CROMPTON CORP
Form 10-K/A
December 23, 2003

U.S. SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K/A

(Mark One)

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2002

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 No. 0-30270

Crompton Corporation

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	**52-2183153** (I.R.S. Employer Identification Number)
199 Benson Road, Middlebury, Connecticut (Address of principal executive offices)	**06749** (Zip Code)

Registrant s telephone number, including area code: (203) 573-2000

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, $0.01 par value	**New York Stock Exchange**

Securities registered pursuant to Section 12(g) of the Act: NONE

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 x No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this
Form 10-K. o

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act).

Yes x No o

The aggregate market value of the voting stock held by non-affiliates of the registrant, computed as of February 28, 2003, was $536,903,925.

The number of shares of Common Stock of the registrant outstanding as of February 28, 2003, was 114,281,040.

DOCUMENTS INCORPORATED BY REFERENCE

Annual Report to Stockholders for fiscal year ended December 31, 2002	Parts I, II and IV
Proxy Statement for Annual Meeting of Stockholders on April 29, 2003	Part III

CROMPTON CORPORATION
AMENDMENT TO ANNUAL REPORT ON FORM 10-K/A
FOR THE YEAR-ENDED DECEMBER 31, 2002

EXPLANATORY NOTE

Pursuant to Rule 12b-15 of the Securities Exchange Act of 1934, this Amendment on Form 10-K/A to the Annual Report on Form 10-K of Crompton Corporation (the Company) for the year ended December 31, 2002 is being filed to (i) revise certain disclosures included in the Notes to Consolidated Financial Statements and (ii) revise the Company s Consolidated Statements of Cash Flows for the years ended December 31, 2002, 2001 and 2000. The Company has provided an explanation of these revisions below.

Revised Disclosure

The Company has reviewed its accounting treatment of the divestiture of the industrial specialties business unit and determined that the assets of the divested industrial specialties business met the held-for-disposal criteria under FASB Statement No. 121, Accounting for the Impairment of Long-Lived Assets to Be Disposed Of, as of December 31, 2001. Accordingly, the Company has provided additional disclosures related to the sale of the industrial specialties business unit in the Divestitures and Joint Ventures footnote included in the Notes to Consolidated Financial Statements in this Form 10-K/A.

Change in Cash Flow Classification

The Company has reclassified the cash flows from its accounts receivable programs from Cash Flows from Financing Activities to Cash Flows from Operating Activities in its Consolidated Statements of Cash Flows for the years ended December 31, 2002, 2001 and 2000. In addition, the Company has provided additional disclosures related to its accounts receivable programs in the Accounts Receivable Programs footnote included in the Notes to Consolidated Financial Statements.

The revisions described above are reflected in Item 6 Selected Financial Data (the net cash provided by operations line), Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations (the second paragraph of the Liquidity and Capital Resources section), and Item 8 Financial Statements and Supplementary Data of Part II, which are filed herewith. Such revisions have no impact on the Independent Auditor s Report included in the Company s Form 10-K for the year ended December 31, 2002 originally filed with the SEC on March 20, 2003.

This Amendment on Form 10-K/A also amends Item 14 Controls and Procedures of Part III and Item 15 Exhibits, Financial Schedules, and Reports on Form 8-K of Part IV of the Company s original Form 10-K. The Company s disclosure in Item 14 has been amended to comply with the SEC rules regarding disclosure controls and procedures adopted in SEC Release No. 33-8238 (June 5, 2003).

This Amendment on Form 10-K/A continues to reflect circumstances as of the date of the original filing on Form 10-K and has not been updated to reflect events that occurred at a later date.

PART II

ITEM 6. SELECTED FINANCIAL DATA

FIVE YEAR SELECTED FINANCIAL DATA

(In millions of dollars, except per share data)	**2002**	2001	2000	1999(a)	1998(a)
Summary of Operations					
Net sales	**$ 2,546.9**	2,718.8	3,038.4	2,092.4	1,796.1
Gross profit	**$ 792.7**	813.5	961.3	731.0	649.9
Operating profit (loss)	**$ 146.4**	(53.6)	268.3	1.4	218.3
Interest expense	**$ 101.7**	109.9	120.4	69.8	78.5
Other expense (income)	**$ 35.4**	25.1	5.5	48.0	(158.9)
Earnings (loss) before income taxes, extraordinary loss and cumulative effect of accounting change	**$ 9.3**	(188.6)	142.4	(116.4)	298.7
Income taxes (benefit)	**$ (6.2)**	(64.7)	53.1	42.9	115.4
Earnings (loss) before extraordinary loss and cumulative effect of accounting change	**$ 15.5**	(123.9)	89.3	(159.3)	183.3
Extraordinary loss	**$**			(15.7)	(21.5)
Cumulative effect of accounting change	**$ (299.0)**				
Net earnings (loss)	**$ (283.5)**	(123.9)	89.3	(175.0)	161.8
After-tax special items (included above):					
Facility closures, severance and related costs	**$ (14.6)**	(75.0)	(15.0)		(21.1)
Antitrust investigation costs	**$ (3.9)**				
Impairment of long-lived assets	**$**	(50.8)			
Gain (loss) on sale of business units	**$ (21.1)**	(14.1)		(38.7)	92.1
Cumulative effect of accounting change	**$ (299.0)**				
Acquired in-process research and development	**$**			(195.0)	
Merger and related costs	**$**			(20.6)	
Early extinguishment of debt	**$**			(15.7)	(21.5)
Other	**$**				(5.0)
Total after-tax special items	**$ (338.6)**	(139.9)	(15.0)	(270.0)	44.5
Per Share Statistics					
Basic					
Earnings (loss) before extraordinary loss and cumulative effect of accounting change	**$ .13**	(1.10)	.78	(1.91)	2.48
Net earnings (loss)	**$ (2.50)**	(1.10)	.78	(2.10)	2.20
Diluted					
Earnings (loss) before extraordinary loss and cumulative effect of accounting change	**$ .13**	(1.10)	.78	(1.91)	2.42
Net earnings (loss)	**$ (2.45)**	(1.10)	.78	(2.10)	2.14
Dividends	**$ .20**	.20	.20	.10	.05
Book value	**$ 1.76**	4.84	6.69	6.50	.96
Common stock trading range: High	**$ 13.00**	12.19	14.19	21.38	32.81
Low	**$ 5.44**	6.20	6.94	7.13	13.25
Average shares outstanding (thousands) Basic	**113,568**	113,061	113,644	83,507	73,696
Average shares outstanding (thousands) Diluted	**115,656**	113,061	115,165	83,507	75,700
Financial Position					
Working capital	**$ 95.6**	132.5	361.4	141.8	203.4
Current ratio	**1.1**	1.2	1.5	1.1	1.5

Total assets	**$ 2,840.8**	3,232.2	3,528.3	3,726.6	1,408.9
Total debt	**$ 1,267.6**	1,422.6	1,506.8	1,391.0	664.2
Stockholders equity	**$ 199.9**	547.5	754.0	759.9	66.7
Total capital employed	**$ 1,467.5**	1,970.2	2,260.8	2,150.9	730.9
Debt to total capital %	**86.4**	72.2	66.7	64.7	90.9
Other Statistics					
Net cash provided by operations	**$ 201.8**	205.0	210.6	88.6	249.5
Capital spending	**$ 100.3**	136.6	154.8	131.8	66.6
Depreciation	**$ 133.8**	146.7	142.7	89.2	59.4
Amortization	**$ 12.8**	38.9	39.3	27.4	21.1
Number of employees	**6,777**	7,340	8,306	8,612	5,536

(a) The Company s 1998 and 1999 operating results may not be comparable to its operating results in subsequent periods due to the merger of Crompton & Knowles Corporation and Witco Corporation on September 1, 1999.

ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

LIQUIDITY AND CAPITAL RESOURCES

The December 31, 2002 working capital balance of $95.6 million decreased $36.9 million from the December 31, 2001 balance of $132.5 million, and the current ratio decreased to 1.1 from 1.2 in 2001. The decreases in working capital and the current ratio were primarily due to a decrease in inventory and an increase in accounts payable, partially offset by decreases in notes payable and accrued expenses. Average days sales in receivables decreased to 27 days in 2002, versus 39 days in 2001, primarily due to improved collection efforts and the impact of accounts receivable securitization programs. Excluding the accounts receivable securitization programs, average days sales in receivables decreased to 63 days in 2002 versus 69 days in 2001. Average inventory turnover increased to 3.8 in 2002, compared to 3.4 in 2001, primarily as a result of the Company s ongoing efforts to reduce its inventory investment.

Net cash provided by operations of $201.8 million decreased $3.3 million from $205.0 million in 2001. The decrease was mainly due to a decline in accounts receivable securitization and less of a reduction in accounts receivable versus 2001, partially offset by a $50 million federal income tax refund resulting from a recent change in tax legislation and improvements in other assets, accounts payable and other liabilities versus 2001. Net cash provided by operations plus proceeds from the sale of the industrial specialties business unit were used primarily to reduce short-term and long-term borrowings, finance capital expenditures and make dividend payments. The Company s debt to total capital increased to 86% in 2002 from 72% in 2001. The increase is due to the decline in stockholders equity resulting principally from the cumulative effect of accounting change of $299 million related to the implementation of FASB Statement No. 142 recorded as of January 1, 2002, partially offset by a reduction of debt of $155 million.

The Company has a five-year revolving credit facility of $400 million available through October 2004. Borrowings on this facility are at various rate options to be determined on the date of borrowing. Borrowings under this facility totaled $25 million at December 31, 2002 and carried an interest rate of 3.56%. The Company had a 364-day revolving credit facility of $125 million that expired in September 2002.

In 2003, the Company will retire $165 million of maturing notes and approximately $57 million of maturing EURIBOR based bank loans. The Company will utilize net cash provided by operations, proceeds from any future divestitures and its credit facility to fund these debt repayments.

The Company also has arrangements with various banks for lines of credit for its international subsidiaries aggregating $30.2 million, of which $4.7 million was outstanding at December 31, 2002.

In addition, the Company has an accounts receivable securitization program to sell up to $200 million of domestic accounts receivable to agent banks. At December 31, 2002, $136.5 million of domestic accounts receivable had been sold under these agreements. On January 17, 2003, the agreement was amended to reduce the program to $150 million of domestic accounts receivable. In addition, the Company s European subsidiaries have two separate agreements to sell their eligible accounts receivable to agent banks. At December 31, 2002, $101 million of eligible international accounts receivable had been sold under these agreements.

The Company has standby letters of credit and guarantees with various financial institutions. At December 31, 2002, the Company had $57.4 million of outstanding letters of credit and guarantees primarily related to its environmental remediation liabilities, insurance obligations and a potential tax exposure.

The following table summarizes our significant contractual cash obligations as of December 31, 2002. Additional details regarding these items are included in the Indebtedness and Leases footnotes in the Notes to Consolidated Financial Statements.

(In millions)	Payments Due by Period					
Contractual Obligations	Total	2003	2004	2005	2006	2007 and Thereafter
Long-term debt	$ 1,261.8	$ 222.1	$ 29.6	$ 602.4	$ 152.6	$ 255.1
Operating leases	124.9	23.5	17.5	14.9	13.0	56.0
	$ 1,386.7	$ 245.6	$ 47.1	$ 617.3	$ 165.6	$ 311.1

On June 28, 2002, the Company sold its industrial specialties business unit (excluding retained accounts receivable and accounts payable, with a net value of approximately $10 million) for $95 million, including cash proceeds of $80 million and a note receivable of $15 million due February 2003. The sale resulted in a pre-tax loss of $34.7 million. The proceeds from this transaction were used to repay indebtedness under the Company s five-year revolving credit facility.

During 2002, the Company recorded a pre-tax charge of $23.3 million for facility closures, severance and related costs. This charge related primarily to the July 2001 cost reduction initiative and the relocation of the corporate headquarters announced in October of 2001. As of December 31, 2002, the Company s cost savings initiative successfully reduced annual operating costs by approximately $60 million.

The Company substantially completed the relocation of its corporate headquarters from Greenwich, CT to Middlebury, CT during the fourth quarter of 2002 and entered into a sublease agreement for a portion of the Greenwich facility. The Company estimates that pre-tax charges relating to the move will approximate $13 million, of which approximately $9 million has been expensed to facility closures, severance and related costs as of December 31, 2002. In addition, the Company expects to realize pre-tax savings of approximately $4 million in 2003 and total pre-tax savings of approximately $8 million per year beginning in 2004.

Capital expenditures for 2002 amounted to $100.3 million as compared to $136.6 million in 2001.The decrease is primarily due to an overall reduction in capital spending and the completion in 2001 of facility expansions for OrganoSilicones in Sistersville, West Virginia and Termoli, Italy. Capital expenditures are expected to approximate $115 million in 2003, primarily for the Company s replacement needs and improvement of domestic and foreign facilities.

ANTITRUST INVESTIGATIONS AND RELATED MATTERS

Antitrust Investigations

The Company and certain of its subsidiaries, together with other domestic and foreign companies, are currently the subject of coordinated criminal investigations being conducted by the United States Department of Justice (the DOJ) and the Canadian Competition Bureau (the CCB) and a coordinated civil investigation being conducted by the European Commission (together with the DOJ and the CCB, the Governmental Authorities) with respect to possible antitrust violations relating to the sale and marketing of certain rubber processing chemicals, ethylene propylene diene monomer (EPDM) and heat stabilizers. The investigations concern possible anticompetitive practices, including price fixing and customer or market allocations, undertaken by the Company and such subsidiaries and certain of their officers and employees. According to reports in the press, The Japan Fair Trade Commission (the JFTC) is conducting an investigation regarding heat stabilizers, impact modifiers and processing aids for plastic. The Company has not been contacted by the JFTC. The Company is actively cooperating with the Governmental Authorities regarding such investigations. Since inception of the investigations, the Company has been conducting its own internal investigation with the assistance of special counsel. Neither the Company, any of its subsidiaries, nor any individual has, to date, been charged in connection with the investigations.

It is the Company s understanding that the investigations by the Governmental Authorities are, as previously stated, focused on rubber processing chemicals, including accelerators, antioxidants and antiozonants (with 2002 sales of $206 million), EPDM (with 2002 sales of $135 million), and heat stabilizers, including tin-based stabilizers and precursors, mixed metal stabilizers and epoxidized soybean oil (ESBO) (with 2002 sales of approximately $220 million).

With respect to rubber chemicals, the Company has held preliminary discussions with the DOJ regarding a possible plea to violations of antitrust laws. At this time, the Company cannot predict the outcome of those discussions, including the timing or the terms of any agreement with the DOJ or the amount of any fines that may be imposed. Moreover, at this time, the Company cannot determine the extent to which criminal or civil fines or other sanctions might be imposed by the other Governmental Authorities. The Company has met and is continuing to meet with the Governmental Authorities in an attempt to resolve all matters relating to the investigations.

With respect to EPDM and heat stabilizers, the Company and its affiliates that are subject to the investigations have received from each of the Governmental Authorities verbal or written assurances of conditional amnesty from prosecution and fines. The European Commission s grant of conditional amnesty with respect to heat stabilizers is presently limited to tin-based stabilizers and their precursors, but the Company expects to be granted conditional amnesty by the European Commission with respect to mixed metal stabilizers and ESBO in the near future. The assurances of

management s discussion and analysis of financial condition and results of operations*continued*

conditional amnesty are conditioned upon several factors, including continued cooperation with the Governmental Authorities.

As previously stated, the Company is conducting a continuing internal investigation of the matters under investigation by the Governmental Authorities, including a review as to any improper or criminal conduct by current and former officers and employees of the Company and its affected subsidiaries. Further, the Company and its special counsel assisting in the investigation are reviewing all other areas of the Company s business and products to determine compliance with applicable antitrust law and with the Company s antitrust guidelines and policies. In connection with the investigations, a senior officer of the Company has been placed on paid administrative leave.

The resolution of any possible antitrust violations against the Company and certain of its subsidiaries and the resolution of any civil claims now pending or hereafter asserted against them may have a material adverse effect on the Company s financial condition, results of operations and prospects. No assurances can be given regarding the outcome or timing of these matters. Through December 31, 2002, the Company has incurred $6.3 million (pre-tax) of antitrust investigation costs, and expects to continue to incur substantial costs until all antitrust investigations are concluded.

The Company has named a compliance officer who will report to the Chief Executive Officer and the Chairman of the Audit Committee. The primary duties of the compliance officer will be to administer the Company s compliance program in accordance with policies and procedures adopted by the Board of Directors of the Company.

State Class Actions

The Company and certain of its subsidiaries along with other companies, have been named as defendants in twenty putative indirect purchaser class action lawsuits filed during the period from October, 2002 through December, 2002 in state courts in seventeen states and in the District of Columbia. The putative class in each of the actions comprises all persons within each of the applicable states and the District of Columbia who purchased tires other than for resale that were manufactured using rubber processing chemicals sold by the defendants since 1994. The complaints principally allege that the defendants agreed to fix, raise, stabilize and maintain the price of rubber processing chemicals used as part of the tire manufacturing process in violation of state antitrust and consumer protection laws and that this illegal conspiracy caused injury to individuals who paid more to purchase tires as a result of such anticompetitive activities. The plaintiffs seek, among other things, treble damages of an unspecified amount, interest and attorneys fees and costs. The Company and its defendant subsidiaries have filed or intend to file motions to dismiss on substantive and personal jurisdictional grounds or answers with respect to each of these actions.

These actions are in early procedural stages of litigation and, accordingly, the Company cannot predict their outcome. The Company and its defendant subsidiaries believe that they have substantial defenses to these actions and intend to defend vigorously all such actions.

ACCOUNTING DEVELOPMENTS

Effective January 1, 2002, the Company adopted the provisions of Financial Accounting Standards Board (FASB) Statement No. 141, Business Combinations and Statement No. 142, Goodwill and Other Intangible Assets. The Company implemented the provisions of Statement No. 141 during the first quarter and completed the implementation of Statement No. 142 during the second quarter. For further details, see the Goodwill and Intangible Assets footnote included in the Notes to Consolidated Financial Statements.

In June 2001, the FASB issued Statement No. 143, Accounting for Asset Retirement Obligations. Statement No. 143 requires companies to record a liability for asset retirement obligations in the period in which a legal obligation is created. Such liabilities are recorded at fair value, with an offsetting increase to the carrying value of the related long-lived assets. In future periods, the liability is accreted to its present value and the capitalized cost is depreciated over the useful life of the related asset. Companies are also required to adjust the liability for changes resulting from the passage of time and/or revisions to the timing or the amount of the original estimate. Upon retirement of the long-lived asset, the Company either settles the obligation for its recorded amount or incurs a gain or loss. The provisions of Statement No. 143 are effective for fiscal years beginning after June 15, 2002. The Company is in the process of implementing the provisions of Statement No. 143 and does not expect the implementation to have a material impact on its earnings or financial position.

Effective January 1, 2002, the Company adopted the provisions of Statement No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. The Company reviewed the provisions of Statement No. 144 and concluded that it is in compliance with the provisions of this Statement and there is no implementation impact.

In June 2002, the FASB issued Statement No. 146, Accounting for Costs Associated with Exit or Disposal Activities. Statement No. 146 requires companies to record exit or disposal costs when they are incurred and to initially measure these costs at fair value. Statement No. 146 also requires that recorded liabilities be adjusted in future periods to reflect changes in timing or estimated cash flows. The provisions of Statement No. 146 are effective for exit or disposal activities initiated after December 31, 2002. The Company is in compliance with existing accounting requirements and will adopt the provisions of Statement No.146 effective January 1, 2003.

In December 2002, the FASB issued Statement No. 148, Accounting for Stock-Based Compensation Transition and Disclosure. Statement No. 148 amends Statement No. 123, Accounting for Stock-Based Compensation, by providing alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. Additionally, Statement No. 148 requires expanded disclosures in both interim and annual financial statements about the method used to account for stock-based compensation and the effect on reported results. At December 31, 2002, the Company continued to apply the provisions of Accounting Principles Board Opinion (APB) 25, Accounting for Stock Issued to Employees, and has implemented the new disclosure requirements of Statement No. 148, which is included in the Accounting Policies footnote in the Notes to Consolidated Financial Statements.

In November 2002, the FASB issued Interpretation No. 45, Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others. Interpretation No. 45 requires the guarantor to recognize a liability for the non-contingent component of a guarantee; that is, the obligation to stand ready to perform in the event that specified triggering events or conditions occur. The initial measurement of this liability is the fair value of the guarantee at its inception. The recognition and measurement provisions of Interpretation No. 45 are effective for all guarantees entered into or modified after December 31, 2002. Interpretation No. 45 also requires additional disclosures related to guarantees in interim and annual financial statements. The Company has implemented the new disclosure requirements of Interpretation No. 45 at December 31, 2002. See the Contingencies and Environmental Matters footnote included in the Notes to Consolidated Financial Statements for further details.

In January 2003, the FASB issued Interpretation No. 46, Consolidation of Variable Interest Entities. Interpretation No. 46 requires existing unconsolidated variable interest entities (VIEs) to be consolidated by their primary beneficiaries if the entities do not effectively disperse risks among the parties involved. The Interpretation applies immediately to VIEs created after January 31, 2003 and to VIEs in which an enterprise obtains an interest after that date. For VIEs in which an enterprise holds a variable interest that was acquired before February 1, 2003, the Interpretation applies for periods beginning after June 15, 2003. The Company has no unconsolidated VIEs and therefore its consolidated financial statements are in compliance with the requirements of Interpretation No. 46 at December 31, 2002.

CRITICAL ACCOUNTING AREAS

The Company s consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America, which require the Company to make estimates and assumptions that affect the amounts and disclosures reported in the consolidated financial statements and accompanying notes. The Company s estimates are based on historical experience and currently available information. Actual results could differ from such estimates. The following paragraphs summarize the Company s critical accounting areas. Additional accounting policies are discussed in the Notes to Consolidated Financial Statements.

Allowance for Doubtful Accounts

The Company regularly reviews past due accounts receivable balances and information regarding the financial stability of its significant customers in order to identify customers with potential collectibility issues. Upon completion of its review, and giving consideration to economic conditions, the Company estimates the probability of default of each of the customer balances identified. Based on its probability estimates, the Company establishes an allowance for doubtful accounts that is deemed sufficient to cover any potential losses. Due to the judgment required to determine the financial stability of customers and to predict future economic conditions, the actual losses from uncollectible accounts could differ from management s estimates.

Inventory Obsolescence

The Company reviews its inventory for potential impairment on a quarterly or more frequent basis as deemed necessary. Such review includes, but is not limited to, reviewing the levels of inventory versus customer requirements, shelf life, obsolescence, and the ability to rework or blend inventory items. The review and evaluation also considers the potential sale of off-grade or impaired inventory at lower than market prices. If it is determined that inventory items are impaired, the Company adjusts its reserves to cover the estimated amount of the impairment.

Recoverability of Long-Lived Assets and Goodwill

The Company evaluates the recoverability of the carrying value of long-lived assets of its businesses, excluding goodwill, whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Under such circumstances, the Company assesses whether the projected undiscounted cash flows of its businesses are sufficient to recover the existing unamortized cost of its long-lived assets. If the undiscounted projected cash flows are not sufficient, the Company calculates the impairment amount by discounting the projected cash flows using its weighted average cost of capital. The amount of the impairment is written off against earnings in the period in which the impairment has been determined.

The Company tests the recoverability of the goodwill of each of its reporting units on an annual basis, or sooner if events occur or circumstances change, by comparing the net book value to the estimated fair value of each of its reporting units to determine if there is a potential impairment issue. The fair value is estimated based on the discounted projected cash flows. If the fair value is not sufficient to cover the carrying value of the reporting unit, the Company calculates the goodwill impairment amount related to that reporting unit in accordance with FASB Statement No. 142. Any impairment is recorded to earnings in the period in which the amount has been determined.

Income Taxes

Income taxes payable reflects the Company s current tax provision and management s estimate of the tax liability relating to the outcome of current and future tax audits. If the actual outcome of audits differs from the Company s estimates, an adjustment to income taxes payable could be required, which may result in additional income tax expense (or benefit).

The Company records deferred tax assets and liabilities based on differences between the financial statement and tax basis of assets and liabilities using currently enacted tax rates. The Company also records deferred tax assets for the expected future tax benefits of net operating losses and credit carryforwards. Valuation allowances are established when the Company determines that the results of future operations may not generate sufficient taxable income to realize its deferred tax assets. Thus, changes in future results of operations could result in adjustments to the Company s valuation allowances.

Stock-Based Compensation

As permitted under FASB Statements No. 123 and No. 148, the Company elected to continue its historical method of accounting for stock-based compensation in accordance with APB 25. Under APB 25, compensation expense for fixed plans is recognized based on the difference between the exercise price and the stock price on the date of grant. Since the Company s fixed plan awards have been granted with an exercise price equal to the stock price on the date of grant, no compensation expense has been recognized in the statement of operations for these awards. However, compensation expense has been recognized for the restricted awards under the Company s long-term incentive programs in accordance with the provisions of APB 25, which would be unchanged under FASB Statements No. 123 and No. 148. Had the provisions of FASB Statements No. 123 and No. 148 been applied to the fixed plan awards, the Company would have assigned a value to each award based on the stock price on the date of grant, the exercise price, the expected life of the award, the dividend yield, the risk-free interest rate and the volatility of the Company s stock. The value of these awards would then be amortized to earnings over the service period. Refer to the Stock Incentive Plans footnote included in the Notes to Consolidated Financial Statements for the estimated earnings impact of applying FASB Statements No. 123 and 148 and the assumptions used.

Pension and Other Post-Retirement Benefits Expense

The Company s calculation of pension and other post-retirement benefits expense is dependent on various assumptions used in determining such amounts. These assumptions include discount rates, health care cost trend rates, expected long-term rates

of return on plan assets, mortality rates, expected salary and wage increases, and other factors. Components of pension and other post-retirement benefits expense include interest and service costs on the pension and other post-retirement benefit plans, expected returns on plan assets and amortization of certain unrecognized costs and obligations. Actual results that differ from the assumptions utilized are accumulated and amortized over future periods and, therefore, generally affect recognized expense and the recorded obligation in future periods. While the Company believes that the assumptions used are appropriate, differences in actual experience or changes in assumptions would affect its pension and other post-retirement benefits costs and obligations.

Consistent with past practice, the Company s discount rate used for the qualified and non-qualified domestic pension plans and the domestic other post-retirement benefit plans is based on high-quality corporate bonds. Since the pay-out structures for all plans are annuity based, rather than lump-sum, the use of bonds with long maturities is deemed appropriate. The Company utilized a discount rate of 6.75% for all domestic plans at December 31, 2002. As a sensitivity measure, a 25 basis point reduction in the discount rate would result in an approximately $0.6 million decrease to net earnings and a $16.8 million increase in the additional minimum liability in 2003.

The Company s rate of compensation increase is 4.0% for all domestic pension plans at December 31, 2002. The Company believes that this is a reasonable expectation of salary growth. As a sensitivity measure, an increase of 25 basis points would decrease net earnings by approximately $0.2 million.

The Company currently utilizes a 9.5% expected long-term rate of return on all domestic plan assets. The domestic expected rate of return on plan assets is derived by applying the expected returns on various asset classes to the Company s assumed asset allocation. The expected returns are based on the expected performance of the various asset classes and the expected benefit from active fund management. They are further supported by historical investment returns for various asset classes. The Company currently utilizes a weighted average expected long-term rate of return of 6.99% on its international plan assets. This international rate is developed primarily based on the same factors considered in developing the domestic long-term rate of return.

The 9.5% domestic expected rate of return is based on an assumed long-term inflation rate of 3%. The Company has assumed that normative investment returns on long-term bonds will be 350 basis points above inflation, or 6.5%. The assumed premiums for domestic and international equity investments over long-term bonds are 400 and 450 basis points, respectively. In addition, the Company has assumed an overall 50 basis point benefit from active fund management.

As noted above, the Company s domestic expected long-term rate of return on plan assets are further supported by historical returns for various classes of assets.[1] The Company believes the period since 1986 provides the most representative indication of potential investment market performance since it excludes the significantly higher interest rate environment of the 1978 through 1985 period. In addition, the Company believes that this period best reflects the policies of the existing Federal Reserve Board and represents an appropriate time period which includes multiple business cycles. The arithmetic average of annual investment returns from passive indices during this period was 10.8%, which is not materially different from the geometric average for the same period.

Although the Company believes post-1985 investment performance is the most relevant, it also believes it is useful to consider investment performance over longer periods of business expansion and contraction. In this regard, both 20-year and 30-year average returns based on the assumed asset allocation also show investment returns that are in excess of the 9.5% domestic expected investment return. The arithmetic average annual investment returns from passive indices during 20-year and 30-year periods were 12% and 11%, respectively.

Based on these factors, the Company believes that its domestic expected long-term rate of return is reasonable. The Company will continue to monitor and evaluate this assumption during 2003 in light of actual investment performance and the economic environment. As a sensitivity measure, a 50 basis point decrease in the expected long-term rate of return on the plan s assets would result in an approximately $1.8 million decrease in net earnings in 2003.

The Company s assumed asset allocation for the domestic pension plans is based on investing approximately 60% of plan assets in equity instruments and 40% of plan assets in fixed income

1 Historical returns are evaluated based on an arithmetic average of annual returns derived from passive indices, such as the S&P 500, for various asset classes.

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investments. The portfolio at December 31, 2002 is 47% invested in equities and 53% invested in fixed income investments. The deviation is a result of active fund management as the Company delayed rebalancing its portolio for equity losses incurred over the prior two years. Given the weak performance of equities over the last year, the deviation from the assumed asset allocation is estimated to have resulted in approximately a 1.4% benefit to overall investment returns in 2002. It is the Company s intention to rebalance to the assumed asset allocation as equity markets recover.

The Company currently utilizes a five-year smoothed asset value for its market-related value (as defined by FASB Statement No. 87) of domestic plan assets whereby 20% of the cumulative investment gains or losses are phased in to the market-related value each year. Due to recent severe investment underperformance, a significant portion of the total unrecognized actuarial losses for the domestic plans will be phased in over the next four years through the asset smoothing methodology. As these losses are phased in over future periods, they will impact the pension cost in two ways: first, the market-related value of assets used to determine the pension cost will be reduced; second, the phased-in losses will become subject to amortization in pension cost.

At December 31, 2002, $148 million of the $206 million of unrecognized actuarial losses on the domestic qualified pension plans represents the asset losses deferred through the asset smoothing. Accordingly, these deferred asset losses will be recognized in the market-related value of plan assets over the next four years. The scheduled recognition of the domestic deferred asset losses would result in a $2.0 million and $3.2 million decrease in net earnings for 2003 and 2004, respectively. The scheduled recognition of the deferred asset losses for the international pension plans are not material. Any future asset losses would primarily be phased in over five years through the smoothed market-related value mechanism and would subsequently be amortized in net earnings.

The remaining $58 million of the $206 million of unrecognized domestic actuarial losses mentioned above are due to prior asset losses that have been reflected in the market-related value, as well as other smaller sources of prior gains and losses. These amounts will be amortized to pension cost over approximately 12 years to the extent that they should exceed the 10% amortization corridor as defined by FASB Statement No. 87. The amortization of these losses would result in a $0.5 million decrease in net earnings for 2003. The amortization of losses associated with the international pension plans will not be material. Since future gains and losses beyond 2003 are a result of various factors as described herein, it is not possible to predict with certainty to what extent the combination of current and future losses may exceed the 10% amortization corridor and thereby be subject to further amortization.

Estimated funding requirements for the domestic pension plans are $20 million for 2003 and between $35 and $40 million for 2004, compared to $18 million contributed in 2002. The funding estimates are based upon actual December 31, 2002 asset values and the assumption that the Company would contribute the minimum required contributions. The funding estimates also assume no significant changes with regard to demographics, legislation, plan provisions, or actuarial assumptions or methods. In addition, it was assumed that 2003 experience matches the IRS/ERISA assumption basis for discounting pension liabilities (currently 8.5%) and that interest rates remain at year-end levels.

In addition, at December 31, 2002, the Company recognized a liability on its balance sheet for each pension plan if the fair value of the assets of that pension plan is less than the accumulated benefit obligation (ABO). This liability is called a minimum pension liability and is recorded as a charge in accumulated other comprehensive loss in stockholders equity. In December 2002, the Company recorded a charge to accumulated other comprehensive loss of $78 million. This charge primarily represents the after-tax impact of recording the minimum pension liability for the pension plans. This charge had no impact on the Company s net income, liquidity, or cash flows.

Refer to the Pension and Other Post-Retirement Benefit Plans footnote in the Notes to Consolidated Financial Statements for more information regarding costs and assumptions for pension and other post-retirement benefits.

Environmental Matters

The Company is involved in claims, litigation, administrative proceedings and investigations of various types in a number of jurisdictions. A number of such matters involve, or may involve, claims for a material amount of damages and relate to or allege environmental liabilities, including clean-up costs associated with hazardous waste disposal sites, natural resource damages, property damage and personal injury. The Company and some of its subsidiaries have been identified by federal, state or local governmental agencies, and by other potentially responsible parties (each a PRP) under the Comprehensive Environmental Response, Compensation and Liability Act of 1980, as amended, or comparable state statutes, as a PRP with respect to costs associated with waste disposal sites at various locations in the United States. In addition, the Company is involved with environmental remediation and compliance activities at some of its current and former sites in the United States and abroad.

Each quarter, the Company evaluates and reviews estimates for future remediation, and maintenance and management costs directly related to remediation, to determine appropriate environmental reserve amounts. For each site, a determination is made of the specific measures that are believed to be required to remediate the site, the estimated total cost to carry out the remediation plan, the portion of the total remediation costs to be borne by the Company and the anticipated time frame over which payments toward the remediation plan will occur. As of December 31, 2002, the Company s reserves for environmental remediation activities totaled $128.8 million. The Company estimates its potential environmental liability to range from $116 million to $142 million as of December 31, 2002. It is possible that the Company s estimates for environmental remediation liabilities may change in the future should additional sites be identified, further remediation measures be required or undertaken, the interpretation of current laws and regulations be modified or additional environmental laws and regulations be enacted.

The Company intends to assert all meritorious legal defenses and all other equitable factors which are available to it with respect to the above matters. The resolution of these environmental matters could have a material adverse effect on its consolidated results of operations in any given year or other reporting period if a number of these matters are resolved unfavorably.

MARKET RISK AND RISK-MANAGEMENT POLICIES

The Company s activities expose its earnings, cash flows and financial position to a variety of market risks, including the effects of changes in foreign currency exchange rates and interest rates. The Company maintains a foreign currency risk-management strategy that uses derivative instruments as needed to mitigate risk against foreign currency movements. The Company also maintains an interest rate risk-management strategy that uses derivative instruments as needed to manage interest rate volatility. The Company does not enter into derivative financial instruments for trading or speculative purposes.

The Company has short-term exposure to changes in foreign currency exchange rates resulting from transactions entered into by the Company and its foreign subsidiaries in currencies other than their local currency (primarily trade payables and receivables). The Company is also exposed to currency risk on intercompany transactions (including intercompany loans). The Company manages these transactional currency risks on a consolidated basis, which allows it to net its trade payable and receivable exposure. The Company purchases foreign currency forward contracts, primarily denominated in Euros, Canadian dollars, Swiss francs and Singapore dollars, to hedge its transaction exposure. These contracts are generally settled on a monthly basis. Realized and unrealized gains and losses on foreign currency forward contracts are recognized in other expense, net to offset the impact of valuing recorded foreign currency trade payables, receivables and intercompany transactions. The Company has not designated these derivatives as hedges under FASB Statement No. 133, although it believes these instruments reduce the Company s exposure to foreign currency risk. The net effect of the realized and unrealized gains and losses on these derivatives and the underlying transactions is not significant at December 31, 2002.

The Company also has equity option contracts that consist of sold put option contracts and purchased call option contracts at various strike prices. The Company entered into these contracts to hedge the expense variability associated with its obligations under its long-term incentive plans. The sold put option contracts and purchased call option contracts cover 3.2 million shares of common stock, with a weighted average strike price of $16.52 per share for the put contracts and $16.69 per share for the call

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contracts. These contracts have an expiration date of February 14, 2003 and require net cash settlement. As of December 31, 2002, a liability of $33.8 million has been included in accrued expenses to reflect the unrealized loss on these option contracts based on the year-end closing price of the Company s common stock. In February 2003, the Company settled these equity option contracts for $35.1 million and entered into a new equity option contract that consists of a sold put option contract and a purchased call option contract, covering 3.2 million shares of common stock, with a strike price of $5.66 for the put contract and $5.75 per share for the call contract. The new contract has an expiration date of May 9, 2003 and requires net cash settlement.

The Company has designated a portion of the equity option contracts as cash flow hedges of the risk associated with the unvested, unpaid awards under its long-term incentive plans. Changes in market value related to the portion of the option contracts designated and effective as hedges have been recorded as a component of accumulated other comprehensive loss (AOCL). The amount included in AOCL is subject to changes in the stock price and is being amortized ratably to selling, general and administrative expense (SG&A) over the remaining service periods of the hedged long-term incentive plans. Changes in market value related to the remaining portion of the option contracts are recognized in SG&A. Based on the December 31, 2002 closing price of the Company s common stock, the anticipated amortization from AOCL to SG&A over the next 12 months will be approximately $1 million.

The Company uses interest rate swap contracts, which expire in 2003, as cash flow hedges to convert its $57.1 million long-term variable rate Euro denominated debt to fixed rate debt. Each interest rate swap contract is designated with the principal balance and the term of the specific debt obligation. These contracts involve the exchange of interest payments over the life of the contract without an exchange of the notional amount upon which the payments are based. The differential to be paid or received as interest rates change is recognized as an adjustment to interest expense. In accordance with FASB Statement No. 133 and FASB Statement No. 138, the changes in the fair value of derivatives that are designated as cash flow hedging instruments are recognized as a component of accumulated other comprehensive loss. In the event of early extinguishment of the designated debt obligations, any realized or unrealized gain or loss from the swap would be recognized in earnings coincident with any extinguishment gain or loss.

The following table provides information about the Company s derivative and other financial instruments that are sensitive to changes in interest rates. For long-term debt, the table presents principal cash flows and related weighted average interest rates by expected maturity date. Weighted average variable interest rates are based on the applicable floating rate index as of the reporting date. For interest rate swaps, the table presents the notional amount and weighted average interest rates by maturity date. The notional amounts are used to calculate the contractual cash flows to be exchanged under the respective contracts.

Interest Rate Sensitivity

(In thousands)	2003	2004	2005	2006	2007	2008 and Thereafter	Total	Fair Value at 12/31/02
Long-term debt:								
Fixed rate	$165,000	$3,560	$601,206	$151,301		$270,000	$1,191,067	$1,117,419
Average interest rate	7.63%	7.80%	7.81%	6.82%	7.19%	7.19%		
Variable rate swapped	$57,051						$57,051	$57,051
Average interest rate (a)	4.80%							
Other variable rate		$25,000				$8,500	$33,500	$33,500
Average interest rate (a)	3.10%	3.10%	1.75%	1.75%	1.75%	1.75%		
Interest rate swaps:								
Total pay fixed/receive variable	$57,051						$57,051	$(883)
Average pay rate	5.11%							
Average receive rate (a)	2.91%							

(a) Average variable interest rate is based on rates in effect at December 31, 2002.

FORWARD-LOOKING STATEMENTS

Certain statements made in this Annual Report are forward-looking statements that involve risks and uncertainties, including, but not limited to, general economic conditions, antitrust investigations, pension and other post-retirement benefit plan assumptions, energy and raw material prices and availability, production capacity, changes in interest rates and foreign currency exchange rates, changes in technology, market demand and customer requirements, expected restructuring activities and cost reductions, the enactment of more stringent environmental laws and regulations, and other risks and uncertainties detailed in the Company s filings with the Securities and Exchange Commission. These statements are based on currently available information and the Company s actual results may differ significantly from the results discussed. Forward-looking information is intended to reflect opinions as of the date this report was produced and such information will not necessarily be updated by the Company.

ADJUSTED FINANCIAL MEASURES

The Company has provided adjusted sales, operating profit and net earnings information in the Operating Results 2002 compared to 2001 and 2001 compared to 2000 sections of Management s Discussion and Analysis of Financial Condition and Results of Operations. The purpose of providing these adjusted financial measures is to more fully explain the underlying operational performance of the Company by eliminating the effect of special items which can obscure trends that are necessary for a balanced appraisal of the Company s activities that occur in the normal course of operations. The adjustments include facility closures, severance and related costs, antitrust investigation costs, impairment charges and losses on the sale of business units. In addition, in the Operating Results 2002 compared to 2001 section, sales and operating profit have been adjusted to exclude the operating results of the divested business units. Readers should not consider these adjusted financial measures as a substitute for the Company s reported financial results, which are presented in accordance with accounting principles generally accepted in the United States of America (GAAP). The additional information should be used as a supplement to GAAP results to assist the reader in better understanding the operational performance of the Company.

OPERATING RESULTS 2002 COMPARED TO 2001

Overview

Consolidated net sales of $2.55 billion in 2002 decreased 6% from $2.72 billion in 2001. The decrease was primarily the result of the divestiture of business units of 4% and lower selling prices of 3%, partially offset by favorable foreign currency impact of 1%. International sales, including U.S. exports, were 50% of total sales, up from 48% in 2001. This increase was primarily due to the weaker domestic economy and the strengthening of the Euro versus the U.S. dollar.

The net loss for 2002 was $283.5 million, or $2.45 per diluted common share, as compared to a net loss of $123.9 million, or $1.10 per common share in 2001. The net loss for 2002 included after-tax special charges for facility closures, severance and related costs ($14.6 million), antitrust investigation costs ($3.9 million), a loss on the sale of the industrial specialties business unit ($21.1 million) and a cumulative effect of accounting change ($299 million). The net loss for 2001 included after-tax special charges for facility closures, severance and related costs ($75 million), an impairment of long-lived assets ($50.8 million) and a loss on the sale of the industrial colors business unit and nitrile rubber joint venture ($14.1 million). Net earnings before such special items were $55.1 million in 2002 as compared to $15.9 million in 2001.

Gross profit as a percentage of sales increased to 31.1% in 2002 from 29.9% in 2001. The increase in gross margin was primarily due to the impact in 2002 of lower manufacturing costs, including savings from cost reduction initiatives and lower raw material and energy costs, plus inventory charges in 2001 related to closed sites of $7.5 million, partially offset by lower selling prices in 2002.

Operating profit for 2002 was $146.4 million as compared to an operating loss of $53.6 million in 2001. Operating profit for 2002 included special charges for facility closures, severance and related costs ($23.3 million) and antitrust investigation costs ($6.3 million). The operating loss for 2001 included special charges for facility closures, severance and related costs ($114 million), an impairment of long-lived assets ($80.4 million) and operating losses related to divested business units ($4.9 million). Operating profit before such special items and divested operations increased 21% to $176 million in 2002 from $145.7 million in 2001, as summarized in the following table.

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		2001		
(In thousands)	**2002**	As Reported (a)	Divested Business Units (b)	As Adjusted
NET SALES				
Polymer Products				
Polymer Additives	**$ 1,110,804**	$ 1,125,910	$	$ 1,125,910
Polymers	**270,954**	292,092		292,092
Polymer Processing Equipment	**172,702**	202,653		202,653
Eliminations	**(15,064)**	(13,805)		(13,805)
	1,539,396	1,606,850		1,606,850
Specialty Products				
OrganoSilicones	**456,601**	432,255		432,255
Crop Protection	**240,142**	245,562		245,562
Other	**310,733**	434,131		