

ENGELHARD CORP  
Form 10-Q  
November 13, 2003

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, 2003

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 1-8142*

**ENGELHARD CORPORATION**

(Exact name of Registrant as specified in its charter)

**DELAWARE**

(State or other jurisdiction or  
incorporation or organization)

**22-1586002**

(I.R.S. Employer Identification No.)

**101 WOOD AVENUE, ISELIN, NEW JERSEY, 08830**

(Address of principal executive offices)

**(732) 205-5000**

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes  No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class of Common Stock  
\$1 par value

Outstanding at October 31, 2003  
125,457,142

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

## PART I FINANCIAL INFORMATION

## Item 1. Financial Statements

**ENGELHARD CORPORATION**  
**CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS**  
(Thousands, except per share data)  
(Unaudited)

|   | Three Months Ended<br>September 30, |            | Nine Months Ended<br>September 30, |              |
|---|-------------------------------------|------------|------------------------------------|--------------|
|   | 2003                                | 2002       | 2003                               | 2002         |
| Net sales   | \$ 915,373                          | \$ 858,574 | \$ 2,675,170                       | \$ 2,842,709 |
| Cost of sales   | 761,234                             | 702,820    | 2,208,573                          | 2,349,107    |
| Gross profit  | 154,139                             | 155,754    | 466,597                            | 493,602      |
| Selling, administrative and other expenses  | 88,038                              | 78,814     | 268,607                            | 262,225      |
| Special credit, net   |                                     |            | (11,978)                           | (7,862)      |
| Operating earnings  | 66,101                              | 76,940     | 209,968                            | 239,239      |
| Equity in earnings of affiliates  | 14,517                              | 3,870      | 27,694                             | 11,940       |
| Equity investment impairment  |                                     | (57,704)   |                                    | (57,704)     |
| Loss on investments   |                                     |            |                                    | (6,659)      |
| Interest income   | 1,004                               | 382        | 2,719                              | 1,125        |
| Interest expense  | (6,514)                             | (6,362)    | (18,539)                           | (20,893)     |
| Earnings before income taxes  | 75,108                              | 17,126     | 221,842                            | 167,048      |
| Income tax expense  | 15,275                              | 14,213     | 49,039                             | 51,693       |
| Net earnings before cumulative effect of a change in accounting principle, net of tax | 59,833                              | 2,913      | 172,803                            | 115,355      |
| Cumulative effect of a change in accounting principle, net of tax of \$1,390          |                                     |            | (2,269)                            |              |
| Net earnings  | \$ 59,833                           | \$ 2,913   | \$ 170,534                         | \$ 115,355   |
| Earnings per share - basic:   |                                     |            |                                    |              |
| Earnings before cumulative effect of a change in accounting principle                 | \$ 0.48                             | \$ 0.02    | \$ 1.38                            | \$ 0.90      |
| Cumulative effect of a change in accounting principle, net of tax                     |                                     |            | (0.02)                             |              |
| Earnings per share - basic  | \$ 0.48                             | \$ 0.02    | \$ 1.36                            | \$ 0.90      |
| Earnings per share - diluted:   |                                     |            |                                    |              |
| Earnings before cumulative effect of a change in accounting principle                 | \$ 0.47                             | \$ 0.02    | \$ 1.36                            | \$ 0.88      |
| Cumulative effect of a change in accounting principle, net of tax                     |                                     |            | (0.02)                             |              |
| Earnings per share - diluted  | \$ 0.47                             | \$ 0.02    | \$ 1.34                            | \$ 0.88      |
| Cash dividends paid per share   | \$ 0.10                             | \$ 0.10    | \$ 0.30                            | \$ 0.30      |
| Average number of shares outstanding - basic  | 124,683                             | 127,732    | 125,601                            | 128,407      |

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|  | Three Months Ended<br>September 30, |         | Nine Months Ended<br>September 30, |         |
|--|-------------------------------------|---------|------------------------------------|---------|
|  |                                     |         |                                    |         |
| Average number of shares outstanding - diluted | 126,877                             | 129,839 | 127,320                            | 130,966 |

See the Accompanying Notes to the Unaudited Condensed Consolidated Financial Statements

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**ENGELHARD CORPORATION**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
(Thousands)  
(Unaudited)

|   | September 30,<br>2003 | December 31,<br>2002 |
|---|-----------------------|----------------------|
| Cash  | \$ 79,377             | \$ 48,246            |
| Receivables, net                                  | 345,758               | 380,270              |
| Committed metal positions                         | 311,610               | 615,441              |
| Inventories                                       | 438,661               | 427,162              |
| Other current assets                              | 102,537               | 94,922               |
| <b>Total current assets</b>                       | <b>1,277,943</b>      | <b>1,566,041</b>     |
| Investments                                       | 141,166               | 136,804              |
| Property, plant and equipment, net                | 855,414               | 860,475              |
| Goodwill  | 273,691               | 272,353              |
| Other intangible and noncurrent assets            | 195,192               | 185,041              |
| <b>Total assets</b>                               | <b>\$ 2,743,406</b>   | <b>\$ 3,020,714</b>  |
| Short-term borrowings                             | \$ 86,469             | \$ 348,749           |
| Accounts payable                                  | 208,387               | 225,045              |
| Hedged metal obligations                          | 274,658               | 537,243              |
| Other current liabilities                         | 274,401               | 275,250              |
| <b>Total current liabilities</b>                  | <b>843,915</b>        | <b>1,386,287</b>     |
| Long-term debt                                    | 392,402               | 247,805              |
| Other noncurrent liabilities                      | 310,787               | 309,455              |
| Shareholders' equity                              | 1,196,302             | 1,077,167            |
| <b>Total liabilities and shareholders' equity</b> | <b>\$ 2,743,406</b>   | <b>\$ 3,020,714</b>  |

See the Accompanying Notes to the Unaudited Condensed Consolidated Financial Statements

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**ENGELHARD CORPORATION**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(Thousands)  
(Unaudited)

|   | Nine Months Ended<br>September 30, |            |
|---|------------------------------------|------------|
|   | 2003                               | 2002       |
| Cash flows from operating activities  |                                    |            |
| Net earnings  | \$ 170,534                         | \$ 115,355 |
| Adjustments to reconcile net earnings to net cash provided by operating activities: |                                    |            |
| Depreciation and depletion  | 93,261                             | 79,303     |
| Amortization of intangible assets   | 2,479                              | 2,153      |
| Loss on investments   |                                    | 6,659      |
| Equity results, net of dividends  | (8,347)                            | (8,187)    |
| Equity investment impairment  |                                    | 57,704     |
| Net change in assets and liabilities:   |                                    |            |
| Materials Services related  | 295,995                            | (20,952)   |
| All other   | (14,448)                           | (18,639)   |
| Net cash provided by operating activities   | 539,474                            | 213,396    |
| Cash flows from investing activities  |                                    |            |
| Capital expenditures  | (68,080)                           | (68,777)   |
| Proceeds from investments   | 7,531                              |            |
| Acquisitions and other investments  |                                    | (2,800)    |
| Net cash used in investing activities   | (60,549)                           | (71,577)   |
| Cash flows from financing activities  |                                    |            |
| Proceeds from short-term borrowings   |                                    | 278,818    |
| Repayment of short-term borrowings  | (262,280)                          | (260,457)  |
| (Decrease) increase in hedged metal obligations                                     | (241,345)                          | 1,329      |
| Proceeds from issuance of long-term debt  | 147,842                            |            |
| Repayment of long-term debt   | (184)                              | (148)      |
| Purchase of treasury stock  | (84,517)                           | (125,788)  |
| Cash from exercise of stock options   | 23,293                             | 46,471     |
| Dividends paid  | (37,823)                           | (38,716)   |
| Net cash used in financing activities   | (455,014)                          | (98,491)   |
| Effect of exchange rate changes on cash   | 7,220                              | 5,498      |
| Net increase in cash  | 31,131                             | 48,826     |
| Cash at beginning of year   | 48,246                             | 33,034     |
| Cash at end of period   | \$ 79,377                          | \$ 81,860  |

See the Accompanying Notes to the Unaudited Condensed Consolidated Financial Statements

**ENGELHARD CORPORATION**  
**BUSINESS SEGMENT INFORMATION**  
(Thousands)  
(Unaudited)

|   | Three Months Ended<br>September 30, |                | Nine Months Ended<br>September 30, |                  |
|---|-------------------------------------|----------------|------------------------------------|------------------|
|   | 2003                                | 2002           | 2003                               | 2002             |
| Net Sales   |                                     |                |                                    |                  |
| Environmental Technologies  | \$ 202,225                          | \$ 158,197     | \$ 624,918                         | \$ 493,202       |
| Process Technologies  | 143,568                             | 125,635        | 401,921                            | 377,487          |
| Appearance and Performance Technologies   | 166,089                             | 171,882        | 500,475                            | 494,884          |
|   | <u>511,882</u>                      | <u>455,714</u> | <u>1,527,314</u>                   | <u>1,365,573</u> |
| Technology segments   |                                     |                |                                    |                  |
| Materials Services  | 385,308                             | 382,080        | 1,108,750                          | 1,438,373        |
| All other   | 18,183                              | 20,780         | 39,106                             | 38,763           |
|   | <u>915,373</u>                      | <u>858,574</u> | <u>2,675,170</u>                   | <u>2,842,709</u> |
| Total net sales   | \$                                  | \$             | \$                                 | \$               |
| Operating Earnings  |                                     |                |                                    |                  |
| Environmental Technologies  | \$ 30,980                           | \$ 20,103      | \$ 87,046                          | \$ 87,747        |
| Process Technologies  | 24,629                              | 21,339         | 62,720                             | 61,380           |
| Appearance and Performance Technologies   | 18,009                              | 27,045         | 55,205                             | 66,896           |
|   | <u>73,618</u>                       | <u>68,487</u>  | <u>204,971</u>                     | <u>216,023</u>   |
| Technology segments   |                                     |                |                                    |                  |
| Materials Services  | 1,295                               | 8,288          | 8,779                              | 45,711           |
| All other   | (8,812)                             | 165            | (3,782)                            | (22,495)         |
|   | <u>66,101</u>                       | <u>76,940</u>  | <u>209,968</u>                     | <u>239,239</u>   |
| Total operating earnings  |                                     |                |                                    |                  |
| Equity in earnings of affiliates  | 14,517                              | 3,870          | 27,694                             | 11,940           |
| Equity investment impairment  |                                     | (57,704)       |                                    | (57,704)         |
| Loss on investments   |                                     |                |                                    | (6,659)          |
| Interest income   | 1,004                               | 382            | 2,719                              | 1,125            |
| Interest expense  | (6,514)                             | (6,362)        | (18,539)                           | (20,893)         |
|   | <u>75,108</u>                       | <u>17,126</u>  | <u>221,842</u>                     | <u>167,048</u>   |
| Earnings before income taxes  |                                     |                |                                    |                  |
| Income tax expense  | 15,275                              | 14,213         | 49,039                             | 51,693           |
|   | <u>59,833</u>                       | <u>2,913</u>   | <u>172,803</u>                     | <u>115,355</u>   |
| Net earnings before cumulative effect<br>of a change in accounting principle, net<br>of tax |                                     |                |                                    |                  |
| Cumulative effect of a change in accounting<br>principle, net of tax of \$1,390             |                                     |                | (2,269)                            |                  |
|   | <u>59,833</u>                       | <u>2,913</u>   | <u>170,534</u>                     | <u>115,355</u>   |
| Net earnings  | \$                                  | \$             | \$                                 | \$               |

See the Accompanying Notes to the Unaudited Condensed Consolidated Financial Statements

*Notes to the Unaudited Condensed Consolidated Financial Statements*

**Note 1 Basis of Presentation**

The unaudited condensed consolidated financial statements of Engelhard Corporation and subsidiaries (the Company) contain all adjustments, which, in the opinion of management, are necessary for a fair presentation of the results for the interim periods presented. The financial statement results for interim periods are not necessarily indicative of financial results for the full year. These financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's 2002 Annual Report to Shareholders. The unaudited condensed consolidated financial statements include the accounts of the Company and its subsidiaries. All significant intercompany transactions and balances have been eliminated in consolidation. Certain prior-year amounts have been reclassified to conform with the current-year presentation.

**Note 2 Special Charges and Credits**

In the first quarter of 2003, the Company entered into a settlement agreement, releasing a claim the Company had brought against Research Corporation and Research Corporation Technologies in exchange for payment of \$38.0 million. Accordingly, the Company recorded a gain of \$28.4 million (\$17.6 million after tax) in the first quarter of 2003, net of legal fees and the portion of the settlement related to future royalties. This gain was included in the Company's All-Other category and in the Special credit, net line in the Condensed Consolidated Statements of Earnings. On October 29, 2002, a jury in the New York County Supreme Court had awarded the Company \$29.8 million in damages in a breach of contract action the Company had brought against Research Corporation and Research Corporation Technologies in 1998. The jury found that the defendants did not share with the Company all of the royalties to which the Company was entitled under a royalty-sharing agreement it entered into with Research Corporation in 1979. Statutory interest to the date of the verdict would have increased the amount awarded to approximately \$42.2 million.

Also in the first quarter of 2003, the Company recorded charges totaling \$8.7 million (\$5.6 million after tax) primarily related to a management consolidation and productivity initiative in the Environmental and Process Technologies segments and within the All-Other category. The amounts of \$5.3 million (\$3.5 million after tax), \$2.6 million (\$1.6 million after tax) and \$0.8 million (\$0.5 million after tax) were reported in the Environmental Technologies segment, the Process Technologies segment and the All-Other category, respectively. These charges are included in the Special credit, net line in the Condensed Consolidated Statements of Earnings.

In the Environmental Technologies segment, the charge of \$5.3 million primarily relates to the closure of the segment's Coleford, U.K. plant (\$2.8 million) and employee severance costs related to productivity initiatives (\$2.5 million). The employee severance charges relate to the reduction of 96 salaried and 12 hourly employees. As a result of closing the Coleford plant, the segment has outsourced the canning operations associated with this business. The closure resulted in an impairment charge of \$1.5 million to write down fixed assets and other exit-related costs of \$1.3 million. As of September 30, 2003, the liability associated with this charge was \$1.2 million.

In the Process Technologies segment, the charge of \$2.6 million primarily relates to employee severance and the termination of an agency agreement associated with sales to the chemical-process market. The employee severance charges relate to the reduction of 13 salaried employees. Selling activities associated with the termination of this agency agreement will be covered by the segment's internal sales force. As of September 30, 2003, the liability associated with this charge was \$0.5 million.

In the All-Other category, the charge of \$0.8 million was for employee severance costs related to the reduction of six salaried employees. As of September 30, 2003, the liability associated with this charge was \$0.2 million.

In the second quarter of 2003, the Company recorded a charge of \$7.8 million (\$4.8 million after tax) related to a previously projected provision for the fair value of the remaining lease cost of certain minerals-storage facilities no longer needed because of productivity initiatives. As of June 30, 2003, the Company's Appearance and Performance Technologies segment had ceased using these facilities and, accordingly, a provision for these remaining lease rentals was reported in the Special credit, net line in the Condensed Consolidated Statements of Earnings. As of September 30, 2003, the liability associated with this charge was \$7.3 million.

**Note 3 Accounting for Asset Retirement Obligations**

The Company adopted Statement of Financial Accounting Standards (SFAS) No. 143, Accounting for Asset Retirement Obligations, on January 1, 2003. This statement, which addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs, requires the fair value of a liability for an asset retirement obligation to be recognized in the period in which it is incurred. The liability is measured at fair value and is adjusted in subsequent periods as accretion expense is recorded. The corresponding asset retirement costs are capitalized as part of the carrying amount of the related long-lived asset and depreciated over the asset's useful life.

The Company's asset retirement obligations primarily relate to kaolin mining operations of its Appearance and Performance Technologies segment. In order to provide kaolin-based products to the Company's customers and the Process Technologies segment, the Company engages in kaolin mining operations. The kaolin mining process includes exploration, topsoil and overburden removal, extraction of kaolin and the subsequent reclamation of mined areas. The Company has a legal obligation to reclaim mined areas under state regulations. Prior to adoption of SFAS No. 143, the Company incurred reclamation costs to comply with state regulation and expensed costs as the mined areas were reclaimed.

At January 1, 2003, the Company recognized transition amounts for existing asset retirement obligation liabilities, associated capitalizable costs and accumulated depreciation. A non-cash transition charge of \$3.7 million (\$2.3 million after tax or \$0.02 per share on a diluted basis) was recorded on January 1, 2003 as the cumulative effect of an accounting change. Pro forma net income and diluted earnings per share as if the provisions of SFAS No. 143 had been adopted on January 1, 2002, excluding the cumulative effect of an accounting change, for the nine-month periods ended September 30, 2003 and September 30, 2002 are \$172.4 million and \$1.35 per share and \$114.9 million and \$0.88 per share, respectively.

The following table represents the change in the Company's asset retirement obligation liability for the nine-month period ended September 30, 2003 (in millions):

|  | <u>2003</u>   |
|--|---------------|
| Asset retirement obligation at January 1, 2003                       | \$            |
| Liability recognized in transition                                   | 7.1           |
| Liability recognized during the nine-months ended September 30, 2003 | 2.3           |
| Accretion expense  | 0.4           |
| Payments   | <u>(0.4)</u>  |
| Asset retirement obligation at September 30, 2003                    | <u>\$ 9.4</u> |

The pro forma amount of liability for asset retirement obligation as if the provisions of SFAS No. 143 had been applied at January 1, 2002 is \$6.7 million.

**Note 4 Inventories**

Inventories consist of the following (in millions):

|                 | <u>September 30,<br/>2003</u> | <u>December 31,<br/>2002</u> |
|-----------------|-------------------------------|------------------------------|
| Raw materials   | \$ 116.4                      | \$ 95.4                      |
| Work in process | 51.9                          | 77.0                         |
| Finished goods  | 254.1                         | 237.4                        |
| Precious metals | <u>16.3</u>                   | <u>17.4</u>                  |

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|                   | September 30,<br>2003 | December 31,<br>2002 |
|-------------------|-----------------------|----------------------|
| Total inventories | \$ 438.7              | \$ 427.2             |

The majority of the Company's physical metal is carried in the committed metal positions line on the balance sheet at fair value with the remainder carried in the inventory line at historical LIFO cost. The market value of the precious metals recorded at LIFO exceeded cost by \$51.8 million and \$58.3 million at September 30, 2003 and December 31, 2002, respectively. Net earnings include after-tax gains of \$3.1 million in each of the third quarter periods ended September 30, 2003 and 2002 from the sale of inventory accounted for under the LIFO method.

In the normal course of business, certain customers and suppliers deposit significant quantities of precious metals with the Company under a variety of arrangements. Equivalent quantities of precious metals are returnable as product or in other forms. Metals held for the accounts of customers and suppliers are not reflected in the Company's financial statements.

**Note 5 Comprehensive Income**

Comprehensive income is summarized as follows (in millions):

|   | Three Months Ended<br>September 30, |         | Nine Months Ended<br>September 30, |          |
|---|-------------------------------------|---------|------------------------------------|----------|
|   | 2003                                | 2002    | 2003                               | 2002     |
| Net earnings                            | \$ 59.8                             | \$ 2.9  | \$ 170.5                           | \$ 115.4 |
| Other comprehensive income (loss):      |                                     |         |                                    |          |
| Foreign currency translation adjustment | 8.2                                 | 17.3    | 38.5                               | 51.1     |
| Cash flow hedge adjustment, net of tax  | (1.1)                               | 0.7     | (1.0)                              | 4.7      |
| Investment adjustment, net of tax       | 0.1                                 | (0.2)   | (0.1)                              | (0.2)    |
| Comprehensive income                    | \$ 67.0                             | \$ 20.7 | \$ 207.9                           | \$ 171.0 |

The foreign currency translation adjustments are not currently adjusted for income taxes as they relate to permanent investments in non-U.S. entities.

**Note 6 Earnings Per Share**

The following table represents the computation of basic and diluted earnings per share:

|  | Three Months Ended<br>September 30, |        | Nine Months Ended<br>September 30, |          |
|--|-------------------------------------|--------|------------------------------------|----------|
|  | 2003                                | 2002   | 2003                               | 2002     |
| (in millions, except per share data)         |                                     |        |                                    |          |
| <u>Basic EPS Computation</u>                 |                                     |        |                                    |          |
| Net earnings applicable to common shares     | \$ 59.8                             | \$ 2.9 | \$ 170.5                           | \$ 115.4 |
| Average number of shares outstanding - basic | 124.7                               | 127.7  | 125.6                              | 128.4    |



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|   | <u>Three Months Ended</u><br><u>September 30,</u> |         | <u>Nine Months Ended</u><br><u>September 30,</u> |          |
|---|---|---------|--|----------|
| Basic earnings per share                              | \$ 0.48   | \$ 0.02 | \$ 1.36  | \$ 0.90  |
| <u>Diluted EPS Computation</u>                        |   |         |  |          |
| Net earnings applicable to common shares              | \$ 59.8   | \$ 2.9  | \$ 170.5   | \$ 115.4 |
| Average number of shares outstanding - basic          | 124.7   | 127.7   | 125.6  | 128.4    |
| Effect of dilutive stock options and other incentives | 2.2   | 2.1     | 1.7  | 2.6      |
| Average number of shares outstanding - diluted        | 126.9   | 129.8   | 127.3  | 131.0    |
| Diluted earnings per share                            | \$ 0.47   | \$ 0.02 | \$ 1.34  | \$ 0.88  |

**Note 7 Derivatives and Hedging**

The Company reports all derivative instruments on the balance sheet at their fair value. Changes in the fair value of derivatives designated as cash flow hedges are initially recorded in comprehensive income and are reclassified to earnings in the period the hedged item is reflected in earnings. Changes in the fair value of derivatives that are not designated as cash flow hedges are reported immediately in earnings.

In order to manage in a manner consistent with historical processes, procedures and systems and to achieve operating economies, certain economic hedge transactions are not designated as hedges for accounting purposes. In those cases, which primarily relate to platinum group metals, the Company will continue to mark to market both the hedge instrument and the related position constituting the risk hedged, recognizing the net effect in current earnings.

The Company documents all relationships between derivative hedging instruments and items impacted by cash flow hedges at the time the hedges are initiated, as well as its risk-management objectives and strategy for entering into various hedge transactions. For the three and nine-month periods ended September 30, 2003 and 2002, there was no gain or loss recognized in earnings resulting from hedge ineffectiveness.

*Foreign Exchange Contracts*

The Company designates as cash flow hedges certain foreign currency derivative contracts entered into as hedges against anticipated receivables or payables which will arise from forecasted transactions that are denominated in currencies other than the functional currency of the entity which will hold those assets or liabilities. The ultimate maturities of the contracts are timed to coincide with the expected occurrence of the underlying sale or purchase transaction.

Other foreign currency derivative contracts entered into to hedge the exposure to foreign currency fluctuations associated with certain monetary assets and liabilities are not designated as hedging instruments for accounting purposes. Changes in the fair value of these contracts are recorded in earnings to offset the foreign exchange gains and losses arising from the effect of changes in exchange rates used to measure related monetary assets and liabilities.

*Commodity Contracts*

The Company enters into contracts that are designated as cash flow hedges to protect a portion of its exposure to movements in certain commodity prices. These contracts primarily relate to derivatives designated as natural gas cash flow hedges. The ultimate maturities of the contracts are timed to coincide with the expected usage of these commodities.

*Interest Rate Derivatives*

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The Company uses interest rate derivatives that are designated as fair value hedges to help achieve its fixed and floating rate debt objectives. The Company currently has two interest rate swap agreements with a total notional value of \$100 million maturing in August 2006 and three interest rate swap agreements with a total notional value of \$150 million maturing in May 2013. These agreements effectively change fixed rate debt obligations into floating rate debt obligations. The total notional values and maturity dates of these agreements are equal to the face values and the maturity dates of the related debt instruments. For these fair value hedges, there was no gain or loss recognized from hedged firm commitments no longer qualifying as fair value hedges for the three and nine-month periods ended September 30, 2003 and 2002.

### Note 8 Guarantees and Warranties

In the normal course of business, the Company incurs obligations with regard to contract completion and product performance. Under certain circumstances, these obligations are supported through the issuance of letters of credit. At September 30, 2003, the aggregate outstanding amount of letters of credit supporting such obligations amounted to \$61.5 million, of which \$44.7 million will expire in less than one year, \$8.4 million will expire in two to three years, \$0.1 million will expire in four to five years and \$8.3 million will expire after five years. In the opinion of management, such obligations will not significantly affect the Company's financial position or results of operations as the Company anticipates fulfilling its performance obligations.

The Company accrues for anticipated product warranty expenses on certain products. Accruals for anticipated warranty liabilities are recorded based upon a review of historical warranty claims experience. Adjustments are made to accruals as claim data and historical experience warrant. The Company's accrual is primarily comprised of warranty liabilities within the non-automotive business of the Environmental Technologies segment.

The change in the Company's product warranty reserves for the nine-month period ended September 30, 2003 is as follows (in millions):

|                               |    |       |
|-------------------------------|----|-------|
| Balance at January 1, 2003    | \$ | 11.1  |
| Payments                      |    | (3.8) |
| Provision                     |    | 1.8   |
|                               |    | 9.1   |
| Balance at September 30, 2003 | \$ | 9.1   |

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### Note 9 Goodwill and Other Intangible Assets

Identifiable intangible assets, such as patents and trademarks, are amortized using the straight-line method over their estimated useful lives. Goodwill was amortized by the straight-line method over periods up to 40 years for all acquisitions completed prior to June 30, 2001. Effective January 1, 2002, with the adoption of Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets (SFAS No. 142), goodwill and other intangible assets that have indefinite useful lives are no longer amortized, but are tested for impairment based on the specific guidance of SFAS No. 142.

The following information relates to acquired amortizable intangible assets (in millions):

|  | As of September 30, 2003    |                             | As of December 31, 2002     |                             |
|--|-----------------------------|-----------------------------|-----------------------------|-----------------------------|
|  | Gross<br>Carrying<br>Amount | Accumulated<br>Amortization | Gross<br>Carrying<br>Amount | Accumulated<br>Amortization |
| Acquired Amortizable Intangible Assets |                             |                             |                             |                             |
| Usage rights                           | \$ 19.1                     | \$ 3.8                      | \$ 17.2                     | \$ 2.6                      |
| Supply agreements                      | 16.8                        | 4.2                         | 15.4                        | 3.1                         |
| Technology licenses                    | 7.5                         | 2.4                         | 7.4                         | 1.9                         |

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|       | As of September 30, 2003 |         | As of December 31, 2002 |        |
|-------|--------------------------|---------|-------------------------|--------|
| Other | 3.7                      | 2.0     | 3.7                     | 1.8    |
| Total | \$ 47.1                  | \$ 12.4 | \$ 43.7                 | \$ 9.4 |

The increased carrying amount of acquired amortizable intangible assets is primarily due to the impact of foreign exchange.

Total accumulated amortization for goodwill and other intangible assets amounted to \$79.3 million and \$76.8 million at September 30, 2003 and December 31, 2002, respectively. As of September 30, 2003, the estimated aggregate amortization expense for each of the five succeeding years is as follows (in millions):

*Estimated Annual Amortization Expense:*

|      |        |
|------|--------|
| 2003 | \$ 3.3 |
| 2004 | 3.3    |
| 2005 | 3.3    |
| 2006 | 3.1    |
| 2007 | 3.1    |

The following table represents the changes in the carrying amount of goodwill for the nine-month period ended September 30, 2003 (in millions):

|   | Environmental Technologies | Process Technologies | Appearance & Performance Technologies | All Other | Total    |
|---|----------------------------|----------------------|---------------------------------------|-----------|----------|
| Balance as of January 1, 2003           | \$ 13.0                    | \$ 106.9             | \$ 152.0                              | \$ 0.5    | \$ 272.4 |
| Foreign currency translation adjustment | 0.1                        | 0.3                  | 0.4                                   |           | 0.8      |
| Other                                   | 0.5                        |                      |                                       |           | 0.5      |
| Balance as of September 30, 2003        | \$ 13.6                    | \$ 107.2             | \$ 152.4                              | \$ 0.5    | \$ 273.7 |

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**Note 10 Committed Metal Positions and Hedged Metal Obligations**

Both spot metal positions and derivative instruments are stated at fair value. Fair value is based on published market prices. The following table sets forth the Company's unhedged metal positions included in committed metal positions on the Company's Condensed Consolidated Balance Sheets:

Metal Positions Information (in millions):

|                       | September 30, 2003 |        | December 31, 2002 |         |
|-----------------------|--------------------|--------|-------------------|---------|
|                       | Net Position       | Value  | Net Position      | Value   |
| Platinum group metals | Short              | \$ 8.0 | Long              | \$ 16.6 |

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|             | September 30, 2003 |         | December 31, 2002 |         |
|-------------|--------------------|---------|-------------------|---------|
| Gold        | Short              | 0.3     | Long              | 1.1     |
| Silver      | Short              | 0.9     | Long              | 0.4     |
| Base metals | Long               | 6.9     | Short             | 2.3     |
|             |                    | \$ 16.1 |                   | \$ 20.4 |

Committed metal positions may include significant advances made for the purchase of precious metals that have been delivered to the Company but for which the final purchase price has not yet been determined. As of September 30, 2003, all such contracts have been final priced and settled without any loss to the Company.

Derivative metal and foreign currency instruments are used to hedge metal positions and obligations. As of September 30, 2003, over 99% of these instruments have settlement terms of less than one year, with the remaining instruments expected to settle within three years. These derivative metal and foreign currency instruments consist of the following:

Metal Hedging Instruments (in millions):

|                                   | September 30, 2003 |          | December 31, 2002 |          |
|-----------------------------------|--------------------|----------|-------------------|----------|
|                                   | Buy                | Sell     | Buy               | Sell     |
| Metal forwards/futures            | \$ 684.4           | \$ 678.5 | \$ 1,234.5        | \$ 494.4 |
| Eurodollar futures                | 101.2              | 146.1    | 113.0             | 86.0     |
| Swaps                             | 24.4               | 30.9     | 4.7               | 7.7      |
| Options                           | 32.6               | 17.5     | 101.7             | 98.7     |
| Foreign exchange forwards/futures |                    | 111.5    |                   | 93.1     |

**Note 11 New Accounting Pronouncements**

In January 2003, the FASB issued Interpretation No. 46, Consolidation of Variable Interest Entities (FIN 46). FIN 46 addresses consolidation by business enterprises of variable interest entities with certain defined characteristics. This interpretation applies immediately to variable interest entities created after January 31, 2003, and to variable interest entities in which an enterprise obtains an interest after that date. It applies at the end of the first fiscal year or interim period ending after December 15, 2003, to variable interest entities in which an enterprise holds a variable interest that it acquired before February 1, 2003. The Company did not obtain an interest in any variable interest entities after January 31, 2003. The Company believes that the provisions of FIN 46 will not have a material impact on the Company's financial statements.

In April 2003, the FASB issued SFAS No. 149, Amendment of Statement 133 on Derivative Instruments and Hedging Activities. This Statement amends and clarifies financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities under SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities. This Statement is effective for contracts entered into or modified after June 30, 2003, with certain exceptions, and for hedging relationships designated after June 30, 2003. The provisions of this Statement that relate to Statement 133 Implementation Issues that have been effective for fiscal quarters that began prior to June 15, 2003, should continue to be applied in accordance with their respective dates. This statement did not have any impact on the accompanying financial statements.

In May 2003, the FASB issued SFAS No. 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity. This Statement establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability or an asset in some circumstances. This Statement is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June

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15, 2003. This Statement did not have any impact on the accompanying financial statements.

**Note 12 Stock Option and Bonus Plans**

The Company has several long-term incentive compensation plans that allow for the granting of stock options to employees. Had compensation cost for the Company's stock option plans been determined based on the fair value at grant date consistent with the provisions of Statement of Financial Accounting Standards ( SFAS ) No. 123, Accounting for Stock Based Compensation, as amended by SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure, the Company's net earnings and earnings per share would have been as follows:

| Pro Forma Information<br>(in millions, except per share data)   | Three Months Ended<br>September 30, |         | Nine Months Ended<br>September 30, |          |
|---|-------------------------------------|---------|------------------------------------|----------|
|   | 2003                                | 2002    | 2003                               | 2002     |
| Net earnings - as reported  | \$ 59.8                             | \$ 2.9  | \$ 170.5                           | \$ 115.4 |
| Deduct: Total stock-based employee compensation<br>expense determined under fair value based<br>method for all awards, net of tax | (1.4)                               | (1.5)   | (4.2)                              | (4.6)    |
| Net earnings - pro forma  | \$ 58.4                             | \$ 1.4  | \$ 166.3                           | \$ 110.8 |
| Earnings Per Share:   |                                     |         |                                    |          |
| Basic earnings per share - as reported  | \$ 0.48                             | \$ 0.02 | \$ 1.36                            | \$ 0.90  |
| Basic earnings per share - pro forma  | 0.47                                | 0.01    | 1.32                               | 0.86     |
| Diluted earnings per share - as reported  | 0.47                                | 0.02    | 1.34                               | 0.88     |
| Diluted earnings per share - pro forma  | 0.46                                | 0.01    | 1.31                               | 0.85     |

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**Note 13 Supplemental Information**

The following table presents certain supplementary information to the Company's Condensed Consolidated Statements of Cash Flows :

**SUPPLEMENTARY CASH FLOW INFORMATION**  
(in millions)

|   | Nine Months Ended<br>September 30, |           |
|---|------------------------------------|-----------|
|   | 2003                               | 2002      |
| Materials Services related:                           |                                    |           |
| Change in assets and liabilities - source (use):      |                                    |           |
| Receivables   | \$ 12.0                            | \$ 6.0    |
| Committed metal positions                             | 282.6                              | 41.8      |
| Inventories   | 0.7                                | (1.2)     |
| Other current assets                                  | (0.2)                              | 16.7      |
| Accounts payable                                      | 25.3                               | (64.8)    |
| Accrued liabilities                                   | (24.4)                             | (19.5)    |
| Net cash flows from changes in assets and liabilities | \$ 296.0                           | \$ (21.0) |

|   | Nine Months Ended<br>September 30, |           |
|---|------------------------------------|-----------|
|   | _____                              | _____     |
| All Other:  |                                    |           |
| Change in assets and liabilities - source (use):      |                                    |           |
| Receivables   | \$ 39.9                            | \$ (7.6)  |
| Inventories   | (0.8)                              | (17.0)    |
| Other current assets                                  | (6.8)                              | (6.8)     |
| Other noncurrent assets                               | (12.9)                             | (5.0)     |
| Accounts payable                                      | (48.2)                             | (3.3)     |
| Accrued liabilities                                   | 18.6                               | 20.5      |
| Noncurrent liabilities                                | (4.2)                              | 0.6       |
|   | _____                              | _____     |
| Net cash flows from changes in assets and liabilities | \$ (14.4)                          | \$ (18.6) |
|   | _____                              | _____     |

**Note 14 Other Matters**

The Company is involved in a value-added tax dispute in Peru. Management believes the Company was targeted by corrupt officials within a former Peruvian government. On December 2, 1999, Engelhard Peru, S.A., a wholly owned subsidiary, was denied refund claims of approximately \$28 million. The Peruvian tax authority also determined that Engelhard Peru, S.A. is liable for approximately \$63 million in refunds previously paid, fines and interest as of December 31, 1999. Interest and fines continue to accrue at rates established by Peruvian law. The Peruvian Tax Court ruled on February 11, 2003 that Engelhard Peru, S.A. was liable for these amounts, overruling precedent to apply a form over substance theory without any determination of fraudulent participation by Engelhard Peru, S.A. The Tax Court is part of the Peruvian Ministry of Economics and Finance. Engelhard Peru, S.A. is contesting these determinations vigorously, and management believes, based on consultation with counsel, that Engelhard Peru, S.A. is entitled to all refunds claimed and is not liable for these additional taxes, fines or interest. In late October 2000, a criminal proceeding alleging tax fraud and forgery related to this value-added tax dispute was initiated against two Lima-based officials of Engelhard Peru, S.A. Although Engelhard Peru, S.A. is not a defendant, it may be civilly liable in Peru if its representatives are found responsible for criminal conduct. In its own investigation, and in detailed review of the materials presented in Peru, management has not seen any evidence of tax fraud by these officials. Accordingly, Engelhard Peru, S.A. is assisting in the vigorous defense of this proceeding. Management believes the maximum economic

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exposure is limited to the aggregate value of all assets of Engelhard Peru, S.A. That amount, which is approximately \$30 million including unpaid refunds, has been fully provided for in the accounts of the Company.

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**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations****Results of Operations****Comparison of the Third Quarter of 2003  
with the Third Quarter of 2002**

Net earnings increased to \$59.8 million in the third quarter of 2003 from \$2.9 million in the same period of 2002. Net earnings in the third quarter of 2002 include an equity investment impairment charge of \$57.7 million associated with the liquidation of the Company's Engelhard-CLAL joint venture. Operating earnings for the third quarter of 2003 decreased 14% to \$66.1 million from \$76.9 million in the same period of 2002. Lower operating earnings from Appearance and Performance Technologies and Materials Services were partially offset by higher operating earnings from Environmental and Process Technologies. Operating earnings in the Company's All-Other category decreased primarily from increased professional fees, increased information technology expenses and higher pension-related costs.

The effective tax rate was 20.3% in the third quarter of 2003 compared with 19.0% (excluding the equity investment impairment of \$57.7 million) in the same period of 2002. The higher rate in the quarter was primarily a result of a shift in the geographical mix of earnings, a reduction to percentage depletion estimates, and a reduction of the research and development tax credits in the quarter. The effective tax rate is expected to be approximately 22% for the full year.

The World Trade Organization has ruled that the extraterritorial income (ETI) exclusion, which provides the Company with a tax benefit based on export sales, is a prohibited export subsidy. As a result, ETI rules are presently under reconsideration by Congress and the repeal of this benefit is likely. In fiscal year 2003, export benefits are expected to reduce the Company's effective tax rate by approximately 3%. It is not possible to predict at this time the eventual outcome of this matter and the impact to the Company. However, if ETI is repealed and legislation that would result in comparable benefits is not enacted, the loss of the tax benefit to the Company could adversely impact the Company's effective tax rate.

The Company's share of equity earnings from affiliates was \$14.5 million for the third quarter of 2003 compared with \$3.9 million for the same period in 2002. Higher equity earnings were primarily from Engelhard-CLAL, a 50%-owned joint venture that manufactures and markets certain products containing precious metals. As previously disclosed, the Company and its partner, Fimalac, are currently in the process of liquidating the Engelhard-CLAL joint venture. Higher equity earnings from Engelhard-CLAL resulted from the sale of platinum inventories at favorable prices, realized gains on the sale of an inactive facility and the strengthening of the Euro versus the US dollar.

Interest expense increased 2% to \$6.5 million for the third quarter of 2003 compared with \$6.4 million for the same period in 2002. Interest income was \$1.0 million in the third quarter of 2003 compared with \$0.4 million for the same period in 2002. Interest expense increased from the prior period a year ago as higher foreign short-term interest rates were partially offset by decreased borrowings.

Net sales increased 7% to \$915.4 million in the third quarter of 2003 from \$858.6 million for the same period in 2002. Higher sales from Environmental Technologies, Process Technologies and Materials Services were partially offset by lower sales from Appearance and Performance Technologies.

*Environmental Technologies*

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Operating earnings increased 54% to \$31.0 million in the third quarter of 2003 from \$20.1 million in the same period of 2002. Net sales for the third quarter of 2003 increased 28% to \$202.2 million from \$158.2 million in the same period of 2002.

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The majority of this segment's sales are derived from technologies to control pollution from mobile sources, including gasoline and diesel-powered passenger cars, sport-utility vehicles, trucks, buses and off-road vehicles.

Operating earnings were higher primarily from increased volumes and a favorable product mix of mobile environmental markets, higher volumes of emission-control systems for gas turbines used in power generation applications and the absence of costs in the year-ago quarter related to rework for power generation applications of \$4.6 million. The increase in operating earnings was partially offset by lower volumes to the surface coatings markets related to lower demand from the aerospace industry, higher depreciation costs of \$2.6 million and higher energy costs of \$0.5 million.

Sales increased primarily from the addition of higher pass-through substrate costs and the favorable impact of foreign exchange, which collectively accounted for slightly less than half the sales increase. Sales were also favorably impacted by higher volumes and a favorable product mix in both diesel OEM and diesel retrofit markets of \$5.9 million and higher volumes and a favorable product mix of emission-control systems for gas turbines used in power generation applications of \$3.0 million. The increase in sales was partially offset by \$2.8 million on lower volumes to the surface coatings markets primarily from lower demand from the aerospace industry.

### *Process Technologies*

Operating earnings increased 15% to \$24.6 million in the third quarter of 2003 from \$21.3 million in the same period of 2002. Net sales for the third quarter of 2003 increased 14% to \$143.6 million from \$125.6 million in the same period of 2002.

Operating earnings were higher primarily from increased demand for new technologies offered to the petroleum-refining, polyolefin and gas-to-liquids markets, the favorable impact of foreign exchange of \$1.5 million, lower raw material costs of \$1.0 million and benefits from productivity programs. The increase in operating earnings was partially offset by higher energy costs of \$1.5 million and higher nickel costs of \$1.0 million.

Sales increased primarily from increased demand for the new technologies offered to the petroleum-refining, polyolefin and gas-to-liquids markets which aggregated \$10.0 million, higher sales to chemical-process markets of \$4.6 million primarily from the timing of orders and the favorable impact of foreign exchange of \$2.7 million. Sales were reduced by \$0.9 million due to lower precious metal prices, which are passed through to chemical-process catalyst customers in Europe.

### *Appearance and Performance Technologies*

Operating earnings decreased 33% to \$18.0 million in the third quarter of 2003 from \$27.0 million in the same period of 2002. Net sales decreased 3% to \$166.1 million for the third quarter of 2003 from \$171.9 million in the same period of 2002.

Sales and operating earnings decreased primarily from lower volumes of minerals-based products sold to paper and certain other industrial end markets. Operating earnings were also lower from higher energy costs of \$3.0 million and higher manufacturing costs. The decrease in operating earnings was partially offset by increased sales volumes to the coatings, cosmetics/personal care and automotive markets and the favorable impact of foreign exchange of \$0.7 million.

### *Materials Services*

Operating earnings decreased 84% to \$1.3 million in the third quarter of 2003 from \$8.3 million in the same period of 2002. Net sales increased 1% to \$385.3 million in the third quarter of 2003 from \$382.1 million in the same period of 2002.

Operating earnings were down as earnings in the third quarter of 2002 were favorably impacted from cash received related to the settlement of litigation for a customer receivable recorded in 1997 that was previously written off (\$3.0 million). In addition, earnings decreased on lower results from recycling services due to higher costs associated with performance issues at our domestic refinery. These issues, which are apart from the current level of operations, are being actively addressed by



management. Overall, reduced industrial demand for certain platinum group metals continue to adversely impact this segment.

### **Comparison of the First Nine Months of 2003 with the First Nine Months of 2002**

Net earnings increased 48% to \$170.5 million in the first nine months of 2003 from \$115.4 million in the same period of 2002. The Company recorded an after-tax transition charge of \$2.3 million on January 1, 2003 as the cumulative effect of an accounting change associated with the adoption of SFAS No. 143 (see Note 3, Accounting for Asset Retirement Obligations, for further detail). Net earnings for the first nine months of 2002 include an equity investment impairment charge of \$57.7 million associated with the liquidation of the Company's Engelhard-CLAL joint venture. Operating earnings for the first nine months of 2003 decreased 12% to \$210.0 million from \$239.2 million in the same period of 2002. For the nine-month period ended September 30, 2003, operating earnings include a charge of \$7.8 million related to lease commitments for idle facilities, restructuring charges totaling \$8.7 million and a royalty settlement gain of \$28.4 million. For the nine-month period ended September 30, 2002, operating earnings include a restructuring charge of \$3.1 million and an insurance settlement gain of \$11.0 million.

Operating earnings in the Company's All-Other category increased primarily from the royalty settlement gain of \$28.4 million reported in the first quarter of 2003.

The effective tax rate was 22.1% in the first nine months of 2003 compared with 23.0% (excluding the equity investment impairment of \$57.7 million) for the same period of 2002. The lower rate was primarily the result of the recognition of favorable tax variances from the export sales exclusion and a shift in the geographical mix of earnings. The effective tax rate is expected to be approximately 22% for the full year.

The Company's share of equity earnings from affiliates was \$27.7 million for the first nine months of 2003 compared with \$11.9 million for the same period in 2002. As previously disclosed, the Company and its partner, Fimalac, are currently in the process of liquidating the Engelhard-CLAL joint venture. The increase was primarily due to higher equity earnings from Engelhard-CLAL resulting from the sale of platinum inventories at favorable prices, realized gains on the sale of an inactive facility and the strengthening of the Euro versus the US dollar and higher Heesung-Engelhard equity earnings. The increase in equity earnings was partially offset by lower equity earnings from N.E. Chemcat resulting from environmental remediation costs and a loss on the sale of investment securities.

Interest expense decreased 11% to \$18.5 million in the first nine months of 2003 from \$20.9 million in the same period of 2002. Interest income increased to \$2.7 million in the first nine months of 2003 from \$1.1 million in the same period in 2002. Lower interest expense was due to decreased borrowings, partially offset by higher foreign short-term interest rates.

Net sales decreased 6% to \$2.7 billion in the first nine months of 2003 from \$2.8 billion in the same period in 2002. Lower sales resulted primarily from decreased sales in the Materials Services segment as a result of lower volumes and prices for certain platinum group metals.

#### *Environmental Technologies*

Operating earnings decreased 1% to \$87.0 million in the first nine months of 2003 from \$87.7 million in the same period of 2002. Net sales for the first nine months of 2003 increased 27% to \$624.9 million from \$493.2 million in the same period of 2002.

Operating earnings were lower primarily from lower volumes of emission-control systems for gas turbines used in power-generation applications and lower volumes to the surface coatings markets. This decline resulted from a difficult comparison from an exceptionally strong year-ago first quarter in the energy market and lower demand from the aerospace industry. Earnings also decreased from a management consolidation and productivity initiative charge of \$5.3 million (see Note 2, Special Charges and Credits, for further detail) recorded in the first quarter of 2003, the reversal of a warranty accrual of \$4.9 million in the first quarter of 2002 for a particular stationary-source, emission-control capital equipment project as a result of improved catalyst technology, higher depreciation costs of \$8.4 million and higher energy costs of \$2.2 million. This decrease was partially offset by increased volumes and a favorable product mix of mobile environmental markets, the absence of costs in

the year-ago period related to rework for power generation applications of \$7.9 million, the favorable impact of foreign exchange of \$3.1 million and a manufacturing consolidation charge of \$3.1 million recorded in the second quarter of 2002.

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Sales increased primarily from the addition of higher pass-through substrate costs and the favorable impact of foreign exchange, which collectively accounted for approximately two-thirds of the sales increase. Sales were also favorably impacted by higher volumes and a favorable product mix in both diesel OEM and diesel retrofit markets. Higher sales were partially offset by \$11.9 million on lower volumes of emission-control systems for gas turbines used in power-generation applications and by \$10.6 million on lower volumes to the surface coatings markets.

#### *Process Technologies*

Operating earnings increased 2% to \$62.7 million in the first nine months of 2003 from \$61.4 million in the same period of 2002. Net sales for the first nine months of 2003 increased 6% to \$401.9 million from \$377.5 million in the same period of 2002.

Operating earnings increased primarily from increased demand for new technologies offered to the petroleum-refining, polyolefin and gas-to-liquids markets, lower raw material costs of \$3.9 million, the favorable impact of foreign exchange of \$3.9 million and benefits from productivity programs. These decreases were partially offset by a productivity charge of \$2.6 million (see Note 2, Special Charges and Credits, for further detail) recorded in the first quarter of 2003, higher energy costs of \$5.1 million and higher nickel costs of \$1.7 million.

Sales increased primarily from increased demand for the new technologies offered to the petroleum-refining, polyolefin and gas-to-liquids markets which aggregated \$30.1 million and the favorable impact of foreign exchange of \$10.0 million. Sales were reduced by \$8.9 million due to lower precious metal prices, which are passed through to chemical-process catalyst customers in Europe and lower sales to chemical-process markets of \$1.6 million primarily from the timing of orders.

#### *Appearance and Performance Technologies*

Operating earnings decreased 17% to \$55.2 million in the first nine months of 2003 from \$66.9 million in the same period of 2002. Net sales for the first nine months of 2003 increased 1% to \$500.5 million from \$494.9 million in the same period of 2002.

Operating earnings decreased primarily from a charge of \$7.8 million recorded in the second quarter of 2003 related to lease commitments for idle facilities, higher energy costs of \$9.9 million, higher manufacturing costs and lower sales volumes of minerals-based products sold to paper and certain other industrial end markets. The decrease in operating earnings was partially offset by increased sales volumes to the coatings, cosmetics/personal care and automotive markets and the favorable impact of foreign exchange of \$3.4 million.

#### *Materials Services*

Operating earnings decreased 81% to \$8.8 million in the first nine months of 2003 from \$45.7 million in the same period of 2002. Net sales for the first nine months of 2003 decreased 23% to \$1.1 billion from \$1.4 billion in the same period of 2002.

Operating earnings in both years were favorably affected by several items that triggered recognition of events reflecting operations from prior periods. Operating earnings in the first nine-months of 2003 benefited from a contract settlement netting \$9.3 million while the year ago prior period included \$22.0 million of income related to platinum-group-metal transactions realized previously but deferred pending the resolution of certain contractual provisions, an insurance settlement gain of \$11.0 million, \$5.5 million of income related to a previously unrecognized contractual benefit and \$3.0 million of income related to cash received from the settlement of litigation for a customer receivable recorded in 1997 that was previously written off. The benefit in the current year was partially offset by higher costs associated with performance issues at our domestic refinery. These issues, which are apart from the current level of operations, are being actively addressed by management. The prior period benefits were partially offset by unusually high operating expenses from multiple causes, including legal and compensation expenses. Overall, reduced industrial demand for certain platinum group metals and lower results from recycling

services continue to adversely impact this segment.

### *Financial Condition and Liquidity*

Working capital was \$434.0 million at September 30, 2003 compared with \$179.8 million at December 31, 2002. The current ratio was 1.5 at September 30, 2003 compared with 1.1 at December 31, 2002. The percentage of total debt to total capitalization was 29% at September 30, 2003 compared with 36% at December 31, 2002.

The variance in cash flows from operating activities primarily occurred in the Materials Services segment and reflects changes in metal positions used to facilitate requirements of the Company, its metals customers and suppliers (see Note 13, Supplemental Information, for Materials Services variances). Materials Services routinely enters into a variety of arrangements for the sourcing of metals. Generally, transactions are hedged on a daily basis. Hedging is accomplished primarily through forward, future and option contracts. However, in closely monitored situations for which exposure levels have been set by senior management, the Company from time to time holds large unhedged industrial commodity positions that are subject to future market price fluctuations. These positions are included in committed metal positions along with hedged metal holdings (see Note 10, Committed Metal Positions and Hedged Metal Obligations, for these positions). The bulk of hedged metal obligations represent spot short positions. As these positions generate cash, their cash effect is included in the financing activities section of the Company's Condensed Consolidated Statements of Cash Flows. Other than in closely monitored situations, these positions are hedged with forward purchases. In addition, the aggregate fair value of derivatives in a loss position is reported in hedged metal obligations (derivatives in a gain position are included in committed metal positions). Materials Services works to ensure that the Company and its customers have an uninterrupted source of metals, primarily platinum group metals, utilizing supply contracts and commodities markets around the world. Committed metal positions may include significant advances made for the purchase of precious metals that have been delivered to the Company but for which the final purchase price has not yet been determined. As of September 30, 2003, all such contracts have been final priced and settled without any loss to the Company.

The variance in cash flows from investing activities is primarily related to liquidating distributions received in connection with the 2002 plan to unwind the Company's Engelhard-CLAL joint venture, an additional non-equity investment in fuel-cell developer Plug Power Inc. in 2002 and changes in capital expenditures.

The variance in cash flows from financing activities was impacted by a change in hedged metal obligations, proceeds received from the issuance of long-term debt in May 2003, a decrease in short-term borrowings and lower net stock repurchase activity. The decrease in hedged metal obligations combined with the decrease in committed metal positions for the nine-month period ended September 30, 2003 was largely due to the conclusion of a large metal contract, combined with lower levels of industrial demand. In October 2003, the Company announced that it raised its quarterly dividend by 10 percent to 11 cents a share. The new dividend is payable on December 31 to shareholders of record on December 15.

Through a public debt offering in May 2003, the Company issued \$150 million of 10-year notes. These notes mature on May 15, 2013 and bear an interest rate of 4.25%. As discussed in Note 7, Derivatives and Hedging, these notes were effectively changed from a fixed rate debt obligation to a floating rate debt obligation through the use of interest rate swap agreements. The notes were issued under the Company's existing \$300 million shelf registration, effectively reducing the shelf registration to \$150 million.

In the third quarter of 2003, the Company made a voluntary \$35 million cash contribution to its defined benefit pension plans. As a result of this contribution, the Company expects the projected benefit obligation of all its combined defined benefit pension plans to be approximately 80% funded. The Company has determined that its net pension cost is projected to be approximately \$27 million in 2004, compared to \$21 million in 2003 and \$12 million in 2002.

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The Company has consistently derived considerable cash flow from operations, which has been used, along with both short-and long-term debt, to pay for capital expenditures, acquisitions, treasury stock purchases, dividends and other corporate requirements. The continuation of these levels of cash flow is expected but is subject to risk factors disclosed in the Company's 2002 Form 10-K and in the Forward-Looking Statements section of this Form 10-Q. In addition, the Company has always maintained investment-grade credit ratings that it considers important for cost-effective and ready access to the credit markets. Management fully expects to be able to obtain future funding from both short- and long-term debt for cash requirements in excess of those from operations. In the event that any of these sources prove to be below expectations, the Company has access to committed lines of credit aggregating \$800 million.

### *Forward-Looking Statements*

This document contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements relate to analyses and other information that are based on forecasts of future results and estimates of amounts not yet determinable. These statements also relate to the future prospects, developments and business strategies. These forward-looking statements are identified by their use of terms and phrases such as anticipate, believe, could, estimate, expect, intend, may, plan, predict, project, will and similar terms and phrases, including references to assumptions. These forward-looking statements involve risks and uncertainties that may cause the Company's actual future activities and results of operations to be materially different from those suggested or described in this document.

Among the risks and uncertainties that could cause actual results to differ materially are the following:

competitive pricing or product development activities that could affect the demand for our products, particularly competing catalyst and kaolin producers

the Company's ability to achieve and execute internal business plans

worldwide political instability as the Company operates primarily in the United States, the European community, the Asia-Pacific region, the Russian Federation, South Africa and South America

alliances and geographic expansions developing differently than anticipated

fluctuations in the supply and prices of precious and base metals and fluctuations in the relationships between forward prices to spot prices

government legislation and/or regulation (particularly on environmental issues), including tax obligations

the impact of the anticipated repeal of the current U.S. export sales tax incentive

technology, manufacturing and legal issues

the impact of any economic downturns and inflation

interest rate risk, foreign currency exchange rate risk, commodity price risk and credit risk

the impact of higher energy and raw material costs, and the availability of natural gas and rare earth elements

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the success of research and development activities and the speed with which regulatory authorizations and product launches may be achieved

the impact of increased employee benefit costs and/or the resultant impact on employee relations

contingencies related to actual or alleged environmental contamination to which the Company may be a party

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the impact of acquisitions, divestitures and restructurings

overall demand for the Company's products, including demand from the worldwide automotive and chemical-process markets

product quality/performance issues

exposure to product liability and other types of lawsuits

the impact of physical inventory losses, particularly with regard to precious and base metals

the loss of business from property and casualty exposure

Investors are cautioned not to place undue reliance upon these forward-looking statements, which speak only as of their dates. The Company disclaims any obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

### **Item 4. Controls and Procedures**

The Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, as of September 30, 2003, of the effectiveness of the design and operation of the Company's disclosure controls and procedures pursuant to Exchange Act Rule 13a-15. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures as of September 30, 2003 were effective to provide reasonable assurance that material information related to the Company (including its consolidated subsidiaries) required to be included in the Company's periodic SEC filings would be timely communicated to them. There have been no significant changes in the Company's internal control over financial reporting which could significantly affect internal control over financial reporting subsequent to the date the Company carried out its evaluation.

The Company's management, including the CEO and CFO, do not expect that our disclosure controls or our internal control over financial reporting will prevent all errors and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the reality that judgments and estimates can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons or by collusion of two or more people. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected. Accordingly, the Company's disclosure controls and procedures are designed to provide reasonable, not absolute, assurance that the objectives of our disclosure control system are met and, as set forth above, the Company's Chief Executive Officer and Chief Financial Officer have concluded, based on their evaluation as of September 30, 2003, that our disclosure controls and procedures were effective to provide reasonable assurance that the objectives of our disclosure control system were met.

## **PART II OTHER INFORMATION**

### **Item 6. Exhibits and Reports on Form 8-K**

(a) (10) Material Contracts

**Pages**

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|  | <u>Pages</u> |
|--|--------------|
| (a) Amendment to the Supplemental Retirement Program of Engelhard Corporation, effective as of October 2, 2003.  | 25           |
| (12) Computation of the Ratio of Earnings to Fixed Charges.  | 26           |
| (31)(a) Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer.   | 27           |
| (31)(b) Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer.   | 28           |
| (32) Section 1350 Certifications of Chief Executive Officer and Chief Financial Officer. *   | 29           |
| (b) In a report on Form 8-K furnished to the Securities and Exchange Commission (SEC) on July 29, 2003, the Company reported that it furnished its earnings release with the SEC for the second quarter of 2003. |              |

\* This certification accompanies this Report pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and shall not be deemed filed by the Company for purposes of Section 18 or any other provision of the Securities Exchange Act of 1934, as amended.

**SIGNATURES**

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.

ENGELHARD CORPORATION

(Registrant)

Date: November 13, 2003

/s/ Barry W. Perry

Barry W. Perry  
Chairman and Chief  
Executive Officer

Date: November 13, 2003

/s/ Michael A. Sperduto

Michael A. Sperduto  
Vice President and Chief  
Financial Officer

Date: November 13, 2003

/s/ Alan J. Shaw

Alan J. Shaw  
Controller

EXHIBIT (10) (a)

**AMENDMENT TO  
SUPPLEMENTAL RETIREMENT PROGRAM  
OF ENGELHARD CORPORATION**

The Supplemental Retirement Program of Engelhard Corporation (the Program) is amended, effective as of October 2, 2003, as set forth below.

*Section 6 of the Program is amended by redesignating paragraph (d) thereof as paragraph (e) and inserting a new paragraph (d) to read as follows:*

(d) the Participant's death; or

*Section 5(d) of the Program is amended to read as follows in its entirety:*

(d) The Excess Benefit Plan and the Supplemental Executive Retirement Plan are intended to be unfunded plans for deferred compensation. With respect to any payments not yet made to a Participant, nothing contained in the Excess Benefit Plan or the Supplemental Executive Retirement Plan shall give any such Participant any rights that are greater than those of a general, unsecured creditor of the Company; provided, however, that the Company may authorize the creation of trusts or make other arrangements to meet the Company's obligations under the Excess Benefit Plan or Supplemental Executive Retirement Plan, so long as such trusts or other arrangements are consistent with the unfunded status of the Plan for federal income tax purposes.

List of current elected executive officers who have entered into this Supplemental Retirement Program of Engelhard Corporation:

Arthur A. Dornbusch, II

Mark Dresner

John C. Hess

Chung Ping Mak

Peter B. Martin

Barry W. Perry

Alan J. Shaw

Michael A. Spurduto

EXHIBIT (12)

**ENGELHARD CORPORATION**  
**COMPUTATION OF THE RATIO OF EARNINGS TO FIXED CHARGES**  
(Dollars in Millions)  
(Unaudited)

|   | Nine Months<br>Ended<br>September 30, | Years Ended December 31, |                 |                 |                 |                 |
|---|---------------------------------------|--------------------------|-----------------|-----------------|-----------------|-----------------|
|   | 2003                                  | 2002                     | 2001            | 2000            | 1999            | 1998            |
| Earnings from continuing operations before provision for income taxes and cumulative effect of an accounting change | \$ 221.8                              | \$ 237.9                 | \$ 305.2        | \$ 245.7        | \$ 284.1        | \$ 260.6        |
| Add/(deduct)  |                                       |                          |                 |                 |                 |                 |
| Portion of rents representative of the interest factor  | 8.7                                   | 11.6                     | 8.4             | 8.8             | 7.0             | 3.5             |
| Interest on indebtedness  | 18.5                                  | 27.4                     | 47.3            | 64.8            | 69.2            | 60.8            |
| Equity dividends  | 4.5                                   | 3.9                      | 4.2             | 4.4             | 2.4             | 2.0             |
| Equity in (earnings) losses of affiliates   | (27.7)                                | (16.2)                   | (29.1)          | (24.2)          | (16.3)          | (10.1)          |
| Earnings, as adjusted   | <u>\$ 225.8</u>                       | <u>\$ 264.6</u>          | <u>\$ 336.0</u> | <u>\$ 299.5</u> | <u>\$ 346.4</u> | <u>\$ 316.8</u> |
| Fixed Charges   |                                       |                          |                 |                 |                 |                 |
| Portion of rents representative of the interest factor  | \$ 8.7                                | \$ 11.6                  | \$ 8.4          | \$ 8.8          | \$ 7.0          | \$ 3.5          |
| Interest on indebtedness  | 18.5                                  | 27.4                     | 47.3            | 64.8            | 69.2            | 60.8            |
| Capitalized interest  | 2.3                                   | 3.0                      | 3.0             | 3.9             | 2.6             | 1.9             |
| Fixed charges   | <u>\$ 29.5</u>                        | <u>\$ 42.0</u>           | <u>\$ 58.7</u>  | <u>\$ 77.5</u>  | <u>\$ 78.8</u>  | <u>\$ 66.2</u>  |
| Ratio of Earnings to Fixed Charges  | <u>7.65</u>                           | <u>6.30</u>              | <u>5.72</u>     | <u>3.86</u>     | <u>4.39</u>     | <u>4.79</u>     |

EXHIBIT (31)(a)

**Rule 13a-14(a)/15d-14(a)**  
**Certification of Chief Executive Officer**

I, Barry W. Perry, Chairman and Chief Executive Officer of Engelhard Corporation (the Company), certify that:

1. I have reviewed this quarterly report on Form 10-Q of the Company;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
- 3.



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Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and we have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and to the audit committee of registrant's board of directors (or persons performing the equivalent function):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 13, 2003

/s/ Barry W. Perry

Barry W. Perry  
Chairman and Chief  
Executive Officer

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EXHIBIT (31)(b)

### **Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer**

I, Michael A. Sperduto, Vice President and Chief Financial Officer of Engelhard Corporation (the Company), certify that:

1. I have reviewed this quarterly report on Form 10-Q of the Company;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
- 3.

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Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and we have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
  
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and to the audit committee of registrant's board of directors (or persons performing the equivalent function):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 13, 2003

/s/ Michael A. Sperduto

Michael A. Sperduto  
Vice President and Chief  
Financial Officer

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EXHIBIT (32)

### **Section 1350 Certifications of Chief Executive Officer and Chief Financial Officer**

The undersigned, Barry W. Perry, Chairman and Chief Executive Officer of Engelhard Corporation (the Company), and Michael A. Sperduto, Vice President and Chief Financial Officer of the Company, each hereby certifies that the Quarterly Report of the Company on Form 10-Q for the period ended September 30, 2003 (the Report) (1) fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934 and (2) the information contained in the Report fairly presents, in all material respects, the financial condition and the results of operations of the Company.

Date: November 13, 2003

/s/ Barry W. Perry

Barry W. Perry

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Chairman and Chief  
Executive Officer

Date: November 13, 2003

/s/ Michael A. Sperduto

Michael A. Sperduto  
Vice President and Chief  
Financial Officer

This certification accompanies this Report pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and shall not be deemed filed by the Company for purposes of Section 18 or any other provision of the Securities Exchange Act of 1934, as amended.

A signed original of this written statement required by Section 906 or other document authenticating, acknowledging or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.