HERCULES INC
Form 10-K/A
March 07, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K/A
AMENDMENT NO. 1

Mark One
x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2006
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934

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
www.herc.com

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

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes x
No ¨.

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Securities Exchange Act. Yes ¨ No x.

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

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 x

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of “accelerated filer and large accelerated filer” in Rule 12b-2 of the Exchange Act. Large accelerated filer x Accelerated filer ¨ Non-accelerated filer ¨.

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

The aggregate market value of registrant's common stock, $\$^{25}/_{48}$ stated value ("Common Stock") held by non-affiliates based on the closing price on the last business day of the Company's most recently completed second fiscal quarter, or June 30, 2006, was approximately $1.7 billion.

As of February 23, 2007, the registrant had 116,417,693 shares of Common Stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive Proxy Statement for its 2007 Annual Meeting of Shareholders (the "Proxy Statement"), when filed, will be incorporated by reference in Part III of this report.

EXPLANATORY NOTE

This Amendment No. 1 to Hercules Incorporated's Annual Report on Form 10-K for the year ended December 31, 2006 is being filed solely for the purpose of amending Item 8 to correct a figure included in Note 13 to the Consolidated Financial Statements. Specifically, the "$132.4 million" in the last sentence in the third full paragraph on page 65 of the Form 10-K as originally filed has been replaced with "$82 million". This change is reflected on page 33 of this Form 10-K/A.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS AND REQUIRED SUPPLEMENTARY DATA

Management's Report on Internal Control Over Financial Reporting

The management of Hercules is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934, as amended. Hercules' internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

Because of the inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Hercules' management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2006. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") in *Internal Control-Integrated Framework*. Based on this assessment, management has concluded that, as of December 31, 2006, the Company's internal control over financial reporting was effective based on those criteria.

Management's assessment of the effectiveness of the Company's internal control over financial reporting as of December 31, 2006 has been audited by BDO Seidman, LLP, the Company's independent registered public accounting firm, as stated in their report, which appears herein.

/s/ Craig A. Rogerson	/s/ Allen A. Spizzo
President and Chief Executive Officer	Vice President and Chief Financial Officer
February 28, 2007	February 28, 2007

Report of Independent Registered Public Accounting Firm

Board of Directors and Shareholders
Hercules Incorporated
Wilmington, Delaware

We have audited the accompanying consolidated balance sheets of Hercules Incorporated as of December 31, 2006 and 2005 and the related consolidated statements of operations and comprehensive income (loss), stockholders' equity (deficit), and cash flows for each of the two years in the period ended December 31, 2006. Our audits also included the financial statement schedule for the two years in the period ended December 31, 2006 as listed in Item 15(a). These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements and financial statement schedule are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements and financial statement schedule, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements and financial statement schedule. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Hercules Incorporated and its subsidiaries at December 31, 2006 and 2005 and the results of its operations and its cash flows for each of the two years in the period ended December 31, 2006, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, the financial statement schedule presents fairly, in all material respects, the information set forth therein.

We have also audited the adjustments to the 2004 financial statements to retrospectively apply the realignment of reporting segments as described in Note 1 and Note 27. Also, we audited the adjustments to the 2004 financial statements to reclassify the assets, liabilities and operating results of the terpenes specialties business as a discontinued operation as described in Note 23. In our opinion, such adjustments are appropriate and have been properly applied. We were not engaged to audit, review, or apply any procedures to the 2004 financial statements of the Company other than with respect to the adjustments and, accordingly, we do not express an opinion or any other form of assurance of the 2004 financial statements taken as a whole.

As discussed in Note 24 to the consolidated financial statements, Hercules Incorporated changed its method of accounting effective December 31, 2006 for defined benefit pension and other postretirement plans as a result of adopting SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans".

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Hercules Incorporated's internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated February 27, 2007 expressed an unqualified opinion thereon.

/s/ BDO Seidman, LLP
Bethesda, Maryland
February 27, 2007

Report of Independent Registered Public Accounting Firm
on Internal Control over Financial Reporting

Board of Directors and Shareholders
Hercules Incorporated
Wilmington, Delaware

We have audited management’s assessment, included in the accompanying Management’s Report on Internal Control over Financial Reporting, that Hercules Incorporated maintained effective internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Hercules Incorporated’s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management’s assessment and an opinion on the effectiveness of the Company’s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management’s assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company’s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company’s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company’s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management’s assessment that Hercules Incorporated maintained effective internal control over financial reporting as of December 31, 2006, is fairly stated, in all material respects, based on the COSO criteria. Also in our opinion, Hercules Incorporated maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on the COSO criteria.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the accompanying consolidated balance sheets of Hercules Incorporated as of December 31, 2006 and 2005, and the related consolidated statements of operations and comprehensive income (loss), changes in stockholders equity (deficit) and cash flows for each of the two years in the period ended December 31, 2006 and our report dated February 27, 2007 expressed an unqualified opinion.

/s/ BDO Seidman, LLP
Bethesda, Maryland
February 27, 2007

Report of Independent Registered Public Accounting Firm

To the Shareholders and Board of Directors of Hercules Incorporated:

In our opinion, the consolidated statements of income and comprehensive income, of shareholders' equity and of cash flows for the period ended December 31, 2004, before the effects of the adjustments to retrospectively reflect discontinued operations and the change in the composition of reportable segments described in Notes 23 and 27, respectively, present fairly, in all material respects, the results of operations and cash flows of Hercules Incorporated and its subsidiaries for period ended December 31, 2004, in conformity with accounting principles generally accepted in the United States of America (the 2004 financial statements before the effects of the adjustments discussed in Notes 23 and 27 are not presented herein). In addition, in our opinion, the financial statement schedule, for the period ended December 31, 2004 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 financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audit. We conducted our audit, before the effects of the adjustments described above, of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards 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 audit provides a reasonable basis for our opinion.

We were not engaged to audit, review, or apply any procedures to the adjustments to retrospectively reflect discontinued operations and the change in the composition of reportable segments described in Notes 23 and 27, respectively, and accordingly, we do not express an opinion or any other form of assurance about whether such adjustments are appropriate and have been properly applied. The audit of these adjustments was performed by other auditors.

/s/ PricewaterhouseCoopers LLP
Philadelphia, Pennsylvania
March 16, 2005

Hercules Incorporated
Consolidated Statements of Operations and Comprehensive Income (Loss)
(Dollars in millions, except per share data)

	Year Ended December 31,		
	2006	2005	2004
Net sales	$ 2,035.3	$ 2,055.0	$ 1,984.3
Cost of sales	1,343.4	1,391.1	1,291.6
Selling, general and administrative expenses	372.2	382.5	382.1
Research and development	38.8	40.8	42.7
Intangible asset amortization (Note 7)	7.2	8.0	8.1
Impairment of FiberVisions goodwill (Note 3)	—	52.9	—
Other operating expense, net (Note 20)	25.1	39.4	26.9
Profit from operations	248.6	140.3	232.9
Interest and debt expense (Note 21)	71.2	89.4	108.7
Vertac litigation charges (Note 13)	108.5	15.0	—
Gain on sale of CP Kelco ApS (Note 3)	—	—	(27.0)
Other expense, net (Notes 3 and 22)	65.7	71.3	116.7
Income (loss) before income taxes, minority interests and equity (loss) income	3.2	(35.4)	34.5
(Benefit) provision for income taxes (Note 9)	(192.2)	(3.8)	3.8
Income (loss) before minority interests and equity loss (income)	195.4	(31.6)	30.7
Minority interests in earnings of consolidated subsidiaries	(1.4)	(1.0)	(0.9)
Equity (loss) income of affiliated companies, net of tax	(3.2)	0.5	0.9
Net income (loss) from continuing operations before discontinued operations and cumulative effect of changes in accounting principle	190.8	(32.1)	30.7
Net income (loss) from discontinued operations, net of tax (Note 23)	47.0	(6.5)	(2.6)
Net income (loss) before cumulative effect of changes in accounting principle	237.8	(38.6)	28.1
Cumulative effect of changes in accounting principle, net of tax (Note 24)	0.9	(2.5)	—
Net income (loss)	$ 238.7	$ (41.1)	$ 28.1
Earnings (loss) per share (Note 26):			
Basic earnings (loss) per share			
Continuing operations	$ 1.72	$ (0.30)	$ 0.28
Discontinued operations	0.42	(0.06)	(0.02)
Cumulative effect of change in accounting principle	0.01	(0.02)	—
Net income (loss)	$ 2.15	$ (0.38)	$ 0.26
Weighted average number of shares (millions)	110.8	108.7	107.3
Diluted earnings (loss) per share			

Continuing operations	$	1.71	$	(0.30)	$	0.28
Discontinued operations		0.42		(0.06)		(0.02)
Cumulative effect of change in accounting principle		0.01		(0.02)		—
Net income (loss)	$	2.14	$	(0.38)	$	0.26
Weighted average number of shares (millions)		111.3		108.7		109.0
Net income (loss)	$	238.7	$	(41.1)	$	28.1
Foreign currency translation		58.7		(72.1)		71.1
Decrease (increase) in additional minimum pension liability, net of tax, due to						
Remeasurement adjustments		85.0		(44.3)		(28.2)
Foreign currency translation		(4.1)		5.5		(1.4)
Revaluation of hedges, net of tax		(34.6)		—		—
Other, net of tax		(0.5)		(0.3)		—
Comprehensive income (loss)	$	343.2	$	(152.3)	$	69.6

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

Hercules Incorporated
Consolidated Balance Sheets
(Dollars in millions)

	December 31, 2006	December 31, 2005
ASSETS		
Current assets		
Cash and cash equivalents	$ 171.8	$ 77.3
Accounts receivable, net (Note 5)	326.6	289.7
Inventories (Note 6)	210.6	179.6
Deferred income taxes (Note 9)	70.2	39.3
FiberVisions assets held for sale (Note 3)	—	202.7
Current assets of discontinued operations (Note 23)	0.4	6.7
Income taxes receivable (Note 9)	170.8	12.6
Other current assets	34.1	35.5
Total current assets	984.5	843.4
Property, plant and equipment, net (Note 18)	600.4	535.4
Intangible assets, net (Note 7)	143.1	142.8
Goodwill (Note 7)	481.5	441.0
Deferred income taxes (Note 9)	374.6	240.4
Asbestos-related assets (Note 13)	87.5	120.7
Deferred charges and other assets (Note 18)	136.9	245.1
Total assets	$ 2,808.5	$ 2,568.8
LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)		
Current liabilities		
Accounts payable	$ 205.3	$ 172.9
FiberVisions liabilities held for sale (Note 3)	—	66.6
Asbestos-related liabilities (Note 13)	36.4	36.4
Current debt obligations (Note 8)	35.8	16.7
Vertac litigation liability (Note 13)	123.5	—
Accrued expenses (Note 18)	228.6	217.0
Current liabilities of discontinued operations (Note 23)	—	2.8
Total current liabilities	629.6	512.4
Long-term debt (Note 8)	959.7	1,092.3
Deferred income taxes (Note 9)	69.7	75.8
Pension obligations (Note 10)	262.5	323.4
Other postretirement benefit obligations (Note 10)	142.2	65.5
Deferred credits and other liabilities (Note 18)	255.6	289.4
Asbestos-related liabilities (Note 13)	233.6	233.6
Total liabilities	2,552.9	2,592.4
Commitments and contingencies (Note 13)		
Minority interests	12.7	1.1
Stockholders' equity (deficit)		
Series preferred stock (Note 15)	—	—
Common stock, $25/48 stated value (Note 16)		
(shares issued: 2006 - 159,997,929 and 2005 - 159,984,444)	83.3	83.3
Additional paid-in capital	454.9	548.9
Unearned compensation (Notes 11)	(42.1)	(65.7)
Accumulated other comprehensive losses (Note 17)	(409.6)	(387.6)

Retained earnings		1,734.1		1,495.4
		1,820.6		1,674.3
Reacquired stock, at cost (shares: 2006 - 43,969,769 and 2005 - 47,247,344)		(1,577.7)		(1,699.0)
Total stockholders' equity (deficit)		242.9		(24.7)
Total liabilities and stockholders' equity (deficit)	$	2,808.5	$	2,568.8

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

Hercules Incorporated
Consolidated Statements of Cash Flows
(Dollars in millions)

	Year Ended December 31, 2006	2005	2004
Cash Flow From Operating Activities:			
Net income (loss)	$ 238.7	$ (41.1)	$ 28.1
Adjustments to reconcile net income (loss) to net cash provided by operations:			
Depreciation	70.7	80.5	74.9
Amortization	24.6	25.4	26.3
Deferred income tax provision	(157.8)	(54.9)	(18.7)
Gain on disposals	(9.0)	(11.8)	(28.0)
Impairment charges	3.2	58.6	9.1
Write-off of debt issuance costs	1.5	1.8	18.0
Loss on sale of 51% interest in FiberVisions	13.3	—	—
Minority interests in earnings of consolidated subsidiaries	1.4	1.0	0.9
Other non-cash charges and credits	7.7	5.3	0.8
Accruals and deferrals of cash receipts and payments (net of acquisitions and dispositions):			
Accounts receivable, net	(17.5)	2.9	(7.6)
Inventories	(8.7)	(3.3)	4.0
Asbestos-related assets and liabilities, net	37.1	61.3	40.2
Other current assets	5.0	(10.7)	20.7
Accounts payable and accrued expenses	3.9	28.2	5.0
Vertac litigation liability	123.5	—	—
Income taxes payable	(125.1)	27.1	(25.4)
Pension and postretirement benefits	(7.9)	(18.3)	(23.1)
Non-current assets and liabilities	(23.8)	(12.8)	(4.7)
FiberVisions net assets held for sale	(7.9)	—	—
Net cash provided by operating activities	172.9	139.2	120.5
Cash Flow From Investing Activities:			
Capital expenditures	(93.6)	(67.5)	(77.4)
Acquisitions and investments, net of cash recognized upon consolidation	(29.4)	(4.4)	—
Proceeds from sale of 51% interest in FiberVisions, net of transaction costs	17.8	—	—
Proceeds of fixed asset disposals	11.3	16.6	1.4
Proceeds from sale of minority interest in CP Kelco ApS	—	—	27.0
Other, net	(0.2)	(2.4)	(0.1)
Net cash used in investing activities	(94.1)	(57.7)	(49.1)
Cash Flow From Financing Activities:			
Long-term debt issued by FiberVisions, net of issuance costs	83.7	—	—
Long-term debt proceeds	22.0	—	650.0
Long-term debt payments	(142.5)	(131.2)	(729.5)

Change in short-term debt	5.8	1.9	1.6
Proceeds from the exercise of stock options	37.0	2.7	5.5
Payment of debt issuance costs and underwriting fees	—	—	(7.8)
Other, net	5.6	(0.4)	6.1
Net cash provided by (used in) financing activities	11.6	(127.0)	(74.1)
Effect of exchange rate changes on cash	4.1	(3.7)	2.9
Net increase (decrease) in cash and cash equivalents	94.5	(49.2)	0.2
Cash and cash equivalents at beginning of year	77.3	126.5	126.3
Cash and cash equivalents at end of year	$ 171.8	$ 77.3	$ 126.5

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

Hercules Incorporated
Consolidated Statements of Stockholders' Equity (Deficit)
(Dollars in millions)

	Common Stock	Paid-in Capital	Unearned Compen-sation	Accumulated Other Comprehen-sive Losses	Retained Earnings	Reacquired Stock	Total
Balances at January 1, 2004	$ 83.3	$ 603.4	$ (86.2)	$ (317.9)	$ 1,508.4	$ (1,765.6)	$ 25.4
(Common shares: issued, 159,984,444; reacquired, 48,992,628)							
Net income	—	—	—	—	28.1	—	28.1
Foreign currency translation adjustment	—	—	—	69.7	—	—	69.7
Release of shares held by ESOP trust	—	(5.0)	13.3	—	—	—	8.3
Increase in additional minimum pension liability, net of tax	—	—	—	(28.2)	—	—	(28.2)
Issuances of treasury stock, net of forfeitures	—	(29.2)	(8.0)	—	—	42.8	5.6
Amortization of unearned compensation	—	—	3.0	—	—	—	3.0
Balances at December 31, 2004	$ 83.3	$ 569.2	$ (77.9)	$ (276.4)	$ 1,536.5	$ (1,722.8)	$ 111.9
(Common shares: issued, 159,984,444; reacquired, 47,842,836)							
Net loss	—	—	—	—	(41.1)	—	(41.1)
Foreign currency translation adjustment	—	—	—	(66.6)	—	—	(66.6)
Release of shares held by ESOP trust	—	(5.0)	12.8	—	—	—	7.8
Repurchase of warrants	—	(2.0)	—	—	—	—	(2.0)
Increase in additional minimum pension liability, net of tax	—	—	—	(44.3)	—	—	(44.3)
Issuances of treasury stock, net of forfeitures	—	(13.3)	(8.5)	—	—	23.8	2.0
Amortization of unearned compensation	—	—	7.9	—	—	—	7.9
Other, net of tax	—	—	—	(0.3)	—	—	(0.3)
Balances at December 31, 2005	$ 83.3	$ 548.9	$ (65.7)	$ (387.6)	$ 1,495.4	$ (1,699.0)	$ (24.7)
(Common shares: issued, 159,984,444; reacquired, 47,247,344)							
Net income	—	—	—	—	238.7	—	238.7

Foreign currency translation adjustment	—	—	—	54.6	—	—	54.6
Release of shares held by ESOP trust	—	(6.4)	11.5	—	—	—	5.1
Repurchase of warrants	—	(1.0)	—	—	—	—	(1.0)
Decrease in additional minimum pension liability, net of tax	—	—	—	85.0	—	—	85.0
Recognition of funded status of pension and postretirement benefit plans, net of tax	—	—	—	(126.5)	—	—	(126.5)
Issuances of treasury stock, net of forfeitures	—	(74.7)	—	—	—	121.3	46.6
Reclassification required by SFAS 123R	—	(12.1)	12.1	—	—	—	—
Conversion of debentures	—	0.2	—	—	—	—	0.2
Revaluation of hedges, net of tax	—	—	—	(34.6)	—	—	(34.6)
Other, net of tax	—	—	—	(0.5)	—	—	(0.5)
Balances at December 31, 2006	$ 83.3	$ 454.9	$ (42.1)	$ (409.6)	$ 1,734.1	$ (1,577.7)	$ 242.9
(Common shares: issued, 159,997,929; reacquired,43,969,769)							

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

-11-

Hercules Incorporated
Summary of Significant Accounting Policies
(Dollars in millions, except per share data)

Nature of Business

Hercules Incorporated (“Hercules” or the “Company”) was incorporated in 1912 under the laws of the State of Delaware and its shares are traded on the New York Stock Exchange under the symbol “HPC.” The Company is a leading manufacturer and marketer of specialty chemicals and related services for a broad range of business, consumer and industrial applications and has approximately 4,430 employees worldwide. The Company has a broad customer base, with no single customer representing greater than 3% of Net sales, and serves many different markets, the largest of which include: tissue and paper towel manufacturing; writing paper; interior and exterior paints; construction materials and energy services. To serve these markets the Company has global manufacturing operations which provide products to customers in more than 135 countries.

Principles of Consolidation

The Consolidated Financial Statements include the accounts of Hercules, all majority-owned subsidiaries where control exists, any other subsidiaries which it controls and variable interest entities ("VIEs") in which Hercules is the primary beneficiary. All significant intercompany transactions and profits have been eliminated. Investments in affiliated companies, where Hercules has a 20% to 50% interest and where the entity is either not a VIE or Hercules is not the primary beneficiary, are accounted for using the equity method of accounting and, accordingly, consolidated income includes Hercules' share of their income or loss. Accordingly, these investments are included in Deferred charges and other assets on the Company’s Consolidated Balance Sheets.

Use of Estimates

Preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the Consolidated Financial Statements and the accompanying Notes. Actual results could differ from these 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 or determinable. Approximately 14%, 13% and 13% of the Company's revenues for the years ended December 31, 2006, 2005 and 2004, respectively, are from consignment inventory. For consignment inventory, title and risk of loss are transferred when the earnings process is considered complete, which generally occurs when the Company's products have been consumed or used in the customer's production process. Revenues exclude amounts for value-added, sales and similar taxes. Accruals are made for sales returns and other allowances based on the Company's experience. Shipping and handling costs are included in Cost of sales.

Allowance for Doubtful Accounts Receivable

The allowance for doubtful accounts represents an estimate of uncollectible accounts receivable. The recorded amount reflects various factors, including accounts receivable aging, customer-specific risk issues, country risk and historical write-off experience. It includes, but is not limited to, a formula driven calculation applied to the aging of trade accounts receivable balances. When a specific accounts receivable balance is deemed uncollectible, a charge is taken to this reserve. Recoveries of balances previously written off are also reflected in this reserve.

Research and Development Expenditures

Research and development expenditures are expensed as incurred.

Environmental Expenditures

The Company has ongoing expenditures for environmental related projects at current and former operating facilities. Accruals for environmental remediation matters are expensed when it is probable that a liability has been incurred and the amount of the liability is reasonably estimable. The Company capitalizes environmental expenditures for projects that extend the life, increase the capacity or improve the safety or efficiency of its facilities. In addition, the Company capitalizes asset retirement obligations relating to environmental remediation liabilities that result from the normal operation of Company facilities. The Company capitalized environmental related expenditures totaling $8.8 million, $3.6 million and $2.6 million for the years ended December 31, 2006, 2005 and 2004, respectively.

Changes in Accounting Principle

Voluntary changes in accounting principles require retrospective application to the earliest fiscal period presented. However, the Consolidated Financial Statements reflect the specific transition requirements associated with new accounting pronouncements, which may not require retrospective application. Note 24 provides a summary of the financial statement effects and required disclosures applicable to those accounting changes implemented during the periods presented.

Hercules Incorporated
Summary of Significant Accounting Policies
(Dollars in millions, except per share data)

Cash and Cash Equivalents

Cash equivalents include commercial paper and other securities with original maturities of 90 days or less at the time of purchase. Book value approximates fair value because of the short maturity of those instruments.

Inventories

Foreign and domestic inventories are stated at the lower of cost or market and are valued principally on the weighted-average-cost method. Elements of costs in inventories include raw materials, direct labor and manufacturing overhead.

Assets Held for Sale

When specific actions to dispose of assets progress to the point that "plan of sale" criteria have been met, impairments, to the extent they exist, are recognized in the Consolidated Statements of Operations and the underlying assets are reclassified as assets held for sale and included in the caption Other current assets or separately disclosed. Gains and losses on sales of assets associated with active business operations and sites are included in Other operating expense while those attributable to former businesses are included in Other expense, net.

Property, Plant and Equipment and Depreciation

Property, plant and equipment are stated at cost. The Company uses the straight line method of depreciation. 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.

Maintenance, repairs and minor renewals are expensed as incurred; major renewals and improvements that extend the lives or increase the capacity of plant assets are capitalized. Upon normal retirement or replacement, the net book value of property (less proceeds of sale or salvage) is charged to income.

Intangible Assets and Goodwill

Intangible assets with finite lives are amortized on a straight-line basis over the estimated future periods to be benefited, generally 40 years for customer relationships, trademarks and tradenames and 3 to 50 years for other intangible assets. Goodwill is tested for impairment on an annual basis as of November 30 with any necessary adjustment charged to expense. The Company has identified its reporting units as Paper Technologies and Ventures and the Aqualon Group, for purposes of applying the impairment test.

Long-lived Assets

The Company reviews its long-lived assets 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 undiscounted future cash flows, the loss is recognized in the Consolidated Statements of Operations. The amount of the impairment loss is the excess of the carrying amount of the impaired asset over its fair value. The fair value represents expected future cash flows from the use of the assets, discounted at the rate used to evaluate potential investments.

Computer Software Development Costs

Capitalized computer software development costs are included in Deferred charges and other assets in the Company's Consolidated Balance Sheets and amortized over a period of 5 to 10 years.

Deferred Financing Costs

The Company capitalizes costs associated with the issuance of debt, including bank, legal, investment advisor and accounting fees and other expenses. Deferred financing costs are amortized over the term of the related financing transaction using the effective interest rate method and are included in Interest and debt expense in the Company’s Consolidated Statements of Operations.

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 tax 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.

Hercules Incorporated
Summary of Significant Accounting Policies
(Dollars in millions, except per share data)

Asset Retirement Obligations

The Company records a liability at fair value for legal obligations associated with the retirement of tangible long-lived assets that result from the acquisition, construction, development and/or normal operations of a long-lived asset. To the extent an obligation is conditional, an obligation is recognized if the fair value of the liability can be reasonably estimated. The Company’s asset retirement obligations principally relate to environmental remediation liabilities associated with current and former operations that were incurred during the course of normal operations.

For the purposes of recognizing obligations requiring the dismantlement of facilities, owned properties, which have no fixed cessation date, are assumed to be in operation for 50 years, although it could be longer. The Company evaluates the status of its facilities on a periodic basis and makes any necessary adjustments to the obligations as required. Dismantlement of facilities at leased sites is assumed to occur upon lease termination unless it is likely that the Company is able to and plans to extend the term.

Foreign Currency Translation

The financial statements of Hercules' non-U.S. entities are translated into U.S. dollars in accordance with U.S. GAAP. Most of the Company’s foreign subsidiaries use the local currency as their functional currency. The Company translates assets and liabilities of those entities into U.S. dollars using the appropriate period end rates of exchange. Net sales and expenses are translated using the average exchange rates for the reporting period. Translation gains and losses are recorded in Accumulated other comprehensive losses.

Derivative Instruments and Hedging

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, interest rates and commodity prices.

The Company's risk management policies establish several 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 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. The Company has used forward contracts to hedge commodity price risk. The Company uses cross-currency interest rate swaps to hedge the foreign currency exposure associated with its net investment in certain foreign operations. Derivative instruments are recorded on the balance sheet at their fair values.

With the exception of the cross-currency interest rate swaps, the Company has not designated any derivatives as a formal hedge instrument and accordingly, changes in fair value are recorded each period in earnings as a component of Other expense, net (foreign currency exposures) and Cost of sales (commodity price exposures) consistent with the reporting of the items hedged. Changes in the fair value of the cross-currency interest rate swaps are recorded in the foreign currency translation adjustments component of Accumulated other comprehensive losses. Net interest payments or receipts from the cross-currency interest rate swaps are recorded as adjustments to Interest and debt expense, net in the Statement of Operations and are reflected in Net cash provided by operating activities in the

Statement of Cash Flows.

Counterparties to all derivative contracts are major financial institutions. Credit loss from counterparty nonperformance is not anticipated.

Stock-based Compensation

Effective, January 1, 2006, the Company adopted Statement of Financial Accounting Standards No. 123 (revised 2004), “Share-Based Payment” (“SFAS 123R”) (see Note 14). The Company had previously adopted, effective January 1, 2003, Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" ("SFAS 123"), as amended by Statement of Financial Accounting Standards No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure" ("SFAS 148"). SFAS 148 amends SFAS 123 by providing alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation and requiring enhanced disclosure regarding stock-based compensation. The Company elected to apply the fair value recognition provisions of SFAS 123 on a prospective basis to all employee awards granted, modified or settled after January 1, 2003 through the date of adoption for SFAS 123R. Therefore, the cost related to stock-based employee compensation included in the determination of net income in 2005 and 2004 was less than that which would have been recognized if the fair value based method had been applied to all awards since the original effective date of SFAS 123.

Hercules Incorporated
Summary of Significant Accounting Policies
(Dollars in millions, except per share data)

The following table presents the pro forma effect on net (loss) income and (loss) earnings per share assuming the Company had applied the fair value recognition provisions of SFAS 123 to all stock-based compensation on a retroactive basis.

	Year Ended December 31, 2005		2004	
Net (loss) income, as reported	$	(41.1)	$	28.1
Add: Total stock-based compensation expense recognized in reported results, net of tax		4.5		1.4
Deduct: Total stock-based compensation expense determined under the fair value based method for all awards, net of tax*		5.1		2.8
Pro forma net (loss) income	$	(41.7)	$	26.7
(Loss) earnings per share:				
Basic - as reported	$	(0.38)	$	0.26
Basic - pro forma	$	(0.38)	$	0.25
Diluted - as reported	$	(0.38)	$	0.26
Diluted - pro forma	$	(0.38)	$	0.24

* For information regarding the weighted-average assumptions used in estimating fair value for 2005 and 2004 see Note 14.

Recent Accounting Pronouncements

In July 2006, the FASB issued FASB Interpretation No. 48, “Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109” (“FIN 48”). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in the financial statements and prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken in a tax return. The Company is currently evaluating the impact of FIN 48, which is to be adopted effective January 1, 2007, and does not anticipate it to have a material impact on its consolidated financial condition or results of operation.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, “Fair Value Measurements” (“SFAS 157”). While SFAS 157 formally defines fair value, establishes a framework for measuring fair value and expands disclosure about fair value measurements, it does not require any new fair value measurements. SFAS 157 applies under other accounting pronouncements that require or permit fair value measurements. SFAS 157 is required to be adopted effective January 1, 2008 and the Company does not presently anticipate any significant impact on its consolidated financial position, results of operations or cash flows.

Reclassifications

Certain amounts in the 2005 and 2004 consolidated financial statements and notes have been reclassified to conform to the 2006 presentation. In addition, see Note 1 regarding the Company’s realignment of its reporting segments.

Hercules Incorporated
Notes to Consolidated Financial Statements
(Dollars in millions, except per share data)

1. Realignment of Reporting Segments

Effective January 1, 2006, the Company realigned its reporting segments. Previously, the Company operated through the Performance Products (Pulp and Paper and Aqualon) and Engineered Materials and Additives (FiberVisions and Pinova) segments. The Company’s new reporting structure includes three segments: (1) Paper Technologies and Ventures (“PTV”), (2) the Aqualon Group (“Aqualon”) and (3) FiberVisions. The Company’s synthetic lubricants business has been transferred from Aqualon to PTV. The Company’s Pinova business has been integrated into the Aqualon Group. In addition, the Company’s terpenes specialties business, which was previously a business unit of Pinova, has been classified as a discontinued operation effective January 1, 2006. As discussed further in Note 23, the Consolidated Financial Statements have been reclassified to accommodate the reporting of this business as a discontinued operation. FiberVisions will remain as a stand-alone segment for historical reporting purposes.

Through the quarter ended March 31, 2006, FiberVisions' results of operations have been consolidated into the Company’s Statement of Operations. As a result of the sale of the Company’s 51% interest (see Note 3), FiberVisions is being treated as an equity investment and the Company includes its proportionate share of earnings and losses using the equity method of accounting for periods beginning April 1, 2006.

Prior period segment information included in Note 27 has been adjusted for retrospective application of the aforementioned changes attributable to the segments.

2. Acquisitions and Investments

During 2006, the Company completed three strategic business investments for a total of $29.4 million including transaction costs, net of cash acquired. These included (1) the acquisition of the guar and guar derivative manufacturing division of Benchmark Polymer Products, L.P. (“Benchmark”), a subsidiary of Benchmark Performance Group, Inc. (“BPG”), as well as a loan to BPG that is convertible into an equity position in BPG, (2) an investment for a 40% ownership interest in the joint venture, Hercules Tianpu Chemicals Company Limited (“Hercules Tianpu”), a manufacturer of methylcellulose (“MC”) in China and (3) the acquisition of the 40% ownership interest not previously held by Hercules in the joint venture, Shanghai Hercules Chemicals Company, Ltd. (“Shanghai Hercules”), from its partner Shanghai Chlor-Alkali Chemical Co. Ltd.

Benchmark

In January 2006, the Company acquired the net assets of Benchmark for a total of $20.2 million including transaction costs plus a provisional earn-out. In addition, the Company signed a five year exclusive agreement to supply BPG with guar products for polymer slurries used in oil and gas fracturing applications. Under the terms of the purchase agreement, the Company acquired Benchmark’s Dalton, Georgia production facility, related working capital and an intangible asset related to the supply agreement. The acquired intangible asset of $3.7 million has a five year life. The Company recorded goodwill in the amount of $9.7 million which is deductible for tax purposes over a period of 15 years. In a related transaction, the Company loaned $2.5 million to BPG. The loan, which is convertible into an equity position in BPG, is reflected on the Balance Sheet as a component of Deferred charges and other assets. The results of operations of Benchmark have been included in the Consolidated Financial Statements since the date of acquisition and have been integrated into the Aqualon business segment.

Hercules Tianpu

During the first quarter of 2006, the formation was completed for the Hercules Tianpu joint venture with the Company contributing a total of $3.2 million in connection with its required subscription for a 40% ownership interest in addition to $4.4 million previously contributed in 2005 during the preliminary formation stage. Prior to formation, the Company paid $1.7 million for the subscription rights attributable to a 1% ownership interest of one of the other joint venture partners as well as $1.1 million for transaction costs. Under the joint venture agreement, the Company has global marketing rights for the output of the joint venture and receives sales commissions as well as royalties for licensed technology. Operations for Hercules Tianpu began during the latter part of the first quarter of 2006 during which time the investment was accounted for as an equity affiliate. Effective April 1, 2006, Hercules Tianpu was consolidated into Hercules' results of operations, cash flows and balance sheet (see Note 4) and is included in the Aqualon business segment. Included in the net assets recognized upon consolidation was $3.5 million of intangible assets related to land use rights with a useful life of 50 years as well as $2.8 million of goodwill which is not deductible for tax purposes.

Hercules Incorporated
Notes to Consolidated Financial Statements
(Dollars in millions, except per share data)

Shanghai Hercules

During 2006, the Company acquired the remaining 40% ownership interest in Shanghai Hercules for $3.3 million, including transaction costs of $0.2 million. The transaction resulted in an increase to Goodwill in the amount of $1.5 million, which is not deductible for tax purposes. As a result of this transaction, PTV will be able to operate with greater flexibility in the region and will be able to execute its expansion plans, including the development of a regional technical and research center. As a controlled, majority-owned subsidiary, the results of operations and net assets of Shanghai Hercules have been included in the Consolidated Financial Statements and those amounts attributable to non-controlling shareholders have been reflected as minority interests in the Statement of Operations and Balance Sheet, respectively. Effective upon completion of the transaction, the Company has reflected its full ownership of Shanghai Hercules and has included 100% of its net income in the Results of Operations.

The following table summarizes the fair values of the assets, liabilities and minority interests recognized as a result of the acquisitions and consolidation during 2006:

Assets			**Liabilities and Minority Interests**		
Cash and cash equivalents	$	2.6	Accounts payable	$	10.3
Accounts receivable, net		3.9	Accrued expenses		5.5
Inventories		10.1	Minority interests		9.6
Other current assets		0.1			
Property, plant and equipment, net		21.2			
Intangible assets, net		7.2			
Goodwill		14.0			
Deferred charges and other assets		2.7			
Total assets	$	61.8	Total liabilities and minority interests	$	25.4

3. Divestitures

FiberVisions

On March 31 2006, the Company completed the sale (the "Transaction" or "FiberVisions Transaction") of a 51% interest in its FiberVisions division to an affiliate of SPG Partners, LLC ("SPG"). In connection with the Transaction, FiberVisions issued long-term debt in the amount of $90.0 million and simultaneously completed a distribution of $82.0 million to the Company and its wholly-owned subsidiary, WSP Inc. ("WSP") in proportion to their respective ownership interests. FiberVisions incurred $6.3 million of costs in connection with the debt issuance. Immediately thereafter, the Company received $27.0 million from SPG in exchange for its 51% interest. The contribution agreement ("Agreement") provided SPG with an option to purchase an additional 14% interest in FiberVisions. However, the option subsequently expired unexercised on January 31, 2007 resulting in a benefit to income of $0.2 million in 2007.

The Agreement also provided for a maximum of $5.7 million of additional contributions to FiberVisions based on defined performance measures during 2006 and 2007. Based on FiberVisions' actual performance subsequent to the

Transaction, the Company was required to provide $4.5 million of additional contributions during 2006. Based on FiberVisions' performance projections for 2007, which continue to be challenged by raw material costs, the Company accrued its remaining commitment of $1.2 million. This amount is expected to be paid during the first half of 2007.

As a result of the Transaction closing and certain post-closing adjustments, including $5.7 million for the performance-based contributions, the Company has recognized a $13.3 million loss on the transaction during 2006 as a component of Other expense, net reflecting the disposition of a non-operating asset held for sale. The loss also reflects a number of adjustments to the Company's investment including the realization of the currency translation adjustment associated with the disposed portion of the Company's investment, a curtailment benefit, net of special termination benefits, associated with FiberVisions' domestic employees that will no longer accrue service benefits under the Company's pension and postretirement benefit plans, certain indemnifications for income taxes, pension and severance obligations, the settlement of substantially all of FiberVisions third party debt obligations prior to closing, a provision for the valuation of SPG's option and other transaction costs. A total of $8.4 million of transaction costs and post-closing adjustments was paid during 2006 and the Company has reflected $1.3 million to be paid during 2007 as a component of Accrued expenses. As noted above, $1.2 million relates to the 2007 additional contribution and the remaining $0.1 is for other transaction costs.

The results of operations and cash flows for FiberVisions for the three months ended March 31, 2006 are included in the Consolidated Statement of Operations and Consolidated Statement of Cash Flows, respectively, as it was wholly-owned by the Company during that period. Effective April 1, 2006, the Company began recording its equity in the earnings of FiberVisions based on its 49% ownership interest. The Company's share of FiberVisions' net loss for the nine months ended December 31, 2006 was $3.4 million. The Company's investment in FiberVisions, as represented by the 49% interest held by WSP, is included in Deferred charges and other assets for $22.5 million, which represents its fair value based on the terms of the Transaction adjusted for equity losses during the nine months ended December 31, 2006.

Hercules Incorporated
Notes to Consolidated Financial Statements
(Dollars in millions, except per share data)

In connection with its initial commitment to sell a majority interest in FiberVisions at the end of 2005, the Company was required to test FiberVisions' underlying goodwill asset for recoverability. The test indicated that the carrying value of goodwill exceeded its fair value. Accordingly, the Company recorded an impairment charge of $52.9 million effective as of December 31, 2005. The impairment charge was based on an estimate of the fair value for the entire division as determined by the negotiated sales price for the aforementioned sale of a majority interest and its impact was reflected in Profit from operations as it represented an active and fully consolidated business during 2005.

As of December 31, 2005, the Company reclassified those assets and liabilities attributable to FiberVisions as held for sale consistent with the Agreement. The amounts included on the Consolidated Balance Sheet consist of the following:

Assets			**Liabilities**		
Cash and cash equivalents	$	2.6	Accounts payable	$	29.9
Accounts receivable, net		34.4	Accrued expenses		7.1
Inventories		20.7	Deferred income taxes		29.2
Other current assets		9.2	Long-term debt		0.3
Property, plant and equipment, net		92.1	Deferred credits and other liabilities		0.1
Intangible assets, net		11.1			
Goodwill		32.0			
Deferred charges and other assets		0.6			
Total FiberVisions assets held for sale	$	202.7	Total FiberVisions liabilities held for sale	$	66.6

CP Kelco

On February 12, 2004, a subsidiary of the Company completed the sale of its minority ownership in CP Kelco ApS to a subsidiary of J. M. Huber Corporation for $27.0 million. The book value of the Company's investment in CP Kelco ApS had been written down to zero in 2002 as the result of an after-tax impairment charge of $19.0 million. Net (loss) income for the month ended January 31, 2004 and the year ended December 31, 2003 was $(2.2) million and $59.3 million, respectively. At the time of disposal, the CP Kelco ApS balance sheet was comprised of total assets and total liabilities of $932.1 million and $816.3 million, respectively.

4. Variable Interest Entities

In accordance with the provisions of FASB Interpretation No. 46, "Consolidation of Variable Interest Entities" (revised December 2003) ("FIN 46R"), the Company has identified Hercules Tianpu as a variable interest entity ("VIE") for which the Company was the primary beneficiary. The financial statements of the Company reflect the consolidation of Hercules Tianpu effective April 1, 2006. As of December 31, 2006, the fair value of the assets in Hercules Tianpu was $52.3 million and the fair values of the associated liabilities and non-controlling interest were $43.6 million. There are no assets of the Company that serve as collateral for Hercules Tianpu. However, the Company has provided guarantees to certain financial institutions that have provided credit to Hercules Tianpu. With respect to the credit facility established primarily to finance Hercules Tianpu's capacity expansion and working capital needs, the Company has provided a guarantee of 55% of the total borrowing. As of December 31, 2006, the total amount outstanding under this facility was $28.1 million.

The Company maintains a 40% ownership interest in Hercules Tianpu and Aqualon has the global marketing rights for the joint venture's output and receives sales commissions as well as royalties for licensed technology. Hercules Tianpu's operations began during the latter part of the first quarter of 2006 as the contribution of cash and manufacturing assets was completed. As of December 31, 2006, the Company's total equity investment in Hercules Tianpu was $11.4 million.

Hercules Incorporated
Notes to Consolidated Financial Statements
(Dollars in millions, except per share data)

5. Accounts Receivable, Net

Accounts Receivable, net includes trade accounts and notes receivable and amounts due from affiliates less an allowance for doubtful accounts. Changes in the allowance for doubtful accounts for the years ended December 31, 2006, 2005 and 2004 are as follows:

	2006	2005	2004
Balance at beginning of year	$ 4.0	$ 4.7	$ 5.5
Charged to costs and expenses	3.2	2.3	5.4
Deductions	(1.6)	(3.0)	(6.2)
Balance at end of year	$ 5.6	$ 4.0	$ 4.7

6. Inventories

The components of inventories as of December 31, 2006 and 2005 are as follows:

	2006	2005
Finished products	$ 115.4	$ 98.4
Raw materials and work-in-process	73.3	60.5
Supplies	21.9	20.7
	$ 210.6	$ 179.6

7. Intangible Assets and Goodwill

The following table provides information regarding the Company's intangible assets with finite lives.

	2006			2005		
	Gross	Accumulated Amortization	Net	Gross	Accumulated Amortization	Net
Customer relationships	$ 90.0	$ 18.6	$ 71.4	$ 90.0	$ 16.4	$ 73.6
Trademarks and tradenames	73.9	15.6	58.3	73.9	13.5	60.4
Other intangible assets	32.2	18.8	13.4	24.8	16.0	8.8
	$ 196.1	$ 53.0	$ 143.1	$ 188.7	$ 45.9	$ 142.8

Total amortization expense for other intangible assets for the years ended December 31, 2006, 2005 and 2004 was $7.2 million, $8.0 million and $8.1 million, respectively, which was included in Profit from operations. It is estimated that amortization expense will be $7.1 million for 2007, $6.8 million for 2008, $5.5 million for 2009, $5.3 million for 2010 and $4.4 million for 2011.

The following table shows the activity and changes in the carrying amount of goodwill for the years ended December 31, 2006 and 2005, by operating segment:

	Paper Technologies and Ventures	Aqualon Group	FiberVisions	Total

Balance at December 31, 2004	$ 425.7	$ 39.7	$ 84.9	$ 550.3
Impairment	—	—	(52.9)	(52.9)
Reclassified to FiberVisions assets held for sale	—	—	(32.0)	(32.0)
Foreign currency translation	(23.1)	(1.3)	—	(24.4)
Balance at December 31, 2005	$ 402.6	$ 38.4	$ —	$ 441.0
Acquisitions and investments	1.5	12.5	—	14.0
Foreign currency translation	25.4	1.1	—	26.5
Balance at December 31, 2006	$ 429.5	$ 52.0	$ —	$ 481.5

Hercules Incorporated
Notes to Consolidated Financial Statements
(Dollars in millions, except per share data)

8. Debt

A summary of debt follows:

	2006	2005
Term B loan due 2010 (a)	$ 375.0	$ 393.0
6.60% notes due 2027 (b)	100.0	100.0
Term notes at various rates from 5.00% to 7.16% due in varying amounts through 2006 (c)	—	6.8
11.125% senior notes due 2007 (d)	16.1	130.0
6.75% senior subordinated notes due 2029 (e)	250.0	250.0
8% convertible subordinated debentures due 2010 (f)	2.4	2.6
6.5% junior subordinated deferrable interest debentures due 2029 (g)	214.1	217.0
Term loans at rates ranging from 5.5575% to 5.814% due in varying amounts through 2011(h)	28.1	—
Other	9.8	9.6
	995.5	1,109.0
Less: Current debt obligations	35.8	16.7
Long term debt	$ 959.7	$ 1,092.3

(a) The term loan, a component of the Company’s Senior Credit Facility, matures on October 8, 2010 and bears interest at LIBOR + 1.50%, with the Company holding the option to reset interest rates for one, two, three or six month periods. The weighted average rate was 6.87% as of December 31, 2006. The Senior Credit Facility is also comprised of a $150 million committed revolving credit facility (the “Revolving Facility”) which matures on April 8, 2009 and provides Hercules the ability, subject to lender approval, to borrow until April 8, 2007 an additional $250 million in the form of an incremental term note. The Senior Credit Facility is secured by liens on the Company's assets (including real, personal and intellectual properties) and is guaranteed by substantially all of the Company's current and future wholly-owned domestic subsidiaries (see Note 29).

As of December 31, 2006, the Company had $105.7 million of outstanding letters of credit under the Revolving Facility. The remaining $44.3 million was available for use.

The Company's Senior Credit Facility requires quarterly compliance with certain financial covenants, including a debt/EBITDA ratio ("leverage ratio") and an interest coverage ratio, and established limitations on the permitted amount of capital expenditures.

(b) 30-year debentures with a 10-year put option, exercisable August 1, 2007 by the bondholder at a redemption price equal to the principal amount.

(c) Debt assumed in conjunction with the acquisition of FiberVisions L.L.C in 1998 and retained by Hercules prior to the FiberVisions Transaction.

(d) The senior notes accrue interest at 11.125% per annum, payable semi-annually. The senior notes are guaranteed by each of Hercules' current and future wholly-owned domestic restricted subsidiaries and matures on November 15, 2007.

(e)

The Company completed a private placement of $250 million aggregate principal amount of 6.75% senior subordinated notes due 2029 during April 2004. The senior subordinated notes are guaranteed by each of Hercules' current and future wholly-owned domestic restricted subsidiaries.

(f) 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.

(g) The 6.5% junior subordinated deferrable interest debentures due 2029 (the "6.5% debentures") had an initial issue price of $741.46 and have a redemption price of $1,000. The 6.5% debentures were initially issued to Hercules Trust II ("Trust II"), a subsidiary trust established in 1999. Trust II had issued, in an underwritten public offering, 350,000 CRESTS Units, each consisting of a 6.5% preferred security of Trust II and a warrant (exercisable through 2029) to purchase 23.4192 shares of the Company's common stock. The preferred securities and the warrants were separable and were initially valued at $741.46 and $258.54, respectively. The Company and Trust II accreted the difference between the initial valuation of the 6.5% debentures and the preferred securities and the redemption value of $1,000 over the term of the 6.5% debentures and the preferred securities. In connection with the Company's dissolution and liquidation of Trust II in December 2004, Trust II distributed the 6.5% debentures to the holders of the preferred securities and the preferred securities were cancelled. The CRESTS Units now consist of the 6.5% debentures and the warrants.

(h) Includes loans issued by Hercules Tianpu secured by liens on Hercules Tinapu's fixed assets for which Hercules has provided a guarantee for 55% of the outstanding balances. The loans are denominated in renminbi and include a short-term loan payable due in 2007 for approximately $5.9 million and a long-term loan payable due in 2011 for approximately $22.2 million.

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During 2006, the Board of Directors authorized the Company, from time to time, subject to market conditions and the Company's credit agreements and indentures, to repurchase up to $150 million of its outstanding indebtedness on the open market. Under this program the Company repurchased $113.9 million (book value) of its 11.125% senior notes. In addition, the Company acquired 5,000 CRESTS Units for $4.2 million in open market purchases. The market value of the 6.5% debentures and CRESTS Units repurchased were $3.3 million and $1.0 million, respectively. The accreted book value of the 6.5% debentures at the time of the purchase was $3.8 million, resulting in the recognition of a $0.5 million gain. The $1.0 million associated with the warrants was recorded as a reduction of Additional paid-in capital. Also, $18.0 million attributable to the Term B loan was paid during 2006, of which, $14.0 million represents a prepayment. In December 2006, the Board of Directors approved a new authorization for the repurchase of up to $200 million of debt.

At December 31, 2006, Hercules had available and unused foreign lines of credit totaling $31.8 million and $29.3 million, respectively.

Debt maturities are $35.8 million in 2007, $10.1 million in 2008, $11.4 million in 2009, $372.8 million in 2010, $1.3 million in 2011 and $564.1 million thereafter.

9. Income Taxes

The domestic and foreign components of income (loss) before income taxes, minority interests and equity (loss) income from continuing operations are listed below:

		2006		2005		2004
Domestic	$	(164.3)	$	(46.9)	$	(154.8)
Foreign		167.5		11.5		189.3
Income (loss) before income taxes, minority interests and equity (loss) income	$	3.2	$	(35.4)	$	34.5

The components of the tax provision from continuing operations are as follows:

Currently payable		2006		2005		2004
U.S. federal	$	(64.0)	$	1.4	$	(29.0)
Foreign		29.6		40.9		38.1
State		—		8.8		13.4
Deferred						
Domestic		(154.6)		(48.3)		(21.5)
Foreign		(3.2)		(6.6)		2.8
(Benefit) provision for income taxes	$	(192.2)	$	(3.8)	$	3.8

On October 25, 2006, the Company reached an agreement with the IRS with respect to its audit of the 2002 and 2003 tax years. The effect of the agreement resulted in the reversal of certain tax reserves in the amount of $48.7 million established with respect to the sale of the Company’s former BetzDearborn Water Treatment business which has been reported as a discontinued operation. The provision for income taxes attributable to discontinued operations and cumulative effect of changes in accounting principle is:

	2006	2005	2004
Benefit on loss from discontinued operations	$ (49.6)	$ (3.4)	$ (1.4)
Cumulative effect of changes in accounting principle	0.5	(1.4)	—
	$ (49.1)	$ (4.8)	$ (1.4)

During the years ended December 31, 2006, 2005 and 2004 the Company recorded items related to the additional minimum liability of its defined benefit plans, the impact of the adoption of Statement of Financial Accounting Standards No. 158, “Employers’ Accounting for Defined Benefit Pension and Other Postretirement Plans - an amendment of FASB Statements No. 87, 88, 106 and 132(R)” (“SFAS 158”) and hedging activities. The impact of the adjustments is posted, net of tax, directly to Accumulated other comprehensive losses (see Note 17). The tax benefit (expense) of these items was as follows:

	2006	2005	2004
Additional minimum pension liability	$ (44.7)	$ 24.8	$ 14.5
Impact of the adoption of SFAS 158	62.2	—	—
Hedging activities	18.6	—	—
Other	0.3	0.2	—
	$ 36.4	$ 25.0	$ 14.5

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The components of the net deferred tax assets (liabilities) as of December 31, are as follows:

	2006	2005
Depreciation	$ (82.8)	$ (81.4)
Pension	(1.3)	(8.2)
Inventory	(3.1)	(4.1)
Investments	(19.3)	(174.3)
Goodwill	(45.0)	(48.4)
Accrued expenses	(2.9)	(3.1)
Other	(7.5)	(13.1)
Gross deferred tax liabilities	$ (161.9)	$ (332.6)
Postretirement benefits other than pensions	$ 70.0	$ 45.5
Pension	87.3	113.4
Goodwill	8.4	7.1
Accrued expenses	242.1	216.1
Loss carryforwards	230.1	349.2
Credit carryforwards	131.4	126.9
Investments	77.5	21.5
Other	14.2	24.6
Gross deferred tax assets	861.0	904.3
Valuation allowance	(335.8)	(380.7)
Net deferred tax assets	$ 363.3	$ 191.0

The reconciliation of the U.S. statutory income tax rate to the effective rate from continuing operations is:

	2006	2005	2004
U.S. statutory income tax rate	35%	35%	35%
Gain on sale of CP Kelco ApS	—	—	(27)
Valuation allowances	(3,137)	(66)	(66)
Tax rate differences on subsidiary earnings	(325)	(8)	(39)
U.S. tax on foreign dividends and undistributed earnings	232	27	21
State taxes	(1)	(15)	30
Reserves	(1,378)	21	61
Exempt export income	(36)	5	(6)
Tax refunds	(1,396)	12	—
Other	—	—	2
Effective tax rate	(6,006)%	11%	11%

Loss carryforwards include both net operating loss carryforwards and capital loss carryforwards. At December 31, 2006, the tax effect of such carryforwards approximated $230.1 million. Of this amount, $130.2 million are domestic capital loss carryforwards that expire in 2007 for which full valuation allowances have been established and $3.4 million are domestic net operating loss carryforwards that expire in 2023 for which no valuation allowance has been established. State net operating loss carryforwards approximate $81.0 million, with expiration dates ranging from 2007 to 2026, for which full valuation allowances have been established. Foreign net operating loss carryforwards approximate $15.5 million and are offset by valuation allowances of $8.5 million. Some of these foreign net operating loss carryforwards expire as early as 2007 and others have expiration dates that are indefinite in nature. Deferred tax assets of $77.5 million attributable to investments represents the basis difference in the carrying value of the Company's 49% investment in FiberVisions for which full valuation allowances have been established. The tax effect of the credit carryforwards approximated $131.4 million at December 31, 2006, with expiration dates ranging from 2011 to 2026, for which no valuation allowances have been established.

The Company provides taxes on undistributed earnings of subsidiaries and affiliates to the extent such earnings are planned to be remitted and not permanently reinvested. 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 $82.5 million and $153.8 million at December 31, 2006 and 2005, 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.

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10. Pension and Other Postretirement Benefits

The Company provides defined benefit pension plans and postretirement benefit plans to most U.S. employees and some foreign employees. The following table summarizes information about the Company's pension and postretirement benefit plans subsequent to the adoption SFAS 158. Certain of the disclosures required by SFAS 158 are not applicable ("N/A") to the 2005 presentation.

	Pension Benefits				Other Postretirement Benefits	
	2006		2005			
Change in benefit obligation:	U.S.	Int'l.	U.S.	Int'l.	2006	2005
Benefit obligation at January 1	$ 1,536.8	$ 340.6	$ 1,413.5	$ 325.7	$ 154.5	$ 181.0
Service cost	11.4	6.0	12.7	5.4	0.5	0.8
Interest cost	86.5	15.5	81.3	15.2	8.8	8.8
Plan amendments	—	0.3	—	(4.5)	—	(32.4)
Foreign currency translation	—	35.3	—	(37.3)	—	0.1
Actuarial (gain) loss	(17.8)	(17.8)	136.1	49.2	14.7	19.8
Settlements/curtailments	(2.3)	(0.6)	—	—	—	—
Special termination benefits	1.6	—	—	—	1.3	—
Benefits paid from plan assets	(109.0)	(15.2)	(101.9)	(13.1)	—	—
Benefits paid from Company assets	(5.1)	—	(4.9)	—	(21.4)	(23.6)
Benefit obligation at December 31	$ 1,502.1	$ 364.1	$ 1,536.8	$ 340.6	$ 158.4	$ 154.5
Change in plan assets:						
Fair value of plan assets at January 1	$ 1,219.3	$ 256.4	$ 1,176.2	$ 245.7	$ —	$ —
Actual return on plan assets	165.7	17.1	105.0	20.9	—	—
Actuarial (loss) gain	—	(0.5)	—	14.7	—	—
Company contributions	30.0	7.5	40.0	13.7	—	—
Participant contributions	—	0.8	—	0.9	—	—
Foreign currency translation	—	27.5	—	(27.7)	—	—
Benefits paid from plan assets	(109.0)	(13.8)	(101.9)	(11.8)	—	—
Fair value of plan assets at December 31	$ 1,306.0	$ 295.0	$ 1,219.3	$ 256.4	$ —	$ —
Funded status of the plan	$ (196.1)	$ (69.1)	$ (317.5)	$ (84.2)	$ (158.4)	$ (154.5)
Unrecognized actuarial loss	—	—	671.2	104.5	—	120.1
Unrecognized prior service benefit	—	—	(22.0)	(2.7)	—	(55.4)
Accrued expenses	—	—	—	(0.2)	—	—
Unrecognized net transition obligation	—	—	—	0.5	—	0.8
Net amount recognized	$ (196.1)	$ (69.1)	$ 331.7	$ 17.9	$ (158.4)	$ (89.0)
Components of the above amounts:						
Prepaid benefit cost	$ —	$ 2.2	$ 369.5	$ 53.3	$ —	$ —

Accrued expenses		(4.9)		—		—		—		(16.2)		(23.5)
Accrued benefit liability (noncurrent)		(191.2)		(71.3)		(37.8)		(35.4)		(142.2)		(65.5)
Additional minimum liability		—		—		(588.6)		(48.2)		—		—
Intangible asset		—		—		—		0.4		—		—
Accumulated other comprehensive losses		—		—		588.6		47.8		—		—
Net amount recognized	$	(196.1)	$	(69.1)	$	331.7	$	17.9	$	(158.4)	$	(89.0)
Amounts included in Accumulated other comprehensive losses:												
Actuarial (losses) gains	$	(545.8)	$	(106.6)		N/A		N/A	$	(126.4)		N/A
Prior service credits		18.2		17.2		N/A		N/A		43.0		N/A
Transition obligations		—		(0.4)		N/A		N/A		(0.7)		N/A
Total	$	(527.6)	$	(89.8)		N/A		N/A	$	(84.1)		N/A
Amortization expected to be recognized during next fiscal year:												
Actuarial losses	$	39.1	$	4.5		N/A		N/A	$	8.9		N/A
Prior service credits		(1.7)		(0.9)		N/A		N/A		(7.8)		N/A
Transition obligations		—		0.1		N/A		N/A		0.1		N/A
Total	$	37.4	$	3.7		N/A		N/A	$	1.2		N/A

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Weighted-average assumptions used to determine the benefit obligation at December 31, 2006 and 2005 were:

	Pension Benefits				Other Postretirement Benefits	
	2006		2005			
	U.S.	Int'l.	U.S.	Int'l.	2006	2005
Weighted-average discount rate	5.90%	4.71%	5.70%	4.35%	5.79%	5.59%
Rate of compensation increase	4.30%	3.10%	4.30%	2.87%	4.29%	4.29%

Net periodic benefit costs are summarized below:

	Pension Benefits						Other Postretirement Benefits		
	2006		2005		2004				
Net periodic benefit cost:	U.S.	Int'l.	U.S.	Int'l.	U.S.	Int'l.	2006	2005	2004
Service cost	$ 11.4	$ 6.0	$ 12.7	$ 5.4	$ 13.3	$ 5.9	$ 0.5	$ 0.8	$ 0.8
Interest cost	86.5	15.5	81.3	15.2	82.3	15.4	8.8	8.8	10.3
Expected return on plan assets	(100.4)	(17.3)	(95.4)	(14.9)	(96.5)	(14.6)	—	—	—
Amortization and deferrals	(1.8)	(0.4)	(1.9)	0.2	1.3	0.6	(8.0)	(7.3)	(8.5)
Participant contributions	—	(0.5)	—	(0.5)	—	(0.7)	—	—	—
Settlements/curtailments (1)	(2.0)	—	—	—	—	(0.1)	(4.4)	—	—
Special benefits/terminations (1)	1.6	—	—	—	1.1	—	1.2	—	—
Amortization of transition (asset) obligation	—	—	—	—	—	(0.1)	—	—	0.1
Actuarial losses recognized	39.9	4.5	40.7	3.4	33.9	3.1	8.4	6.5	5.2
Benefit cost	$ 35.2	$ 7.8	$ 37.4	$ 8.8	$ 35.4	$ 9.5	$ 6.5	$ 8.8	$ 7.9

(1) During 2006, the impact of these items was directly attributable to the FiberVisions transaction and, accordingly, these items are reflected in the loss on the sale of a 51% interest in FiberVisions (see Notes 3 and 22).·

Weighted-average assumptions used to determine net periodic benefit cost:

	2006		2005		2004				
	U.S.	Int'l.	U.S.	Int'l.	U.S.	Int'l.	2006	2005	2004
Weighted-average discount rate	6.00%	4.53%	5.75%	5.04%	6.10%	5.35%	5.81%	5.51%	6.08%
Expected return on plan assets	8.50%	6.36%	8.50%	6.49%	8.75%	6.64%	N/A	N/A	N/A
Rate of compensation increase	4.30%	2.99%	4.50%	2.79%	4.50%	2.86%	4.29%	4.49%	4.49%

Defined Benefit Pension Plans

Assets of the Company’s defined benefit pension plans are primarily invested in U.S. and international equity securities and U.S. and international fixed income securities. Both the assets and the projected benefit obligations (“PBO”) of the United States defined benefit pension plan (“U.S. Plan”) represent approximately 81% of the total plan assets and PBO for all defined benefit plans sponsored by the Company as of December 31, 2006. The Company uses a measurement date of December 31 for all material defined benefit pension and other postretirement benefit plans.

During 2006, the Company made contributions to its defined benefit plans totaling $37.5 million, some of which were required by local funding requirements. The Company presently anticipates making voluntary cash contributions to the U.S. Plan of approximately $40.0 million during 2007. Additionally, the Company anticipates making contributions of approximately $21.0 million to its international defined benefit pension plans in 2007.

Other Postretirement Benefits

The non-pension postretirement benefit plans include group life insurance coverage and health care reimbursement for eligible employees/retirees in the U.S. and Canada. The benefit obligation of the U.S. other postretirement benefit plan constitutes more than 98% of the Company's consolidated benefit obligation at December 31, 2006 for non-pension postretirement benefits. The assumed participation rate in these plans for future eligible retirees was 50% for health care and 100% for life insurance. The health care plans are contributory with participants' contributions adjusted annually; the life insurance plans are non-contributory for most retirees. The postretirement health care plans include a limit on the Company's share of costs for recent and future retirees and the related accounting anticipates future cost-sharing changes to the written plans that are consistent with the increase in health care cost. Participant contributions are directly applied to claim payments and as such are not included as contributions to plan assets. New employees are ineligible for retiree life insurance or benefits supplemental to Medicare health care.

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The assumed health care cost trend rate as of December 31, 2006 was an initial rate of 10% in 2007 reducing to 5.0% in 2009 and thereafter. A one-percentage point increase in the assumed health care cost trend rate would increase the postretirement benefit obligation by approximately $3.9 million and the aggregate service and interest cost components by $0.3 million, while a decrease of the same magnitude would decrease the postretirement benefit obligations by approximately $4.3 million and the aggregate service and interest cost components by $0.4 million.

U. S. Pension and Postretirement Benefit Plans

The Company provides both funded and unfunded non-contributory defined benefit pension plans to substantially all of its U.S. employees. During 2004, some terms of the U.S. Plan were amended, rendering new hires ineligible and changing the calculation formula to remaining participants from “final pay” to “modified career average pay,” effective January 1, 2005. New employees are ineligible for retiree life insurance or postretirement health care benefits.

The asset allocation for the U.S. Plan as of December 31, 2006 and 2005 and the target allocation for 2007, by asset category, is as follows:

	Target Allocation	Percentage of Plan Assets at December 31,	
Asset category:	2007	2006	2005
Equity securities	61%	71%	66%
Fixed income	32%	22%	26%
Other	7%	7%	8%
Totals	100%	100%	100%

Equity securities are invested in both U.S. and non-U.S. (international) companies. U.S. equity includes the common stock of large, medium, and small companies that are predominantly U.S. based. The plan did not own Hercules common stock as of December 31, 2006 or December 31, 2005. Non-U.S. equity represents equity securities issued by companies domiciled outside the U.S. Fixed income securities include U.S. and non-U.S. government obligations, mortgage-backed securities, collateralized mortgage obligations and corporate debt obligations. Other investments primarily include market neutral, long/short, and event driven-type hedge funds. Investment managers may employ limited use of derivatives, including futures contracts, options on futures, and interest rate swaps in place of direct investment in securities to gain efficient exposure to markets.

The expected long-term rate of return on plan assets was 8.5% for both 2006 and 2005. The overall expected long-term rate of return on assets assumption is a function of the target asset allocation for plan assets, the long-term equilibrium rate of return for the asset class, plus an incremental return attributable to the active management of plan assets.

In developing its investment strategy, the Company considered the following factors for its U.S. Plan: the nature and relative size of the liabilities, the allocation of such liabilities between active and retired members, net cash flows and funded position. The Company also considers the applicable investment horizon, historical and expected capital market return, and the benefits of investment diversification.

The Company manages plan assets with the primary objective of maximizing the long-term investment return given available market opportunities and moderate levels of risk consistent with the nature and purpose of the plan. Plan assets are invested using a combination of active and passive investment strategies. Active strategies employ multiple investment management firms. Managers within each asset class cover a range of investment styles and approaches and are combined in a way that controls market capitalization, style (growth, value, and core) and interest rate risk versus benchmark indices. Security selection is the primary means where value is added from active management. Risk is controlled through diversification among multiple asset classes, managers, styles, and securities. Risk is further controlled both at the manager and asset class level by monitoring performance against assigned return and variability targets.

Expected cash flows for the U.S. Plan and the Company's other postretirement benefit plans, including the total anticipated contributions to be made by the Company in 2007 as well as the future benefit payments expected to be paid from plan or Company assets, are as follows:

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	Pension Benefits			
	Qualified Plan	Non-qualified Plan	Total	Other Postretirement Benefits
Expected employer contributions for 2007	$ 40	$ —	$ 40	$ —
Expected benefit payments				
2007	88	5	93	16
2008	87	5	92	16
2009	88	5	93	15
2010	88	5	93	14
2011	89	5	94	13
2012-2016	476	25	501	55

International Pension Plans

The International Plans are Company provided defined benefit and contribution plans to eligible employees in Europe, Canada and Asia Pacific. The International defined benefit Plans provide benefits based on years of service and final average salary, except for the defined benefit pension plans in The Netherlands ("The Netherlands Plan") and the United Kingdom (the "U.K. Plan") which have both been amended to provide benefits based on a career average pay basis effective January 1, 2006.

The asset allocation for International Plans as of December 31, 2006 and 2005 and the target allocation for 2007, by asset category, is as follows:

	Target Allocation	Percentage of Plan Assets at December 31,	
Asset category:	2007	2006	2005
Equity securities	58%	58%	61%
Fixed income	41%	41%	38%
Other	1%	1%	1%
Totals	100%	100%	100%

The total assets held by The Netherlands Plan and the U.K. Plan account for approximately 90% of the total assets held by International Plans.

The Netherlands Plan's long-term target asset allocation is 58% global equity securities which are actively managed and 42% fixed income investments (debt and debt-like securities, including preferred securities). The fixed income securities are denominated in Euro and are issued and/or guaranteed by European Monetary Union governments (mainly Belgium, Germany, France, Italy and The Netherlands). The fixed income manager may invest on a tactical basis in investment grade corporate bonds denominated in Euro. Investment managers may employ limited use of derivatives, including futures contracts, options on futures, and interest rate swaps in place of direct investment in securities to gain efficient exposure to markets. Derivatives are not used to leverage portfolios.

The expected long-term rate of return on plan assets was 6.75% for 2006 and 6.8% for 2005, respectively. The overall expected long-term rate of return on assets assumption is a function of the target asset allocation for plan assets, the long-term equilibrium rate of return for the asset class, plus an incremental return attributable to the active management of plan assets.

In developing an investment strategy for The Netherlands Plan, the Company has considered the following factors: the nature of the plan's liabilities, the allocation of such liabilities between active members and retired members, the funded status of the plan, the net cash flow of the plan, the investment horizon of the plan, the size of the plan, historical and expected capital market returns and the benefits of investment diversification.

The target asset allocation for the U.K. Plan is 50% global equity securities and 50% fixed income investments (debt and debt-like securities, including preferred securities). The expected long-term rate of return on plan assets was 5.2% and 5.6% for 2006 and 2005, respectively. The overall expected long-term rate of return on assets assumption is a function of the target asset allocation for plan assets, the long-term equilibrium rate of return for the asset class, plus an incremental return attributable to the active management of plan assets.

The Company considers the following factors in the development of its U.K. Plan investment strategy: the nature and relative size of the liabilities, the allocation of such liabilities between active and retired members, net cash flows and funded positions, the applicable investment horizon, historical and expected capital market returns, and the benefits of investment diversification.

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The Company invests its U.K. Plan assets with a Manager of Managers, who invests them with a broad selection of investment managers, each specializing in a different asset class or market. This approach provides a diversified portfolio of managers in order to capitalize on the perceived strengths of each manager within this structure. The Company delegates responsibility for the selection and monitoring of the underlying investment managers to the Manager of Managers.

Expected cash flows for the International Plans, reflecting the total anticipated Company contributions to be made in 2007 and the total benefit payments expected to be paid from the plan assets or Company assets through the year 2016, are summarized in the table below:

	Pension Plan Benefits
Expected employer contributions for 2007	$ 21
Expected benefit payments:	
2007	15
2008	15
2009	16
2010	16
2011	18
2012-2016	97

11. Savings and Investment Plans

The Hercules Incorporated Savings and Investment Plan (“SIP Plan”) allows employees to invest a portion of compensation in a defined contribution 401(k) plan. The Company's matching contributions, made in the form of Hercules' common stock contributed through an Employee Stock Ownership Plan Trust (“ESOP Trust”) are equal to 50% of the first 6% of the employee's contributed compensation and vest immediately. Shares used to fulfill the Company's matching contribution are released at the fair market value of those shares in the period in which they are allocated. The pre-tax difference between cost and fair market value of these allocated shares, which was $6.4 million, $7.3 million and $8.2 million for the years ended December 31, 2006, 2005 and 2004, respectively, is recorded in Additional paid-in capital. Total shares allocated to fund these plan payments were 106,977 and 103,717 for the years ended December 31, 2006 and 2005, respectively. The unallocated shares held by the trust are reflected in Unearned compensation as a reduction in Stockholders' (deficit) equity on the balance sheet of $42.1 million and $53.6 million at December 31, 2006 and 2005, respectively. The unallocated shares have a cost basis of $31.625 per share.

At December 31, 2006 and 2005, the ESOP Trust had $28.3 million and $39.2 million in long-term debt outstanding, respectively, under its loan agreement with the Company; the Company has an offsetting receivable in each year, which is eliminated upon consolidation.

	2006	2005
Allocated	1,200,346	1,458,065
Unallocated	1,332,965	1,695,387
Total shares held by ESOP Trust	2,533,311	3,153,452

The Company's SIP related expense was $6.1 million, $4.0 million and $3.9 million for the years ended December 31, 2006, 2005 and 2004, respectively.

12. Asset Retirement Obligations

The Company has recorded asset retirement obligations (“ARO”) in order to recognize legal obligations associated with the retirement of tangible long-lived assets and for the remediation of environmental liabilities associated with current and former operations incurred during the course of normal operations. Other AROs are attributable to requirements to dismantle facilities and component assets upon their retirement as well as returning leased property to its original condition upon the expiration of their underlying lease terms.

The Company has a number of AROs that are conditional in nature including those triggered upon commitments by the Company to take certain actions, including demolition, renovation and other retirement-related activities as contemplated by FASB Interpretation No. 47, “Accounting for Conditional Asset Retirement Obligations - an interpretation of FASB Statement No. 143” (“FIN 47”). These actions include the preparation of certain properties for sale or for alternative uses as well as the requirement to dismantle the Company’s manufacturing facilities in certain countries upon their ultimate retirement or land lease expiration dates. There are also conditional requirements for asset component retirements in which the Company can reasonably estimate both the amount of the required settlement as well as the range of settlement dates.

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There are a number of remaining conditional AROs whereby the Company does not have sufficient information to estimate the fair value of the liabilities because the range of settlement dates has not been specified by others and/or cost estimates are not available to apply an expected present value technique. Most significant among these unrecognized conditional AROs are those attributable to the abatement of asbestos at manufacturing facilities, and environmental contamination. Asbestos is present in a substantial number of the Company's facilities. In general, regulations in the U.S. and other countries do not require removal or abatement unless the condition is hazardous or if the structure or component is disturbed through such activities as renovation or demolition.

With respect to environmental contamination, the Company operates within the requirements of numerous regulations at the local, state and U.S. Federal and foreign levels regarding issues such as the handling and disposal of hazardous chemicals, waste-water treatment and effluent and emissions limitations, among others. From a practical standpoint, certain environmental contamination cannot be reasonably determined until a facility or asset is retired or an event occurs that otherwise requires the facility to be tested and monitored. In the absence of such requirements to test for environmental contamination prior to an asset or facility retirement, the Company has concluded that it cannot reasonably estimate the cost associated with such environmental-related AROs. In addition, the Company anticipates operating its manufacturing facilities indefinitely into the future thereby rendering the potential range of settlement dates as indeterminate.

As of December 31, 2006, the Company has accrued a total of $76.3 million with respect to AROs. Of this amount, approximately $72.3 million is for environmental remediation associated with current and former operating sites. An amount of $21.0 million is included in Accrued expenses representing amounts to be settled during 2007 and the remaining $55.3 million is included in Deferred credits and other liabilities. The AROs have been recognized on a discounted basis using a credit-adjusted risk free rate. Accretion of the AROs is recorded in Other operating expense, net for active operating sites and facilities and Other expense, net for inactive sites associated with businesses that have been exited or divested.

The following table provides a reconciliation of changes in the AROs during the period:

	Active Sites	Inactive Sites	Total
Balance at January 1, 2005	$ 7.1	$ 89.2	$ 96.3
Impact of the adoption of FIN 47	4.0	—	4.0
Accretion	0.2	1.8	2.0
Settlement payments	(1.2)	(9.0)	(10.2)
Changes in estimated obligations	0.3	3.2	3.5
Transfers of obligations	—	(4.4)	(4.4)
Foreign currency translation	(0.2)	(0.7)	(0.9)
Balance at December 31, 2005	$ 10.2	$ 80.1	$ 90.3
Accretion	0.8	1.4	2.2
Settlement payments	(4.3)	(14.1)	(18.4)
Changes in estimated obligations	3.2	(1.6)	1.6
Foreign currency translation	0.2	0.4	0.6
Balance at December 31, 2006	$ 10.1	$ 66.2	$ 76.3

While not reflected in the table above, the Company has recognized $5.3 million for environmental contingencies whereby it is reasonably likely that the Company has incurred a liability for costs associated with environmental remediation or for the probable settlement of related litigation. Liabilities included in this amount are attributable to sites that the Company formerly owned as well as sites that the Company did not have an ownership interest therein, but was associated with activities at such sites, including landfills, waste sites and other similar properties.

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13. Commitments and Contingencies

Guarantees

In accordance with FASB Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" ("FIN 45"), disclosures about each group of similar guarantees are provided below:

Indemnifications

In connection with the sale of the Company assets and businesses, the Company has indemnified respective buyers against certain liabilities that may arise in connection with the sales transactions and business activities prior to the ultimate closing of the sale. These indemnifications typically pertain to environmental, tax, employee and/or product related matters. If the indemnified party were to incur a liability or have a liability increase as a result of a successful claim, pursuant to the terms of the indemnification, the Company would be required to reimburse the buyer. These indemnifications are generally subject to threshold amounts, specified claim periods and/or other restrictions and limitations. The carrying amount recorded for indemnifications as of December 31, 2006 was $41.2 million. Although it is reasonably possible that future payments may exceed amounts accrued, due to the nature of indemnified items, it is not possible to make a reasonable estimate of the maximum potential loss or range of loss. Generally, there are no specific recourse provisions.

In addition, the Company provides certain indemnifications in the ordinary course of business such as product, patent and performance warranties in connection with the manufacture, distribution and sale of its products and services. Due to the nature of these indemnities, it is not possible to make a reasonable estimate of the maximum potential loss or range of loss.

Debt and Other Obligations

The Company has directly guaranteed up to $43.5 million of various obligations under agreements with third parties related to subsidiaries, VIEs and affiliates of which $30.4 million is outstanding. The outstanding balance reflects guarantees of debt for terms of varying length as well as a guarantee related to a foreign-based pension plan with an indefinite term. The Company has also provided $2.9 million in collateral in the form of a mortgage security for the aforementioned pension plan. Existing guarantees for subsidiaries and affiliates arose from liquidity needs in normal operations.

Intercompany Guarantees

The Company and its subsidiaries have authorized intercompany guarantees between and among themselves which aggregate $191.5 million, of which $179.6 million was outstanding as of December 31, 2006. These guarantees relate to intercompany loans used to facilitate normal business operations and have been eliminated from the Company's Consolidated Financial Statements.

Leases

Hercules has operating leases (including office space, transportation and data processing equipment) expiring at various dates. Lease expense of $19.7 million, $20.6 million and $22.1 million in 2006, 2005 and 2004, respectively, is net of sub-lease income of $5.1 million, $5.2 million and $5.4 million in 2006, 2005 and 2004, respectively.

At December 31, 2006, minimum rental payments under non-cancelable leases aggregated $133.4 million with offsetting subleases of $32.4 million. A significant portion of these payments relate to a long-term operating lease for corporate office facilities. The minimum payments over the next five years, net of minimum sublease receipts, are $18.9 million in 2007, $18.9 million in 2008, $25.7 million in 2009, $11.8 million in 2010, $11.0 million in 2011 and $14.7 million thereafter.

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.

The Company 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 Company 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 ("EPA") 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.

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While the Company is involved in numerous environmental matters, the following matters are described below because they are currently viewed by management as potentially material to the Company's consolidated financial position, results of operations and cash flows.

United States of America v. Vertac Chemical Corporation, et al., No. 4:80CV00109 (United States District Court, Eastern District of Arkansas, Western Division)

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 in litigation since 1980, and involves liability for costs in connection with the investigation and remediation of the Vertac Chemical Corporation ("Vertac") site in Jacksonville, Arkansas. The Company 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, the Company sold the site to Vertac. The site was abandoned by Vertac in 1987, and Vertac was subsequently placed into receivership. Both prior to and following the abandonment of the site, the EPA and the Arkansas Department of Pollution Control and Ecology were involved in the investigation and remediation of contamination at and around the site. Pursuant to several orders issued under CERCLA, the Company actively participated in many of those activities. The cleanup is essentially complete, except for certain on-going maintenance and monitoring activities. This litigation primarily concerns the responsibility and allocation of liability for the costs incurred in connection with the activities undertaken by the EPA.

The procedural history of this litigation is discussed in greater detail in reports previously filed by the Company with the SEC. In summary, in 1999, the District Court finalized a ruling holding the Company and Uniroyal jointly and severally liable for approximately $100 million in costs incurred by the EPA, as well as costs to be incurred in the future. In 2000, the District Court allocated 2.6% of such amounts to Uniroyal and 97.4% of such amounts to the Company. Both the Company and Uniroyal appealed those rulings to the U.S. Court of Appeals for the Eighth Circuit (the "Court of Appeals"). In 2001, the Court of Appeals reversed the District Court's rulings as to joint and several liability and allocation, and remanded the case back to the District Court for several determinations, including a determination of whether the harms at the site giving rise to the EPA's claims were divisible. The trial on remand occurred in late 2001.

By Memorandum Opinion and Order dated March 30, 2005, the District Court largely affirmed its prior findings and prior judgment against the Company and Uniroyal, and the prior allocation with respect to the Company and Uniroyal, although the District Court did agree that the Company should not be liable for costs associated with a particular off-site landfill, and held that the judgment should be reduced accordingly. By Order dated June 6, 2005, the District Court entered a Final Judgment in favor of the United States and against the Company for $119.3 million, of which amount Uniroyal has been held jointly and severally liable for $110.4 million, with the Company alone liable for the difference. The Final Judgment also provided that both the Company and Uniroyal are responsible for any additional response costs incurred or to be incurred by the United States after June 1, 1998, as well as post-judgment interest running from the date of the Final Judgment. In addition, the District Court re-affirmed its prior holding which allocated 2.6% of the $110.4 million in response costs for which Uniroyal is jointly and severally liable, or $2.9 million, to Uniroyal. Finally, the Final Judgment found Uniroyal liable to the Company for 2.6% of the response costs incurred by the Company of approximately $27.4 million, or $0.7 million. Both the Company and Uniroyal appealed the Final Judgment to the Court of Appeals, asserting that the District Court had committed reversible error.

On July 13, 2006, a panel of the Court of Appeals affirmed the Final Judgment of the District Court. The Company requested that the panel's determination be reviewed *en banc*, but that request was denied by Order dated September

19, 2006. On December 14, 2006, the Company filed a Petition for a Writ of Certiorari with the United States Supreme Court, requesting that the Supreme Court review this matter. No action has yet been taken by the Supreme Court with respect to the Company's Petition. While the Company continues to believe that the Final Judgment should be reversed, the Supreme Court agrees to review very few matters, and it is therefore probable that the Company will not be successful in having the Supreme Court agree to review the July 13, 2006 decision which affirmed the Final Judgment. Accordingly, the Company has accrued its total net liability of $123.5 million, including interest but not including amounts for which Uniroyal has been held liable, based on the Final Judgment, which is recorded as a current liability at December 31, 2006. The Company will continue to accrue interest on this amount until such time as the Final Judgment is either reversed or is paid. If the Company is ultimately required to pay such amount to the United States, an event which could occur in 2007 or thereafter, the payment of such amount could have a material adverse effect upon the Company's cash flows in such annual, quarterly or other period.

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Alleghany Ballistics Laboratory

The Alleghany Ballistics Laboratory (“ABL”) is a government-owned facility which was operated by the Company from 1945 to 1995 under contract with the United States Department of the Navy. The Navy and the Company have commenced discussions with respect to certain environmental liabilities which the Navy alleges are attributable to the Company’s past operations at ABL. During the course of discussions, the Navy has stated that, pursuant to CERCLA, it has spent and anticipates spending in the future a total of approximately $76 million. The Company has conducted an investigation of the Navy’s allegations, including the basis of the Navy’s claims, and believes the contracts with the government pursuant to which the Company operated ABL may provide the Company with a defense from some or all of the amounts sought. The Company has exchanged information with the Navy and discussions with the Navy are continuing. 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 below.

Kim Stan Landfill

The Company is one of a limited number of industrial companies that have been identified by the EPA as a PRP at the Kim Stan Landfill, near Covington, Virginia. The EPA is seeking to have the PRPs undertake the remediation of the site at a currently estimated cost of $12.0 million (including EPA oversight charges). Based on the investigation conducted to date, the Company believes that parties not named by the EPA as PRPs may be responsible for the majority of the costs that have been and will be incurred at the site and intends to seek contribution from those parties to the extent it is required to pay any monies in connection with the site. As a result of that investigation, the Company believes that it has defenses that would substantially reduce its exposure. The Company and two other PRPs are in negotiations with the EPA in an attempt to resolve this matter in an equitable manner. The Company believes it is probable that this matter will ultimately be amicably resolved, and the amount the Company reasonably estimates that it will pay is included in the accrued liability for environmental matters reported below.

Clean Air Act Notice of Violation

On December 23, 2005, EPA Region III issued a Notice of Violation (“NOV”) to the Company and to Eastman Company (“Eastman”) that alleges various violations of the Clean Air Act, primarily focused on the Act’s requirements governing emissions of volatile organic compounds, at a manufacturing facility located in West Elizabeth, Pennsylvania. (In the Matter of Eastman Company and Hercules Incorporated, EPA Region III, Docket No. CAA-III-06-011.) That facility was sold to Eastman as part of the Company's divestiture of its Resins business in May 2001. The EPA has not specifically made a demand for monetary penalties upon the Company and Eastman. The Company is continuing to investigate the allegations set forth in the NOV, as well as any indemnification obligations that it may owe to Eastman pursuant to the terms of the purchase and sale agreement. At this time, however, the Company cannot reasonably estimate its liability, if any, with respect to this matter and, accordingly, has not included this site in the accrued liability for environmental matters reported below.

Range of Exposure

The reasonably possible share of costs for environmental matters involving current and former operating sites, including those with identified asset retirement obligations (see Note 12), the Vertac site and other locations where the Company may have a liability, is approximately $205 million as of December 31, 2006. This accrued liability is evaluated at least quarterly 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. The actual costs for these matters 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 or more years. While it is not feasible to predict the outcome of all pending environmental matters, the ultimate resolution of one or more of these environmental matters could have a material adverse effect upon the Company's financial position, results of operations and/or cash flows for any annual, quarterly or other period.

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Litigation

The Company is involved in litigation arising out of or incidental to the conduct of its business. Such litigation typically falls within the following broad categories: environmental (discussed above); antitrust; commercial; intellectual property; labor and employment; personal injury; property damage; product liability; and toxic tort. These matters typically seek unspecified or large monetary damages or other relief, and may also seek punitive damages. While it is not feasible to predict the outcome of all pending matters, the ultimate resolution of one or more of these matters could have a material adverse effect upon the Company's financial position, results of operations and/or cash flows for any annual, quarterly or other period. While the Company is involved in numerous matters, certain matters are described below because they are currently viewed by management as potentially material. From time to time, management may determine (based on further analysis or additional information that becomes available through discovery or otherwise) that other matters are or have become potentially material to the Company. As appropriate, descriptions of such matters will be included in the periodic report following such determination. Occasionally, management may not determine that a matter is material until it has been settled or otherwise resolved. In such a situation, that matter may not have been described in the Company's periodic reports prior to such settlement or resolution, but the impact of such settlement or resolution would be reflected in the financial statements included in the periodic report following such settlement or resolution.

Asbestos

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 an on-going basis.

As of December 31, 2006, there were approximately 26,045 unresolved claims, of which approximately 980 were premises claims and the rest were products claims. There were also approximately 2,075 unpaid claims which have been settled or are subject to the terms of a settlement agreement. In addition, as of December 31, 2006, there were approximately 528 claims which have either been dismissed without payment or are in the process of being dismissed without payment, but with plaintiffs retaining the right to re-file should they be able to establish exposure to an asbestos-containing product for which the Company bears liability.

Between January 1, 2006 and December 31, 2006, the Company received approximately 2,665 new claims. During that same period, the Company spent approximately $31.5 million to resolve and defend asbestos matters, including $23.1 million in settlement payments and approximately $8.4 million for defense costs.

The Company's primary and first level excess insurance policies that provided coverage for these asbestos-related matters exhausted their products limits at or before the end of July 2003. On November 27, 2002, the Company initiated litigation against the solvent excess insurance carriers that provided insurance coverage for asbestos-related liabilities in a matter captioned Hercules Incorporated v. OneBeacon, et al., Civil Action No. 02C-11-237 (SCD), Superior Court of Delaware, New Castle County. Beginning in August 2004 and continuing through October 2004, the Company entered into settlements with all of the insurers named in that lawsuit. As a result, the lawsuit was dismissed in early November 2004.

As discussed in greater detail in reports previously filed by the Company with the SEC, the Company entered into several settlements with its insurers in 2004. The first such settlement involved insurance policies issued by certain underwriters at Lloyd's, London, and reinsured by Equitas Limited and related entities ("Equitas") (the "First Settlement Agreement"). As part of that settlement, Equitas placed $67.0 million into a trust (the "Equitas Trust") set up to reimburse the Company for a portion of the costs it incurred to defend and resolve certain asbestos claims. In exchange, the Company released the underwriters from past, present and future claims under those policies, agreed to the cancellation of those policies, and agreed to indemnify the underwriters from any claims asserted under those policies. In addition, the settlement provided that if federal asbestos reform legislation was not enacted into law on or prior to January 3, 2007, any funds remaining in the Equitas Trust would be available to the Company to pay asbestos-related liabilities or to use for other corporate purposes. Federal asbestos reform legislation was not enacted on or prior to January 3, 2007. As a result, on January 4, 2007, the Company received as a lump sum distribution approximately $41.3 million, an amount representing a complete liquidation of the remaining balance of the Equitas Trust, including accrued interest, and the Equitas Trust has been terminated.

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In addition, effective October 8, 2004, the Company entered into a comprehensive confidential settlement agreement with respect to certain insurance policies issued by various insurance companies operating in the London insurance market, and by one insurance company located in the United States (the "Second Settlement Agreement"). Under the terms of the Second Settlement Agreement, the participating insurers agreed to place a total of approximately $102.2 million into a trust (the "Second Trust"), with such amount to be paid over a four-year period commencing in January 2005 and ending in 2008. In exchange, the Company released the insurers from past, present and future claims under those policies, agreed to the cancellation of those policies, and agreed to indemnify the insurers from any claims asserted under those policies. The trust funds have been and are continuing to be used to reimburse the Company for costs it incurs to defend and resolve asbestos-related claims. Any funds remaining in the Second Trust subsequent to December 31, 2008 may be used by the Company to defend and resolve both asbestos-related claims and non-asbestos related claims. As of December 31, 2006, approximately $66.1 million of the $102.2 million had been placed into the Second Trust, and the Second Trust had a balance of approximately $13.8 million. On or about January 31, 2007, an additional $16.4 million was placed into the Second Trust.

The Company also reached settlement agreements with additional insurers whose level of participation in the Company's insurance program is substantially lower than the aggregate participation of the insurers referred to above (the "Other Settlement Agreements"). Pursuant to the Other Settlement Agreements, the Company has released or partially released its rights to coverage under insurance policies issued by such insurers. The Company has received all amounts due under the Other Settlement Agreements.

In addition, effective October 13, 2004, the Company reached a confidential settlement agreement with the balance of its solvent excess insurers whereby a significant portion of the costs incurred by the Company with respect to future asbestos product liability claims will be reimbursed, subject to those claims meeting certain qualifying criteria (the "Future Coverage Agreement"). That agreement is not expected to result in reimbursement to the Company, however, unless and until defense costs and settlement payments for qualifying asbestos products claims paid by the Company subsequent to the effective date of the agreement (with credit for certain amounts spent prior to the effective date of the agreement) aggregate to approximately $330 million to $370 million, with the foregoing approximation based on various assumptions, including that there are sufficient qualifying claims to require such payments, that for such qualifying claims the time periods of each claimant's alleged exposure to asbestos products falls within the time periods covered by the participating insurers' policies, and that each of the participating insurers remain solvent and honor their commitments under the terms of the Future Coverage Agreement. The Company expects that such amounts, if required to be paid, would be paid by the Company using monies from the above settlements and from other sources. If and when such amounts are paid by the Company, the insurers' obligations pursuant to the terms of the Future Coverage Agreement would be triggered, and the participating insurers would thereafter be required to pay their allocated share of defense costs and settlement payments for asbestos product liability claims that qualify for reimbursement subject to the limits of their insurance policies, which limits are believed to be sufficient to cover the insurers' allocated shares of an amount that exceeds the high end of the reasonably possible range of financial exposure described below. The Company will be responsible for the share of such costs and payments that are not reimbursed by the participating insurers pursuant to the terms of the Future Coverage Agreement, as well as for such costs and payments for those claims that do not qualify for reimbursement under the terms of the Future Coverage Agreement. Should asbestos reform legislation be passed, some or all of the obligations under the Future Coverage Agreement will be suspended for so long as such legislation remains in effect. As of December 31, 2006, defense costs and settlement payments for qualifying asbestos products claims of approximately $82 million have been credited towards the range of $330 million to $370 million noted above.

As a result of the above settlements, the Company is expected to have available to it a combination of cash and trust fund monies which can be used to pay or reimburse the Company for a significant portion of the defense costs and settlement payments that may be incurred by the Company with respect to its asbestos-related liabilities. Upon exhaustion of the trust fund monies, the Company will be required to fund such liabilities itself until such time as the insurers' obligations under the Future Coverage Agreement are triggered. If and when those obligations are triggered, the Company and the insurers who are participants in the Future Coverage Agreement will share qualifying asbestos product liability claims defense costs and settlement payments at varying levels over time, with the Company typically bearing a slightly larger share than such participating insurers. Of note, as a result of the First Settlement Agreement, Second Settlement Agreement and Other Settlement Agreements, substantially all of the Company's insurance coverage applicable to asbestos products claims has been cancelled (except for obligations under the Future Coverage Agreement), and such insurance coverage will no longer be available to cover any such claims. In addition and as described above, as a result of the First Settlement Agreement, Second Settlement Agreement and Other Settlement Agreements, substantial amounts of insurance coverage that would have been available to cover insured claims other than asbestos products claims have been cancelled and will no longer be available to cover such claims.

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Based on the current number of claims pending, the amounts the Company anticipates paying to resolve those claims which are not dismissed or otherwise resolved without payment, and anticipated future claims, the Company believes that the total monetary recovery under the settlements noted above will provide coverage for a significant portion, but less than a majority, of the Company's monetary exposure going forward for its estimated asbestos-related liabilities. Since the settlements noted above were entered into, the Company's insurers have paid over $207 million to the Company and to the Trusts referred to above. Some of those payments have been used to pay or reimburse the Company for asbestos-related liabilities, and some of those payments have been used by the Company for other corporate purposes. Based on the Company's current claims experience, it is possible that before the end of 2007, the Company will be responsible for payment of a portion of its asbestos-related liabilities without the ability to seek reimbursement from the Second Trust, and that by mid-2008, or earlier, it is likely that the Company will be responsible for payment of all such liabilities until such time as the obligations under the Future Coverage Agreement are triggered, at which point in time the Company is expected to share the cost of defending and settling qualifying asbestos product liability claims with the participating insurers, with it being anticipated that the Company will typically bear a slightly larger share than the participating insurers. In any period of time, however, including after obligations under the Future Coverage Agreement are triggered, the amounts paid by the Company in connection with the defense and settlement of asbestos claims versus the amounts funded and to be funded by settlement monies and amounts anticipated to be reimbursed by the Future Coverage Agreement are expected to vary significantly.

In early 2003, the Company commissioned a study of its asbestos-related liabilities by a recognized expert at a major national university, who is a member of the American Academy of Actuaries with broad experience in estimating such liabilities. Since that time, such study has been updated several times to take into account the then most current data concerning, among other factors, the Company's claims and payment experience. In January 2007, the study was updated again and, as a result, the reasonably possible exposure for these matters as of December 31, 2006 was revised to a range of $270 million to $770 million, which is the same as the previously established range at the lower end, and slightly lower than the previously established range at the high end. Due to inherent uncertainties in estimating the timing and amounts of future payments, the foregoing range does not include the effects of inflation and has not been discounted for the time value of money. In addition, the range of financial exposures set forth above does not include estimates for future legal costs. It is the Company's policy to expense these legal costs as incurred. Cash payments related to this exposure are expected to be made over an extended number of years and actual payments, when made, could be for amounts in excess of the range due to potential future changes in estimates as well as the effects of inflation.

The foregoing is based on the Company's assumption that the number of future claims filed per year and claim resolution payments will vary considerably from year-to-year and by plaintiff, disease, venue and other circumstances, but will, when taken as a whole, remain relatively consistent with the Company's experience to date and will decline as the population of potential future claimants expires due to non-asbestos-related causes. It is also based on the results of the updated study and the status of the Company's settlements with its insurers, as described above. However, the Company recognizes that the number of future claims filed per year and claim resolution payments could greatly exceed those reflected by its past experience and contemplated by the study referenced above, that the Company's belief of the range of its reasonably possible financial exposure could change as the study referenced above is periodically updated, and that its evaluation of the total payments to be received from its insurers may change depending upon numerous variables including potential legislation and the risk that one or more insurance carriers may refuse or be unable to meet their obligations to the Company. Moreover, while the expert noted above has applied his methodology in determining the Company's reasonably possible range of exposures for these liabilities on a consistent basis, other methods in practice exist which place a differing degree of emphasis on the underlying variables used to measure asbestos-related contingencies. Such other methods could yield significantly different ranges of reasonably possible exposures.

Due to the dynamic nature of asbestos litigation, the Company's estimates are inherently uncertain, and these matters may present significantly greater financial exposures than presently anticipated. In addition, the Company intends to periodically update the asbestos study referenced above, and further analysis combined with new data received in the future could result in a material modification of the range of reasonably possible financial exposure set forth above. As a result of all of the foregoing, the Company's liability with respect to asbestos-related matters could vary significantly from present estimates and may require a material change in the accrued liability for these matters within the next 12 months. If the Company's liability does exceed amounts recorded in the balance sheet sufficient to trigger the obligations under the Future Coverage Agreement, the Company presently believes that a significant portion of the liability it may reasonably anticipate will be reimbursed by monies to be received pursuant to the Future Coverage Agreement. However, there can be no assurance that such liabilities will be reimbursed.

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The findings of the updated study referenced above identified a range of the Company's reasonably possible financial exposure for these asbestos-related matters. The Company adjusted its accrual for present and future potential asbestos claims before anticipated insurance recoveries at December 31, 2006 to $270.0 million, reflecting the low end of the range noted above in accordance with generally accepted accounting principles (since no amount within the range is a better estimate than any other amount).

The following table presents the beginning and ending balances and balance sheet activity for the Company's asbestos-related accounts for the year ended December 31, 2006.

	Balance January 1, 2006	Interest Income/ Additional Accruals	Insurance Recovered/ Liabilities Settled	Accretion/ Reclassification	Balance December 31, 2006
Asbestos-related assets:					
Insurance receivable	$ 65.2	$ —	$ (33.3)	$ 0.9	$ 32.8
Restricted cash in trust	55.5	3.0	(3.8)	—	54.7
Asbestos-related assets	$ 120.7	$ 3.0	$ (37.1)	$ 0.9	$ 87.5
Asbestos-related liabilities:					
Asbestos-related liabilities, current	$ 36.4	$ —	$ —	$ —	$ 36.4
Asbestos-related liabilities, non-current	233.6	23.1	(23.1)	—	233.6
Total asbestos-related liabilities	$ 270.0	$ 23.1	$ (23.1)	$ —	$ 270.0

The Company, in conjunction with outside advisors, will continue to study its asbestos-related matters, insurance recovery expectations and reserves on an ongoing basis, and make adjustments as appropriate.

Composite Products Antitrust and Qui Tam Matters

Commencing in 1999, the Company was one of several companies sued in a series of civil antitrust and related lawsuits concerning the pricing and sale of carbon fiber and carbon prepreg products (together referred to as "carbon fiber products"). These products were manufactured and sold by the Company's former Composite Products division, which division was sold to Hexcel Corporation in 1996. These lawsuits encompassed the following: (a) a federal class action brought on behalf of direct purchasers of carbon fiber products captioned Thomas & Thomas Rodmakers v. Newport Adhesives and Composites, Case No. CV-99-07796-GHK (CTx) (U.S. District Court, Central District of California; (b) a total of nine California state purported class actions brought on behalf of indirect purchasers of carbon fiber products, all consolidated under the caption Carbon Fiber Cases I, II, and III, Judicial Council Coordination Proceeding Nos. 4212, 4216 and 4222, Superior Court of California, County of San Francisco; (c) a Massachusetts state purported class action brought on behalf of indirect purchasers of carbon fiber products captioned Saul M. Ostroff, et al. v. Newport Adhesives, et al., Civil Action No. 02-2385, Superior Court of Middlesex County; and (d) a lawsuit brought by Horizon Sports Technologies, a company that had "opted out" of the federal class action lawsuit referred to above and captioned Horizon Sports Technologies, Inc. v. Newport Adhesives and Composites, Inc., et al., Case No. CV02-8126 FMC (RNEX), U.S. District Court, Central District of California, Western Division. In addition, the Company and the other defendants in the foregoing lawsuits were sued in a related "Qui Tam" action captioned Randall M. Beck, et al. v. Boeing Defense and Space Group, Inc., et al., (Civil Action No. 99 CV 1557 JM JAH), which lawsuit was originally filed under seal in 1999 pursuant to the False Claims Act, 31 U.S.C. Section 729 et seq. Throughout 2005, the Company entered into agreements to resolve each of the foregoing lawsuits, and the results of such settlements have been reflected in the Company's financial statements. At this time, all of the forgoing lawsuits have been resolved, and all payments have been made, without any admission of liability. Each of the settlements was entered into by the Company in order to avoid the risks, uncertainties and costs inherent in litigation. In addition to the foregoing, two of the Company's former customers have "opted-out" of the Federal and California state class actions referred to above. The Company believes it probable that the claims of these two former customers will ultimately be amicably resolved, and the amount that the Company reasonably estimates that it will pay is included in the accrued liability for non-asbestos litigation reported below. Furthermore, by letter dated January 30, 2007, one of the defendants in the foregoing lawsuits asserted a claim against the Company for damages as a result of the alleged anticompetitive activities alleged in the lawsuits described above, and requested that the Company enter into settlement discussions. The Company intends to investigate this claim, but currently believes it is without merit and legally defensible.

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In December 2004, the Company filed a lawsuit against Hexcel Corporation (Hercules Incorporated v. Hexcel Corporation, Supreme Court of the State of New York, County of New York, Index No.04/604098) seeking indemnification for the settlements described above. The lawsuit against Hexcel is based on the terms of the purchase and sale agreement by which the Company sold its Composite Products division to Hexcel in 1996. In response, Hexcel Corporation has denied liability and has filed a counter-claim also seeking indemnification. Both parties have filed motions for summary judgment, but no ruling has yet been issued by the Court. No date for trial has been set.

Agent Orange Litigation

Agent Orange is a defoliant that was manufactured by several companies, including the Company, at the direction of the U.S. Government, and used by the U.S. Government in military operations in both Korea and Vietnam from 1965 to 1970. In 1984, as part of a class action settlement, the Company and other defendants settled the claims of persons who were in the U.S., New Zealand and Australian Armed Forces who alleged injury due to exposure to Agent Orange. In Re "Agent Orange" Prod. Liab. Litig., 597 F. Supp. 740 (E.D.N.Y. 1984). Following that settlement, all claims for alleged injuries due to exposure to Agent Orange by persons who had served in the Armed Forces of those countries were treated as covered by that class action settlement.

On June 9, 2003, the United States Supreme Court affirmed the decision of the United States Court of Appeals for the Second Circuit in a case captioned Dow Chemical Company, et al. v. Daniel Raymond Stephenson, et al., 123 S. Ct. 2161 (2003), where plaintiffs Stephenson and Isaacson (in a separate but consolidated case) alleged that they were injured from exposure to Agent Orange and that such injury did not manifest until after exhaustion of the settlement fund created through the 1984 class action settlement. As a result of that decision, the claims of persons who allege injuries due to exposure to Agent Orange and whose injuries first manifest themselves after exhaustion of the settlement fund created through the 1984 class action settlement may no longer be barred by the 1984 class action settlement and such persons may now be able to pursue claims against the Company and the other former manufacturers of Agent Orange.

Currently, the Company is a defendant in approximately twenty-eight lawsuits (including two purported class actions) where plaintiffs allege that exposure to Agent Orange caused them to sustain various personal injuries. On February 9, 2004, the U.S. District Court for the Eastern District of New York issued a series of rulings granting several motions filed by defendants in the two cases that had been remanded to the U.S. District Court by the U.S. Court of Appeals for the Second Circuit on remand from the U.S. Supreme Court (In re: "Agent Orange" Product Liability Litigation: Joe Isaacson, et al v. Dow Chemical Company, et al. and Daniel Raymond Stephenson, et al. v. Dow Chemical Company, et al. (MDL 381, CV 98-6383 (JBW), CV 99-3056 (JBW))). In relevant part, those rulings held that plaintiffs' claims against the defendant manufacturers of Agent Orange that were brought in the state courts are properly removable to federal court under the "federal officer removal statute" and that such claims are subject to dismissal by application of the "government contractor defense." The Court then dismissed plaintiffs' claims, but stayed its decision to allow plaintiffs to obtain additional discovery and to move for reconsideration of the Court's decision. A hearing on the motion for reconsideration was held on February 28, 2005. By Orders dated March 2, 2005, the Court denied reconsideration, lifted the stay of the earlier decision, and dismissed plaintiffs' claims in all of the lawsuits that were before the Court at that time. Plaintiffs have appealed those dismissals to the United States Court of Appeals for the Second Circuit.

In addition, in January 2004, the Company was sued in a purported class action filed in the United States District Court for the Eastern District of New York by The Vietnam Association for Victims of Agent Orange/Dioxin and several individuals who claim to represent between two and four million Vietnamese who allege that Agent Orange used by the United States during the Vietnam War caused them or their families to sustain personal injuries. (The Vietnam Association for Victims of Agent Orange/Dioxin, et al. v. The Dow Chemical Company, et al., Civil Action No. 04 CV 0400 (JBW)). That complaint alleges violations of international law and war crimes, as well as violations of the common law for products liability, negligence and international torts. The defendants moved to dismiss this case on several grounds, including failure to state a claim under the Alien Tort Claims Statute, lack of jurisdiction and justiciability, the bar of the statute of limitations, failure to state claims for violations of international law, and the "government contractor defense." A hearing on these motions was held on February 28, 2005. By order dated March 10, 2005, the Court dismissed this lawsuit. Plaintiffs have appealed that dismissal to the United States Court of Appeals for the Second Circuit.

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In addition, in 1999, approximately 17,200 Korean veterans of the Vietnam War filed suit in the 13th Civil Department of the District Court in Seoul, Korea, against The Dow Chemical Company ("Dow") and Monsanto Company ("Monsanto") for their alleged injuries from exposure to Agent Orange. These lawsuits were filed under various captions, including Dong Jin Kim and 9 others, 99 Gahap 84123, Il Joo La and 9 others, 99 Gahap 84147, and Dae Jin Jang, 99 Gahap 84130. Following the commencement of those lawsuits, Dow and Monsanto petitioned the court to issue Notices of Pendency to each of the non-defendant manufacturers of Agent Orange, including the Company, in an attempt to bind those companies to factual and legal findings which may be made in the Korean courts if Dow and Monsanto are held liable to plaintiffs and sue those companies for contribution. Thereafter, the Company was served with such notices through diplomatic channels. In 2002, the District Court dismissed the plaintiffs' claims, and the plaintiffs appealed. It has been reported that on January 26, 2006, the intermediate appellate court in Seoul reversed the District Court and awarded damages of $65.2 million plus pre- and post-judgment interest to approximately 6,800 of the approximately 17,200 plaintiffs that filed these lawsuits. The Company has been informed that Dow and Monsanto have appealed. If Dow and Monsanto are not successful on appeal, it is possible that they might initiate an action seeking contribution from the non-defendant manufacturers of Agent Orange, including the Company. Further, if the intermediate appellate court's decision is ultimately upheld, it is possible that new lawsuits could be brought in Korea against the Agent Orange manufacturers, including the Company, by other Korean veterans of the Vietnam War.

The Company believes that it has substantial meritorious defenses to all of the Agent Orange-related claims described above and those that may yet be brought. To that end, the Company denies any liability to plaintiffs, and will vigorously defend all actions now pending or that may be brought in the future.

Other Litigation

The Company is one of several defendants that had been sued by over 2,000 individuals in a series of lawsuits, including a purported class action lawsuit, captioned Jerry Oldham, et al. v. The State of Louisiana, et al., Civil Action No. 55,160, John Capone, et al. v. The State of Louisiana, et al., Civil Action No. 56,048C, and Georgenner Batton, et al. v. The State of Louisiana, et al., Civil Action No. 55,285, all brought in the 18th Judicial District Court, Parish of Iberville, Louisiana. The purported class members and plaintiffs, who claimed to have worked or lived at or around the Georgia Gulf facility in Iberville Parish, Louisiana, alleged injury and fear of future illness from the consumption of contaminated water and, specifically, elevated levels of arsenic in that water. As to the Company, plaintiffs alleged that the Company itself and as part of a joint venture operated a nearby plant and, as part of those operations, used a groundwater injection well to dispose of various wastes, and that those wastes contaminated the potable water supply at Georgia Gulf. In August 2005, the Company and several other defendants entered into an agreement to settle these matters with the Company agreeing to pay $1,412,000, an amount which has since been paid. On May 4, 2006, the Court granted settlement class certification. This settlement, which was agreed to by the Company without any admission of liability, is pending final approval by the Court.

On May 7, 2004, Ciba Specialty Chemicals Corporation ("Ciba") filed a Complaint against the Company and Cytec Industries, Inc. ("Cytec") in the United States District Court for the District of Delaware alleging infringement of two patents owned by Ciba (Ciba Specialty Chemicals Corporation v. Hercules Incorporated and Cytec Industries, Inc., C.A. No. 04-293 (KAJ)). The two patents in question are U.S. Patent 5,167,766 (issued on December 1, 1992) entitled "Charged Organic Polymer Microbeads in Paper Making Process" and U.S. Patent 5,171,808 (issued on December 15, 1992) entitled "Cross-linked Anionic and Amphoteric Polymeric Microparticles." The alleged conduct related to the manufacture, use, sale and offer to sell of certain products of the Company's Paper Technologies and Ventures segment. Ciba sought to enjoin alleged continued infringement, obtain a judgment that the defendants infringed the patents, and obtain an award of damages and reasonable attorney's fees. The Company agreed to indemnify Cytec with respect to Ciba's patent infringement charges. On June 26, 2006, the Court issued a Memorandum Opinion in which the Court granted the Company's and Cytec's motions for summary judgment and denied Ciba's motion for summary judgment. On July 27, 2006, the Court entered Judgment in favor of the Company and Cytec and against Ciba. On August 25, 2006, Ciba filed a Notice of Appeal to the United States Court of Appeals for the Federal Circuit. Settlement discussions with Ciba and Cytec followed and a confidential settlement was reached in December 2006. Ciba withdrew its appeal and, in January 2007, this matter was dismissed.

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In June 2004, a purported class action captioned Charles Stepnowski v. Hercules Inc.; The Pension Plan of Hercules Inc.; The Hercules Inc. Finance Committee; and Edward V. Carrington, Hercules' Vice President Human Resources, Civil Action No. 04-cv-2296, was filed in the United States District Court, Eastern District of Pennsylvania. The Stepnowski lawsuit sought the payment of benefits under the Pension Plan of Hercules Incorporated (the "Plan"), and alleged violations of the Employee Retirement Income Security Act, 29 U.S.C. §1001 et seq. ("ERISA"). Under the Plan, eligible retirees of the Company may opt to receive a single cash payment of 51% of the present value of their accrued benefit (with the remaining 49% payable as a monthly annuity). In the Stepnowski lawsuit, it was alleged that the Company's adoption in 2002 of a new interest rate assumption used to determine the 51% cash payment constituted a breach of fiduciary duty and a violation of the anti-cutback requirements of ERISA, the Internal Revenue Code and the terms of the Plan, and that its communications to employees concerning the new interest rate assumption constituted a breach of fiduciary duty. The Stepnowski lawsuit sought, among other things, the payment of additional benefits under ERISA (as well as costs and attorneys fees), and to compel the Company to use an interest rate assumption that is more favorable to eligible retirees. In December 2005, a virtually identical purported class action lawsuit was filed in the same Court in a matter captioned Samuel J. Webster, et al. v. Hercules, Inc.; The Pension Plan of Hercules Inc.; The Hercules Inc. Finance Committee; and Edward V. Carrington, Hercules' Vice President Human Resources, Civil Action No. 05-6404. In January 2006, the Court consolidated the Stepnowski and Webster lawsuits for discovery and trial. In March 2006, the Court certified the Webster action as a class action. By Order dated April 20, 2006, the Court entered partial summary judgment in favor of plaintiffs, holding that while the interest rate change did not violate the anti-cutback provisions of ERISA, such change did violate provisions of the Plan, and ordered the Company to recalculate the lump sum pension benefit owed to class members by using the prior interest rate assumption (the "PBGC" rate, which was the rate used prior to the change to the new interest rate, as referenced above) to calculate benefits accrued through December 31, 2001, and the new interest rate (the "30-Year Treasury Bond" rate) for all benefits accrued after December 31, 2001. That Order also required the Company to make certain payments to Mr. Stepnowski and Mr. Webster, with such payments representing the additional lump sum benefit payable as a result of the adjusted lump sum calculation described in the preceding sentence, plus interest. On October 4, 2006, the parties entered into a settlement in principle to resolve both the Stepnowski lawsuit and Webster class action lawsuit. Preliminary approval of the settlement was granted by the Court on December 4, 2006. A hearing for final approval of the settlement is set for April 16, 2007. The main points of the settlement are: (1) each Class member's lump sum will be computed using the 30 Year Treasury Bond rate applied to all eligible service through December 31, 2004 as the "floor," plus 75% of the additional value gained, if any, by using the PBGC rate for that portion of eligible service accrued through December 31, 2001 (the Plan's actuaries have estimated that the "present value" of the total settlement award is approximately $18.2 million, without consideration of additional interest payments); (2) each Class member who has already received a lump sum will also receive 3% interest, compounded annually, on his or her settlement award, from the date the original lump sum amount was paid until the settlement award has been paid; and (3) Defendants will pay $0.3 million toward the fees and litigation costs of plaintiffs' counsel. In addition, plaintiffs and plaintiffs' counsel have agreed to petition the Court for an additional award which, if approved, will be credited against the present value of the aggregate settlement award and will reduce each Class member's settlement award by the same percentage. Of note, except for $0.3 million, the payments to be made as a result of this lawsuit will be made by the Company's pension plan.

Acevedo, et al. v. Union Pacific Railroad Company, et al., Case No. C-4885-99-F. 332nd Judicial District Court, Hidalgo County, Texas (2001), and related lawsuits, are mass toxic tort lawsuits alleging pesticide exposure relating to operations at a former pesticide formulation facility in Mission, Texas. There are currently approximately 1,700 plaintiffs and approximately 30 defendants, including the Company. Plaintiffs include former workers at the pesticide formulation facility, and persons who currently reside, or in the past resided, near the facility. All plaintiffs allege personal injuries and some plaintiffs also allege property damage. The vast majority of the plaintiffs allege residential exposure to a variety of pesticide and chemical products as a result of leaks, spills, flooding, and airborne emissions from the pesticide formulation facility. It is alleged that certain of the Company's products were sold to or used by the pesticide formulation facility prior to its ceasing operations in 1967. In November 2004, Defendants filed a Petition for a Writ of Mandamus in the Texas Supreme Court seeking to set aside an order consolidating the claims of certain plaintiffs for trial, and seeking to require the plaintiffs to provide certain evidence of exposure and injury before being permitted to proceed in court. In response, the Texas Supreme Court issued a partial stay of the underlying litigation. In November 2005, oral argument with respect to Defendants' Petition for Writ of Mandamus was held before the Texas Supreme Court. No decision has yet been rendered with respect to that petition. The Company denies any liability to plaintiffs and intends to vigorously defend these matters.

The Company and others have been sued by approximately 520 former employees and employees of third-party contractors who allege hearing loss as a result of their having worked at plants located in or about Lake Charles, Louisiana. The Company formerly owned and operated a plant in Lake Charles. In July 2005, the Company and other defendants reached a settlement in principle with plaintiffs' lawyers which provides for the resolution of these claims over a period of approximately two years, and since that time, a portion of these claims have been resolved. The Company has accrued its remaining probable and reasonably estimable liability as a portion of the amount described in the paragraph below entitled "Amounts Accrued for Non-Asbestos Litigation." The lawsuits at issue are all pending in the 14th Judicial District Court of Calcasieu Parish, Louisiana, and are captioned as follows: James Allee, et al. v. Canadianoxy Offshore Production Co., et al., Case No. 2001-4085, James Hollingsworth, et al. v. Hercules Inc., Civil Action No. 2001-4064, Joseph Kelley, et al. v. Canadianoxy Offshore Production Co., et al., Civil Action No. 98-2802, Robert Corbin, et al. v. Canadianoxy Offshore Production Co., et al., Civil Action No. 98-1097, Carl Belaire, et al. v. Bridgestone Firestone Inc., et al., Civil Action No. 2005-004369, Darrell Comeaux, et al. v Bridgestone/Firestone, Inc., et al., Civil Action No. 2006-2242, and Howard Dejean, et al. v. Bridgestone/Firestone, Inc., et al., Civil Action No. 2006-6276.

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Amounts Accrued for Non-Asbestos Litigation

During the period January 1, 2006 through December 31, 2006, the Company incurred charges totaling $12.2 million and paid $7.1 million in settlement payments including defense costs with respect to the settlement of non-asbestos and non-environmental litigation. The December 31, 2006 Consolidated Balance Sheet reflects a current liability of $8.6 million for non-asbestos and non-environmental related litigation matters, representing management’s best estimate of the probable and reasonably estimable losses for such matters. A separate liability is provided for the Vertac litigation. While it is not feasible to predict the outcome of all pending legal proceedings, it is reasonably possible that an exposure to loss exists in excess of the amounts accrued for these and other matters, and the ultimate resolution of one or more of these matters could have a material adverse effect upon the Company’s financial position, results of operations and/or cash flows for any annual, quarterly or other period.

14. Stock-Based Compensation

Effective January 1, 2006 (the “effective date”), the Company adopted SFAS 123R as interpreted by SEC Staff Accounting Bulletin No. 107. The Company adopted SFAS 123R using the “modified prospective” method in which compensation cost is recognized beginning with the effective date based on (a) the requirements of SFAS 123R for all share-based payments granted after the effective date and (b) the requirements of SFAS 123 for all awards granted to employees prior to the effective date of SFAS 123R that remain unvested on the effective date. The Company continues to use the Black-Scholes option-pricing model, which is an acceptable option valuation model in accordance with SFAS 123R, to estimate the value of stock options granted to employees.

The Company previously adopted SFAS 123 on a prospective basis for all employee and non-employee director awards granted, modified or settled after January 1, 2003. Excluding stock options issued to non-employee directors which vest immediately upon grant due to certain retirement-eligibility provisions, the Company did not issue any stock options to employees during 2003 and 2004. During 2005, the Company granted nonqualified stock options to its Chief Executive Officer (“CEO”). Those stock options have been accounted for in accordance with SFAS 123. Stock options issued to employees during years prior to 2003, which were accounted for in accordance with APB 25, had fully vested by December 31, 2005. Accordingly, there is no cost attributable to such options to be recorded subsequent to 2005. During 2006, the Company issued nonqualified stock options as well as restricted stock awards to the CEO and other management personnel. These awards have been accounted for in accordance with SFAS 123R.

The Company has in the past and continues to provide for the grant of stock options and the award of restricted common stock and other market-based units to key employees and non-employee directors under the following plans: (1) Hercules Incorporated Long Term Incentive Compensation Plan (“LTICP”), (2) Management Incentive Compensation Plan (“MICP”), and (3) Hercules Incorporated Omnibus Equity Compensation Plan for Non-Employee Directors (“Omnibus Plan”) (collectively, the “Plans”). As of December 31, 2006, 8,546,964 shares were available for grant under the Plans as stock awards or stock option awards. A summary of the valuation and accounting for share-based awards granted under the Plans is described in further detail below.

The compensation cost attributable to the Plans during 2006, 2005 and 2004 was $6.6 million, $8.1 million and $3.2 million, respectively, and was recognized as a component of Selling, general and administrative expenses. During 2006, $0.4 million attributable to the acceleration of cost related to FiberVisions employees was included as a component of the loss on disposition. The total income tax benefit recognized in the Statement of Operations for share-based compensation arrangements was $2.3 million, $2.8 million and $1.1 million for 2006, 2005 and 2004, respectively. In connection with the transition to SFAS 123R, the Company determined that it will account for the income tax effects of share-based compensation with a pool of windfall tax benefits (the “pool”) set at zero upon the effective date. In addition, the Company recognized $6.2 million of tax benefits in Additional paid-in capital resulting from the exercise of stock options and vesting of restricted stock during 2006.

Upon the adoption of SFAS 123R, the Company recorded a $0.9 million benefit, net of income taxes, as a cumulative effect of a change in accounting principle to reflect the required change in accounting policy for recognition of forfeitures from occurrence-based to one whereby the recognition of cost is based upon an estimate of the total number of awards that are expected to vest over the requisite service period for all awards. The adjustment was based on the unvested portion of awards issued prior to 2006 that were outstanding upon the effective date.

The Company issues shares from treasury stock upon the exercise of stock options and the grant of restricted stock awards. During 2006, the Company issued 3,559,294 shares of stock from treasury, of which 2,966,552 were attributable to the exercise of stock options and 516,252 were attributable to the grant of restricted stock awards. In addition, 121,993 shares were returned to treasury stock as a result of forfeitures of restricted stock awards. Cash received from the exercise of stock options during 2006 was $37.0 million.

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Stock Options

Regular stock options are granted under the Plans at the market price on the date of grant or measurement date and are exercisable at various periods from one to nine years after date of grant. Performance accelerated stock options ("PASOs") are also granted at the market price at 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 stock options and PASOs expire ten years after the date of grant. These awards 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 Plans do not provide the award recipients the ability to require a cash settlement except in the case of a standard cashless exercise program.

The fair value of option awards granted during 2006, 2005 and 2004 is measured on the date of grant using the Black-Scholes option pricing model and the weighted-average assumptions in the following table:

	2006	2005	2004
Expected volatility	30.10%	28.65%	31.22%
Expected dividend yield	0.00%	0.00%	0.00%
Expected life (in years)	6.0	6.0	6.0
Risk-free interest rate	4.60%	4.08%	3.73%

A summary of outstanding stock option activity under the Plans during 2004, 2005 and 2006 is presented as follows:

	Regular		Performance Accelerated	
	Number of Shares	Weighted-average Price	Number of Shares	Weighted-average Price
Outstanding at January 1, 2004	12,306,559	$ 24.47	4,779,700	$ 43.66
Granted	21,000	14.25	—	—
Exercised	(402,855)	11.48	—	—
Forfeited	(886,820)	33.19	(963,725)	38.25
Outstanding at December 31, 2004	11,037,884	$ 24.22	3,815,975	$ 45.03
Granted	224,229	14.01	—	—
Exercised	(200,752)	11.53	—	—
Forfeited	(2,679,349)	33.45	(2,473,860)	45.87
Outstanding at December 31, 2005	8,382,012	$ 21.31	1,342,115	$ 43.49
Granted	503,430	12.52	—	—
Exercised	(2,966,552)	12.29	—	—
Forfeited	(1,241,595)	32.12	(621,125)	46.67
Outstanding at December 31, 2006	4,677,295	$ 23.22	720,990	$ 40.75

The weighted-average grant date fair value of options granted during 2006, 2005 and 2004 was $4.86, $5.13 and $5.38 per option, respectively. These options vest over a period of three years with 40% vesting in each of the first two years and 20% in the third year. Accordingly, the Company amortizes compensation cost using the graded vesting method. The total intrinsic value of options exercised was $17.1 million, $0.6 million and $1.0 million during 2006, 2005 and 2004, respectively. As of December 31, 2006, there was $1.6 million of unrecognized compensation cost related to stock options granted under the Plans. That cost is expected to be recognized over a remaining weighted-average period of 1.9 years. The total fair value of option shares charged to compensation expense during 2006 was $1.6

million.

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Following is a summary of stock options outstanding and exercisable at December 31, 2006:

	Outstanding Options				Exercisable Options			
	Number Outstanding	Weighted-average Remaining Contractual Life		Weighted-average Exercise Price	Number Exercisable		Weighted-average Exercise Price
Regular Stock Options							
$8.50 - $11.75	608,150	5.00	$	11.13	608,150	$	11.13
$11.76 - $15.00	1,359,464	7.12	$	12.46	772,746	$	12.28
$15.01 - $25.00	801,686	3.37	$	17.21	776,210	$	17.20
$25.00 - $33.75	404,200	1.69	$	25.70	404,200	$	25.70
$33.76 - $40.00	1,203,945	1.46	$	38.54	1,203,945	$	38.54
$40.01 - $55.00	299,850	1.32	$	47.79	299,850	$	47.79
	4,677,295				4,065,101		
Performance-Accelerated Stock Options							
$25.00 - $37.00	11,075	2.45	$	31.16	—		—
$37.01 - $45.00	511,405	1.75	$	38.19	150,850	$	39.50
$45.01 - $50.00	197,185	1.33	$	47.83	575	$	47.25
$50.01 - $61.00	1,325	0.65	$	52.21	—		—
	720,990				151,425		

The intrinsic value of Regular stock options outstanding and exercisable as of December 31, 2006 was $16.0 million and $12.0 million, respectively. The Performance-Accelerated stock options did not have any intrinsic value as their exercise prices exceeded the market value of Hercules' stock.

Restricted Stock Awards

Restricted stock and other market based units are awarded with respect to certain programs in connection with the Plans. During the restriction period, award holders have the rights of stockholders, including the right to vote and receive cash dividends, if any, but cannot transfer ownership and nonvested shares are subject to forfeiture. Restricted stock awards are recorded at the fair value of the Company's stock on the grant date (measurement date). These awards 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.

A summary of restricted stock award activity under the Plans during 2006 is presented as follows:

	Number of Shares		Weighted-Average Grant Date Fair Value
Outstanding at January 1, 2006	2,093,631	$	11.38
Granted	516,252		12.47
Vested	(430,482)		9.17
Forfeited	(121,993)		12.36
Outstanding at December 31, 2006	2,057,408	$	12.05

The restricted stock awards granted during 2006 vest based on relative stock performance over a period of three to seven years from the date of grant. Vesting can be accelerated to as early as three years from the date of grant or delayed to seven years based upon share price fluctuation with a market-based benchmark. Currently, the 2006 awards are being amortized over a five year period. Restricted stock awards granted in periods prior to 2006 include awards which vest based on continuous service as well as those whose vesting can be accelerated upon the achievement of a market-based benchmark. The total number of restricted stock awards that are expected to vest is adjusted by estimated forfeiture rates. As of December 31, 2006, there was $12.9 million of unrecognized compensation cost related to restricted stock awards granted under the Plans. That cost is expected to be recognized over a remaining weighted-average period of 3.5 years. The total fair value of shares charged to compensation expense during 2006, 2005 and 2004 was $5.4 million, $6.9 million and $3.1 million, respectively.

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Amortization of compensation cost for those awards issued prior to 2006 is based on a normal five-year vesting period. Consistent with prior periods, the Company will continue to amortize the cost of these awards based on this policy unless there is an acceleration or deceleration event or change in estimated forfeitures, upon which compensation cost will be adjusted accordingly.

15. 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.

16. Common Stock

Hercules common stock has a stated value of $25/48, and 300,000,000 shares are authorized for issuance. At December 31, 2006, a total of 20,708,528 shares were reserved for issuance for the following purposes: 5,398,285 shares for the exercise of awards under the Stock Option Plan; 8,546,964 shares for awards under incentive compensation plans; 159,065 shares for conversion of debentures; and 6,604,214 shares for exercise of the warrant component of the CRESTS Units.

17. Accumulated Other Comprehensive Losses

The components of Accumulated other comprehensive losses are as follows:

	December 31, 2006	December 31, 2005	December 31, 2004
Pension and postretirement benefit plan adjustments, net of tax (1)	$ (461.3)	$ (415.7)	$ (376.9)
Foreign currency translation adjustments, net of hedging activities and taxes	52.5	28.4	100.5
Other, net of tax	(0.8)	(0.3)	—
	$ (409.6)	$ (387.6)	$ (276.4)

(1) Includes the impact of the adoption of SFAS 158 effective December 31, 2006 and minimum pension liability adjustments prior to the adoption of SFAS 158.

The tax impact of charges to the above components of Accumulated other comprehensive losses for the years ended December 31, 2006, 2005 and 2004 is summarized in Note 9.

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18. Additional Balance Sheet Detail

	2006	2005
Property, plant and equipment:		
Land	$ 16.4	$ 10.6
Buildings and equipment	1,643.0	1,613.6
Construction in progress	85.0	38.0
Total	1,744.4	1,662.2
Accumulated depreciation	(1,144.0)	(1,126.8)
Property, plant and equipment, net	$ 600.4	$ 535.4

	2006	2005
Deferred charges and other assets:		
Tax deposits	$ 3.0	$ 66.1
Capitalized software, net	44.8	62.6
Prepaid pension assets	2.2	42.8
Cash surrender value of life insurance policies	22.3	21.4
Unamortized debt issuance costs	7.7	10.3
Investment securities available for sale	2.6	1.0
Equity method investments	25.6	2.6
Other	28.7	38.3
	$ 136.9	$ 245.1

	2006	2005
Accrued expenses:		
Compensation and benefits	$ 53.0	$ 37.0
Current portion of postretirement benefits	16.2	23.5
Current portion of asset retirement obligations	21.0	21.6
Severance and other exit costs	10.5	16.6
Income taxes payable	24.5	14.5
Interest payable	14.6	12.9
Current deferred income taxes	11.8	12.9
Sales rebate accrual	10.9	9.3
Current pension liability	4.9	6.2
Litigation accrual	8.6	3.5
Current portion of deferred rent	3.3	3.0
Other taxes payable	2.8	2.3
Other	46.5	53.7
	$ 228.6	$ 217.0

	2006	2005
Deferred credits and other liabilities:		
Non-current income tax liabilities	$ 41.7	$ 95.7
Asset retirement obligations - noncurrent	55.3	68.7
Indemnifications	40.0	40.0
Deferred rent	26.3	30.6

Environmental contingencies	5.3	17.6
Fair value of cross-currency interest rate swaps	53.2	—
Workers compensation	13.9	14.6
Other	19.9	22.2
	$ 255.6	$ 289.4

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19. Restructuring Programs

2006

A summary of charges incurred during 2006 in connection with restructuring programs as well as an allocation to the reporting segments is provided as follows:

	Severance	Other Exit Costs	Asset Charges[1]	Total
Research and development consolidation				
Jacksonville, FL	$ 1.7	$ 0.3	$ 0.4	$ 2.4
Wilmington, DE	0.9	0.9	0.8	2.6
	2.6	1.2	1.2	5.0
Manufacturing rationalization				
Pendlebury, UK	0.4	0.8	2.1	3.3
Alliance-related rationalization [2]	0.5	0.2	0.6	1.3
	0.9	1.0	2.7	4.6
Business segment realignment				
Paper Technologies and Ventures	6.1	—	—	6.1
Aqualon Group	3.7	0.4	—	4.1
	9.8	0.4	—	10.2
Business Infrastructure Projects	2.9	2.3	4.4	9.6
Total restructuring and asset charges	$ 16.2	$ 4.9	$ 8.3	$ 29.4
Paper Technologies and Ventures	$ 8.7	$ 1.8	$ 3.1	$ 13.6
Aqualon Group	3.7	0.4	—	4.1
Corporate	3.8	2.7	5.2	11.7
Total by reporting segment	$ 16.2	$ 4.9	$ 8.3	$ 29.4

(1) Includes accelerated depreciation and amortization of $5.1 million, and an impairment of capitalized software of $3.2 million.

(2) Impacts Savannah, GA, Hattiesburg, MS and Portland, OR.

Research and Development Consolidation

This program, which was initiated during 2004 in connection with efforts to centralize the Company's research and development activities into regional centers, reflects the transfer of activities from the Jacksonville, Florida facility to the Wilmington, Delaware research center ("WRC"). The severance charge of $2.6 million reflects the termination of 59 employees at the Jacksonville and WRC sites, including those that were required to provide services through predetermined transition periods. The Company expects to incur additional charges of $0.1 million during 2007 as certain transition activities continue.

In connection with this program, the Company substantially expanded and upgraded the WRC as well as its technical staff as this site will serve as the primary research and development facility for the Company in the Americas. The expansion and upgrade was partially funded by a grant received from the State of Delaware in the amount of $2.3 million, of which $1.8 million has been allocated as a reduction of capital additions and $0.4 million has been allocated as a reduction of relocation expenses. The remaining $0.1 million is expected to be allocated to capital additions in 2007. The Company incurred $1.2 million in relocation and other exit costs attributable to the closure and transfer of activities and employees from the Jacksonville facility. Asset charges associated with the program include $0.4 million of accelerated depreciation for the Jacksonville facility through its date of closure and $0.8 million for certain assets at the WRC prior to their demolition or reconfiguration in connection with the upgrade and expansion project.

PTV Manufacturing and Alliance-related Rationalization

This program, which was initiated during 2005, resulted in the closure of the Company's manufacturing facility in Pendlebury, United Kingdom during 2006. While the majority of the workforce at Pendlebury was terminated at the end of 2005, the Company incurred a total of $0.4 million in severance charges in connection with the termination of 7 additional employees that were retained through the date of closure in 2006. Other exit costs of $0.8 million were incurred in connection with the closure and shut-down and transfer of certain component assets to other European PTV facilities. Accelerated depreciation charges of $2.1 million were recorded during 2006 while the facility was still in operation.

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During 2006, PTV signed an alliance agreement with MeadWestvaco whereby Hercules will serve as the sole distributor for certain rosin-based sizing products currently produced by both Hercules and MeadWestvaco. Under the agreement, Hercules assumed MeadWestvaco's sales accounts and services all orders. MeadWestvaco acquired access to Hercules' technology and is assuming production of the products. The manufacturing transition will be phased in through 2007 and will result in the shut-down of certain production lines at the Company's Savannah, Georgia, Hattiesburg, Mississippi and Portland, Oregon manufacturing facilities. Accordingly, the Company has accelerated depreciation in the amount of $0.6 million for certain of these facilities, which will continue through the transition period. During 2006, the Company incurred $0.5 million in severance and termination benefits associated with 14 employees at these facilities. The Company anticipates $0.2 million in additional severance and termination benefits to be incurred during 2007 as production is transitioned to MeadWestvaco.

Business Segment Realignment

In connection with the Company's realignment of its business segments, the Company eliminated 52 positions, primarily representing sales and marketing and related support functions, in an effort to further de-layer management and streamline the organizational structures. This resulted in charges for severance and termination benefits in the amount of $9.8 million during 2006. The Company also incurred $0.4 million in other exit costs, including contract terminations, attributable to this program.

Business Infrastructure Projects

The most significant program initiated during 2006 related to the Business Infrastructure Projects. These projects were developed primarily as a result of efforts to reduce stranded corporate costs resulting from the FiberVisions transaction. The reorganization component was essentially completed in 2006 yielding approximately $10 million in annual savings. An additional objective of the projects is to realign the Company's support organization through selected outsourcing and offshoring service arrangements such that a substantial proportion of the underlying costs become more variable in nature. This should allow the Company greater flexibility to scale the level of support services required in response to changing business demands as well as provide access to larger service organizations that can provide a greater depth and breadth of services. The Company anticipates an additional $7 million in annual cost reductions to be achieved by the end of 2007 as a result of these projects.

An ancillary action to the project is the Company's commitment to a significant technical and functional upgrade of its primary information technology platform ("IT upgrade"). As a result, the Company has begun the acceleration of amortization of certain of its capitalized software development cost assets as their remaining useful lives have been reduced to coincide with the implementation of the IT Upgrade. Total accelerated amortization to be recorded through 2008 is expected to be approximately $19 million. In addition, $3.2 million of software development costs previously capitalized have been written off as their utility has been nullified by the planned upgrade.

In connection with the Business Infrastructure Projects and the IT upgrade, the Company plans to eliminate approximately 220 positions worldwide resulting in a commitment to provide approximately $14 million in severance and termination benefits as well as completion bonuses contingent upon the successful transition of job functions and responsibilities to the outsource and offshore service providers. The plans impact a number of business and corporate functional areas and contemplate individual targets, milestones and scheduling. A total of $2.9 million of severance and termination benefits has been incurred through December 31, 2006 and the remainder will be incurred through individual dates of completion, at which time cash payments will begin. While the majority of such actions will take place during 2007 and 2008, certain actions and cash flows will continue into 2009.

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2005

A summary of charges incurred during 2005 in connection with restructuring programs as well as an allocation to the reporting segments is provided as follows:

	Severance	Other Exit Costs	Asset Charges(1)	Total
Research and development consolidation				
Barneveld, The Netherlands	$ 2.9	$ 1.4	$ 1.8	$ 6.1
Jacksonville, FL	0.4	—	0.1	0.5
Wilmington, DE	0.5	—	0.5	1.0
	3.8	1.4	2.4	7.6
Manufacturing rationalization				
Paper Technologies and Ventures	1.9	—	1.1	3.0
Aqualon Group	1.3	0.2	0.5	2.0
FiberVisions	3.4	—	1.5	4.9
	6.6	0.2	3.1	9.9
Global marketing and management realignment				
Paper Technologies and Ventures	12.7	—	—	12.7
Aqualon Group	1.8	—	—	1.8
	14.5	—	—	14.5
Corporate support realignment	4.8	0.5	—	5.3
Sub-total for continuing operations	29.7	2.1	5.5	37.3
Terpenes specialties exit	2.4	—	5.7	8.1
Total restructuring and asset charges	$ 32.1	$ 2.1	$ 11.2	$ 45.4

Paper Technologies and Ventures	$ 17.5	$ 0.1	$ 3.0	$ 20.6
Aqualon Group	3.1	0.2	0.5	3.8
FiberVisions	3.4	—	1.5	4.9
Corporate	5.7	1.8	0.5	8.0
Discontinued operations	2.4	—	5.7	8.1
Total by reporting segment	$ 32.1	$ 2.1	$ 11.2	$ 45.4

(1) Includes accelerated depreciation of $3.5 million, asset impairments of $5.7 million (Brunswick, GA and Hattiesburg, MS) and inventory write-downs of $2.0 million (Brunswick and Covington, GA).

Research and Development Consolidation

At the end of 2004, the Company initiated the first phase of its program to realign and consolidate research and development activities into regional centers in Europe and North America, respectively. In connection with that program, the Company closed its research facility in Barneveld, The Netherlands during 2005 and terminated 50 employees and relocated remaining employees to the Company's Helsingborg, Sweden site, which now serves as the primary center for PTV application activities in Europe. A total of $2.9 million in severance charges and benefits, incurred ratably over the service period from the announcement date through the closure, was recognized as well as an additional $1.4 million of other exit costs related to the closure of the facility.

The second phase of the program began during 2005 with the planned closure of the Jacksonville facility and concurrent transfer to and expansion of the WRC as discussed above. The Company began recognition of severance charges for the affected employees from Jacksonville as they began their transition service periods. In addition, certain functions at the WRC were realigned resulting in the termination of 10 employees and the recognition of $0.5 million of severance charges. The Company also recorded accelerated depreciation charges for Barneveld, Jacksonville and certain assets at the WRC in connection with phased implementation of the plan.

Manufacturing Rationalization

PTV closed its Pandaan, Indonesia manufacturing facility concurrent with its strategic realignment in the Asia Pacific region. In connection with the closing, the Company terminated approximately 50 employees and recognized severance charges of $0.6 million. PTV also announced its intention to close its Pendlebury, U.K. facility as part of its strategic realignment in Europe. As a result of this action, the Company recognized severance charges of $1.3 million related to the termination of approximately 40 employees. In addition, PTV accelerated the depreciation of its Pandaan and Pendlebury facilities while they remained in operation.

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Aqualon terminated 7 employees in connection with a program at its Parlin, New Jersey manufacturing facility resulting in a charge of $0.3 million recognized during the period in which certain energy-related assets were taken out of service. Aqualon also accrued $1.0 million in connection with the termination of 18 employees at the Brunswick, Georgia manufacturing facility. Additionally, Aqualon recorded an impairment charge at the Hattiesburg, Mississippi manufacturing facility attributable to the termination of production of certain rosins which serve as an intermediate to other finished products, as well as $0.2 million charged as incurred in connection with the termination of a product distribution agreement.

Primarily as a result of declining market demand for certain products, FiberVisions ceased production on certain lines at its facilities in North America and reduced headcount at its Varde, Denmark manufacturing facility resulting in the termination of approximately 80 employees and severance charges of $3.4 million. FiberVisions also recorded write-downs in the value of certain inventories and spare parts at the Covington, Georgia manufacturing facility.

Global Marketing and Management Realignment

Throughout 2005, PTV and Aqualon engaged in significant actions designed to realign their global marketing infrastructure and de-layer management in connection with their strategic plans. Accordingly, approximately 80 positions were eliminated worldwide resulting in charges for severance and related benefits of $14.5 million.

Corporate Support Realignment

In order to support the various initiatives to realign and restructure the Company’s operations on a global basis, the Company initiated several corporate actions including the establishment of a centralized European headquarters facility in Schaffhaussen, Switzerland. During 2005, the Company accrued $0.5 million in relocation costs related to this move. In addition, the Company streamlined other support functions resulting in headcount reductions of approximately 40 employees in various functional departments including Information Management and Procurement. In connection with the reduction, the Company recorded $4.8 million of severance and related benefits.

Terpenes Specialties Exit

Primarily as a result of the Company’s decision to exit the Terpenes Specialties business during 2005, a total of 52 employees at the Brunswick, Georgia manufacturing facility were terminated resulting in severance charges of $2.4 million. In addition, certain assets directly attributable to this business were impaired resulting in a charge of $5.2 million and related spare parts inventories in the amount of $0.5 million were written-down.

<u>2004</u>

Restructuring charges recorded during the year ended December 31, 2004 were primarily related to employee severance and related benefits in connection with various regional and functional restructuring and general headcount reduction programs. Severance charges amounted to $9.6 million in 2004, including $0.3 million of charges attributable to the initial actions at the Barneveld facility as discussed above. The total is attributable as follows: $7.6 million to PTV, $0.3 million to Aqualon, $1.4 to FiberVisions and $0.3 to Corporate.

The year ended December 31, 2004 also included asset impairment charges of $9.2 million. Of the total, $3.6 million was attributable to a raw material production line at the Hopewell, Virginia manufacturing facility, $2.9 million related to the closure of the former Kalamazoo, Michigan manufacturing facility and $0.5 million and $0.3 million for certain lines at the Pendlebury, U.K. and Savannah, Georgia manufacturing facilities, respectively. These impairment charges are reflected in Other operating expense, net. The remaining $1.9 million relates to a write-down to fair value of the Company's former operating facility at Langhorne, Pennsylvania prior to its classification as held for sale. This amount is reflected in Other expense, net. The total is attributable to the reporting segments as follows: $3.7 million to PTV, $3.6 million to Aqualon and $1.9 million to Corporate.

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All severance, other exit costs and asset charges for 2006, 2005 and 2004 are included in the Statement of Operations as a component of Other operating expenses except those related to the Terpenes Specialties exit incurred during 2005, which are included in the results of operations attributable to discontinued operations and the aforementioned Langhorne impairment which is included in Other expense, net.

A reconciliation of activity, including cash payments, with respect to the liabilities for these plans is as follows:

	2006	2005	2004
Balance at beginning of the year	$ 16.6	$ 5.8	$ 6.0
Accrued charges for severance and related benefits	16.2	32.1	9.6
Accrued charges for other exit and restructuring costs	3.8	0.5	—
Cash payments	(26.9)	(21.4)	(9.9)
Other, including foreign currency translation	0.8	(0.4)	0.1
Balance at end of the year	$ 10.5	$ 16.6	$ 5.8

In addition, the Company made cash payments of $1.5 million and $1.6 million during 2006 and 2005, respectively, for certain exit costs that have been charged as incurred and are not included in the reconciliation above.

20. Other Operating Expense, Net

Other operating expense, net, consists of the following:

	2006	2005	2004
Severance, restructuring and other exit costs, net	$ 21.1	$ 31.8	$ 9.6
Accelerated depreciation and amortization	5.1	3.5	—
Asset charges	3.2	2.0	7.3
Legal settlements	(2.0)	0.7	—
Environmental charges	0.8	0.2	0.4
Special executive pension adjustment	—	—	1.6
(Gains) losses on asset dispositions, net	(6.2)	0.1	1.0
Nitrocellulose facility shutdown costs	—	—	6.5
Dismantlement costs	1.6	—	—
Other miscellaneous charges	1.5	1.1	0.5
	$ 25.1	$ 39.4	$ 26.9

21. Interest and Debt Expense

Interest and debt costs are summarized as follows:

	2006	2005	2004
Incurred	$ 71.5	$ 89.8	$ 109.8
Capitalized	(0.3)	(0.4)	(1.1)
Net expensed	$ 71.2	$ 89.4	$ 108.7

22. Other Expense, Net

Other expense, net, consists of the following:

	2006	2005	2004
Asbestos-related costs, net	$ 29.0	$ 44.6	$ 48.8

Loss on sale of 51% interest in FiberVisions (see Note 3)		13.3		—		—
Loss on repurchases of debt		11.4		14.2		41.0
Environmental charges		6.5		7.3		6.7
Litigation settlements and accruals		9.2		19.0		19.2
Gains on dispositions of assets, net		(1.4)		(10.9)		—
Asset impairment charges		—		—		1.9
Other, net		(2.3)		(2.9)		(0.9)
	$	65.7	$	71.3	$	116.7

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23. Discontinued Operations

Terpenes Specialties

In December 2005, the Company announced its intention to exit the unprofitable terpenes specialties business. The results of operations for the terpenes specialties business are reported as a discontinued operation for 2006, 2005 and 2004, and accordingly, the consolidated financial statements have been reclassified to separately report the assets, liabilities and operating results of this business.

The following are the summarized results of operations for the terpenes specialties business:

	2006		2005		2004	
Net sales	$	2.5	$	13.7	$	12.4
Loss from operations before income taxes	$	(2.6)	$	(9.9)	$	(4.0)
Income tax benefit on operations		0.9		3.4		1.4
Net loss from discontinued operations, net of tax	$	(1.7)	$	(6.5)	$	(2.6)

The major classes of assets and liabilities of the discontinued operation in the Balance Sheet are as follows:

	2006		2005	
Accounts receivable, net	$	0.2	$	1.3
Inventories		0.2		5.4
Current assets of discontinued operations	$	0.4	$	6.7
Accounts payable	$	—	$	0.5
Accrued expenses		—		2.3
Current liabilities of discontinued operation	$	—	$	2.8

BetzDearborn Water Treatment Business

During 2006, the Company reversed certain tax reserves in the amount of $48.7 million established with respect to the sale of the Company's former BetzDearborn Water Treatment business which has been reported as a discontinued operation (see Note 9).

24. Changes in Accounting Principle

SFAS 123R

Effective January 1, 2006, the Company adopted SFAS 123R using the "modified prospective" method in which compensation cost is recognized for all awards granted to employees during 2006 as well as those awards granted prior to 2006 that remain unvested on the effective date. Upon the adoption of SFAS 123R, the Company recorded a $0.9 million benefit, net of income taxes, as a cumulative effect of a change in accounting principle to reflect the required change in accounting policy for the recognition of forfeitures.

SFAS 158

The Company adopted SFAS 158 effective December 31, 2006 which required the recognition of the funded status of its defined benefit pension and other postretirement benefit plans in the Consolidated Balance Sheet. While the adoption of SFAS 158 did not have an impact on the 2006 Statement of Operations, the Company was required to increase its pension and postretirement benefit obligations, provide for deferred tax assets and record an after-tax charge to Accumulated other comprehensive losses included in Stockholders' equity.

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The following table illustrates the adjustments made to the relevant items included in the Company's balance sheet on December 31, 2006.

	Before Application of SFAS 158	Adjustments	After Application of SFAS 158
Deferred income taxes	$ 312.4	$ 62.2	$ 374.6
Deferred charges and other assets	185.8	(48.9)	136.9
Total assets	2,795.2	13.3	2,808.5
Pension obligations	206.8	55.7	262.5
Other postretirement benefit obligations	58.1	84.1	142.2
Total liabilities	2,413.1	139.8	2,552.9
Accumulated other comprehensive losses	(283.1)	(126.5)	(409.6)
Total stockholders' equity	369.4	(126.5)	242.9

FIN 47

Effective December 31, 2005, the Company recorded a $2.5 million cumulative effect adjustment, net of tax in accordance with the provisions of FIN 47. The cumulative effect adjustment includes the recognition of approximately $4.0 million in AROs and the capitalization of approximately $0.2 million in related asset retirement costs offset by accumulated depreciation on those assets of $0.1 million.

The following table reflects the pro forma effect of FIN 47 on net (loss) income and net (loss) earnings per share as if the provisions had been in effect for the periods presented.

	2005	2004
Net (loss) income before cumulative effect of changes in accounting principle:		
As reported	$ (38.6)	$ 28.1
Accretion and depreciation	—	(0.1)
Adjusted net (loss) income before cumulative effect of changes in accounting principle	$ (38.6)	$ 28.0
Basic and diluted (loss) earnings per share before cumulative effect of changes in accounting principle:		
As reported	$ (0.36)	$ 0.26
Adjusted	$ (0.36)	$ 0.26
Net (loss) income:		
As reported	$ (41.1)	$ 28.1
Accretion and depreciation	—	(0.1)
Adjusted net income (loss)	$ (41.1)	$ 28.0
Basic and diluted (loss) earnings per share:		
As reported	$ (0.38)	$ 0.26
Adjusted	$ (0.38)	$ 0.26

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25. Supplemental Disclosure of Statement of Operations and Cash Flows Data

	2006	2005	2004
Depreciation:			
Included in Cost of sales and Selling, general and administrative expenses	$ 66.8	$ 76.6	$ 74.5
Accelerated depreciation included in Other operating expense, net	3.9	3.5	—
Included in Net loss from discontinued operations	—	0.4	0.4
	$ 70.7	$ 80.5	$ 74.9
Amortization:			
Intangible assets	$ 7.2	$ 8.0	$ 8.1
Capitalized software (normal basis)	15.2	15.3	15.0
Accelerated amortization of capitalized software	1.1	—	—
Deferred financing costs	1.1	2.1	3.2
	$ 24.6	$ 25.4	$ 26.3
Cash paid during the period for:			
Interest	$ 70.9	$ 86.4	$ 97.1
Income taxes, net of refunds received	37.6	18.4	40.7
Non-cash investing and financing activities:			
Increase in Property, plant and equipment, net related to the consolidation of Hercules Tianpu	$ 19.0	$ —	$ —
Increase in Intangible assets, net related to the consolidation of Hercules Tianpu	3.5	—	—
De-consolidation of debt issued by FiberVisions	90.0	—	—
De-consolidation of FiberVisions capitalized debt issuance costs	(6.3)	—	—
Incentive and other share-based compensation plan issuances	13.9	13.4	15.7
Elimination of 6.5% junior subordinated deferrable interest debentures due 2029	—	—	(34.6)
Elimination of investment in Hercules Trust II upon its dissolution	—	—	27.4

26. Earnings (Loss) Per Share

The following table shows the weighted-average number of common shares (in millions) used in computing basic and diluted earnings (loss) per share:

	2006	2005	2004
Weighted-average number of common shares outstanding - Basic	110.8	108.7	107.3
Dilutive effect of:			
Convertible debentures	0.2	0.2	0.2

Share-based compensation plans	0.3	1.5	1.5
Weighted-average number of common shares outstanding - Diluted	111.3	110.4	109.0

The effect of convertible debentures and share-based compensation plans for 2005 was anti-dilutive as a result of the loss incurred during that period. Accordingly, 108.7 million weighted-average shares were used to determine both basic and diluted earnings per share. The related interest on the convertible subordinated debentures has an immaterial impact on earnings per share calculations.

The following table shows the number of options and warrants (in millions) that have been excluded from the computation of diluted earnings per share as their exercise price exceeded their current market value:

	2006	2005	2004
Options to purchase common stock	3.4	5.8	10.6
Warrants to purchase common stock	6.6	6.7	7.1

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27. Reporting Segment and Geographic Data

The Company operates through two active reporting segments, Paper Technologies and Ventures and the Aqualon Group. A reporting segment is maintained for historical reporting purposes for FiberVisions, of which a majority interest was sold during 2006 (see Notes 1 and 3).

Paper Technologies and Ventures Group: Products and services offered by PTV are designed to enhance customers' profitability by improving manufacturing processes, enhancing productivity and improving overall product quality as well as enabling customers to meet their environmental objectives and regulatory requirements.

PTV is one of the key global suppliers of functional and process chemicals for the paper industry offering a wide and highly sophisticated range of technology and applications expertise with in-mill capabilities which run from influent treatment through the paper making process to paper finishing.

The Ventures portion of the group consists of a portfolio of businesses each targeting a family of vertical markets with a distinct set of products. Current businesses within Ventures are pulp and biorefining, water treatment for the pulp and paper industry, aviation and refrigeration compressor synthetic lubricants, and building and converted products.

Aqualon Group: Products offered by Aqualon are designed to manage the properties of aqueous (water-based) systems. Most of the products are 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 such as thickening, water retention, film formation, emulsifying action and binding power. Major end uses for Aqualon products include personal care products, food additives, pharmaceutical products, construction materials, paints, coatings and oil and gas recovery, where polymers are used to modify viscosity, gel strength and/or fluid loss. Aqualon also manufactures wood and gum rosin resins and is the world’s only producer of pale wood rosin derivatives. Product applications and markets include food and beverage, construction specialties, adhesives, and rubber and plastic modifiers.

FiberVisions: FiberVisions is one of the largest manufacturers of polyolefin staple fibers used in disposable products like diapers and wipes. FiberVisions produces monocomponent polypropylene fibers and bicomponent fibers comprised of a polypropylene core and a polyethylene sheath. FiberVisions also produces polyolefin fiber and yarn for the industrial and textile markets used in concrete and asphalt, wipes, upholstery and automotive fabrics, geotextile fabrics and filtration products.

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A summary of reporting segment data is provided as follows:

	Paper Technologies and Ventures	Aqualon Group	FiberVisions	Corporate	Consolidated	
2006						
Net sales	$ 1,075.3	$ 890.8	$ 69.2	$ —	$ 2,035.3	
Profit (loss) from operations	80.8	187.4	0.5	(20.1)	248.6	
Depreciation	29.3	35.1	—	6.3	70.7	(1)
Amortization	14.2	8.2	—	2.2	24.6	(2)
Research and development	19.1	18.6	0.4	0.7	38.8	
Total assets	976.1	756.5	—	1,075.9	2,808.5	(3)
Capital expenditures	25.1	59.1	—	9.4	93.6	
2005						
Net sales	$ 1,017.3	$ 755.0	$ 282.7	$ —	$ 2,055.0	
Profit (loss) from operations	61.4	155.5	(64.9)	(11.7)	140.3	
Depreciation	29.6	33.0	10.9	7.0	80.5	(1)
Amortization	14.3	7.5	1.5	2.1	25.4	(2)
Research and development	18.6	18.4	2.8	1.0	40.8	
Total assets	903.6	638.1	202.7	824.4	2,568.8	(3)
Capital expenditures	18.7	37.1	4.2	7.5	67.5	
2004						
Net sales	$ 978.5	$ 724.6	$ 281.2	$ —	$ 1,984.3	
Profit (loss) from operations	84.5	157.9	(4.1)	(5.4)	232.9	
Depreciation	25.4	30.8	11.6	7.1	74.9	(1)
Amortization	13.8	7.7	1.6	3.2	26.3	(2)
Research and development	19.4	18.0	2.9	2.4	42.7	
Total assets	1,029.2	676.2	286.0	728.9	2,720.3	(3)
Capital expenditures	26.6	41.3	4.0	5.5	77.4	

(1) Depreciation for Corporate is allocated to the business segments in the determination of Profit from operations.

(2) Corporate includes accelerated amortization of capitalized software and deferred financing costs.

(3) Corporate assets include cash and cash equivalents, income taxes receivable, deferred tax assets, asbestos-related assets, investments, assets of discontinued operations and certain other assets not directly attributable to the business segments.

A reconciliation of totals provided by reporting segment to the applicable line captions included in the Consolidated Statement of Operations is provided as follows:

	2006	2005	2004
Profit from operations from the reporting segments	$ 248.6	$ 140.3	$ 232.9
Interest and debt expense	71.2	89.4	108.7
Vertac litigation charges	108.5	15.0	—

Gain on sale of CP Kelco ApS	—	—	(27.0)
Other expense, net	65.7	71.3	116.7
Income (loss) before income taxes, minority interests and equity (loss) income	$ 3.2	$ (35.4)	$ 34.5

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Geographic Reporting

For geographic reporting purposes, no single country, outside the United States, is material for separate disclosure. However, because the Company has significant foreign operations, Net sales and Property, plant and equipment, net are disclosed by geographic region.

Net sales are reported on a "customer basis," meaning that they are included in the geographic area in which the customer is located. Property, plant and equipment, net is included in the geographic areas in which the producing entities are located.

Geographic Areas	**United States**	**Europe**	**Americas**	**Asia Pacific**	**Total**
2006					
Net Sales	$ 897.2	$ 696.0	$ 214.7	$ 227.4	$ 2,035.3
Property, plant and equipment, net	272.1	242.6	17.0	68.7	600.4
2005					
Net Sales	$ 871.9	$ 747.7	$ 201.7	$ 233.7	$ 2,055.0
Property, plant and equipment, net	262.1	233.8	15.7	23.8	535.4
2004					
Net Sales	$ 824.1	$ 761.8	$ 184.0	$ 214.4	$ 1,984.3
Property, plant and equipment, net	325.2	331.4	16.2	22.6	695.4

28. Financial Instruments and Risk Management, Including Derivatives

The fair value of cash and cash equivalents, accounts receivable, net and accounts payable approximate their carrying values primarily due to their short-term nature. The Company’s investment securities that are available for sale include certain relatively insignificant debt and equity securities. Changes in the fair value of these securities are recognized in Accumulated other comprehensive losses. Fair value measurements for these investments are generally based on third party quotes or the present value of expected future cash flows. The fair values of the Company’s debt securities is determined based on the 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. The fair values of the Company’s derivative instruments, including foreign exchange contracts and cross-currency interest rate swaps, are based on exchange and interest rates in effect at year-end.

The Company has selectively used foreign currency forward contracts and currency swaps to offset the effects of foreign currency exchange rate changes on reported earnings, cash flow and net asset positions. The primary exposures are denominated in the Euro, Swedish kroner, Danish 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. The Company had net outstanding external forward-exchange contracts to sell foreign currencies aggregating $14.6 million and $12.8 million at December 31, 2006 and 2005, respectively. Net cross-currency trades entered into by non-U.S. dollar denominated entities aggregated $14.5 million and $25.8 million at December 31, 2006 and 2005, respectively. The foreign exchange contracts outstanding at December 31, 2006 matured on or before January 28, 2007. During 2006, $1.8 million was recorded as a component of Other expense, net representing the net loss due to underlying foreign currency exposures net of the impact of foreign currency contracts. The notional amounts of the contracts referenced above 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 Company also uses cross-currency interest rate swaps and during February and March of 2006, entered into a series of floating rate cross-currency interest rate swap agreements (the “Swaps”) and designated them as a hedge of the Company’s foreign currency exposure associated with its net investment in certain foreign operations that utilize the Euro as their functional currency. The combined notional amounts of the Swaps is for $500.0 million/€ 420.2 million and requires the Company to receive three month LIBOR + 1.50% and pay three month EURIBOR plus an average margin at 1.59% on a quarterly basis for a five year term. The Swaps have been recorded at fair value, with changes in value attributable to changes in foreign exchange rates recorded in Accumulated other comprehensive losses. During 2006, a credit of $7.1 million was recorded as an adjustment to Interest and debt expense representing the net amount received from the Swaps in excess of amounts paid.

Hercules Incorporated
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The following table presents the net carrying amounts and fair values of the Company's financial instruments, including derivatives and excluding those instruments of a short-term nature as referenced above, as well as the balance sheet caption in which they are included at December 31, 2006 and 2005:

	2006		2005	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Deferred charges and other assets				
Investment securities available for sale	$ 2.6	$ 2.6	$ 1.0	$ 1.0
Foreign exchange contracts, net	(0.1)	(0.1)	(0.2)	(0.2)
Current and long-term debt obligations	995.5	964.2	1,109.0	1,092.1
Deferred credits and other liabilities				
Cross currency interest rate swaps	53.2	53.2	—	—

Fair values of the above financial instruments are indicative of cash that would have been received or required had settlement been made at December 31, 2006 and 2005.

29. Condensed Consolidating Financial Information of Guarantor Subsidiaries

The 11.125% senior notes due 2007 are guaranteed by substantially all of the Company's current and future wholly-owned domestic restricted subsidiaries (the "guarantor subsidiaries"). The Senior Credit Facility entered into in April 2004 also provides for a guarantee by each guarantor subsidiary. The guarantees by each guarantor subsidiary are full and unconditional and joint and several. The indenture under which the Company's 6.60% notes due 2027 were issued requires such notes to be guaranteed or secured on the same basis as any other subsequently issued debt that is guaranteed or secured. As a result, at December 31, 2006, the following wholly-owned domestic restricted subsidiaries fully and unconditionally and jointly and severally guarantee the Senior Credit Facility, the 6.60% notes due 2027, the 11.125% notes due 2007 and the 6.75% notes due 2029.

Aqualon Company	Hercules Flavor, Inc.
East Bay Realty Services, Inc.	Hercules Hydrocarbon Holdings, Inc.
Hercules Euro Holdings, LLC	Hercules Paper Holdings, Inc.
Hercules Finance Company	WSP, Inc.

The non-guarantor subsidiaries include 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 such 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 the 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. Additionally, prior year information has been reclassified to conform to the presentation in the Consolidated Financial Statements.

Hercules Incorporated
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Condensed Consolidating Statement of Operations
Year Ended December 31, 2006

	Parent	Unconsolidated Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations and Adjustments	Consolidated
Net sales	$ 596.7	$ 478.2	$ 1,124.6	$ (164.2)	$ 2,035.3
Cost of sales	417.5	345.7	744.6	(164.4)	1,343.4
Selling, general and administrative expenses	101.0	121.3	150.7	(0.8)	372.2
Research and development	19.7	16.9	2.2	—	38.8
Intangible asset amortization	5.9	0.7	0.6	—	7.2
Other operating expense, net	15.5	(1.8)	11.4	—	25.1
Profit (loss) from operations	37.1	(4.6)	215.1	1.0	248.6
Interest and debt expense (income), net	173.2	(103.7)	1.7	—	71.2
Vertac litigation charges	108.5	—	—	—	108.5
Other expense, net	58.7	6.5	0.5	—	65.7
Income (loss) before income taxes, minority interests and equity (loss) income	(303.3)	92.6	212.9	1.0	3.2
(Benefit) provision for income taxes	(230.3)	(4.6)	42.3	0.4	(192.2)
Income (loss) before minority interests and equity (loss) income	(73.0)	97.2	170.6	0.6	195.4
Minority interests in earnings of consolidated subsidiaries	—	—	(1.4)	—	(1.4)
Equity (loss) income of affiliated companies	—	(3.5)	1.6	(1.3)	(3.2)
Equity income (loss) from consolidated subsidiaries	263.8	0.5	(0.8)	(263.5)	—
Net income from continuing operations before discontinued operations and cumulative effect of change in accounting principle	190.8	94.2	170.0	(264.2)	190.8
Net income from discontinued operations, net of tax	47.0	—	—	—	47.0
Net income before cumulative effect of change in accounting principle	237.8	94.2	170.0	(264.2)	237.8
	0.9	—	—	—	0.9

Cumulative effect of change in accounting principle, net of tax										
Net income (loss)	$	238.7	$	94.2	$	170.0	$	(264.2)	$	238.7

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Condensed Consolidating Statement of Operations
Year Ended December 31, 2005

	Unconsolidated				
	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations and Adjustments	Consolidated
Net sales	$ 548.9	$ 491.2	$ 1,175.2	$ (160.3)	$ 2,055.0
Cost of sales	386.2	382.7	794.7	(172.5)	1,391.1
Selling, general, and administrative expenses	103.7	130.0	148.8	—	382.5
Research and development	19.2	18.4	3.2	—	40.8
Intangible asset amortization	6.0	1.5	0.5	—	8.0
Impairment of FiberVisions' goodwill	-	52.9	—	—	52.9
Other operating expenses, net	8.0	9.0	22.4	—	39.4
Profit (loss) from operations	25.8	(103.3)	205.6	12.2	140.3
Interest and debt expense (income), net	173.1	(71.6)	(12.1)	—	89.4
Vertac litigation charges	15.0	—	—	—	15.0
Other expense (income), net	72.3	2.4	(3.4)	—	71.3
(Loss) income before income taxes, minority interests and equity income (loss)	(234.6)	(34.1)	221.1	12.2	(35.4)
(Benefit) provision for income taxes	(100.3)	20.0	72.2	4.3	(3.8)
Income (loss) before minority interests and equity income (loss)	(134.3)	(54.1)	148.9	7.9	(31.6)
Minority interests in earnings of consolidated subsidiaries	—	—	(1.0)	—	(1.0)
Equity income (loss) of affiliated companies	—	(1.1)	1.5	0.1	0.5
Equity income (loss) from consolidated subsidiaries	102.2	10.0	(3.2)	(109.0)	—
Net (loss) income from continuing operations before discontinued operations and cumulative effect of change in accounting principle	(32.1)	(45.2)	146.2	(101.0)	(32.1)
Net loss from discontinued operations, net of tax	(6.5)	—	—	—	(6.5)
Net (loss) income before cumulative effect of	(38.6)	(45.2)	146.2	(101.0)	(38.6)

changes in accounting principle, net of tax										
Cumulative effect of change in accounting principle, net of tax		(2.5)		—		—		—		(2.5)
Net (loss) income	$	(41.1)	$	(45.2)	$	146.2	$	(101.0)	$	(41.1)

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Condensed Consolidating Statement of Operations
Year Ended December 31, 2004

	Unconsolidated				
	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations and Adjustments	Consolidated
Net sales	$ 528.4	$ 474.8	$ 1,131.9	$ (150.8)	$ 1,984.3
Cost of sales	358.8	352.5	731.1	(150.8)	1,291.6
Selling, general, and administrative expenses	100.8	126.0	155.3	—	382.1
Research and development	19.7	17.4	5.6	—	42.7
Goodwill and intangible asset amortization	6.1	1.5	0.5	—	8.1
Other operating expenses, net	4.8	12.9	9.2	—	26.9
Profit (loss) from operations	38.2	(35.5)	230.2	—	232.9
Interest and debt expense (income), net	177.6	(59.7)	(9.2)	—	108.7
Gain on sale of CP Kelco ApS	—	—	(27.0)	—	(27.0)
Other expense (income), net	256.6	3.9	(143.8)	—	116.7
Income (loss) before income taxes, minority interest and equity income (loss)	(396.0)	20.3	410.2	—	34.5
Provision (benefit) for income taxes	(86.8)	38.1	52.5	—	3.8
Income (loss) before minority interests and equity income (loss)	(309.2)	(17.8)	357.7	—	30.7
Minority interests in earnings of consolidated subsidiaries	—	—	(0.9)	—	(0.9)
Equity income (loss) of affiliated companies	—	(0.7)	1.8	(0.2)	0.9
Equity income (loss) from consolidated subsidiaries	339.9	6.0	(1.6)	(344.3)	—
Net income (loss) from continuing operations before discontinued operations	30.7	(12.5)	357.0	(344.5)	30.7
Net loss from discontinued operations, net of tax	(2.6)	—	—	—	(2.6)
Net income (loss)	$ 28.1	$ (12.5)	$ 357.0	$ (344.5)	$ 28.1

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Hercules Incorporated
Notes to Consolidated Financial Statements
(Dollars in millions, except per share data)

Condensed Consolidating Balance Sheet
Year ended December 31, 2006

		Unconsolidated			
Assets	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations and Adjustments	Consolidated
Current assets					
Cash and cash equivalents	$ 89.7	$ 0.5	$ 81.6	$ —	$ 171.8
Accounts receivable, net	69.9	45.6	211.1	—	326.6
Intercompany receivables	68.0	9.8	(6.4)	(71.4)	—
Inventories	56.2	68.9	87.0	(1.5)	210.6
Deferred income taxes	57.6	3.2	9.4	—	70.2
Current assets of discontinued operations	0.4	—	—	—	0.4
Income taxes receivable	170.8	—	—	—	170.8
Other current assets	12.3	2.4	19.4	—	34.1
Total current assets	524.9	130.4	402.1	(72.9)	984.5
Property, plant and equipment, net	139.9	132.2	328.3	—	600.4
Investments in subsidiaries and advances, net	2,569.7	85.2	44.9	(2,699.8)	—
Intangible assets, net	131.8	2.9	8.4	—	143.1
Goodwill	58.7	37.6	385.2	—	481.5
Deferred income taxes	357.1	—	19.5	(2.0)	374.6
Asbestos-related assets	87.5	—	—	—	87.5
Deferred charges and other assets	87.7	27.7	21.5	—	136.9
Total assets	$ 3,957.3	$ 416.0	$ 1,209.9	$ (2,774.7)	$ 2,808.5
Liabilities and Stockholders' Equity					
Current liabilities					
Accounts payable	$ 63.2	$ 35.0	$ 107.1	$ —	$ 205.3
Intercompany payables	2.0	43.4	26.1	(71.5)	—
Asbestos-related liabilities	36.4	—	—	—	36.4
Current debt obligations	20.0	—	15.8	—	35.8
Vertac litigation liability	123.5	—	—	—	123.5
Accrued expenses	119.8	68.3	82.4	(41.9)	228.6
Total current liabilities	364.9	146.7	231.4	(113.4)	629.6
Long-term debt	937.5	—	22.2	—	959.7
Deferred income taxes	—	2.0	69.7	(2.0)	69.7
Pension obligations	191.2	—	71.3	—	262.5
Other postretirement benefit obligations	139.9	2.1	0.2	—	142.2
Deferred credits and other liabilities	220.8	14.1	20.7	—	255.6

Asbestos-related liabilities		233.6		—		—		—		233.6
Intercompany notes payable (receivable)		1,626.5		(1,413.5)		(255.0)		42.0		—
Minority interests		—		—		12.7		—		12.7
Total stockholders' equity		242.9		1,664.6		1,036.7		(2,701.3)		242.9
Total liabilities and stockholders' equity	$	3,957.3	$	416.0	$	1,209.9	$	(2,774.7)	$	2,808.5

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Condensed Consolidating Balance Sheet
December 31, 2005

		Unconsolidated			
Assets	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations and Adjustments	Consolidated
Current assets					
Cash and cash equivalents	$ 9.1	$ 1.0	$ 67.2	$ —	$ 77.3
Accounts receivable, net	62.1	35.8	191.6	0.2	289.7
Intercompany receivable	68.7	17.5	21.4	(107.6)	—
Inventories	52.7	52.4	76.6	(2.1)	179.6
Deferred income taxes	24.0	2.9	12.4	—	39.3
FiberVisions assets held for sale	—	138.8	63.9	—	202.7
Current assets of discontinued operations	6.7	—	—	—	6.7
Income taxes receivable	12.6	—	—	—	12.6
Other current assets	12.8	1.8	20.7	0.2	35.5
Total current assets	248.7	250.2	453.8	(109.3)	843.4
Property, plant and equipment, net	145.6	107.2	282.6	—	535.4
Investments in subsidiaries and advances, net	2,461.4	88.3	44.9	(2,594.6)	—
Intangible assets, net	137.7	—	5.1	—	142.8
Goodwill	58.7	27.9	354.4	—	441.0
Deferred income taxes	361.7	—	18.3	(139.6)	240.4
Asbestos-related assets	120.7	—	—	—	120.7
Deferred charges and other assets	171.6	13.7	59.8	—	245.1
Total assets	$ 3,706.1	$ 487.3	$ 1,218.9	$ (2,843.5)	$ 2,568.8
Liabilities and Stockholders' (Deficit) Equity					
Current liabilities					
Accounts payable	$ 51.5	$ 16.7	$ 104.5	$ 0.2	$ 172.9
FiberVisions liabilities held for sale	—	51.2	15.4	—	66.6
Asbestos-related liabilities	36.4	—	—	—	36.4
Intercompany payable	1.5	60.7	42.0	(104.2)	—
Current debt obligations	4.0	—	12.7	—	16.7
Accrued expenses	76.2	60.5	80.3	—	217.0
Current liabilities of discontinued operations	2.8	—	—	—	2.8
Total current liabilities	172.4	189.1	254.9	(104.0)	512.4
Long-term debt	1,088.6	—	3.7	—	1,092.3
Deferred income taxes	—	142.6	72.2	(139.0)	75.8

Pension obligations	251.7	—	71.7	—	323.4
Other postretirement benefit obligation	63.1	2.1	0.3	—	65.5
Deferred credits and other liabilities	254.2	18.8	16.4	—	289.4
Asbestos-related liabilities	233.6	—	—	—	233.6
Intercompany notes payable (receivable)	1,667.2	(1,208.7)	(458.5)	—	—
Minority interests	—	—	1.1	—	1.1
Total stockholders' (deficit) equity	(24.7)	1,343.4	1,257.1	(2,600.5)	(24.7)
Total liabilities and stockholders' (deficit) equity	$ 3,706.1	$ 487.3	$ 1,218.9	$ (2,843.5)	$ 2,568.8

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Hercules Incorporated
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Condensed Consolidating Statement of Cash Flows
Year Ended December 31, 2006

		Unconsolidated			
	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations and Adjustments	Consolidated
Net Cash Provided By (Used In) Operating Activities	$ 166.7	$ (1.2)	$ 482.1	$ (474.7)	$ 172.9
Cash Flow From Investing Activities:					
Capital expenditures	(21.3)	(21.0)	(51.3)	—	(93.6)
Acquisitions and investments, net of cash, recognized upon consolidation	—	(22.7)	(6.7)	—	(29.4)
Proceeds from sale of 51% interest in FiberVisions, net	17.8	—	—	—	17.8
Proceeds of fixed asset disposals	1.1	5.9	4.3	—	11.3
Other, net	(0.2)	—	—	—	(0.2)
Net cash used in investing activities	(2.6)	(37.8)	(53.7)	—	(94.1)
Cash Flow From Financing Activities:					
Long-term debt issued by FiberVisions, net of issuance costs	83.7	—	—	—	83.7
Long-term debt proceeds	—	—	22.0	—	22.0
Long-term debt payments	(135.7)	—	(6.8)	—	(142.5)
Change in short-term debt	—	—	5.8	—	5.8
Change in intercompany advances	(71.5)	38.5	(388.7)	421.7	—
Proceeds from the exercise of stock options	37.0	—	—	—	37.0
Dividends paid	—	—	(53.0)	53.0	—
Other, net	5.6	—	—	—	5.6
Net cash provided by (used in) financing activities	(80.9)	38.5	(420.7)	474.7	11.6
Effect of exchange rate changes on cash	—	—	4.1	—	4.1
Net increase (decrease) in cash and cash equivalents	83.2	(0.5)	11.8	—	94.5
Cash and cash equivalents at beginning of year	6.5	1.0	69.8	—	77.3
Cash and cash equivalents at end of year	$ 89.7	$ 0.5	$ 81.6	$ —	$ 171.8

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Condensed Consolidating Statement of Cash Flows
Year Ended December 31, 2005

	Parent	Unconsolidated Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations and Adjustments	Consolidated
Net Cash Provided By (Used In) Operating Activities	$ (4.6)	$ 29.1	$ (81.2)	$ 195.9	$ 139.2
Cash Flow From Investing Activities:					
Capital expenditures	(16.7)	(26.7)	(24.1)	—	(67.5)
Investments	—	—	(4.4)	—	(4.4)
Proceeds of fixed asset disposals	13.3	—	3.3	—	16.6
Other, net	—	—	(2.4)	—	(2.4)
Net cash used in investing activities	(3.4)	(26.7)	(27.6)	—	(57.7)
Cash Flow From Financing Activities:					
Long-term debt payments	(112.8)	—	(18.4)	—	(131.2)
Change in short-term debt	—	—	1.9	—	1.9
Change in intercompany advances	82.2	(2.3)	159.2	(239.1)	—
Proceeds from the exercise of stock options	2.7	—	—	—	2.7
Dividends paid	—	—	(43.2)	43.2	—
Other, net	(0.4)	—	—	—	(0.4)
Net cash (used in) provided by financing activities	(28.3)	(2.3)	99.5	(195.9)	(127.0)
Effect of exchange rate changes on cash	—	—	(3.7)	—	(3.7)
Net (decrease) increase in cash and cash equivalents	(36.3)	0.1	(13.0)	—	(49.2)
Cash and cash equivalents at beginning of year	42.8	0.9	82.8	—	126.5
Cash and cash equivalents at end of year	$ 6.5	$ 1.0	$ 69.8	$ —	$ 77.3

Hercules Incorporated
Notes to Consolidated Financial Statements
(Dollars in millions, except per share data)

Condensed Consolidating Statement of Cash Flows
Year Ended December 31, 2004

	Parent	Unconsolidated Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations and Adjustments	Consolidated
Net Cash Provided By Operating Activities	$ 155.4	$ 40.9	$ 490.0	$ (565.8)	$ 120.5
Cash Flow From Investing Activities:					
Capital expenditures	(22.5)	(15.4)	(39.4)	(0.1)	(77.4)
Proceeds of fixed asset disposals	0.8	—	0.6	—	1.4
Proceeds from sale of minority interest in CP Kelco ApS	27.0	—	—	—	27.0
Other, net	0.8	(1.5)	0.7	(0.1)	(0.1)
Net cash (used in) provided by investing activities	6.1	(16.9)	(38.1)	(0.2)	(49.1)
Cash Flow From Financing Activities:					
Long-term debt proceeds	650.0	—	—	—	650.0
Long-term debt payments	(713.2)	—	(16.3)	—	(729.5)
Change in short-term debt	—	—	1.6	—	1.6
Change in intercompany advances	(68.4)	(25.2)	(262.2)	355.8	—
Proceeds from the exercise of stock options	5.5	—	—	—	5.5
Payment of debt issuance costs and underwriting fees	(7.8)	—	—	—	(7.8)
Dividends paid	—	—	(210.2)	210.2	—
Other, net	6.1	—	—	—	6.1
Net cash used in financing activities	(127.8)	(25.2)	(487.1)	566.0	(74.1)
Effect of exchange rate changes on cash	—	—	2.9	—	2.9
Net increase (decrease) in cash and cash equivalents	33.7	(1.2)	(32.3)	—	0.2
Cash and cash equivalents at beginning of year	9.1	2.1	115.1	—	126.3
Cash and cash equivalents at end of year	$ 42.8	$ 0.9	$ 82.8	$ —	$ 126.5

Hercules Incorporated
Notes to Consolidated Financial Statements
(Dollars in millions, except per share data)

30. Summary of Quarterly Results (Unaudited)

	1st Quarter		2nd Quarter		3rd Quarter		4th Quarter		Year	
	2006	2005	2006	2005	2006	2005	2006	2005	2006	2005
Net sales	$ 527.3	$ 501.9	$ 501.0	$ 534.7	$ 513.1	$ 519.6	$ 493.9	$ 498.8	$ 2,035.3	$ 2,055.0
Cost of sales	360.7	337.6	324.7	351.2	332.2	353.7	325.8	348.6	1,343.4	1,391.1
Selling, general and administrative expenses	91.3	99.7	90.7	99.9	92.8	92.7	97.4	90.2	372.2	382.5
Research and development	9.6	10.3	9.4	10.0	9.3	10.1	10.5	10.4	38.8	40.8
Intangible asset amortization	1.6	2.0	2.0	2.0	1.8	2.0	1.8	2.0	7.2	8.0
Impairment of FiberVisions goodwill	—	—	—	—	—	—	—	52.9	—	52.9
Other operating expense, net	7.2	9.7	8.6	10.4	4.6	11.1	4.7	8.2	25.1	39.4
Profit (loss) from operations	56.9	42.6	65.6	61.2	72.4	50.0	53.7	(13.5)	248.6	140.3
Interest and debt expense	20.7	22.2	16.7	22.8	16.7	22.5	17.1	21.9	71.2	89.4
Vertac litigation charges	—	14.8	106.0	0.1	1.0	0.1	1.5	—	108.5	15.0
Other expense, net	10.6	6.4	21.1	25.6	4.6	0.1	29.4	39.2	65.7	71.3
Income (loss) before income taxes, minority interests and equity loss	25.6	(0.8)	(78.2)	12.7	50.1	27.3	5.7	(74.6)	3.2	(35.4)
(Benefit) provision for income taxes	10.7	(6.5)	(27.5)	3.1	14.1	2.8	(189.5)	(3.2)	(192.2)	(3.8)
Income (loss) before minority interests and equity loss	14.9	5.7	(50.7)	9.6	36.0	24.5	195.2	(71.4)	195.4	(31.6)
Minority interests in earnings of consolidated subsidiaries	(0.1)	(0.4)	(0.3)	(0.2)	(0.4)	(0.3)	(0.6)	(0.1)	(1.4)	(1.0)
Equity loss of affiliated companies, net of tax	(0.4)	0.3	(0.6)	—	(1.1)	0.2	(1.1)	—	(3.2)	0.5
Net income (loss) from continuing operations before	14.4	5.6	(51.6)	9.4	34.5	24.4	193.5	(71.5)	190.8	(32.1)

discontinued operations and cumulative effect of changes in accounting principle										
Net income (loss) from discontinued operations, net of tax	(0.6)	(0.7)	(0.7)	(0.2)	(0.3)	(0.4)	48.6	(5.2)	47.0	(6.5)
Net income (loss) before cumulative effect of changes in accounting principle	13.8	4.9	(52.3)	9.2	34.2	24.0	242.1	(76.7)	237.8	(38.6)
Cumulative effect of changes in accounting principle	0.9	—	—	—	—	—	—	(2.5)	0.9	(2.5)
Net income (loss)	$ 14.7	$ 4.9	$ (52.3)	$ 9.2	$ 34.2	$ 24.0	$ 242.1	$ (79.2)	$ 238.7	$ (41.1)
Basic earnings (loss) per share:										
Continuing operations	$ 0.13	$ 0.06	$ (0.46)	$ 0.09	$ 0.31	$ 0.22	$ 1.72	$ (0.66)	$ 1.72	$ (0.30)
Discontinued operations	(0.01)	(0.01)	(0.01)	(0.01)	—	—	0.43	(0.05)	0.42	(0.06)
Cumulative effect of changes in accounting principle	0.01	—	—	—	—	—	—	(0.02)	0.01	(0.02)
Net income (loss)	$ 0.13	$ 0.05	$ (0.47)	$ 0.08	$ 0.31	$ 0.22	$ 2.15	$ (0.73)	$ 2.15	$ (0.38)
Diluted earnings (loss) per share:										
Continuing operations	$ 0.13	$ 0.05	$ (0.46)	$ 0.08	$ 0.31	$ 0.22	$ 1.71	$ (0.66)	$ 1.71	$ (0.30)
Discontinued operations	(0.01)	(0.01)	(0.01)	—	—	—	0.43	(0.05)	0.42	(0.06)
Cumulative effect of changes in accounting principle	0.01	—	—	—	—	—	—	(0.02)	0.01	(0.02)
Net income (loss)	$ 0.13	$ 0.04	$ (0.47)	$ 0.08	$ 0.31	$ 0.22	$ 2.14	$ (0.73)	$ 2.14	$ (0.38)

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 7, 2007.

	HERCULES INCORPORATED
By:	/s/ Craig A. Rogerson
	President and Chief Executive Officer

EXHIBIT INDEX

Number	Description
31.1*	Certification of President and Chief Executive Officer Pursuant to Exchange Act Rule 13a-14(a)/15d-14(a)
31.2*	Certification of Vice President and Chief Financial Officer Pursuant to Exchange Act Rule 13a-14(a)/15d-14(a)
32.1*	Section 1350 Certification of President and Chief Executive Officer
32.2*	Section 1350 Certification of Vice President and Chief Financial Officer

*Filed herewith