

GRAFTECH INTERNATIONAL LTD

Form 10-Q

July 28, 2011

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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 June 30, 2011**

**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)

**27-2496053**  
(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

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 July 18, 2011, 145,277,067 shares of common stock, par value \$.01 per share, were outstanding.

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	At December 31, 2010	At June 30, 2011
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents	\$ 13,096	\$ 9,296
Accounts and notes receivable, net of allowance for doubtful accounts of \$3,892 at December 31, 2010 and \$4,201 at June 30, 2011	179,755	237,715
Inventories	340,418	402,042
Prepaid expenses and other current assets	12,615	27,336
<b>Total current assets</b>	<b>545,884</b>	<b>676,389</b>
Property, plant and equipment	1,328,004	1,424,752
Less: accumulated depreciation	635,530	684,414
Net property, plant and equipment	692,474	740,338
Deferred income taxes	6,746	5,477
Goodwill	499,238	500,688
Other assets	168,700	158,715
Restricted cash	141	0
<b>Total assets</b>	<b>\$ 1,913,183</b>	<b>\$ 2,081,607</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 69,930	\$ 65,712
Short-term debt	155	11,626
Accrued income and other taxes	30,019	25,443
Supply chain financing liability	24,959	23,633
Other accrued liabilities	95,580	94,555
<b>Total current liabilities</b>	<b>220,643</b>	<b>220,969</b>
Long-term debt	275,799	348,730
Other long-term obligations	114,728	115,247
Deferred income taxes	72,287	80,346
Contingencies Note 14		
Stockholders equity:		
Preferred stock, par value \$.01, 10,000,000 shares authorized, none issued	0	0
	1,491	1,494

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Common stock, par value \$.01, 225,000,000 shares authorized, 149,063,197 shares issued at December 31, 2010 and 149,447,642 shares issued at June 30, 2011		
Additional paid-in capital	1,782,859	1,790,724
Accumulated other comprehensive loss	(235,758)	(212,082)
Accumulated deficit	(203,941)	(148,109)
Less: cost of common stock held in treasury, 4,081,134 shares at December 31, 2010 and 4,122,396 at June 30, 2011	(113,942)	(114,773)
Less: common stock held in employee benefit and compensation trusts, 76,259 shares at December 31, 2010 and 73,125 shares at June 30, 2011	(983)	(939)
<b>Total stockholders' equity</b>	<b>1,229,726</b>	<b>1,316,315</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$ 1,913,183</b>	<b>\$ 2,081,607</b>

*See accompanying Notes to Consolidated Financial Statements*

**Table of Contents****PART I (CONT D)****GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF INCOME***(In thousands, except per share amounts)**(Unaudited)*

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2010	2011	2010	2011
Net sales	\$ 254,854	\$ 320,231	\$ 470,518	\$ 626,368
Cost of sales	178,936	245,072	325,306	478,274
Gross profit	75,918	75,159	145,212	148,094
Research and development	3,091	2,934	5,526	6,004
Selling and administrative expenses	32,030	32,656	54,263	64,875
Operating income	40,797	39,569	85,423	77,215
Equity in earnings of non-consolidated affiliate	(1,684)	0	(910)	0
Other income, net	(8,596)	(196)	(11,855)	(187)
Interest expense	1,296	4,584	2,202	8,988
Interest income	(507)	(115)	(1,068)	(244)
Income before provision for income taxes	50,288	35,296	97,054	68,658
Provision for income taxes	9,541	6,727	21,354	12,826
Net income	\$ 40,747	\$ 28,569	\$ 75,700	\$ 55,832
Basic income per common share:				
Net income per share	\$ 0.34	\$ 0.20	\$ 0.63	\$ 0.39
Weighted average common shares outstanding	120,340	145,166	120,395	145,011
Diluted income per common share:				
Net income per share	\$ 0.34	\$ 0.20	\$ 0.63	\$ 0.38
Weighted average common shares outstanding	121,088	145,964	121,083	145,723

*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 Six Months Ended June 30,</b>	
	<b>2010</b>	<b>2011</b>
<b>Cash flow from operating activities:</b>		
Net income	\$ 75,700	\$ 55,832
<b>Adjustments to reconcile net income to cash provided by operations:</b>		
Depreciation and amortization	18,697	40,321
Deferred income tax (benefit) provision	(8,239)	5,539
Equity in earnings of non-consolidated affiliate	(910)	0
Post-retirement and pension plan	1,836	1,780
Currency gains	(14,768)	(1,073)
Stock-based compensation	3,404	3,883
Interest expense	1,029	5,732
Other charges (credits), net	2,416	(3,893)
Increase in working capital*	(60,912)	(123,022)
Increase in long-term assets and liabilities	(4,318)	(3,062)
<b>Net cash provided by (used in) operating activities</b>	<b>13,935</b>	<b>(17,963)</b>
<b>Cash flow from investing activities:</b>		
Capital expenditures	(30,282)	(61,823)
Proceeds from repayment of loan to non-consolidated affiliate	6,000	0
Proceeds (payments) from derivative instruments	(120)	3,068
Net change in restricted cash	246	141
Cash paid for acquisition	0	(6,500)
Other	203	308
<b>Net cash used in investing activities</b>	<b>(23,953)</b>	<b>(64,806)</b>
<b>Cash flow from financing activities:</b>		
Short-term debt (reductions) borrowings, net	(892)	11,438
Revolving Facility borrowings	0	160,000
Revolving Facility reductions	0	(92,000)
Principal payments on long-term debt	(56)	(116)
Supply chain financing	29,604	(1,326)
Proceeds from exercise of stock options	1,015	1,066
Purchase of treasury shares	(1,138)	(655)
Excess tax benefit from stock-based compensation	1,037	703
Long-term financing obligations	(562)	(417)
Revolver facility refinancing cost	(4,392)	0
<b>Net cash provided by financing activities</b>	<b>24,616</b>	<b>78,693</b>
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>14,598</b>	<b>(4,076)</b>
Effect of exchange rate changes on cash and cash equivalents	(1,403)	276

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Cash and cash equivalents at beginning of period	50,181	13,096
Cash and cash equivalents at end of period	\$ 63,376	\$ 9,296
* Net change in working capital due to the following components:		
Increase in current assets:		
Accounts and notes receivable, net	\$ (44,569)	\$ (47,099)
Effect of factoring of accounts receivable	(1,115)	0
Inventories	(42,913)	(53,830)
Prepaid expenses and other current assets	(2,884)	(6,330)
Restructuring payments	(232)	0
Increase (decrease) in accounts payables and accruals	30,829	(15,633)
(Decrease) in interest payable	(28)	(130)
Increase in working capital	\$ (60,912)	\$ (123,022)

*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) Organization and Summary of Significant Accounting Policies**

**A. Organization**

GrafTech International Ltd. is one of the world's largest manufacturers and providers of high quality synthetic and natural graphite and carbon based products. References herein to GTI, we, our, or us refer collectively to GrafTech International Ltd. and its subsidiaries. We have five major product categories: graphite electrodes, refractory products, needle coke products, advanced graphite materials and natural graphite, which are reported in the following segments:

*Industrial Materials* includes graphite electrodes, refractory products, and needle coke products, and primarily serves the steel industry.

*Engineered Solutions* include advanced graphite materials products for the transportation, solar, and oil and gas exploration industries, as well as natural graphite thermal management products used in electronics.

**B. Basis of Presentation**

The 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 audited 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/A for the year ended December 31, 2010 (the Annual Report ).

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 period presented. The results for the interim periods are not necessarily indicative of results which may be expected for any other interim period or for the full year.

**C. Significant Accounting Policies**

**Change in Accounting Policy Regarding Pension and Other Postretirement Benefits**

Effective January 1, 2011, we elected to change our method of recognizing actuarial gains and losses for our defined benefit pension plans and other postretirement benefit plans. Previously, we recognized the actuarial gains and losses as a component of Stockholders' Equity on our consolidated balance sheets on an annual basis and amortized them into our operating results to the extent such gains and losses were outside of a corridor. In addition, we used a calculated market-related value of plan assets for purposes of calculating the expected return on plan assets. We have elected to immediately recognize the change in the fair value of plan assets and net actuarial gains and losses annually in the fourth quarter of each year (MTM Adjustment) and whenever a plan is remeasured (e.g. due to a significant curtailment,

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settlement, etc.). The remaining components of pension and other postretirement benefits expense will be recorded on a quarterly basis (On-going Pension Expense). While our historical policy of recognizing pension and other postretirement benefit expense was considered acceptable, we believe that the new policy is preferable as it eliminates the delay in recognizing gains and losses in our operating results. This change will also improve transparency in our operating results by more quickly recognizing the effects of economic and interest rate conditions on plan obligations and assets.

We have applied these changes retrospectively, adjusting all prior periods.

Effective January 1, 2011, we also elected to change our method of accounting for certain costs included in inventory. We have elected to exclude the inactive portion of our pension and other postretirement benefit costs as a component of inventoriable costs. While our historical policy of including all pension and other postretirement benefit costs as components of inventoriable costs was acceptable, we believe that the new policy is preferable, as it only includes costs that are directly attributable to current inventory production.

Applying this change retrospectively, in connection with the change in accounting for pension and other postretirement benefit costs, did not have a material impact on previously reported inventory and cost of sales in any prior period presented.

The impacts of all adjustments made to the financial statements are summarized below (in thousands, except per share amounts):

**Consolidated Statement of Income**

	<b>For the Three Months Ended June 30, 2010</b>		
	<b>Previously Reported</b>	<b>Revised</b>	<b>Effect of Change</b>
Cost of sales	\$ 180,127	\$ 178,936	\$ (1,191)
Research and development	3,191	3,091	(100)
Selling and administrative expense	32,308	32,030	(278)
Income before provision for income taxes	48,719	50,288	1,569
Provision for income taxes	9,397	9,541	144
Net income	39,322	40,747	1,425
Earnings per share of common stock-basic	0.33	0.34	0.01
Earnings per share of common stock-diluted	0.32	0.34	0.02

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	<b>For the Six Months Ended June 30, 2010</b>		
	<b>Previously Reported</b>	<b>Revised</b>	<b>Effect of Change</b>
Cost of sales	\$ 327,688	\$ 325,306	\$ (2,382)
Research and development	5,726	5,526	(200)
Selling and administrative expense	54,819	54,263	(556)
Income before provision for income taxes	93,916	97,054	3,138
Provision for income taxes	21,066	21,354	288
Net income	72,850	75,700	2,850
Earnings per share of common stock-basic	0.61	0.63	0.02
Earnings per share of common stock-diluted	0.60	0.63	0.03

**Consolidated Statement of Cash Flows**

	<b>For the Six Months Ended June 30, 2010</b>		
	<b>Previously Reported</b>	<b>Revised</b>	<b>Effect of Change</b>
Net income	\$ 72,850	\$ 75,700	\$ 2,850
Deferred income tax provision	(8,242)	(8,239)	3
Postretirement and pension plan	4,689	1,836	(2,853)

Had these changes not been made in 2011, net income would have been \$27.4 million compared to the \$28.6 million actually recorded for the three months ended June 30, 2011 and \$53.4 million compared to the \$55.8 million actually recorded for the six months ended June 30, 2011. Diluted earnings per share would have been \$0.19 compared to \$0.20 for the three months ended June 30, 2011 and \$0.37 compared to \$0.38 for the six months ended June 30, 2011.

**Major Maintenance and Repair Costs**

We perform scheduled major maintenance of the storage and processing units at our Seadrift plant (referred to as *overhaul* ). Time periods between overhauls vary by unit. We also perform an annual scheduled significant maintenance and repair shutdown of the plant (referred to as *turnaround* ).

Costs of overhauls and turnarounds include plant personnel, contract services, materials, and rental equipment. We defer these costs when incurred and use the straight-line method to amortize them over the period of time estimated to lapse until the next scheduled overhaul of the applicable storage or

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**GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

processing unit or over one year for our turnaround. In the three and six months ended June 30, 2011, we deferred \$4.9 million and \$5.4 million, respectively under this policy.

Our turnaround, normally scheduled during the spring or early summer of each year, was completed during the three months ended June 30, 2011.

**D. New Accounting Standards**

**Revenue Recognition**

We adopted a new revenue recognition standard that applies to sales arrangements entered into or materially modified in the year beginning January 1, 2011. The guidance:

Provides principles and application guidance on whether multiple deliverables exist, how the arrangement should be separated and consideration allocated;

Eliminates the residual method of allocating revenue;

Requires the allocation of consideration received in a bundled revenue arrangement among the separate deliverables by introducing an estimated selling price method for valuing elements if vendor-specific objective evidence or third-party evidence of a selling price is not available; and

Expands related disclosure requirements.

The adoption of this standard had no material effect on our consolidated financial statements or on existing revenue recognition policies.

**E. Recently Issued Accounting Standards**

Accounting guidance issued by various standard setting and governmental authorities that have not yet become effective with respect to our Consolidated Financial Statements are described below, together with our assessment of the potential impact they may have on our results of operation and financial position.

*Fair Value Measurement and Disclosure*

In May 2011 the FASB issued Accounting Standards Update 2011-04, *Fair Value Measurement: Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs* ( ASU 2011-04 ). The new guidance results in a consistent definition of fair value and common requirements for measurement of and disclosure about fair value between U.S. GAAP and IFRS. While disclosure requirements have been enhanced, most amendments clarify existing guidance in U.S. GAAP.

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ASU 2011-04 becomes effective for us in the first quarter of 2012, with early adoption prohibited. All amendments are to be applied prospectively. We are currently assessing its impact on our Consolidated Financial Statements.

**Table of Contents****PART I (CONT D)****GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited)****(2) Acquisitions****Seadrift Coke L.P. and C/G Electrodes LLC**

On November 30, 2010, we acquired from the equity holders of Seadrift Coke L.P. ( Seadrift ) the 81.1% of the equity interests of Seadrift that we did not already own and from the equity holders of C/G Electrodes LLC ( St. Marys facility ) 100% of the equity interests of the St. Marys facility. Because Seadrift and the St. Marys facility meet the SEC definition of common control, we have treated the transactions as the acquisition of one business. Seadrift and the St. Marys facility (collectively referred to as the Acquisitions ) are included in our Consolidated Financial Statements beginning as of December 1, 2010.

Seadrift is one of the largest producers of petroleum-based needle coke in the world and owns the world's only known stand-alone petroleum-based needle coke plant. Needle coke is the key raw material used to make graphite electrodes, including premium UHP graphite electrodes, which are critical consumables in electric arc furnace ( EAF ) steel production. We believe the acquisition of Seadrift will assure us of a stable supply of a portion of our requirements for needle coke, the primary raw material in the production of graphite electrodes.

The St. Marys facility is a U.S.-based producer of large diameter premium UHP graphite electrodes used in the EAF steel making process. The St. Marys facility also sells various other graphite-related products, including specialty graphite blocks, granular graphite and partially processed electrodes. The acquisition of the St. Marys facility provides us with a large diameter graphite electrode manufacturing facility in the U.S. which we believe will allow us to respond to customer orders more quickly and reduce freight cost and transit time for North American shipments.

*Consideration transferred:* The consideration paid to the equity holders of Seadrift consisted of \$90.0 million in cash (including working capital adjustments), approximately 12 million shares of GTI common stock and \$100 million in aggregate face amount of Senior Subordinated Notes of GTI due 2015. The consideration paid to the equity holders of the St. Marys facility consisted of \$159.5 million in cash (including working capital adjustments), approximately 12 million shares of GTI common stock and \$100 million in aggregate face amount of Senior Subordinated Notes of GTI due in 2015.

The computation of the fair value of the total consideration at the date of acquisition follows (in thousands, except share price):

GTI common shares issued	24,000
Price per share of GTI common stock	\$ 19.47
Fair value of consideration attributable to common stock	\$ 467,280
Fair value of Senior Subordinated Notes	142,597
Cash	249,444
Total consideration paid to equity holders	859,321
Fair value of our previously held 18.9% equity interest in Seadrift	77,342
Total consideration	\$ 936,663

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The volume weighted average price of a share of GTI common stock on November 30, 2010 was used to determine the fair value of the stock issued as consideration in connection with the Acquisitions. The fair value of the non-interest bearing senior subordinated notes was determined using an interest rate of 7%. Accounting guidance required us to remeasure the book value of our previously held 18.9% equity interest in Seadrift at November 30, 2010 to its fair value and recognize the resulting gain of \$9.6 million in our 2010 earnings.

*Recording of assets acquired and liabilities assumed:* The Acquisitions are accounted for using the acquisition method of accounting in accordance with FASB ASC 805, *Business Combinations* ( ASC 805 ). Under the acquisition method, the identifiable assets acquired and the liabilities assumed are assigned a new basis of accounting reflecting their estimated fair values. The information included herein has been prepared based on the preliminary allocation of purchase price using estimates of the fair values and useful lives of assets acquired and liabilities assumed based on the best available information determined with the assistance of independent valuations, quoted market prices and management estimates. The purchase price allocations are subject to further adjustment until all pertinent information regarding the property, plant and equipment, intangible assets, other long-term assets, goodwill, long-term debt, other long-term liabilities, and deferred income tax liabilities are fully evaluated by us and independent valuations are complete.

The following table summarizes the fair values of the identifiable assets acquired and liabilities assumed at the acquisition date (in thousands):

Cash	\$ 8,240
Accounts receivable	23,079
Inventories	82,665
Property, plant and equipment	280,710
Intangible assets	158,200
Other assets	988
Accounts payable	14,130
Other accrued liabilities	6,830
Debt obligations	1,197
Other long-term liabilities	1,000
Deferred tax liability	83,306
Net identifiable assets acquired	447,419
Goodwill	489,244
Net assets acquired	\$ 936,663

*Intangible assets:* The following table is a summary of the fair values of the identifiable intangible assets and their estimated useful lives (dollars in thousands):

	<b>Fair Value</b>	<b>Weighted Average Amortization Period</b>
Customer relationships	\$ 107,500	13.4 years
Technology and know-how	42,800	8.1 years
Tradenames	7,900	7.7 years

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Total intangible assets	\$ 158,200	11.6 years
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*Goodwill:* Goodwill of approximately \$489.2 million was recognized for the Acquisitions and is calculated as the excess of the consideration transferred over the net assets acquired and represents the future economic benefits arising from other assets acquired that could not be individually identified and separately recognized. Specifically, the goodwill recorded as part of the Acquisitions includes:

the expected synergies and other benefits that we believe will result from combining the operations of Seadrift and the St. Marys facility with the operations of GrafTech;

any intangible assets that do not qualify for separate recognition such as the assembled workforce; and

the value of the going-concern element of Seadrift's and St. Marys facility's existing businesses (the higher rate of return on the assembled collection of net assets versus acquiring all of the net assets separately).

We have assigned the goodwill to our Industrial Materials segment. Approximately \$168.2 million of the goodwill is deductible for federal income tax purposes.

*Debt:* We repaid \$80.6 million of debt and interest rate swaps and assumed an additional \$1.2 million of debt. The recorded amount of the debt assumed approximated its fair value. The following is a summary of the third-party debt assumed and not repaid in connection with the close of the Acquisitions (dollars in thousands):

Pennsylvania Industrial Development Authority mortgage note due 2018, interest rate of 3%	\$ 1,020
Secured promissory note due 2014, interest rate of 6.25%	177
<b>Total debt assumed</b>	<b>\$ 1,197</b>

*Previously held 18.9% equity interest in Seadrift:* On June 30, 2008, we acquired 100% of Falcon-Seadrift Holding Corp., now named GrafTech Seadrift Holding Corp. (GTSD), which held approximately 18.9% of the equity interests in Seadrift. The substance of the transaction was the acquisition of an asset, the limited partnership units, rather than a business combination. Because the amount we paid for the limited partnership interests exceeded their tax basis accounting guidance required us to recognize a deferred tax liability for this difference and increase our purchase price. We also had a deferred tax asset valuation allowance at the time we acquired the limited partnership units. Accounting guidance required us to reduce the valuation allowance and decrease the purchase price because the deferred tax liability recorded for the purchase was expected to reverse during the same period that our deferred tax assets were expected to reverse.

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We accounted for our investment in Seadrift using the equity method of accounting because we had the ability to exercise significant influence, but not exercise control. In 2008 and 2009, we determined that the fair value of our investment was less than our carrying amount and that the losses in value were other than temporary. We recorded non-cash impairments of \$34.5 million and \$52.8 million in 2008 and 2009, respectively, to recognize these other than temporary losses in value. Summarized financial information for Seadrift, including adjustments for material intervening events, for the three and six months ended June 30, 2010 was (dollars in thousands):

	<b>Three Months Ended June 30, 2010</b>	<b>Six Months Ended June 30, 2010</b>
Net sales	\$ 39,911	\$ 62,700
Gross profit	14,006	16,937
Net income	10,912	10,037

*Loan to Seadrift:* In late June 2009 and July 2009, Seadrift entered into agreements to borrow up to \$17.0 million from certain of its shareholders, which included up to \$8.5 million from us. In early July the shareholder group loaned Seadrift \$12.0 million which included \$6.0 million from us. Each loan was evidenced by a demand note with an interest rate of 10%.

We recorded our \$6.0 million loan at its face amount, which reasonably approximated its present value. Seadrift repaid the total borrowing of \$12.0 million on March 31, 2010.

**Micron Research Corporation**

On February 9, 2011, we purchased substantially all of the assets and assumed certain trade liabilities of Micron Research Corporation ( Micron Research ), a subsidiary of E. Holdings, Inc, for \$6.5 million of cash. Micron Research manufactures super fine grain graphite materials and primarily services Electrical Discharge Machining customers. We intend to utilize their technology and capability to service other applications including solar, electronics and medical. The substance of the transaction is the acquisition of a business and we accounted for the transaction following the guidance in ASC 805. Tangible assets acquired and liabilities assumed were recorded at their estimated fair values of \$5.0 million and \$0.2 million, respectively. The estimated fair values of finite-lived intangible assets acquired of \$1.3 million related to technology and know-how and customer relationships are being amortized over their estimated useful lives ranging from 5 to 15 years. Goodwill of \$0.4 million represents the excess of the consideration transferred over the net assets acquired and has been assigned to our Engineered Solutions segment.

**(3) Stock-Based Compensation**

In the three months ended June 30, 2010 and 2011, we recognized \$1.6 million and \$1.8 million, respectively, in stock-based compensation expense. A majority of the expense, \$1.5 million and \$1.6 million, respectively, was recorded as selling and administrative expenses in the Consolidated Statement of Income, with the remaining expenses incurred as cost of sales and research and development.

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In the six months ended June 30, 2010 and 2011, we recognized \$3.4 million and \$4.0 million, respectively, in stock-based compensation expense. A majority of the expense, \$3.1 million and \$3.5 million, respectively, was recorded as selling and administrative expenses in the Consolidated Statement of Income, with the remaining expenses incurred as cost of sales and research and development.

As of June 30, 2011, the total compensation cost related to non-vested restricted stock and performance shares and stock options not yet recognized was \$14.4 million, which will be recognized over the weighted average life of 1.4 years.

*Restricted Stock and Performance Shares*

Restricted stock and performance share awards activity under the plans for the six months ended June 30, 2011 was:

	<b>Number of Shares</b>	<b>Weighted- Average Grant Date Fair Value</b>
Outstanding unvested at January 1, 2011	1,338,053	\$ 15.91
Granted	133,986	22.79
Vested	(150,996)	16.90
Forfeited/canceled/expired	(218,097)	18.12
Outstanding unvested at June 30, 2011	1,102,946	\$ 16.18

*Stock Options*

Stock option activity under the plans for the six months ended June 30, 2011 was:

	<b>Number of Shares</b>	<b>Weighted- Average Exercise Price</b>
Outstanding at January 1, 2011	1,274,107	\$ 11.96
Granted	7,600	20.73
Forfeited/canceled/expired	(38,971)	18.30
Exercised	(125,666)	9.33
Outstanding at June 30, 2011	1,117,070	\$ 12.10

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The following table shows the information used in the calculation of our share counts for basic and diluted earnings per share:

	For the		For the	
	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2010	2011	2010	2011
Weighted average common shares outstanding for basic calculation	120,340,272	145,165,549	120,395,405	145,010,867
Add: Effect of stock options and restricted stock	748,148	798,855	687,099	712,178
Weighted average common shares outstanding for diluted calculation	121,088,420	145,964,404	121,082,504	145,723,045

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 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.

The weighted average common shares outstanding for the diluted calculation excludes consideration of stock options covering 227,000 shares and 2,600 shares in the three months ended June 30, 2010 and 2011, respectively, and 232,000 shares and 2,600 shares in the six months ended June 30, 2010 and 2011, respectively, because the exercise prices were greater than the weighted average market price of our common stock for each of those periods.

**(5) Segment Reporting**

Our businesses are reported in the following reportable segments:

**Industrial Materials.** Our Industrial Materials segment manufactures and delivers high quality graphite electrodes, refractory products and needle coke 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. Needle coke is a key raw material in the manufacture of the graphite electrodes used in the EAF steel production process.

**Engineered Solutions.** Engineered Solutions include advanced graphite materials products for the transportation, solar, and oil and gas exploration industries, as well as natural graphite thermal management products used in electronics.

We continue to 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 net sales.

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The following tables summarize financial information concerning our reportable segments:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2010 <i>(Dollars in thousands)</i>	2011 <i>(Dollars in thousands)</i>	2010 <i>(Dollars in thousands)</i>	2011 <i>(Dollars in thousands)</i>
Net sales to external customers:				
Industrial Materials	\$ 208,723	\$ 269,751	\$ 391,146	\$ 533,236
Engineered Solutions	46,131	50,480	79,372	93,132
Total net sales	\$ 254,854	\$ 320,231	\$ 470,518	\$ 626,368
Segment operating income:				
Industrial Materials	\$ 35,379	\$ 32,136	78,274	\$ 66,335
Engineered Solutions	5,418	7,433	7,149	10,880
Total segment operating income	40,797	39,569	85,423	77,215
Reconciliation of segment operating income to income before provision for income taxes				
Equity in earnings of non-consolidated affiliate	(1,684)	0	(910)	0
Other income, net	(8,596)	(196)	(11,855)	(187)
Interest expense	1,296	4,584	2,202	8,988
Interest income	(507)	(115)	(1,068)	(244)
Income before provision for income taxes	\$ 50,288	\$ 35,296	\$ 97,054	\$ 68,658

**(6) Other Income, Net**

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

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2010 <i>(Dollars in thousands)</i>	2011 <i>(Dollars in thousands)</i>	2010 <i>(Dollars in thousands)</i>	2011 <i>(Dollars in thousands)</i>
Currency (gains) losses	\$ (8,965)	\$ (160)	\$ (12,683)	\$ 472
Bank and other financing fees	531	496	996	979

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Other	(162)	(532)	(168)	(1,638)
Total other income, net	\$ (8,596)	\$ (196)	\$ (11,855)	\$ (187)

Other income for the six months ended June 30, 2011, includes \$0.7 million resulting from the collection of an acquired account receivable in the first quarter 2011 at an amount in excess of its fair value at the acquisition date.

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During the second quarter of 2007, we sold land and certain assets related to our former graphite electrode manufacturing facility in Caserta, Italy. The sale agreement provides that, upon completion of certain milestones in the remediation and landfill closure activities, portions of the escrowed amounts shall be paid to us. We recognize returns of funds held in escrow as other income when received. During the first quarter 2011, we completed all required activities and as such, the final \$0.1 million was released from escrow and recognized as income as the restricted cash was released.

**(7) Benefit Plans**

As discussed in Note 1, Organization and Summary of Significant Accounting Policies, effective January 1, 2011, we changed our method of recognizing actuarial gains and losses for our defined benefit pension plans and other postretirement benefits. This change was applied retrospectively and all prior period amounts have been adjusted accordingly. See Note 1 for further details.

The components of our consolidated net pension cost are set forth in the following table:

	For the		For the	
	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2010	2011	2010	2011
	<i>(Dollars in thousands)</i>		<i>(Dollars in thousands)</i>	
Service cost	\$ 164	\$ 164	\$ 328	\$ 328
Interest cost	2,446	2,446	4,892	4,892
Expected return on plan assets	(2,138)	(2,138)	(4,276)	(4,276)
Amortization of prior service cost	13	13	26	26
<b>Net Cost</b>	<b>\$ 485</b>	<b>\$ 485</b>	<b>\$ 970</b>	<b>\$ 970</b>

The components of our consolidated net postretirement cost are set forth in the following table:

	For the		For the	
	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2010	2011	2010	2011
	<i>(Dollars in thousands)</i>		<i>(Dollars in thousands)</i>	
Service cost	\$ 41	\$ 41	\$ 82	\$ 82
Interest cost	440	440	880	880
Amortization of prior service benefit	(48)	(48)	(96)	(96)
<b>Net Cost</b>	<b>\$ 433</b>	<b>\$ 433</b>	<b>\$ 866</b>	<b>\$ 866</b>





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## PART I (CONT D)

## GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

**(8) Goodwill and Other Intangible Assets**

The changes in the carrying value of goodwill during the six months ended June 30, 2011 are as follows:

	<b>Total</b> <i>(Dollars in Thousands)</i>
<b>Balance as of December 31, 2010</b>	499,238
Currency translation effect	(160)
Business acquisition (a)	1,610
<b>Balance as of June 30, 2011</b>	<b>\$ 500,688</b>

(a) Includes adjustment to preliminary assignment of fair value to net assets acquired.

The following table summarizes intangible assets with determinable useful lives by major category as of December 31, 2010 and June 30, 2011:

	At December 31, 2010			At June 30, 2011		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
	<i>(Dollars in Thousands)</i>					
Patents	\$ 3,520	\$ (1,168)	\$ 2,352	\$ 3,520	\$ (1,280)	\$ 2,240
Trade name	7,900	(124)	7,776	7,900	(861)	7,039
Technological know-how	42,800	(497)	42,303	43,349	(3,508)	39,841
Customer related intangible	107,500	(1,258)	106,242	108,267	(8,810)	99,457
<b>Total finite-lived intangible assets</b>	<b>\$ 161,720</b>	<b>\$ (3,047)</b>	<b>\$ 158,673</b>	<b>\$ 163,036</b>	<b>\$ (14,459)</b>	<b>\$ 148,577</b>

Amortization expense of intangible assets was \$0.1 million and \$5.7 million in the three months ended June 30, 2010 and 2011, respectively, and \$0.1 million and \$11.4 million in the six months ended June 30, 2010 and 2011, respectively.

**(9) Long-Term Debt and Liquidity**

The following table presents our long-term debt:

	At December 31, 2010	At June 30, 2011
	<i>(Dollars in thousands)</i>	
Revolving Facility	\$ 130,000	\$ 198,000

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Senior Subordinated Notes	143,404	148,338
Other debt	2,395	2,392
Total	\$ 275,799	\$ 348,730

*Revolving Facility*

On April 28, 2010, we successfully completed the refinancing of our principal revolving credit

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**GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

facility ( Revolving Facility ). Borrowers under the Revolving Facility are GrafTech Finance Inc. ( GrafTech Finance ) and GrafTech Switzerland S.A. ( Swissco ), both wholly-owned subsidiaries.

As amended and restated, the credit agreement provides for, among other things, an extension until April 29, 2013 of the maturity of our Revolving Facility in the initial amount of \$260 million, additional flexibility for investments and acquisitions and, subject to certain conditions, an accordion feature that permits GrafTech Finance and Swissco to establish additional credit facilities thereunder in an aggregate amount, together with our Revolving Facility, of up to \$390 million.

The interest rate applicable to the Revolving Facility is, at GrafTech's option, either LIBOR plus a margin ranging from 2.50% to 3.50% (depending on our total net leverage ratio and/or senior unsecured rating) or, in the case of dollar denominated loans, the alternate base rate plus a margin ranging from 1.50% to 2.50% (depending upon such ratio or rating). The alternate base rate is the highest of (i) the prime rate announced by JP Morgan Chase Bank, N.A., (ii) the federal fund effective rate plus 0.50% and (iii) the London interbank offering rate (as adjusted) for a one-month period plus 1.00%. GrafTech Finance and Swissco pay a per annum fee ranging from 0.375% to 0.750% (depending on such ratio or rating) on the undrawn portion of the commitments under the Revolving Facility.

The Revolving Facility contains financial covenants which require us to maintain a minimum interest coverage ratio of 1.75 to 1.00 and a maximum net senior secured leverage ratio of 2.25 to 1.00, subject to adjustment for certain events. The Revolving Facility also contains a number of other covenants which restrict certain corporate activities including annual capital expenditures, the payment of dividends and repurchases of our common stock. At June 30, 2011, we were in compliance with all financial and other covenants contained in the Revolving Facility, as applicable.

*Senior Subordinated Notes*

On November 30, 2010, in connection with the Acquisitions, we issued Senior Subordinated Notes for an aggregate total face amount of \$200 million. These Senior Subordinated Notes are non-interest bearing and mature in 2015, see Note 2, Acquisitions. Because the promissory notes are non-interest bearing, we were required to record them at their present value (determined using an interest rate of 7%). The difference between the face amount of the promissory notes and their present value is recorded as debt discount. The debt discount will be amortized using the interest method over the life of the promissory notes. The loan balance, net of unamortized discount, was \$148.3 million at June 30, 2011.

*Other Debt*

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. Because the loan is non-interest bearing, we were required to record the loan at its present value (determined using an interest rate of 4.33%). The difference between the proceeds received and the present value of debt is recorded as debt discount and deferred expense. The discount is amortized to income using the interest method; the deferred charge is amortized using the same basis and over the same period as the capital projects are depreciated. The loan balance, net of unamortized discount, was \$1.3 million at June 30, 2011.

Also included in other debt is a mortgage note due 2018, payable to the Pennsylvania Industrial

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Development Authority. The mortgage requires monthly payments of \$12 thousand including interest at 3% and is collateralized by our St. Marys facility. The balance of this debt was \$1.0 million at June 30, 2011.

**(10) Inventories**

Inventories are comprised of the following:

	At December 31, 2010	At June 30, 2011
	<i>(Dollars in thousands)</i>	
<b>Inventories:</b>		
Raw materials and supplies	\$ 118,691	\$ 173,166
Work in process	160,368	168,685
Finished goods	64,075	63,901
	343,134	405,752
Reserves	(2,716)	(3,710)
	\$ 340,418	\$ 402,042

We recognize abnormal amounts of idle facility expense, freight, handling costs, and wasted materials (spoilage) as current period charges. We are required to 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 at certain facilities being below normal capacity for the quarters ended June 30, 2010 and 2011. Costs in excess of normal absorption at December 31, 2010 and June 30, 2011 were \$1.4 million and \$0.5 million, respectively.

**(11) Interest Expense**

The following table presents an analysis of interest expense:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2010	2011	2010	2011
	<i>(Dollars in thousands)</i>		<i>(Dollars in thousands)</i>	
Interest incurred on debt	\$ 162	\$ 1,397	\$ 301	\$ 2,600
Amortization of discount on Senior Subordinated Notes	0	2,488	0	4,934
Amortization of debt issuance costs	676	385	1,002	772

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Supply chain financing mark-up	441	302	851	662
Interest incurred on other items	17	12	48	20
Total interest expense	\$ 1,296	\$ 4,584	\$ 2,202	\$ 8,988

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Other comprehensive income consisted of the following:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2010	2011	2010	2011
	<i>(Dollars in thousands)</i>		<i>(Dollars in thousands)</i>	
Net Income	\$ 40,747	\$ 28,569	\$ 75,700	\$ 55,832
Other comprehensive income:				
Foreign currency translation adjustments	(30,055)	7,356	(47,885)	16,195
Commodities and foreign currency derivatives, net of tax \$(1), \$1,176, \$180, \$5,083	365	1,950	472	7,481
<b>Total comprehensive income</b>	<b>\$ 11,057</b>	<b>\$ 37,875</b>	<b>\$ 28,287</b>	<b>\$ 79,508</b>

**(13) Supply Chain Financing**

We are party to a supply chain financing arrangement with a third party. Under this arrangement, we essentially assign 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 to the financing party for this needle coke includes a mark up (the Mark-Up). The Mark-Up is a premium expressed as a percentage of the purchase price. For the first six months of 2011 the Mark-Up was based on 2 month LIBOR plus a margin of 2.75%. The Mark-Up is subject to quarterly reviews. This arrangement helps us to maintain a balanced cash conversion cycle between inventory payments and the collection of receivables. Based on the terms of the arrangement, the total amount that we owe to the financing party may not exceed \$49.3 million at any point in time.

We record the inventory once title and risk of loss transfers from the supplier to the financing party. The amount recorded as a liability to the financing party was \$25.0 million and \$23.6 million at December 31, 2010 and June 30, 2011, respectively.

For the three months ended June 30, 2010 and 2011, the financing party invoiced us \$55.4 million and \$43.0 million, respectively, for purchases of inventory under this arrangement. For the three months ended June 30, 2010 and 2011, we recognized a Mark-Up of \$0.5 million and \$0.3 million, respectively, as interest expense.

For the six months ended June 30, 2010 and 2011, the financing party invoiced us \$106.6 million and \$91.4 million, respectively, for purchases of inventory under this arrangement. For the six months ended June 30, 2010 and 2011, we recognized a Mark-Up of \$0.9 million and \$0.7 million, respectively, as interest expense.

**(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



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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. Claims accrued but not yet paid amounted to \$2.7 million at December 31, 2010 and \$1.8 million at June 30, 2011. The following table presents the activity in this accrual for the six months ended June 30, 2011 (dollars in thousands):

Balance at January 1, 2011	\$ 2,653
Product warranty adjustments	(326)
Payments and settlements	(487)
Balance at June 30, 2011	\$ 1,840

**(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, impairment charges, adjustments to prior period uncertain tax positions, or 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 June 30, 2010 and 2011 was a tax expense of \$9.5 million on pretax income of \$50.3 million, and a tax expense of \$6.7 million on pretax income of \$35.3 million, respectively. The effective tax rates were 19.0% and 19.1% for the three months ended June 30, 2010 and 2011, respectively. The current year effective tax rate differs from the U.S. statutory rate of 35% primarily due to jurisdictional mix of income and changes in the utilization of attributes and related valuation allowances.

The provision for income taxes for the six months ended June 30, 2010 and 2011 was a tax expense of \$21.4 million on pretax income of \$97.1 million, and a tax expense of \$12.8 million on pretax income of \$68.7 million, respectively. The effective tax rates were 22.0% and 18.7% for the six months ended June 30, 2010 and 2011, respectively. The current year effective tax rate differs from the U.S. statutory rate of 35% primarily due to jurisdictional mix of income and changes in the utilization of attributes and related valuation allowances.

Our cumulative year-to-date unrecognized tax benefits have not materially changed from the prior period. As of June 30, 2011, we had unrecognized tax benefits of \$13.8 million, which would have a favorable impact on our effective tax rate. It is reasonably possible that a reduction of unrecognized tax benefits in a range of \$1.5 million to \$2.5 million may occur within 12 months as a result of settlements and 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. All U.S. tax years prior to 2008 are closed by statute or have been audited and settled with





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**GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES**

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the U.S. tax authorities. We are currently under federal audit by the Internal Revenue Service for the 2008 and 2009 tax years. We are also under audit in Switzerland for federal, cantonal, and communal taxes for the fiscal years 2006 – 2008, and in Italy for our 2006 tax year. All other non-U.S. jurisdictions are still open to examination beginning after 2005.

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.

Certain of our derivative contracts contain provisions that require us to provide collateral. 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.

*Foreign currency derivatives*

We enter into foreign currency derivatives 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 such as foreign currency denominated debt, sales, receivables, payables, and purchases. Forward exchange contracts are agreements to exchange different currencies at a specified future date and at a specified rate. There was no ineffectiveness on these contracts during either the three or six months ended June 30, 2011.

In 2010 and 2011, we entered into foreign forward currency derivatives as hedges of anticipated cash flows and firm commitments denominated in the Mexican peso, Brazilian real, euro and Japanese yen. These derivatives 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 the Mexican peso, Brazilian real, euro and Japanese yen. As of June 30, 2011, we had outstanding Mexican peso, Brazilian real, euro, and Japanese yen currency contracts, with aggregate notional amounts of \$139.0 million. The foreign currency derivatives outstanding as of June 30, 2011 have several maturity dates ranging from July 2011 to March 2012.

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We periodically enter into derivative contracts for natural gas and certain refined oil products. These contracts are entered into to protect against the risk that eventual cash flows related to these products will be adversely affected by future changes in prices. There was no ineffectiveness on these contracts during either the three or six months ended June 30, 2011. As of June 30, 2011, we had outstanding derivative swap contracts for refined oil products and natural gas with aggregate notional amounts of \$93.5 million and \$0.7 million respectively. These contracts have maturity dates ranging from July 2011 to June 2012.

The fair value of all derivatives is recorded as assets or liabilities on a gross basis in our Consolidated Balance Sheets. At December 31, 2010 and June 30, 2011, 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, 2010</b>				
Derivatives designated as cash flow hedges:				
Foreign currency derivatives	Other receivables	\$ 1,226	Other payables	\$ 390
Commodity derivative contracts	Other current assets	803	Other current liabilities	225
Total fair value		\$ 2,029		\$ 615

<b>As of June 30, 2011</b>				
Derivatives designated as cash flow hedges:				
Foreign currency derivatives	Other receivables	\$ 2,906	Other payables	\$ 2,038
Commodity derivative contracts	Other current assets	8,691	Other current liabilities	477
Total fair value		\$ 11,597		\$ 2,515

	Asset Derivatives		Liability Derivatives	
	Location	Fair Value	Location	Fair Value
	<i>(Dollars in Thousands)</i>			
<b>As of December 31, 2010</b>				
Derivatives designated as fair value hedges:				
Foreign currency derivatives	Other receivables	\$ 0	Other payables	\$ 0
Total fair value		\$ 0		\$ 0

<b>As of June 30, 2011</b>				
Derivatives designated as fair value hedges:				
Foreign currency derivatives	Other receivables	\$ 0	Other payables	\$ 126

Total fair value	\$	0	\$	126
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**Table of Contents****PART I (CONT D)****GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited)**

The location and amount of realized (gains) losses on derivatives are recognized in the Statement of Income when the hedged item impacts earnings and are as follows for the three months ended June 30, 2010 and 2011:

Three Months ended June 30,	Location of (Gain)/Loss Reclassified from Other Comprehensive Income (Effective Portion)	Amount of (Gain)/Loss Recognized (Effective Portion)	
		2010	2011
<i>(Dollars in Thousands)</i>			
Derivatives designated as cash flow hedges:			
Foreign currency derivatives	Cost of goods sold/Other (income) expense / Revenue	\$ (197)	\$ 9
Commodity forward derivatives	Cost of goods sold / Revenue	\$ 157	\$ (1,039)

Three Months ended June 30,	Location of (Gain)/Loss Recognized in the Consolidated Statement of Income	Amount of (Gain)/Loss Recognized (Effective Portion)	
		2010	2011
<i>(Dollars in Thousands)</i>			
Derivatives designated as fair value hedges:			
Foreign currency derivatives	Cost of goods sold/Other (income) expense / Revenue	\$ 0	\$ 328

Six Months ended June 30,	Location of (Gain)/Loss Reclassified from Other Comprehensive Income (Effective Portion)	Amount of (Gain)/Loss Recognized (Effective Portion)	
		2010	2011
<i>(Dollars in Thousands)</i>			
Derivatives designated as cash flow hedges:			
Foreign currency derivatives	Cost of goods sold/Other (income) expense / Revenue	\$ (261)	\$ 881
Commodity forward derivatives	Cost of goods sold / Revenue	\$ 186	\$ (801)

Six Months ended June 30,	Location of (Gain)/Loss Recognized in the Consolidated Statement of Income	Amount of (Gain)/Loss Recognized (Effective Portion)	
		2010	2011
<i>(Dollars in Thousands)</i>			
Derivatives designated as fair value hedges:			
Foreign currency derivatives	Cost of goods sold/Other (income) expense / Revenue	\$ 0	\$ 328

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Our foreign currency and commodity derivatives 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*.

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**PART I (CONT D)**

**GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES**

**(Unaudited)**

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

**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 of 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 and Risk Factors 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 including any regulatory initiatives with respect to greenhouse gas emissions which may be proposed; consulting projects; potential offerings, sales and other actions regarding debt or equity securities of us or our subsidiaries; and costs, working

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**PART I (CONT D)**

**GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES**

**(Unaudited)**

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** expressions, or 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 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 a determination by the U.S. government that we have failed to comply with one or more export controls or trade sanctions to which we are subject with respect to products exported from the United States or otherwise subject to U.S. jurisdictions could result in civil or criminal penalties, including imposition of significant fines, denial of export privileges and loss of revenues from certain customers;

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, which may affect their demand for the products we sell or supply to them;

the possibility that continued 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;

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**PART I (CONT D)**

**GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES**

**(Unaudited)**

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 permanent closing of blast furnace capacity or delay of blast furnace capacity additions or replacements which may affect demand and prices for our refractory products;

the possibility that economic, political and other risks with operating globally, including national and international conflicts, terrorist acts, political and economic instability, civil unrest, and natural or nuclear calamities might interfere with our supply chains, customers or activities in a particular location;

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, maintain appropriate relations with unions, associations and employees 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 potential unpredictability of litigation pending in Brazil involving disputes arising out of the interpretation of certain collectively bargained wage increase provisions applicable in 1989 and 1990 to employers (including our subsidiary in Brazil) in the Bahia region of Brazil. While the most recent ruling by the Supreme Court of Brazil has held that such provisions are not enforceable, and thus employers are not liable for the wage increases claimed on behalf of employees, further proceedings are pending seeking to reverse that ruling. While we cannot predict the outcome of the pending proceedings, if the wage increase provisions are declared enforceable, claims could be filed against our Brazilian subsidiary which could become substantial;

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;

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;

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

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**PART I (CONT D)**

**GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES**

**(Unaudited)**

expected;

the possibility that challenging conditions or changes in the capital markets will limit our ability to obtain financing 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 the actual outcome of uncertainties associated with assumptions and estimates using judgment when applying critical accounting policies and preparing financial statements may have a material impact on our results of operations or financial position;

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 new or expanded regulatory initiatives with respect to greenhouse gas emissions, if implemented, could have an impact on our facilities, increase the capital intensive nature of our business, and add to our costs of production of our products;

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;

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 North Africa, 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;

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,

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**PART I (CONT D)**

**GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES**

**(Unaudited)**

among other things, natural or nuclear 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 that our key or other raw materials become unavailable and that the magnitude of changes in the cost of key and other raw materials, including petroleum based coke, by reason of shortages, market pricing, pricing terms in applicable supply contracts, or other events 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.

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.

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For a more complete discussion of these and other factors, see Risk Factors, in Part I, Item 1A of the Annual Report and Part II, Item 1A of this Report.

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**PART I (CONT D)**

**GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES**

**(Unaudited)**

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

**Global Economic Conditions and Outlook**

We are impacted in varying degrees, both positively and negatively, as global, regional or country conditions fluctuate. Our discussions about market data and global economic conditions below are based on or derived from published industry accounts and statistics.

Based on current International Monetary Fund (IMF) projections and other global economic forecasts, global GDP growth was revised downward slightly to expand by approximately 4.3 percent in 2011. However, degrees of growth will continue to vary in both advanced and emerging economies. Stronger growth is projected in emerging economies, given robust internal demand.

The IMF cited a slower pace of growth in the second quarter of 2011 compared to the first quarter. The IMF indicated that it believes that the following factors have elevated risks to the stability of the global economic recovery:

Financial sector weakness in the United States and euro area;

Rising inflation in China and other emerging countries;

Global supply chain disruptions from the Japan earthquake/tsunami; and

Geopolitical uncertainty in the Middle East and North Africa.

Global steel operating rates continued to rise in the second quarter of 2011, but have started to lull in response to weaker demand in some countries from key steel end-markets, such as automotive, construction, and appliances.

According to published reports, global steel capacity utilization was approximately 82% for the three and six months ended June 30, 2011, relatively flat with the three months ended June 30, 2010 and an increase of 2 percentage points compared to the six months ended June 30, 2010. The United States steel industry operated at approximately 75% and 74% utilization for the three and six months ended June 30, 2011, respectively, compared to 73% and 70% utilization for the comparable periods in 2010. For the United States, this is an increase of 2 and 4 percentage points, respectively.

Demand for our Industrial Materials segment's 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. During the three and six months ended June 30, 2011, global steel production, excluding China, is estimated to have increased by 4% and 6%, respectively, compared to the same periods last year. China's steel production is estimated to have increased by 9% and 10%, respectively, during the three and six months ended June 30, 2011, contributing to estimated global steel production increases of 6% and 8%, respectively, in these periods compared to 2010 levels.

EAF steel production has followed a similar trend as overall steel production. During the three and six months ended June 30, 2011, estimated EAF steel production, excluding China, is estimated to have increased by 6% and 9% respectively, compared to the same periods last year. China's estimated EAF steel production increased by 16% and 14%, respectively, during the three and six months ended June 30, 2011, contributing to estimated global EAF steel production increases of 7% and 10% respectively, compared to the same periods last year. The improved efficiency of electric arc furnaces has resulted in a decrease in the average rate of consumption of graphite electrodes per metric ton of



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steel produced in electric arc furnaces (called specific consumption ). Generally, changes in graphite electrode demand have tracked changes in EAF steel production, offset by declines in specific consumption.

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**GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES**

**(Unaudited)**

If in 2011 the IMF projections and other economic forecasts described above were to materialize, we would then expect the following results:

Earnings before interest, taxes, depreciation and amortization would be in approximately \$285 million, calculated as Operating Income of \$200 million, plus depreciation and amortization of approximately \$85 million;

Overhead expense (selling and administrative and research and development expenses) would be in the range of \$145 million to \$155 million;

Interest expense in the range of \$18 million to \$20 million;

Capital expenditures would be approximately \$145 million to \$160 million;

Depreciation and amortization expense would be approximately \$85 million;

The effective tax rate would be in the range of 22 percent to 24 percent;

Cash flow from operations would be in the range of \$150 million to \$180 million.

Our outlook could be significantly impacted by, among other things, factors described under **Forward Looking Statements and Risks** in this Report. For a more complete discussion of these and other factors, see **Risk Factors** in the Annual Report and in Part II, Item 1A of this Report.

**Table of Contents****PART I (CONT D)****GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES****(Unaudited)****Results of Operations and Segment Review****Three Months Ended June 30, 2010 as Compared to Three Months Ended June 30, 2011.**

The tables presented in our period-over-period comparisons summarize our consolidated statements of income and illustrate key financial indicators used to assess the consolidated financial results. Financial information is presented for the three months ended June 30, 2010 and 2011. Throughout our MD&A, changes that are less than 5% or less than \$1.0 million, are deemed to be not meaningful and are designated as NM .

**(in thousands, except per share data and % change)**

	<b>For the Three Months Ended June 30,</b>		<b>Increase (Decrease)</b>	<b>% Change</b>
	<b>2010</b>	<b>2011</b>		
Net sales	\$ 254,854	\$ 320,231	\$ 65,377	26
Cost of sales	178,936	245,072	66,136	37
Gross profit	75,918	75,159	(759)	NM
Research and development	3,091	2,934	(157)	NM
Selling and administrative expenses	32,030	32,656	626	NM
Operating income	40,797	39,569	(1,228)	NM
Equity in earnings of non-consolidated affiliate	(1,684)	0	1,684	(100)
Other income, net	(8,596)	(196)	8,400	(98)
Interest expense	1,296	4,584	3,288	254
Interest income	(507)	(115)	(392)	NM
Income before provision for income taxes	50,288	35,296	(14,992)	(30)
Provision for income taxes	9,541	6,727	(2,814)	(29)
Net income	\$ 40,747	\$ 28,569	\$ (12,178)	(30)
Basic income per common share:	\$ 0.34	\$ 0.20	\$ (0.14)	
Diluted income per common share:	\$ 0.34	\$ 0.20	\$ (0.14)	

*Net sales.* We experienced higher sales for both of our operating segments as a result of the global economic recovery. Our acquisitions of Seadrift and the St. Marys facility on November 30, 2010 and of Micron Research in February 2011 resulted in \$55.7 million of additional sales in the three months ended June 30, 2011. Excluding sales from these acquisitions, net sales increased \$9.7 million, due primarily to volume increases.

Net sales, by operating segment for the three months ended June 30, 2010 and 2011 were:

**(in thousands, except per % change)**

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	For the Three Months Ended June 30,		Increase (Decrease)	% Change
	2010	2011		
Industrial materials	\$ 208,723	\$ 269,751	\$ 61,028	29
Engineered solutions	46,131	50,480	4,349	9
Total net sales	\$ 254,854	\$ 320,231	\$ 65,377	26

**Table of Contents****PART I (CONT D)****GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES****(Unaudited)**

Our analysis of the percentage change in net sales for Industrial Materials and Engineered Solutions is set forth in the following table:

	Volume	Price/Mix	Currency	Net Change
Industrial Materials	30%	(6%)	5%	29%
Engineered Solutions	5%	1%	3%	9%

*Net sales.* Net sales for our Industrial Materials segment increased significantly in the three months ended June 30, 2011 compared to the three months ended June 30, 2010 due to higher graphite electrode sales volume, including increases resulting from the acquisition of the St. Marys facility, as well as additional sales resulting from the inclusion of the acquired needle coke and related by-products business in this segment. These acquisitions resulted in \$55.0 million in additional sales in the quarter. Graphite electrode demand continued to recover in 2011, however, the increase in demand was offset, in part, by a decline in the average selling price of approximately 7%, exclusive of currency impacts. The weakening of the U.S. dollar relative to other currencies, primarily the Euro, virtually offset the decline in average selling price.

Net sales for our Engineered Solutions segment increased in the three months ended June 30, 2011, compared to the three months ended June 30, 2010, due to higher volumes, particularly related to natural graphite products used to displace heat in electronics, and the impact of the decline of the U.S. dollar.

*Cost of sales.* For the three months ended June 30, 2011, we experienced increases in cost of sales of \$42.8 million as a result of increased sales volumes, primarily resulting from our acquisitions of Seadrift and St. Marys, and the \$4.3 million impact of purchase accounting adjustments. Incentive compensation expense ( ICP ) in the three months ended June 30, 2011 was \$1.5 million lower than the three months ended June 30, 2010. Our Industrial Materials segment was further negatively impacted by changes in foreign currency, which increased costs by an additional \$15.3 million, and the increased cost of needle coke.

Needle coke is the primary raw material in the manufacture of graphite electrodes. Although a portion of our needle coke requirements are supplied by Seadrift, our cost of needle coke for producing a graphite electrode in the second quarter of 2011 increased. Our gross margin in the second quarter of 2011 was negatively impacted by these cost increases which we were not able to pass on to our customers.

Due to rising costs and increasing demand for our products, we announced price increases to our customers for normal premium grade needle coke and graphite electrodes in June and early July, respectively. While we do not expect a material impact to 2011 results from these price increases as the majority of our 2011 business is booked, it better positions us early in 2012 to manage margins amid rising costs.

We perform an annual scheduled significant maintenance and repair shutdown (referred to as a turnaround ) at our Seadrift facility. Costs directly related to the turnaround, including plant personnel, contract services, materials, and rental equipment, are deferred when incurred and amortized to cost of sales using the straight-line method generally over a one year term. Our 2011 turnaround was performed and completed in May and costs of \$5.0 million were deferred. Our results of operation for the three months ended June 30, 2011 include amortization of \$0.4 million for these costs.

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A new collective bargaining agreement between our Clarksburg, West Virginia facility and the United Steelworkers was ratified by our bargaining team members on June 11, 2011, to replace the contract that expired in June 2010.

*Selling and administrative expenses.* The amortization of acquired intangibles resulted in \$4.4 million of expense in the three months ended June 30, 2011. This increase was partially offset by a decrease of \$3.3 million related to lower ICP expense in the three months ended June 30, 2011 compared to June 30, 2010. During the three months ended June 30, 2010 we incurred \$6.6 million of acquisition costs (i.e., advisory, legal, valuation, and other professional fees, etc.) associated with our November 30, 2010 acquisitions of Seadrift and St. Marys which did not recur in 2011.

*Equity in losses of non-consolidated affiliate.* During the three months ended June 30, 2010 our equity in earnings of our non-consolidated affiliate, on a one-month lag, was \$2.2 million. On November 30, 2010, we acquired from the equity holders of Seadrift the 81.1% of the equity interests of Seadrift that we did not already own, and Seadrift is now included in our consolidated results of operations.

*Interest expense.* Interest expense increased \$3.3 million in the three months ended June 30, 2011 compared to the three months ended June 30, 2010, primarily due to the amortization of the discount on the Senior Subordinated Notes issued as consideration for the acquisitions of Seadrift and the St. Marys facility, as well as increased interest due to higher borrowings under our Revolving Facility used primarily to finance the acquisitions.

*Other (income) expense, net.* Other (income), decreased from \$8.6 million in the three months ended June 30, 2010 to \$0.2 million in the three months ended June 30, 2011. The primary driver of this change is the remeasurement of non-dollar denominated inter-company loans. For the three months ended June 30, 2010, currency gains totaled \$9.0 million, compared to currency gains of \$0.2 million for the three months ended June 30, 2011 due principally to translation rate changes.

*Segment operating income.* Corporate expenses are allocated to segments based on each segment's percentage of consolidated sales. The following table represents our operating income by segment for the three months ended June 30, 2010 and 2011:

	<b>For the Three Months Ended June 30,</b>	
	<b>2010</b>	<b>2011</b>
	<i>(Dollars in thousands)</i>	
Industrial Materials	\$ 35,379	\$ 32,136
Engineered Solutions	5,418	7,433
<b>Total segment operating income</b>	<b>\$ 40,797</b>	<b>\$ 39,569</b>

The percentage relationship of operating expenses to sales for Industrial Materials and Engineered Solutions is set forth in the following table:

	<b>For the Three Months Ended June 30,</b>		
	<b>2010</b>	<b>2011</b>	<b>Change</b>
	<i>(Percentage of sales)</i>		
Industrial Materials	83%	88%	5%

Engineered Solutions

88%

85%

(3%)

**Table of Contents****PART I (CONT D)****GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES****(Unaudited)**

Segment operating costs and expenses as a percentage of sales for Industrial Materials increased 5 percentage points to 88% in the three months ended June 30, 2011. Total operating costs and expenses increased \$64.3 million in the three months ended June 30, 2011 as compared to the three months ended June 30, 2010. The increase in total operating costs was a result of volume increases of \$41.7 million, due in part to increased volumes as a result of our acquisitions, as well as unfavorable currency changes of \$15.3 million.

Even though total segment operating costs and expenses in our Engineered Solutions segment increased \$2.3 million for the three months ended June 30, 2011, as compared to the three months ended June 30, 2010; they declined as a percentage of sales by 3 percentage points to 85%.

*Provision for income taxes.* The provision for income taxes for the three months ended June 30, 2010 was a tax expense of \$9.5 million on pretax income of \$50.3 million as compared to tax expense of \$6.7 million on pretax income of \$35.3 million for the three months ended June 30, 2011. The effective tax rates were 19.0% and 19.1% for the three months ended June 30, 2010 and 2011, respectively. The current year effective tax rate differs from the U.S statutory rate of 35% primarily due to jurisdictional mix of income and changes in the utilization of attributes and related valuation allowances.

**Six Months Ended June 30, 2010 as Compared to Six Months Ended June 30, 2011.**

The tables presented in our period-over-period comparisons summarize our consolidated statements of income and illustrate key financial indicators used to assess the consolidated financial results. Financial information is presented for the six months ended June 30, 2010 and 2011. Throughout our MD&A, changes that are less than 5% or less than \$1.0 million, are deemed to be not meaningful and are designated as NM.

**(in thousands, except per share data and % change)**

	<b>For the Six Months Ended June 30,</b>		<b>Increase (Decrease)</b>	<b>% Change</b>
	<b>2010</b>	<b>2011</b>		
Net sales	\$ 470,518	\$ 626,368	\$ 155,850	33
Cost of sales	325,306	478,274	152,968	47
Gross profit	145,212	148,094	2,882	NM
Research and development	5,526	6,004	478	NM
Selling and administrative expenses	54,263	64,875	10,612	20
Operating income	85,423	77,215	(8,208)	(10)
Equity in earnings of non-consolidated affiliate	(910)	0	910	NM
Other income, net	(11,855)	(187)	11,668	(98)
Interest expense	2,202	8,988	6,786	308
Interest income	(1,068)	(244)	(824)	NM
Income before provision for income taxes	97,054	68,658	(28,396)	(29)
Provision for income taxes	21,354	12,826	(8,528)	(40)
Net income	\$ 75,700	\$ 55,832	\$ (19,868)	(26)





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Basic income per common share:	\$ 0.63	\$ 0.39	\$ (0.24)
Diluted income per common share:	\$ 0.63	\$ 0.38	\$ (0.25)

*Net sales.* We experienced higher sales for both of our operating segments as a result of the global economic recovery. Our acquisitions of Seadrift and the St. Marys facility on November 30, 2010 and of Micron Research in February 2011 resulted in \$121.1 million of additional sales in the six months ended June 30, 2011 compared to the six months ended June 30, 2010. Excluding sales from acquisitions, net sales increased \$34.8 million, due primarily to volume increases.

Net sales, by operating segment for the six months ended June 30, 2010 and 2011 were:

(in thousands, except per % change)

	For the Six Months Ended June 30,		Increase (Decrease)	% Change
	2010	2011		
Industrial materials	\$ 391,146	\$ 533,236	\$ 142,090	36
Engineered solutions	79,372	93,132	13,760	17
<b>Total net sales</b>	<b>\$ 470,518</b>	<b>\$ 626,368</b>	<b>\$ 155,850</b>	<b>33</b>

Our analysis of the percentage change in net sales for Industrial Materials and Engineered Solutions is set forth in the following table:

	Volume	Price/Mix	Currency	Net Change
Industrial Materials	41%	(8%)	3%	36%
Engineered Solutions	14%	2%	1%	17%

*Net sales.* Net sales for our Industrial Materials segment increased significantly in the six months ended June 30, 2011 compared to the six months ended June 30, 2010 due to higher graphite electrode sales volume, including increases resulting from the acquisition of the St. Marys facility, as well as additional sales resulting from the inclusion of the acquired needle coke and related by-products business in this segment. These acquisitions resulted in \$120.0 million in additional sales in the quarter. Graphite electrode demand continued to recover in 2011, however, the increase in demand was offset, in part, by a decline in the average selling price of approximately 7%, exclusive of currency impacts. The weakening of the U.S. dollar relative to other currencies, primarily the Euro, partially offset the decline in average selling price.

Net sales for our Engineered Solutions segment increased in the six months ended June 30, 2011, compared to the six months ended June 30, 2010, due to higher volumes, particularly related to natural graphite products used to displace heat in electronics, and the impact of the decline of the U.S. dollar.

*Cost of sales.* For the six months ended June 30, 2011, we experienced increased cost of sales of \$110.2 million as a result of increased sales volumes, primarily resulting from our acquisitions, and the \$10.4 million impact of purchase accounting adjustments. Our Industrial Materials segment was further negatively impacted by changes in foreign currency, which increased costs by an additional \$20.4 million,



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and the increased cost of needle coke.

Needle coke is the primary raw material in the manufacture of graphite electrodes. Although a portion of our needle coke requirements are supplied by Seadrift, our cost of needle coke for producing a graphite electrode in the first half of 2011 increased. Our gross margin in the first half of 2011 was negatively impacted by these cost increases which we were not able to pass on to our customers.

We perform an annual scheduled significant maintenance and repair shutdown (referred to as a turnaround ) at our Seadrift facility. Costs directly related to the turnaround, including plant personnel, contract services, materials, and rental equipment, are deferred when incurred and amortized to cost of sales using the straight-line method generally over a one year term. Our 2011 turnaround was performed and completed in May and costs of \$5.0 million were deferred. Our results of operation for the six months ended June 30, 2011 include \$0.4 of amortization for these costs.

*Selling and administrative expenses.* Selling and administrative expenses increased \$10.6 million in the six months ended June 30, 2011 compared to the six months ended June 30, 2010. This increase was due primarily to the amortization of acquired intangibles, which resulted in \$8.6 million of expense in the six months ended June 30, 2011. The increased costs incurred in the 2011 period attributable to the additional employees acquired in the acquisitions largely offset the fact that significant costs incurred in the six months ended June 30, 2010 did not recur in the 2011 period. General selling costs, including sales commissions and technical service, increased \$4.4 million in the six months ended June 30, 2011 in order to support our high sales volumes. These increases were offset by a decrease in ICP expense of \$4.7 million. During the six months ended June 30, 2010 we incurred \$6.7 million of acquisition costs (i.e., advisory, legal, valuation, and other professional fees, etc.) associated with our November 30, 2010 acquisitions of Seadrift and St. Marys.

*Equity in losses of non-consolidated affiliate.* During the six months ended June 30, 2010 our equity in earnings of our non-consolidated affiliate, on a one-month lag, was \$1.9 million. On November 30, 2010, we acquired from the equity holders of the Seadrift 81.1% of the equity interests of Seadrift that we did not already own, and Seadrift is now included in our consolidated results of operations.

*Interest expense.* Interest expense increased \$6.8 million in the six months ended June 30, 2011, compared to the six months ended June 30, 2010, primarily due to the amortization of the discount on the Senior Subordinated Notes issued as consideration for the acquisitions of Seadrift and the St. Marys facility, as well as increased interest due to higher borrowings under our Revolving Facility, as well as increased interest due to higher borrowings under our Revolving Facility used primarily to finance the acquisitions.

*Other (income) expense, net.* Other (income), decreased from \$11.9 million in the six months ended June 30, 2010 to \$0.2 million in the six months ended June 30, 2011. The primary driver of this change is remeasurement of non-dollar denominated inter-company loans. For the six months ended June 30, 2010, currency gains totaled \$12.7 million, compared to currency losses of \$0.5 million for the six months ended June 30, 2011 due principally to translation rate changes. During the six months ended June 30, 2011, we also recorded other income of \$0.7 million resulting from the collection of an acquired account receivable at an amount in excess of its estimated fair value at the acquisition date, as well as the release of the final \$0.1 million escrow balance related to our Caserta, Italy sale.

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*Segment operating income.* Corporate expenses are allocated to segments based on each segment's percentage of consolidated sales. The following table represents our operating income by segment for the six months ended June 30, 2010 and 2011:

	<b>For the Six Months Ended June 30, 2010                  2011</b>	
	<i>(Dollars in thousands)</i>	
Industrial Materials	\$ 78,274	\$ 66,335
Engineered Solutions	7,149	10,880
<b>Total segment operating income</b>	<b>\$ 85,423</b>	<b>\$ 77,215</b>

The percentage relationship of operating expenses, to sales for Industrial Materials and Engineered Solutions is set forth in the following table:

	<b>For the Six Months Ended June 30, (Percentage of sales)</b>		
	<b>2010</b>	<b>2011</b>	<b>Change</b>
Industrial Materials	80%	88%	8%
Engineered Solutions	91%	88%	(3%)

Segment operating costs and expenses as a percentage of sales for Industrial Materials increased 8 percentage points to 88% in the six months ended June 30, 2011. Total operating costs and expenses increased \$154.0 million in the six months ended June 30, 2011 compared to the six months ended June 30, 2010. The increase in total operating costs was a result of volume increases of \$103.0 million, due in part to increased volumes as a result of our acquisitions, as well as unfavorable currency changes of \$20.4 million.

Segment operating costs and expenses as a percentage of sales for Engineered Solutions decreased 3 percentage points to 88% for the six months ended June 30, 2011. In total, operating costs increased \$7.3 million as a result of higher volumes.

*Provision for income taxes.* The provision for income taxes for the six months ended June 30, 2010 was a tax expense of \$21.4 million on pretax income of \$97.1 million as compared to tax expense of \$12.8 million on pretax income of \$68.7 million for the six months ended June 30, 2011. The effective tax rates were 22.0% and 18.7% for the six months ended June 30, 2010 and 2011, respectively. The current year effective tax rate differs from the U.S. statutory rate of 35% primarily due to jurisdictional mix of income and changes in the utilization of attributes and related valuation allowances.

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**Effects of Changes in Currency Exchange Rates**

When the currencies of non-U.S. countries in which we have a manufacturing facility decline (or increase) in value relative to the U.S. dollar, this has the effect of reducing (or increasing) the U.S. dollar equivalent cost of sales and other expenses with respect to those facilities. In certain countries where we have manufacturing facilities, and in certain instances where we price our products for sale in export markets, we sell in currencies other than the dollar. Accordingly, when these currencies increase (or decline) in value relative to the dollar, this has the effect of increasing (or reducing) net sales. The result of these effects is to increase (or decrease) operating profit and net income.

Many of the non-U.S. countries in which we have a manufacturing facility have been subject to significant economic and political 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.

During the six months ended June 30, 2011, the average exchange rates for the Japanese yen, Brazilian real, and South African increased significantly, by approximately 11.6%, 10.2% and 9.2%, respectively, when compared to their average exchange rates for the six months ended June 30, 2010. During the six months ended June 30, 2011 the average exchange rate for the Mexican peso, the euro and the British pound increased roughly 6.5%, 5.7% and 5.9%, respectively, compared to their average exchange rates for the six months ended June 30, 2010

For net sales of Industrial Materials, the impact of changes in the average exchange rates for the period was an increase of \$10.8 million in the six months ended June 30, 2011. For the cost of Industrial Materials, the impact of these events was an increase of \$20.4 million in the six months ended June 30, 2011.

As part of our cash management, we also have intercompany loans between our subsidiaries. These loans 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 Income. Our Switzerland location is party to many of these loans. Effective January 1, 2011, the functional currency of this location was switched to the U.S. dollar, as the majority of these loans and the purchases made are denominated in the U.S. dollar. This change minimizes our exposure to exchange rate changes related to our intercompany loans.

We had a net total currency gain of \$12.7 million in the six months ended June 30, 2010 as compared to a net total currency loss of \$0.5 million in the six months ended June 30, 2011, primarily due to the remeasurement of intercompany loans and the effect of transaction gains and losses on intercompany activities.

We have in the past and may in the future use various financial instruments to manage certain exposures to specific financial market risks caused by changes in currency exchange rates, as described under Part I, Item 3 Quantitative and Qualitative Disclosures about Market Risk .

**Table of Contents****PART I (CONT D)****GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES****(Unaudited)****Liquidity and Capital Resources**

Global capital markets have been, and may 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, including availability under our Revolving Facility, to meet all of our present operating needs. Continued turbulence in the U.S. and international financial markets, however, could adversely affect the cost and availability of financing to us in the future.

Our financing obligations are as follows:

	At December 31, 2010	At June 30, 2011
	<i>(Dollars in thousands)</i>	
Short-term debt	\$ 155	\$ 11,626
Supply chain financing liability	24,959	23,633
<b>Total current financing liabilities</b>	<b>25,114</b>	<b>35,259</b>
Long-term debt	275,799	348,730
<b>Total financing liabilities</b>	<b>\$ 300,913</b>	<b>\$ 383,989</b>

At June 30, 2011, we had cash and cash equivalents of \$9.3 million, short-term debt of \$11.6 million, long-term debt of \$348.7 million and stockholders' equity of \$1,316.3 million. We also have \$52.5 million available through our Revolving Facility. 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.

Our sources of funds have consisted principally of cash flow from operations, debt including our Revolving Facility, equity financings, and supply chain financings. Our uses of those funds (other than for operations) have consisted principally of capital expenditures, payment of pension and post-retirement contributions, debt reductions, purchases of treasury shares and other obligations. As of June 30, 2011, we have accrued liabilities for several future significant cash expenditures including pension plan funding obligations approximating \$3.4 million, of which we paid \$1.3 million on July 15, 2011.

We have an accounts receivable factoring arrangement in place that provides additional working capital liquidity of up to \$25.0 million. We did not sell any receivables under this arrangement during the three and six months ended June 30, 2010 or 2011.

Accounts receivable are sold without recourse under this arrangement. 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. This accounts receivable factoring facility renewed for a one year term that expires June 30, 2012.

We are party to a supply chain financing arrangement with a third party that provides additional working capital liquidity of up to \$50 million. Under this arrangement, we essentially assign 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





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the financing party. Our payment to the financing party for this needle coke includes a mark up (the Mark-Up ). For the first six months of 2011 the Mark-Up was based on 2 month LIBOR plus a margin of 2.75%. 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 six months ended June 30, 2011, the financing party invoiced us \$91.4 million and we had net payments of \$1.3 million for purchases of inventory under this arrangement, including a Mark-Up of \$0.7 million.

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, any such shortfall would be made up by borrowings under our Revolving Facility.

We use cash and cash equivalents, cash flow from operations, funds from receivable and payable factoring arrangements, supply chain financing, and funds available under the Revolving Facility (subject to continued compliance with the financial covenants and representations under the Revolving Facility) as our primary sources of liquidity. The Revolving Facility is secured, and provides for maximum borrowings of up to \$260 million including a letters of credit sub-facility of up to \$35 million and, subject to certain conditions (including a maximum senior secured leverage ratio test), an accordion feature that permits GrafTech Finance to establish additional credit facilities thereunder in an aggregate amount, together with the Revolving Facility, of up to \$390 million. The Revolving Facility matures in April 2013.

At June 30, 2011, we had outstanding borrowings drawn from the Revolving Facility of \$201.4 million, and \$52.5 million was available (after consideration of outstanding letters of credit of \$6.1 million). It is possible that our future ability to borrow under the Revolving Facility will 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.

The interest rate applicable to the Revolving Facility is, at GrafTech's option, either LIBOR plus a margin ranging from 2.50% to 3.50% (depending on our total net leverage ratio and/or senior unsecured rating) or, in the case of dollar denominated loans, the alternate base rate plus a margin ranging from 1.50% to 2.50% (depending upon such ratio or rating). The alternate base rate is the highest of (i) the prime rate announced by JP Morgan Chase Bank, N.A., (ii) the federal fund effective rate plus 0.50% and (iii) the London interbank offering rate (as adjusted) for a one-month interest period plus 1.00%. GrafTech Finance and Swisso pay a per annum fee ranging from 0.375% to 0.750% (depending on such ratio or rating) on the undrawn portion of the commitments under the Revolving Facility.

At June 30, 2011, we were in compliance with all financial and other covenants contained in the Revolving Facility, as applicable. These covenants include maintaining an interest coverage ratio of at least 1.75 to 1.00 and a maximum net senior secured leverage ratio of 2.25 to 1.00, subject to adjustment 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 through maturity of our Revolving Facility. 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.

At June 30, 2011, approximately 42% of our debt consists of fixed rate or zero interest rate obligations compared to 53% at December 31, 2010.

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***Cash Flow and Plans to Manage Liquidity.*** Our business strategies include efforts to enhance our capital structure by further reducing our gross obligations. Our efforts include leveraging our global manufacturing network by driving higher utilization rates and more 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.

Certain of our obligations could have a material impact on our liquidity. Cash flow from operations and from financing activities services payment of our obligations, including our incentive compensation program paid out in the second quarter of 2011, thereby reducing funds available to us for other purposes. Although we currently have \$52.5 million of additional borrowing capacity under the Revolving Facility, continued improvement, or another downturn, in the global economy may require increased borrowings under our Revolving Facility, particularly if our accounts receivable and supply chain financing arrangements are terminated. An improving economy, while resulting in improved results of operations and cash flows, could require significant cash requirements to purchase inventories and pay other obligations as accounts receivable increase. A downturn 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 our existing financial covenants in 2011. However, we cannot predict whether additional or more restrictive covenants, if any, may result from a new credit arrangement or our ability to comply therewith.

In order to seek to minimize our credit risks, we limit our sales of, or refuse to sell (except for cash on delivery or under letters of credit), 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. Our unrecovered trade receivables worldwide have not been material during the last 3 years individually or in the aggregate. 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 reduced credit ratings of customers or by a reduction in the amount permitted to be financed under the arrangement.

In December 2007, our Board of Directors approved a share repurchase program authorizing the purchase of up to 3 million shares of our common stock. Share repurchases may take place from time to time in the open market, or through privately negotiated transactions, as market conditions warrant. We intend to fund any such share repurchases from available cash and cash flows. These share repurchases may be suspended or discontinued at any time.

***Related Party Transactions.*** In late June and early July 2009, our then non-consolidated affiliate, Seadrift Coke L.P. ( Seadrift ), entered into agreements to borrow up to \$17.0 million from certain of its shareholders, which included GrafTech. We agreed to loan up to \$8.5 million and on July 2, 2009, we loaned Seadrift \$6.0 million.

The Demand Notes were repaid in full with interest on March 31, 2010 and the obligation to make any further loans or advances ceased and terminated.

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We have not engaged in or been a party to any other material transactions with affiliates or related parties except for transactions with our current or former subsidiaries and compensatory transactions with directors and officers (including employee benefits, stock option and restricted stock grants, compensation deferral, executive employee loans and stock purchases).

***Cash Flows.***

The following is a discussion of our cash flow activities:

	<b>For the Six Months Ended June 30,</b>	
	<b>2010</b>	<b>2011</b>
	<i>(Dollars in millions)</i>	
Cash flow provided by (used in):		
Operating activities	\$ 13.9	\$ (18.0)
Investing activities	(24.0)	(64.8)
Financing activities	24.6	78.7

***Operating Activities***

Cash flow from operating activities represents cash receipts and cash disbursements related to all our activities other than to investing and financing activities. Operating cash flow is derived by adjusting net income for:

Non-cash items such as depreciation and amortization; post retirement obligations, severance and pension plan changes; stock-based compensation charges

Gains and losses attributed to investing and financing activities such as gains and losses on the sale of assets and unrealized currency transaction gains

Changes in operating assets and liabilities which reflect timing differences between the receipt and payment of cash associated with transactions and when they are recognized in results of operations

The net impact of the changes in working capital (operating assets and liabilities), which are discussed in more detail below, include the impact of changes in: receivables, inventories, prepaid expenses, accounts payable, accrued liabilities, interest payable, and payments of other current liabilities.

We continue to attempt to maximize our operating cash flows by continuing to improve those working capital items that are most directly affected by changes in sales volume, such as accounts receivable, inventories and accounts payable.

During the six months ended June 30, 2011, changes in working capital resulted in a net use of funds of \$123.0 million which was impacted by:

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use of funds of \$47.1 million from the increase in accounts receivable, which are due primarily to increased sales for the period;

use of funds for inventories of \$53.8 million primarily due to the increased sales volume and the acquisitions of Seadrift and the St. Marys facility;

use of funds of \$6.3 million related to increased prepaid expenses primarily due to the deferral of \$5.0 million of major maintenance and turnaround costs at Seadrift as well as the payment

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of insurance policy premiums in the second quarter; and

use of funds of \$15.6 million from a decrease in accounts payable and accruals, caused primarily by the payment of incentive compensation.

During the six months ended June 30, 2010, changes in working capital resulted in a net use of funds of \$60.9 million which was impacted by:

use of funds of \$45.7 million from the increase in accounts receivable, including the effect of factoring for \$1.1 million, which are due primarily to increased sales for the period and the limited use of factoring;

use of funds for inventories of \$42.9 million primarily due to the increased sales volume; and

sources of funds of \$30.8 million from an increase in accounts payable and accruals through normal operations and inventory purchases.

Other items that affected our cash balance during the six months ended June 30, 2010 included payment of incentive compensation of \$19.6 million, payments of acquisition costs of \$4.1 million, Federal income tax payments in the United States of \$4.1 million, and income tax payments in Mexico, South Africa and Switzerland of \$2.0 million, \$2.7 million, and \$5.2 million, respectively, as well as a franchise tax refund of \$0.5 in the United States.

*Investing Activities.*

Net cash used in investing activities was \$24.0 million during the six months ended June 30, 2010 and included capital expenditures of \$30.3 million, which was offset by proceeds received on our loan to our non-consolidated affiliate of \$6.0 million.

Net cash used in investing activities was \$64.8 million during the six months ended June 30, 2011 and included capital expenditures of \$61.8 million and cash paid for the acquisition of Micron Research of \$6.5 million, partially offset by proceeds from derivative instruments of \$3.1 million.

*Financing Activities.*

Net cash flow provided by financing activities was \$24.6 million during the six months ended June 30, 2010 and included net borrowings under our supply chain financing arrangement of \$29.6 million, offset by bank fees and charges to amend and restate our credit agreement of \$4.4 million and purchases of treasury shares of \$1.1 million.

Net cash flow provided by financing activities was \$78.7 million during the six months ended June 30, 2011, due primarily to net borrowings under our Revolving Facility of \$68.0 million and \$11.4 million of short term debt borrowings. The cash from these borrowings was used primarily to fund capital expenditures and working capital additions during the period.

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**Restrictions on Dividends and Stock Repurchases**

A description of the restriction on our ability to pay dividends and our ability to repurchase common stock is set forth under Item 5 Dividend Policies and Restrictions in the Annual Report and such description is incorporated herein by reference. Such description contains all of the information required with respect thereto.

**Recent Accounting Pronouncements**

We discuss recently adopted accounting standards on page 6 in Note 1, Organization and Summary of Significant Accounting Policies of the Notes to the Consolidated Financial Statements.

**Description of Our Financing Structure**

We discuss our financing structure in more detail on page 18 in Note 9, Long-Term Debt and Liquidity of the Notes to the Consolidated Financial Statements.

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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, energy commodity 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. 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 derivatives from time to time to attempt to manage exposure to changes in currency exchange rates. These foreign currency derivatives, 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 foreign currency derivatives at December 31, 2010 and June 30, 2011 represented a net unrealized gain of \$0.8 million and \$0.7 million, respectively.

***Energy Commodity Management.*** We periodically enter into commodity derivative contracts and short duration fixed rate purchase contracts to effectively fix some or all of our natural gas, and refined oil product exposure. The outstanding contracts at December 31, 2010 and June 30, 2011 represented a net unrealized gain of \$0.6 million and \$8.2 million, respectively.

***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 currently do not have any such contracts outstanding.

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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*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 six months ended June 30, 2011 by approximately \$0.1 million. Based on this analysis, a hypothetical increase in interest rates of 1,000 basis points (10%) would have increased our interest expense by \$10.5 million for the six months ended June 30, 2011.

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**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 our Chief Financial Officer, we have evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of June 30, 2011. Based on that evaluation, our Chief Executive Officer and our Principal Financial Officer have concluded that these controls and procedures are effective at the reasonable assurance level as of June 30, 2011.

*Changes in Internal Controls over Financial Reporting.* We acquired Seadrift and St. Marys during the fourth quarter of 2010. We have extended the Section 404 compliance program under the Sarbanes-Oxley Act and the applicable rules and restrictions under the Act to include Seadrift and St. Marys. We will report on the assessment of the effectiveness of internal controls over financial reporting for the combined operations at December 31, 2011. There have been no other changes in our internal controls over financial reporting that occurred during the three months ended June 30, 2011 that materially affected or are reasonably likely to materially affect our internal controls over financial reporting.

**Table of Contents****PART I (CONT D)****GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES****(Unaudited)****Item 1. Legal Proceedings**

The information required by this Item is set forth on page 21 in Note 14, *Contingencies* of Notes to Consolidated Financial Statements and is incorporated herein by reference.

**Item 1A. Risk Factors**

The following additional Risk Factor should be read in conjunction with the Risk Factors set forth in Item 1A of the Annual Report.

*Risks related to our defined benefit pension plans may adversely impact our results of operations and cash flow.*

Significant changes in actual investment return on pension assets, discount rates, and other factors could adversely affect our results of operations and pension contributions in future periods. U.S. generally accepted accounting principles require that we calculate income or expense for the plans using actuarial valuations. These valuations reflect assumptions about financial markets and interest rates, which may change based on economic conditions. Funding requirements for our U.S. pension plans may become more significant. However, the ultimate amounts to be contributed are dependent upon, among other things, interest rates, underlying asset returns and the impact of legislative or regulatory changes related to pension funding obligations. For a discussion regarding the significant assumptions used to estimate pension expense, including discount rate and the expected long-term rate of return on plan assets see Note 12 in our Annual Report.

For a more complete discussion of these and other factors, see Risk Factors, in Part I, Item 1A of our Annual Report.

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

In December 2007, we announced that our Board of Directors had approved a share repurchase program authorizing the purchase of up to 3 million shares of our common stock. Purchases may take place from time to time in the open market, or through privately negotiated transactions, as market conditions warrant. In addition to the repurchase program, we occasionally purchase or withhold vested restricted stock shares from employees as payment for the withholding taxes due upon the vesting or payment of stock awards.

<i>Period</i>	<i>Total Number of Shares Purchased*</i>	<i>Average Price Paid per Share</i>	<i>Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs</i>	<i>Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs</i>
April 1 through April 30, 2011	6,852	\$ 20.60	0	2,051,905
May 1 through May 31, 2011	0	0.00	0	2,051,905
June 1 through June 30, 2011	0	0.00	0	2,051,905

\* Represents purchases of vested restricted stock shares from employees as payment for the withholding taxes due upon the vesting or payment of stock awards.

**Table of Contents****PART I (CONT D)****GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES****(Unaudited)****Item 3. Defaults upon Senior Securities**

Not applicable.

**Item 4. [Removed and Reserved.]****Item 5. Other Information.**

In accordance with the original recommendation of the Board and the expressed preference of our stockholders reflected in the advisory vote on Proposal 3 set forth in our Proxy Statement filed with the SEC on April 14, 2011, we have determined that we will include an advisory stockholder vote on executive compensation in our proxy materials on an annual basis until the next required advisory vote on the frequency of stockholder votes on executive compensation, which will occur no later than our Annual Meeting of Stockholders in 2017.

On July 25, 2011, our Vice President, General Counsel and Secretary, John D. Moran, entered into a severance compensation agreement with the Company similar to those applicable to the Company's other named executive officers that contains double-trigger change-in-control provisions where there must be both a change in control and termination to trigger severance payments to encourage continued employment following a change in control. The severance compensation agreements are described in the Company's Proxy Statement for the 2011 Annual Meeting of Stockholders filed with the SEC on April 14, 2011. The Company's 2011 form severance compensation agreement for our executive officers in the U.S. is attached hereto as Exhibit 10.11.2.

**Item 6. Exhibits**

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

<b>Exhibit</b>	<b>Description of Exhibit</b>
<b>Number</b>	<b>Description of Exhibit</b>
10.11.2	Form of Severance Compensation Agreement for Senior Management (2011 U.S. Version)
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 (Principal Executive Officer)
31.2	Certification pursuant to Rule 13a-14(a) under the Exchange Act by Craig S. Shular, Chief Executive Officer, President, and Chairman of the Board (Principal 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 (Principal Executive Officer)
32.2	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 (Principal Financial Officer)
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document

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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: July 28, 2011

By: */s/* Craig S. Shular  
Craig S. Shular

Chief Executive Officer, President, and

Chairman of the Board

(Principal Executive Officer)

**Table of Contents****EXHIBIT INDEX**

<b>Exhibit</b>	
<b>Number</b>	<b>Description of Exhibit</b>
*10.11.2	Form of Severance Compensation Agreement for senior management (U.S. 2.99 Version Revised)
*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 Craig S. Shular, Chief Executive Officer, President and Chairman of the Board.
*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 Craig S. Shular, Chief Executive Officer, President and Chairman of the Board.

\*Filed herewith

101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document