dollar. For the nine months ended September 30, 2008 and 2009, we had a net total of \$5.8 million of currency gains and \$6.5 million of currency losses, respectively, due to the remeasurement of intercompany loans and the effect of transaction gains and losses related to foreign subsidiaries whose functional currency is the US dollar. To manage certain exposures to specific financial market risks caused by changes in currency exchange rates, we may use various financial instruments as described under Item 3 Quantitative and Qualitative Disclosures about Market Risk.

**Liquidity and Capital Resources**

Global capital markets have been, and continue to be, disrupted and volatile. The cost and availability of funding has been and may continue to be adversely affected by illiquid credit markets. We believe that we have adequate liquidity to meet all of our present needs. Continued turbulence in the United States and international financial markets, however, could adversely affect the cost and availability of financing to us in the future.

Our sources of funds have consisted principally of cash flow from operations and debt financings. Our uses of those funds (other than for operations) have consisted principally of capital expenditures, our equity investment in and loan to our non-consolidated affiliate, payment of restructuring costs, pension and post-retirement contributions, debt reduction payments and payments of other obligations. During the second quarter of 2009, we paid out \$18.1 million under our employee incentive compensation plan (\$3.7 million of which was paid in company stock).

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At September 30, 2009, we had short-term debt of \$10.3 million, of which \$5.0 million was outstanding under our Revolving Facility; long-term debt of \$1.5 million; cash and cash equivalents of \$8.7 million; and stockholders' equity of \$546.9 million.

As part of our cash management activities, we manage accounts receivable credit risk, collections, and accounts payable vendor terms to maximize our free cash at any given time and minimize accounts receivable losses. In the three and nine months ended September 30, 2009, certain subsidiaries sold receivables totaling \$8.4 million and \$32.1 million, respectively. Proceeds of the sale of receivables are used to reduce debt and to fund operations. If we had not sold receivables, our accounts receivable and our debt would have been about \$25.4 million higher at December 31, 2008 and about \$9.4 million higher at September 30, 2009. All receivables sold during 2008 and 2009 were sold without recourse, and no amount of accounts receivable sold remained on the Consolidated Balance Sheets at December 31, 2008 and September 30, 2009.

Lower sales volumes for our products and reduced credit quality of our customers may limit the amount of receivables that we sell in the future. Our current receivable sales facility automatically renews for a one year period on June 30, 2010 and each year thereafter unless a termination notice is sent by either party 30 days prior to the applicable date.

During the second half of 2008, we entered into a supply chain financing arrangement with a financing party. Under this arrangement, we essentially assigned our rights to purchase needle coke from our supplier to the financing party. The financing party purchases the product from our supplier under the standard payment terms and then immediately resells it to us under longer payment terms. The financing party pays the supplier the purchase price for the product and then we pay the financing party. Our payment for this needle coke will include a mark up (the Mark-Up). The Mark-Up is subject to quarterly reviews. In effect, we have a longer period of time to pay the financing party than by purchasing directly from the supplier which helps us maintain a balanced cash conversion cycle between inventory payments and the collection of receivables. During the nine months ended September 30, 2009, we purchased \$10.5 million of needle coke under this arrangement, and made payments of \$56.1 million, including \$0.6 million related to the Mark-Up. The majority of this payment, \$50.6 million, related to purchases of inventory made in 2008. In September 2009 we arranged for the financing party to purchase \$5.1 million of needle coke under this arrangement; payment by us is due in December 2009.

Lower demand for our products may continue to diminish our need for needle coke. As such, we may not utilize this financing arrangement to the full extent allowed under the agreement. This agreement automatically renewed for one year on August 28, 2009 and automatically renews for one year periods beginning August 28, 2010 and each year thereafter for a maximum of three years unless a termination notice is sent by either party 90 days prior to the applicable date.

In the event that operating cash flow, the sales of receivables and the financing of needle coke purchases fail to provide sufficient liquidity to meet our business needs, including capital expenditures, we anticipate that any such shortfall would be made up by increased borrowings available under our Revolving Facility.

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We use cash and cash equivalents, cash flow from operations, funds from receivable factoring arrangements and funds available under the Revolving Facility (subject to continued compliance with the financial covenants and representations under the Revolving Facility) as well as cash on hand as our primary sources of liquidity. The Revolving Facility is secured and provides - subject to certain conditions (including a maximum senior secured leverage ratio test) - for maximum borrowings of up to \$215.0 million. Additionally, the facility has an accordion feature that permits GrafTech Finance to establish incremental credit facilities thereunder in an aggregate amount, together with the Revolving Facility, of up to \$425 million, if certain additional conditions are met (including a maximum senior secured leverage ratio test). Although we are currently in compliance with such additional conditions, given the current economic environment, we are uncertain if we would be able to fully utilize this feature. Eleven banks are participants in our credit facility. All of these eleven banks currently have Standard & Poor's ratings of A- or better. Based on these ratings, we do not foresee a significant risk that our availability under this current facility may be reduced due to the financial positions of the lenders.

Our Revolving Facility matures in July 2010. We believe that our credit and economic conditions will reasonably allow us to extend or refinance the Revolving Facility before such date. However, we cannot assure that we will be able to do so, or that the conditions of such refinancing will be comparable to current conditions, especially if financial markets conditions deteriorate further.

At September 30, 2009, \$5.0 million was outstanding under the Revolving Facility, and \$204.2 million was available (after consideration of outstanding revolving and swingline loans of \$5.0 million and letters of credit of \$5.8 million). It is possible that our future ability to borrow under the Revolving Facility may effectively be less because of the impact of additional borrowings upon our compliance with the maximum net senior secured debt leverage ratio permitted or minimum interest coverage ratio required under the Revolving Facility.

We also have approximately \$100 million of working capital liquidity available to us through our factoring and supply chain financing arrangements currently in place. However, we may be unable to fully utilize this amount due to lower accounts receivable balances, reduced credit ratings of our customers, or decreased inventory purchases.

As of September 30, 2009, we had a corporate Standard & Poor's rating of BB- and a Moody's rating of Ba2. The improvement to our balance sheet was recognized by Standard & Poor's which placed our corporate rating on positive watch. Standard & Poor's positive credit watch means that their assessment of our rating may be raised. However, continued weakness in the global economy, the termination of our accounts receivable factoring program or the termination of our supply chain financing agreement may result in higher borrowings on our Revolving Facility, which could negatively impact our rating.

At September 30, 2009, we were in compliance with all applicable financial and other covenants contained in the Revolving Facility. These covenants include maintaining an interest coverage ratio of at least 1.75 and a maximum senior secured leverage ratio of 2.25 based on a rolling average of the prior four quarters. Based on expected operating results and expected cash flows, we expect to be in compliance with these covenants over the next twelve months. If we were to believe that we would not continue to comply with these covenants, we would seek an appropriate waiver or amendment from the lenders thereunder. We cannot assure you that we would be able to obtain such waiver or amendment on acceptable terms or at all.

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Borrowings under the Revolving Facility had the following effective interest rates: revolving loans - 1.8% at September 30, 2009 compared to 2.9% at December 31, 2008; swingline loans - 3.75% at September 30, 2009 and December 31, 2008. In September 2009 we redeemed all of our outstanding Senior Notes which had a fixed interest rate of 10.25%. At September 30, 2009, 90% (or \$10.6 million) of our total debt consists of variable rate obligations.

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

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

Typically, our cash flow from operations fluctuates significantly between quarters due to various factors. These factors include customer order patterns, fluctuations in working capital requirements, and other factors.

We expect cash flow from operations to be positively impacted by reduced cash interest payments of about \$15 million, on an annual basis compared to 2008, related to our Senior Note obligations having been redeemed in 2009 and the retirement during 2008 of the Debentures, lower inventory balances, and decreases in cash outlays for restructuring activities. We expect our cash flow from operations to be negatively impacted by lower sales, higher raw material prices, payment of certain international deferred taxes, post retirement contributions, and severance payments.

Our debt and other obligations could have a material impact on our liquidity. Cash flow from operations and borrowings under our Revolving Facility services payment of our debt and other obligations, thereby reducing funds available to us for other purposes. Although our current debt level is relatively low, continued or further downturns in the global economy may require increased borrowings under our Revolving Facility, particularly if our accounts receivable and supply chain financing arrangements are terminated or the level of our receivables or purchases do not result in borrowing capacity under such arrangements. Such downturns could significantly negatively impact our results of operations and cash flows, which, coupled with increased borrowings, could negatively impact our credit ratings, our ability to comply with debt covenants, our ability to secure additional financing and the cost of such financing, if available.

Based on expected operating results and expected cash flows, we expect to be in compliance with applicable financial covenants for the remainder of 2009.

In order to seek to minimize our credit risks, we reduced our sales of, or refused to sell (except for cash on delivery), our products to some customers and potential customers. In the current economic environment, our customers may experience liquidity shortages or difficulties in obtaining credit, including letters of credit. We cannot assure you that we will not be materially adversely affected by accounts receivable losses in the future. In addition, we have historically factored a portion of our accounts receivable and used the proceeds to reduce debt. Our ability to factor accounts receivable in the future may be limited by lower receivables balances as a result of decreased sales or by reduced credit ratings of customers.

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On September 28, 2009, we redeemed the remaining outstanding balance of our Senior Notes which approximated \$19.9 million. During the nine months ended September 30, 2008, we redeemed a total of \$180 million of our Senior Notes. There are no Senior Notes outstanding at September 30, 2009.

We occasionally enter into natural gas derivative contracts and short duration fixed rate purchase contracts to effectively fix some or all of our natural gas cost exposure, as described under "Quantitative and Qualitative Disclosure about Market Risks" in this Report. At September 30, 2009, these contracts represented an asset of \$0.1 million.

We occasionally enter into foreign currency exchange contracts to hedge our exposure against the Mexican Peso and the Brazilian Real. At September 30, 2009, these contracts represented an asset of \$0.4 million.

*Cash Flow Provided by Operating Activities.* Cash flow provided by operating activities was \$121.7 million in the nine months ended September 30, 2009 as compared to \$169.3 million in the nine months ended September 30, 2008, a decrease of \$47.6 million.

Cash provided by net income, after adding back the effect of non-cash items, was \$79.1 million for the nine months ended September 30, 2009. We incurred a \$54.3 million charge related to the equity in losses and write-down of investment in our non-consolidated affiliate. Other non-cash charges included depreciation and amortization of \$23.9 million, \$6.7 million of pension and post-retirement plan changes, interest expense of \$1.0 million, stock-based compensation of \$6.0 million, and other charges of \$14.7 million. We also had a non-cash credit of \$10.8 million for deferred income tax provision. These non-cash charges were slightly offset by currency gains of \$5.1 million. During the nine months ended September 30, 2009, we received \$0.1 million of dividends from our non-consolidated affiliate, and used cash of \$5.3 million to reduce certain of our long-term liabilities. Working capital provided cash of \$47.7 million for the nine months ended September 30, 2009, due primarily to a \$48.2 decrease in accounts receivable, including the effects of factoring, and a \$62.8 million decrease in inventories. These sources of cash were offset by a \$61.8 million decrease in accounts payable and accruals, and a \$1.5 million net decrease in interest payable, prepaid and other assets, and restructuring payments.

Cash provided by net income, after adding back the effect of non-cash items, was \$201.8 million for the nine months ended September 30, 2008. Non-cash items included \$26.7 million of depreciation and amortization, \$4.1 million gain on the redemption of the Debentures, \$7.8 million of foreign currency gains, primarily from intercompany loans, \$7.5 million in interest expense, a \$10.2 million provision for deferred income taxes, \$3.9 million of stock based compensation expense, \$6.7 million of pension and post-retirement plan changes and a use of \$7.3 million for other items. Changes in working capital used cash flow of \$29.6 million for the nine months ended September 30, 2008, due primarily to a \$36.5 million increase in accounts receivable, including the effects of factoring, driven by higher sales in the nine months ended September 30, 2008. Other working capital uses of cash were an \$11.0 million increase in inventories, a \$0.7 million increase in prepaid assets, \$0.9 million of restructuring payments, and an \$8.8 million decrease in interest payable. These uses of cash were offset by a \$28.4 million increase in accounts payable and accrued expenses. Also affecting cash flows from operations for the nine months ended September 30, 2008 was an increase in long-term assets and liabilities of \$3.0 million.

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*Cash Flow Used in Investing Activities.* Cash flow used in investing activities was \$47.0 million in the nine months ended September 30, 2009 compared to \$183.3 million in the nine months ended September 30, 2008.

In the nine months ended September 30, 2009, capital expenditures were \$40.5 million, a loan to our non-consolidated affiliate was \$6.0 million, restricted cash increased \$1.0 million related to non-interest bearing loan from the Spanish government for capital expenditures, and \$0.5 million of cash was provided from the settlement of derivative instruments and the sale of assets.

In the nine months ended September 30, 2008, investing activities used cash of \$183.3 million. We used a net \$136.4 million of cash to purchase our equity investment of Seadrift Coke LP. Capital expenditures used an additional \$47.6 million of cash, while the proceeds from derivative instruments resulted in a \$0.3 million increase. The uses of cash were offset slightly by changes in restricted cash totaling \$0.1 million and proceeds from the sale of assets of \$0.3 million

*Cash Flow Used in Financing Activities.* Cash flow used in financing activities was \$78.8 million in the nine months ended September 30, 2009, compared to cash used by financing activities of \$28.4 million in the nine months ended September 30, 2008.

During the nine months ended September 30, 2009, we repaid a net \$30.5 million under our Revolving Facility, and had other short-term borrowings of \$0.8 million. We also repaid \$30.1 million for needle coke purchases under our supply chain financing arrangement. We made payments on long-term debt totaling \$20.0 million which included the redemption of the remaining outstanding balance of our Senior Notes of \$19.9 million. We received proceeds of \$1.8 million from a zero interest loan from the Spanish government for capital expenditures. We also had other sources of financing activities totaling \$0.8 million.

During the nine months ended September 30, 2008, we redeemed \$180 million of our Senior Notes, and borrowed a net \$109.8 million under the Revolving Facility, primarily to fund our investment in our non-consolidated affiliate. Other short-term borrowings were \$11.6 million, which related primarily to bank overdrafts at our international locations. We used these borrowings primarily to fund working capital requirements and for capital expenditures. We also purchased \$21.2 million of treasury shares during the nine months ended September 30, 2008. Other long-term financing obligations used cash of \$0.3 million. These uses of cash were offset by proceeds from the exercise of stock options of \$36.9 million, and excess tax benefit from stock-based compensation of \$14.3 million.

**Restrictions on Dividends and Stock Repurchases**

A description of the restrictions on our ability to pay dividends and our ability to repurchase common stock is set forth under Part II, Item 5 Dividend Policies and Restrictions in the Annual Report and such description is incorporated herein by reference, except for the reference to the restrictions of the Senior Notes. These restrictions are no longer applicable as a result of our redemption of the remaining balance of our Senior Notes on September 28, 2009. Such description contains all of the information required with respect thereto.

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**Recent Accounting Pronouncements**

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

**Description of Our Financing Structure**

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

**Proceedings Against Us**

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



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

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

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

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

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

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

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

***Currency Rate Management.*** We enter into foreign currency instruments from time to time to attempt to manage exposure to changes in currency exchange rates. These foreign currency instruments, which include, but are not limited to, forward exchange contracts and purchased currency options, attempt to hedge global currency exposures, net, relating to non-dollar denominated debt and identifiable foreign currency receivables, payables and commitments held by our foreign and domestic subsidiaries. Forward exchange contracts are agreements to exchange different currencies at a specified future date and at a specified rate. Purchased foreign currency options are instruments, which give the holder the right, but not the obligation, to exchange different currencies at a specified rate at a specified date or over a range of specified dates. Forward exchange contracts and purchased currency options are carried at market value. The outstanding contracts at September 30, 2009 and December 31, 2008 represented net unrealized gains of \$0.3 million and \$0.2 million, respectively.

***Commercial Energy Rate Management.*** We periodically enter into natural gas derivative contracts and short duration fixed rate purchase contracts to effectively fix some or all of our natural gas cost exposure. The outstanding contracts at December 31, 2008 represented an unrealized loss of \$1.5 million. The outstanding contracts at September 30, 2009 represented an unrealized gain of \$0.1 million.

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

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



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**PART I (CONT D)**

**GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

*Sensitivity Analysis.* We used a sensitivity analysis to assess the potential effect of changes in currency exchange rates on gross margin and changes in interest rates on interest expense. Based on this analysis, a hypothetical 10% weakening or strengthening in the dollar across all other currencies would have changed our reported gross margin for the nine months ended September 30, 2009 by about \$10.2 million. Based on this analysis, a hypothetical increase in interest rates of 100 basis points would have increased our interest expense by \$0.1 million for the nine months ended September 30, 2009.

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**PART I (CONT D)**

**GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**Item 4. Controls and Procedures**

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

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we have evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of September 30, 2009. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that these controls and procedures are effective at the reasonable assurance level as of September 30, 2009.

*Changes in Internal Controls over Financial Reporting.* There have been no changes in our internal controls over financial reporting that occurred during the three months ended September 30, 2009 that materially affected or are reasonably likely to materially affect our internal controls over financial reporting.

**Table of Contents****PART II. OTHER INFORMATION****GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES****Item 1. Legal Proceedings**

The information required in response to this Item is set forth under *Contingencies* in Note 14 to the Notes to Consolidated Financial Statements contained in this Report, and such description is incorporated herein by reference.

**Item 6. Exhibits**

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

**Exhibit**

<b>Number</b>	<b>Description of Exhibit</b>
31.1	Certification pursuant to Rule 13a-14(a) under the Exchange Act by Craig S. Shular, Chief Executive Officer, President and Chairman of the Board.
31.2	Certification pursuant to Rule 13a-14(a) under the Exchange Act by Mark R. Widmar, Vice President and Chief Financial Officer.
32.1	Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 by Craig S. Shular, Chief Executive Officer, President and Chairman of the Board.
32.2	Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 by Mark R. Widmar, Vice President and Chief Financial Officer.
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

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**SIGNATURE**

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

**GRAFTECH INTERNATIONAL LTD.**

Date: October 29, 2009

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

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**EXHIBIT INDEX**

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