

SECURITIES AND EXCHANGE COMMISSION

FORM 10-Q

Quarterly report pursuant to sections 13 or 15(d)

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HERCULES INC

CIK: **46989** | IRS No.: **510023450** | State of Incorporation: **DE** | Fiscal Year End: **1231**
Type: **10-Q** | Act: **34** | File No.: **001-00496** | Film No.: **94527865**
SIC: **2821** Plastic materials, synth resins & nonvulcan elastomers

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SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For Quarter Ended March 31, 1994 Commission file number 1-496

HERCULES INCORPORATED

A Delaware Corporation
I.R.S. Employer Identification No. 51-0023450
Hercules Plaza
Wilmington, Delaware 19894
Telephone: 302-594-5000

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 and (2) has been subject to such filing requirements for the past 90 days.

As of April 30, 1994, 39,967,440 shares of registrant's common stock were outstanding.

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements.

CONSOLIDATED STATEMENT OF INCOME
(Dollars in thousands, except per share)

	(Unaudited)	
	Three Months Ended March 31	
	1994	1993
	----	----
NET SALES.	\$680,028	\$671,985
Cost of sales.	476,454	478,048
Selling, general and administrative expenses . .	93,594	93,048
Research and development	15,978	16,535
Other operating expenses, net.	15,511	35,939
	-----	-----
PROFIT FROM OPERATIONS	78,491	48,415
Equity in income of affiliated companies	6,367	4,469
Interest and debt expense.	7,249	9,616
Other income, net.	775	27,452
	-----	-----
INCOME BEFORE INCOME TAXES AND EFFECT OF CHANGES IN ACCOUNTING PRINCIPLES.	78,384	70,720
Provision for income taxes	26,042	26,843
	-----	-----
INCOME BEFORE EFFECT OF CHANGES IN ACCOUNTING PRINCIPLES.	52,342	43,877
Effect of changes in accounting principles . . .	--	(238,218)
NET INCOME (LOSS).	\$ 52,342	(\$194,341)
	=====	=====
EARNINGS (LOSS) PER SHARE:		
Before effect of changes in accounting principles	\$1.28	\$1.01
Effect of changes in accounting principles . . .	--	(\$5.48)
	-----	-----
EARNINGS (LOSS) PER SHARE.	\$ 1.28	(\$4.47)
	=====	=====
DIVIDENDS PER SHARE.	\$.56	\$.56
	=====	=====

See accompanying notes to financial statements.

CONSOLIDATED BALANCE SHEET
(Dollars in thousands)

	(Unaudited)	
	March 31	December 31
	1994	1993
	----	----
ASSETS		
Current Assets		
Cash and cash equivalents.	\$ 64,969	\$ 154,628
Accounts and notes receivable.	629,800	575,924
Inventories		

Finished products.	194,406	199,053
Materials, supplies, and work in process . . .	224,899	213,313
Deferred income taxes.	83,605	83,605
	-----	-----
Total current assets.	1,197,679	1,226,523
Property, plant and equipment.	3,324,353	3,270,296
Accumulated depreciation and amortization. . . .	2,001,341	1,960,961
	-----	-----
Net property, plant and equipment.	1,323,012	1,309,335
Investments.	209,656	232,077
Other assets	378,069	394,026
	-----	-----
	\$3,108,416	\$3,161,961
	=====	=====
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities		
Accounts payable and accrued expenses.	\$ 633,847	\$ 633,771
Short-term debt.	237,962	163,901
Income taxes payable	56,478	86,539
	-----	-----
Total current liabilities.	928,287	884,211
Long-term debt	308,414	316,871
Deferred income taxes.	131,298	126,203
Postretirement benefits and other liabilities. .	467,482	466,469
Stockholders' equity		
Common stock (issued 1994, 60,413,800; 1993, 59,899,295 shares)	31,466	31,198
Additional paid-in capital	450,044	453,553
Foreign currency translation adjustment.	31,490	29,593
Retained earnings.	1,984,750	1,955,005
	-----	-----
	2,497,750	2,469,349
Reacquired stock, at cost (1994, 20,134,972; 1993, 19,062,295).	1,224,815	1,101,142
	-----	-----
Total stockholders' equity.	1,272,935	1,368,207
	-----	-----
	\$3,108,416	\$3,161,961
	=====	=====

See accompanying notes to financial statements.

(Dollars in thousands)

	(Unaudited)	
	Three Months Ended March 31	
	1994	1993
	----	----
Net Cash Provided by Operations	\$ 16,264	\$ 68,626
	-----	-----
Cash Flow from Investing Activities:		
Capital expenditures	(38,383)	(34,724)
Proceeds of investment and fixed asset disposals	607	164
Cash invested in unconsolidated affiliates . . .	4,108	(4,929)
Other, net	(3,430)	3,818
	-----	-----
Net Cash Used in Investing Activities	(37,098)	(35,671)
	-----	-----
Cash Flow from Financing Activities:		
Long-term borrowings	11,400	49,143
Long-term debt repayments	(82,072)	(51,586)
Change in short-term debt	154,866	45,022
Common stock issued	2,576	6,492
Common stock reacquired	(133,581)	(67,941)
Dividends paid	(22,597)	(24,031)
	-----	-----
Net Cash Used in Financing Activities	(69,408)	(42,901)
	-----	-----
Effect of exchange rate changes on cash	583	(240)
	-----	-----
Net Decrease in Cash and Cash Equivalents . . .	(89,659)	(10,186)
Cash and cash equivalents - beginning of period.	154,628	53,552
	-----	-----
Cash and cash equivalents - end of period . . .	\$ 64,969	\$ 43,366
	=====	=====
Supplemental Disclosures of Cash Flow Information:		
Cash paid during the year for:		
Interest (net of amount capitalized)	\$7,252	\$9,196
Income taxes	51,529	4,619
Noncash investing and financing activities:		
Conversion of notes and debentures	22,648	8,483
Contribution of net assets to joint venture . .	--	--
Accounts payable for common stock acquisitions	14,566	4,824
Incentive plan stock issuances	4,026	2,937

See accompanying notes to financial statements.

1. These condensed financial statements are unaudited, but in the opinion of management include all adjustments (consisting of only normal accruals) necessary to present fairly the company's financial position and results of operations for interim periods. It is suggested that these condensed financial statements be read in conjunction with the accounting policies and the financial statements and notes thereto included in the company's annual report for 1993.

2. Equity in income of affiliated companies is reported before applicable income taxes. Previously, equity in income of affiliated companies was reported net of applicable income taxes. Management believes that the current presentation is more meaningful. The effect on income before income taxes and provision for income taxes is \$6,367 and \$2,302, respectively for the quarter ended March 31, 1994 and \$4,467 and \$1,999, respectively for the quarter ended March 31, 1993. 1993 financial statements have been reclassified to conform with the 1994 presentation.

3. Primary earnings per share are calculated on the basis of average number of common and common equivalent shares of 40,849,575 at March 31, 1994 and 43,489,460 at March 31, 1993. Earnings have been adjusted to reflect the elimination of interest expense, net of taxes, on the 6.5% convertible debentures, of \$56 for the quarter ended March 31, 1994, and \$42 for the quarter ended March 31, 1993.

Fully diluted earnings per share, which additionally assume conversion of the 8% convertible subordinated debentures, are not materially different from primary earnings per share. In the fully diluted computation, the number of shares is increased by 1,716,835 in 1994 and 2,498,046 in 1993. Earnings are further adjusted in both 1994 and 1993 to reflect the elimination of interest expense on the 8% debentures (net of taxes) in the amount of \$1,116 and \$1,461, respectively.

4. Cost and expenses include depreciation and amortization of \$39,183 and \$41,703 for the quarters ended March 31, 1994 and 1993, respectively.

5. Other operating expenses, net for the quarters ended March 31, 1994 and 1993 include environmental cleanup costs, principally for nonoperating sites, of \$5,234 and \$3,947, respectively, and net restructuring charges and writeoffs of \$9,809 and \$31,992, respectively.

6. Interest and debt costs are summarized as follows:

	March 31	
	1994	1993
Three Months Ended:	----	----
Costs incurred	\$8,765	\$10,775
Amount capitalized	1,516	1,159
	-----	-----
Interest expense	\$7,249	\$ 9,616
	=====	=====

7. Other income (expense), net for the quarter ended March 31, 1994, includes gains from the sale of an investment of \$4,461. The first quarter of 1993 includes gains from litigation settlements of \$27,536.

8. Dividends received from affiliated companies accounted for on the equity method were \$6,677 and \$8,075 during the quarters ended March 31, 1994 and 1993, respectively.

9. Accounts receivable include amounts under long-term contracts and subcontracts (principally with the U.S. Government or U.S. Government contractors) of \$203,311 at March 31, 1994 and \$196,465 at December 31, 1993, net of progress payments of \$388,479 and \$373,132, respectively. Included in these amounts are unbilled accounts receivable (work in progress and claims) of \$145,469 and \$113,282, respectively, representing recoverable costs and accrued profits which will be billed in accordance with contract terms and delivery schedules. Receivables which will not be collected within one year are \$21,104 at March 31, 1994 and \$15,144 at December 31, 1993.

Long-term U.S. Government contracts and subcontracts are subject to termination by the government; however, in these circumstances an equitable settlement of work performed is negotiated unless in the unlikely event it is determined to be a termination for default. Additionally, certain contracts are subject to renegotiation.

10. A summary of short-term and long-term debt follows:

	March 31, 1994	December 31, 1993
Short-term:	----	----
Commercial paper	\$156,525	\$ --
Banks	27,908	29,566
Current maturities	53,529	134,335
	-----	-----
	\$237,962	\$163,901
	=====	=====

At March 31, 1994, Hercules had \$74,753 of unused lines of credit that may be drawn as needed. Lines of credit in use or supporting commercial paper at March 31, 1994, were \$26,719.

Long-term:		
6.625 notes due 2003	\$124,828	\$124,823
6.5% convertible subordinated debentures due 1999	4,873	5,568
8% convertible subordinated debentures due 2010 .	74,806	96,759
7.85% notes due 2000	25,000	25,000
Term loans due 1993-1995	101,795	52,166
Variable rate loans (a)	11,400	--
9.6% notes due 1994	--	50,000

8.5% debentures due 2017 (b)	--	79,144
Other	19,241	17,746
	-----	-----
	361,943	451,206
Current maturities of long-term debt.	(53,529)	(134,335)
	-----	-----
Net long-term debt.	\$308,414	\$316,871
	=====	=====

- (a) Unsecured bank borrowings with average maturities of 400 days, with interest at a negotiated spread over lenders' cost of funds.
- (b) Debentures were redeemed in the first quarter of 1994.

11. Since 1991, the Board of Directors has authorized the repurchase of up to 15,950,000 shares of company common stock, 1,450,000 shares of which is

intended to satisfy requirements of various employee benefit programs. Through March 31, 1994, a total of 9,969,400 shares of common stock (including 950,000 shares for employee benefit programs) had been purchased in the open market at an average price of \$73.44 per share.

12. (a) Environmental

Hercules has been identified as a potentially responsible party (PRP) by Federal and State authorities for environmental cleanup at numerous sites. The estimated range of the reasonably possible costs of remediation is between \$69,000 and \$226,000. The actual costs will depend upon numerous factors, including the number of parties found liable at each environmental site and their ability to pay, the actual method of remediation, outcome of negotiations with regulatory authorities, outcome of litigation, changes in environmental laws and regulations, technological developments, and the years of remedial activity required, which could range up to 30 years. Hercules brought suit in late 1992 against its insurance carriers for past and future costs for remediation of certain environmental sites. Hercules has not included any insurance recovery in the estimates set forth above.

Litigation over liability at Jacksonville, Arkansas, the most significant site, has been pending since 1980. As a result of a pretrial court ruling in October 1993, Hercules has been held jointly and severally liable for costs incurred and for future remediation costs at the Jacksonville site by the District Court, Eastern District of Arkansas. In mid-November, an advisory jury found Uniroyal Chemical, Ltd. liable for the Jacksonville site, but also found that Uniroyal had proven a reasonable basis for allocation of responsibility. That same advisory jury found that Standard Chlorine of Delaware is not a liable party for the Jacksonville site. The Court may take the jury's findings into consideration when reaching its decision regarding these parties.

Other defendants in this litigation have either settled with the Government or, in the case of the Department of Defense (DoD), have been held

not liable. Hercules intends to appeal the Court's decision holding it jointly and severally liable, and Hercules has filed a notice of appeal to the court's order finding the DoD not liable. Once the Court issues its opinion on Uniroyal and Standard Chlorine, appeals on these issues may also be made.

Hercules' potential costs for remediation of the Jacksonville site are presently estimated between \$28,000 and \$136,000. Hercules' potential costs are based on its assessment of potential liability, the level of participation by other PRPs and upon current estimates of the costs to remediate the Jacksonville site. The costs to remediate will vary as Records of Decision are issued on each operable unit at the site and as remediation methods are determined and approved by the U.S. Environmental Protection Agency (EPA).

At March 31, 1994, the accrued liability for environmental remediation represents management's best estimate of the probable and reasonably estimable costs related to environmental remediation. The measurement of the liability is evaluated quarterly based on currently available information, including the progress of remedial investigation 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 company does not anticipate that its financial condition will be materially affected by environmental remediation costs in excess of amounts accrued, although quarterly or annual operating results could be materially affected.

(b) Litigation

Hercules is a defendant in numerous lawsuits that arise out of and are incidental to the conduct of its business. In these legal proceedings no

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director, officer or affiliate is a party or a named defendant. These suits concern issues such as product liability, contract disputes, labor-related matters, patent infringement, environmental proceedings and personal injury matters. Hercules is also a defendant in one Federal administrative law proceeding. While it is not feasible to predict the outcome of all pending suits and claims, management does not anticipate that the ultimate resolution of these matters will have a material adverse effect upon the consolidated financial position of the company.

13. On April 7, 1994, Hercules completed the divestiture of its Packaging Films unit for \$161,000 in cash, subject to post-closing adjustments. The effect of the divestiture on the results of operations is not significant. Net sales of this unit were \$42,000 and \$40,000 for the quarters ended March 31, 1994 and March 31, 1993. Operating profits for the comparable periods were \$1,000 and \$2,000, respectively.

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OTHER FINANCIAL INFORMATION

Operational Highlights
(Dollars in millions)

	Three Months Ended March 31	
	1994	1993
Net Sales by Industry Segment	----	----
Chemical Specialties	\$255	\$240
Food & Functional Products . . .	222	215
Aerospace	160	172
Corporate and Other	43	45
	----	----
TOTAL	\$680	\$672
	====	====
Profit (Loss) from Operations by Industry Segment		
Chemical Specialties	\$43	\$36
Food & Functional Products . . .	33	31
Aerospace	9	13
Corporate and Other	(7)	(32) (a)
	---	---
TOTAL	\$78	\$48
	===	===

(a) Includes a \$25 charge for restructuring

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Results of Operations

All comparisons within the following discussion are with the corresponding periods in the previous year, unless otherwise stated.

Consolidated net sales for the first quarter of 1994 were marginally higher. Sales in the Chemical Specialties and Food & Functional Products segments increased by 5% to \$477 million while Aerospace sales declined by 7% to \$160 million, reflecting continued contraction in the defense business.

Profit from operations increased by 62% to \$78 million, principally from lower restructuring charges (included in other operating expenses) and higher gross profit margins. 1994 restructuring charges are largely comprised of additional severance costs (particularly affecting the Aerospace segment) related to a company-wide reduction in personnel, which was completed in March 1994. 1993 restructuring charges principally reflect the planned disposition of Liquid Molding Resins. Selling, general and administrative, and research and development expenses were relatively flat. Cost savings from previous restructurings and the continuation of cost management programs were offset by increased expenses for employee incentive compensation programs (principally related to performance above target levels and increases in the company's stock price).

Chemical Specialties: Higher resins pricing along with higher absorbent and textile products volumes resulted in a 6% increase in net sales. In addition to the increased sales, lower manufacturing costs in both resins and absorbent and textile products resulted in a 20% improvement in profit from operations. Paper chemicals sales and operating results were relatively flat reflecting continued sluggish conditions in the paper industry.

Food and Functional Products: Net sales and profit from operations were relatively flat across all business units compared with the prior year's first quarter. Price increases in water soluble polymers reflecting strong demand in the paint and construction markets were more than offset by lower demand in the oil and gas services market. Although food gums volumes were up, continued worldwide excess capacity and competitive pressures resulted in price softening during the quarter.

Aerospace sales decreased by 7% due to continued declines in defense business, including the beginning of the phasedown of the Titan IV solid rocket motor upgrade subcontract. The effect on operating profit of the sales decline was offset by improved performance on the Titan program. Contract termination settlement and incentive award fees of \$5 million were at the same level as the previous year. Profit from operations, however, declined by 31% principally because of higher severance costs.

Corporate and Other: While net sales were relatively flat for the quarter, operating losses declined by \$25 million, principally reflecting lower restructuring charges in 1994.

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Equity in income of affiliated companies (see note 2) increased by \$2 million principally reflecting higher earnings in Tastemaker, the 50% owned flavors joint venture formed in early 1992.

Interest and debt costs incurred declined by \$2 million due to reduced levels of debt and decreases in interest rates.

Other income (expense), net showed an unfavorable change of \$27 million, principally due to favorable litigation settlements in 1993, aggregating \$28 million, partially offset by the \$4 million gain in 1994 on the sale of an investment.

The provision for income taxes for the first quarter of 1994 reflects an estimated annual effective tax rate of 33.6%, combined with a relatively low rate on the sale of an investment. Both the 1994 estimated rate and the 1993 full-year rate of 34% are lower than the federal statutory rate. While the 1994 rate has been favorably affected by increased utilization of foreign tax credits and reduced foreign taxes, the 1993 rate was favorably affected by a research and experimentation tax credit of \$10 million, offset by a relatively high tax rate on the sale of Hercules' investment in a foreign affiliate.

Financial Condition

Cash flow from operations was \$16 million for the first quarter of 1994, compared to \$68 million for the corresponding quarter in 1993. The decrease is principally attributable to the timing of income tax payments associated with the restructuring of the Titan IV solid rocket motor upgrade contract. Income tax payments in the first quarter of 1994 were \$47 million higher than the corresponding period of 1993.

Short-term liquidity has remained stable since year-end 1993. Both the current ratio and the quick ratio are relatively flat at 1.3 and 0.8, respectively. At March 31, 1994, \$75 million is available under short-term lines of credit.

During the first quarter of 1994, an additional 1,114,100 shares of common stock were reacquired in the open market. As a percentage of total capitalization, total debt increased from 26% to 30%, during the first quarter of 1994, principally as a result of increased debt. Management intends to maintain this ratio at approximately 30%. Funds available under revolving credit agreements at March 31, 1994 exceed \$223 million; in addition, \$50 million is accessible, depending upon market conditions, under a shelf registration.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings.

In September 1993, Hercules and the U.S. Environmental Protection Agency (EPA) Region 1 reached an agreement in principle which, when effectuated, will settle the EPA's claims that Hercules violated its wastewater permit with the City of Chicopee and the federal pretreatment standards for industrial users of publicly owned treatment works at its Chicopee, MA facility. Under the agreement in principle, Hercules would sign a Consent Decree (the "decree") requiring supplemental environmental projects (at a cost of approximately \$350,000), compliance with permit limits in the future, and \$250,000 in fines. Hercules expects the Decree will be finalized in the second quarter of 1994.

On February 17, 1994, Hercules received an Administrative Order and Notice of Civil Administrative Penalty Assessment (the "Order") for alleged violations of Hercules' water discharge (NPDES) permit at its Kenil, New Jersey facility. The fine identified in the Order is \$141,750. Although Hercules has requested an administrative hearing on this matter, negotiations with the State of New Jersey Department of Environment and Energy ("NJDEPE") are ongoing. Hercules expects that the ultimate penalty amount to be paid to the NJDEPE under the terms of the Order will exceed \$100,000.

Item 4. Submission of Matters to a Vote of Security Holders.

A SUMMARY OF THE FINAL RESULTS OF VOTING ON THE RESOLUTIONS PROPOSED TO SHAREHOLDERS AT THE ANNUAL MEETING HELD APRIL 28, 1994, IS AS FOLLOWS:

1. Election of Directors

A total of 33,377,155 shares, or 82.19 percent of the shares entitled to vote at the meeting, voted FOR Richard M. Fairbanks, III, as a director; 33,369,304 shares, or 82.17 percent, voted FOR Edith E. Holiday; 33,382,615 shares, or 82.20 percent, voted FOR H. Eugene McBrayer; and 33,374,906 shares, or 82.19 percent, voted FOR Lee M. Thomas. A total of 207,845 shares, or 0.51 percent of the shares entitled to vote at the meeting, WITHHELD votes for Mr. Fairbanks; 215,696 shares, or 0.53 percent, WITHHELD votes for Mrs. Holiday; 202,385 shares, or 0.50 percent, WITHHELD votes for Mr. McBrayer and 210,094 shares, or 0.52 percent, WITHHELD votes for Mr. Thomas.

Directors continuing in office after the meeting are: Manfred Caspari, R. Keith Elliott, Thomas L. Gossage, Robert G. Jahn, Gaynor E. Kelley, Ralph L. MacDonald, Jr., and Richard Schwartz .

2. Ratification of Coopers & Lybrand as Auditors

The proposal received the required favorable majority vote necessary FOR approval. Of the shares voting on this proposal, 33,411,157, or 99.48 percent, were FOR; 106,499, or 0.32 percent, were AGAINST; and 67,344, or 0.20 percent, ABSTAINED.

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

- (a) Exhibits - None
- (b) Reports on Form 8-K.

Hercules was not required to file any reports on Form 8-K for the quarter ended March 31, 1994.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Hercules Incorporated

by R. Keith Elliott

R. Keith Elliott
Senior Vice President
and Chief Financial Officer
(Principal Financial Officer
and duly authorized signatory)
May 11, 1994

by T. A. Ciconte

T. A. Ciconte
Vice President and Controller
(Principal Accounting Officer)
May 11, 1994