

GRAFTECH INTERNATIONAL LTD

Form 10-Q

October 27, 2016

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

for the quarterly period ended September 30, 2016

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 27-2496053
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification Number)

Suite 300 Park Center I 44131
6100 Oak Tree Boulevard (Zip code)
Independence, OH
(Address of principal executive offices)
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

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

As of October 15, 2016, 100 shares of common stock, par value \$.01 per share, were outstanding.

* The registrant is a voluntary filer and is not subject to the filing requirements of the Securities Exchange Act of 1934. However, during the preceding 12 months, the registrant has filed all reports that it would have been required to file by Section 13 or 15(d) of the Securities Exchange Act of 1934 if the registrant was subject to the filing requirements of the Securities Exchange Act of 1934.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(Dollars in thousands)

Unaudited

	Successor	
	As of December 31, 2015	As of September 30, 2016
ASSETS		
Current assets:		
Cash and cash equivalents	\$6,927	\$12,147
Accounts and notes receivable, net of allowance for doubtful accounts of \$300 as of December 31, 2015 and \$434 as of September 30, 2016	82,390	74,613
Inventories	218,130	166,683
Prepaid expenses and other current assets	21,157	22,792
Current assets of discontinued operations	98,281	94,886
Total current assets	426,885	371,121
Property, plant and equipment	571,329	594,727
Less: accumulated depreciation	20,166	61,810
Net property, plant and equipment	551,163	532,917
Deferred income taxes	15,326	20,324
Goodwill	172,059	171,117
Other assets	152,613	143,131
Long-term assets of discontinued operations	103,975	—
Total assets	\$1,422,021	\$1,238,610
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$40,147	\$41,982
Short-term debt	4,772	6,465
Accrued income and other taxes	5,933	5,577
Rationalizations	1,195	210
Other accrued liabilities	20,994	29,469
Current liabilities of discontinued operations	23,082	16,953
Total current liabilities	96,123	100,656
Long-term debt	362,455	364,132
Other long-term obligations	94,318	89,181
Deferred income taxes	57,430	46,867
Long-term liabilities of discontinued operations	1,167	867
Contingencies – Note 11		—
Stockholders' equity:		
Preferred stock, par value \$.01, 10,000,000 shares authorized, none issued	—	—
Common stock, par value \$.01, 225,000,000 shares authorized, 100 shares issued as of December 31, 2015 and September 30, 2016	—	—
Additional paid-in capital	854,337	854,337
Accumulated other comprehensive (loss) income	(10,255) 3,864
Accumulated deficit	(33,554) (221,294)

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Total stockholders' equity	810,528	636,907
Total liabilities and stockholders' equity	\$ 1,422,021	\$ 1,238,610
See accompanying Notes to Condensed Consolidated Financial Statements		

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GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES
 CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS
 (Dollars in thousands, except per share amounts)
 (Unaudited)

	Predecessor	Successor	
	For the Period July 1 2015 Through August 14, 2015	For the Period August 15, 2015 Through September 30, 2015	For the Three Months Ended September 30, 2016
CONSOLIDATED STATEMENTS OF OPERATIONS			
Net sales	\$ 51,604	\$ 74,774	\$ 111,590
Cost of sales	47,408	67,887	113,602
Additions to lower of cost or market inventory reserve	—	—	4,898
Gross profit (loss)	4,196	6,887	(6,910)
Research and development	710	220	526
Selling and administrative expenses	24,585	6,809	12,215
Rationalizations	(39)	156	—
Operating loss	(21,060)	(298)	(19,651)
Other expense (income), net	269	703	(567)
Interest expense	8,790	3,349	6,964
Interest income	(22)	(21)	(158)
Loss from continuing operations before provision for income taxes	(30,097)	(4,329)	(25,890)
Provision for (benefit from) income taxes	5,234	1,107	(1,789)
Net loss from continuing operations	(35,331)	(5,436)	(24,101)
(Loss) income from discontinued operations, net of tax	(6,893)	(1,867)	1,134
Net loss	\$ (42,224)	\$ (7,303)	\$ (22,967)
STATEMENTS OF COMPREHENSIVE LOSS			
Net loss	\$ (42,224)	\$ (7,303)	\$ (22,967)
Other comprehensive loss:			
Foreign currency translation adjustments	(5,840)	(5,966)	2,300
Commodities and foreign currency derivatives and other, net of tax of \$10, \$13 and \$(12), respectively	375	(237)	118
Other comprehensive (loss) income, net of tax:	(5,465)	(6,203)	2,418
Comprehensive loss	\$ (47,689)	\$ (13,506)	\$ (20,549)

See accompanying Notes to Condensed Consolidated Financial Statements

GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES

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CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS

(Dollars in thousands, except per share amounts)

(Unaudited)

	Predecessor	Successor	
	For the	For the	For the
	Period	Period	Nine
	January 1	August	Months
	Through	15, 2015	Ended
	August 14,	Through	September
	2015	September	30, 2016
		30, 2015	
CONSOLIDATED STATEMENTS OF OPERATIONS			
Net sales	\$ 339,907	\$ 74,774	\$ 322,530
Cost of sales	305,001	67,887	331,297
Additions to lower of cost or market inventory reserve	—	—	19,523
Gross profit (loss)	34,906	6,887	(28,290)
Research and development	3,377	220	1,964
Selling and administrative expenses	64,383	6,809	39,372
Rationalizations	14	156	58
Impairments	35,381	—	—
Operating loss	(68,249)	(298)	(69,684)
Other expense (income), net	1,421	703	(1,528)
Interest expense	26,211	3,349	19,860
Interest income	(363)	(21)	(169)
Loss from continuing operations before provision for income taxes	(95,518)	(4,329)	(87,847)
Provision for (benefit from) income taxes	6,452	1,107	(7,675)
Net loss from continuing operations	(101,970)	(5,436)	(80,172)
Loss from discontinued operations, net of tax *	(18,679)	(1,867)	(107,568)
Net loss	\$(120,649)	\$(7,303)	\$(187,740)
STATEMENTS OF COMPREHENSIVE LOSS			
Net loss	\$(120,649)	\$(7,303)	\$(187,740)
Other comprehensive loss:			
Foreign currency translation adjustments	(27,936)	(5,966)	13,974
Commodities and foreign currency derivatives and other, net of tax of (\$68), \$13 and \$1, respectively	1,262	(237)	145
Other comprehensive (loss) income, net of tax:	(26,674)	(6,203)	14,119
Comprehensive loss	\$(147,323)	\$(13,506)	\$(173,621)

* Loss on discontinued operations includes a pretax impairment charge of \$105,600 in the nine months ended September 30, 2016. See Note 3 "Discontinued Operations and Related Assets Held for Sale"

See accompanying Notes to Condensed Consolidated Financial Statements

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CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in thousands, unaudited)

	Predecessor	Successor	
	For the	For the	For the
	Period	Period	Nine
	January 1	August	Months
	Through	15, 2015	Ended
	August 14,	Through	September
	2015	September	30, 2016
		30, 2015	
Cash flow from operating activities:			
Net loss	\$(120,649)	\$(7,303)	\$(187,740)
Adjustments to reconcile net loss to cash provided by operations:			
Depreciation and amortization	45,461	10,604	62,775
Impairments	35,381	—	105,623
Change in lower of cost or market inventory reserve, net of depreciation	—	—	6,000
Deferred income tax provision	924	863	(11,738)
Post-retirement and pension plan changes	2,998	486	3,164
Stock-based compensation	15,357	—	—
Interest expense	14,180	786	4,872
Other charges, net	102	(492)	(2,042)
Net change in working capital*	45,594	(47)	54,005
Increase in long-term assets and liabilities	(11,025)	(985)	(6,188)
Net cash provided by operating activities	28,323	3,912	28,731
Cash flow from investing activities:			
Capital expenditures	(32,301)	(5,239)	(22,257)
Proceeds from the sale of assets	646	542	685
Derivative instrument settlements, net	(8,263)	84	(1,171)
Net cash used in investing activities	(39,918)	(4,613)	(22,743)
Cash flow from financing activities:			
Short-term debt, net	18,511	(10,180)	503
Revolving Facility borrowings	160,000	22,000	40,000
Revolving Facility reductions	(99,000)	(21,000)	(41,000)
Repayment of Senior Subordinated Notes	(200,000)	—	—
Issuance of Preferred Shares	150,000	—	—
Principal payments on long-term debt	(89)	(12)	(104)
Proceeds from exercise of stock options	32	—	—
Purchase of treasury shares	(63)	—	—
Revolving Facility refinancing fees	(5,068)	—	(922)
Other	(3,499)	(1,385)	—
Net cash provided by (used in) financing activities	20,824	(10,577)	(1,523)
Net change in cash and cash equivalents	9,229	(11,278)	4,465
Effect of exchange rate changes on cash and cash equivalents	(1,746)	(294)	755
Cash and cash equivalents at beginning of period	17,550	25,033	6,927
Cash and cash equivalents at end of period	\$25,033	\$13,461	\$12,147

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

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Accounts and notes receivable, net	\$61,008	\$(16,927)	\$9,685
Inventories	1,164	18,436	41,399
Prepaid expenses and other current assets	2,551	3,375	(1,170)
Change in accounts payable and accruals	(18,728)	(5,822)	1,774
Rationalizations	(2,677)	(1,642)	(2,544)
Increase in interest payable	2,276	2,533	4,861
Net change in working capital	\$45,594	\$(47)	\$54,005
See accompanying Notes to Condensed Consolidated Financial Statements			

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PART I (CONT'D)

GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(1) Organization and Summary of Significant Accounting Policies

A. Organization

GrafTech International Ltd. (the "Company") 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 seven major product categories: graphite electrodes, refractory products, needle coke products, advanced electronics technologies, advanced graphite materials, advanced composite materials and advanced materials.

On February 26, 2016, the Company announced it plans to realign its two business segments. Industrial Materials will now be comprised of graphite electrodes and needle coke products. Engineered Solutions will now be comprised of advanced graphite materials, advanced composite materials, advanced electronic technologies, and refractory products. Refractory products was previously included in the Industrial Materials business segment. Advanced materials products will now be a part of the business segment where these products are produced.

This realignment of the business segments will allow the Company to better direct its resources and simplify its operations. The Industrial Materials business segment will continue to focus on being the lowest cost producer providing the best quality of graphite electrodes in a very challenging market. The Engineered Solutions business segment will continue to leverage the intellectual property of carbon and graphite material science to innovate and commercialize advanced technologies and new products in high growth markets.

The Company also announced that it plans to review strategic alternatives for its Engineered Solutions business segment. This process is currently under way. See Note 3 "Discontinued Operations and Assets Held for Sale" for further information.

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"). The December 31, 2015 financial position data included herein was derived from the audited consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2015 (the "Annual Report") but does not include all disclosures required by GAAP in audited financial statements. These interim consolidated financial statements should be read in conjunction with the audited consolidated financial statements, including the accompanying notes, contained in 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, comprehensive income and cash flows for the interim periods 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. Predecessor and Successor Reporting

On August 17, 2015, the Company was acquired by affiliates of Brookfield Asset Management Inc. (see Note 2 "Preferred Share Issuance and Merger"). We elected to account for the acquisition under the acquisition method of accounting. Under the acquisition method of accounting, the assets and liabilities of GTI were adjusted to their fair market value as of August 15, 2015, the day that Brookfield effectively took control of the Company.

Our consolidated statements of operations subsequent to the acquisition include amortization expense relating to the fair value adjustments and depreciation expense based on the fair value of the Company's property, plant and equipment that had previously been carried at historical cost less accumulated depreciation. Therefore, the Company's financial information prior to the acquisition is not comparable to the financial information subsequent to the Merger. As a result, the financial statements and certain note presentations are separated into two distinct periods, the period before the consummation of the acquisition (labeled "Predecessor") and the period after the date of acquisition (labeled "Successor"), to indicate the application of the different basis of accounting between the periods presented.

PART I (CONT'D)

GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

D. New Accounting Standards

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers. This ASU supersedes the revenue recognition requirements in Accounting Standards Codification 605—Revenue Recognition and most industry-specific guidance throughout the Codification. This ASU requires that an entity recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This ASU was expected to be effective for fiscal years beginning after December 15, 2016, and for interim periods within those fiscal years. On July 9, 2015, the FASB deferred the effective date to fiscal years beginning after December 15, 2017. We are in the process of assessing the impact of the adoption of ASU 2014-09 on the Company's financial position, results of operations and cash flows. In April 2015, the FASB issued ASU 2015-3, Simplifying the Presentation of Debt Issuance Costs, which requires debt issuance costs to be presented in the balance sheet as a direct deduction from the carrying value of the associated debt liability. The standard is effective for financial statements issued for fiscal years beginning after December 15, 2015 with early adoption permitted. We had no capitalized debt issuance costs as of December 31, 2015. We adopted this ASU as of January 1, 2016, and adoption resulted in no significant impact on the Company's financial position, results of operations or cash flows.

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842). Under this new guidance, a company will now recognize most leases on its balance sheet as lease liabilities with corresponding right-of-use assets. This ASU is effective for fiscal years beginning after December 15, 2018. The Company is currently evaluating the impact of the adoption of this standard on its financial position, results of operations or cash flows.

(2) Preferred Share Issuance and Merger

Preferred Stock

On August 11, 2015, the Company issued and sold to BCP IV GrafTech Holdings LP ("BCP"), an affiliate of Brookfield Asset Management Inc. ("Brookfield") (i) 136,616 shares of a new Series A Convertible Preferred Stock, par value \$0.01 per share (the "Series A Preferred Stock"), convertible into 19.9% of the shares of common stock of the Company outstanding immediately prior to such issuance and (ii) 13,384 shares of a new Series B Convertible Preferred Stock, par value \$0.01 per share (the "Series B Preferred Stock," and, together with the Series A Preferred Stock, the "Preferred Stock"), for an aggregate purchase price of \$150,000,000 in cash (the "Purchase Price"), under the Investment Agreement dated May 4, 2015 (the "Investment Agreement") between the Company and Brookfield. The closing of such issuance and sale occurred after the satisfaction of the closing conditions set forth in the Investment Agreement.

Pursuant to the Investment Agreement, the Company reimbursed Brookfield for \$500,000 of out-of-pocket fees and expenses (including fees and expenses of legal counsel) incurred by Brookfield in connection with the transaction. The proceeds from the issuance and sale were used by the Company, along with funds available under the Company's \$40 million delayed draw term loan facility, senior revolving credit facility and cash on hand, to prepay the Company's \$200 million Senior Subordinated Notes due November 30, 2015.

Merger Agreement

On May 18, 2015, the Company entered into an Agreement and Plan of Merger (the "Merger Agreement"), dated May 17, 2015, with BCP and Athena Acquisition Subsidiary Inc. a wholly owned subsidiary of BCP ("Acquisition Sub"). Pursuant to the Merger Agreement, on May 26, 2015, BCP commenced a cash tender offer to purchase any and all of the outstanding shares of common stock, par value \$0.01 per share (the "Shares"), of the Company, at a purchase price of \$5.05 per Share in cash (the "Offer Price"), on the terms and subject to the conditions set forth in the Offer to Purchase, dated May 26, 2015 (together with any amendments and supplements thereto, the "Offer to Purchase") and in the related Letter of Transmittal (the "Letter of Transmittal" and, together with the Offer to Purchase, the "Offer"). On August 14, 2015, Acquisition Sub accepted for payment all Shares validly tendered in the Offer and not withdrawn prior to the expiration of the Offer, and payment of the Offer Price for such Shares was made promptly. On August

17, 2015, Acquisition Sub merged with and into the Company, with the Company surviving as a wholly-owned subsidiary of BCP (the "Merger").

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PART I (CONT'D)

GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Pursuant to the Merger Agreement, upon consummation of the Merger, each Share that was not tendered and accepted pursuant to the Offer (other than canceled shares, dissenting shares and shares held by the Company's subsidiaries or BCP's subsidiaries (other than Acquisition Sub)) was canceled and converted into cash consideration in an amount equal to the Offer Price.

Business Combination

The computation of the fair value of the total consideration at the date of acquisition follows:

Purchase Consideration

(In thousands except share price)

	# Shares	Unit Price	Amount
Convertible Preferred Equity			
Series A and B	150	\$1,000.00	\$150,000
Common Equity			
Common Shares	139,397	\$5.05	\$703,955
Net value of options			\$382
Total			\$854,337

Recording of assets acquired and liabilities assumed: The acquisition was accounted for using the acquisition method of accounting. 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 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 following table summarizes the fair values of the identifiable assets acquired and liabilities assumed at the acquisition date:

Net identifiable assets acquired

Cash	\$25,032
Accounts receivable	94,298
Inventories	344,765
Property, plant and equipment	650,405
Intangible assets	155,700
Deferred tax assets	41,606
Prepaid and other current assets	49,716
Other non-current assets	8,428
Accounts payable	(68,005)
Short-term debt	(18,779)
Other accrued liabilities	(53,252)
Long-term debt	(367,811)
Other long-term liabilities	(101,648)
Deferred tax liabilities	(79,235)
Net identifiable assets acquired	\$681,220

Goodwill	\$173,117
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Net assets acquired \$854,337

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PART I (CONT'D)

GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Goodwill: Goodwill of approximately \$173.1 million was recognized for the acquisition 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. Goodwill was increased by \$1.1 million in March 2016, as a result of a decreased inventory valuation of \$2.0 million offset by an increase to deferred tax assets of \$0.9 million.

(3) Discontinued Operations and Related Assets Held for Sale

On February 26, 2016, the Company announced that it had initiated a strategic review of its Engineered Solutions business segment to better direct its resources and simplify its operations. Any potential sale of assets was prohibited by the Revolving Facility without approval of the requisite lenders thereunder. On April 27, 2016, GrafTech and certain of its subsidiaries entered into an amendment to the Revolving Facility (see Note 8 "Debt and Liquidity") which, among other things, permits the sale of assets with the restriction that the proceeds be utilized to pay down revolver borrowings. As of June 30, 2016, the Engineered Solutions segment qualified for reporting as discontinued operations as we expect the divestiture to be complete within 12 months of the qualification.

During the second quarter, we evaluated the fair value of the Engineered Solutions business segment utilizing the market approach (Level 3 measure). As a result, we incurred an impairment charge to our Engineered Solutions business segment of \$105.6 million to align the carrying value with estimated fair value. The analysis was updated as of September 30, 2016, and did not result in further adjustment. The estimate reflects Management's view of the manner in which the Engineered Solutions business will be divested, including assumptions as to if and how it will be split, given the lines of business and asset groups that constitute the Engineered Solutions segment. Amongst other things, the split into groups influences the computation of the impairment charge. The impairment charge and resulting loss in the nine months ended September 30, 2016 is not offset by expected gains on certain group(s), and as a result may or may not later be partially offset through gains depending on the outcome of the divestiture. These assumptions and estimates are subject to change until divestiture is completed and may be adjusted in the quarter that the information becomes available.

PART I (CONT'D)

GRAFTECH INTERNATIONAL LTD. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

The following tables summarize the results of the Engineered Solutions business segment, reclassified as discontinued operations for the three and nine months ended September 30, 2015 and 2016.

For the
Period
July 1
2015
Through
August
14, 2015