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HERCULES INC
Form 10-K405
March 29, 2002

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D. C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 2001

Commission file number 1-496

HERCULES INCORPORATED

A DELAWARE CORPORATION
I.R.S. EMPLOYER IDENTIFICATION NO. 51-0023450
HERCULES PLAZA
1313 NORTH MARKET STREET
WILMINGTON, DELAWARE 19894-0001
TELEPHONE: 302-594-5000

Securities registered pursuant to Section 12(b) of the Act
(Each class is registered on the New York Stock Exchange, Inc.)

Title of each class

Common Stock (\$25/48 Stated Value)
8% Convertible Subordinated Debentures due August 15, 2010
9.42% Trust Originated Preferred Securities
(\$25 liquidation amount), issued by Hercules Trust I
and guaranteed by Hercules Incorporated
Preferred Share Purchase Rights

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

As of March 15, 2002, registrant had 109,157,515 shares of common stock, \$25/48 stated value ("Common Stock") outstanding, which is registrant's only class of common stock.

The aggregate market value of registrant's Common Stock held by non-affiliates based on the closing price on March 15, 2002 was approximately \$1.3 billion.

DOCUMENTS INCORPORATED BY REFERENCE
(SPECIFIC PAGES INCORPORATED ARE IDENTIFIED UNDER THE APPLICABLE ITEM HEREIN.)

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Portions of the registrant's definitive Proxy Statement (the "Proxy Statement"), when filed, will be incorporated by reference in Part III of this Report. Other documents incorporated by reference in this report are listed in the Exhibit Index (see page 84).

PART I

FORWARD-LOOKING STATEMENT

This Annual Report on Form 10-K includes forward-looking statements, as defined in the Private Securities Litigation Reform Act of 1995, reflecting management's current analysis and expectations, based on reasonable assumptions. Forward-looking statements may involve known and unknown risks, uncertainties and other factors, which may cause the actual results to differ materially from those projected, stated or implied depending on such factors as: inability to generate cash and reduce debt, the result of the pursuit of strategic alternatives, ability to execute work process redesign and reduce costs, business climate, business performance, economic and competitive uncertainties, failure to complete transactions or to achieve benefit from transactions, inability to monetize certain identified businesses, higher manufacturing costs, reduced level of customer orders, changes in strategies, risks in developing new products and technologies, environmental and safety regulations and clean-up costs, foreign exchange rates, adverse legal and regulatory developments, including increases in the number or financial exposures of claims, lawsuits, settlements or judgments, or the inability to eliminate or reduce such financial exposures by collecting indemnity payments from insurers, and adverse changes in economic and political climates around the world. Accordingly, there can be no assurance that the Company will meet future results, performance or achievements expressed or implied by such forward-looking statements. As appropriate, additional factors are contained in reports filed with the Securities and Exchange Commission, including the Form S-4 Registration Statement filed October 31, 2001. This paragraph is included to provide safe harbor for forward-looking statements, which are not generally required to be publicly revised as circumstances change.

ITEM 1. BUSINESS:

Hercules Incorporated is a leading manufacturer and marketer of specialty chemicals and related services for a broad range of business, consumer and industrial applications. The Company is focused on maximizing cash flow and delivering stockholder value by concentrating on managed growth in its core businesses as well as ongoing improvements in its manufacturing processes. Hercules operates on a global scale, with significant operations in North America, Europe, Asia and Latin America. Product sales occur in over 50 countries with significant revenue streams generated in four continents.

The Company's principal products are chemicals used by the paper industry to increase product performance and enhance the manufacturing process; chemicals which improve water treatment and industrial process chemicals; water-soluble polymers; resins and polypropylene and polyethylene fibers. These products impart such qualities as durability, water-resistance and improved aesthetics for everyday consumer goods such as writing paper, toothpaste and diapers. The primary markets the Company serves include pulp and paper, personal care, petroleum refining, oil and gas drilling and recovery, paints and coatings, construction materials, adhesives and pharmaceuticals.

While the Company's products have a low cost impact on its customers' total product costs, they frequently possess characteristics important to the functionality and aesthetics of the finished product or the efficient operation of the manufacturing process. Examples of the Company's products in consumer

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end-uses include strength additives for tissue and toweling, sizing agents for milk and juice cartons, fibers that comprise the inner and outer linings of disposable diapers and feminine hygiene products, thickeners in products such as toothpaste, shampoos and water-based paints and water control additives for building products such as tile cements, grouts, stuccos, plasters and joint compounds. The Company also offers products and related services that improve and reduce the cost of a variety of manufacturing processes, including water management programs that are designed to protect and maintain equipment and reduce operating costs.

Although price is important to the Company's competitive strategy, the Company primarily competes based on the performance and quality of its products. The Company strives to continually improve its products by investing in technology and research and development and has committed substantial resources to its research and development efforts. Research and development expenditures totaled approximately \$67 million in 2001. Such expenditures enable the Company to consistently bring to market products which have improved functional properties or which offer similar properties at a lower cost. This area has become increasingly important, as customers have come to rely more on Hercules to provide new solutions to improve their product offerings and processes. Additionally, the Company strives to make its products more price-competitive by effectively managing its production costs and sharing savings with customers.

The Company continually reviews its corporate strategy and directives in order to compete most effectively in its changing markets.

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Prior to 1995, the Company focused primarily on increasing its return on equity and reducing operating costs. From 1995 through 2000, the Company implemented internal and external initiatives to achieve growth. The Company has divested a number of businesses that did not fit into its portfolio and acquired other businesses that complement its strategy and product offerings. In 1998, Hercules made five major acquisitions. The largest of these was the purchase of BetzDearborn Inc., a global specialty company providing water and process treatment to a variety of commercial and industrial processes. Additionally, the Company acquired Houghton International's paper chemicals group; Citrus Colloids, a pectin manufacturer; Alliance Technical Products ("ATP"), a manufacturer of resins serving the water-based adhesives industry; and the 49% share of FiberVisions owned by Hercules' joint venture partner, making FiberVisions a wholly-owned subsidiary.

Starting in 2000, the Company implemented a program designed to refocus its business by monetizing certain non-core assets, thereby generating cash to reduce its debt, while concentrating on improving the efficiency, profitability and growth potential of the Company's core businesses. As part of this strategy, the Company has actively sold non-core businesses in the last 18 months. In September 2000, the Food Gums business, including Citrus Colloids, was sold to CP Kelco; in May 2001, the hydrocarbon resins business and select portions of its rosin resins business, including ATP, were sold to Eastman Chemical Company and the peroxy chemicals business was sold to GEO Specialty Chemicals Inc. The Company received in excess of \$730 million in gross proceeds in consideration for these sales, which was used to reduce debt. In the fourth quarter of 2000, the Company announced its intention to pursue a sale or merger of all or part of the Company.

In 2001, the strategy was expanded to include an aggressive and comprehensive cost reduction and work process redesign program to improve return on capital, streamline organizational structure, improve work processes and consolidate manufacturing and non-manufacturing resources. The objective was to achieve fixed costs reductions of \$100 million on an annualized basis (as

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compared to 2000 results, excluding divested businesses) by June 2002. Approximately 975 employees have been or will be terminated pursuant to this initiative. At the end of 2001, the Company has achieved the \$100 million annualized cost reduction target. In 2002, the cost reduction target to be achieved by December 2002 was increased to \$200 million in annualized fixed cost reductions (as compared to 2000 results, excluding divested businesses), including \$125 million for the remaining businesses and \$75 million for the BetzDearborn Division.

On February 12, 2002, the Company entered into an agreement to sell the BetzDearborn Division businesses and certain Pulp and Paper Division treatment businesses (the "Water Treatment Business") to GE Specialty Materials ("GESM"), a unit of General Electric Company (the "GE Transaction"). The transaction is subject to regulatory and other customary approvals, and is expected to close in the second quarter of 2002. The selling price is \$1.8 billion in cash, with net after tax proceeds available for debt reduction of approximately \$1.665 billion. The sale of the Water Treatment Business will enable the Company to significantly reduce its debt, provide greater financial flexibility, permit better support of the Company's remaining businesses and enhance shareholder value. The Company will then focus on the future of its remaining businesses. See Part II, Item 7 for additional discussion.

In order to facilitate the GE transaction, the Company was required to obtain amendments to its senior credit facility and ESOP credit facility (the "Facilities"). Effective March 6, 2002, the Facilities were amended (the "Amendments") to (i) modify certain financial covenants (ii) change the mandatory prepayment provisions; (iii) permit the reorganization of the Company in order to effect the separation of the Water Treatment Business; and (iv) permanently reduce the revolving committed amount under the credit facility to \$200 million. The amendment to the

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Facilities also included provisions that are effective only upon the consummation of the sale of the Water Treatment Business and the prepayment of the Facilities. These additional provisions include the following: (i) the release of the subsidiary stock pledged to the collateral agent; (ii) the elimination of the requirement that stock of any additional subsidiaries be pledged in the future; and (iii) the revision of the permitted amount of asset purchases and dispositions. If the GE Transaction does not close by July 15, 2002, the financial covenants set forth in the Fifth Amendment revert back to the previously established levels.

Over the long term, the Company is focused on improving profitability through net sales growth, new product offerings, cost improvements and superior customer service and cross-selling of products.

REPORTABLE SEGMENTS

The reportable segments of the Company are Process Chemicals and Services (comprised of Pulp and Paper and BetzDearborn); Functional Products (comprised of Aqualon); and Chemical Specialties (comprised of FiberVisions and Resins). The financial information regarding these segments, which includes net sales and profit from operations for each of the three years ended December 31, 2001, 2000 and 1999 and capital employed as of December 31, 2001, 2000 and 1999, is provided in Note 23 to the Consolidated Financial Statements (See Part II, Item 8).

PROCESS CHEMICALS AND SERVICES (PULP AND PAPER AND BETZDEARBORN)

Products and services in this segment are designed to enhance customers'

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profitability by improving production yields and overall product quality, and to better enable customers to meet their environmental objectives and regulatory requirements.

The Company believes its Pulp and Paper Division is one of the largest suppliers of functional, process and water management chemicals for the pulp and paper industry. Pulp and Paper offers a wide and highly-sophisticated range of technology and applications expertise with in-mill capabilities which run from the boilers, through the paper machine, to the finished paper on the winder. The Company is the only true broad-based supplier able to offer a complete portfolio of products to its paper customers.

The Company believes BetzDearborn is the world's second largest supplier of advanced-engineered chemical treatment programs for water, wastewater and process systems operating in a wide range of industries. BetzDearborn has extensive experience in lowering water and energy consumption, maximizing plant efficiency and productivity, solving complex environmental problems and improving the yield and quality of customer processes.

The Company has entered into an agreement to sell the Water Treatment Business to GESM. The paper process chemicals business, currently representing approximately one-third of the business that Hercules acquired when it purchased BetzDearborn in 1998, will remain with Hercules. In addition, Hercules will have an agreement with GESM to distribute and service BetzDearborn's water treatment products to the pulp and paper industry.

At December 31, 2001, the principal products and primary markets of this segment were:

DIVISION	PRINCIPAL PRODUCTS	PRIMARY MARKETS
	Performance chemicals:	
	Wet strength, dry strength, sizing and surface treatments, creping adhesives and release.	Makers of tissues, paper towels, packaging, beverage containers,
	Process treatment chemicals:	newsprint, papers for magazines and books, printing and writing paper and other stationery items such as labels and envelopes,
PULP AND PAPER	Deposit, contaminant, microbiological and foam control, clarification, retention/drainage, felt conditioning, deinking, fiber recovery and water closure.	health care and skin care products, household products and pharmaceuticals.
	Water treatment chemicals(1):	
	Influent water, effluent water, cooling towers and utility systems.	
	Water treatment(1):	Industrial, commercial and institutional establishments.
	Influent water, boilers, cooling systems and wastewater.	

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Process treatment(1):

BETZ DEARBORN	Antifoulants, emulsion breakers, antifoams, finished additives, polymerization inhibitors, deposit and corrosion control, cleaners and sterilizers, clarifying aids, leaching and agglomeration aids, polymers, dust control, membrane cleaners, conversion coatings, sealers, paint detackifiers, strippers and grate cleaners.	Petroleum refineries, chemical plants, manufacturers of metals and plastics, automobile assembly plants, mineral processors and makers of food and beverages.
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(1) Included in the GE Transaction.

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FUNCTIONAL PRODUCTS (AQUALON)

Products in this segment modify the physical properties of aqueous (water-based) and non-aqueous systems. These products are principally derived from renewable natural raw materials and are sold as key ingredients to other manufacturers where they are used as small-quantity additives to provide functionality for thickening, water retention, rheology control, film formation, suspending and emulsifying action and binding power. Aqualon's ability to offer its customers a broad sophisticated product line has earned it the number one or two market position across most of its market sectors. Major end uses for Aqualon's products include personal care products, food additives, pharmaceutical products, construction, paints, coatings and oil recovery, where Aqualon's polymers are used to modify viscosity, gel strength, and/or fluid loss.

In June 2000, Aqualon sold its nitrocellulose operations, which it had decided to exit in December 1999 due to economic conditions brought on by a persistent worldwide over-supply.

At December 31, 2001, the principal products and primary markets of this segment were:

DIVISION	PRINCIPAL PRODUCTS	PRIMARY MARKETS
AQUALON	Water-soluble polymers: Hydroxyethylcellulose (HEC), Carboxymethylcellulose (CMC), Methylcellulose (MC) and derivatives, Hydroxypropylcellulose (HPC) and Guar and its derivatives.	Manufacturers of interior and architectural paints, oilfield companies for oil and gas dri recovery, paper mills, constr manufacturers and makers of o products and personal care pr
	Solvent-soluble polymers: Pentaerythritol (PE) and Ethylcellulose (EC).	Producers of coating resins, inks and aviation fluids.

CHEMICAL SPECIALTIES (FIBERVISIONS AND RESINS)

FiberVisions is a manufacturer of thermal-bond polypropylene fine denier staple fibers used in hygienic products like disposable diapers. FiberVisions produces monocomponent polypropylene fibers and bicomponent fibers comprised of a polypropylene core and a polyethylene sheath. FiberVisions also produces olefin fiber and yarn for the domestic textile and industrial markets used in fabrics, residential upholstery and geotextiles, carpets and asphalt.

The Resins Division, which consists of the rosin and terpenes specialty business, is the remaining portion of the Resins Division after the divestitures of the hydrocarbon resins, select portions of the rosin resins, toner resins and peroxy chemicals businesses in 2001. Resins manufactures wood and gum rosin resins and terpene resins and specialties. Product applications include adhesives, rubber and plastic modifiers, food and beverages and aroma chemicals.

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At December 31, 2001, the principal products and primary markets of this segment were:

DIVISION	PRINCIPAL PRODUCTS	PRIMARY MARKETS
FIBER VISIONS	Hygiene fibers: for disposable hygiene products.	Makers of nonwoven and woven fabrics for applications including baby care, feminine care, adult incontinence, wipes, geotextile, construction and upholstery.
	Textile fibers: for decorative and fabric applications.	
	Industrial fibers: for geotextile fabrics, wipes and industrial products.	
RESINS	Rosin resins: for adhesives, food, rubber and plastics.	Makers of consumer and industrial products such as masking, packaging, arts and duct tape, construction materials, beverages, chewing gum, plastics, adhesives, fragrances and flavors.
	Terpene resins: for chewing gum and adhesives.	
	Terpene specialties: for flavor and fragrance in household and industrial products.	

RAW MATERIALS AND ENERGY SUPPLY

Raw materials and supplies are purchased from a variety of industry sources, including agricultural, forestry, mining and petroleum and chemical industries.

Important raw materials for the Process Chemicals and Services segment are cationic and anionic polyacrylamides and emulsions, biocides, amines, surfactants, rosin, adipic acid, epichlorohydrin, fumaric acid, stearic acid, diethylenetriamine, phosphorus trichloride, wax and starch, kathon 886F, bromicide, dequest 2010, age, aetac, antimicrobial 7287, piror 850, aromatic solvent, acrylic acid and TKPP.

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Raw materials important to the Functional Products segment are cellulose (derived from wood pulp and cotton linters), guar, ethylene chloride, caustic soda, monochloroacetic acid, methanol, methyl chloride, acetaldehyde and valeric acids.

The important raw materials for the Chemical Specialties segment are polyethylene and polypropylene resins, ketones, alcohols, phenol, adipic acid, fumaric acid, stearic acid, phosphorus trichloride, wax, casein, starch, pigments, antioxidants, d-limonene, turpentine, rosin, pine wood stumps, catalysts, toluene, clay and process oils.

FiberVisions purchases polypropylene and other polymers based on market prices as indicated domestically by the CDI and internationally by the Platts Indices. FiberVisions has been susceptible to supplier pricing power because a major processing line requires polypropylene in flake form, which is not as readily available as pellets. FiberVisions has recently undertaken initiatives to expand its qualified flake suppliers.

Major requirements for key raw materials and fuels are typically purchased pursuant to multi-year contracts. Hercules is not dependent on any one supplier for a material amount of its raw material or fuel requirements, but certain important raw materials are obtained from sole-source or a few major suppliers.

While temporary shortages of raw materials and fuels may occur occasionally, these items are currently readily available. However, their continuing availability and price are subject to domestic and world market and political conditions as well as to the direct or indirect effect of governmental action or regulations. The impact of any future raw material and energy shortages on the Company's business as a whole or in specific world areas cannot be accurately predicted. Operations and products may, at times, be adversely affected by governmental action, shortages or international or domestic events.

COMPETITION

The specialty chemicals industry is highly fragmented and its participants offer a broad array of product lines and categories, representing many different products designed to meet specific customer requirements. Individual product or service offerings compete on a global, regional and local level due to the nature of the businesses and products, as well as the end-markets and customers served. The industry has become increasingly global as participants focus on establishing and maintaining leadership positions in relatively narrow market niches. Many of the Company's mature product lines face the competitive domestic and international pressures discussed above, including industry consolidation, pricing pressures, and competing technologies. In Pulp and Paper, for example, the end-markets are consolidating and many of the Company's

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competitors are attempting to enhance their product offerings on a worldwide basis through alliances and distributor arrangements. In the water treatment industry (BetzDearborn), large suppliers have increasingly aligned themselves with single suppliers. Customer stability in Resins is expected to remain strong due to the fact that the majority of the Resin Division's products are unique and have strong brand recognition. In addition, certain of the Company's businesses are subject to intense pricing pressures in various product lines, such as fibers in its hygiene products line. FiberVisions, as a hygienic fibers manufacturer for carded non-woven applications, faces competition from spunbond (SB) and spunbond/melt blown/spunbond (SMS) technologies. SB/SMS products may offer cost savings compared to the products of FiberVisions; however, FiberVisions believes that its carded products provide improved softness,

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uniformity and liquid management properties preferred by certain segments of the disposable diaper and other hygiene products markets. The threat of new producers in the thermal-bonded hygienic product line is relatively low due to high entry barriers as the production process involves significant investment in plant and equipment.

PATENTS AND TRADEMARKS

Patents covering a variety of products and processes have been issued to the Company's assignees. The Company is licensed under certain other patents held by other parties covering its products and processes. The Company's rights under these patents and licenses constitute a valuable asset. The Company currently has over 3,500 patents worldwide covering its products.

The Company and its wholly owned subsidiaries also have many global trademarks covering its products. Some of the more significant trademarks include: Aquapel(R) sizing agent, Hercon(R) sizing emulsions, Aqualon(R) water-soluble polymers, Natrosol(R) hydroxyethylcellulose, Culminal(R) methylcellulose, Klucel(R) hydroxypropylcellulose, Natrosol FPS(R) water-soluble polymer suspension, Precis(R) sizing agent, Novus(R) polymer, Dianodic(R) cooling water products, Continuum(R) cooling water products, Kymene(R) resin, Herculon(R) fiber, Presstige(R) deposit control additives, Spectrum(R) microbiocides, Ultra-pHase(R) sizing agent, Hercobond(R) dry strength resin, Chromaset(R) surface size, ProSoft(R) tissue softeners and Zenix(R) contaminant control.

The Company does not consider any individual patent, license or trademark to be of material importance to Hercules taken as a whole.

RESEARCH AND DEVELOPMENT

The Company is heavily focused on product innovation as one of its key growth strategies. Research and development efforts are directed toward the discovery and development of new products and processes, the improvement and refinement of existing products and processes, the development of new applications for existing products and cost improvement initiatives. Hercules spent \$67 million on research activities during 2001, as compared to \$80 million in 2000 and \$85 million in 1999. The decrease in the amounts spent for research and development activities is largely due to business divestitures that occurred in the last two years (see Part I Item I Business).

Process Chemicals and Services currently focuses its research and development efforts on growth (innovative high-value product development), technical sales and services (incremental improvements to existing products and services) and cost reduction programs to meet diverse customer needs worldwide. The Company's state-of-the-art facilities located in Europe and the U.S. are large and sophisticated research and development laboratories with pilot plant capabilities that simulate actual operating conditions in its customer facilities. This allows an accurate assessment of the potential impact of new products on plant performance.

New product development for performance chemicals is focused on improving end-use properties. Understanding the product end uses is a critical step in the development of strength additives and internal and surface sizes, as well as in the design of products for tissue creping, release and softeners.

In four regional operations centers located in Europe, Asia Pacific, South America and the U.S., the Company's scientists conduct research and customer optimization studies focused on solving water and process treatment challenges by using sophisticated techniques and equipment to provide high level analytical testing and advanced technical support to customers worldwide.

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Aqualon focuses its research and development efforts on targeted, market-oriented technology programs, process technology and responsive technical service to customers. New product development is focused on products with water-based applications to satisfy the market demand to find alternatives to solvent-based systems.

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Aqualon has a number of applications and development laboratories positioned in Europe, Asia and the Americas that provide technical support to its major customers. At these laboratories, teams work as a network to develop products, identify new product applications and solve customer problems.

Much of the research and development efforts in FiberVisions are primarily focused on developing new hygiene fiber applications. The major focus is to improve fiber strength while enhancing hygiene product properties for loft, softness and stretch, thereby creating a competitive platform that is equal to or better than spunmelt products. Other research is directed toward the binding, dusting and bonding functions of bicomponent fibers. The industrial and textile product units are investigating the use of specific fibers for new applications in the upholstery, wipes, geotextiles and construction industries.

FiberVisions has research and development facilities in the U.S. and Europe designed to serve the business needs of its customers. Pilot spinning and processing lines are used to examine new polymers and processing concepts such as monocomponent or bicomponent fibers from single filament spinning to full-scale production facilities.

The Resins Division focuses a significant portion of its research and development efforts primarily on cost improvement techniques in its production processes.

ENVIRONMENTAL MATTERS

The Company believes it is in compliance, in all material respects, with applicable federal, state and local environmental laws and regulations. Expenditures relating to environmental cleanup costs have not materially affected, and are not expected to materially affect, capital expenditures or competitive position. Additional information regarding environmental matters is provided in Item 3.

EMPLOYEES

As of December 31, 2001, the Company had 9,665 employees worldwide, of which approximately 3,800 were employees of the Water Treatment Business. Approximately 4,878 of worldwide employees were located in the United States, of which about 14% were represented by various local or national unions. Total worldwide employment at December 31, 2000 was 11,913.

INTERNATIONAL OPERATIONS

Information on net sales and long-lived assets by geographic areas, for each of the three years ended December 31, 2001, 2000 and 1999 appears in Note 23 to the Consolidated Financial Statements (See Part II, Item 8). Direct export sales from the United States to unaffiliated customers were \$216 million, \$253 million and \$278 million for 2001, 2000 and 1999, respectively. The Company's operations outside the United States are subject to the usual risks and limitations related to investments in foreign countries, such as fluctuations in currency values, exchange control regulations, wage and price controls, employment regulations, effects of foreign investment laws, governmental instability (including expropriation or confiscation of assets) and other

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potentially detrimental domestic and foreign governmental policies affecting United States companies doing business abroad.

ITEM 2. PROPERTIES:

The Company's corporate headquarters and major research center are located in Wilmington, Delaware, while the administrative headquarters of BetzDearborn is located in Trevose, Pennsylvania. The Company also owns a number of plants and facilities worldwide, in locations strategic to the sources of raw materials or to customers. All of the Company's principal properties are owned by the Company, except for its corporate headquarters, which is leased. The following are the Company's major worldwide plants:

Process Chemicals and Services

BETZDEARBORN - Addison, Illinois; Bakersfield, California; Bangalore, India; Beaumont, Texas; Buenos Aires, Argentina; Chalon, France; Edmonton, Alberta, Canada; Ferentino, Italy; Garland, Texas; Helsingborg, Sweden*; Herentals, Belgium; Iksan City, Korea; Ingelburn, Australia; Jurong Town, Singapore; Langhorne, Pennsylvania; Macon, Georgia*; New Philadelphia, Ohio; Orange, Texas; Point-Claire, Quebec, Canada; Pudahuel, Santiago, Chile; Santa Fe de Bogota, Colombia; Sorocaba, Brazil; Valencia, Venezuela; Washougal, Washington; and Widnes, Cheshire, United Kingdom.

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*Excluded from GE Transaction.

PULP AND PAPER - Aberdeen, Scotland; Beringen, Belgium; Burlington, Ontario, Canada; Busnago, Italy; Chicopee, Massachusetts; Franklin, Virginia; Hattiesburg, Mississippi; Kalamazoo, Michigan; Kimcheon, Korea; Milwaukee, Wisconsin; Nantou, Taiwan; Pandaan, Indonesia; Paulinia, Brazil; Pendlebury, United Kingdom; Portland, Oregon; St. Jean, Quebec, Canada; Sandarne, Sweden; Sara, Mexico; Savannah, Georgia; Shanghai, China; Sobernheim, Germany; Tampere, Finland; Tarragona, Spain; Traun, Austria; Voreppe, France; and Zwijndrecht, The Netherlands.

Functional Products

AQUALON - Alizay, France; Doel, Belgium; Hopewell, Virginia; Kenedy, Texas; Louisiana, Missouri; Parlin, New Jersey; and Zwijndrecht, The Netherlands.

Chemical Specialties

FIBERVISIONS - Athens, Georgia; Covington, Georgia; Suzhou, China; and Varde, Denmark.

RESINS - Brunswick, Georgia; Hattiesburg, Mississippi; and Savannah, Georgia.

The Company's plants and facilities, which are continually added to and modernized, are generally considered to be in good condition with adequate capacity for projected business operations. From time to time the Company discontinues operations at, or disposes of, facilities that have for one reason or another become unsuitable.

During 2001, the Company completed the following major expansion projects designed to strengthen its market position in key growth areas while continuing

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to improve its manufacturing efficiencies:

- A 7,000 metric ton methylcellulose capacity increase in Doel, Belgium;
- A 1,000 metric ton expansion of the Kenedy, Texas facility to manufacture a newly developed rheology modifier;
- A 400 metric ton hydroxypropylcellulose capacity increase in Hopewell, Virginia; and
- A 7,000 metric ton capacity increase in Pendlebury, United Kingdom for production of kymene.

ITEM 3. LEGAL PROCEEDINGS:

ENVIRONMENTAL

In the ordinary course of its business, the Company is subject to numerous environmental laws and regulations covering compliance matters or imposing liability for the costs of, and damages resulting from, cleaning up sites, past spills, disposals and other releases of hazardous substances. Changes in these laws and regulations may have a material adverse effect on the Company's financial position and results of operations. Any failure by the Company to adequately comply with such laws and regulations could subject the Company to significant future liabilities.

Hercules has been identified as a potentially responsible party (PRP) by U.S. federal and state authorities, or by private parties seeking contribution, for the cost of environmental investigation and/or cleanup at numerous sites. The estimated range of the reasonably possible share of costs for the investigation and cleanup is between \$81 million and \$256 million. The Company believes that the actual cost will more likely approximate \$81 million based on its estimation methods and prior experience. The actual costs will depend upon numerous factors, including the number of parties found responsible at each environmental site and their ability to pay; the actual methods of remediation required or agreed to; outcomes of negotiations with regulatory authorities; outcomes of litigation; changes in environmental laws and regulations; technological developments; and the years of remedial activity required, which could range from 0 to 30 years.

Hercules becomes aware of sites in which it may be named a PRP in investigatory and/or remedial activities through correspondence from the U.S. Environmental Protection Agency or other government agencies or from previously named PRPs, who either request information or notify the Company of its potential liability. The Company has established procedures for identifying environmental issues at its plant sites. In addition to environmental audit programs, the Company has environmental coordinators who are familiar with environmental laws and regulations and act as a resource for identifying environmental issues.

United States, et al. v. Vertac Corporation, et al., USDC No. LR-C-80-109 and LR-C-80-110 (E.D. Ark.)

This case, a cost-recovery action based upon the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA, or the Superfund statute), as well as other statutes, has been pending since 1980, and involves

liability for costs expended and to be expended in connection with the investigation and remediation of the Vertac Chemical Company (Vertac) site in Jacksonville, Arkansas. Hercules owned and operated the site from December 1961 until 1971. The site was used for the manufacture of certain herbicides and, at

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the order of the United States, Agent Orange. In 1971, the site was leased to Vertac's predecessor. In 1976, Hercules sold the site to Vertac. The site was abandoned by Vertac in 1987, and Vertac was subsequently placed into receivership by the Court. Both prior to and following the abandonment of the site, the U.S. Environmental Protection Agency (EPA) and the Arkansas Department of Pollution Control and Ecology (ADPC&E) were involved in the investigation and remediation of contamination at and around the site. Pursuant to several orders issued pursuant to CERCLA, Hercules actively participated in many of these activities. The cleanup is essentially complete, except for certain on-going maintenance and monitoring activities. This litigation primarily concerns the responsibility for and the allocation of liability for the costs incurred in connection with these activities.

Although the case initially involved many parties, as a result of various United States District Court rulings and decisions, as well as a trial, Hercules and Uniroyal were held jointly and severally liable for the approximately \$100 million in costs allegedly incurred by the EPA, as well as costs to be incurred in the future. That decision was made final by the District Court on September 13, 1999. Both Hercules and Uniroyal timely appealed that judgment to the United States Court of Appeals for the Eighth Circuit.

On February 8, 2000, the District Court issued a final judgment on the allocation between Hercules and Uniroyal finding Uniroyal liable for 2.6 percent and Hercules liable for 97.4 percent of the costs at issue. Hercules timely appealed that judgment. Oral argument in both appeals was held before the Eighth Circuit on June 12, 2000.

On April 10, 2001, the United States Court of Appeals for the Eighth Circuit issued an opinion in the consolidated appeals described above. In that opinion, the Appeals Court reversed the District Court's decision which had held Hercules jointly and severally liable for costs incurred and to be incurred at the Jacksonville site, and remanded the case back to the District Court for a determination of whether the harms at the site giving rise to the government's claims were divisible, as well as other findings of the District Court. The Appeals Court also vacated the District Court's allocation decision holding Hercules liable for 97.4 percent of the costs at issue, ordering that these issues be revisited following further proceedings with respect to divisibility. Finally, the Appeals Court affirmed the judgment of liability against Uniroyal.

The trial on remand commenced on October 8, 2001 and continued through October 19, 2001, and resumed on December 11, 2001, concluding on December 14, 2001. At the trial, the Company presented both facts and law to the District Court in support of its belief that the Company should not be liable under CERCLA for some or all of the costs incurred by the government in connection with the site because those harms are divisible. Should the Company prevail on remand, any liability to the government will be either eliminated or reduced.

Hercules Incorporated v. Aetna Casualty & Surety Company, et al., Del. Super., C.A. No. 92C-10-105 and 90C-FE-195-1-CV (consolidated)

In 1992, Hercules brought suit against its insurance carriers for past and future costs for cleanup of certain environmental sites. In April 1998, the trial regarding insurance recovery for the Jacksonville, Arkansas, site (see discussion above) was completed. The jury returned a "Special Verdict Form" with findings that, in conjunction with the Court's other opinions, were used by the Court to enter a judgment in August 1999. The judgment determined the amount of Hercules' recovery for past cleanup expenditures and stated that Hercules is entitled to similar coverage for costs incurred since September 30, 1997 and in the future. Hercules has not included any insurance recovery in the estimated range of costs above. Since entry of the Court's August 1999 order, Hercules has entered into settlement agreements with several of its insurance carriers and has recovered certain settlement monies. The terms of those settlements and

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amounts recovered are confidential. On August 15, 2001, the Delaware Supreme Court issued a decision in Hercules Incorporated v. Aetna Casualty & Surety Company, et al., Del. Super., C.A. No. 92C-10-105 and 90C-FE-195-1-CV (consolidated). In its decision, the Delaware Supreme Court affirmed the trial court in part, reversed the trial court in part and remanded the case for further proceedings. The specific basis upon which the Delaware Supreme Court reversed the trial court was the trial court's application of pro rata allocation to determine the extent of the insurers' liability. At this time, proceedings at the trial court have not yet commenced.

The Allegany Ballistics Laboratory ("ABL") is a government owned facility which was operated by Hercules from 1945 to 1995. The United States Department of the Navy has notified Hercules that the Navy would like to negotiate with Hercules with respect to certain environmental liabilities which, the Navy alleges, are attributable to Hercules' past operations at ABL. The Navy alleges that, pursuant to CERCLA, it has spent a total of \$24.8 million and that it expects to spend an additional \$60 million over the next 10 years. The Company is currently investigating the Navy's allegations, including the basis of the Navy's claims, and whether the Company's contracts with the government pursuant to which the Company operated ABL may insulate the Company from some or all of the amounts sought. At this time, however, the

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Company cannot reasonably estimate its liability, if any, with respect to ABL and, accordingly, has not included this site in the range of its environmental liabilities reported above.

At December 31, 2001, the accrued liability of \$81 million for environmental remediation represents management's best estimate of the probable and reasonably estimable costs related to environmental remediation. The extent of liability is evaluated quarterly. The measurement of the liability is evaluated based on currently available information, including the progress of remedial investigations at each site and the current status of negotiations with regulatory authorities regarding the method and extent of apportionment of costs among other PRPs. While it is not feasible to predict the outcome of all pending suits and claims, the ultimate resolution of these environmental matters could have a material effect upon the results of operations and the financial position of Hercules, and the resolution of any of these matters during a specific period could have a material effect on the quarterly or annual results of that period.

LITIGATION

The Company is a defendant in numerous asbestos-related personal injury lawsuits and claims which typically arise from alleged exposure to asbestos fibers from resin-encapsulated pipe and tank products which were sold by one of the Company's former subsidiaries to a limited industrial market ("products claims"). The Company is also a defendant in lawsuits alleging exposure to asbestos at facilities formerly or presently owned or operated by the Company ("premises claims"). Claims are received and settled or otherwise resolved on a regular basis. In late December 1999, the Company entered into a settlement agreement to resolve the majority of the claims then pending. In connection with that settlement, the Company also entered into an agreement with several of the insurance carriers which sold that former subsidiary primary and first level excess insurance policies. Under the terms of that agreement, the majority of the amounts paid to resolve those products claims will be insured, subject to the limits of the insurance coverage provided by those policies. The terms of both settlement agreements are confidential.

Since entering into those agreements, the Company has continued to receive and settle or otherwise resolve claims on a regular basis, with the number of

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new claims averaging approximately 2,200 per year during the past two years. As of February 2002, the Company had pending approximately 5,170 unresolved claims, of which approximately 625 are premises claims. In addition, as of February 2002, there were pending approximately 5,830 unpaid claims which have been settled or are subject to the terms of a settlement agreement. In accordance with the terms of the previously mentioned agreement with several insurance carriers, as well as agreements with two other excess insurance carriers, the majority of the amounts paid and to be paid to resolve those claims will be insured.

The Company anticipates that the primary and first level excess insurance policies referenced above will exhaust over the next 12 to 24 months, assuming that the rate of settlements and payments remains relatively consistent with the Company's past experience. Nonetheless, based on the current number of claims pending, the amounts the Company presently pays to resolve those claims, and anticipated future claims (the Company's assumption being that the number of future claims filed per year and claim resolution payments remain relatively consistent with the Company's past experience, and that these matters cease to be an ongoing liability after ten years), the Company believes that it and its former subsidiary together have sufficient additional insurance to cover the majority of its current and future asbestos-related liabilities. The Company is seeking defense and indemnity payments or an agreement to pay from those carriers responsible for excess coverage whose levels of coverage have been or will soon be reached. Although those excess carriers have not yet agreed to defend or indemnify it, the Company believes that it is likely that they will ultimately agree to do so, and that the majority of future asbestos related costs will ultimately be paid or reimbursed by those carriers. However, if the Company is not able to reach satisfactory agreements with those carriers prior to exhaustion of the primary and first level excess insurance policies now covering the majority of its current asbestos related claims, then beginning as early as sometime in 2003, the Company might be required to completely fund these matters while it seeks reimbursement from its carriers.

Based on the assumptions set forth in the preceding paragraph, the reasonably possible future financial exposure for these matters is estimated to be less than \$200 million. As stated above, the Company presently believes that the majority of this financial exposure will be funded by insurance proceeds. Cash payments related to this exposure are expected to be made over an extended number of years.

Due to the dynamic nature of asbestos litigation and the present uncertainty concerning the participation of its excess insurance carriers, however, the Company's estimates are inherently uncertain, and these matters may present significantly greater and longer lasting financial exposures than presently anticipated. As a result, the Company's liability with respect to asbestos-related matters could exceed the amount noted above. If the Company's liability does exceed that amount, the Company presently believes that the majority of any additional liability it may reasonably anticipate will be paid or reimbursed by its insurance carriers.

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The Company has estimated and, therefore, recorded a gross liability for asbestos-related matters in its December 31, 2001 balance sheet of \$80 million. The Company believes that it is probable that \$66 million of that amount will be funded by or recovered from insurance carriers. Accordingly, the Company has recorded an asset in this amount in its December 31, 2001 balance sheet.

In June 1998, Hercules and David T. Smith Jr., a former Hercules employee and a former plant manager at the Brunswick plant, along with Georgia-Pacific Corporation and AlliedSignal Inc., were sued in Georgia State Court by 423

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plaintiffs for alleged personal injuries and property damage. This litigation is captioned *Coley, et al. v. Hercules Incorporated, et al.*, No. 98 VSO 140933 B (Fulton County, Georgia). Plaintiffs allege they were damaged by the discharge of hazardous waste from the companies' plants. On February 11, 2000, the Georgia State Court dismissed Georgia-Pacific Corporation and AlliedSignal Inc., without prejudice. In September 2000, David T. Smith Jr., was dismissed by the Georgia State Court with prejudice. On July 18, 2000, the Company was served with a complaint in a case captioned *Erica Nicole Sullivan, et al. v. Hercules Incorporated and David T. Smith, Jr.*, Civil Action File No. 00-1-05463-99 (Cobb County, Georgia). Based on the allegations contained in the complaint, this matter is very similar to the *Coley* litigation, and is brought on behalf of approximately 700 plaintiffs for alleged personal injury and property damage arising from the discharge of hazardous waste from Hercules' plant. Although venue had been removed to the United States District Court for the Northern District of Georgia, the case was ultimately remanded back to state court. Both the *Coley* and the *Erica Nicole Sullivan* cases are in the early stages of motion practice and discovery. The Company denies any liability to plaintiffs, and it will vigorously defend both of these cases.

In August 1999, the Company was sued in an action styled as *Cape Composites, Inc. v. Mitsubishi Rayon Co., Ltd.*, Case No. 99-08260 (U.S. District Court, Central District of California), one of a series of similar purported class action lawsuits brought on behalf of purchasers (excluding government purchasers) of carbon fiber and carbon prepreg in the United States from the named defendants from January 1, 1993 through January 31, 1999. The lawsuits were brought following published reports of a Los Angeles federal grand jury investigation of the carbon fiber and carbon prepreg industries. In these lawsuits, plaintiffs allege violations of Section 1 of the Sherman Antitrust Act for alleged price fixing. In September 1999, these lawsuits were consolidated by the Court into a case captioned *Thomas & Thomas Rodmakers v. Newport Adhesives and Composites*, Case No. CV-99-07796-GHK (CTx) (U.S. District Court, Central District of California), with all related cases ordered dismissed. This lawsuit is in the early stages of motion practice and discovery. On March 11, 2002, the Court tentatively granted plaintiffs' Motion to Certify Class. The Company is named in connection with its former Composites Products Division, which was sold to Hexcel Corporation in 1996, has denied liability and will vigorously defend this action.

Beginning in September 2001, Hercules, along with the other defendants in the *Thomas & Thomas Rodmakers* action referred to above, has been sued in nine California state court purported class actions brought on behalf of indirect purchasers of carbon fiber. In January 2002, these were consolidated into a case captioned *Carbon Fiber Cases I, II, and III*, Judicial Council Coordination Proceedings Nos. 4212, 4216 and 4222, Superior Court of California, County of San Francisco. These actions all allege violations of the California Business and Professions Code relating to alleged price fixing of carbon fiber and unfair competition. The Company denies liability and will vigorously defend each of these actions.

In connection with the grand jury investigation noted above, in January 2000, the United States Department of Justice (DOJ), Antitrust Division, served a grand jury subpoena duces tecum upon Hercules. The Company has been advised that it is one of several manufacturers of carbon fiber and carbon prepreg that have been served with such a subpoena.

In December 1999, an action was filed in the U.S. District Court for the Eastern District of Pennsylvania on behalf of two classes of individuals: (1) veterans of the South Korean military who claim they were exposed to Agent Orange and other chemical defoliants used in the demilitarized zone between North and South Korea between 1967 and 1970 and (2) veterans of the United States military who claim to have been similarly exposed. This case is captioned *Chang Ok-Lee, Individually and as Representative of a Class, and Thomas Wolfe,*

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Individually and as Representative of a Class v. Dow Chemical Co., et al., Civil Action No. 99-6127 (U.S. District Court, Eastern District of Pennsylvania). During 2000, this case was transferred by the Multi-District Litigation (MDL) Panel to the United States District Court for the Eastern District of New York, where Agent Orange cases have previously been consolidated. In late 2001, this case was dismissed voluntarily by the plaintiffs, with plaintiffs retaining the right to re-file in the future.

In 1999, the Company was sued by Hexcel Corporation (Hexcel) in a case captioned Hexcel Corporation v. Hercules Incorporated, Index No. 602293/99, Supreme Court of New York, County of New York. In that case, Hexcel sought recovery of a total of approximately \$8,422,000 (plus interest) in alleged "post-closing" adjustments to the purchase price paid by Hexcel for Hercules' former Composite Products Division. The basis for these alleged "adjustments" derive from the Sale and Purchase Agreement between Hercules and Hexcel dated as of April 15, 1996. In June 2000, the Court granted Hexcel's motion for summary judgment as to liability, finding the Company liable to Hexcel on technical grounds, but reserved ruling on the amount of damages. The Court then referred the damages determination to a Special Referee. In

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January 2001, the Special Referee issued a report, recommending that the Company be found liable to Hexcel for a total of approximately \$7,300,000 plus interest, costs and expenses. In February 2001, Hexcel moved to confirm the Special Referee's Report and the Company moved to confirm in part and reject in part the Special Referee's Report. The Company specifically challenged the majority of the Special Referee's findings, and argued that a \$2,000,000 indemnity "basket" established by the terms of the April 1996 Sale and Purchase Agreement should apply, reducing any award to Hexcel by \$2,000,000. In May 2001, the Court accepted the Special Referee's Report and rejected the Company's position. As a result, judgment was entered against the Company in the amount of \$10,219,685, which included pre-judgment interest, costs and expenses. The Company appealed to the Supreme Court, Appellate Division, First Department. On February 5, 2002, the Supreme Court of New York, Appellate Division, First Department, affirmed the decision of the trial court, entering judgment in favor of Hexcel in the full amount. Interest continues to accrue. The Company continues to believe that the decision of the trial and intermediate appellate courts is incorrect, and has filed a Motion for Reargument or for Leave to Appeal to the Court of Appeals. That motion was denied on March 19, 2002. Hercules will be filing a motion for Leave to Appeal to the New York Court of Appeals directly with the Court of Appeals. The granting of a motion for an appeal to the Court of Appeals is discretionary and there can be no assurance that it will be granted. In addition to the foregoing, in October 2000, Hexcel brought an action against Hercules to compel arbitration to determine the proper "Working Capital Adjustment" under the terms of the Sale and Purchase Agreement. Hexcel claimed it was owed approximately \$1,500,000, while the Company claimed that the Company was owed approximately \$129,000. In late 2001, this matter was submitted to binding arbitration. In December 2001, the arbitrator found in the Company's favor and awarded damages to the Company of \$129,000.

In December 1999, BetzDearborn and Bill Blythe, its employee, were sued by M.C. Dixon Lumber Company, Inc. (M.C. Dixon Lumber Company, Inc. v. BetzDearborn and Bill Blythe, Circuit Court of Barbour County, Alabama, Case No. 99-0177). In this lawsuit, M.C. Dixon sought recovery for alleged damage to wood drying kilns and other equipment, as well as lost production and other consequential damages. M.C. Dixon alleged that these damages were caused by BetzDearborn's negligence and breach of contract in the administration of the water treatment program at M.C. Dixon's plant. On September 4, 2001, this case went to trial. During the course of the trial, the Company agreed to settle this case for an amount which is confidential. In connection with that settlement, the Company reached an

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agreement with one of BetzDearborn's insurance carriers whereby the total amount paid by BetzDearborn towards the settlement was \$1.75 million.

On September 28, 2000, the Company sold its Food Gums Division to CP Kelco ApS, a joint venture that the Company entered into with Lehman Brothers Merchant Banking Partners II, L.P. CP Kelco also acquired the biogums business of Pharmacia Corporation (formerly Monsanto Company). In April 2001, CP Kelco U.S., Inc., a wholly-owned subsidiary of CP Kelco ApS, sued Pharmacia (CP Kelco U.S., Inc. v. Pharmacia Corporation, U.S. District Court for the District of Delaware, Case No. 01-240-RRM) alleging federal securities fraud, common law fraud, breach of warranties and representations, and equitable fraud. In essence, the lawsuit alleges that Pharmacia misrepresented the value of the biogums business, resulting in damages to CP Kelco U.S., including the devaluation of CP Kelco U.S.'s senior debt by the securities markets. The complaint seeks over \$430 million in direct damages, as well as punitive damages. In June 2001, Pharmacia filed a third-party complaint against the Company and Lehman. That complaint seeks contribution and indemnification from the Company and Lehman, jointly and severally, for any damages that may be awarded to CP Kelco U.S. in its action against Pharmacia. This lawsuit is in early discovery. The Company believes that the third-party lawsuit against it and Lehman is without merit. The Company has denied any liability to Pharmacia and is vigorously defending this action.

At December 31, 2001, the consolidated balance sheet reflects a current liability of approximately \$50 million and a long-term liability of approximately \$51 million for litigation and claims. These amounts represent management's best estimate of the probable and reasonably estimable losses related to litigation or claims. The extent of the liability and recovery is evaluated quarterly. While it is not feasible to predict the outcome of all pending suits and claims, the ultimate resolution of these matters could have a material effect upon the financial position of Hercules, and the resolution of any of the matters during a specific period could have a material effect on the quarterly or annual operating results for that period.

EXECUTIVE OFFICERS OF THE REGISTRANT:

The name, age and current position of each executive officer of Hercules as of March 15, 2002 are listed below.

There are no family relationships among executive officers.

NAME	AGE	CURRENT POSITION
William H. Joyce	66	Chairman and Chief Executive Officer
Fred G. Aanonsen	54	Vice President and Controller

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Edward V. Carrington	59	Vice President, Human Resources and Corporate Resources
Richard G. Dahlen	62	Chief Legal Counsel
Robert C. Flexon	43	Vice President, Corporate Affairs, Strategic Planning and Work P
Israel J. Floyd	55	Corporate Secretary and General Counsel

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Bruce W. Jester	50	Vice President, Taxes
Stuart C. Shears	51	Vice President and Treasurer

William H. Joyce joined Hercules as Chief Executive Officer in May 2001. Dr. Joyce had been Chairman, President and Chief Executive Officer of Union Carbide Corporation since 1996. From 1995 to 1996, Dr. Joyce was President and Chief Executive Officer and from 1993 to 1995, he was President. Prior to that, Dr. Joyce had been Chief Operating Officer since 1992. Dr. Joyce holds a B.S. degree in Chemical Engineering from Pennsylvania State University and an M.B.A. and Ph.D. from New York University. Dr. Joyce received the National Medal of Technology Award in 1993 and the Plastics Academy's Industry Achievement Award in 1994 and Lifetime Achievement Award in 1997. In 1997, he was inducted into the National Academy of Engineering. Dr. Joyce is a director of CVS Corporation. Dr. Joyce is also a trustee of the Universities Research Association, Inc. and Co-Chairman of the Government-University-Industry Research Round Table of the National Academies.

Fred G. Aanonsen joined Hercules in July 2001. Prior to joining Hercules, he spent 25 years at Union Carbide Corporation, where most recently he had been the Director of Accounting and Financial Processing since 1998. Mr. Aanonsen is a Certified Public Accountant and a member of the American Institute of Certified Public Accountants, the New York State Society of Certified Public Accountants and the Financial Executives Institute.

Edward V. Carrington originally joined Hercules when it acquired Radiant Color in 1969 and assumed his current position in June 2001. Prior to that, he had served in a consulting role since October 2000. From 1997 until 2000, he was Vice President of Buttonwood Cottages, Inc., a vacation resort complex, and President of Rentals in Paradise, Inc., a vacation home rental business. From 1992 until his retirement from Hercules in 1997, he was Vice President, Human Resources.

Richard G. Dahlen originally joined Hercules in 1996. Mr. Dahlen assumed his current position in June 2001. Prior to that, he had served in a consulting role since October 2000. From 1999 until 2000, he was retired and from 1996 until his retirement in 1999, he served as Vice President, Law and General Counsel. Mr. Dahlen is a member of the Personnel Committee and Board of Directors of the Delaware Theatre Company.

Robert C. Flexon joined Hercules in 2000 and has held his current position since February 2002. He had been Vice President, Work Processes, since June 2001 and Vice President, Business Analysis and Controller since 2000. Previously, he was with Atlantic Richfield Company for more than ten years, serving in several capacities that included: General Auditor, ARCO, from 1998 to 2000; Franchise Manager, ARCO Products Company, from 1996 to 1998; and Controller, ARCO Products Company, from 1995 to 1996.

Israel J. Floyd joined Hercules in 1973 and has held his current position since 2001. He had been Vice President, Secretary and General Counsel since 1999 and, prior to that, was Secretary and Assistant General Counsel from 1992 to 1999.

Bruce W. Jester joined Hercules in 1980 and has held his current position since 1997. He was Assistant Treasurer and Director, Taxes, from 1994 to 1997.

Stuart C. Shears joined Hercules in 1978 and has held his current position since 1999. He was Assistant Treasurer from 1997 to 1999 and, prior to that, was Director, Finance & Credit from 1991 to 1997.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS:

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No matter was submitted to a vote of security holders during the fourth quarter of 2001, through the solicitations of proxies or otherwise.

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PART II

ITEM 5. MARKET FOR HERCULES' COMMON STOCK AND RELATED STOCKHOLDER MATTERS:

The Company's common stock is listed on the New York Stock Exchange (ticker symbol HPC), The Stock Exchange, London, and the Swiss Stock Exchange. It is also traded on the Philadelphia, Midwest and Pacific Stock Exchanges.

The approximate number of holders of record of its common stock (\$25/48 stated value) as of March 15, 2002 was 18,113.

2000	High ----	Low ---
First Quarter	\$ 28.00	\$ 13.94
Second Quarter	\$ 17.88	\$ 13.88
Third Quarter	\$ 16.19	\$ 11.38
Fourth Quarter	\$ 20.19	\$ 13.75
2001		
First Quarter	\$ 20.00	\$ 12.15
Second Quarter	\$ 14.45	\$ 11.00
Third Quarter	\$ 12.00	\$ 6.50
Fourth Quarter	\$ 10.94	\$ 7.43

On December 31, 2001, the closing price of the common stock was \$10.00.

The payment of quarterly dividends was suspended in the fourth quarter of 2000, subject to reconsideration by the Board in its discretion, when warranted under appropriate circumstances and subject to restrictions in the indenture governing the Company's 11 1/8% senior notes due 2007. Quarterly dividends of \$0.27 per share were declared and paid for each of the first two quarters of 2000 and a quarterly dividend of \$.08 per share was declared and paid for the third quarter 2000. In addition, payment of future dividends is significantly restricted by the indenture governing the 11 1/8% senior notes.

In November 2000, Hercules issued \$400 million aggregate principal amount of 11 1/8% senior notes due 2007 to Donaldson, Lufkin & Jenrette and Credit Suisse First Boston (the "Initial Purchasers"). The underwriting commissions totaled approximately \$23 million. The maturity date of the 11 1/8% senior notes is November 15, 2007. The Company is obligated to pay interest semi-annually at a rate of 11 1/8% per year commencing May 15, 2001.

The 11 1/8% senior notes were issued and sold in transactions exempt from registration requirements of the Securities Act of 1933, as amended (the "Securities Act"), to persons reasonably believed by the Initial Purchasers to be "Qualified Institutional Buyers" ("QIBs"), as defined in Rule 144A under the Securities Act, or institutional accredited investors or sophisticated buyers.

The 11 1/8% senior notes were subject to a registration rights agreement that required Hercules to file an exchange offer registration statement with the Securities and Exchange Commission within 270 days (no later than August 11, 2001) and to use its best efforts to have the registration statement declared

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effective within 330 days. On August 9, 2001, Hercules filed a Registration Statement on Form S-4 (the "Registration Statement") with the Securities and Exchange Commission, pursuant to which the Company offered to exchange all of its \$400 million aggregate principal amount of 11 1/8% senior notes due 2007 ("old notes") for \$400 million aggregate principal amount of 11 1/8% senior notes due 2007 ("new notes"). The form and terms of the new notes are the same as the form and terms of the old notes except that, because the issuance of the new notes was registered under the Securities Act, the new notes do not bear legends restricting their transfer and are not entitled to certain registration rights under the registration rights agreement. The new notes evidence the same debt as the old notes and the new notes and the old notes are governed by the same indenture. On October 31, 2001, Hercules filed Amendment No. 1 to the Registration Statement on Form S-4 with the Securities and Exchange Commission and the Registration Statement became effective. Hercules did not receive any proceeds from the exchange offer. When the exchange offer expired on December 7, 2001, \$375.3 million of the old notes had been tendered for a like amount of new notes.

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At any time prior to November 15, 2003, Hercules may on any one or more occasions, redeem up to 35% of the aggregate principal amount of the 11 1/8% senior notes issued at a redemption price of 111.125% of the principal amount, plus accrued and unpaid interest and liquidated damages, if any, to the redemption date, with the net cash proceeds of one or more public equity offerings; provided that (i) at least 65% of the aggregate principal amount of the 11 1/8% senior notes issued under the indenture remains outstanding immediately after the occurrence of such redemption (excluding notes held by Hercules and its subsidiaries); and (ii) the redemption occurs within 45 days of the date of the closing of such public equity offering. Except as described above, the 11 1/8% senior notes will not be redeemable at Hercules' option prior to maturity. Hercules is not required to make mandatory redemption or sinking fund payments with respect to the 11 1/8% senior notes. If a change of control occurs, each holder of the notes will have the right to require Hercules to repurchase all or any part of that holder's notes pursuant to a change of control offer on the terms set forth in the indenture. In the change of control offer, Hercules is required to offer a change of control payment in cash equal to 101% of the aggregate principal amount of the notes repurchased plus accrued and unpaid interest and liquidated damages, if any, on the notes repurchased, to the date of purchase.

ITEM 6. SELECTED FINANCIAL DATA:

A summary of selected financial data for Hercules for the years and as of the end of years specified is set forth in the table below. See Part I, Item 1 Business for a description of significant acquisitions and divestitures that affect the comparability of the following data.

	(Dollars and share	
	2001	20
Net sales	\$ 2,620	\$3,1
Profit from operations	287	4
(Loss) income before effect of change in accounting principle	(58)	
Net (loss) income	(58)	
 Dividends	 --	

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Per share of common stock		
Basic:		
(Loss) earnings before effect of change in accounting principle	(0.54)	0.
(Loss) earnings	(0.54)	0.
Diluted:		
(Loss) earnings before effect of change in accounting principle	(0.54)	0.
(Loss) earnings	(0.54)	0.
Dividends declared	--	0.
Total assets	\$ 5,049	\$5,5
Long-term debt	1,959	2,3
Company-obligated preferred securities of subsidiary trusts	624	6

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

Hercules is a leading manufacturer and marketer of specialty chemicals and related services for a broad range of business, consumer and industrial applications. Hercules operates on a global scale, with significant operations in

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North America, Europe, Asia and Latin America. The Company's principal products are chemicals used by the paper industry to increase product performance and enhance the manufacturing process; chemicals which improve the efficiency of various water treatment and industrial processes; water-soluble polymers; resins and polypropylene and polyethylene fibers. The Company operates through three reportable segments and five divisions: Process Chemicals and Services (Pulp and Paper and BetzDearborn), Functional Products (Aqualon) and Chemical Specialties (FiberVisions and Resins).

On February 12, 2002, the Company entered into an agreement to sell the BetzDearborn Division businesses and certain Pulp and Paper Division treatment business (the "Water Treatment Business") to GE Specialty Materials ("GESM"), a unit of General Electric Company (the "GE Transaction"). The selling price is \$1.8 billion in cash, with net after tax proceeds available for debt reduction of approximately \$1.665 billion. The transaction is subject to regulatory and other customary approvals, and is expected to close in the second quarter of 2002. Hercules acquired the Water Treatment Business in 1998 when it acquired BetzDearborn. The Paper Process Chemicals business, currently representing approximately one-third of the business that the Company acquired from BetzDearborn in 1998, will remain with Hercules. In addition, Hercules will have an agreement with GE to distribute and service BetzDearborn's water treatment products to the pulp and paper industry. The Water Treatment Business had net assets, including goodwill and identifiable intangibles from the BetzDearborn acquisition, of approximately \$2.0 billion at December 31, 2001. Although the Company has not completed its transitional impairment analysis required by Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets", ("SFAS 142"), it anticipates that initial adoption of this standard will result in recording a loss ranging from \$200 to \$300 million related to impaired goodwill of the Water Treatment Business in the quarter ending March 31, 2002. The Water Treatment Business had net sales, excluding sales to be covered under the supply and distribution agreements prospectively, of approximately \$844 million in 2001. Proceeds from the divestiture will be used to pay down debt in accordance with bank agreements and to provide collateral for currently outstanding letters of credit.

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The following discussion should be read in connection with the information contained in the Consolidated Financial Statements and Notes thereto. All references to individual Notes refer to Notes to the Consolidated Financial Statements. Certain statements contained herein may constitute forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995.

CRITICAL ACCOUNTING POLICIES

The Company's discussion and analysis of its financial condition and results of operations is based on its consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires Hercules to make estimates and assumptions that affect the amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. Hercules evaluates its estimates on a regular basis, including those related to sales returns and allowances, bad debts, inventories, intangible assets, income taxes, restructuring, contingencies, including litigation and environmental, and pension and other benefit obligations. Hercules bases its estimates on various factors including historical experience, consultation and advice from third party subject matter experts and on various assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions and circumstances.

Hercules believes the following critical accounting policies affect its more significant judgments and estimates used in the preparation of its consolidated financial statements.

Hercules records estimated reductions to revenue for customer returns and other allowances, including volume-based incentives and pricing adjustments.

The Company maintains allowances for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments. Allowances for doubtful accounts are based on historical experience and known factors regarding specific customers and industries in which the customers operate. If the financial condition of the Company's customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances would be required.

Hercules writes down its inventories for estimated slow moving and obsolete goods equal to the difference between the carrying cost of the inventory and the estimated market value based upon assumptions about future demand and market conditions.

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The Company records an impairment loss on its long-lived assets, including goodwill and intangibles, based on the excess of the carrying amount over fair value, when expected future cash flows are insufficient to recover the carrying amount of the asset. Deterioration in future economic conditions or poor operating results in a business could result in losses or the inability to recover the carrying value of the asset, thereby possibly requiring an impairment in the future.

Hercules records a valuation allowance to reduce its deferred tax assets to an amount that is more likely than not to be realized after consideration of future taxable income and prudent and reasonable tax

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planning strategies. In the event Hercules were to determine that it would not be able to realize all or part of its deferred tax assets in the future, an adjustment to the deferred tax asset would be charged to income in the period such determination was made.

Hercules has recorded restructuring charges for the estimated costs of employee severance and other exit costs. In the event that it is determined that additional employees must be involuntarily terminated pursuant to work process redesign and other cost reduction initiatives, additional restructuring reserves would be required which would result in an additional charge against earnings in the period that Hercules has authorized and committed to a plan and significantly all actions have been identified. In the event that the number of employees involuntarily terminated pursuant to restructuring plans is less than anticipated due to greater than anticipated voluntary resignations, an adjustment to reduce excess restructuring reserves would increase income in the period that the determination was made.

Hercules establishes reserves for environmental matters, asbestos claims, litigation and other contingencies when it is probable that a liability has been incurred and the amount of the liability is reasonably estimable. If the contingency is resolved for an amount greater or less than has been accrued, or Hercules' share of the contingency increases or decreases, or other assumptions relevant to the development of the estimate were to change, Hercules would recognize an additional expense or benefit in income in the period such determination was made.

Pension and other post employment benefit obligations and the related expense (income) are determined based upon assumptions regarding mortality, medical inflation rates, discount rates, long-term return on assets, salary increases, Medicare availability and other factors (the "Variables"). The actual return on plan assets currently being earned in 2002 is, and the historical return on plan assets earned in 2000 and 2001 was, less than the corresponding assumption. If actual results differ from the assumptions for some or all of the Variables, the Company may be required to recognize additional benefit expense and possibly recognize additional liabilities for accumulated benefit obligations in excess of funded benefits. At December 31, 2001, the funded benefits in the U.S. defined benefit pension plan marginally exceeded the accumulated benefit obligation ("ABO") for this plan. Based on current economic conditions and anticipated benefit payments, it is reasonably possible the ABO will exceed the funded benefits at December 31, 2002. If this occurs at December 31, 2002, (or at an earlier date if an interim valuation is required), the Company will be required to recognize an additional liability equal to the sum of such excess plus the prepaid pension asset balance, with a corresponding net-of-tax charge to other comprehensive income in stockholders' equity. The prepaid pension asset balance for the U.S. plan is approximately \$250 million at December 31, 2001.

ACQUISITIONS, DIVESTITURES AND UNUSUAL ITEMS

During May 2001, in a series of unrelated transactions, the Company completed the divestiture of a significant portion of its Resins Division (the "Resins Divestitures"). On May 1, 2001, Hercules completed the sale of its hydrocarbon resins business and select portions of its rosin resins business to a subsidiary of Eastman Chemical Company, receiving proceeds of approximately \$244 million (the "Eastman Transaction"). On May 31, 2001, Hercules completed the sale of its peroxy chemicals business to GEO Specialty Chemicals, Inc., receiving proceeds of approximately \$92 million (the "Peroxide Transaction"). Additionally, on May 25, 2001, the Company completed the sale of its interest in Hercules - Sanyo, Inc., a toner resin joint venture, to Sanam Corporation, a

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wholly owned subsidiary of Sanyo Chemicals Industries, Ltd., its joint venture partner. The Company realized net gains from these dispositions of \$74 million (see Note 16).

In June 2001, the Company announced an aggressive and comprehensive cost reduction and work process redesign program to improve return on capital, streamline organizational structure, improve work processes and consolidate manufacturing and non-manufacturing resources. The objective was to achieve fixed cost reductions of \$100 million on an annualized basis (as compared to 2000 results, excluding divested businesses) by June 2002. Approximately 975 employees have left or will leave the company (see Note 14) under this plan. Pursuant to this program, the Company incurred restructuring charges totaling \$51 million during the third and fourth quarters of 2001. The plan includes reductions throughout the Company with the majority of them from support functions as well as the Process Chemicals and Services segment. The cost reductions are being implemented as the sale of the Water Treatment Business awaits regulatory and

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other customary approvals. After the divestiture has been completed, this cost reduction program will continue in 2002 for the remaining businesses. In 2002, the cost reduction target to be achieved by December 2002 was then increased to \$200 million in annualized fixed cost reductions (as compared to 2000 results, excluding divested business).

During 2001, the Company recognized a pension curtailment gain of \$5 million related to the Eastman Transaction. As a result of resolving issues relating to a prior year divestiture, an additional gain of \$5 million was recognized. The Company recognized \$10 million in net environmental expense, \$5 million of executive severance charges, \$5 million in pre-payment penalties relating to the ESOP credit facility, \$3 million in non-recurring fees related to the 2001 proxy contest and other matters and \$4 million in other costs.

During 2000, the Company monetized certain non-core assets, completing the divestitures of its nitrocellulose and Food Gums businesses. In May 2000, Hercules acquired the paper chemicals business of Quaker Chemical Corporation. In September 2000, the Company announced the formation of a strategic marketing alliance with National Starch and Chemical Company for the sale of over 300 million pounds of National Starch's papermaking chemicals starch product line. These transactions are consistent with the Company's announced strategy to monetize non-core businesses and grow core businesses. In the fourth quarter of 2000, Hercules announced its intention to pursue a sale or merger of the Company in the belief that, over the long term, becoming part of a larger enterprise is the best strategic path for the Company. To that end, the Company retained Goldman, Sachs & Co. and Credit Suisse First Boston to assist the Board of Directors in its identification and evaluation of various alternatives.

The Company incurred a loss of \$25 million (see Note 16), including \$4 million for termination benefits in connection with the June 2000 sale of the nitrocellulose business. The Company completed the sale of its Food Gums division to CP Kelco, a joint venture with Lehman Brothers Merchant Banking II, L.P., in the third quarter 2000, realizing a net gain on the sale of approximately \$168 million. The Company received approximately \$395 million in cash proceeds, recorded certain selling and tax expenses of approximately \$77 million and retained a 28% equity position in CP Kelco. CP Kelco simultaneously acquired the Kelco biogums business of Pharmacia Corporation (formerly Monsanto Company).

During 2000, the Company recognized \$66 million in asset impairment charges and write-offs, primarily in the FiberVisions business. Restructuring

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charges of \$18 million, including the previously noted \$4 million related to the nitrocellulose divestiture, were incurred for 2000 restructuring plans, primarily relating to severance and termination benefits for approximately 212 employee terminations in its Process Chemicals and Services segment and corporate realignment due to the divestitures of its non-core businesses. Offsetting these restructuring charges was \$4 million of reversals relating to prior year plans. Environmental charges of \$8 million were incurred, offset by \$11 million in recoveries of insurance and environmental claims. Profit from operations also included \$16 million in severance charges and compensation expense not associated with restructuring plans. Additionally, the Company incurred \$5 million of integration charges, primarily for consulting and other costs associated with the BetzDearborn acquisition and \$1 million for other items. The asset impairments were triggered by significantly higher raw material costs and the loss of a facility's major customer (see Note 16). Selling, general and administrative expenses increased in 2000 as a result of a \$21 million increase to the Company's reserve for doubtful accounts.

In 1999, the Company incurred \$39 million of integration charges (\$3 million reflected in cost of sales), primarily for employee incentive and retention, consulting, legal and other costs associated with the acquisition of BetzDearborn partly offset by a \$4 million restructuring charge reversal. During the fourth quarter of 1999, the Company decided to exit the nitrocellulose business, part of the Functional Products segment, and to take steps to address the performance of some of the specialty product lines in the Chemical Specialties segment. As a result of these decisions, the Company incurred \$28 million of pre-tax costs, consisting of \$25 million of asset write-downs and disposal costs (\$9 million related to the Functional Products segment and \$16 million related to a Chemical Specialties segment plant) and \$3 million of severance benefits for approximately 20 manufacturing employees at a Chemical Specialties segment plant (see Note 16). The 1999 profit from operations also included a net \$5 million charge related to legal and environmental matters. Additionally, a production facility fire, a works accident and the impact of Hurricane Floyd added approximately \$8 million to cost of sales and an executive transition agreement increased selling, general and administrative expense by \$8 million. In 1999, the Company sold its Chilean Agar business, part of the Functional Products segment, for a pre-tax gain of \$16 million (see Notes 1 and 16).

The impairment losses recognized in all three years are calculated pursuant to the Company's policy for accounting for long-lived assets (see Summary of Significant Accounting Policies).

The above-mentioned unusual items are primarily included in Reconciling items in each of the respective years in the segment footnote disclosure (see Note 23).

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RESULTS OF OPERATIONS

(All comparisons are with the previous year unless otherwise stated.).

The table below reflects Net sales and Profit from operations for the years ended December 31, 2001, 2000 and 1999.

(Dollars in millions)
2001 2000 1999

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Net Sales:			
Process Chemicals and Services	\$ 1,654	\$ 1,717	\$ 1,725
Functional Products	541	742	875
Chemical Specialties	425	695	711
Reconciling Items	--	(2)	(2)
	-----	-----	-----
Consolidated	\$ 2,620	\$ 3,152	\$ 3,309
	=====	=====	=====
Profit from Operations:			
Process Chemicals and Services	\$ 295	\$ 297	\$ 338
Functional Products	123	176	218
Chemical Specialties	38	59	89
Reconciling Items	(169)	(88)	(165)
	-----	-----	-----
Consolidated	\$ 287	\$ 444	\$ 480
	=====	=====	=====

2001 vs. 2000:

Consolidated net sales were \$2,620 million for 2001, a decrease of \$532 million, or 17%. Approximately \$57 million of this decrease is attributable to the strength of the U.S. dollar in 2001, principally versus the Euro that continued to weaken throughout the year. Approximately \$219 million of the decrease is attributable to the businesses comprising the Resins Divestitures (see Note 1). Sales from continuing businesses decreased by approximately \$256 million in 2001, excluding currency effects. Contributing to the decline is reduced volume in all business divisions, except BetzDearborn, versus 2000. Excluding divested businesses, volumes declined 3%. Regionally, net sales declined 4% in North America, 8% in Europe, 3% in Asia Pacific and 1% in Latin America. Weak market demand negatively impacted the Company's sales. The sale of Water Treatment Business is expected to reduce sales by approximately 36%. The Company expects sales from continuing businesses to remain relatively flat in 2002 assuming market conditions remain the same.

Consolidated profit from operations decreased \$157 million, or 35%. Of this decrease, \$51 million was attributable to business divestitures, \$29 million, net, related to non-recurring items and \$13 million was due to foreign

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currency. Excluding divested businesses, non-recurring items and foreign currency, consolidated profit from operations decreased approximately \$64 million, or 20%. Unallocated corporate expenses increased \$53 million, principally reflecting stranded corporate overhead costs of approximately \$30 million previously absorbed by the divested businesses coupled with higher costs incurred in complying with new regulatory reporting requirements resulting from the Company's debt refinancing in the fourth quarter of 2000 and higher ESOP expenses. Additionally, operating profit improvements in BetzDearborn and FiberVisions were completely negated by lower profit from operations in Pulp and Paper and Aqualon. Pulp and Paper and Aqualon continue to experience weakness in the industries they service. Pursuant to the comprehensive cost reduction and work process redesign program (see Note 14) initiated in 2001, the Company began reducing its fixed cost structure and saw cost improvements in the fourth quarter operating profit. Non-recurring items impacting 2001 profit from operations included \$51 million in restructuring charges associated with the cost reduction program and \$6 million, net, of other gains. Offsetting these charges were \$74 million of pre-tax non-recurring gains from the Resins

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Divestitures. The Company has targeted \$200 million in annualized savings for implementation by the end of 2002, including \$125 million for the remaining businesses and \$75 million for the BetzDearborn Division. On an annualized basis, savings of approximately \$100 million in cost savings were achieved as of December 31, 2001. The sale of the Water Treatment Business will allow the Company to further simplify work processes and overall corporate structure to support a less complex organization. This simplification is expected to yield an additional \$25 million in net annual savings, primarily relating to unallocated corporate costs, which it will begin to implement upon the closing of the sale of the Water Treatment Business. Profit from operations in 2000 was favorably impacted by a \$168 million non-recurring gain associated with the sale of the Food Gums business, partially offset by the following non-recurring charges: loss associated with the divestiture of the nitrocellulose business, asset impairment charges, restructuring charges and executive severance charges not associated with the restructuring plans.

Process Chemicals and Services segment revenues were down \$63 million, or 4%. Excluding the impact of the stronger dollar, revenues decreased \$16 million or less than 1% with relatively flat volumes year over year. Continuing weak demand in the global paper industry primarily drove the decline in segment revenues. Profit from operations decreased \$2 million, or less than 1%. Profit from operations benefited from cost reduction initiatives commenced in 2001, especially in the BetzDearborn Division.

The Pulp & Paper Division is a large and technically advanced provider of pulp and paper chemicals and technical paper process solutions. In the Pulp and Paper Division, both Net sales and Profit from operations declined year over year. The business continued to be impacted by weak global demand. Sales and Profit from operations were negatively impacted by volume declines of 5% from last year. Higher energy and transportation costs, partially offset by lower overhead costs and bad debt expenses, contributed to the lower Profit from operations. The division began to see benefits from the cost reduction and work process redesign program in the fourth quarter in lower overhead costs. The division anticipates further improvement in Profit from operations in 2002 as it moves to fully implement cost reductions and work process redesign. The industry in which the Pulp and Paper Division competes is projected to experience average growth rates of 2% - 5% through 2004. Demand for sizing agents, retention aids and strength resins has increased as the high quality pulp in paper products has been reduced. However, the industry has become increasingly competitive as consolidation continues within the pulp and paper customer base.

BetzDearborn is a supplier of chemical treatment programs and products for water, wastewater and process systems. Its expertise is lowering water and energy consumption, maximizing plant efficiency and solving complex environmental problems for chemical, metals, automobile, oil refinery and food and beverage companies. Net sales in the BetzDearborn Division declined slightly while Profit from operations improved significantly for the year. Excluding the impact of the stronger dollar, revenues increased marginally year over year. Volumes in BetzDearborn increased approximately 6%, however the sales product mix was unfavorable in comparison to 2000. Profit from operations benefited from lower overhead costs attributable to the cost reduction and work process redesign program, price increases in the North American region and lower bad debt expenses. The BetzDearborn Division achieved \$61 million in cost reductions on an annualized basis as of December 31, 2001. The water treatment industry is a mature industry, and is not expected to grow beyond GDP in developed countries. Large customers have increasingly aligned themselves with single suppliers.

Functional Products segment revenues decreased \$201 million, or 27%, and Profit from operations decreased \$53 million, or 30%. Aqualon is a supplier of products that manage the properties of aqueous (water-based) systems. Aqualon's products are mostly derived from renewable natural raw materials, including

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cellulose and guar, and are used in paints and coatings, personal care products such as toothpaste and shampoo, oil and gas well drilling to provide fluid

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loss control and as a strengthening agent in mortar and plaster, among other uses. Volumes for this segment decreased approximately 18%. The decline in volumes, revenue and Profit from operations all reflect by the full year effect of the Food Gums and nitrocellulose divestitures in 2000. Excluding the divested businesses, segment revenues decreased \$18 million, or 3%, Profit from operations decreased \$23 million, or 16%, and volumes decreased 2%. Division results continue to be hampered by the currency effects of a strong dollar, principally versus the Euro, which was particularly evident in the first half of 2001. Excluding the impact of the stronger dollar, revenues were down \$11 million, or about 2%, and Profit from operations was down \$20 million, or 14%. Profit from operations was negatively impacted by volume declines, higher raw material and energy costs, competitive pricing issues and unfavorable fixed cost absorption at lower production levels. These negative drivers were partially offset by lower overhead costs attributable to the cost reduction and work process redesign program. Volume declines are reflective of weak general economic conditions. The water-soluble polymer industry is mature, growing at rates near or slightly higher than GDP. Mergers and the withdrawal of marginal producers have improved profitability.

Chemical Specialties segment revenues decreased \$270 million, or 39%, and Profit from operations decreased \$21 million, or 36%. In May 2001, Hercules sold its hydrocarbon resins and select portions of its rosin resins businesses, its peroxy chemicals business and its interest in a toner resin joint venture. The Resins division, including the businesses that the Company sold, had approximately \$450 million in net sales in 2000. Excluding the divested businesses, segment volumes declined 10% and revenues decreased \$51 million, or 14%, while Profit from operations increased \$2 million or 4%.

FiberVisions is a global supplier of synthetic non-woven fibers made from polypropylene and used primarily in disposable diapers and other hygienic products. Net sales declined while profit from operations increased significantly. The decline in Net sales is primarily due to 9% lower volumes for the full year attributable to the exit from the low margin automotive segment and increased usage of lower basis weight hygiene fabrics combined with adverse economic conditions in the decorative fiber segment, contractual customer pass through of lower polymer costs, the impact of the stronger dollar and competitive pricing issues. Operating performance was positively impacted by lower polymer costs, lower overhead costs attributable to the cost reduction and work process redesign program and lower depreciation expense as a result of assets impairments in 2000.

The Resins Division offers products that generally are custom made to fit a particular use in an industry and impart or improve the properties of a variety of compounded substances. Net sales and Profit from operations in the Resins Division significantly declined in 2001 as a result of the Resins Divestitures (see Note 1). Volumes were down approximately 60%. Excluding divested businesses, Net sales and Profit from operations still experienced deterioration in 2001, with volumes decreasing 14% for the full year. Operating performance was primarily impacted by unfavorable fixed cost absorption at lower production levels and weak overall demand, the most significant in the Terpenes product line.

2000 vs. 1999:

Consolidated net sales were \$3,152 million for 2000, a decrease of \$157 million or 5% from 1999. Approximately \$135 million of this decrease is

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attributable to the strength of the U.S. dollar in 2000, principally versus the Euro which weakened dramatically throughout the year. Excluding the impact of the stronger dollar, consolidated revenues decreased approximately \$22 million or 1%. Additionally, consolidated revenues decreased approximately \$111 million when compared to 1999 as a result of the loss of revenues attributable to the divested Food Gums, nitrocellulose and agar businesses. Revenues relating to Hercules' ongoing businesses (excluding Food Gums, nitrocellulose and agar) increased by approximately \$89 million in 2000 after adjusting for currency effects. Consolidated profit from operations decreased \$36 million or 8%. Excluding divested businesses, consolidated profit from operations decreased \$140 million. The Euro adversely impacted operating profit by approximately \$36 million. Raw material and energy costs escalated significantly in 2000 and were difficult to recover in a timely manner. As 2000 ended, demand slowed in several of the Company's key markets. Excluding the foreign currency effects, consolidated profit from operations decreased approximately \$104 million or 21%.

Process Chemicals and Services segment revenues were down \$8 million or less than 1%. Excluding the impact of the stronger dollar, revenues were up \$51 million or 3%, reflecting a 2% increase in volumes over 1999. Profit from operations decreased \$41 million or 12%. Excluding the impact of the stronger dollar, profit from operations was down \$26 million or 8%. During 2000, the Company increased its reserve for doubtful accounts by \$21 million.

Functional Products segment revenues were down \$133 million or 15% and profit from operations decreased \$42 million or 19%. Excluding the divested Food Gums and nitrocellulose businesses, segment revenues were down \$22 million

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or 4% and profit from operations decreased \$33 million or 18%. The strengthening U.S. dollar vis-a-vis the Euro was the primary variant in year on year operating results. Excluding the impact of the stronger dollar, revenues were up \$16 million or 3% and profit from operations was down \$16 million or 9%. Higher raw material and energy costs, combined with unfavorable product mix changes negatively impacted operating profit towards the end of the year. Demand in the paint and construction markets normally slows at year-end; however, the Company saw a more significant slowdown in demand than is typical in these markets. Business in the oilfield industry remained strong in the fourth quarter. Volumes for this segment were up almost 7% year over year.

Chemical Specialties segment revenues were down \$16 million or 2% and profit from operations decreased \$30 million or 34%. Excluding the impact of the stronger dollar, revenues were up \$22 million or 3%, and profit from operations was down \$27 million or 30%. Operating performance was negatively impacted by significantly higher polypropylene feed stock costs and lower volumes. Volumes for this segment were down just under 1%. The slowdown in the adhesives end market was a primary driver in lower volumes.

Interest and Debt Expense and Preferred Security Distributions; Equity Income;

Provision for Income Taxes:

Interest and debt expense and preferred security distributions of subsidiary trusts decreased \$6 million or 2% in 2001 versus 2000. Interest and debt expense increased \$32 million in 2001 versus 2000 reflecting higher borrowing costs, partially offset by lower debt as a result of the application of proceeds from the sale of businesses. Preferred security distributions of subsidiary trusts decreased \$38 million in 2001 versus 2000 reflecting the repayment of \$370 million of these securities in the latter part of 2000.

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Equity in income of affiliated companies declined over the three-year period ended December 31, 2001 principally as a result of the equity losses relating to CP Kelco in 2001 and 2000.

Provision for income taxes reflects effective tax rates of 310% in 2001, 40% in 2000 and 31% in 1999. The increase in the effective tax rate for the year 2001 reflects the effect of non-deductible goodwill amortization and other provisions on a lower pre-tax income base. The primary cause of the increase in the effective tax rate for the year 2000 was the effect of non-deductible goodwill amortization on a lower pre-tax income base, offset by the benefit of the utilization of research and development credits, favorable audit settlements and utilization of a capital loss. The 1999 rate was favorably impacted by the utilization of a capital loss and other adjustments related to prior years' assessments.

FINANCIAL CONDITION

Liquidity and financial resources: Net cash flow from operations was \$109 million in 2001, \$70 million in 2000 and \$280 million in 1999. Hercules has improved its operating cash flow in 2001 by significantly reducing its working capital requirements. The 2000 decrease versus 1999 reflects lower net income, the payment of legal settlements, net of insurance recoveries, and higher working capital requirements. The 1999 increase reflects higher profit from operations, primarily from acquired businesses, and lower tax payments offset by higher interest payments, cash expenditures for integration, termination benefits and other exit costs, along with higher working capital requirements.

Net cash provided by (used in) investing activities was \$284 million in 2001, \$213 million in 2000 and (\$193) million in 1999. Hercules has improved its cash flow from investing activities in 2001 by significantly reducing its capital expenditures. Capital expenditures were \$63 million, \$179 million and \$204 million in 2001, 2000 and 1999, respectively. The decrease in capital expenditures in 2001 and 2000 was primarily due to the completion of the plant expansion in Doel, Belgium and stringent capital spending controls instituted during the latter part of 2000 and into the year 2001. Additionally, cash flow from investing activities in both 2001 and 2000 have benefited from the monetization of certain non-core assets. In May 2001, the Company completed the sale of its hydrocarbon resins business and select portions of its rosin resins business to a subsidiary of Eastman Chemical Company, receiving proceeds of approximately \$244 million, and the sale of its peroxy chemicals business to GEO Specialty Chemicals, Inc., receiving proceeds of approximately \$92 million. In September 2000, the Company sold its Food Gums business to CP Kelco receiving proceeds of approximately \$395 million. After recording certain selling and tax expenses of \$77 million, the net proceeds of approximately \$318 million were applied to repay term loan tranche C.

Management remains focused on minimizing capital expenditures and working capital needs for the year 2002.

Net cash used in financing activities was \$368 million, \$290 million and \$88 million, respectively, in 2001, 2000 and 1999. The Company has used cash from business divestitures in 2001 and 2000 to pay down long-term debt.

The Company regularly reviews its financial structure to appropriately support the organization. In March 1999, Hercules Trust I, a wholly owned consolidated subsidiary trust of Hercules, completed a public offering of \$362 million of Trust Originated Preferred Securities (TOPrS) (see Note 7). Proceeds of the offering were used to repay long-term debt. Hercules Trust I's obligations are guaranteed by the Company.

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During the second quarter of 1999, the Company amended its credit agreement to allow for borrowing in euros, as well as in U.S. dollars. Approximately \$950 million of U.S. dollar denominated debt was converted to euro indebtedness.

In July 1999, the Company completed a public offering of 5,000,000 shares of its common stock, which provided the Company with net proceeds of \$171.5 million (see Note 9). On the same date, the Company and Hercules Trust II, a wholly owned consolidated subsidiary trust of the Company, completed a public offering of 350,000 CRESTS Units (see Note 7). Each CRESTS Unit consists of one preferred security of Hercules Trust II and one warrant to purchase 23.4192 shares of Hercules common stock at an initial exercise price of \$1,000 (equivalent to \$42.70 per share). The warrants may be exercised, subject to certain conditions, at any time before March 31, 2029, unless there is a reset and remarketing event. This transaction provided net proceeds to Hercules of \$340.4 million. Proceeds of the offerings were used to repay long-term debt. Hercules Trust II's obligations are guaranteed by the Company.

On December 23, 1999, Hercules Trust VI, a wholly owned consolidated subsidiary trust of Hercules, completed a private placement of 170,000 Floating Rate Preferred Securities (Floating Rate Preferred) (see Note 7). The Company repaid the Floating Rate Preferred with a portion of the proceeds of the November 2000 11 1/8% senior notes offering on December 29, 2000.

On November 14, 2000, the Company completed a refinancing and modification of its existing debt. In conjunction with and conditioned upon the effectiveness of the amendment to its credit facilities, the Company borrowed \$375 million under the senior credit facility (term loan tranche D) and also issued \$400 million of 11 1/8% senior notes due 2007. Concurrently with, and as a condition to, term loan tranche D and the offering of the 11 1/8% senior notes, the senior credit facility and ESOP credit facility were amended to: (i) modify the Company's financial covenants; (ii) change the mandatory prepayment provisions; and (iii) provide for security, among other things.

Term loan tranche D initially bore interest at LIBOR + 2.75%, matures on November 15, 2005 and will require only nominal principal payments prior to maturity. The senior notes accrue interest at 11 1/8% per annum, payable semi-annually. The senior notes are guaranteed by each of Hercules' current and future wholly owned domestic restricted subsidiaries. The 11 1/8% senior notes were subject to a registration rights agreement that required Hercules to file an Exchange Offer Registration Statement with the Securities and Exchange Commission within 270 days (no later than August 11, 2001) and to use its best efforts to have it declared effective within 330 days. On August 9, 2001, Hercules filed a Registration Statement on Form S-4 with the Securities and Exchange Commission, pursuant to which the Company offered to exchange all of its \$400 million aggregate principal amount of 11 1/8% senior notes due 2007 ("old notes") for \$400 million aggregate principal amount of 11 1/8% Senior Notes due 2007 ("new notes"). The form and terms of the new notes are the same as the form and terms of the old notes except that, because the new notes were registered under the Securities Act, the new notes do not bear legends restricting their transfer and are not entitled to certain registration rights under the registration rights agreement. The new notes evidence the same debt as the old notes and the new notes and the old notes are governed by the same indenture. On October 31, 2001, Hercules filed Amendment No. 1 to the Registration Statement on Form S-4 with the Securities and Exchange Commission and the Registration Statement became effective. Hercules did not receive any proceeds from the exchange offer. When the exchange offer expired on December 7, 2001, \$375.3 million of the old notes had been tendered for a like amount of new notes.

At any time prior to November 15, 2003, Hercules may on any one or more

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occasions, redeem up to 35% of the aggregate principal amount of the 11 1/8% senior notes at a redemption price of 111.125% of the principal amount, plus accrued and unpaid interest and liquidated damages, if any, to the redemption date, with the net cash proceeds of one or more public equity offerings, provided that (i) at least 65% of the aggregate principal amount of the 11 1/8% senior notes issued under the indenture remains outstanding, immediately after the occurrence of such redemption (excluding notes held by Hercules and its Subsidiaries); and (ii) the redemption occurs within 45 days of the date of the closing of such public equity offering. Except as described above, the 11 1/8% senior notes will not be redeemable at Hercules' option prior to maturity. Hercules is not required to make mandatory redemption or sinking fund payments with respect to the senior notes.

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The proceeds of term loan tranche D and the 11 1/8% senior notes were used to reduce borrowings under the revolving credit agreement, repay the Redeemable Hybrid INcome Overnight Shares (RHINOS) and Floating Rate Preferred Securities and reduce the current portion of term loan tranche A.

As of December 31, 2001, the Company had \$292 million available under the revolving credit agreement and \$42 million of short-term lines of credit. However, the actual availability under the revolving credit agreement is constrained by the Company's ability to meet covenants in its senior credit facility. At December 31, 2001, the Company's incremental borrowing capacity was \$58 million.

Both the senior credit facility and the ESOP credit facility (Note 6) require quarterly compliance with certain financial covenants, including a leverage ratio ("debt/EBITDA ratio"), an interest coverage ratio and minimum net worth. In addition, the Company is required to deliver its annual audited consolidated financial statements to the lenders within 90 days of the Company's fiscal year end.

Due to the delay in closing the Eastman transaction, which in turn delayed the pay down of the debt, the Company's debt as of March 31, 2001 was significantly higher than planned. As a result, the Company would have been out of compliance with the debt/EBITDA ratio covenant of its senior credit facility as of March 31, 2001. In addition, due to the fact that the Company extended the filing date for the 2000 10-K, the Company's annual audited financial statements were not provided to the lenders by March 31, 2001.

On April 5, 2001, in consideration for the payment of a fee, the senior credit facility bank syndicate and ESOP lender granted waivers with respect to: (1) compliance with the debt/EBITDA ratio as of March 31, 2001 and (2) an extension of time to deliver the December 31, 2000 audited financial statements to April 17, 2001. These statements were delivered on April 17, 2001.

With respect to the covenant regarding the debt/EBITDA ratio, the waiver required that the Eastman transaction be consummated on or before May 31, 2001. In addition, the Company had to demonstrate, as of the last day of the month in which the Eastman transaction closed, that the leverage ratio did not exceed 4.75 to 1.00 after giving effect to the application of the net cash proceeds from the Eastman transaction to prepay portions of the tranche A term loan and the ESOP credit facility. The Company achieved this leverage ratio. The Eastman and Peroxide transactions closed in May 2001.

In order to facilitate the GE Transaction, the Company was required to obtain amendments to its senior credit facility and ESOP credit facilities (the "Facilities"). Effective March 6, 2002, the Facilities were amended to (i) modify certain financial covenants; (ii) change the mandatory prepayment

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provisions; (iii) permit the reorganization of the Company in order to effect the separation of the Water Treatment Business; and (iv) permanently reduce the revolving committed amount under the credit facility to \$200 million. The amendment to the credit facility also included provisions that will be effective only upon the consummation of the sale of the Water Treatment Business and the prepayment of the credit facility. These additional provisions include the following: (i) the release of the subsidiary stock pledged to the collateral agent; (ii) the elimination of the requirement that stock of any additional subsidiaries be pledged in the future; and (iii) the revision of the permitted amount of asset purchases and dispositions. If the GE Transaction does not close by July 15, 2002, the financial covenants set forth in the Amendments will revert back to the previously established levels.

While the Company expects to remain in compliance with its debt covenants, current and future compliance is dependent upon generating sufficient EBITDA and cash flow which are, in turn, impacted by business performance, economic climate, competitive uncertainties and possibly the resolution of contingencies, including those set forth in Note 22 to the consolidated financial statements.

In the event the Company is not in compliance with the debt covenants in the future, it will pursue various alternatives, which may include, among other things, refinancing of debt, debt covenant amendments or debt covenant waivers. While the Company believes that it would be successful in pursuing these alternatives, there can be no assurance that the Company would be successful.

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Capital Structure and Commitments: Total capitalization (stockholders' equity, company obligated preferred securities of subsidiary trusts and debt) decreased to \$3.5 billion from \$4.0 billion, and the ratio of debt-to-total capitalization decreased to 62% from 64% at December 31, 2001 and December 31, 2000, respectively, as a result of the application of the proceeds from the sale of businesses in 2001. The current ratio decreased to .92 at December 31, 2001, compared to 1.1 at December 31, 2000. The quick ratio decreased to .66 at December 31, 2001, compared to .78 at December 31, 2000.

On October 4, 2000, Moody's Investors Service, Inc., downgraded the Company's senior unsecured credit rating to Ba1 with a stable outlook. On October 19, 2000, Standard & Poor's Ratings Services downgraded the corporate credit rating to BB+ and placed Hercules on credit watch with "developing" implications. On November 9, 2000, Moody's Investors Service, Inc., assigned a Ba1 rating to term loan tranche D and a Ba2 rating to the 11 1/8% senior notes. Also on November 9, 2000, Standard & Poor's Ratings Services assigned a BB+ rating to the term loan tranche D and a BB- rating to the 11 1/8% senior notes. Both ratings were placed on credit watch with "developing" implications. On January 23, 2001, Standard & Poor's Ratings Services downgraded the corporate credit rating to BB, which initiated a 50 basis point increase in the interest rates of term loan tranche A and term loan tranche D. On January 25, 2001, Standard & Poor's Ratings Services assigned a B+ rating to the 11 1/8% senior notes. These actions and future adverse actions, if any, by the rating agencies are likely to result in the Company incurring higher interest costs in future periods.

Quarterly dividends of \$0.27 per share were declared and paid in the first and second quarters of 2000. In August 2000, the Board of Directors reduced the quarterly dividend payment to \$.08 per share, which was paid in September 2000 for the third quarter of 2000. On November 13, 2000, the Board of Directors determined to suspend the payment of the quarterly dividend beginning with the fourth quarter of this year, subject to reconsideration of the policy by the Board, in its discretion, when warranted under appropriate circumstances. In addition, payment of future dividends is significantly restricted by the

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indenture governing the senior notes. The annual dividend was \$.62 and \$1.08 per share during 2000 and 1999, respectively.

Capital expenditures are expected to approximate \$60 million during 2002. This includes funds for continuing or completing existing projects and for implementing new projects.

The Company's contractual commitments are summarized as follows:

	(Dollars in millions)			
	Payments Due by Period			
	Total	Less than 1 year	1 - 3 years	4 - 5
Long-term debt	\$2,201	\$242	\$1,008	\$
Non-cancelable operating leases	228	40	56	-
	-----	----	-----	-
Total Contractual Cash Obligations	\$2,429	\$282	\$1,064	\$
	=====	====	=====	=

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The Company had the following commercial commitments at December 31, 2001: lines of credit of \$9 million and standby letters of credit of \$100 million, both of which may require payments in the future.

RISK FACTORS

Indebtedness

The Company has a significant amount of indebtedness. As of December 31, 2001, the Company's total debt was approximately \$2,210 million. Total debt does not include \$624 million of company-obligated preferred securities of subsidiary trusts. The Company's substantial indebtedness has significant consequences. For example, it could: increase the Company's vulnerability to economic downturns and competitive pressures; require the Company to dedicate a substantial portion of its cash flow from operations to payments on its indebtedness, thereby reducing the availability of its cash flow to fund working capital, capital expenditures, research and development efforts and other general corporate purposes; reduce the Company's cash flow due to increased interest expense in times of rising interest rates; limit the Company's flexibility in planning for, or reacting to, changes in its business and the industries in which it operates or in pursuing attractive business opportunities requiring debt financing; place the Company at a disadvantage to its competitors that have less debt; and limit the Company's ability to borrow additional funds due to restrictive covenants.

The senior credit facility, the ESOP credit facility and the indenture governing the 11 1/8% senior notes due 2007, which together account for a large portion of the Company's debt, contain numerous restrictive covenants, including, among other things, covenants that limit the Company's ability to: borrow money and incur contingent liabilities; make dividend or other restricted payments; use assets as security in other transactions; enter into transactions with affiliates; enter into new lines of business; issue and sell stock of restricted subsidiaries; and sell assets or merge with or into other companies. In addition, the senior credit facility and the ESOP credit facility require the

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Company to meet financial ratios and tests, including maximum leverage, minimum net worth and interest coverage levels. These restrictions could limit the Company's ability to plan for or react to market conditions or meet extraordinary capital needs and could otherwise restrict corporate activities.

The Company's ability to comply with the covenants and other terms of the senior credit facility, the ESOP credit facility and the indenture governing the senior notes and to satisfy these and other debt obligations will depend upon the Company's current and future performance and its ability to consummate the sale of the Water Treatment Business or sell other assets. The Company's performance is affected by general economic conditions and by financial, competitive, political, business and other factors, many of which are beyond the Company's control. The Company believes that the cash generated from its business will be sufficient to enable the Company to comply with the covenants and other terms of the senior credit facility, the ESOP credit facility and the indenture governing the senior notes and to make debt payments as they become due. If, however, the Company does not generate enough cash, the Company may be required to refinance some or all of its indebtedness, sell equity or to obtain waivers from its lenders. No assurance can be given that any refinancings, additional borrowings or sales of equity will be available when needed or that the Company will be able to negotiate acceptable terms. In addition, the Company's access to capital is affected by prevailing conditions in the financial and equity capital markets, as well as the Company's financial condition (including leverage levels), financial performance and prospects. While the Company has been successful in obtaining waivers from its lenders in the past, it may be more difficult to do so in the future. Accordingly, there can be no guarantee that the Company will be able to obtain future waivers. If the Company fails to comply with the covenants and terms of the senior credit facility, the ESOP credit facility and the indenture governing the senior notes or to satisfy these and other debt obligations, the Company may be in default, debt could be accelerated and any underlying security could be enforced.

Despite current indebtedness levels, the Company and its subsidiaries may incur additional indebtedness in the future. As of December 31, 2001, the Company had a \$1.8 billion senior credit facility with a syndicate of banks and an \$84 million

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credit facility related to the BetzDearborn ESOP Trust. Under the senior credit facility, the Company has a \$900 million revolving credit agreement, which permits certain additional borrowings. If new indebtedness is added to the Company's current indebtedness levels, the risks described above could increase.

Market Risk

Fluctuations in interest and foreign currency exchange rates affect the Company's financial position and results of operations. The Company has used several strategies to actively hedge interest rate and foreign currency exposure and minimize the effect of such fluctuations on reported earnings and cash flow. (See "Foreign Currency Translation" and "Derivative Financial Instruments and Hedging" in the Summary of Significant Accounting Policies and Notes 18 and 21.) Sensitivity of the Company's financial instruments to selected changes in market rates and prices, which are reasonably possible over a one-year period, are described below. Market values are the present value of projected future cash flows based on the market rates and prices chosen. The market values for interest rate risk are calculated by the Company utilizing a third-party software model that employs standard pricing models to determine the present value of the instruments based on the market conditions as of the valuation date.

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During 2000, the interest rate swap portfolio was substantially terminated due to the conversion of foreign denominated debt to U.S. dollar denominated debt in the first half of 2000 and the November 2000 debt restructuring which replaced variable rate debt with fixed rate debt.

The Company's derivative and other financial instruments subject to interest rate risk consists substantially of debt instruments and trust preferred securities. At December 31, 2001 and 2000, net market value of these combined instruments, substantially all of which were debt at December 31, 2001, was a liability of \$2.61 billion and \$3.08 billion, respectively. The sensitivity analysis assumes an instantaneous 100-basis point move in interest rates from their levels, with all other variables held constant. A 100-basis point increase in interest rates at December 31, 2001 and 2000 would result in a \$52 million and \$70 million decrease, respectively, in the net market value of the liability. A 100-basis point decrease in interest rates at December 31, 2001 and 2000 would result in a \$57 million and \$78 million increase, respectively, in the net market value of the liability, respectively.

Our financial instruments subject to foreign currency exchange risk consist of foreign currency forwards and options and represent a net asset position of \$.2 million at December 31, 2001 and a net liability position of \$1 million at December 31, 2000. The following sensitivity analysis assumes an instantaneous 10% change in foreign currency exchange rates from year-end levels, with all other variables held constant. A 10% strengthening of the U.S. dollar versus other currencies at December 31, 2001 and 2000 would result in a \$2 million increase in the net asset position for 2001 and a \$2 million decrease in the net liability position for 2000, while a 10% weakening of the dollar versus all currencies would result in a \$2 million decrease in the net asset position for 2001 and a \$3 million increase in the net liability position for 2000.

Foreign exchange forward and option contracts have been used to hedge the Company's firm and anticipated foreign currency cash flows. Thus, there is either an asset or cash flow exposure related to all the financial instruments in the above sensitivity analysis for which the impact of a movement in exchange rates would be in the opposite direction and substantially equal to the impact on the instruments in the analysis. There are presently no significant restrictions on the remittance of funds generated by the Company's operations outside the United States. The free market exchange rate of the Argentinean peso did not have a significant impact on the operations of the Company.

The Company has not designated any derivative as a hedge instrument under SFAS 133 and, accordingly, changes in the fair value of derivatives are recorded each period in earnings.

Environmental

In the ordinary course of its business, the Company is subject to numerous environmental laws and regulations covering compliance matters or imposing liability for the costs of, and damages resulting from, cleaning up sites, past spills, disposals and other releases of hazardous substances. Changes in these laws and regulations may have a material adverse effect on the Company's financial position and results of operations. Any failure by the Company to adequately comply with such laws and regulations could subject the Company to significant future liabilities.

Hercules has been identified by U.S. federal and state authorities as a "potentially responsible party" for environmental cleanup at numerous sites. The estimated range of reasonably possible costs for remediation is between \$81 million and \$256 million. These cost estimates are based upon the facts and circumstances as they are presently known and are updated quarterly based upon new information that the Company receives. While the Company believes that the

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actual cost will more likely approximate \$81 million based on its estimation methods and prior experience, actual remediation-related liabilities may exceed current estimates. While it is not

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feasible to predict the outcome of all pending suits and claims, the ultimate resolution of these environmental matters could have a material effect upon the results of operations and financial position of Hercules (see Note 22).

Environmental remediation expenses are funded from internal sources of cash. Such expenses are not expected to have a significant effect on the Company's ongoing liquidity. Environmental cleanup costs, including capital expenditures for ongoing operations, are a normal, recurring part of operations and are not significant in relation to total operating costs or cash flows.

Litigation

Hercules is a defendant in numerous lawsuits that arise out of, and are incidental to, the conduct of its business. These suits concern issues such as product liability, contract disputes, labor-related matters, patent infringement, environmental proceedings, property damage and personal injury matters. While it is not feasible to predict the outcome of all pending suits and claims, the ultimate resolution of these matters could have a material effect upon the financial position of Hercules, and the resolution of any of the matters during a specific period could have a material effect on the quarterly or annual operating results for that period (see Note 22)

On February 5, 2002, the Appellate Division of the New York Supreme Court affirmed a trial court judgment against Hercules currently totaling approximately \$10.9 million including interest, costs and expenses in the case, Hexcel Corporation v Hercules Incorporated. Hercules continues to believe that the decisions of the trial court and intermediate appellate courts are incorrect and has filed a motion for Reargument or for Leave to Appeal to the Court of Appeals. That motion was denied on March 19, 2002. Hercules will be filing a motion for Leave to Appeal to the New York Court of Appeals directly with the Court of Appeals. The granting of a motion for an appeal to the Court of Appeals is discretionary and there can be no assurance that it will be granted.

Other

The Company has undertaken a comprehensive cost reduction program to improve its return on capital. While the cost reduction program may ultimately benefit the Company and its stockholders, cost reduction programs also can have an adverse effect on a company's operations and there can be no assurance that the Company's cost reduction program will be successful.

RECENT ACCOUNTING PRONOUNCEMENTS

In June 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 141, "Business Combinations" ("SFAS 141"), and Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" ("SFAS 142"). SFAS 141 supersedes Accounting Principles Board Opinion ("APB") No. 16, Business Combinations. The provisions of SFAS 141 (1) require that the purchase method of accounting be used for all business combinations initiated after June 30, 2001, (2) provide specific criteria for the initial recognition and measurement of intangible assets apart from goodwill and (3) require that unamortized negative goodwill be written off immediately as extraordinary gain instead of being deferred and amortized. SFAS 141 also requires that upon adoption of SFAS 142 the Company reclassify the carrying amounts of certain intangible assets into or out of goodwill, based on

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certain criteria. SFAS 142 supersedes APB No. 17, Intangible Assets, and is effective for fiscal years beginning after December 15, 2001. SFAS 142 primarily addresses the accounting for goodwill and intangible assets subsequent to their initial recognition. The provisions of SFAS 142 (1) prohibit the amortization of goodwill and indefinite-lived intangible assets, (2) require that goodwill and indefinite-lived intangible assets be tested annually for impairment (and in interim periods if certain events occur indicating that the carrying value of goodwill and/or indefinite-lived intangible assets may be impaired) based on fair value (as opposed to cost recovery using future undiscounted cash flows), (3) require that reporting units be identified for the purpose of assessing potential future impairments of goodwill and (4) remove the forty-year limitation on the amortization period of intangible assets that have finite lives.

The Company will adopt the provisions of SFAS 142 in its first quarter ended March 31, 2002. The Company is in the process of preparing for its adoption of SFAS 142 and is making the determinations as to what its reporting units are and what amounts of goodwill, intangible assets, other assets and liabilities should be allocated to those reporting units. As required by SFAS 142, the Company will reclassify \$47 million of assembled workforce intangible assets to goodwill. The Company will no longer record \$49 million of annual amortization relating to its existing goodwill and intangibles, as adjusted for the reclassifications just mentioned.

SFAS 142 requires that goodwill be tested upon transition and annually thereafter for impairment using a two-step process. The first step is to identify a potential impairment and, in transition, this step must be measured as of the beginning

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of the fiscal year. However, the Company has six months from the date of adoption to complete the first step. The second step of the goodwill impairment test measures the amount of the impairment loss (measured as of the beginning of the year of adoption), if any, and must be completed by the end of the Company's fiscal year. The Company expects to complete both steps of its transitional impairment analysis in time to fully recognize the provisions of SFAS 142 in the first quarter 2002 results. Although the Company has not completed its transitional impairment analysis required by SFAS 142, it anticipates that initial adoption of this standard will result in recording a loss ranging from \$200 to \$300 million related to impaired goodwill of the Water Treatment Business. Also, it is likely that an additional transitional goodwill impairment charge due to adopting SFAS 142 will be taken with respect to the FiberVisions Business ranging from \$70 to \$125 million. These impairment charges are net of tax since they are not tax deductible and will be reported as a cumulative effect of a change in accounting principle.

Goodwill related to both the Water Treatment and FiberVisions businesses was evaluated for impairment at December 31, 2001 under Statement of Financial Accounting Standards No. 121 "Accounting for the Impairment of Long-Fixed Assets and for Long-Lived Assets to Be Disposed of". Such evaluations indicated that goodwill associated with these businesses was recoverable from anticipated future undiscounted cash flows. Accordingly, no impairment loss was recorded in the December 31, 2001 financial statements.

In estimating future cash flows, the Company assumed that both of these businesses would remain in its business portfolio for the foreseeable future, which was the most likely case based on the facts that existed as of December 31, 2001.

In addition, in June 2001, the FASB approved the issuance of Statement of

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Financial Accounting Standards No. 143, "Accounting for Asset Retirement Obligations" ("SFAS 143"). SFAS 143 establishes accounting standards for the recognition and measurement of legal obligations associated with the retirement of tangible long-lived assets. SFAS 143 will become effective for the Company on January 1, 2003 and requires recognition of a liability for an asset retirement obligation in the period in which it is incurred. Management is in the process of evaluating the impact this standard will have on the Company's financial statements.

In October 2001, the FASB issued Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS 144"). SFAS 144 addresses financial accounting and reporting for the impairment or disposal of long-lived assets. The provisions of this statement are effective for financial statements issued for fiscal years beginning after December 15, 2001. Management is in the process of evaluating the impact this standard will have on the Company's financial statements.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK:

For discussion of quantitative and qualitative disclosures about market risk, see the caption "Risk Factors" under Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA:

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS AND
REQUIRED SUPPLEMENTARY DATA
HERCULES INCORPORATED

CONSOLIDATED FINANCIAL STATEMENTS

Report of Independent Accountants
Consolidated Statement of Operations for the Years Ended December 31, 2001, 2000 and 1999
Consolidated Balance Sheet as of December 31, 2001 and 2000
Consolidated Statement of Cash Flows for the Years Ended December 31, 2001, 2000 and 1999
Consolidated Statement of Stockholders' Equity for the Years Ended December 31, 2001, 2000 and 1999
Consolidated Statement of Comprehensive (Loss) Income for the Years Ended December 31, 2001, 2000 and 1999
Summary of Significant Accounting Policies and Notes to Consolidated Financial Statements

SUPPLEMENTARY DATA

Summary of Quarterly Results (Unaudited)
Subsidiaries of Registrant

REPORT OF INDEPENDENT ACCOUNTANTS

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To the Shareholders and the Board of Directors of
Hercules Incorporated
Wilmington, Delaware

In our opinion, the consolidated financial statements listed in the accompanying index present fairly, in all material respects, the financial position of Hercules Incorporated and subsidiaries at December 31, 2001 and 2000, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2001 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the index appearing under Item 14(a)(2) on page 82 presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. These financial statements and the financial statement schedule are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements and the financial statement schedule based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

PricewaterhouseCoopers LLP
Philadelphia, Pennsylvania
March 28, 2002

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HERCULES INCORPORATED CONSOLIDATED STATEMENT OF OPERATIONS

	(Dollars in millions, except per share)	
	2001	2000
	----	----
Net sales	\$ 2,620	\$ 3,152
	-----	-----
Cost of sales	1,464	1,784
Selling, general, and administrative expenses	743	810
Research and development	67	80
Goodwill and intangible asset amortization	76	80
Other operating (income) expenses, net (Note 16)	(17)	(46)
	-----	-----
Profit from operations	287	444
Interest and debt expense (Note 17)	196	164
Preferred security distributions of subsidiary trusts	58	96
Other expense, net (Note 18)	10	18
	-----	-----
Income before income taxes and equity (loss) income	23	166
Provision for income taxes (Note 19)	72	66
	-----	-----

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(Loss) income before equity (loss) income	(49)	100
Equity (loss) income of affiliated companies, net of tax	(9)	(2)
	-----	-----
Net (loss) income	\$ (58)	\$ 98
	=====	=====
(Loss) earnings per share (Note 20)		
Basic:	\$ (0.54)	\$ 0.91
Diluted:	\$ (0.54)	\$ 0.91

The accompanying accounting policies and notes are an integral part of the consolidated financial statements.

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HERCULES INCORPORATED
CONSOLIDATED BALANCE SHEET

	(Dollars in m December 2001 -----)
ASSETS	
Current assets	
Cash and cash equivalents	\$ 76
Accounts and notes receivable, net (Note 2)	506
Inventories (Note 3)	233
Deferred income taxes (Note 19)	27

Total current assets	842
Property, plant and equipment, net (Note 12)	903
Investments (Note 4)	43
Goodwill and other intangible assets, net (Note 13)	2,476
Prepaid pension (Note 15)	215
Deferred charges and other assets	570

Total assets	\$ 5,049
	=====
LIABILITIES AND STOCKHOLDERS' EQUITY	
Current liabilities	
Accounts payable	\$ 203
Short-term debt (Note 5)	251
Accrued expenses (Note 12)	463

Total current liabilities	917
Long-term debt (Note 6)	1,959
Deferred income taxes (Note 19)	334
Other postretirement benefits (Note 15)	107
Deferred credits and other liabilities	396

Total liabilities	3,713
Commitments and contingencies (Note 22)	--
Company-obligated preferred securities of subsidiary trusts (Note 7)	624
Stockholders' equity	

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Series preferred stock (Note 8)	--
Common stock, \$25/48 par value (Note 9)	83
(shares issued: 2001 - 159,984,444; 2000 - 159,984,444)	
Additional paid-in capital	697
Unearned compensation (Note 10)	(104)
Accumulated other comprehensive losses	(218)
Retained earnings	2,099

	2,557
Reacquired stock, at cost (shares: 2001 - 51,196,972; 2000 - 52,442,393)	1,845

Total stockholders' equity	712

Total liabilities and stockholders' equity	\$ 5,049
	=====

The accompanying accounting policies and notes are an integral part of the consolidated financial statements.

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HERCULES INCORPORATED CONSOLIDATED STATEMENT OF CASH FLOW

		(Dollars in millions)
	2001	-----
CASH FLOW FROM OPERATING ACTIVITIES:		
Net (loss) income		\$ (58)
Adjustments to reconcile net income to net cash provided from operations:		
Depreciation		102
Amortization		110
Gain on disposals		(77)
Restructuring plans		48
Noncash charges (credits)		21
Accruals and deferrals of cash receipts and payments:		
Affiliates' earnings in excess of dividends received		9
Accounts receivable		100
Inventories		14
Accounts payable and accrued expenses		(31)
Deferred taxes		(51)
Noncurrent assets and liabilities		(78)

Net cash provided by operations		109

CASH FLOW FROM INVESTING ACTIVITIES:		
Capital expenditures		(63)
Proceeds of investment and fixed asset disposals		356
Acquisitions, net of cash acquired		--
Other, net		(9)

Net cash provided by (used in) investing activities		284

CASH FLOW FROM FINANCING ACTIVITIES:		

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Long-term debt proceeds	349
Long-term debt repayments	(626)
Change in short-term debt	(107)
Payment of debt issuance costs and underwriting fees	--
Proceeds from issuance of subsidiary trusts preferred securities	--
Repayment of subsidiary trust preferred securities	--
Proceeds from issuance of warrants	--
Common stock issued	17
Common stock reacquired	(1)
Proceeds from issuance of subsidiary preferred stock	--
Dividends paid	--

Net cash used in financing activities	(368)

Effect of exchange rate changes on cash	(3)

Net increase (decrease) in cash and cash equivalents	22
Cash and cash equivalents at beginning of year	54

Cash and cash equivalents at end of year	\$ 76
	=====

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION

Cash paid during the period for:

Interest (net of amount capitalized)	\$ 157
Preferred security distributions of subsidiary trusts	61
Income taxes, net of refunds received	37
Noncash investing and financing activities:	
Conversion of notes and debentures	--
Acquisition of minority interest	--
Incentive and other employee benefit stock plan issuances	12

The accompanying accounting policies and notes are an integral part of the consolidated financial statements.

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HERCULES INCORPORATED
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

(Dollars in millions)

	Common Stock	Paid-in Capital	Un- C s
Balances at January 1, 1999	\$ 81	\$ 504	\$
(Common shares: issued, 154,823,496; reacquired, 53,995,692)			
Net income	--	--	
Common dividends, \$1.08 per common share	--	--	
Foreign currency translation adjustment	--	--	
Impact of allocation of shares held by ESOP	--	--	
Purchase of common stock, 126,893 shares	--	--	
Warrants issued in connection with CRESTS			
Units offering (Note 7)	--	88	
Issuance of common stock:			

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Incentive plans, net, 535,220 shares from reacquired stock	--	--	
Conversion of notes and debentures, 153,234 shares	--	2	
Public offering, 5,000,000 shares	2	163	

Balances at December 31, 1999	\$ 83	\$ 757	\$
(Common shares: issued, 159,976,730; reacquired, 53,587,365)			
Net income	--	--	
Common dividends, \$0.62 per common share	--	--	
Foreign currency translation adjustment	--	--	
Impact of allocation of shares held by ESOP	--	--	
Purchase of common stock, 174,547 shares	--	--	
Issuance of common stock:			
Incentive plans, net, 1,319,519 shares, from reacquired stock	--	(31)	
Conversion of notes and debentures, 7,714 shares	--	--	

Balances at December 31, 2000	\$ 83	\$ 726	\$
(Common shares: issued, 159,984,444; reacquired, 52,442,393)			
Net loss	--	--	
Foreign currency translation adjustment	--	--	
Impact of allocation of shares held by ESOP	--	--	
Additional minimum pension liability, net of tax	--	--	
Purchase of common stock, 66,470 shares	--	--	
Issuances of common stock:			
Incentive plans, net, 1,311,891 shares, from reacquired stock	--	(29)	

Balances at December 31, 2001	\$ 83	\$ 697	\$
(Common shares: issued, 159,984,444; reacquired, 51,196,972)			
(Dollars in million)			
		Accumulated	
		Other	
		Comprehen-	Retained
		sive Loss	Earnings

Balances at January 1, 1999	\$ (13)	\$ 2,068	
(Common shares: issued, 154,823,496; reacquired, 53,995,692)			
Net income	--	168	
Common dividends, \$1.08 per common share	--	(111)	
Foreign currency translation adjustment	(31)	--	
Impact of allocation of shares held by ESOP	--	--	
Purchase of common stock, 126,893 shares	--	--	
Warrants issued in connection with CRESTS			
Units offering (Note 7)	--	--	
Issuance of common stock:			
Incentive plans, net, 535,220 shares from reacquired stock	--	--	
Conversion of notes and debentures, 153,234 shares	--	--	
Public offering, 5,000,000 shares	--	--	

Balances at December 31, 1999	\$ (44)	\$ 2,125	
(Common shares: issued, 159,976,730; reacquired, 53,587,365)			
Net income	--	98	
Common dividends, \$0.62 per common share	--	(66)	
Foreign currency translation adjustment	(99)	--	

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Impact of allocation of shares held by ESOP	--	--
Purchase of common stock, 174,547 shares	--	--
Issuance of common stock:		
Incentive plans, net, 1,319,519 shares, from reacquired stock	--	--
Conversion of notes and debentures, 7,714 shares	--	--

Balances at December 31, 2000	\$ (143)	\$ 2,157
(Common shares: issued, 159,984,444; reacquired, 52,442,393)		
Net loss	--	(58)
Foreign currency translation adjustment	(69)	--
Impact of allocation of shares held by ESOP	--	--
Additional minimum pension liability, net of tax	(6)	--
Purchase of common stock, 66,470 shares	--	--
Issuances of common stock:		
Incentive plans, net, 1,311,891 shares, from reacquired stock	--	--

Balances at December 31, 2001	\$ (218)	\$ 2,099
(Common shares: issued, 159,984,444; reacquired, 51,196,972)		

The accompanying accounting policies and notes are an integral part of the consolidated financial statements.

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HERCULES INCORPORATED CONSOLIDATED STATEMENT OF COMPREHENSIVE (LOSS) INCOME

	(Dollars in millions)		
	Year Ended December 31,		
	2001	2000	1999
	----	----	----
Net (loss) income	\$ (58)	\$ 98	\$ 168
Foreign currency translation	(69)	(99)	(31)
Additional minimum pension liability, net of tax	(6)	--	--
	-----	-----	-----
Comprehensive (loss) income	\$ (133)	\$ (1)	\$ 137
	=====	=====	=====

The accompanying accounting policies and notes are an integral part of the consolidated financial statements.

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HERCULES INCORPORATED SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

PRINCIPLES OF CONSOLIDATION

The Consolidated Financial Statements include the accounts of Hercules and all majority-owned subsidiaries where control exists. Following the acquisition of BetzDearborn, the Company continued BetzDearborn's practice of using a November 30 fiscal year-end for certain former BetzDearborn non-U.S. subsidiaries to expedite the year-end closing process. All intercompany

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transactions and profits have been eliminated. Investments in affiliated companies with a 20% or greater ownership interest are accounted for using the equity method of accounting and, accordingly, consolidated income includes Hercules' share of their income.

USE OF ESTIMATES

Preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

REVENUE RECOGNITION

The Company recognizes revenue when the earnings process is complete. This generally occurs when products are shipped to the customer or services are performed in accordance with terms of the agreement, title and risk of loss have been transferred, collectibility is probable and pricing is fixed and determinable. Accruals are made for sales returns and other allowances based on the Company's experience. The corresponding shipping and handling costs are included in cost of sales.

RESEARCH AND DEVELOPMENT EXPENDITURES

Research and development expenditures are expensed as incurred.

ENVIRONMENTAL EXPENDITURES

Environmental expenditures that pertain to current operations or future revenues are expensed or capitalized according to the Company's capitalization policy. Expenditures for remediation of an existing condition caused by past operations that do not contribute to current or future revenues are expensed. Liabilities are recognized for remedial activities when the cleanup is probable and the cost can be reasonably estimated.

CASH AND CASH EQUIVALENTS

Cash in excess of operating requirements is invested in short-term, income-producing instruments. Cash equivalents include commercial paper and other securities with original maturities of 90 days or less. Book value approximates fair value because of the short maturity of those instruments.

INVENTORIES

Inventories are stated at the lower of cost or market. Domestic inventories are valued predominantly on the last-in, first-out (LIFO) method. Foreign and certain domestic inventories, which in the aggregate represented 66% and 67%, respectively, of total inventories at December 31, 2001 and 2000, are valued principally on the average-cost method. Elements of costs in inventories include raw materials, direct labor and manufacturing overhead.

PROPERTY AND DEPRECIATION

Property, plant and equipment are stated at cost. The Company changed to the straight-line method of depreciation, effective January 1, 1991, for newly acquired processing facilities and equipment. Assets acquired before then continue to be depreciated by accelerated methods. The Company believes straight-line depreciation provides a better matching of costs and revenues over the lives of the assets. The estimated useful lives of depreciable assets are as follows: buildings - 30 years; plant machinery and equipment - 15 years; other machinery and equipment - 3 to 15 years.

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Maintenance, repairs and minor renewals are charged to income; major renewals and betterments are capitalized. Upon normal retirement or replacement, the net book value of property (less proceeds of sale or salvage) is charged to income.

GOODWILL AND OTHER INTANGIBLE ASSETS

Goodwill and other intangible assets have been amortized on a straight-line basis over the estimated future periods to be benefited, generally 40 years for goodwill, customer relationships and trademarks and tradenames and 5 to 15 years for other intangible assets. Pursuant to Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" (SFAS 142), beginning January 1, 2002, goodwill will not be amortized but will be tested for impairment annually and any necessary adjustment charged to expense. Intangible assets with finite lives will be amortized over their useful lives.

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HERCULES INCORPORATED SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

LONG-LIVED ASSETS

The Company reviews its long-lived assets, including goodwill and other intangibles, for impairment on an exception basis whenever events or changes in circumstances indicate carrying amounts of the assets may not be recoverable through undiscounted future cash flows. If an impairment loss has occurred based on expected future cash flows (undiscounted), the loss is recognized in the income statement. The amount of the impairment loss is the excess of the carrying amount of the impaired asset over the fair value of the asset. The fair value represents expected future cash flows from the use of the assets, discounted at the rate used to evaluate potential investments.

INCOME TAXES

The provision for income taxes has been determined using the asset and liability approach for accounting for income taxes. Under this approach, deferred taxes represent the future tax consequences expected to occur when the reported amounts of assets and liabilities are recovered or paid. The provision for income taxes represents income taxes paid or payable for the current year plus the change in deferred taxes during the year. Deferred taxes result from differences between the financial and tax basis of the Company's assets and liabilities and are adjusted for changes in tax rates and tax laws when changes are enacted. Valuation allowances are recorded to reduce deferred tax assets when it is more likely than not that a tax benefit will not be realized.

FOREIGN CURRENCY TRANSLATION

The financial statements of Hercules' non-U.S. entities are translated into U.S. dollars using current rates of exchange, with gains or losses included in accumulated other comprehensive losses.

DERIVATIVE INSTRUMENTS AND HEDGING

On January 1, 2001, the Company adopted Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS 133"). SFAS 133, as amended by Statement No. 137, "Accounting for Derivative Instruments and Hedging Activity - Deferral of the Effective Date of FASB Statement No. 133," and Statement No. 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities," requires that all

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derivative instruments be recorded on the balance sheet at their fair values. The Company has not designated any derivative as a hedge instrument and accordingly, changes in fair value of derivatives are recorded each period in earnings. The adoption of SFAS 133 did not result in a pre-tax or post-tax cumulative-effect-type adjustment to income and did not result in a change to other comprehensive losses. Under procedures and controls established by the Company's risk management policies, the Company strategically enters into contractual arrangements (derivatives) in the ordinary course of business to reduce the exposure to foreign currency rates and interest rates.

The Company's risk management policies establish a variety of approved derivative instruments to be utilized in each risk management program and the level of exposure coverage based on the assessment of risk factors. Derivative instruments utilized include forwards, swaps and options. The Company has not designated any non-derivatives as hedging instruments. The Company uses forward exchange contracts and options, generally no greater than three months in term, to reduce its net currency exposure. The objective of this program is to maintain an overall balanced position in foreign currencies so that exchange gains and losses resulting from exchange rate changes are minimized. The Company has used interest rate swap agreements to manage interest costs and risks associated with changing rates.

Counterparties to the forward exchange, currency swap, options and interest swap contracts are major financial institutions. Credit loss from counterparty nonperformance is not anticipated.

STOCK-BASED COMPENSATION

Compensation costs attributable to stock option and similar plans are recognized based on any excess of the quoted market price of the stock on the date of grant over the amount the employee is required to pay to acquire the stock (the intrinsic-value method under Accounting Principles Board Opinion 25 ("APB 25")). Such amount, if any, is accrued over the related vesting period, as appropriate. Statement of Financial Accounting Standard No. 123, "Accounting for Stock-Based Compensation" ("SFAS 123"), requires companies electing to continue to use the intrinsic-value method to make pro forma disclosures of net income and earnings per share as if the fair-value-based method of accounting had been applied.

COMPUTER SOFTWARE COSTS

Effective January 1, 1999, the Company adopted the American Institute of Certified Public Accountants Statement of Position 98-1, "Accounting for the Cost of Computer Software Developed or Obtained for Internal Use" (SOP 98-1). The Company's prior accounting was generally consistent with the requirements of SOP 98-1 and, accordingly, adoption of SOP 98-1 had no material effect. Computer software costs are being amortized over a period of 5 to 10 years.

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HERCULES INCORPORATED SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

RECENT ACCOUNTING PRONOUNCEMENTS

In June 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 141, "Business Combinations" ("SFAS 141"), and Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" ("SFAS 142"). SFAS 141 supersedes Accounting

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Principles Board Opinion ("APB") No. 16, Business Combinations. The Provisions of SFAS 141 (1) require that the purchase method of accounting be used for all business combinations initiated after June 30, 2001, (2) provide specific criteria for the initial recognition and measurement of intangible assets apart from goodwill and (3) require that unamortized negative goodwill be written off immediately as extraordinary gain instead of being deferred and amortized. SFAS 141 also requires that upon adoption of SFAS 142 the Company reclassify the carrying amounts of certain intangible assets into or out of goodwill, based on certain criteria. SFAS 142 supersedes APB No. 17, Intangible Assets, and is effective for fiscal years beginning after December 15, 2001. SFAS 142 primarily addresses the accounting for goodwill and intangible assets subsequent to their initial recognition. The provisions of SFAS 142 (1) prohibit the amortization of goodwill and indefinite-lived intangible assets, (2) require that goodwill and indefinite-lived intangible assets be tested annually for impairment (and in interim periods if certain events occur indicating that the carrying value of goodwill and/or indefinite-lived intangible assets may be impaired), based on fair value (as opposed to cost recovery using future undiscounted cash flows), (3) require that reporting units be identified for the purpose of assessing potential future impairments of goodwill and (4) remove the forty-year limitation on the amortization period of intangible assets that have finite lives.

The Company will adopt the provisions of SFAS 142 in its first quarter ended March 31, 2002. The Company is in the process of preparing for its adoption of SFAS 142 and is making the determinations as to what its reporting units are and what amounts of goodwill, intangible assets, other assets and liabilities should be allocated to those reporting units. In connection with the adoption of SFAS 142, the Company will reclassify \$47 million of assembled workforce intangible assets to goodwill. The Company will no longer record \$49 million of annual amortization relating to existing goodwill and intangibles, as adjusted for the reclassifications just mentioned.

SFAS 142 requires that goodwill be tested upon transition and annually thereafter for impairment using a two-step process. The first step is to identify a potential impairment and, in transition, this step must be measured as of the beginning of the fiscal year. However, the Company has six months from the date of adoption to complete the first step. The second step of the goodwill impairment test measures the amount of the impairment loss (measured as of the beginning of the year of adoption), if any, and must be completed by the end of the Company's fiscal year. The Company expects to complete both steps of its transitional impairment analysis in time to fully recognize the provisions of SFAS 142 in first quarter 2002 results.

Goodwill related to both our Water Treatment and FiberVisions businesses was evaluated for impairment at December 31, 2001 under Statement of Financial Accounting Standards No. 121 "Accounting for the Impairment of Long-Fixed Assets and for Long-Lived Assets to Be Disposed of". Such evaluations indicated that goodwill associated with these businesses was recoverable from anticipated future undiscounted cash flows. Accordingly, no impairment loss was recorded in our December 31, 2001 financial statements.

In estimating future cash flows, we assumed that both of these businesses would remain in our business portfolio for the foreseeable future, which was the most likely case based on the facts that existed as of December 31, 2001.

In addition, in June 2001, the FASB approved the issuance of Statement of Financial Accounting Standards No. 143, "Accounting for Asset Retirement Obligations" ("SFAS 143"). SFAS 143 establishes accounting standards for the recognition and measurement of legal obligations associated with the retirement of tangible long-lived assets. SFAS 143 will become effective for the Company on January 1, 2003 and requires recognition of a liability for an asset retirement obligation in the period in which it is incurred. Management is in the process

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of evaluating the impact this standard will have on the Company's financial statements.

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HERCULES INCORPORATED SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

In October 2001, the FASB issued Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS 144"). SFAS 144 addresses financial accounting and reporting for the impairment or disposal of long-lived assets. The provisions of this statement are effective for financial statements issued for fiscal years beginning after December 15, 2001. Management is in the process of evaluating the impact this standard will have on the Company's financial statements.

RECLASSIFICATIONS

Certain amounts in the 2000 and 1999 consolidated financial statements and notes have been reclassified to conform to the 2001 presentation.

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HERCULES INCORPORATED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. ACQUISITIONS AND DIVESTITURES

All acquisitions have been accounted for under the purchase method. The results of operations of the acquired businesses are included in the consolidated financial statements from the dates of acquisition.

The Company made one acquisition in 1999 and one in 2000 for an aggregate purchase price of approximately \$16 million in cash. These acquisitions included the Scripset(R) water-soluble polymer resin business of Solutia Inc. in July 1999; and Quaker Chemical Corporation's paper chemicals business in May 2000. Allocations of the purchase prices for these acquisitions resulted in approximately \$8 million of goodwill, which is being amortized over estimated useful lives ranging from 30 to 40 years.

In December 1999, the Company sold its 70% interest in Algas Marinas, its Chilean Agar business, for approximately \$27 million. The transaction resulted in a pre-tax gain of approximately \$16 million. This unit was included in the Functional Products segment and contributed approximately \$24 million of revenue to this segment in 1999.

On September 28, 2000, the Company sold its Food Gums business to CP Kelco, a joint venture the Company entered into with Lehman Brothers Merchant Banking Partners II, L.P., which contributed approximately \$300 million in equity. The Company received approximately \$395 million in cash proceeds, recorded certain selling and tax expenses of approximately \$77 million and retained a 28% equity position in CP Kelco. CP Kelco simultaneously acquired Pharmacia's Kelco biogums business. The net proceeds from the sale of the Food Gums business have been used to permanently reduce borrowings under Hercules' senior credit facility. Food Gums had net sales of approximately \$208 million in 1999.

On May 1, 2001, the Company completed the sale of its hydrocarbon resins

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business and select portions of its rosin resins business to a subsidiary of Eastman Chemical Company, receiving proceeds of approximately \$244 million. On May 31, 2001, the Company completed the sale of its peroxy chemicals business to GEO Specialty Chemicals, Inc., receiving proceeds of approximately \$92 million. Additionally, on May 25, 2001, the Company completed the sale of its interest in Hercules - Sanyo, Inc., a toner resin joint venture, to Sanam Corporation, a wholly owned subsidiary of Sanyo Chemicals Industries, Ltd., its joint venture partner.

The Company announced on February 12, 2002 that it has entered into an agreement to sell the BetzDearborn Division businesses and certain Pulp and Paper Division's treatment business (the "Water Treatment Business") to GE Specialty Materials ("GESM"), a unit of General Electric Company. The Paper Process Chemicals business, approximately one-third of the BetzDearborn company purchased by Hercules in 1998, will remain with Hercules. In addition, Hercules will have an agreement with GESM to distribute and service BetzDearborn's water treatment products to the pulp and paper industry. This transaction is subject to regulatory and other customary approvals, and is expected to close in the second quarter of 2002. The purchase price is \$1.8 billion in cash, with net after tax proceeds available for debt reduction of approximately \$1.665 billion.

2. ACCOUNTS AND NOTES RECEIVABLE, NET

Accounts and notes receivable, net, consists of:

	(Dollars in millions)	
	2001	2000
	----	----
Trade	\$463	\$562
Other	67	91
	----	----
Total	530	653
Less allowance for doubtful accounts	24	27
	----	----
	\$506	\$626
	====	====

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HERCULES INCORPORATED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

3. INVENTORIES

The components of inventories are:

	(Dollars in millions)	
	2001	2000
	----	----
Finished products	\$127	\$171
Raw materials and work-in-process	85	108

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Supplies	21	26
	----	----
	\$233	\$305
	=====	=====

Inventories valued on the LIFO method were lower than if valued under the average-cost method, which approximates current cost, by \$20 and \$31 million, respectively, at December 31, 2001 and 2000. The average-cost basis of inventories subject to LIFO was \$100 million and \$132 million at December 31, 2001 and 2000, respectively.

4. INVESTMENTS

Total equity investments in affiliated companies were \$29 million at December 31, 2001 and \$40 million at December 31, 2000. As of December 31, 2000, the Company retained a 28% equity position with a historical cost basis of \$30 million in CP Kelco. The investment in CP Kelco at December 31, 2001 was \$26 million.

Other investments, at cost or less, were \$14 million and \$13 million at December 31, 2001 and 2000, respectively. Included in these amounts are non-current marketable securities aggregating \$12 million for both years which are classified as "available for sale." The value of these investments, based upon market quotes, approximates book values.

5. SHORT-TERM DEBT

A summary of short-term debt follows:

	(Dollars in millions)	
	2001	2000
	----	----
Banks	\$ 9	\$118
Current maturities of long-term debt	242	143
	----	----
	\$251	\$261
	=====	=====

Bank borrowings represent primarily foreign overdraft facilities and short-term lines of credit, which are generally payable on demand with interest at various rates. Book values of bank borrowings approximate market value because of their short maturity period.

At December 31, 2001, Hercules had \$42 million of unused short-term lines of credit that may be drawn as needed, with interest at a negotiated spread over lenders' cost of funds. However, actual availability for these lines of credit is constrained by the Company's ability to meet covenants in its senior credit facility. Weighted-average interest rates on short-term borrowings at December 31, 2001 and 2000 were 6.64% and 5.88%, respectively.

6. LONG-TERM DEBT

A summary of long-term debt follows:

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

	(Dollars in millions)	
	2001	2000
	----	----
6.60% notes due 2027 (a)	\$ 100	\$ 100
6.625% notes due 2003 (b)	125	125
11.125% senior notes due 2007 (c)	400	400
8% convertible subordinated debentures due 2010 (d)	3	3
Term loan tranche A due in varying amounts through 2003 (e)	543	875
Term loan tranche D due 2005 (e)	372	375
Revolving credit agreement due 2003 (e)	516	437
ESOP debt (f)	84	101
Term notes at various rates from 5.23% to 9.72% due in varying amounts through 2006 (g)	52	65
Other	6	4
	-----	-----
Current maturities of long-term debt	\$ 2,201 (242)	\$ 2,485 (143)
	-----	-----
Net long-term debt	\$ 1,959 =====	\$ 2,342 =====

(a) 30-year debentures with a 10-year put option, exercisable by bondholder at a redemption price equal to principal amount.

(b) Par value of \$125 million issued June 1993.

(c) The senior notes accrue interest at 11 1/8% per annum, payable semi-annually. The senior notes are guaranteed by each of Hercules' current and future wholly owned domestic restricted subsidiaries. At any time prior to November 15, 2003, Hercules may on any one or more occasions, redeem up to 35% of the aggregate principal amount of the senior notes issued at a redemption price of 111.125% of the principal amount, plus accrued and unpaid interest and liquidated damages, if any, to the redemption date, with the net cash proceeds of one or more public equity offerings; provided that (i) at least 65% of the aggregate principal amount of the senior notes issued under the indenture remains outstanding immediately after the occurrence of such redemption (excluding notes held by Hercules and its subsidiaries); and (ii) the redemption occurs within 45 days of the date of the closing of such public equity offering. Except as described above, the senior notes will not be redeemable at Hercules' option prior to maturity. Hercules is not required to make mandatory redemption or sinking fund payments with respect to senior notes. If a change of control occurs, each holder of the notes will have the right to require Hercules to repurchase all or any part of that Holder's notes pursuant to a change of control offer on the terms set forth in the indenture. In the change of control offer, Hercules will offer a change of control payment in cash equal to 101% of the aggregate principal amount of the notes repurchased plus accrued and unpaid interest and liquidated damages, if any, on the notes repurchased, to the date of purchase. The notes were subject to a registration rights agreement that required Hercules to file an exchange offer registration statement with the Securities and Exchange Commission within 270 days (no later than August 11, 2001)

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and to use its best efforts to have the registration statement declared effective within 330 days. On August 9, 2001, Hercules filed a Registration Statement on Form S-4 with the Securities and Exchange Commission, pursuant to which the Company offered to exchange all of its \$400 million aggregate principal amount of 11 1/8% Senior Notes due 2007 ("old notes") for \$400 million aggregate principal amount of 11 1/8% senior notes due 2007 ("new notes"). The form and terms of the new notes are the same as the form and terms of the old notes except that, because the issuance of the new notes is registered under the Securities Act, the new notes do not bear legends restricting their transfer and are not entitled to certain registration rights under the registration rights agreement. The new notes evidence the same debt as the old notes and the new notes and the old notes are governed by the same indenture. On October 31, 2001, Hercules filed Amendment No. 1 to the Registration Statement on Form S-4 with the Securities and Exchange Commission and the Registration Statement became effective. Hercules did not receive any proceeds from the exchange offer. When the exchange offer expired on December 7, 2001, \$375.3 million of the old notes had been tendered for a like amount of new notes.

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HERCULES INCORPORATED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

- (d) The convertible subordinated debentures are convertible into common stock at \$14.90 per share and are redeemable at the option of the Company at varying rates. The annual sinking fund requirement of \$5 million, beginning in 1996, has been satisfied through conversions of debentures.
- (e) The BetzDearborn acquisition was financed with borrowings under a \$3,650 million credit facility with a syndicate of banks, and was consummated on October 15, 1998. The syndication included three tranches of varying maturity term loans totaling \$2,750 million, of which \$543 million was outstanding at year end 2001, and a \$900 million revolving credit agreement of which \$516 million was outstanding at year end 2001. On April 19, 1999, the credit agreement was amended to allow borrowings in euros, as well as U.S. dollars. Approximately U.S. \$950 million of term loan tranche A domestic borrowings were converted into indebtedness denominated in euros during the second quarter 1999. In addition, a Canadian subsidiary of the Company can borrow up to U.S. \$100 million from select lenders in Canada in Canadian dollars that bears interest at Bankers' Acceptances Rate plus 2.75% at December 31, 2001. Interest rates are reset for one, three or six month periods at the Company's option. The Company's credit agreement contains various restrictive covenants that, among other things, require maintenance of certain financial covenants: leverage, net worth and interest coverage, and provides that the entry of judgment or judgments involving aggregate liabilities of \$50 million or more be vacated, discharged, stayed or bonded pending appeal within 60 days of entry. Issuance costs related to the financing are included in deferred charges and other assets and are being amortized over the term of the loans, using the effective interest method. As of December 31, 2001, \$292 million of the \$900 million multi-currency revolver is available for use. However, actual availability under the revolving credit agreement is constrained by the Company's ability to meet covenants in its senior credit facility. At December 31, 2001, the Company's incremental borrowing capacity was \$58 million. Effective November 14, 2000, the

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senior credit facility and the ESOP credit facility were amended to (i) modify certain financial covenants; (ii) change the mandatory prepayment provisions; and (iii) provide for security, among other things. The senior credit facility amendments were conditioned upon, among other things, the issuance by the Company of the 11 1/8% senior notes and term loan tranche D (described below). The amendment to the senior credit facility increased the interest rate on amounts outstanding under the revolving credit agreement and term loan tranche A to LIBOR + 2.25%. The senior credit facility and ESOP credit facility, as amended, are secured by liens on the Company's property and assets, a pledge of the stock of substantially all of Hercules' domestic subsidiaries and 65% of the stock of first tier foreign subsidiaries and a pledge of domestic intercompany indebtedness. In connection with the amendments to the senior credit facility and the ESOP credit facility, the 6.60% notes due 2027 and the 6.625% notes due 2003 were also secured as required by the indenture under which such notes were issued. On January 23, 2001, Hercules' corporate credit rating was downgraded by Standard & Poor's Rating Services to BB which resulted in an increase to the interest rates under the revolving credit agreement and term loan tranche A to LIBOR + 2.75% (5.03% at December 31, 2001). On November 14, 2000, in conjunction with and conditioned upon the effectiveness of the amendment, the Company borrowed \$375 million under the senior credit facility (term loan tranche D) and Hercules' issued \$400 million of 11 1/8% senior notes due 2007. Term loan tranche D initially bore interest at LIBOR + 2.75%, matures on November 15, 2005, and will require only nominal principal payments prior to maturity. On January 23, 2001, the corporate credit rating downgrade by Standard & Poor's Rating Services resulted in an increase to the Company's interest rate on tranche D to LIBOR + 3.25% (5.87% at December 31, 2001). Due to the delay in closing the Eastman transaction, which in turn delayed the pay down of the debt, the Company's debt as of March 31, 2001 was significantly higher than planned. As a result, the Company would have been out of compliance with the debt/EBITDA ratio of its senior credit facility as of March 31, 2001. In addition, due to the fact that the Company extended the filing date for the 2000 10-K, the Company's annual audited financial statements were not provided to the lenders by March 31, 2001. On April 5, 2001, in consideration for the payment of a fee, the senior credit facility bank syndicate and ESOP lender granted waivers with respect to: (1) compliance with the debt/EBITDA ratio as of March 31, 2001 and (2) an extension of time to deliver the December 31, 2000 audited financial statements to April 17, 2001. These statements were delivered on April 17, 2001. With respect to the covenant regarding the debt/EBITDA ratio, the waiver required that the Eastman transaction be consummated on or before May 31, 2001. In addition, the Company had to demonstrate, as of the last day of the month in which the Eastman transaction closed, that the leverage ratio did not exceed 4.75 to 1.00 after giving affect to the application of the net cash proceeds from the Eastman transaction to prepay portions of the tranche A term loan and the ESOP credit facility. The Company achieved this leverage ratio. The Eastman and Peroxide transactions closed in May 2001. In order to facilitate the

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GE Transaction, the Company was required to obtain amendments to its senior credit facility and ESOP credit facilities (the "Facilities"). Effective March 6, 2002, Facilities were amended to (i) modify certain financial covenants (ii) change the mandatory prepayment provisions; (iii) permit the reorganization of the Company in order to effect the separation of the Water Treatment Business; and (iv) permanently reduce the revolving committed amount under the credit facility to \$200 million. The amendment to the credit facility also included provisions that are effective only upon the consummation of the sale of the Water Treatment Business and the prepayment of the credit facility. These additional provisions include the following: (i) the release of the subsidiary stock pledged to the collateral agent; (ii) the elimination of the requirement that stock of any additional subsidiaries be pledged in the future; and (iii) the revision of the permitted amount of asset purchases and dispositions. If the GE Transaction does not close by July 15, 2002, the financial covenants set forth in the Fifth Amendment revert back to the previously established levels. While, as indicated above, the Company expects to remain in compliance with its debt covenants, current and future compliance is dependent upon generating sufficient EBITDA and cash flow which are, in turn, impacted by business performance, economic climate, competitive uncertainties and possibly the resolution of contingencies, including those set forth in Note 22 to the consolidated financial statements. In the event the Company is not in compliance with the debt covenants in the future it will pursue various alternatives, which may include, among other things, refinancing of debt, debt covenant amendments or debt covenant waivers. While the Company believes that it would be successful in pursuing these alternatives, there can be no assurance that the Company would be successful.

- (f) The Company assumed a \$94 million loan related to the BetzDearborn ESOP Trust. The proceeds of the loan were originally used by the ESOP Trust for the purchase of BetzDearborn preferred shares that, upon acquisition by Hercules, were converted into equivalent shares of Hercules common stock (see Note 10). The loan was recorded at a fair market value of \$110 million at the date of acquisition, and the \$16 million fair value step-up is being amortized over the term of the debt. The loan and guarantee mature in June 2009. Effective November 14, 2000, the senior credit facility and the ESOP credit facility were amended. The senior credit facility and ESOP credit facility, as amended, are secured by liens on the Company's property and assets, a pledge of the stock of substantially all of Hercules' domestic subsidiaries and 65% of the stock of first tier foreign subsidiaries and a pledge of domestic intercompany indebtedness. Effective with the third amendment, the interest rate was increased to 11.95%. Effective January 23, 2001, as a result of the lowered credit rating, the interest rate on the loan and guarantee increased to 12.95%. As a result of the Company's divestiture in May 2001 of its hydrocarbon resins business and select portions of its rosin resins business to a subsidiary of Eastman Chemical Company and its peroxy chemicals business to GEO Specialty Chemicals Inc., the Company was required to use a portion of the proceeds to prepay the ESOP credit facility. The Company paid \$13 million against the loan principal, resulting in the incurrence of \$5 million in pre-payment penalties which were expensed (see Note 16).
- (g) Debt assumed in conjunction with the acquisition of FiberVisions L.L.C., net of repayments through December 31, 2001.

Long-term debt maturities during the next five years are \$242 million in 2002, \$985 million in 2003, \$23 million in 2004, \$383 million in 2005 and \$15

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million in 2006.

7. COMPANY-OBLIGATED PREFERRED SECURITIES OF SUBSIDIARY TRUSTS

Redeemable Hybrid INcome Overnight Shares

In November 1998, Hercules Trust V, the Company's wholly owned consolidated subsidiary, completed a private placement of \$200 million Redeemable Hybrid INcome Overnight Shares (RHINOS). The Company repaid the RHINOS with a portion of the proceeds from the offering of 11 1/8% senior notes on November 14, 2000.

Trust Originated Preferred Securities

In March 1999, Hercules Trust I ("Trust I"), the Company's wholly owned consolidated subsidiary trust, completed a \$362 million underwritten public offering of 14,500,000 shares of 9.42% Trust Originated Preferred Securities. Trust I invested the proceeds from the sale of the preferred securities in an equal principal amount of 9.42% Junior Subordinated Deferrable Interest Debentures of Hercules due March 2029. The Company used these proceeds to repay long-term debt.

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HERCULES INCORPORATED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Trust I distributes quarterly cash payments it receives from the Company on the Debentures to preferred security holders at an annual rate of 9.42% on the liquidation amount of \$25 per preferred security. The Company may defer interest payments on the debentures at any time, for up to 20 consecutive quarters. If this occurs, Trust I will also defer distribution payments on the preferred securities. The deferred distributions, however, will accumulate distributions at a rate of 9.42% per annum.

Trust I will redeem the preferred securities when the debentures are repaid at maturity on March 31, 2029. The Company may redeem the Debentures, in whole or, on or after March 17, 2004, in part, before their maturity at a price equal to 100% of the principal amount of the debentures redeemed, plus accrued interest. When the Company redeems any Debentures before their maturity, Trust I will use the cash it receives to redeem preferred securities and common securities as provided in the trust agreement. The Company guarantees the obligations of Trust I on the preferred securities.

CRESTS Units

In July 1999, the Company completed a public offering of 350,000 CRESTS Units with Hercules Trust II, a wholly owned consolidated subsidiary trust ("Trust II"). This transaction provided net proceeds to the Company and Trust II of \$340.4 million. Each CRESTS Unit consists of one preferred security of Trust II and one warrant to purchase 23.4192 shares of the Company's common stock at an initial exercise price of \$1,000 (equivalent to \$42.70 per share). The preferred security component of the CRESTS Units was initially valued at \$741.46 per unit and the warrant component of the CRESTS Units was initially valued at \$258.54 per warrant. The preferred security and warrant components of each CRESTS Unit may be separated and transferred independently. The warrants may be exercised, subject to certain conditions, at any time before March 31, 2029, unless there is a reset and remarketing event. No reset and remarketing event will occur before July 27, 2004, unless all of its common stock is acquired in a transaction that includes cash for a price above a predetermined level. Trust II used the proceeds from the sale of its preferred securities to purchase junior

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subordinated deferrable interest debentures of Hercules. As of December 31, 2001, no warrants had been exercised.

The Company pays interest on the debentures, and Trust II pays distributions on its preferred securities. Both are paid quarterly at an annual rate of 6 1/2% of the scheduled liquidation amount of \$1,000 per debenture and/or preferred security until the scheduled maturity date and redemption date of June 30, 2029, unless there is a reset and remarketing event. The Company guarantees payments by Trust II on its preferred securities. Trust II must redeem the preferred securities when the debentures are redeemed or repaid at maturity.

The Company used the proceeds from the CRESTS Units offering to repay long-term debt. Issuance costs related to the preferred security component of the CRESTS Units are being amortized over the life of the security and costs related to the warrants were charged to additional paid-in capital.

Floating Rate Preferred Securities

In December 1999, Hercules Trust VI, the Company's wholly owned consolidated subsidiary trust ("Trust VI"), completed a \$170 million private offering of 170,000 shares of Floating Rate Preferred Securities. The Company repaid the debentures with a portion of the proceeds from the offering of the 11 1/8% senior notes on December 29, 2000.

8. SERIES PREFERRED STOCK

There are 2,000,000 shares of series preferred stock without par value authorized for issuance, none of which have been issued.

9. COMMON STOCK

Hercules common stock has a stated value of \$25/48, and 300,000,000 shares are authorized for issuance. At December 31, 2001, a total of 28,602,168 shares were reserved for issuance for the following purposes: 71,190 shares for sales to the Savings Plan Trustee; 18,892,273 shares for the exercise of awards under the Stock Option Plan; 1,265,493 shares for awards under incentive compensation plans; 176,492 shares for conversion of debentures and notes; and 8,196,720 shares for exercise of the warrant component of the CRESTS Units.

For the Company's stock repurchase program, from its start in 1991 through year-end 2001, the Board authorized the repurchase of up to 74,650,000 shares of Company common stock. Of that total, 6,150,000 shares were intended to satisfy requirements of various employee benefit programs. During this period, a total of 66,858,726 shares of common stock were purchased in the open market at an average price of \$37.26 per share.

HERCULES INCORPORATED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

In July 1999, Hercules completed a public offering of 5,000,000 shares of its common stock, which provided the Company with proceeds of \$171.5 million, net of underwriting fees of \$3.5 million. Hercules used the proceeds from the common stock offering for the partial repayment of a term loan under its credit facility. Issuance costs associated with the stock offering were charged to additional paid-in capital.

10. EMPLOYEE STOCK OWNERSHIP PLAN (ESOP)

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In connection with the acquisition of BetzDearborn in 1998, the Company acquired BetzDearborn's ESOP and related trust as a long-term benefit for substantially all of BetzDearborn's U.S. employees. The plan is a supplement to BetzDearborn's 401(k) plan. The ESOP trust had long-term debt of \$75 million and \$91 million at December 31, 2001 and 2000, respectively, which is guaranteed by Hercules. Upon acquisition, the debt had a fair value in excess of its recorded amount for which a \$16 million step-up was recorded and is being amortized over the remaining term of the debt. The fair value, included in long-term debt, was \$84 million and \$101 million at December 31, 2001 and 2000, respectively. The proceeds of the original loan were used to purchase BetzDearborn convertible preferred stock, which, at the date of acquisition, was converted into Hercules common stock.

Under the provisions of the BetzDearborn 401(k) program, employees may invest 2% to 15% of eligible compensation. The Company's matching contributions, made in the form of Hercules common stock, are equal to 50% of the first 6% of employee contributions, and fully vest to employees upon the completion of 5 years of service. The Company's matching contributions are included in ESOP expense.

The Company's contributions and dividends on the shares held by the trust are used to repay the loan, and the shares are allocated to participants as the principal and interest are paid. The Company's common stock dividends were suspended during the fourth quarter of 2000. Long-term debt is reduced as payments are made on the third party financing. In addition, unearned compensation is also reduced as the shares are allocated to employees. The unallocated shares held by the trust are reflected in unearned compensation as a reduction in stockholders' equity on the balance sheet for \$104 million and \$115 million at December 31, 2001 and 2000, respectively.

	2001 ----	2000 ----
Allocated	2,075,687	1,858,459
Unallocated	3,228,690	3,582,334
	-----	-----
Total shares held by ESOP	5,304,377	5,440,793
	=====	=====

The ESOP expense is calculated using the shares-allocated method and includes net interest incurred on the debt of \$8 million and \$6 million for 2001 and 2000, respectively. The Company is required to make quarterly contributions to the plan, which enable the trust to service its indebtedness. Net ESOP expense is comprised of the following elements:

	(Dollars in millions)	
	2001 ----	2000 ----
ESOP expense	\$ 19	\$ 13
Common stock dividends (charged to retained earnings)	--	(3)
	----	----
Net ESOP expense	\$ 19	\$ 10
	----	----
ESOP Contributions	\$ 15	\$ 10
	=====	=====

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11. LONG-TERM INCENTIVE COMPENSATION PLANS

The Company's long-term incentive compensation plans provide for the grant of stock options and the award of common stock and other market-based units to certain key employees and non-employee directors. Through 1994, shares of common stock awarded under these plans normally were either restricted stock or performance shares. During the restriction period, award holders have the rights of stockholders, including the right to vote and receive cash dividends, but they cannot transfer ownership.

In 1995, Hercules changed the structure of the long-term incentive compensation plans to place a greater emphasis on shareholder value creation through grants of regular stock options, performance-accelerated stock options and Cash Value Awards (performance-based awards denominated in cash and payable in shares of common or restricted stock, subject to the same restrictions as restricted stock). Restricted stock and other market-based units are awarded with respect to certain

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HERCULES INCORPORATED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

programs. The number of awarded shares outstanding was 189,704 at December 31, 2001, and 491,488 and 926,689 at December 31, 2000 and 1999, respectively.

At December 31, 2001, under the Company's incentive compensation plans, 1,265,493 shares of common stock were available for grant as stock awards or stock option awards. Stock awards are limited to approximately 15% of the total authorizations. Regular stock options are granted at the market price on the date of grant and are exercisable at various periods from one to five years after date of grant. Performance-accelerated stock options are also granted at the market price on the date of grant and are normally exercisable at nine and one-half years. Exercisability may be accelerated based upon the achievement of predetermined performance goals. Both regular and performance-accelerated stock options expire 10 years after the date of grant.

Restricted shares, options and performance-accelerated stock options are forfeited and revert to the Company in the event of employment termination, except in the case of death, disability, retirement, or other specified events.

The Company applies APB Opinion 25 in accounting for its plans. Accordingly, no compensation cost has been recognized for the stock option plans. The cost of stock awards and other market-based units, which are charged to income over the restriction or performance period, amounted to \$2 million for 2001, \$1 million for 2000 and \$3 million for 1999.

Below is a summary of outstanding stock option grants under the incentive compensation plans during 1999, 2000 and 2001:

	Regular		Performance-Accelerated	
	Number of Shares	Weighted-average Price	Number of Shares	Weighted-average Price
December 31, 1998	6,351,278	\$37.83	5,031,252	\$46.12

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Granted	1,705,335	\$37.49	1,079,455	\$36.52
Exercised	(94,275)	\$22.07	--	--
Forfeited	(158,780)	\$37.80	(99,866)	\$44.41
December 31, 1999	7,803,558	\$37.94	6,010,841	\$44.42
Granted	3,418,275	\$16.75	187,500	\$14.06
Exercised	(28,500)	\$11.83	--	--
Forfeited	(217,405)	\$34.30	(38,916)	\$42.31
December 31, 2000	10,975,928	\$31.49	6,159,425	\$43.51
Granted	2,781,675	\$11.60	--	--
Exercised	(44,400)	\$15.01	(187,500)	\$14.06
Forfeited	(663,255)	\$25.89	(129,600)	\$43.61
December 31, 2001	13,049,948	\$27.42	5,842,325	\$44.45

The weighted-average fair value of regular stock options granted during 1999, 2000 and 2001 was \$8.18, \$7.19 and \$5.91 respectively. The weighted-average fair value of performance-accelerated stock options granted during 1999 and 2000 was \$7.82 and \$5.86, respectively. There were no performance-accelerated stock options granted during 2001.

Following is a summary of regular stock options exercisable at December 31, 1999, 2000 and 2001, and their respective weighted-average share prices:

Options Exercisable	Number of Shares	Weighted-average Exercise Price
December 31, 1999	4,651,273	\$39.95
December 31, 2000	6,237,147	\$38.43
December 31, 2001	9,297,983	\$32.97

At December 31, 2000 and 2001, respectively, there were 50,000 and 75,000 performance-accelerated stock options exercisable at a weighted average exercise price of \$47.00 per share. There were no performance-accelerated stock options exercisable at December 31, 1999.

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Following is a summary of stock options outstanding at December 31, 2001:

Exercise Price Range	Outstanding Options		
	Number Outstanding at 12/31/01	Weighted-average Remaining Contractual Life	Weighted-average Exercise Price
Regular Stock Options \$11.00 - \$15.00	3,310,800	9.40	\$12.06

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\$15.01 - \$22.50	2,708,313	7.97	\$17.23
\$22.51 - \$33.75	1,762,400	6.27	\$25.69
\$33.76 - \$40.00	3,196,910	6.09	\$38.28
\$40.01 - \$60.00	2,071,525	4.77	\$50.00

	13,049,948		
	=====		

Performance-Accelerated Stock Options

\$24.00 - \$36.00	639,225	6.99	\$31.73
\$36.01 - \$45.01	1,401,705	6.54	\$38.37
\$45.01 - \$50.00	3,027,495	4.83	\$47.10
\$50.01 - \$61.00	773,900	4.08	\$55.64

	5,842,325		
	=====		

The Company currently expects that 100% of performance-accelerated stock options will eventually vest.

The Company's Employee Stock Purchase Plan was a qualified non-compensatory plan, which allows eligible employees to acquire shares of common stock through systematic payroll deductions. The plan consists of three-month subscription periods, beginning July 1 of each year. The purchase price is 85% of the fair market value of the common stock on either the first or last day of that subscription period, whichever is lower. Purchases may range from 2% to 15% of an employee's base salary each pay period, subject to certain limitations. Shares issued at December 31, 2001 and 2000 under the qualified plan were 1,758,081 and 1,597,861 respectively. Currently, there are no shares of Hercules common stock registered for offer and sale under the plan. The plan was converted to a non-qualified employee stock purchase plan in 2001 and the shares are funded from treasury stock. The shares issued under the non-qualified plan totaled 385,255 at December 31, 2001. The Company applies APB Opinion 25 and related interpretations in accounting for its Employee Stock Purchase Plan. Accordingly, no compensation cost has been recognized for the qualified Employee Stock Purchase Plan. The 15% discount on the purchase price of the common stock has been recognized as compensation expense for the non-qualified Employee Stock Purchase Plan.

Had compensation cost for the Company's Stock-Based Incentive Plans and Employee Stock Purchase Plan been determined on the basis of fair value according to SFAS No. 123, the fair value of each option granted or share purchased would be estimated on the grant date using the Black-Scholes option pricing model.

The following weighted-average assumptions would be used in estimating fair value for 2001, 2000 and 1999:

Assumption	Regular Plan	Performance Accelerated Plan	Employee Stock Purchase Plan
-----	-----	-----	-----
Dividend yield	0.96%	3.83%	0.0%
Risk-free interest rate	5.80%	5.57%	4.86%
Expected life	7.1 yrs.	5 yrs.	3 mos.
Expected volatility	33.36%	29.78%	49.11%

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The Company's net (loss) income and (loss) earnings per share for 2001, 2000 and 1999 would approximate the pro forma amounts below:

	(Dollars in millions, except per share)		
	2001	2000	1999
	----	----	----
Net (loss) income			
As reported	\$ (58)	\$ 98	\$ 168
Pro forma	\$ (78)	\$ 74	\$ 149
Basic (loss) earnings per share			
As reported	\$ (0.54)	\$ 0.91	\$ 1.63
Pro forma	\$ (0.73)	\$ 0.69	\$ 1.45
Diluted (loss) earnings per share			
As reported	\$ (0.54)	\$ 0.91	\$ 1.62
Pro forma	\$ (0.73)	\$ 0.69	\$ 1.44

12. ADDITIONAL BALANCE SHEET DETAIL

	(Dollars in millions)	
	2001	2000
	----	----
Property, plant and equipment		
Land	\$ 34	\$ 44
Buildings and equipment	2,133	2,394
Construction in progress	67	126
	-----	-----
Total	2,234	2,564
Accumulated depreciation and amortization	(1,331)	(1,460)
	-----	-----
Property, plant and equipment, net	\$ 903	\$ 1,104
	=====	=====

	(Dollars in millions)	
	2001	2000
	----	----
Accrued expenses		
Payroll and employee benefits	\$ 60	\$ 78
Income taxes payable	105	17
Restructuring liability	43	34
Interest payable	15	30
Current portion of postretirement benefits	23	20
Current portion of legal accrual	50	25
Current portion of environmental accrual	9	24
Other	158	174
	-----	-----

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\$463 \$402
 =====

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HERCULES INCORPORATED
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

13. GOODWILL AND OTHER INTANGIBLE ASSETS

At December 31, 2001 and 2000, the goodwill and other intangible assets were:

	(Dollars in millions)	
	2001	2000
	----	----
Goodwill	\$ 1,985	\$ 2,022
Customer relationships	335	342
Trademarks and tradenames	255	260
Other intangibles	205	209
	-----	-----
Total	2,780	2,833
Less accumulated amortization	(304)	(223)
	-----	-----
Goodwill and other intangible assets, net	\$ 2,476	\$ 2,610
	=====	=====

14. RESTRUCTURING

The consolidated balance sheet reflects liabilities for employee severance benefits and other exit costs of \$43 million and \$34 million, respectively, at December 31, 2001 and 2000. During the third quarter of 2001, management authorized and committed to a plan to reduce the workforce as part of the comprehensive cost reduction and work process redesign program. The Company incurred restructuring charges of \$45 million, which includes charges of \$41 million for employee termination benefits and \$4 million for exit costs related to facility closures. During the fourth quarter of 2001, the estimate for severance benefits and for exit costs related to facility closures increased \$5 million and \$1 million, respectively. Under this plan, approximately 975 employees have left or will leave the Company. The plan includes reductions throughout the Company with the majority of them from support functions as well as the Process Chemicals and Services segment.

The restructuring liabilities also include amounts relating to the 1998 plan initiated upon the acquisition of BetzDearborn and additional plans that the Company committed to in 2000 relating to the restructuring of the Process Chemicals and Services segment and corporate realignment due to the divestiture of non-core businesses. The total number of employee terminations relating to the 1998 plan is 889. The total number of employee terminations relating to the 2000 plan is 212. Actions under the 1998 and 2000 plans were substantially complete as of December 31, 2000 and December 31, 2001, respectively.

Pursuant to the above plans, approximately 808 employees were terminated during the year ended December 31, 2001. Cash payments during 2001 and 2000 included \$25 million and \$45 million, respectively, for severance benefits and

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other exit costs. Severance benefits paid during the current year represent the continuing benefit streams of previously terminated employees as well as those terminated in the current year. During the second and third quarters of 2001, the Company completed assessments of the remaining expenditures for the 1998 BetzDearborn plan and the 2000 plans, respectively. As a result of these assessments, the estimates for severance benefits and other exit costs were lowered by \$17 million, with corresponding reductions to goodwill and expense of \$10 million and \$7 million, respectively. The lower than planned severance benefits are the result of higher than anticipated attrition, with voluntary resignations not requiring the payment of termination benefits. A reconciliation of activity with respect to the liabilities established for these plans is as follows:

	(Dollars in million)	
	2001	2000
	----	----
Balance at beginning of year	\$ 34	\$ 77
Additional termination benefits and other exit costs	51	18
Cash payments	(25)	(45)
Reversals against goodwill	(10)	(12)
Reversals against earnings	(7)	(4)
	----	----
Balance at end of year	\$ 43	\$ 34
	====	====

HERCULES INCORPORATED
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The balance at the end of the period represents severance benefits and other exit costs of which \$35 million pertains to the 2001 restructuring plan, \$5 million pertains to the 1998 BetzDearborn plan which is being paid out over multiple years and \$3 million relates to other restructuring plans initiated in 2000.

15. PENSION AND OTHER POSTRETIREMENT BENEFITS

The Company provides a defined benefit pension and postretirement benefit plans to employees. Assets of the defined benefit plan are invested in domestic and international corporate equity securities (including \$6 million of Company stock), domestic and international fixed income securities (including governments, agencies, mortgages, asset backed, corporates) and various derivative and money market securities. The following chart lists benefit obligations, plan assets and funded status of the plans.

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	Pension Benefits	
	2001	2000
	----	----
CHANGE IN BENEFIT OBLIGATION		
Benefit obligation at January 1	\$ 1,462	\$ 1,381
Service cost	25	26
Interest cost	104	105
Amendments	6	--
Assumption change	--	71
Settlements	--	(6)
Divestiture	(45)	--
Translation difference	(10)	(16)
Actuarial loss	64	12
Benefits paid from plan assets	(134)	(111)
Benefits paid by company	--	--
	-----	-----
Benefit obligation at December 31	\$ 1,472	\$ 1,462
	=====	=====
CHANGE IN PLAN ASSETS		
Fair value of plan assets at January 1	\$ 1,571	\$ 1,736
Actual return on plan assets	(95)	(44)
Actuarial loss	(27)	--
Divestiture	(26)	--
Company contributions	4	9
Settlements	--	(1)
Translation difference	(10)	(19)
Plan participant contributions	1	--
Benefits paid from plan assets	(134)	(110)
	-----	-----
Fair value of plan assets at December 31	\$ 1,284	\$ 1,571
	=====	=====
Funded status of the plans	\$ (188)	\$ 109
Unrecognized actuarial loss	380	69
Unrecognized prior service cost (benefit)	32	32
Unrecognized net transition obligation	1	1
Amount included in accrued expenses- other	--	--
	-----	-----
Net amount recognized	\$ 225	\$ 211
	=====	=====
AMOUNTS RECOGNIZED IN THE STATEMENT OF FINANCIAL POSITION CONSIST OF:		
Prepaid benefit cost	\$ 268	\$ 245
Accrued benefit liability	(53)	(34)
Deferred tax asset	4	--
Accumulated other comprehensive income	6	--
	-----	-----
Net amount recognized	\$ 225	\$ 211
	=====	=====
ASSUMPTIONS AS OF DECEMBER 31		
Weighted-average discount rate	7.25%	7.50
Expected return on plan assets	9.25%	9.25
Rate of compensation increase	4.50%	4.50

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Net Periodic Benefit (Credit) Cost

	Pension Benefits			Other Postretirement	
	2001	2000	1999	2001	2000
Service cost	\$ 25	\$ 26	\$ 30	\$ 1	\$ 1
Interest cost	104	105	97	14	14
Return on plan assets (expected)	(141)	(142)	(134)		(1)
Special termination benefits	2	4	--	--	--
Amortization and deferrals	5	3	3	(1)	(2)
Amortization of transition asset	2	(11)	(14)	--	--
	-----	-----	-----	-----	-----
Benefit (credit) cost	\$ (3)	\$ (15)	\$ (18)	\$ 14	\$ 12
	=====	=====	=====	=====	=====

At December 31, 2001, the funded benefits in the U.S. defined benefit pension plan marginally exceeded the accumulated benefit obligation ("ABO") for this plan. Based on current economic conditions and anticipated benefit payments, it is reasonably possible the ABO will exceed the funded benefits at December 31, 2002. If this occurs at December 31, 2002 (or at an earlier date if an interim valuation is required), the Company will be required to recognize an additional liability equal to the sum of such excess plus the prepaid pension asset balance, with a corresponding net-of-tax charge to other comprehensive income in stockholders' equity. The prepaid pension asset balance for the U.S. plan is approximately \$250 million at December 31, 2001.

Other Postretirement Benefits

The non-pension postretirement benefit plans are contributory health care and life insurance plans. The assumed participation rate in these plans for future eligible retirees was 60% for health care and 100% for life insurance. In August 1993, a Voluntary Employees' Beneficiary Association Trust was established and funded with \$10 million of Company funds. The Company periodically obtains reimbursement for union retiree claims, while other claims are paid from Company assets. The participant contributions are immediately used to cover claim payments, and for this reason do not appear as contributions to plan assets.

The assumed health care cost trend rate was 7.0% for the year ended December 31, 2001. The assumed health care cost trend rate was 8.0% for the year ended December 31, 2000 and 4.5% for the year ended December 31, 1999. The assumed health care cost trend rate will be 10% in 2002, decreasing to 4.5% by 2006 and for all subsequent years.

A one-percentage point increase or decrease in the assumed health care cost trend rate would increase or decrease the postretirement benefit obligation by \$6 million either way, and would not have a material effect on aggregate service and interest cost components.

As of December 31, 2001, Hercules recognized an additional minimum liability of \$6 million, net of tax, attributable to the nonqualified pension plan.

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16. OTHER OPERATING (INCOME) EXPENSES, NET

Other operating (income) expense, net, in 2001 includes \$74 million in net gains from the sale of the Company's hydrocarbon resins business, select portions of its rosin resins business, its peroxy chemicals business and its 50% interest in Hercules-Sanyo, Inc. In addition, a pension curtailment gain of \$5 million was recognized related to the divestiture of the Company's hydrocarbon resins business and select portions of its rosins resins business. As a result of resolving issues relating to a prior year business divestiture, an additional gain of \$5 million was recognized. The Company incurred \$51 million in restructuring charges associated with the comprehensive cost reduction and work process redesign program (see Note 14). Partially offsetting these restructuring charges was \$5 million of reversals pertaining to prior year plans.

In addition, the Company recognized \$10 million in net environmental expense, \$5 million of executive severance charges, \$5 million in pre-payment penalties relating to the ESOP credit facility, \$3 million in non-recurring fees related to the 2001 proxy contest and other matters and \$4 million for other items.

Other operating (income) expenses, net, in 2000 includes a gain of \$168 million from the sale of the Food Gums business. On September 28, 2000, the Company sold its Food Gums business to CP Kelco, a joint venture with Lehman Brothers Merchant Banking Partners II, L.P., which contributed approximately \$300 million in equity. The Company received approximately \$395 million in cash proceeds, recorded certain selling and tax expenses of approximately \$77

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HERCULES INCORPORATED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

million and retained a 28% equity position in CP Kelco. CP Kelco simultaneously acquired Kelco biogums business of Pharmacia Corporation (formerly Monsanto Corporation).

Partially offsetting the gain from the sale of the Food Gums business is \$66 million of charges for asset impairments and write-offs, primarily in the FiberVisions business. Restructuring charges of \$18 million, including \$4 million (below) related to the nitrocellulose divestiture, were incurred for 2000 plans, primarily relating to severance and termination benefits for approximately 212 employee terminations in its Process Chemicals and Services segment and corporate realignment due to the divestitures of its non-core businesses (Food Gums, Resins and nitrocellulose). Offsetting these restructuring charges was \$4 million of reversals relating to prior year plans. Environmental charges of \$8 million were incurred, offset by \$11 million in recoveries of insurance for environmental claims. Additionally, the Company incurred a loss of \$25 million, including \$4 million for severance and termination benefits (see Note 14), associated with the sale of the nitrocellulose business, and \$5 million associated with the integration of the BetzDearborn acquisition. Also reflected in 2000 are \$16 million of severance benefits and compensation expense not associated with restructuring plans and \$1 million for other items. The asset impairments were triggered by significantly higher raw material costs and the loss of a facility's major customer.

Other operating expenses (income), net, in 1999 included integration charges of \$36 million, primarily for employee incentive and retention, consulting, legal and other costs associated with the BetzDearborn acquisition. During 1999, the Company recognized charges of approximately \$36 million related to a legal settlement and asset write-downs and disposal costs including

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impairment losses of approximately \$16 million in the Chemical Specialties segment. Additionally, the Company recognized an additional \$3 million of severance benefits under a plan to terminate approximately 20 employees, primarily manufacturing personnel (see Note 14). The asset write-down and severance charges were incurred primarily as a result of the decisions to exit the nitrocellulose business and rationalize assets in the resins business, which will no longer be utilized. Also during 1999, the Company realized a \$16 million gain on the sale of its Agar business, a \$6 million net environmental insurance recovery, \$4 million reversal of restructuring charges and \$2 million for other items.

17. INTEREST AND DEBT EXPENSE

Interest and debt costs are summarized as follows:

	(Dollars in millions)		
	2001	2000	1999
	----	----	----
Costs incurred	\$199	\$175	\$197
Amount capitalized	3	11	12
	----	----	----
Amount expensed	\$196	\$164	\$185
	=====	=====	=====

18. OTHER EXPENSE, NET

Other expense, net, consists of the following:

	(Dollars in millions)		
	2001	2000	1999
	----	----	----
Net (gains) losses on dispositions	\$ (3)	\$ 1	\$ (10)
Legal settlements and accruals, net	16	10	7
Minority interests	(1)	--	2
Exchange and translation	(6)	(1)	1
Other, net	4	8	2
	----	----	----
	\$ 10	\$ 18	\$ 2
	=====	=====	=====

Net gains (losses) on dispositions include a \$3 million gain from the sale of the country club in 2001, a loss of \$1 million from the sale of non-operating real estate and other investments in 2000 and gains of \$10 million in 1999. Legal settlements and accruals in all years primarily represent certain other legal expenses and settlements associated with former operations of the Company.

19. INCOME TAXES

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The domestic and foreign components of income before taxes and equity (loss) income are presented below:

	(Dollars in millions)		
	2001	2000	1999
	----	----	----
Domestic	\$ (99)	\$ (15)	\$ 3
Foreign	122	181	239
	-----	-----	-----
	\$ 23	\$ 166	\$242
	=====	=====	=====

A summary of the components of the tax provision follows:

	(Dollars in millions)		
	2001	2000	1999
	----	----	----
Currently payable			
U.S. federal	\$ 69	\$ 14	\$ (25)
Foreign	58	70	82
State	13	4	(4)
Deferred			
Domestic	(60)	(21)	15
Foreign	(8)	(1)	7
	-----	-----	-----
Provision for income taxes	\$ 72	\$ 66	\$ 75
	=====	=====	=====

Deferred tax liabilities (assets) at December 31 consisted of:

	(Dollars in millions)	
	2001	2000
	----	----
Depreciation	\$ 230	\$ 232
Prepaid pension	80	68
Inventory	7	11
Investments	48	88
Goodwill	214	219
Other	90	79
	-----	-----
Gross deferred tax liabilities	\$ 669	\$ 697
	-----	-----
Postretirement benefits other than pensions	\$ (68)	\$ (70)
Accrued expenses	(204)	(172)
Loss carryforwards	(34)	(10)
Other	(93)	(104)
	-----	-----
Gross deferred tax assets	(399)	(356)
	-----	-----

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Valuation allowance	37	28
	-----	-----
	\$ 307	\$ 369
	=====	=====

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

A reconciliation of the U.S. statutory income tax rate to the effective rate follows:

	2001	2000
	-----	-----
U.S. statutory income tax rate	35%	35%
Goodwill amortization	103	14
Valuation allowances	49	3
Research and development credits	--	(6)
Tax rate differences on subsidiary earnings	(42)	(5)
Incremental tax on cash repatriations from non-US subsidiaries	24	2
State taxes	11	2
Reserves	129	(6)
Other	1	1
	-----	-----
Effective tax rate	310%	40%
	=====	=====

The net operating losses have indefinite carryforward periods, but may be limited in their use in any given year.

The Company provides taxes on undistributed earnings of subsidiaries and affiliates to the extent such earnings are planned to be remitted and not reinvested permanently. The undistributed earnings of subsidiaries and affiliates on which no provision for foreign withholding or U.S. income taxes has been made amounted to approximately \$227 million and \$246 million at December 31, 2001 and 2000, respectively. U.S. and foreign income taxes that would be payable if such earnings were distributed may be lower than the amount computed at the U.S. statutory rate because of the availability of tax credits.

20. EARNINGS PER SHARE

The following table shows the amounts used in computing earnings per share and the effect on income and the weighted-average number of shares of dilutive common stock:

	(Dollars in millions, except per share)		
	2001	2000	1999
	-----	-----	-----
BASIC EPS COMPUTATION:			
Net (loss) income	\$ (58)	\$ 98	\$ 168
	=====	=====	=====

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Weighted-average shares outstanding	108.2	107.2	103.2
	-----	-----	-----
(Loss) earnings per share	\$ (0.54)	\$ 0.91	\$ 1.63
	=====	=====	=====
DILUTED EPS COMPUTATION:			
Net (loss) income	\$ (58)	\$ 98	\$ 168
	=====	=====	=====
Weighted-average shares outstanding	108.2	107.2	103.2
Options	0.0	0.0	0.4
Convertible debentures	0.0	0.2	0.3
	-----	-----	-----
Adjusted weighted-average shares	108.2	107.4	103.9
	=====	=====	=====
(Loss) earnings per share	\$ (0.54)	\$ 0.91	\$ 1.62
	=====	=====	=====

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HERCULES INCORPORATED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

21. DERIVATIVE FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

The Company enters into forward-exchange contracts and currency swaps to reduce currency exposure. The Company used interest rate swap agreements to manage interest costs and risks associated with changing rates.

Notional Amounts and Credit Exposure of Derivatives

The notional amounts of the derivative contracts summarized below do not represent the amounts exchanged by the parties involved, and, thus, are not a measure of the Company's exposure to various risks through its use of derivatives. The amounts exchanged by the parties are calculated on the basis of the notional amounts, underlyings such as interest rates and exchange rates, and other terms of the derivative contracts.

Interest Rate Risk Management

The aggregate notional principal amount for interest rate swaps at the end of 2001 and 2000 was \$20 million for both years. These swaps act as a hedge against the Company's interest rate exposure on its outstanding variable rate debt.

During 2000, the interest rate swap portfolio, which replaced variable rate debt with fixed rate debt, was substantially terminated due to the conversion of foreign denominated debt to U.S. dollar denominated debt in the first half of 2000 and the November 2000 debt restructuring.

The following table indicates the types of swaps used and their weighted-average interest rates:

(Dollars in millions)

2001

2000

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Pay fixed on swaps notional amount (at year-end)	\$	20		\$	20
Average pay rate		6.2%			6.2%
Average receive rate		4.4%			4.3%

Foreign Exchange Risk Management

The Company has selectively used foreign currency forward contracts and currency swaps to offset the effects of exchange rate changes on reported earnings, cash flow, and net asset positions. The primary exposures are denominated in the Euro, Swedish kroner and British pound sterling. Some of the contracts involve the exchange of two foreign currencies, according to local needs in foreign subsidiaries. The term of the currency derivatives is rarely more than three months. At December 31, 2001 and 2000, the Company had outstanding forward-exchange contracts to purchase foreign currencies aggregating \$8 million and \$19 million and to sell foreign currencies aggregating \$24 million and \$39 million, respectively. Non-U.S. dollar cross-currency trades aggregated \$222 million and \$188 million at December 31, 2001 and 2000, respectively. The foreign exchange contracts outstanding at December 31, 2001 will mature by March 31, 2002.

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HERCULES INCORPORATED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Fair Values

The following table presents the carrying amounts and fair values of the Company's financial instruments at December 31, 2001 and 2000:

	(Dollars in millions)		
	2001		
	Carrying Amount	Fair Value	Carrying Amount
Investment securities (available for sale)	\$ 11	\$ 12	\$
Long-term debt	(1,959)	(1,948)	(2,000)
Company-obligated preferred securities of subsidiary trusts	(624)	(408)	(624)
Foreign exchange contracts	--	--	--
Interest rate swap contracts	--	(1)	--

Fair values of derivative contracts are indicative of cash that would have been required had settlement been made at December 31, 2001 and 2000.

Basis of Valuation

- Investment securities: Quoted market prices.
- Long-term debt: Present value of expected cash flows related to existing borrowings discounted at rates currently available to the Company for long-term borrowings with similar terms and remaining maturities.
- Company obligated preferred securities of subsidiary trusts: Year-end interest rates and Company common stock price.

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- Foreign exchange contracts: Year-end exchange rates.
- Currency swaps: Year-end interest and exchange rates.
- Interest rate swap contracts: Bank or market quotes or discounted cash flows using year-end interest rates.

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HERCULES INCORPORATED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

22. COMMITMENTS AND CONTINGENCIES

Leases

Hercules has operating leases (including office space, transportation and data processing equipment) expiring at various dates. Rental expense was \$56 million in 2001, \$57 million in 2000 and \$55 million in 1999.

At December 31, 2001, minimum rental payments under noncancelable leases aggregated \$251 million with subleases of \$23 million. A significant portion of these payments relates to a long-term operating lease for corporate office facilities. The net minimum payments over the next five years are \$40 million in 2002, \$31 million in 2003, \$25 million in 2004, \$18 million in 2005 and \$16 million in 2006.

Environmental

In the ordinary course of its business, the Company is subject to numerous environmental laws and regulations covering compliance matters or imposing liability for the costs of, and damages resulting from, cleaning up sites, past spills, disposals and other releases of hazardous substances. Changes in these laws and regulations may have a material adverse effect on the Company's financial position and results of operations. Any failure by the Company to adequately comply with such laws and regulations could subject the Company to significant future liabilities.

Hercules has been identified as a potentially responsible party (PRP) by U.S. federal and state authorities, or by private parties seeking contribution, for the cost of environmental investigation and/or cleanup at numerous sites. The estimated range of the reasonably possible share of costs for the investigation and cleanup is between \$81 million and \$256 million. The Company believes that the actual cost will more likely approximate \$81 million based on its estimation methods and prior experience. The actual costs will depend upon numerous factors, including the number of parties found responsible at each environmental site and their ability to pay; the actual methods of remediation required or agreed to; outcomes of negotiations with regulatory authorities; outcomes of litigation; changes in environmental laws and regulations; technological developments; and the years of remedial activity required, which could range from 0 to 30 years.

Hercules becomes aware of sites in which it may be named a PRP in investigatory and/or remedial activities through correspondence from the U.S. Environmental Protection Agency or other government agencies or from previously named PRPs, who either request information or notify the Company of its potential liability. The Company has established procedures for identifying environmental issues at its plant sites. In addition to environmental audit programs, the Company has environmental coordinators who are familiar with environmental laws and regulations and act as a resource for identifying environmental issues.

United States, et al. v. Vertac Corporation, et al., USDC No. LR-C-80-109

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and LR-C-80-110 (E.D. Ark.)

This case, a cost-recovery action based upon the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA, or the Superfund statute), as well as other statutes, has been pending since 1980, and involves liability for costs expended and to be expended in connection with the investigation and remediation of the Vertac Chemical Company (Vertac) site in Jacksonville, Arkansas. Hercules owned and operated the site from December 1961 until 1971. The site was used for the manufacture of certain herbicides and, at the order of the United States, Agent Orange. In 1971, the site was leased to Vertac's predecessor. In 1976, Hercules sold the site to Vertac. The site was abandoned by Vertac in 1987, and Vertac was subsequently placed into receivership by the Court. Both prior to and following the abandonment of the site, the U.S. Environmental Protection Agency (EPA) and the Arkansas Department of Pollution Control and Ecology (ADPC&E) were involved in the investigation and remediation of contamination at and around the site. Pursuant to several orders issued pursuant to CERCLA, Hercules actively participated in many of these activities. The cleanup is essentially complete, except for certain on-going maintenance and monitoring activities. This litigation primarily concerns the responsibility for and the allocation of liability for the costs incurred in connection with these activities.

Although the case initially involved many parties, as a result of various United States District Court rulings and decisions, as well as a trial, Hercules and Uniroyal were held jointly and severally liable for the approximately \$100 million

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HERCULES INCORPORATED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

in costs allegedly incurred by the EPA, as well as costs to be incurred in the future. That decision was made final by the District Court on September 13, 1999. Both Hercules and Uniroyal timely appealed that judgment to the United States Court of Appeals for the Eighth Circuit.

On February 8, 2000, the District Court issued a final judgment on the allocation between Hercules and Uniroyal finding Uniroyal liable for 2.6 percent and Hercules liable for 97.4 percent of the costs at issue. Hercules timely appealed that judgment. Oral argument in both appeals was held before the Eighth Circuit on June 12, 2000.

On April 10, 2001, the United States Court of Appeals for the Eighth Circuit issued an opinion in the consolidated appeals described above. In that opinion, the Appeals Court reversed the District Court's decision which had held Hercules jointly and severally liable for costs incurred and to be incurred at the Jacksonville site, and remanded the case back to the District Court for a determination of whether the harms at the site giving rise to the government's claims were divisible, as well as other findings of the District Court. The Appeals Court also vacated the District Court's allocation decision holding Hercules liable for 97.4 percent of the costs at issue, ordering that these issues be revisited following further proceedings with respect to divisibility. Finally, the Appeals Court affirmed the judgment of liability against Uniroyal.

The trial on remand commenced on October 8, 2001 and continued through October 19, 2001, and resumed on December 11, 2001, concluding on December 14, 2001. At the trial, the Company presented both facts and law to the District Court in support of its belief that the Company should not be liable under CERCLA for some or all of the costs incurred by the government in connection with the site because those harms are divisible. Should the Company prevail on

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remand, any liability to the government will be either eliminated or reduced.

Hercules Incorporated v. Aetna Casualty & Surety Company, et al., Del. Super., C.A. No. 92C-10-105 and 90C-FE-195-1-CV (consolidated)

In 1992, Hercules brought suit against its insurance carriers for past and future costs for cleanup of certain environmental sites. In April 1998, the trial regarding insurance recovery for the Jacksonville, Arkansas, site (see discussion above) was completed. The jury returned a "Special Verdict Form" with findings that, in conjunction with the Court's other opinions, were used by the Court to enter a judgment in August 1999. The judgment determined the amount of Hercules' recovery for past cleanup expenditures and stated that Hercules is entitled to similar coverage for costs incurred since September 30, 1997 and in the future. Hercules has not included any insurance recovery in the estimated range of costs above. Since entry of the Court's August 1999 order, Hercules has entered into settlement agreements with several of its insurance carriers and has recovered certain settlement monies. The terms of those settlements and amounts recovered are confidential. On August 15, 2001, the Delaware Supreme Court issued a decision in Hercules Incorporated v. Aetna Casualty & Surety Company, et al., Del. Super., C.A. No. 92C-10-105 and 90C-FE-195-1-CV (consolidated). In its decision, the Delaware Supreme Court affirmed the trial court in part, reversed the trial court in part and remanded the case for further proceedings. The specific basis upon which the Delaware Supreme Court reversed the trial court was the trial court's application of pro rata allocation to determine the extent of the insurers' liability. At this time, proceedings at the trial court have not yet commenced. The Allegany Ballistics Laboratory ("ABL") is a government owned facility which was operated by Hercules from 1945 to 1995. The United States Department of the Navy has notified Hercules that the Navy would like to negotiate with Hercules with respect to certain environmental liabilities which, the Navy alleges, are attributable to Hercules' past operations at ABL. The Navy alleges that, pursuant to CERCLA, it has spent a total of \$24.8 million and that it expects to spend an additional \$60 million over the next 10 years. The Company is currently investigating the Navy's allegations, including the basis of the Navy's claims, and whether the Company's contracts with the government pursuant to which the Company operated ABL may insulate the Company from some or all of the amounts sought. At this time, however, the Company cannot reasonably estimate its liability, if any, with respect to ABL and, accordingly, has not included this site in the range of its environmental liabilities reported above.

At December 31, 2001, the accrued liability of \$81 million for environmental remediation represents management's best estimate of the probable and reasonably estimable costs related to environmental remediation. The extent of liability is evaluated quarterly. The measurement of the liability is evaluated based on currently available information, including the progress of remedial investigations at each site and the current status of negotiations with regulatory authorities regarding the method and extent of apportionment of costs among other PRPs. While it is not feasible to predict the outcome of all pending suits and claims, the ultimate resolution of these environmental matters could have a material effect upon the results of operations and the financial position of Hercules, and the resolution of any of these matters during a specific period could have a material effect on the quarterly or annual operating results of that period.

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The Company is a defendant in numerous asbestos-related personal injury lawsuits and claims which typically arise from alleged exposure to asbestos fibers from resin-encapsulated pipe and tank products which were sold by one of the Company's former subsidiaries to a limited industrial market ("products claims"). The Company is also a defendant in lawsuits alleging exposure to asbestos at facilities formerly or presently owned or operated by the Company ("premises claims"). Claims are received and settled or otherwise resolved on a regular basis. In late December 1999, the Company entered into a settlement agreement to resolve the majority of the claims then pending. In connection with that settlement, the Company also entered into an agreement with several of the insurance carriers which sold that former subsidiary primary and first level excess insurance policies. Under the terms of that agreement, the majority of the amounts paid to resolve those products claims will be insured, subject to the limits of the insurance coverage provided by those policies. The terms of both settlement agreements are confidential.

Since entering into those agreements, the Company has continued to receive and settle or otherwise resolve claims on a regular basis, with the number of new claims averaging approximately 2,200 per year during the past two years. As of February 2002, the Company had pending approximately 5,170 unresolved claims, of which approximately 625 are premises claims. In addition, as of February 2002, there were pending approximately 5,830 unpaid claims which have been settled or are subject to the terms of a settlement agreement. In accordance with the terms of the previously mentioned agreement with several insurance carriers, as well as agreements with two other excess insurance carriers, the majority of the amounts paid and to be paid to resolve those claims will be insured.

The Company anticipates that the primary and first level excess insurance policies referenced above will exhaust over the next 12 to 24 months, assuming that the rate of settlements and payments remains relatively consistent with the Company's past experience. Nonetheless, based on the current number of claims pending, the amounts the Company presently pays to resolve those claims, and anticipated future claims (the Company's assumption being that the number of future claims filed per year and claim resolution payments remain relatively consistent with the Company's past experience, and that these matters cease to be an ongoing liability after ten years), the Company believes that it and its former subsidiary together have sufficient additional insurance to cover the majority of its current and future asbestos-related liabilities. The Company is seeking defense and indemnity payments or an agreement to pay from those carriers responsible for excess coverage whose levels of coverage have been or will soon be reached. Although those excess carriers have not yet agreed to defend or indemnify it, the Company believes that it is likely that they will ultimately agree to do so, and that the majority of future asbestos related costs will ultimately be paid or reimbursed by those carriers. However, if the Company is not able to reach satisfactory agreements with those carriers prior to exhaustion of the primary and first level excess insurance policies now covering the majority of its current asbestos related claims, then beginning as early as sometime in 2003, the Company might be required to completely fund these matters while it seeks reimbursement from its carriers.

Based on the assumptions set forth in the preceding paragraph, the reasonably possible future financial exposure for these matters is estimated to be less than \$200 million. As stated above, the Company presently believes that the majority of this financial exposure will be funded by insurance proceeds. Cash payments related to this exposure are expected to be made over an extended number of years.

Due to the dynamic nature of asbestos litigation and the present uncertainty concerning the participation of its excess insurance carriers, however, the Company's estimates are inherently uncertain, and these matters may

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present significantly greater and longer lasting financial exposures than presently anticipated. As a result, the Company's liability with respect to asbestos-related matters could exceed the amount noted above. If the Company's liability does exceed that amount, the Company presently believes that the majority of any additional liability it may reasonably anticipate will be paid or reimbursed by its insurance carriers.

The Company has estimated and therefore recorded a gross liability for asbestos-related matters in its December 31, 2001 balance sheet of \$80 million. The Company believes that it is probable that \$66 million of that amount will be funded by or recovered from insurance carriers. Accordingly, the Company has recorded an asset in this amount in its December 31, 2001 balance sheet.

In June 1998, Hercules and David T. Smith Jr., a former Hercules employee and a former plant manager at the Brunswick plant, along with Georgia-Pacific Corporation and AlliedSignal Inc., were sued in Georgia State Court by 423 plaintiffs for alleged personal injuries and property damage. This litigation is captioned *Coley, et al. v. Hercules Incorporated, et al.*, No. 98 VSO 140933 B (Fulton County, Georgia). Plaintiffs allege they were damaged by the discharge of hazardous waste from the companies' plants. On February 11, 2000, the Georgia State Court dismissed Georgia-Pacific Corporation and AlliedSignal Inc., without prejudice. In September 2000, David T. Smith Jr., was dismissed by the Georgia

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HERCULES INCORPORATED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

State Court with prejudice. On July 18, 2000, the Company was served with a complaint in a case captioned *Erica Nicole Sullivan, et al. v. Hercules Incorporated and David T. Smith, Jr.*, Civil Action File No. 00-1-05463-99 (Cobb County, Georgia). Based on the allegations contained in the complaint, this matter is very similar to the *Coley* litigation, and is brought on behalf of approximately 700 plaintiffs for alleged personal injury and property damage arising from the discharge of hazardous waste from Hercules' plant. Although venue had been removed to the United States District Court for the Northern District of Georgia, the case was ultimately remanded back to state court. Both the *Coley* and *Erica Nicole Sullivan* cases are in the early stages of motion practice and discovery. The Company denies any liability to plaintiffs, and it will vigorously defend both of these cases.

In August 1999, the Company was sued in an action styled as *Cape Composites, Inc. v. Mitsubishi Rayon Co., Ltd.*, Case No. 99-08260 (U.S. District Court, Central District of California), one of a series of similar purported class action lawsuits brought on behalf of purchasers (excluding government purchasers) of carbon fiber and carbon prepreg in the United States from the named defendants from January 1, 1993 through January 31, 1999. The lawsuits were brought following published reports of a Los Angeles federal grand jury investigation of the carbon fiber and carbon prepreg industries. In these lawsuits, plaintiffs allege violations of Section 1 of the Sherman Antitrust Act for alleged price fixing. In September 1999, these lawsuits were consolidated by the Court into a case captioned *Thomas & Thomas Rodmakers v. Newport Adhesives and Composites*, Case No. CV-99-07796-GHK (CTx) (U.S. District Court, Central District of California), with all related cases ordered dismissed. This lawsuit is in the early stages of motion practice and discovery. On March 11, 2002, the Court tentatively granted plaintiffs' motion to Certify Class. The Company is named in connection with its former Composites Products Division, which was sold to Hexcel Corporation in 1996, has denied liability and will vigorously defend this action.

Beginning in September 2001, Hercules, along with the other defendants in

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the Thomas & Thomas Rodmakers action referred to above, has been sued in nine California state court purported class actions brought on behalf of indirect purchasers of carbon fiber. In January 2002, these were consolidated into a case captioned Carbon Fiber Cases I, II, and III, Judicial Council Coordination Proceedings Nos. 4212, 4216 and 4222, Superior Court of California, County of San Francisco. These actions all allege violations of the California Business and Professions Code relating to alleged price fixing of carbon fiber and unfair competition. The Company denies liability and will vigorously defend each of these actions.

In connection with the grand jury investigation noted above, in January 2000, the United States Department of Justice (DOJ), Antitrust Division, served a grand jury subpoena duces tecum upon Hercules. The Company has been advised that it is one of several manufacturers of carbon fiber and carbon prepreg that have been served with such a subpoena.

In December 1999, an action was filed in the U.S. District Court for the Eastern District of Pennsylvania on behalf of two classes of individuals: (1) veterans of the South Korean military who claim they were exposed to Agent Orange and other chemical defoliants used in the demilitarized zone between North and South Korea between 1967 and 1970 and (2) veterans of the United States military who claim to have been similarly exposed. This case is captioned Chang Ok-Lee, Individually and as Representative of a Class, and Thomas Wolfe, Individually and as Representative of a Class v. Dow Chemical Co., et al., Civil Action No. 99-6127 (U.S. District Court, Eastern District of Pennsylvania). During 2000, this case was transferred by the Multi-District Litigation (MDL) Panel to the United States District Court for the Eastern District of New York, where Agent Orange cases have previously been consolidated. In late 2001, this case was dismissed voluntarily by the plaintiffs, with plaintiffs retaining the right to re-file in the future.

In 1999, the Company was sued by Hexcel Corporation (Hexcel) in a case captioned Hexcel Corporation v. Hercules Incorporated, Index No. 602293/99, Supreme Court of New York, County of New York. In that case, Hexcel sought recovery of a total of approximately \$8,422,000 (plus interest) in alleged "post-closing" adjustments to the purchase price paid by Hexcel for Hercules' former Composite Products Division. The basis for these alleged "adjustments" derive from the Sale and Purchase Agreement between Hercules and Hexcel dated as of April 15, 1996. In June 2000, the Court granted Hexcel's motion for summary judgment as to liability, finding the Company liable to Hexcel on technical grounds, but reserved ruling on the amount of damages. The Court then referred the damages determination to a Special Referee. In January 2001, the Special Referee issued a report, recommending that the Company be found liable to Hexcel for a total of approximately \$7,300,000 plus interest, costs and expenses. In February 2001, Hexcel moved to confirm the Special Referee's Report and the Company moved to confirm in part and reject in part the Special Referee's Report. The Company specifically challenged the majority of the Special Referee's findings, and argued that a \$2,000,000 indemnity "basket" established by the terms of the April 1996 Sale and Purchase Agreement should apply, reducing any award to Hexcel by \$2,000,000. In May 2001, the Court accepted the Special Referee's Report and rejected the Company's position. As a result, judgment was entered against the Company in the amount of \$10,219,685, which included pre-judgment interest, costs and expenses. The Company appealed to the Supreme Court, Appellate Division, First Department. On February 5, 2002, the Supreme Court of New York, Appellate Division, First Department, affirmed the decision of the trial court, entering

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judgment in favor of Hexcel in the full amount. Interest continues to accrue. The Company continues to believe that the decision of the trial and intermediate appellate courts is incorrect, and the Company filed a Motion for Reargument or for Leave to Appeal to the Court of Appeals. That motion was denied on March 19, 2002. Hercules will be filing a motion for Leave to Appeal to the New York Court of Appeals directly with the Court of Appeals. The granting of a motion for an appeal to the Court of Appeals is discretionary and there can be no assurance that it will be granted. In addition to the foregoing, in October 2000, Hexcel brought an action against Hercules to compel arbitration to determine the proper "Working Capital Adjustment" under the terms of the Sale and Purchase Agreement. Hexcel claimed it was owed approximately \$1,500,000, while the Company claimed that the Company was owed approximately \$129,000. In late 2001, this matter was submitted to binding arbitration. In December 2001, the arbitrator found in the Company's favor and awarded damages to the Company of \$129,000.

In December 1999, BetzDearborn and Bill Blythe, its employee, were sued by M.C. Dixon Lumber Company, Inc. (M.C. Dixon Lumber Company, Inc. v. BetzDearborn and Bill Blythe, Circuit Court of Barbour County, Alabama, Case No. 99-0177). In this lawsuit, M.C. Dixon sought recovery for alleged damage to wood drying kilns and other equipment, as well as lost production and other consequential damages. M.C. Dixon alleged that these damages were caused by BetzDearborn's negligence and breach of contract in the administration of the water treatment program at M.C. Dixon's plant. On September 4, 2001, this case went to trial. During the course of the trial, the Company agreed to settle this case for an amount which is confidential. In connection with that settlement, the Company reached an agreement with one of BetzDearborn's insurance carriers whereby the total amount paid by BetzDearborn towards the settlement was \$1.75 million.

On September 28, 2000, the Company sold its Food Gums Division to CP Kelco ApS, a joint venture that the Company entered into with Lehman Brothers Merchant Banking Partners II, L.P. CP Kelco also acquired the biogums business of Pharmacia Corporation (formerly Monsanto Company). In April 2001, CP Kelco U.S., Inc., a wholly-owned subsidiary of CP Kelco ApS, sued Pharmacia (CP Kelco U.S., Inc. v. Pharmacia Corporation, U.S. District Court for the District of Delaware, Case No. 01-240-RRM) alleging federal securities fraud, common law fraud, breach of warranties and representations, and equitable fraud. In essence, the lawsuit alleges that Pharmacia misrepresented the value of the biogums business, resulting in damages to CP Kelco U.S., including the devaluation of CP Kelco U.S.'s senior debt by the securities markets. The complaint seeks over \$430 million in direct damages, as well as punitive damages. In June 2001, Pharmacia filed a third-party complaint against the Company and Lehman. That complaint seeks contribution and indemnification from the Company and Lehman, jointly and severally, for any damages that may be awarded to CP Kelco U.S. in its action against Pharmacia. This lawsuit is in early discovery. The Company believes that the third-party lawsuit against it and Lehman is without merit. The Company has denied any liability to Pharmacia and is vigorously defending this action.

At December 31, 2001, the consolidated balance sheet reflects a current liability of approximately \$50 million and a long-term liability of approximately \$51 million for litigation and claims. These amounts represent management's best estimate of the probable and reasonably estimable losses related to litigation or claims. The extent of the liability and recovery is evaluated quarterly. While it is not feasible to predict the outcome of all pending suits and claims, the ultimate resolution of these matters could have a material effect upon the financial position of Hercules, and the resolution of any of the matters during a specific period could have a material effect on the quarterly or annual operating results for that period.

Other

At December 31, 2001, Hercules had \$100 million in letters of credit

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outstanding with lenders, \$92 million of which were issued under the senior credit facility (see Note 6).

23. OPERATIONS BY INDUSTRY SEGMENT AND GEOGRAPHIC AREA

In 1998, Hercules adopted Statement of Financial Accounting Standards No. 131, "Disclosures about Segments of an Enterprise and Related Information" (SFAS 131). The statement established new standards for reporting information about operating segments in annual financial statements and required selected information about operating segments in interim financial reports. It also established standards for related disclosure about products and services, geographic area and major customers. In compliance with SFAS 131, the Company has identified three reportable segments.

Process Chemicals and Services: (Pulp and Paper and BetzDearborn.) Products and services in this segment are designed to enhance customers' processes and products, improve their manufacturing costs or environmental impact. Principal products and markets include performance additives and water and process treatment chemicals and related on-site services for a wide variety of industrial and commercial applications including pulp and paper mills, refineries, chemical plants, metals manufacturers, automobile assembly plants and makers of food and beverages.

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HERCULES INCORPORATED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Functional Products: (Aqualon.) Products from this segment are principally derived from natural resources and are sold as key raw materials to other manufacturers. Principal products and markets include water-soluble polymers and solvent-soluble polymers, used as thickeners, emulsifiers and stabilizers for water-based paints, oil and gas exploration, building materials, and personal care products and producers of inks and aviation fluids. Prior to September 28, 2000, this segment also included the Food Gums Division, which was sold to CP Kelco, a joint venture the Company entered into with Lehman Brothers Merchant Banking Partners II, L.P.

Chemical Specialties: (FiberVisions and Resins.) Products in this segment provide low-cost, technology driven solutions to meet customer needs and market demands. Principal products and markets include rosin and hydrocarbon resins for adhesives, food and beverage, flavor and fragrance and construction specialties markets; thermal-bond polypropylene staple fiber for disposable diapers and other hygienic products, and industrial fiber products.

The Company evaluates performance and makes decisions based primarily on "Profit from Operations" and "Capital Employed." Consolidated capital employed represents the total resources employed in the Company and is the sum of total debt, Company-obligated preferred securities of subsidiary trusts and stockholders' equity. Capital employed in each reportable segment represents the net operating assets employed to conduct business in that segment and generally includes working capital (excluding cash) and property, plant and equipment. Other assets and liabilities, primarily goodwill and other intangibles, not specifically allocated to business segments, are reflected in "Reconciling Items" in the table below.

Hercules has no single customer representing greater than 10% of its revenues.

GEOGRAPHIC REPORTING

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For geographic reporting, no single country, outside the United States, is material for separate disclosure. However, because the Company has significant foreign operations, revenues and long-lived assets are disclosed by geographic region.

Revenues are reported on a "customer basis," meaning that net sales are included in the geographic area where the customer is located. Long-lived assets are included in the geographic areas in which the producing entities are located.

Intersegment sales are eliminated in consolidation.

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HERCULES INCORPORATED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in m

INDUSTRY SEGMENTS	PROCESS CHEMICALS AND SERVICES	FUNCTIONAL PRODUCTS	CHEMIC SPECIALT

2001			
Net sales	\$1,654	\$541	\$425
Profit (loss) from operations	295	123	38
Interest and debt expense			
Preferred security distributions of subsidiary trusts			
Other expense, net			
Income before income taxes and equity income (loss)			
Capital employed (a)	530	221	116
Capital expenditures	24	22	10
Depreciation and amortization	50	19	21

2000			
Net sales	\$1,717	\$742	\$695
Profit (loss) from operations	297	176	59
Interest and debt expense			
Preferred security distributions of subsidiary trusts			
Other expense, net			
Income before income taxes and equity income (loss)			
Capital employed (a)	632	219	308
Capital expenditures	39	76	36
Depreciation and amortization	51	26	25

1999			
Net sales	\$1,725	\$875	\$711
Profit (loss) from operations	338	218	89
Interest and debt expense			
Preferred security distributions of subsidiary trusts			

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Other expense, net

Income before income taxes and equity income (loss)

Capital employed (a)	735	372	379
Capital expenditures	51	74	39
Depreciation and amortization	66	33	30

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HERCULES INCORPORATED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in millions)

GEOGRAPHIC AREAS	UNITED STATES	EUROPE	AMERICAS (f)	ASIA PACIFIC	TOTAL
2001					
Net sales	\$1,454	\$ 765	\$184	\$217	\$2,620
Long-lived assets (g)	2,253	684	347	95	3,379
2000					
Net sales	\$1,702	\$ 964	\$215	\$271	\$3,152
Long-lived assets (g)	2,410	797	382	125	3,714
1999					
Net sales	\$1,742	\$1,074	\$220	\$273	\$3,309
Long-lived assets (g)	2,264	948	529	150	3,891

- (a) Represents total segment assets net of operating liabilities
- (b) Assets and liabilities not specifically allocated to business segments, primarily goodwill, intangibles and other long-term assets, net of liabilities.
- (c) Includes environmental charges, legal and insurance expenses, pre-payment penalties relating to the ESOP credit facility (see Note 10) and restructuring charges relating to the 2001 cost reduction program (see Note 14). Also included are amortization of goodwill and intangibles and other corporate items not specifically allocated to the business segments. Partially offsetting these charges were net gains from the sale of the hydrocarbon resins business, select portions of the rosins resins business and the peroxy chemicals business, restructuring reversals pertaining to prior year plans, a pension curtailment gain and an additional gain recognition relating to a prior year business divestiture.
- (d) Includes integration expenses, restructuring charges, asset impairment charges, environmental charges, a loss on the sale of the nitrocellulose business offset by a gain on the sale of Food Gums business, insurance recoveries and restructuring reversals (see Note 14). Also included are amortization of goodwill and intangibles and

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other corporate items not specifically allocated to the business segments.

- (e) Includes integration expenses, severance costs, asset write-downs and other charges net of litigation and insurance settlements, partially offset by a gain on the sale of a subsidiary and the reversal of restructuring charges (see Notes 14 and 16). Also included are amortization of goodwill and intangibles, corporate research and development and other corporate items not specifically allocated to business segments.
- (f) Ex-U.S.A.
- (g) Long-lived assets include property, plant and equipment, goodwill and other intangible assets.

24. CONSOLIDATING CONDENSED FINANCIAL INFORMATION OF GUARANTOR SUBSIDIARIES

One of the amendments to the senior credit facility effective November 14, 2000 (see Note 6) included a guarantee by each of the Company's current and future wholly owned domestic restricted subsidiaries (each, a "Guarantor Subsidiary"). The guarantee of each Guarantor Subsidiary is full and unconditional and joint and several. The indenture under which the Company's registered 6.6% notes due 2027 and 6.625% notes due 2003 were issued requires the holders of such notes to be on the same basis as the holders of any other subsequently issued debt that provides either guarantees or pledges of collateral. As a result, the following wholly-owned domestic restricted subsidiaries jointly and severally, and full and unconditionally guarantee the senior credit facility, the registered 6.6% notes due 2027, the 6.625% notes due 2003 and the 11.125% notes due 2007.

Aqualon Company	FiberVisions, L.L.C.
Athens Holding Inc.	FiberVisions L.P.
BetzDearborn China, Inc.	Hercules Chemical Corporation
BetzDearborn Europe, Inc.	Hercules Country Club, Inc.
BetzDearborn International, Inc.	Hercules Credit, Inc.
BetzDearborn Inc.	Hercules Euro Holdings, L.L.C.

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HERCULES INCORPORATED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

BL Chemicals Inc.	Hercules Finance Company
BL Technologies, Inc.	Hercules Flavor, Inc.
BLI Holdings, Inc.	Hercules International Limited
Chemical Technologies India, Ltd.	Hercules International Limited, L.L.C.
Covington Holdings, Inc.	Hercules Investments L.L.C.
DRC, Ltd.	Hercules Shared Services Corp.
East Bay Realty Services, Inc.	HISPAN Corporation
FiberVisions Incorporated	WSP, Inc.
FiberVisions Products, Inc.	

The non-guarantor subsidiaries (the "Non-Guarantor Subsidiaries") include

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all of the Company's foreign subsidiaries and certain domestic subsidiaries. The Company conducts much of its business through and derives much of its income from its subsidiaries. Therefore, the Company's ability to make required payments with respect to its indebtedness and other obligations depends on the financial results and condition of its subsidiaries and its ability to receive funds from its subsidiaries. There are no restrictions on the ability of any of the Guarantor Subsidiaries to transfer funds to the Company, however there may be restrictions for certain foreign Non-Guarantor Subsidiaries.

The following condensed consolidating financial information for the Company presents the financial information of Hercules, the Guarantor Subsidiaries and the Non-Guarantor Subsidiaries based on the Company's understanding of Securities and Exchange Commission's interpretation and application of Rule 3-10 under the Securities and Exchange Commission's Regulation S-X. The financial information may not necessarily be indicative of results of operations or financial position had the Guarantor Subsidiaries or Non-Guarantor Subsidiaries operated as independent entities.

In this presentation, Hercules consists of parent company operations. Guarantor Subsidiaries and Non-Guarantor Subsidiaries of Hercules are reported on an equity basis. For companies acquired during 1998, the goodwill and fair values of the assets and liabilities acquired have been presented on a "push-down" accounting basis.

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HERCULES INCORPORATED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Consolidating Condensed Statement of Operations
December 31, 2001

	(Millions of)		
	Unconsolidated		
	Parent	Guarantor Subsidiaries	Non-Guarant Subsidiari
Net sales	\$ 417	\$ 1,207	\$ 1,260
Cost of sales	288	713	727
Selling, general, and administrative expenses	57	331	355
Research and development	29	30	8
Goodwill and intangible asset amortization	3	51	22
Other operating (income) expense, net	(60)	34	9
	-----	-----	-----
Profit from operations	100	48	139
Interest and debt expense (income)	334	(108)	(30)
Preferred security distributions of subsidiary trusts	--	--	58
Other (expense) income, net	(13)	9	(6)
	-----	-----	-----
(Loss) income before income taxes and equity income (loss)	(247)	165	105
(Benefit) provision for income taxes	(40)	78	34
	-----	-----	-----

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(Loss) income before equity income (loss)	(207)	87	71
Equity income (loss) of affiliated companies	--	1	(10)
Equity income (loss) from consolidated subsidiaries	149	(10)	1
	-----	-----	-----
Net (loss) income	\$ (58)	\$ 78	\$ 62
	=====	=====	=====

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HERCULES INCORPORATED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Consolidating Condensed Statement of Operations
December 31, 2000

	(Millions of)		
	----- Unconsolidated -----		
	Parent	Guarantor Subsidiaries	Non-Guarant Subsidiari

Net sales	\$ 606	\$ 1,532	\$ 1,701
Cost of sales	432	995	1,050
Selling, general, and administrative expenses	84	338	388
Research and development	33	35	12
Goodwill and intangible asset amortization	7	48	25
Other operating expenses (income), net	38	92	(176)
	-----	-----	-----
Profit from operations	12	24	402
Interest and debt expense (income)	283	(129)	10
Preferred security distributions of subsidiary trusts	--	--	96
Other (expense) income, net	(21)	(15)	18
	-----	-----	-----
(Loss) income before income taxes and equity income (loss)	(292)	138	314
(Benefit) provision for income taxes	(58)	68	54
	-----	-----	-----
(Loss) income before equity income (loss)	(234)	70	260
Equity loss of affiliated companies	--	--	(2)
Equity income (loss) from consolidated subsidiaries	332	65	3
	-----	-----	-----
Net income (loss)	\$ 98	\$ 135	\$ 261
	=====	=====	=====

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HERCULES INCORPORATED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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Consolidating Condensed Statement of Operations
December 31, 1999

	(Millions of)		
	Unconsolidated		
	Parent	Guarantor Subsidiaries	Non-Guarant Subsidiari
Net sales	\$ 584	\$ 1,570	\$ 1,827
Cost of sales	424	974	1,100
Selling, general, and administrative expenses	118	365	304
Research and development	28	13	44
Goodwill and intangible asset amortization	9	53	17
Other operating expenses, net	23	23	1
(Loss) profit from operations	(18)	142	361
Interest and debt expense (income)	261	(51)	(25)
Preferred security distributions of subsidiary trusts	--	--	51
Other (expense) income net	(3)	(1)	4
(Loss) income before income taxes and equity income (loss)	(282)	192	339
(Benefit) provision for income taxes	(121)	89	110
(Loss) income before equity income (loss)	(161)	103	229
Equity income (loss) from affiliated companies	2	--	(1)
Equity income (loss) from consolidated subsidiaries	327	143	6
Net income (loss)	\$ 168	\$ 246	\$ 234

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HERCULES INCORPORATED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Consolidating Condensed Balance Sheet
December 31, 2001

	(Millions of)		
	Unconsolidated		
	Parent	Guarantor Subsidiaries	Non-Guara Subsidia

ASSETS
Current assets

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Cash and cash equivalents	\$ 8	\$ 12	\$ 5
Accounts and notes receivable, net	103	134	26
Intercompany receivable	87	60	6
Inventories	45	89	10
Deferred income taxes	7	16	
	-----	-----	-----
Total current assets	250	311	50
Property, plant and equipment, net	186	327	39
Investments in subsidiaries and advances, net	4,546	1,485	5
Goodwill and other intangible assets, net	33	1,631	81
Deferred charges and other assets	690	36	10
	-----	-----	-----
Total assets	\$ 5,705	\$ 3,790	\$ 1,85
	=====	=====	=====
LIABILITIES AND STOCKHOLDERS' EQUITY			
Current liabilities			
Accounts payable	50	44	10
Accrued expenses	154	207	10
Intercompany payable	104	21	8
Short-term debt	230	5	1
	-----	-----	-----
Total current liabilities	538	277	31
Long-term debt	1,832	79	4
Deferred income taxes	(73)	351	5
Other postretirement benefits and other liabilities	324	140	3
Company-obligated preferred securities of subsidiary trusts	--	--	62
Intercompany notes payable (receivable)	2,372	(1,209)	(1,15
Stockholders' equity	712	4,152	1,93
	-----	-----	-----
Total liabilities and stockholders' equity	\$ 5,705	\$ 3,790	\$ 1,85
	=====	=====	=====

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HERCULES INCORPORATED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Consolidating Condensed Balance Sheet
December 31, 2000

(Millions of

	Unconsolidated		
	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries
ASSETS			
Current assets			
Cash and cash equivalents	\$ 1	\$ 7	\$ 4
Accounts and notes receivable, net	110	183	33
Intercompany receivables	19	84	9
Inventories	63	124	12

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Deferred income taxes	28	2	
	-----	-----	-----
Total current assets	221	400	61
Property, plant, and equipment, net	281	352	47
Investments in subsidiaries and advances, net	4,350	1,595	6
Goodwill and other intangible assets, net	35	1,690	88
Deferred charges and other assets	648	37	10
	-----	-----	-----
Total assets	\$ 5,535	\$ 4,074	\$ 2,13
	=====	=====	=====
LIABILITIES AND STOCKHOLDERS' EQUITY			
Current liabilities			
Accounts payable	72	62	12
Accrued expenses	135	131	13
Intercompany payables	73	20	10
Short-term debt	127	5	12
	-----	-----	-----
Total current liabilities	407	218	49
Long-term debt	2,233	97	1
Deferred income taxes	92	264	5
Other postretirement benefits and other liabilities	210	169	4
Company-obligated preferred securities of subsidiary trusts	--	--	62
Intercompany notes payable/(receivable)	1,777	(746)	(1,02
Stockholders' equity	816	4,072	1,93
	-----	-----	-----
Total liabilities and stockholders' equity	\$ 5,535	\$ 4,074	\$ 2,13
	=====	=====	=====

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HERCULES INCORPORATED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Consolidating Condensed Statement of Cash Flows
December 31, 2001

	(Millions of)		
	----- Unconsolidated -----		
	Parent	Guarantor Subsidiaries	Non-Guara Subsidia

NET CASH (USED IN) PROVIDED BY OPERATIONS	\$ (407)	\$ 404	\$ 13
CASH FLOW FROM INVESTING ACTIVITIES:			
Capital expenditures	(11)	(19)	(3
Proceeds of investment and fixed asset disposals	229	5	12
Other, net	--	--	(
	-----	-----	-----
Net cash provided by (used in) investing activities	218	(14)	8
	-----	-----	-----
CASH FLOW FROM FINANCING ACTIVITIES:			

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Long-term debt proceeds	347	--	
Long-term debt repayments	(585)	(16)	(2)
Change in short-term debt	--	--	(10)
Change in intercompany, noncurrent	418	(369)	(4)
Common stock issued	17	--	--
Common stock reacquired	(1)	--	--
Dividends paid	--	--	(1)
	-----	-----	-----
Net cash provided by (used in) financing activities	196	(385)	(19)
	-----	-----	-----
Effect of exchange rate changes on cash	--	--	(
	-----	-----	-----
Net increase in cash and cash equivalents	7	5	1
Cash and cash equivalents at beginning of year	1	7	4
	-----	-----	-----
Cash and cash equivalents at end of year	\$ 8	\$ 12	\$ 5
	=====	=====	=====

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HERCULES INCORPORATED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Consolidating Condensed Statement of Cash Flows
December 31, 2000

	(Millions of)		
	----- Unconsolidated -----		
	Parent	Guarantor Subsidiaries	Non-Guara Subsidiaria

NET CASH (USED IN) PROVIDED BY OPERATIONS	\$ (85)	\$ (34)	\$ 23
CASH FLOW FROM INVESTING ACTIVITIES:			
Capital expenditures	(37)	(38)	(11)
Proceeds of investment and fixed asset disposals	--	14	40
Acquisitions, net of cash acquired	(6)	--	--
Other, net	(19)	(1)	--
	-----	-----	-----
Net cash (used in) provided by investing activities	(62)	(25)	30
	-----	-----	-----
CASH FLOW FROM FINANCING ACTIVITIES:			
Long-term debt proceeds	1,858	27	--
Long-term debt repayments	(1,756)	(27)	(
Change in short-term debt	--	--	9
Payment of debt issuance costs and underwriting fees	(28)	--	--
Repayment of subsidiary trust preferred securities	--	--	(37)
Change in intercompany, noncurrent	155	43	(19)
Common stock issued	13	--	--
Common stock reacquired	(2)	--	--
Dividends paid	(94)	--	(4)
	-----	-----	-----
Net cash provided by (used in) financing activities	146	43	(52)
	-----	-----	-----

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Effect of exchange rate changes on cash	--	--	(
	-----	-----	-----
Net (decrease) increase in cash and cash equivalents	(1)	(16)	
Cash and cash equivalents at beginning of year	2	23	3
	-----	-----	-----
Cash and cash equivalents at end of year	\$ 1	\$ 7	\$ 4
	=====	=====	=====

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HERCULES INCORPORATED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Consolidating Condensed Statement of Cash Flows
December 31, 1999

	(Millions of)		
	----- Unconsolidated -----		
	Parent	Guarantor Subsidiaries	Non-Guara Subsidia

NET CASH (USED IN) PROVIDED BY OPERATIONS	\$ (59)	\$ 198	\$ 24
CASH FLOW FROM INVESTING ACTIVITIES:			
Capital expenditures	(42)	(66)	(8
Proceeds of investment and fixed asset disposals	2	28	2
Acquisitions, net of cash acquired	(10)	--	-
Other, net	(24)	(15)	-
	-----	-----	-----
Net cash (used in) provided by investing activities	(74)	(53)	(6
	-----	-----	-----
CASH FLOW FROM FINANCING ACTIVITIES:			
Long-term debt proceeds	274	5	-
Long-term debt repayments	(1,344)	(16)	-
Change in short-term debt	99	(17)	(6
Payment of debt issuance costs and underwriting fees	--	--	(1
Proceeds from issuance of subsidiary trusts' preferred	--	--	79
Change in intercompany, noncurrent	915	(112)	(80
Proceeds from issuance of warrants	90	--	-
Common stock issued	182	--	-
Common stock reacquired	(3)	--	-
Proceeds from issuance of subsidiary preferred stock	--	12	-
Dividends paid	(83)	--	(10
	-----	-----	-----
Net cash provided by (used in) financing activities	130	(128)	(19
	-----	-----	-----
Effect of exchange rate changes on cash	--	--	(
	-----	-----	-----
Net (decrease) increase in cash and cash equivalents	(3)	17	(1
Cash and cash equivalents at beginning of year	5	6	5
	-----	-----	-----
Cash and cash equivalents at end of year	\$ 2	\$ 23	\$ 3

HERCULES INCORPORATED
SUMMARY OF QUARTERLY RESULTS (UNAUDITED)

	(Dollars in millions, except per share)			
	1st Quarter		2nd Quarter	
	2001	2000	2001	2000
	----	----	----	----
Net Sales	\$ 702	\$798	\$ 670	\$ 822
Cost of sales	409	450	375	462
Selling, general, and administrative expenses	190	197	195	206
Research and development	19	21	17	20
Goodwill and intangible asset amortization	19	20	19	20
Other operating expenses (income), net	3	4	(65)	18
	-----	-----	-----	-----
Profit from operations	\$ 62	\$106	\$ 129	\$ 96
Interest and debt expense	55	32	53	42
Preferred security distributions of subsidiary trusts	15	23	14	23
Other (expense) income, net	(3)	5	4	(6)
	-----	-----	-----	-----
(Loss) income before income taxes and equity income (loss)	\$ (11)	\$ 56	\$ 66	\$ 25
(Benefit) provision for income taxes	(4)	20	42	9
	-----	-----	-----	-----
(Loss) income before equity income (loss)	(7)	36	24	16
Equity (loss) income of affiliated companies, net of tax	(3)	--	(1)	--
	-----	-----	-----	-----
Net (loss) income	\$ (10)	\$ 36	\$ 23	\$ 16
	=====	=====	=====	=====
(Loss) earnings per share Basic:				
(Loss) earnings per share	\$ (0.09)	\$0.34	\$0.21	\$0.15
Diluted:				
(Loss) earnings per share	\$ (0.09)	\$0.34	\$0.21	\$0.15

	(Dollars in millions, except per share)			
	4th Quarter		Year	
	2001	2000	2001	2000
	----	----	----	----
Net Sales	\$ 611	\$ 717	\$ 2,620	\$ 3,000
Cost of sales	331	409	1,464	1,600
Selling, general, and administrative expenses	179	197	743	780
Research and development	15	19	67	70
Goodwill and intangible asset amortization	19	20	76	76
Other operating expenses (income), net	2	37	(17)	10
	-----	-----	-----	-----

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Profit from operations	\$ 65	\$ 35	\$ 287	\$
Interest and debt expense	42	48	196	
Preferred security distributions of subsidiary trusts	14	27	58	
Other (expense) income, net	(5)	(4)	(10)	
	-----	-----	-----	-----
(Loss) income before income taxes and equity income (loss)	\$ 4	\$ (44)	\$ 23	\$
(Benefit) provision for income taxes	5	(17)	72	
	-----	-----	-----	-----
(Loss) income before equity income (loss)	(1)	(27)	(49)	
Equity (loss) income of affiliated companies, net of tax	1	(2)	(9)	
	-----	-----	-----	-----
Net (loss) income	--	\$ (29)	\$ (58)	\$
	=====	=====	=====	=====
(Loss) earnings per share Basic:				
(Loss) earnings per share	--	\$ (0.28)	\$ (0.54)	\$
Diluted:				
(Loss) earnings per share	--	\$ (0.28)	\$ (0.54)	\$

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HERCULES INCORPORATED

PRINCIPAL CONSOLIDATED SUBSIDIARIES AS OF DECEMBER 31, 2001

ARGENTINA

Hercules Argentina S.A.

AUSTRALIA

BetzDearborn Australia Pty, Ltd.
Little H Pty Ltd.

AUSTRIA

Hercules Austria GmbH.

BAHAMAS

Hercules International Trade Corporation Limited

BELGIUM

BetzDearborn N.V.
Hercules Beringen B.V.B.A.
Hercules Doel B.V.B.A.
Hercules Europe B.V.B.A.
Hercules Holding B.V./B.V.B.A.

BERMUDA

Curtis Bay Insurance Co. Ltd.

BRAZIL

Hercules BetzDearborn Ltda.
Hercules do Brasil Produtos Quimicos Ltda.

CANADA

BetzDearborn Canada, Inc.
Hercules Canada Inc.
Hercules Canada (partnership)

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CHILE

Hercules Quimica Chile Ltda

CHINA

Beijing Hercules Chemical Co. Ltd.*
FiberVisions (Suzhou) Nonwovens Products Co. Ltd.
FiberVisions (China) Textile Products Ltd.
Shanghai Hercules Chemicals Co., Ltd.*

COLOMBIA

Hercules de Colombia S.A.

CROATIA

BetzDearborn d.o.o.

CURACAO

BetzDearborn Caribbean N.V.

CZECH (REPUBLIC)

Hercules CZ s.r.o.

DENMARK

Hercules Denmark A/S
FiberVisions, A/S
Hercules Investments ApS

ECUADOR

BetzDearborn de Ecuador S.A.

FINLAND

Hercules Finland OY

FRANCE

Aqualon France B.V.
BetzDearborn SA
Hercules SA

GERMANY

Abieta Chemie, GmbH*
BetzDearborn GmbH
Hercules Deutschland GmbH
Hercules GmbH

HONG KONG

Hercules China Limited

HUNGARY

BetzDearborn Hungary Kft

INDIA

Hercules Specialty Chemicals (India) Private Limited

INDONESIA

P.T. BetzDearborn Persada
P.T. Hercules Chemicals Indonesia

IRELAND

BetzDearborn Ireland Limited

ITALY

Hercules Italia SpA

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JAPAN

Hercules Japan Ltd.
Nippon BetzDearborn K.K.*

KOREA

BetzDearborn Korea, Ltd.
Hercules Korea Chemical Co. Ltd.

LIECHTENSTEIN

Organa Trust

LUXEMBOURG

Hercules Investments S.a.r.l.
Hercules Luxembourg S.a.r.l.
Hercules European Participations S.a.r.l.

MALAYSIA

Hercules Chemicals (Malaysia) Sdn. Bhd

MEXICO

BetzDearborn de Mexico S.A. de C.V.
Hercules Inc. Mexico, S.A. de C.V.
Hercules Mexico, S.A. de C.V.

* This entity is owned in part by Hercules with the remaining interest held by a third party.

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HERCULES INCORPORATED

NETHERLANDS

Aqualon France B.V.
Betz Chemical Technologies B.V.
BetzDearborn B.V.
Hechem B.V.
Hercules B.V.

NORWAY

Hercules Norway A/S

PERU

Hercules del Peru S.A.

POLAND

Hercules Polska Sp. z.o.o.

PORTUGAL

Misan Portuguesa, Lda.

SINGAPORE

Hercules Chemicals Singapore Pte Ltd.

SOUTH AFRICA

Hercules Chemicals South Africa (Pty) Ltd.

SPAIN

Hercules Quimica, S.A.

SWEDEN

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Betz KEMI AB
BetzDearborn AB
Hercules AB

SWITZERLAND

Fibervisions A.G./Fibervisions Ltd.

TAIWAN

Hercules Chemicals (Taiwan) Co., Ltd.

THAILAND

Hercules Chemicals (Thailand) Co., Ltd.

UNITED KINGDOM

BetzDearborn Limited
Hercules Investments Global Ltd.
Hercules Limited
Hercules GB Holdings Limited

URUGUAY

BetzDearborn de Uruguay S.A.

UNITED STATES

Aqualon Company, Delaware
Athens Holding Inc., Delaware
BetzDearborn Europe, Inc., Delaware
BetzDearborn Inc., Pennsylvania
BetzDearborn International, Inc., Pennsylvania
BL Chemicals Inc., Delaware
BL Technologies, Inc., Delaware
BLI Holding Inc., Delaware
Chemical Technologies India, Ltd., Delaware
Covington Holdings Inc., Delaware
DRC., Ltd. Delaware
East Bay Realty Services, Inc., Delaware
FiberVisions Incorporated, Delaware
FiberVisions, L.L.C., Delaware
FiberVisions L.P., Delaware
FiberVisions Products, Inc., Georgia
Hercules Chemical Corporation, Delaware
Hercules Chemicals International, Inc., Delaware
Hercules Credit Inc., Delaware
Hercules Euro Holdings, L.L.C., Delaware
Hercules Finance Company, Delaware
Hercules Flavor, Inc., Delaware
Hercules International Limited, Delaware
Hercules International Limited, L.L.C., Delaware
Hercules Trust I
Hercules Trust II
Hercules Shared Services Corporation, Delaware*
WSP, Inc., Delaware

VENEZUELA

Hercules BetzDearborn C.A.

VIRGIN ISLANDS

Hercules Islands Corporation *
Hercules Overseas Corp.

* This entity is owned in part by Hercules with the remaining interest held by a third party

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ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE:

None.

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HERCULES INCORPORATED

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT:

Information regarding directors and nominees for directors of Hercules and executive officers will be included in the Proxy Statement and is incorporated herein by reference.

EXECUTIVE OFFICERS OF THE REGISTRANT:

The name, age and current position of each executive officer of Hercules as of March 15, 2002 are listed below. There are no family relationships among executive officers.

NAME	AGE	CURRENT POSITION
William H. Joyce	66	Chairman and Chief Executive Officer
Fred G. Aanonsen	54	Vice President and Controller
Edward V. Carrington	59	Vice President, Human Resources and Corporate Resources
Richard G. Dahlen	62	Chief Legal Counsel
Robert C. Flexon	43	Vice President, Corporate Affairs, Strategic Planning and Work
Israel J. Floyd	55	Corporate Secretary and General Counsel
Bruce W. Jester	50	Vice President, Taxes
Stuart C. Shears	51	Vice President and Treasurer

ITEM 11. EXECUTIVE COMPENSATION:

Information regarding executive compensation of Hercules' directors and executive officers will be in the Proxy Statement, and is incorporated herein by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT:

Information regarding beneficial ownership of Hercules common stock by certain beneficial owners and by management of Hercules will be included in the Proxy Statement and is incorporated herein by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS:

In 2001, no director or officer had an involvement in such transactions of

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a nature or magnitude to require disclosure under the applicable SEC thresholds.

HERCULES INCORPORATED

PART IV

ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K:

(a) Documents filed as part of this Report:

1. Financial Statements

See Item 8 for an Index to the Consolidated Financial Statements of Hercules.

2. Financial Statement Schedules:

Schedule II - Valuation and Qualifying Accounts.....

All other schedules are omitted because they are not applicable, not required or the information required is either presented in the Notes to Financial Statements or has not changed materially from that previously reported.

3. Exhibits:

A complete listing of exhibits required is included in the Exhibit Index filed with this Report.

(b) Reports on Form 8-K.

None.

HERCULES INCORPORATED
SCHEDULE II - VALUATION AND QUALIFYING ACCOUNTS (Dollars in millions)

Col. A.	Col. B	Col. C	Col. D	Col. E
Additions				
Description	Balance at beginning of period	Charged to costs and expenses	Charged to other accounts	Deductions
 YEAR 2001				
Allowance for doubtful accounts	\$27	11	--	(14)
Tax valuation allowance	28	9	--	--
 YEAR 2000				
Allowance for doubtful accounts	\$16	21	--	(10)
Tax valuation allowance	16	12	--	--

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YEAR 1999				
Allowance for doubtful accounts	\$13	--	3	--
Tax valuation allowance	12	--	4	--

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HERCULES INCORPORATED

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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 on March 29, 2002.

HERCULES INCORPORATED

By: /s/ William H. Joyce

Chairman and Chief Executive
Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant in the capacities indicated on March 29, 2002.

PRINCIPAL EXECUTIVE OFFICERS AND DIRECTORS:

Chairman and Chief Executive Officer /s/ William H. Joyce

William H. Joyce

PRINCIPAL FINANCIAL OFFICER:

Vice President and Treasurer /s/ Stuart C. Shears

Stuart C. Shears

PRINCIPAL ACCOUNTING OFFICER:

Vice President and Controller /s/ Fred G. Aanonsen

Fred G. Aanonsen

DIRECTORS:

/s/ William H. Joyce /s/ Sunil Kumar

William H. Joyce Sunil Kumar

/s/ John G. Drosdick /s/ Jeffrey M. Lipton

John G. Drosdick Jeffrey M. Lipton

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/s/ Richard M. Fairbanks, III	/s/ Peter McCausland
-----	-----
Richard M. Fairbanks, III	Peter McCausland
/s/ Samuel J. Heyman	/s/ Gloria Schaffer
-----	-----
Samuel J. Heyman	Gloria Schaffer
/s/ Alan R. Hirsig	/s/ Paula A. Sneed
-----	-----
Alan R. Hirsig	Paula A. Sneed
/s/ Edith E. Holiday	/s/ Raymond S. Troubh
-----	-----
Edith E. Holiday	Raymond S. Troubh
/s/ Robert D. Kennedy	/s/ Joe B. Wyatt
-----	-----
Robert D. Kennedy	Joe B. Wyatt

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HERCULES INCORPORATED

EXHIBIT INDEX

NUMBER	DESCRIPTION	INCORPORATED
2-A	Agreement and Plan of Merger among Hercules, Water Acquisition Company and BetzDearborn Inc., dated July 30, 1998	Exhibit 2.1, Current Report filed July 30, 1998
3-A.1	Restated Certificate of Incorporation of Hercules, as revised and amended July 6, 1988	Exhibit 3-A, Form 10-K filed July 6, 1988
3-A.2	Certificate of Amendment dated October 24, 1995, to Hercules' Restated Certificate of Incorporation as revised and amended July 5, 1998	Exhibit 4.1a, Statement on September 15, 1998
3-B	By-Laws of Hercules, as revised and amended October 30, 1991	Exhibit 3-B, Form 10-K filed October 30, 1991
4-A	Officers' Certificate, dated as of March 17, 1999, pursuant to the Junior Subordinated Debentures Indenture between Hercules and Chase	Exhibit 4.1, Form 8-K dated March 17, 1999
4-B	Form of Preferred Securities Guarantee by Hercules and Chase, with respect to Hercules Trust I	Exhibit 4.28, to Registrars Form S-3, filed July 1, 1998

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4-C	Form of Amended and Restated Trust Agreement of Hercules Trust I	Exhibit 4.13 to Registrat Form S-3, fi 1998
4-D	Form of 9.42% Trust Originated Preferred Securities of Hercules Trust I	Exhibit 4.2, Form 8-K, da
4-E	Form of 9.42% Junior Subordinated Deferrable Interest Debentures due 2029	Exhibit 4.3, Form 8-K, da
4-F	Officer's Certificate, dated as of July 27, 1999, pursuant to the Junior Subordinated Debentures Indenture between Hercules and Chase, dated as of November 12, 1998	Exhibit 4.1, Form 8-K, da
4-G	Amended and Restated Trust Agreement of Hercules Trust II, dated as of July 27, 1999, together with Annex I thereto	Exhibit 4.2, Form 8-K, da
4-H	Unit Agreement, dated July 27, 1999, among Hercules, Hercules Trust II and The Chase Manhattan Bank, as unit agent	Exhibit 4.3, Form 8-K, da
4-I	Warrant Agreement, dated July 27, 1999, between Hercules and The Chase Manhattan Bank, as warrant agent	Exhibit 4.4, Form 8-K, da
4-J	Form of Series A Junior Subordinated Deferrable Interest Debentures	Exhibit 4.5, Form 8-K, da
4-K	Form of Trust II Preferred Securities	Exhibit 4.6, Form 8-K, da
4-L	Form of CRESTS Unit	Exhibit 4.7, Form 8-K, da
4-M	Form of Warrant	Exhibit 4.8, Form 8-K, da

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HERCULES INCORPORATED

NUMBER	DESCRIPTION	INCORPORATE
4-N	Rights Agreement, dated as of August 24, 2000, between Hercules Incorporated and Chase Mellon Shareholder Services, L.L.C.	Exhibit 4.1 Registration Classes of S 8-A filed Au
4-O	Indenture, dated as of November 14, 2000, between Hercules Incorporated, as issuer and Wells Fargo Bank Minnesota, N.A., as trustee (including the form of 11 1/8% senior notes due 2007 included as Exhibit A thereto).	Exhibit 4-A, on Form 10-Q 14, 2000
4-P	Registration Rights Agreement, dated as of November 14, 2000, among Hercules Incorporated and all of its domestic subsidiaries and Donaldson, Lufkin & Jenrette Securities Corporation and Credit Suisse First Boston Corporation, as the initial	Exhibit 4-B on Form 10-Q 14, 2000

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purchasers.

Hercules is party to several long-term debt instruments under which in each case the total amount of securities Authorized does not exceed 10% of the total assets of Hercules. Hercules agrees to furnish a copy of such instruments to the Securities and Exchange Commission upon request.

10-A	Hercules Executive Survivor Benefit Plan	Exhibit 10-D Form 10-K, f 1981
10-B	Hercules Phantom Stock Plan	Exhibit E, N Meeting and dated Februa
10-C	Hercules Deferred Compensation Plan	Exhibit 10-I Form 10-K, f 1988
10-D	Hercules Annual Management Incentive Compensation Plan	Exhibit 10-H Form 10-K, f 1993
10-E	Hercules 1993 Nonemployee Director Stock Accumulation Plan	Exhibit 4.1, Statement on July 16, 199
10-F	Hercules Deferred Compensation Plan for Nonemployee Directors	Exhibit 10-J Form 10-K, f 1993
10-G	Hercules Employee Pension Restoration Plan	Exhibit 10-L Form 10-K, f 1993
10-H	Form of Employment Contract between Hercules and certain of its officers	Exhibit 10-J Form 10-K, f 1988
10-I	Form of Indemnification Agreement between Hercules and certain officers and directors of Hercules	Annex II, No Meeting and dated Februa
10-J	Employment Agreement effective August 1, 1998, between Hercules and Vincent J. Corbo	Exhibit 10-T Form 10-K, f 1999
10-K	Hercules Amended and Restated Long Term Incentive Compensation Plan	Exhibit 10-K Form 10-K, f 2000
10-L	BetzDearborn Inc. Employee Stock Ownership and 401(k) Plan	Exhibit 10-L Form 10-K, f 2000
10-M	Amended and Restated Credit Agreement, dated April 19, 1999, among Hercules, NationsBank, N.A., as Administrative Agent, and the lenders party thereto	Exhibit 10.2 on Form 8-K, 1999

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HERCULES INCORPORATED

NUMBER	DESCRIPTION	INCORPORATE
10-N	Underwriting Agreement, dated March 12, 1999, among Hercules, Hercules Trust I and the Underwriters named therein	Exhibit 1.1, Form 8-K, da
10-O	CRESTS Units Underwriting Agreement, dated July 21, 1999, among Hercules, Hercules Trust II and the Underwriters named therein	Exhibit 1.1, Form 8-K, da
10-P	Common Stock Underwriting Agreement, dated July 21, 1999, among Hercules and the Underwriters named therein	Exhibit 1.2, Form 8-K, da
10-Q	First Amendment to Amended and Restated Credit Agreement, dated March 31, 2000, among Hercules Incorporated, BetzDearborn Canada, certain subsidiaries of Hercules, the several banks and other financial institutions identified in the agreement and Bank of America, N.A., as administrative agent, and Bank of America Canada, as Canadian administrative agent.	Exhibit 10-A on Form 10-Q 15, 2000
10-R	Second Amendment to Amended and Restated Credit Agreement, dated July 26, 2000, among Hercules Incorporated, BetzDearborn Canada, certain subsidiaries of Hercules, the several banks and other financial institutions identified in the agreement and Bank of America, N.A., as administrative agent, and Bank of America Canada, as Canadian administrative agent.	Exhibit 10-B on Form 10-Q 2000
10-S	Share Purchase Agreement, dated as of August 10, 2000, among CP Kelco ApS (formerly known as Hercules Copenhagen ApS), Hercules Investment ApS, Hercules Incorporated, Lehman FG Newco, Inc., WSP, Inc. and Hercules Holding BV/BVBA.	Exhibit 2-1, Form 8-K, da 2000
10-T	Third Amendment to Amended and Restated Credit Agreement, dated November 14, 2000, among Hercules Incorporated, BetzDearborn Canada, certain subsidiaries of Hercules, the several banks and other financial institutions identified in the agreement, and Bank of America, N.A., as administrative agent, and Bank of America Canada, as Canadian administrative agent.	Exhibit 10-T Form 10-K, f 2001.
10-U	Form of Change-of-Control Employment Agreements between Hercules Incorporated and each of Dominick W. DiDonna and Israel J. Floyd.	Exhibit 10-1 on Form S-4,
10-V	Resignation Agreement, dated as of October 17, 2000, between Hercules Incorporated and Vincent J. Corbo.	Exhibit 10-2 on Form S-4,
10-W	Letter Agreement, dated November 1, 2000, between Hercules Incorporated and Harry J. Tucci.	Exhibit 10-2 on Form S-4,
10-X	Letter Agreement, dated November 1, 2000, between	Exhibit 10-B

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	Hercules Incorporated and Thomas L. Gossage.	on Form 10-Q 2001.
10-Y	Employment Agreement, effective as of May 8, 2001, between Hercules Incorporated and William H. Joyce.	Exhibit 10-A Form 10-Q, f
10-Z	Change-of-Control Employment Agreement, dated as of May 8, 2001, by and between Hercules Incorporated and William H. Joyce	Exhibit 10-2 on Form S-4,

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HERCULES INCORPORATED

NUMBER	DESCRIPTION	INCORPORATE
10-Aa	Form of Change-of-Control Employment Agreements, dated as of June 15, 2001, by and between Hercules Incorporated and each of Edward V. Carrington and Richard G. Dahlen.	Exhibit 10- on Form S-4
10-Bb	Separation Agreement and General Release of Claims, dated June 22, 2001, between Hercules Incorporated and June B. Barry.	Exhibit 10- on Form S-4
10-Cc	Separation Agreement and General Release of Claims, dated June 21, 2001, between Hercules Incorporated and George MacKenzie.	Exhibit 10- on Form S-4
10-Dd	Change-of-Control Employment Agreement, dated as of July 2, 2001, by and between Hercules Incorporated and Fred G. Aanonsen.	Exhibit 10- on Form S-4
10-Ee	Fourth Amendment to Amended and Restated Credit Agreement, dated July 17, 2001, among Hercules Incorporated, BetzDearborn Canada, certain subsidiaries of Hercules, the several banks and other financial institutions identified in the agreement and Bank of America, N.A., as administrative agent, and Bank of America Canada, as Canadian administrative agent.	Exhibit 10- on Form S-4
10-Ff	Note Purchase Agreement, dated as of June 19, 1989, between the Betz Laboratories, Inc. Employee Stock Ownership Plan and the Betz Laboratories, Inc.	Exhibit 10- on Form S-4
10-Gg	First Amendment to Note Purchase Agreement, dated as of June 25, 1996, among BetzDearborn Laboratories, Inc., Putnam Fiduciary Trust Company and The Prudential Insurance Company of America.	Exhibit 10- on Form S-4
10-Hh	Second Amendment to Note Purchase Agreement, dated as of June 25, 1998, among BetzDearborn, Inc., Putnam Fiduciary Trust Company and The Prudential Insurance Company of America.	Exhibit 10- on Form S-4
10-Ii	Third Amendment and Assumption Agreement with respect to Note Purchase Agreement, dated as of December 31, 1998, among BetzDearborn, Inc., Putnam Fiduciary Trust Company, Hercules	Exhibit 10- on Form S-4

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Incorporated and The Prudential Insurance Company of America.

10-Jj	Fourth Amendment with respect to Note Purchase Agreement, dated as of April 19, 1999, among Hercules Incorporated, Putnam Fiduciary Trust Company and The Prudential Insurance Company of America.	Exhibit 10- on Form S-4
10-Kk	Fifth Amendment with respect to Note Purchase Agreement, dated as of July 26, 2000, among Hercules Incorporated, Putnam Fiduciary Trust Company and The Prudential Insurance Company of America.	Exhibit 10- on Form S-4
10-Ll	Sixth Amendment with respect to Note Purchase Agreement, dated as of November 14, 2000, among Hercules Incorporated, Putnam Fiduciary Trust Company and The Prudential Insurance Company of America.	Exhibit 10-3 on Form S-4,
10-Mm	Seventh Amendment with respect to Note Purchase Agreement, dated as of July 17, 2001 among Hercules Incorporated, Putnam Fiduciary Trust Company and The Prudential Insurance Company of America.	Exhibit 10-3 on Form S-4,
10-Nn*	Fifth Amendment to Amended and Restated Credit Agreement, dated March 6, 2002, among Hercules Incorporated, BetzDearborn Canada, certain subsidiaries of Hercules, the several banks and other financial institutions identified in the agreement and Bank of America, N.A., as administrative agent, and Bank of America Canada, as Canadian administrative agent.	
21.1	Subsidiaries of Registrant	See Part II, of Annual Re filed April

* Filed herewith.