

W R GRACE & CO
Form 10-Q
November 08, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

☒ X

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

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2007

OR

☐ O

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

Commission File Number 1-13953

W. R. GRACE & CO.

Delaware
(State of Incorporation)

65-0773649
(I.R.S. Employer
Identification No.)

7500 Grace Drive

Columbia, Maryland 21044

(410) 531-4000

(Address and phone number of

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principal executive offices)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes ☒

No ☐

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

Large accelerated filer ☐

Accelerated filer ☒

Non-accelerated filer ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes ☐

No ☒

70,409,225 shares of Common Stock, \$0.01 par value, were outstanding at October 31, 2007.

W. R. GRACE & CO. AND SUBSIDIARIES

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PART I. FINANCIAL INFORMATION

Item 1. FINANCIAL STATEMENTS

Review by Independent Registered Public Accounting Firm

A review of the interim consolidated financial statements included in this Quarterly Report on Form 10-Q for the three and nine months ended September 30, 2007 and 2006 has been performed by PricewaterhouseCoopers LLP, the company's independent registered public accounting firm. Their report on the interim consolidated financial statements follows. This report is not considered a report within the meaning of Sections 7 and 11 of the Securities Act of 1933, and, therefore, the independent accountants' liability under Section 11 does not extend to it.

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Report of Independent Registered Public Accounting Firm

To the Shareholders and Board of Directors of W. R. Grace & Co.:

We have reviewed the accompanying consolidated balance sheet of W. R. Grace & Co. and its subsidiaries as of September 30, 2007, and the related consolidated statements of operations, shareholders' equity (deficit) and comprehensive income (loss) for each of the three-month and nine-month periods ended September 30, 2007 and September 30, 2006 and the consolidated statements of cash flows for the nine-month periods ended September 30, 2007 and September 30, 2006. These interim financial statements are the responsibility of the Company's management.

We conducted our review in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the accompanying interim consolidated financial statements for them to be in conformity with accounting principles generally accepted in the United States of America.

The accompanying interim consolidated financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Notes 1 and 2 to the interim consolidated financial statements, on April 2, 2001, the Company and substantially all of its domestic subsidiaries voluntarily filed for protection under Chapter 11 of the United States Bankruptcy Code, which raises substantial doubt about the Company's ability to continue as a going concern in its present form. Management's intentions with respect to this matter are also described in Notes 1 and 2. The accompanying interim consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet as of December 31, 2006, and the related consolidated statements of operations, cash flows, shareholders' equity (deficit) and comprehensive income (loss) for the year then ended, management's assessment of the effectiveness of the Company's internal control over financial reporting as of December 31, 2006 and the effectiveness of the Company's internal control over financial reporting as of December 31, 2006; and in our report dated March 1, 2007, we expressed (i) an unqualified opinion on those consolidated financial statements with an explanatory paragraph relating to the Company's ability to continue as a going concern and, (ii) unqualified opinions on management's assessment of the effectiveness of the Company's internal control over financial reporting and on the effectiveness of the Company's internal control over financial reporting. The consolidated financial statements and management's assessment of the effectiveness of internal control over financial reporting referred to above are not presented herein. In our opinion, the information set forth in the accompanying consolidated balance sheet as of December 31, 2006, is fairly stated in all material respects in relation to the consolidated balance sheet from which it has been derived.

/s/ PricewaterhouseCoopers LLP
McLean, Virginia
November 8, 2007

W. R. Grace & Co. and Subsidiaries

Consolidated Statements of Operations (Unaudited)

In millions, except per share amounts

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006
Net sales	\$ 783.1	\$ 741.4	\$ 2,311.5	\$ 2,129.1
Cost of goods sold, exclusive of depreciation and amortization shown separately below	518.4	483.6	1,531.0	1,391.4
Selling, general and administrative expenses, exclusive of net pension expense and depreciation and amortization shown separately below	142.6	149.4	408.5	420.7
Depreciation and amortization	28.3	29.2	83.5	85.7
Research and development expenses	19.5	14.9	55.0	44.3
Net pension expense	13.1	15.9	38.9	47.5
Interest expense and related financing costs	17.4	18.8	57.1	54.5
Provision for environmental remediation			12.0	30.0
Chapter 11 expenses, net of interest income	21.3	12.0	62.7	32.2
Other (income) expense, net	(4.9)	(6.3)	(20.6)	(22.1)
	755.7	717.5	2,228.1	2,084.2
Income (loss) before income taxes and minority interest	27.4	23.9	83.4	44.9
Benefit from (provision for) income taxes	(7.4)	2.4	(31.6)	(5.4)
Minority interest in consolidated entities	(3.3)	(7.9)	(9.8)	(26.2)
Net income (loss)	\$ 16.7	\$ 18.4	\$ 42.0	\$ 13.3
Basic earnings (loss) per share:				
Net income (loss)	\$ 0.24	\$ 0.27	\$ 0.60	\$ 0.20
Weighted average number of basic shares	70.2	68.3	69.9	67.7
Diluted earnings (loss) per share:				
Net income (loss)	\$ 0.23	\$ 0.27	\$ 0.59	\$ 0.20
Weighted average number of diluted shares	71.5	68.5	71.5	68.1

The Notes to Consolidated Financial Statements are an integral part of these statements.

W. R. Grace & Co. and Subsidiaries

Consolidated Statements of Cash Flows (Unaudited)

In millions

	Nine Months Ended September 30,	
	2007	2006
OPERATING ACTIVITIES		
Net income (loss)	\$ 42.0	\$ 13.3
Reconciliation to net cash provided by (used for) operating activities:		
Depreciation and amortization	83.5	85.7
Chapter 11 expenses, net of interest income	62.7	32.2
(Benefit from) provision for income taxes	31.6	5.4
Income taxes paid, net of refunds	(35.8)	(36.2)
Minority interest in consolidated entities	9.8	26.2
Dividends paid to minority interests in consolidated entities	(12.0)	(0.1)
Interest accrued on pre-petition liabilities subject to compromise	56.2	53.1
Net (gain) loss on sales of investments and disposals of assets	(2.8)	(2.6)
Net pension expense	38.9	47.5
Payments under defined benefit pension arrangements	(85.5)	(109.5)
Payments under postretirement benefit plans	(4.6)	(10.7)
Net income from life insurance policies	(3.0)	(2.2)
Provision for uncollectible receivables	(0.4)	3.2
Provision for environmental remediation	12.0	30.0
Expenditures for environmental remediation	(7.1)	(8.7)
Expenditures for retained obligations of divested businesses	(0.8)	(2.7)
Changes in assets and liabilities, excluding effect of businesses acquired/divested and foreign currency translation:		
Working capital items (trade accounts receivable, inventories and accounts payable)	(45.4)	(59.7)
Other accruals and non-cash items	(7.3)	17.0
Net cash provided by (used for) operating activities before Chapter 11 expenses and settlements	132.0	81.2
Cash paid to resolve contingencies subject to Chapter 11	(10.3)	
Chapter 11 expenses paid	(55.9)	(31.8)
Net cash provided by (used for) operating activities	65.8	49.4
INVESTING ACTIVITIES		
Capital expenditures	(89.8)	(82.5)
Purchase of marketable securities	(25.0)	
Purchase of equity investment	(6.3)	
Proceeds from sales of investments and disposals of assets	5.5	7.3
Proceeds from sale of product line	21.8	
Businesses acquired, net of cash acquired	(5.5)	(20.0)
Net investment in life insurance policies	(1.2)	0.2
Net cash provided by (used for) investing activities	(100.5)	(95.0)
FINANCING ACTIVITIES		
Net payments of loans secured by cash value of life insurance policies	(0.1)	(0.1)
Net (repayments) borrowings under credit arrangements	0.7	0.5
Fees under debtor-in-possession credit facility	(2.0)	(1.8)
Proceeds from exercise of stock options	20.2	15.8
Net cash provided by (used for) financing activities	18.8	14.4
Effect of currency exchange rate changes on cash and cash equivalents	14.6	10.2
Increase (decrease) in cash and cash equivalents	(1.3)	(21.0)

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Cash and cash equivalents, beginning of period		536.3		474.7
Cash and cash equivalents, end of period	\$	535.0	\$	453.7

The Notes to Consolidated Financial Statements are an integral part of these statements.

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W. R. Grace & Co. and Subsidiaries

Consolidated Balance Sheets

In millions, except par value and shares

	September 30, 2007 (Unaudited)	December 31, 2006
ASSETS		
Current Assets		
Cash and cash equivalents	\$ 535.0	\$ 536.3
Marketable securities	28.5	3.3
Trade accounts receivable, less allowance of \$5.6 (2006 - \$6.6)	492.9	426.3
Inventories	298.7	284.6
Deferred income taxes	38.8	37.8
Other current assets	77.1	80.5
Total Current Assets	1,471.0	1,368.8
Properties and equipment, net of accumulated depreciation and amortization of \$1,565.1 (2006 - \$1,510.5)	681.2	664.5
Goodwill	120.8	116.5
Cash value of life insurance policies, net of policy loans	93.5	89.2
Deferred income taxes	716.4	728.5
Asbestos-related insurance	500.0	500.0
Overfunded defined benefit pension plans	71.3	38.4
Other assets	140.2	131.5
Total Assets	\$ 3,794.4	\$ 3,637.4
LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIT)		
Liabilities Not Subject to Compromise		
Current Liabilities		
Debt payable within one year	\$ 4.1	\$ 3.3
Accounts payable	191.8	172.7
Other current liabilities	324.4	272.6
Total Current Liabilities	520.3	448.6
Debt payable after one year	0.3	0.2
Deferred income taxes	54.6	58.9
Minority interest in consolidated entities	62.7	65.0
Underfunded and unfunded defined benefit pension plans	258.3	349.6
Other liabilities	40.2	43.3
Total Liabilities Not Subject to Compromise	936.4	965.6
Liabilities Subject to Compromise Note 2		
Pre-petition debt plus accrued interest	787.2	739.5
Accounts payable	31.7	31.7
Income tax contingencies	99.1	141.2
Asbestos-related contingencies	1,700.0	1,700.0
Environmental contingencies	366.0	361.1
Postretirement benefits	166.4	158.9
Other liabilities and accrued interest	113.4	89.2
Total Liabilities Subject to Compromise	3,263.8	3,221.6
Total Liabilities	4,200.2	4,187.2
Commitments and Contingencies		

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Shareholders' Equity (Deficit)

Common stock issued, par value \$0.01; 300,000,000 shares authorized; outstanding: 2007	70,227,725		
(2006 68,915,022)		0.8	0.8
Paid-in capital		428.4	423.8
Accumulated deficit		(443.4)	(487.6)
Treasury stock, at cost: shares: 2007 - 6,752,035; (2006 - 8,064,738)		(80.4)	(96.0)
Accumulated other comprehensive income (loss)		(311.2)	(390.8)
Total Shareholders' Equity (Deficit)		(405.8)	(549.8)
Total Liabilities and Shareholders' Equity (Deficit)	\$	3,794.4	\$ 3,637.4

The Notes to Consolidated Financial Statements are an integral part of these statements.

W. R. Grace & Co. and Subsidiaries

Consolidated Statements of Shareholders Equity (Deficit) (Unaudited)

In millions

	Common Stock and Paid-in Capital	Accumulated Deficit	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total Shareholders Equity (Deficit)
Balance, June 30, 2007	\$ 429.5	\$ (460.1)	\$ (81.5)	\$ (337.3)	\$ (449.4)
Net income (loss)		16.7			16.7
Stock plan activity	(0.3)		1.1		0.8
Other comprehensive income (loss)				26.1	26.1
Balance, September 30, 2007	\$ 429.2	\$ (443.4)	\$ (80.4)	\$ (311.2)	\$ (405.8)
Balance, December 31, 2006	\$ 424.6	\$ (487.6)	\$ (96.0)	\$ (390.8)	\$ (549.8)
Cumulative effect of adoption of FASB Interpretation No. 48		2.2			2.2
Balance, January 1, 2007	\$ 424.6	\$ (485.4)	\$ (96.0)	\$ (390.8)	\$ (547.6)
Net income (loss)		42.0			42.0
Stock plan activity	4.6		15.6		20.2
Other comprehensive income (loss)				79.6	79.6
Balance, September 30, 2007	\$ 429.2	\$ (443.4)	\$ (80.4)	\$ (311.2)	\$ (405.8)

W. R. Grace & Co. and Subsidiaries

Consolidated Statements of Comprehensive Income (Loss) (Unaudited)

In millions

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006
Net income (loss)	\$ 16.7	\$ 18.4	\$ 42.0	\$ 13.3
Other comprehensive income (loss):				
Foreign currency translation adjustments	19.8	8.3	34.4	22.9
Gain (loss) from hedging activities, net of income taxes	(0.2)	(0.4)	(0.3)	(0.7)
Defined benefit pension and other postretirement plans, net of income taxes	6.5		45.5	
Total other comprehensive income (loss)	26.1	7.9	79.6	22.2
Comprehensive income (loss)	\$ 42.8	\$ 26.3	\$ 121.6	\$ 35.5

The Notes to Consolidated Financial Statements are an integral part of these statements.

W. R. Grace & Co. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

1. Basis of Presentation and Summary of Significant Accounting and Financial Reporting Policies

W. R. Grace & Co., through its subsidiaries, is engaged in specialty chemicals and specialty materials businesses on a worldwide basis through two operating segments: Grace Davison, which includes silica- and alumina-based catalysts and materials used in a wide range of industrial applications; and Grace Performance Chemicals, which includes specialty chemicals and materials used in commercial and residential construction and in rigid food and beverage packaging.

W. R. Grace & Co. conducts substantially all of its business through a direct, wholly-owned subsidiary, W. R. Grace & Co.-Conn. (Grace-Conn.). Grace-Conn. owns substantially all of the assets, properties and rights of W. R. Grace & Co. on a consolidated basis, either directly or through subsidiaries.

As used in these notes, the term *Company* refers to W. R. Grace & Co. The term *Grace* refers to the Company and/or one or more of its subsidiaries and, in certain cases, their respective predecessors.

Voluntary Bankruptcy Filing During 2000 and the first quarter of 2001, Grace experienced several adverse developments in its asbestos-related litigation, including: a significant increase in personal injury claims, higher than expected costs to resolve personal injury and certain property damage claims, and class action lawsuits alleging damages from Zonolite Attic Insulation (*ZAI*) a former Grace attic insulation product.

After a thorough review of these developments, the Board of Directors concluded that a federal court-supervised bankruptcy process provided the best forum available to achieve fairness in resolving these claims and on April 2, 2001 (the *Filing Date*), Grace and 61 of its United States subsidiaries and affiliates, including Grace-Conn. (collectively, the *Debtors*), filed voluntary petitions for reorganization (the *Filing*) under Chapter 11 of the United States Bankruptcy Code in the United States Bankruptcy Court for the District of Delaware (the *Bankruptcy Court*). The cases were consolidated and are being jointly administered under case number 01-01139 (the *Chapter 11 Cases*). Grace's non-U.S. subsidiaries and certain of its U.S. subsidiaries were not included in the Filing.

Under Chapter 11, the Debtors have continued to operate their businesses as debtors-in-possession under court protection from creditors and claimants, while using the Chapter 11 process to develop and implement a plan for addressing the asbestos-related claims. Since the Filing, all motions necessary to conduct normal business activities have been approved by the Bankruptcy Court. (See Note 2 for Chapter 11-Related Information.)

Basis of Presentation The interim Consolidated Financial Statements presented herein are unaudited and should be read in conjunction with the Consolidated Financial Statements presented in the Company's 2006 Annual Report on Form 10-K. Such interim Consolidated Financial Statements reflect all adjustments that, in the opinion of management, are necessary for a fair presentation of the results of the interim periods presented; all such adjustments

are of a normal recurring nature. Potential accounting adjustments discovered during normal reporting and accounting processes are evaluated on the basis of materiality, both individually and in the aggregate, and are recorded in the accounting period discovered, unless a restatement of a prior period is necessary. All significant intercompany accounts and transactions have been eliminated.

The results of operations for the nine-month interim period ended September 30, 2007 are not necessarily indicative of the results of operations for the year ending December 31, 2007.

Reclassifications Certain amounts in prior years Consolidated Financial Statements have been reclassified to conform to the 2007 presentation. Such reclassifications have not materially affected previously reported amounts in the Consolidated Financial Statements.

Use of Estimates The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires that management make estimates and assumptions affecting the assets and liabilities reported at the date of the Consolidated Financial Statements, and the revenues and expenses reported for the periods presented. Actual amounts could differ from those estimates, and the differences could be material. Changes in estimates are recorded in the period identified. Grace's accounting measurements that are most affected by management's estimates of future events are:

Contingent liabilities which depend on an assessment of the probability of loss and an estimate of ultimate resolution cost, such as asbestos-related matters (see Notes 2 and 3), environmental remediation (see Note 12), income taxes (see Note 4), and litigation (see Note 12);

Pension and postretirement liabilities that depend on assumptions regarding participant life spans, future inflation, discount rates and total returns on invested funds (see Note 13); and

Realization values of net deferred tax assets and insurance receivables, which depend on projections of future income and cash flows and assessments of insurance coverage and insurer solvency.

The accuracy of management's estimates may be materially affected by the uncertainties arising under Grace's Chapter 11 proceeding.

Effect of New Accounting Standards In June 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48), which prescribes a recognition threshold and measurement attribute for tax positions taken or expected to be taken in tax returns. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. Grace adopted FIN 48 effective in the first quarter of 2007. See Note 4 for a discussion of the impact of the adoption of FIN 48.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*. SFAS No. 159 permits entities to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. SFAS No. 159 is effective for the first quarter of 2008, and Grace is currently evaluating the impact on its financial statements of adopting SFAS No. 159.

In September 2006, the FASB Emerging Issues Task Force (EITF) promulgated Issue No. 06-4, *Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements*. This Issue specifies that if a company provides a benefit to an employee under an endorsement split-dollar life insurance arrangement that extends to postretirement periods, it would have to recognize a liability and related compensation costs. In November 2006, the EITF promulgated Issue No. 06-10, *Accounting for Deferred Compensation and Postretirement Benefit Aspects of Collateral Assignment Split-Dollar Life Insurance Arrangement*. EITF 06-10, among other things, extends the guidance in EITF 06-4 to collateral assignment split-dollar life insurance arrangements. Grace will adopt EITF 06-4 and EITF 06-10 effective in the first quarter of 2008, and has not yet assessed the impact of these Issues on its Consolidated Financial Statements.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements. SFAS No. 157 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. Grace will adopt SFAS No. 157 effective in the first quarter of 2008, and has not yet assessed the estimated impact on its Consolidated Financial Statements.

2. Chapter 11-Related Information

Official Parties to Grace's Chapter 11 Proceedings Three creditors' committees, two representing asbestos claimants, the Official Committee of Asbestos Personal Injury Claimants (the PI Committee) and the Official Committee of Asbestos Property Damage Claimants (the PD Committee) and the third representing other unsecured creditors, and a committee representing

shareholders, have been appointed in the Chapter 11 Cases. These committees, and a legal representative of future asbestos claimants (the FCR), have the right to be heard on all matters that come before the Bankruptcy Court and have important roles in the Chapter 11 Cases. The Debtors are required to bear certain costs and expenses of the committees and of the FCR, including those of their counsel and financial advisors.

Plan of Reorganization On November 13, 2004 Grace filed a plan of reorganization, as well as several associated documents, including a disclosure statement, with the Bankruptcy Court. On January 13, 2005, Grace filed an amended plan of reorganization (the Plan) and related documents to address certain objections of creditors and other interested parties. The Plan is supported by committees representing general unsecured creditors and equity holders, but is not supported by the PI Committee, the PD Committee or the FCR.

Under the terms of the Plan, a trust would be established under Section 524(g) of the Bankruptcy Code to which all pending and future asbestos-related claims would be channeled for resolution. The Plan contemplates that the Bankruptcy Court will conduct hearings to determine, among other things, the amount that would need to be paid into the trust on the effective date of the Plan to satisfy Grace's asbestos-related liabilities and trust administration costs and expenses over time. The Plan provides that Grace's asbestos-related liabilities would be satisfied using cash and securities from Grace and third parties.

The Plan will become effective only after a vote of eligible creditors and with the approval of the Bankruptcy Court and the U.S. District Court for the District of Delaware. Votes on the Plan may not be solicited until the Bankruptcy Court approves the disclosure statement. The Bankruptcy Court has currently deferred consideration of the disclosure statement and Plan until after completion of hearings on the amount of Grace's asbestos-related liability (see Note 3).

Under the terms of the Plan, claims would be satisfied under the Chapter 11 Cases as follows:

Asbestos-Related Claims and Costs

Under the Plan, a trust would be established under Section 524(g) of the Bankruptcy Code to which all pending and future asbestos-related claims would be channeled for resolution. The trust would utilize specified trust distribution procedures to satisfy the following allowed asbestos-related claims and costs:

Personal injury claims that meet specified exposure and medical criteria (Personal Injury-Symptomatic Eligible or PI-SE Claims) In order to qualify for this class, claimants would have to prove that their health is impaired from meaningful exposure to asbestos-containing products formerly manufactured by Grace.

Personal injury claims that do not meet the exposure and medical criteria necessary to qualify as PI-SE Claims (Personal Injury-Asymptomatic and Other or PI-AO Claims) This class would contain all asbestos-related personal injury claims against Grace that do not meet the specific requirements to be PI-SE Claims, but do meet certain other specified exposure and medical criteria.

Property damage claims, including claims related to ZAI (PD Claims) In order to qualify for this class, claimants would have to prove Grace liability for loss of property value or remediation costs related to products formerly manufactured by Grace that claimants allege contained asbestos.

Trust administration costs and legal expenses

The pending asbestos-related legal proceedings are described in Asbestos-Related Litigation (see Note 3). The claims arising from such proceedings would be subject to this classification process as part of the Plan.

The Bankruptcy Court has entered separate case management orders for estimating liability for pending and future personal injury claims and adjudicating pending property damage claims, excluding ZAI claims. A trial for estimating liability for personal injury claims is currently scheduled to begin in the first quarter of 2008. The Debtors expect that the estimated liability for all asbestos-related claims may provide the basis for determining the amount to be paid into a trust on the effective date of a plan of reorganization.

Under the Plan, asbestos personal injury claimants, including both PI-SE and PI-AO claims, would have the option either to litigate their claims against the trust in federal court in Delaware or, if they meet specified eligibility criteria, accept a settlement amount based on the severity of their condition. Under the Plan, asbestos property damage claimants would be required to present allowed claims to the trust or litigate their claims against the trust in federal court in Delaware. The Plan provides that, as a condition precedent to confirmation, the maximum estimated aggregate funding amount for all asbestos-related liabilities (PI-SE, PI-AO and PD including ZAI) and trust administration costs and expenses as determined by the Bankruptcy Court cannot exceed \$1,613 million, which Grace believes would fund over \$2 billion in claims, costs and expenses over time.

The PI-SE Claims, the PD Claims and the related trust administration costs and expenses would be funded with (1) a payment of \$512.5 million in cash (plus interest at 5.5% compounded annually from December 21, 2002) and 18 million shares (reflecting a two-for-one stock split) of common stock of Sealed Air Corporation (Sealed Air) to be made directly by Cryovac, Inc., a wholly owned subsidiary of Sealed Air (Cryovac), to the asbestos trust pursuant to the terms of a settlement agreement resolving asbestos-related, successor liability and fraudulent transfer claims against Sealed Air and Cryovac and (2) Grace common stock. The number of shares of Grace common stock required to satisfy these claims will depend on the price of Grace common stock on the effective date of the Plan, liability measures approved by the Bankruptcy Court, and the value of the Sealed Air settlement, which changes daily with the accrual of interest and the trading value of Sealed Air common stock. The Sealed Air settlement agreement has been approved by the Bankruptcy Court, but remains subject to the fulfillment of specified conditions.

The PI-AO Claims would be funded with warrants exercisable for that number of shares of Grace common stock which, when added to the shares issued directly to the trust on the effective date of the Plan, would represent 50.1% of Grace's voting securities. If the common stock issuable upon exercise of the warrants is insufficient to pay all PI-AO Claims (the liability for which is uncapped under the Plan), then Grace would pay any additional liabilities in cash.

Under the Plan, the amounts to fund PI-SE Claims, PD Claims and the expense of trust administration would be capped at the amount determined by the Bankruptcy Court. Amounts required to fund PI-AO Claims would not be capped, so if the amount funded in respect thereof later proved to be inadequate, Grace would be responsible for contributing additional funds into the asbestos trust to satisfy PI-AO Claims. Because of the number and nature of the uncertainties involved, Grace is unable to determine the extent to which, if any, the liability under the Plan for PI-AO claims may exceed the amount funded into the trust in respect thereof.

Other Claims

The Plan provides that all allowed administrative or priority claims would be paid 100% in cash and all general unsecured claims, other than those covered by the asbestos trust, would be paid 85% in cash and 15% in Grace common stock. Grace estimates that claims with a recorded value of approximately \$1,312 million, including interest accrued through September 30, 2007, would be satisfied in this manner at the effective date of the Plan. Grace would finance these payments with cash on hand, cash from Fresenius Medical Care Holdings, Inc. (Fresenius) paid in settlement of asbestos and other Grace-related claims, new Grace debt, and Grace common stock. Grace would satisfy other

non-asbestos related liabilities and claims (primarily certain environmental, tax, pension and retirement medical obligations) as they become due and payable over time using cash flow from operations, insurance proceeds from policies and settlement agreements covering asbestos-related liabilities, and new credit facilities. Proceeds from available product liability insurance applicable to asbestos-related claims would supplement operating cash flow to service new debt and liabilities not paid on the effective date of the Plan.

Effect on Grace Common Stock

The Plan provides that Grace common stock will remain outstanding at the effective date of the Plan, but that the interests of existing shareholders would be subject to dilution by additional shares of common stock issued under the Plan. In addition, in order to preserve significant tax benefits from net operating loss carryforwards (NOLs) and certain future deductions, which are subject to elimination or limitation in the event of a change in control (as defined by the Internal Revenue Code) of Grace, the Plan places restrictions on the purchase of Grace common stock. The restrictions would prohibit (without the consent of Grace), for a period of three years after the effective date of the Plan, a person or entity from acquiring more than 4.75% of the outstanding Grace common stock or, for those persons already holding more than 4.75%, prohibit them from increasing or decreasing their holdings. The Bankruptcy Court has approved the trading restrictions described above, excluding the restriction on sales, until the effective date of the Plan.

Grace intends to address all pending and future asbestos-related claims and all other pre-petition claims as outlined in the Plan. However, the Plan may not be ultimately approved by the Bankruptcy Court and other interested parties. For example, the PI and PD Committees and the FCR have challenged the confirmability of the Plan, arguing that the Plan impairs the rights of asbestos creditors and impermissibly denies them voting rights, and have asserted that Grace's asbestos-related liabilities exceed the fair value of Grace's assets. As a result of these challenges and other Bankruptcy Court rulings, a materially different plan of reorganization may ultimately be approved. Under the ultimate plan of reorganization, the interests of the Company's shareholders could be substantially diluted or cancelled and the value of non-asbestos claims could be materially different from that reflected in Grace's balance sheet. The value of Grace common stock and the extent of any recovery by non-asbestos-related creditors, will depend principally on the amount of Grace's asbestos-related liability under a confirmed plan of reorganization.

On July 26, 2007, the Bankruptcy Court terminated Grace's exclusive rights to propose a plan of reorganization and solicit votes thereon. The termination of such rights will permit any party-in-interest to propose a competing plan of reorganization.

Claims Filings The Bankruptcy Court established a bar date of March 31, 2003 for claims of general unsecured creditors, asbestos-related property damage claims (other than ZAI claims) and medical monitoring claims related to asbestos. The bar date did not apply to asbestos-related personal injury claims or claims related to ZAI.

Approximately 14,900 proofs of claim were filed by the March 31, 2003 bar date. Of these claims, approximately 9,400 were non-asbestos related, approximately 4,300 were for asbestos-related property damage, and approximately 1,000 were for medical monitoring. The medical monitoring claims were made by individuals who allege exposure to asbestos through Grace's products or operations. These claims, if sustained, would require Grace to fund ongoing health monitoring costs for qualified claimants. In addition, approximately 800 proofs of claim were filed after the bar date.

Approximately 7,000 of the non-asbestos related claims involve claims by employees or former employees for future retirement benefits such as pension and retiree medical coverage. Grace views most of these claims as contingent and has proposed a plan of reorganization that would

retain such benefits. These claims include claims for payment of goods and services, taxes, product warranties,

principal and interest under pre-petition credit facilities, amounts due under leases and other contracts, leases and other executory contracts rejected in the Bankruptcy Court, environmental remediation, pending non-asbestos-related litigation, and non-asbestos-related personal injury. Claims for indemnification or contribution to actual or potential codefendants in asbestos-related and other litigation were also filed.

The Debtors have analyzed the claims filed pursuant to the March 31, 2003 bar date and have found that many are duplicates, represent the same claim filed against more than one of the Debtors, lack any supporting documentation, or provide insufficient supporting documentation. As of September 30, 2007, of the approximately 4,035 asbestos property damage claims filed, five claims have been resolved (four of these agreements are voidable depending on the terms of a confirmed plan of reorganization), approximately 3,570 claims have been expunged or withdrawn by claimants, leaving approximately 460 claims to be addressed through the property damage case management order approved by the Bankruptcy Court. As of September 30, 2007, of the approximately 3,260 non-asbestos claims filed, approximately 1,830 have been expunged or withdrawn by claimants, approximately 1,140 have been resolved, and an additional approximately 290 claims are to be addressed through the claim objection process and the dispute resolution procedures approved by the Bankruptcy Court.

Grace believes that its recorded liabilities for claims subject to the March 31, 2003 bar date represent a reasonable estimate of the ultimate allowable amount for claims that are not in dispute or have been submitted with sufficient information to both evaluate the merit and estimate the value of the claim. The asbestos-related claims are considered as part of Grace's overall asbestos liability and are being accounted for in accordance with the conditions precedent under the Plan, as described in "Accounting Impact" below. Grace will adjust its recorded asbestos-related liability, as necessary, to reflect rulings by the Bankruptcy Court. Any such adjustments could be material to its consolidated financial position and results of operations.

Litigation Proceedings in Bankruptcy Court In September 2000, Grace was named in a purported class action lawsuit filed in California Superior Court for the County of San Francisco, alleging that the 1996 reorganization involving a predecessor of Grace and Fresenius AG and the 1998 reorganization involving a predecessor of Grace and Sealed Air were fraudulent transfers (*Abner, et al., v. W.R. Grace & Co., et al.*). The Bankruptcy Court authorized the PI and PD Committees to proceed with claims against Fresenius and Sealed Air and Cryovac on behalf of the Debtors' bankruptcy estate.

On November 29, 2002, Sealed Air (and Cryovac) and Fresenius each announced that they had reached agreements in principle with the PI and PD Committees to settle asbestos, successor liability and fraudulent transfer claims related to such transactions (the "litigation settlement agreements"). Under the terms of the Fresenius settlement, subject to the fulfillment of certain conditions, Fresenius would pay \$115.0 million to the Debtors' estate as directed by the Bankruptcy Court upon confirmation of the Debtors' plan of reorganization. In July 2003, the Fresenius settlement was approved by the Bankruptcy Court. Under the terms of the Sealed Air settlement, subject to the fulfillment of certain conditions, Cryovac would make a payment of \$512.5 million (plus interest at 5.5% compounded annually, commencing on December 21, 2002) and nine million shares (now 18 million shares to reflect a two-for-one stock split) of Sealed Air common stock (collectively valued at \$1,122.0 million as of September 30, 2007), as directed by the Bankruptcy Court upon confirmation of the Debtors' plan of reorganization. In June 2005, the Sealed Air settlement was approved by the Bankruptcy Court.

Debt Capital All of the Debtors' pre-petition debt is in default due to the Filing. The accompanying Consolidated Balance Sheets reflect the classification of the Debtors' pre-petition debt within "liabilities subject to compromise."

The Debtors have entered into a debtor-in-possession post-petition loan and security agreement with Bank of America, N.A. (the DIP facility) in the aggregate amount of \$250 million. The term of the DIP facility expires on April 1, 2008.

Accounting Impact The accompanying Consolidated Financial Statements have been prepared in accordance with Statement of Position 90-7 (SOP 90-7), Financial Reporting by Entities in Reorganization Under the Bankruptcy Code, promulgated by the American Institute of Certified Public Accountants. SOP 90-7 requires that financial statements of debtors-in-possession be prepared on a going concern basis, which contemplates continuity of operations, realization of assets and liquidation of liabilities in the ordinary course of business. However, as a result of the Filing, the realization of certain of the Debtors' assets and the liquidation of certain of the Debtors' liabilities are subject to significant uncertainty. While operating as debtors-in-possession, the Debtors may sell or otherwise dispose of assets and liquidate or settle liabilities for amounts other than those reflected in the Consolidated Financial Statements. Further, the ultimate plan of reorganization could materially change the amounts and classifications reported in the Consolidated Financial Statements.

Pursuant to SOP 90-7, Grace's pre-petition and future liabilities that are subject to compromise are required to be reported separately on the balance sheet at an estimate of the amount that will ultimately be allowed by the Bankruptcy Court. As of September 30, 2007, such pre-petition liabilities include fixed obligations (such as debt and contractual commitments), as well as estimates of costs related to contingent liabilities (such as asbestos-related litigation, environmental remediation, and other claims). Obligations of Grace subsidiaries not covered by the Filing continue to be classified on the Consolidated Balance Sheets based upon maturity dates or the expected dates of payment. SOP 90-7 also requires separate reporting of certain expenses, realized gains and losses, and provisions for losses related to the Filing as reorganization items. Grace presents reorganization items as Chapter 11 expenses, net of interest income, a separate caption in its Consolidated Statements of Operations.

Grace has not recorded the benefit of any assets that may be available to fund asbestos-related and other liabilities under the litigation settlements with Sealed Air and Fresenius, as such agreements are subject to conditions, which, although expected to be met, have not been satisfied and confirmed by the Bankruptcy Court. The value available under these litigation settlement agreements as measured at September 30, 2007, was \$1,237.0 million comprised of \$115.0 million in cash from Fresenius and \$1,122.0 million in cash and stock from Cryovac. Payments under the Sealed Air settlement will be made directly to the asbestos trust by Cryovac, and will be accounted for as a satisfaction of a portion of Grace's recorded asbestos-related liability and a credit to shareholders' equity.

Grace's Consolidated Balance Sheets separately identify the liabilities that are subject to compromise as a result of the Chapter 11 proceedings. In Grace's case, liabilities subject to compromise represent both pre-petition and future liabilities as determined under U.S. generally accepted accounting principles. The bases for the asbestos-related liability component of liabilities subject to compromise are described in Note 3. Changes to the recorded amount of such liabilities will be based on developments in the Chapter 11 Cases and management's assessment of the claim amounts that will ultimately be allowed by the Bankruptcy Court. Changes to pre-petition liabilities subsequent to the Filing Date reflect: 1) cash payments under approved court orders; 2) the terms of Grace's proposed plan of reorganization, as discussed above, including the accrual of interest on pre-petition debt and other fixed obligations; 3) accruals for employee-related programs; and 4) changes in estimates related to other pre-petition contingent liabilities.

Components of liabilities subject to compromise are as follows:

	September 30, 2007	December 31, 2006
<i>(In millions)</i>		
Debt, pre-petition plus accrued interest	\$ 787.2	\$ 739.5
Asbestos-related contingencies	1,700.0	1,700.0
Income taxes ⁽¹⁾	99.1	141.2
Environmental contingencies	366.0	361.1
Postretirement benefits other than pension	78.2	72.7
Unfunded special pension arrangements	99.3	95.6
Retained obligations of divested businesses ⁽²⁾	31.4	18.0
Accounts payable	31.7	31.7
Other accrued liabilities	82.0	71.2
Reclassification to current liabilities ⁽³⁾	(11.1)	(9.4)
Total Liabilities Subject to Compromise	\$ 3,263.8	\$ 3,221.6

(1) Amounts as of September 30, 2007 and December 31, 2006 are net of expected refunds of \$75.0 million and \$15.0 million, respectively.

(2) Increased \$13.4 million from December 31, 2006 due to reclass from tax reserves.

(3) As of September 30, 2007 and December 31, 2006, approximately \$11.1 million and \$9.4 million, respectively, of certain pension and postretirement benefit obligations subject to compromise have been presented in other current liabilities in the Consolidated Balance Sheets in accordance with SFAS No. 158.

Note that the unfunded special pension arrangements reflected above exclude non-U.S. pension plans and qualified U.S. pension plans that became underfunded subsequent to the Filing. Contributions to qualified U.S. pension plans are subject to Bankruptcy Court approval.

Change in Liabilities Subject to Compromise

Set forth below is a reconciliation of the changes in pre-filing date liability balances for the period from the Filing Date through September 30, 2007.

	Cumulative Since Filing
<i>(In millions)</i>	
Balance, Filing Date April 2, 2001	\$ 2,366.0
Cash disbursements and/or reclassifications under Bankruptcy Court orders:	
Freight and distribution order	(5.7)
Trade accounts payable order	(9.1)
Resolution of contingencies subject to Chapter 11	(130.0)
Other court orders including employee wages and benefits, sales and use tax, and customer programs	(346.4)
Expense/(income) items:	
Interest on pre-petition liabilities	331.1
Employee-related accruals	51.7
Provision for asbestos-related contingencies	744.8
Provision for estimate of environmental contingencies	307.6
Provision for estimate of income tax contingencies	(9.4)
Balance sheet reclassifications	(36.8)
Balance, end of period	\$ 3,263.8

Additional liabilities subject to compromise may arise due to the rejection of executory contracts or unexpired leases, or as a result of the Bankruptcy Court's allowance of contingent or disputed claims.

For the holders of pre-petition bank credit facilities, beginning January 1, 2006, Grace agreed to pay interest on pre-petition bank debt at the prime rate, adjusted for periodic changes, and compounded quarterly. The effective rates for the nine months ended September 30, 2007 and 2006 were 8.23% and 7.86%, respectively. From the Filing Date through December 31, 2005, Grace accrued interest on pre-petition bank debt at a negotiated fixed annual rate of 6.09%, compounded quarterly.

For the holders of claims who, but for the Chapter 11 filing, would be entitled under a contract or otherwise to accrue or be paid interest on such claim in a non-default (or non-overdue payment) situation under applicable non-bankruptcy law, Grace accrues interest at the rate provided in the contract between the Grace entity and the claimant or such rate as may otherwise apply under applicable non-bankruptcy law.

For all other holders of allowed general unsecured claims, Grace accrues interest at a rate of 4.19% per annum, compounded annually, unless otherwise negotiated during the claim settlement process.

Chapter 11 Expenses

**Three Months Ended
September 30,
2007**

**Nine Months Ended
September 30,**