HERCULES INC
Form 10-K/A
March 25, 2004

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-K/A
AMENDMENT NO. 1
ANNUAL REPORT
PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2003 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
9.42% Trust Originated Preferred Securities (\$25 liquidation amount), issued by Hercules Trust I
and guaranteed by Hercules Incorporated

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 ____.

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

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 day of the Company's most recently completed second fiscal quarter, or June 30, 2003, was approximately \$1.1 billion.

As of February 27, 2004, registrant had 111,469,048 shares of Common Stock outstanding, which is registrant's only class of common stock.

DOCUMENTS INCORPORATED BY REFERENCE
(Specific pages incorporated are identified under the applicable item herein.)

Portions of the registrant's definitive Proxy Statement for its 2004 Annual Meeting of Shareholders (the "Proxy Statement"), when filed, will be incorporated by reference in Part III of our Annual Report on Form 10-K. Other documents incorporated by reference in our Annual Report on Form 10-K are listed in the Exhibit Index (see page 68).

EXPLANATORY NOTE

Hercules Incorporated (the "Company" or "Hercules") has determined that two line items within the "Cash Flow From Operating Activities" section of the Consolidated Statements of Cash Flows included in Part II, Item 8, Financial Statements and Supplementary Data, of the Annual Report on Form 10-K filed on March 15, 2004 ("Form 10-K") by Hercules were misstated by equal and offsetting amounts. Accordingly, the Company is filing this 10-K/A to correct these line items, as shown below:

	(Dollars in millions) December 31, 2003	
	As Previously Reported	As Corrected
Income taxes payable	$(156)	$(88)
Non-current assets and liabilities	72	4

Other than the line items described above, no changes have been made to the Consolidated Financial Statements and the Form 10-K has not otherwise been updated.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS AND

REQUIRED SUPPLEMENTARY DATA

HERCULES INCORPORATED

CONSOLIDATED FINANCIAL STATEMENTS Page

Report of Independent Auditors... 4
Consolidated Statements of Operations for the Years Ended December 31, 2003, 2002 and 2001..................................... 5
Consolidated Balance Sheets as of December 31, 2003 and 2002.. 6
Consolidated Statements of Cash Flows for the Years Ended December 31, 2003, 2002 and 2001.................................... 7
Consolidated Statements of Stockholders' Equity (Deficit) for the Years Ended December 31, 2003, 2002 and 2001...... 8
Consolidated Statements of Comprehensive Income (Loss) for the Years Ended December 31, 2003, 2002 and 2001.... 9
10

Summary of Significant Accounting Policies and Notes to Consolidated Financial Statements......................................

SUPPLEMENTARY DATA

Summary of Quarterly Results (Unaudited)... 62

Valuation and Qualifying Accounts... 65

Report of Independent Auditors

To the Shareholders and Board of Directors

of Hercules Incorporated:

In our opinion, the consolidated financial statements listed in the index appearing under Item 15(a)(1) on page 65 present fairly, in all material respects, the financial position of Hercules Incorporated and subsidiaries at December 31, 2003 and 2002, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2003 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the index appearing under Item 15(a)(2) on page 65 presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. These financial statements and the financial statement schedule are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements and the financial statement schedule based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 1 to the consolidated financial statements, during the year ended December 31, 2003, the Company changed its method of accounting for its employee stock ownership plan from the method prescribed by Statement of Position 76-3, "Accounting Practices for Certain Employee Stock Ownership Plans," to the method prescribed by Statement of Position 93-6, "Employers' Accounting for Employee Stock Ownership Plans."

As discussed in Note 6 to the consolidated financial statements, the Company adopted Statement of Financial Accounting Standards No. 150, "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity" on July 1, 2003.

As discussed in Notes 7 and 14 to the consolidated financial statements, the Company adopted FASB Interpretation No. 46 (Revised), "Consolidation of Variable Interest Entities" on July 1, 2003, as it related to the two joint ventures, ES FiberVisions Holdings A/S and ES FiberVisions L.P. and on December 31, 2003 as it related to its trust preferred securities.

As discussed in Note 11 to the consolidated financial statements, the Company adopted Statement of Financial Accounting Standards 148, "Accounting for Stock-Based Compensation – Transition and Disclosure" on January 1, 2003.

As discussed in Note 12 to the consolidated financial statements, the Company adopted Statement of Financial Accounting Standards No. 143, "Accounting for Asset Retirement Obligations" on January 1, 2003.

As discussed in Note 4 to the consolidated financial statements, the Company changed its accounting for goodwill and indefinite-lived intangible assets effective January 1, 2002, with the adoption of Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets."

/s/ PricewaterhouseCoopers LLP

Philadelphia, Pennsylvania

March 11, 2004

Hercules Incorporated
Consolidated Statements of Operations

	(Dollars in millions, except per share)		
	2003	2002	2001
Net sales	$ 1,846	$ 1,705	$ 1,776
Cost of sales	1,167	1,040	1,133
Selling, general and administrative expenses	360	348	398
Research and development	39	42	53
Goodwill and intangible asset amortization (Note 4)	8	9	24
Other operating expense (income), net (Note 19)	17	46	(16)
Profit from operations	255	220	184
Interest and debt expense (Note 20)	131	99	204
Preferred security distributions of subsidiary trusts	-	58	58
Other expense, net (Note 21)	29	115	8
Income (loss) before income taxes and equity income (loss)	95	(52)	(86)
Provision (benefit) for income taxes (Note 8)	21	(3)	14
Income (loss) before equity income (loss)	74	(49)	(100)
Equity income (loss) of affiliated companies, net of tax	-	2	(9)
Net income (loss) from continuing operations before discontinued operations and cumulative effect of changes in accounting principle	74	(47)	(109)
Net income (loss) on discontinued operations, net of tax (Note 25)	4	(196)	56
Net income (loss) before cumulative effect of changes in accounting principle	78	(243)	(53)
Cumulative effect of changes in accounting principle, net of tax (Notes 4, 6 and 12)	(33)	(368)	-
Net income (loss)	$ 45	$ (611)	$ (53)
Earnings (loss) per share (Note 22)			
Basic earnings (loss) per share			
Continuing operations	$ 0.69	$ (0.44)	$ (1.04)
Discontinued operations	$ 0.04	$ (1.85)	$ 0.53
Cumulative effect of changes in accounting principle	$ (0.31)	$ (3.47)	$ -
Net income (loss)	$ 0.42	$ (5.76)	$ (0.51)
Weighted average number of shares (millions)	107.8	106.0	104.8
Diluted earnings (loss) per share			
Continuing operations	$ 0.69	$ (0.44)	$ (1.04)
Discontinued operations	$ 0.04	$ (1.85)	$ 0.53
Cumulative effect of changes in accounting principle	$ (0.31)	$ (3.47)	$ -
Net income (loss)	$ 0.42	$ (5.76)	$ (0.51)
Weighted average number of shares (millions)	107.9	106.0	104.8

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, 2003	2002
ASSETS		
Current assets		
Cash and cash equivalents	$ 125	$ 209
Restricted cash (Note 6)	-	125
Accounts and notes receivable, net (Note 2)	415	395
Inventories (Note 3)	187	167
Deferred income taxes (Note 8)	93	46
Total current assets	820	942
Property, plant and equipment, net (Note 17)	677	663
Intangible assets, net (Note 4)	187	198
Goodwill, net (Note 4)	518	468
Deferred income taxes (Note 8)	27	15
Deferred charges and other assets (Note 17)	537	521
Total assets	$ 2,766	$ 2,807
LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)		
Current liabilities		
Accounts payable	$ 192	$ 176
Short-term debt (Note 5)	22	145
Accrued expenses (Note 17)	243	277
Total current liabilities	457	598
Long-term debt (Note 6)	1,326	738
Deferred income taxes (Note 8)	78	80
Pension liability (Note 9)	249	294
Other postretirement benefits (Note 9)	96	103
Deferred credits and other liabilities (Note 17)	494	493
Total liabilities	2,700	2,306
Commitments and contingencies (Note 13)	-	-
Company-obligated preferred securities of subsidiary trusts (Note 6)	-	624
Stockholders' equity (deficit)		
Series preferred stock (Note 15)	-	-
Common stock, $25/48 par value (Note 16)	83	83
(shares issued and outstanding: 2003 - 159,984,444; 2002 - 159,984,444)		
Additional paid-in capital	603	665
Unearned compensation (Note 10)	(80)	(91)
Accumulated other comprehensive losses	(317)	(454)
Retained earnings	1,543	1,498
	1,832	1,701
Reacquired stock, at cost (shares: 2003 - 48,992,628; 2002 - 50,615,487)	1,766	1,824
Total stockholders' equity (deficit)	66	(123)
Total liabilities and stockholders' equity (deficit)	$ 2,766	$ 2,807

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

Hercules Incorporated
Consolidated Statements of Cash Flow

	(Dollars in millions) 2003	2002	2001
Cash Flow From Operating Activities:			
Net income (loss)	$ 45	$ (611)	$ (53)
Net (income) loss from discontinued operations	(4)	196	(56)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operations:			
Depreciation	73	71	77
Amortization	27	29	57
Provision for deferred income taxes	8	17	(64)
Gain on disposals	(4)	-	(77)
Impairment charges	2	368	3
Non-cash charges	10	62	72
Accruals and deferrals of cash receipts and payments (net of acquisitions and dispositions):			
Affiliates' earnings in excess of dividends received	-	(2)	9
Accounts receivable	14	(7)	65
Inventories	(7)	(5)	6
Accounts payable and accrued expenses	(57)	(115)	(214)
Income taxes payable	(88)	(148)	122
Non-current assets and liabilities	4	(70)	(45)
Net cash provided by (used in) continuing operations	23	(215)	(98)
Cash Flow From Investing Activities:			
Capital expenditures	(48)	(43)	(52)
Proceeds of investment and fixed asset disposals	10	1,816	356
Decrease (increase) in restricted cash	125	(125)	-
Acquisitions, net of cash acquired	(10)	-	-
Investment in CRESTS Units preferred securities	(27)	-	-
Other, net	(2)	11	(9)
Net cash provided by investing activities from continuing operations	48	1,659	295
Cash Flow From Financing Activities:			
Long-term debt proceeds	-	450	349
Long-term debt payments	(165)	(1,776)	(626)
Change in short-term debt	(1)	(8)	(107)
Payment of debt issuance costs and underwriting fees	-	(5)	-
Repurchase of CRESTS Units warrants	(7)	-	-
Common stock issued	2	5	15
Common stock reacquired	-	-	(1)
Net cash used in financing activities	(171)	(1,334)	(370)
Effect of exchange rate changes on cash	16	(2)	(3)
Net cash flow from discontinued operations (Note 25)	-	25	198
Net (decrease) increase in cash and cash equivalents	(84)	133	22
Cash and cash equivalents at beginning of year	209	76	54
Cash and cash equivalents at end of year	$ 125	$ 209	$ 76
Supplemental Disclosures of Cash Flow Information:			
Cash paid during the period for:			
Interest (net of amount capitalized)	$ 122	$ 96	$ 157
Preferred security distributions of subsidiary trusts	-	57	61
Income taxes, net of refunds received	65	142	37
Non-cash investing and financing activities:			
Acquisition of minority interest	2	-	-
Incentive and other employee benefit stock plan issuances	19	7	11

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) Accumulated Other		
	Common Stock	Paid-in Capital	Unearned Compen-sation	Comprehen-sive Loss	Retained Earnings	Reacquired Stock
Balances at January 1, 2001, as previously reported *(Common shares: issued, 159,984,444; reacquired, 52,442,393)*	$ 83	$ 726	$ (115)	$ (143)	$ 2,157	$ (1,892)
Adjustment for the cumulative effect on prior years of retroactively applying the new method of accounting for the Employee Stock Ownership Plan (Note 1)	-	(7)	2	-	5	-
Balances at January 1, 2001, as restated	$ 83	$ 719	$ (113)	$ (143)	$ 2,162	$ (1,892)
Net loss	-	-	-	-	(53)	-
Foreign currency translation adjustment	-	-	-	(69)	-	-
Release of shares held by ESOP trust	-	(5)	11	-	-	-
Additional minimum pension liability, net of tax	-	-	-	(6)	-	-
Purchase of common stock, 66,470 shares	-	-	-	-	-	(1)
Issuances of common stock:						
Incentive plans, net, 1,311,891 shares, from reacquired stock	-	(29)	-	-	-	48
Balances at December 31, 2001 *(Common shares: issued, 159,984,444; reacquired, 51,196,972)*	$ 83	$ 685	$ (102)	$ (218)	$ 2,109	$ (1,845)
Net loss	-	-	-	-	(611)	-
Foreign currency translation adjustment	-	-	-	15	-	-
Release of shares held by ESOP trust	-	(5)	11	-	-	-
Additional minimum pension liability, net of tax	-	-	-	(354)	-	-
Reclassification adjustment relating to disposal of business	-	-	-	103	-	-
Purchase of common stock, 16,960 shares	-	-	-	-	-	-
Issuances of common stock:						
Incentive plans, net, 598,445 shares, from reacquired stock	-	(15)	-	-	-	21
Balances at December 31, 2002 *(Common shares: issued, 159,984,444; reacquired, 50,615,487)*	$ 83	$ 665	$ (91)	$ (454)	$ 1,498	$ (1,824)
Net income	-	-	-	-	45	-
Foreign currency translation adjustment	-	-	-	122	-	-
Release of shares held by ESOP trust	-	(5)	11	-	-	-
Debt issuance costs on warrants issued with trust preferred securities	-	(7)	-	-	-	-
Repurchase of warrants	-	(7)	-	-	-	-
Decrease in additional minimum pension liability, net of tax	-	-	-	15	-	-
Issuances of common stock:						
Incentive plans, net, 1,622,859 shares, from reacquired stock	-	(43)	-	-	-	58
Balances at December 31, 2003 *(Common shares: issued, 159,984,444; reacquired, 48,992,628)*	$ 83	$ 603	$ (80)	$ (317)	$ 1,543	$ (1,766)

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

Hercules Incorporated
Consolidated Statements of Comprehensive Income (Loss)

	(Dollars in millions) Year Ended December 31,		
	2003	2002	2001
Net income (loss)	$ 45	$ (611)	$ (53)
Foreign currency translation	122	15	(69)
Reclassification adjustment relating to disposal of business	-	103	-
Decrease (increase) in additional minimum pension liability, net of tax	15	(354)	(6)
Comprehensive income (loss)	$ 182	$ (847)	$ (128)

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

Hercules Incorporated

Summary of Significant Accounting Policies

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. Following the acquisition of BetzDearborn and continuing through December 31, 2002, the Company continued BetzDearborn's practice of using a November 30 fiscal year-end for certain former BetzDearborn non-U.S. subsidiaries to expedite the year-end closing process. As of December 31, 2003, these subsidiaries have adopted a December 31 fiscal year-end. All 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. Subsidiaries of the Company (Hercules Trust I and Hercules Trust II) that are VIEs and with respect to which Hercules is not the primary beneficiary have been de-consolidated as of December 31, 2003.

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 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. Revenue arrangements with multiple deliverables are reported separately for deliverables that have stand-alone value when there is objective and reliable evidence as to the fair value of the deliverable and the delivery of any undelivered item is probable and substantially controlled by the Company. Approximately 12%, 12% and 11% of the Company's revenues for the years ended December 31, 2003, 2002 and 2001, 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. Accruals are made for sales returns and other allowances based on the Company's experience. The corresponding shipping and handling costs are included in cost of sales.

Research and Development Expenditures

Research and development expenditures are expensed as incurred.

Environmental Expenditures

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 Company 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 and asset retirement obligations totaling $1.9 million, $0.9 million and $2.7 million for the years ended December 31, 2003, 2002 and 2001, respectively.

Cash and Cash Equivalents

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

Inventories

Inventories are stated at the lower of cost or market. A portion of domestic inventories are valued on the last-in, first-out ("LIFO") method. Foreign and certain domestic inventories, which in the aggregate represented 84% of total inventories at December 31, 2003 and 2002, are valued principally on the average-cost method. Elements of costs in inventories include raw materials, direct labor and manufacturing overhead.

Property and Depreciation

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

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

Goodwill and Other Intangible Assets

Pursuant to Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" ("SFAS 142"), beginning January 1, 2002, goodwill is not amortized but is tested for impairment at least annually with any necessary adjustment charged to expense. The Company has selected November 30 as the date for performing the annual impairment test. Prior to January 1, 2002, goodwill and other intangible assets have been amortized on a straight-line basis over the estimated future periods to be benefited, generally 40 years for goodwill, customer relationships, trademarks and tradenames and 5 to 15 years for other intangible assets. Intangible assets with finite lives are amortized over their useful lives.

Investments

Investments in affiliated companies in which the Company has a 20% to 50% interest and exercises significant influence are accounted for using the equity method of accounting. Accordingly, these investments are included in deferred charges and other assets on the Company's consolidated balance sheet and the income or loss from these investments is included in equity income (loss) of affiliated companies in the Company's Consolidated Statement of Operations.

Investments in affiliated companies in which the Company does not have a controlling interest, or an ownership and voting interest so large as to exert significant influence, are accounted for using the cost method of accounting. Accordingly, these investments are included in deferred charges and other assets on the Company's Consolidated Balance Sheet.

Other investments include non-current marketable securities whose value approximates market value.

Investments in Subsidiary Trusts

The Company has two subsidiary trusts, Hercules Trust I and Hercules Trust II, that are variable interest entities for which the Company is not the primary beneficiary. The Company utilizes the cost method to account for its investments in the subsidiary trusts.

Long-lived Assets

The Company reviews its long-lived assets, including other intangibles, for impairment on an exception basis whenever events or changes in circumstances indicate carrying amounts of the assets may not be recoverable through undiscounted future cash flows. If an impairment loss has occurred based on expected future cash flows (undiscounted), the loss is recognized in the income statement. The amount of the impairment loss is the excess of the carrying amount of the impaired asset over the fair value of the asset. The fair value represents expected future cash flows from the use of the assets, discounted at the rate used to evaluate potential investments. The Company reviews its long-lived assets under Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS 144").

Computer Software Costs

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

Deferred Financing Costs

The Company capitalizes costs associated with the issuance of debt (deferred financing costs), 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.

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.

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. 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.

Foreign Currency Translation

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

Derivative Instruments and Hedging

On January 1, 2001, the Company adopted Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS 133"). SFAS 133, as amended by Statement No. 137, "Accounting for Derivative Instruments and Hedging Activity – Deferral of the Effective Date of FASB Statement No. 133, "Statement No. 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities," and Statement No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities," requires that all derivative instruments be recorded on the balance sheet at their fair values. The Company has not designated any derivative as a hedge instrument and accordingly, changes in fair value of derivatives are recorded each period in earnings. The adoption of SFAS 133 did not result in a pre-tax or post-tax cumulative-effect-type adjustment to income and did not result in a change to other comprehensive losses. Under procedures and controls established by the Company's risk management policies, the Company strategically enters into contractual arrangements (derivatives) in the ordinary course of business to reduce the exposure to foreign currency rates and interest rates.

The Company's risk management policies establish 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 not designated any non-derivatives as hedging instruments.

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

Stock-based Compensation

Effective January 1, 2003, the Company adopted 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 has 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. Awards under the Company's stock-based compensation plans vest over periods ranging from 1 to a maximum of 10 years; however, vesting can be extended with the approval of the Board of Directors. Therefore, the cost related to stock-based employee compensation included in the determination of net income in 2003 is 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. The Company did not grant any stock options pursuant to SFAS 123, as amended by SFAS 148, to employees in 2003. However, the Company did make grants of restricted stock to employees in 2003. Restricted stock awards under the Hercules Long-term Incentive Compensation Plan are valued at the quoted market price (fair value) of the Company's stock on the grant date (measurement date). Stock acquired through the Employee Stock Purchase Plan and "above target" restricted stock awarded under the Hercules Management Incentive Compensation Plan is discounted 15% from market price as permitted by IRS regulations and the provisions of the Company's incentive compensation plans. The value of the award and the discount, if any, are amortized into expense over the vesting (restriction) period. Forfeitures are recorded as incurred. The Company recognized $4.3 million, $0.5 million and $1.7 million of expense in 2003, 2002 and 2001, respectively, in connection with restricted stock awards.

Pursuant to the disclosure requirements of SFAS 123, as amended by SFAS 148, the following table presents the pro forma effect on net income (loss) and earnings (loss) per share assuming the Company had applied the fair value recognition provisions of SFAS 123 to all stock-based employee compensation on a retroactive basis.

	(Dollars in millions, except per share)		
	Year Ended December 31,		
	2003	2002	2001
Net income (loss), as reported	$ 45	$ (611)	$ (53)
Add: Total stock-based employee compensation expense recognized in reported results	5	5	4
Deduct: Total stock-based employee compensation expense determined under the fair value based method for all awards, net of tax*	12	17	24
Pro forma net income (loss)	$ 38	$ (623)	$ (73)
Earnings (loss) per share:			
Basic - as reported	$ 0.42	$ (5.76)	$ (0.51)
Basic - pro forma	$ 0.35	$ (5.88)	$ (0.70)
Diluted - as reported	$ 0.42	$ (5.76)	$ (0.51)
Diluted - pro forma	$ 0.35	$ (5.88)	$ (0.70)

* For information regarding the weighted-average assumptions that would be used in estimating fair value for 2003, 2002 and 2001, see Note 11 of the Notes to Consolidated Financial Statements.

Recent Accounting Pronouncements

In December 2003, the SEC issued SAB 104, "Revenue Recognition," which supersedes SAB 101, "Revenue Recognition in Financial Statements," and updates portions of the interpretive guidance included in Topic 13 of the codification of staff accounting bulletins in order to make this interpretive guidance consistent with current authoritative accounting guidance. The Company had previously adopted the necessary changes incorporated into SAB 104, which did not have a material effect on the Company's financial position, results of operations or cash flows.

In January 2004, the FASB issued Staff Position FAS 106-1, "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003" ("FSP 106-1"). FSP 106-1 permits a sponsor of a postretirement health care plan that provides a prescription drug benefit to make a one-time election to defer accounting for the effects of the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the "Medicare Act"). The Medicare Act, which was signed by the President on December 8, 2003, introduces a prescription drug benefit under Medicare (Medicare Part D) as well as a federal subsidy to sponsors of retiree health care benefit plans that provide a benefit that is at least actuarially equivalent to Medicare Part D.

The Company offers a prescription drug benefit plan and has elected to defer current recognition of the effects of the Act in the accounting for its plan pursuant to FSP 106-1 until authoritative guidance on the accounting for the federal subsidy is issued. As such, any measures of the accumulated projected benefit obligation or net periodic postretirement benefit cost in the financial statements or accompanying notes do not reflect the effects of the Act on the plan and, as the specific authoritative guidance on the accounting for the federal subsidy is still pending, it is possible that when guidance is issued it could require the Company to change previously reported information.

Reclassifications

Certain amounts in the 2002 and 2001 consolidated financial statements and notes have been reclassified to conform to the 2003 presentation.

Hercules Incorporated

Notes to Consolidated Financial Statements

1. Change in Method of Accounting for Employee Stock Ownership Plan

During the year ended December 31, 2003, the Company changed its method of accounting for its Employee Stock Ownership Plan ("ESOP") from the method prescribed by Statement of Position 76-3, "Accounting Practices for Certain Employee Stock Ownership Plans," ("SOP 76-3") to the method prescribed by Statement of Position 93-6 "Employers' Accounting for Employee Stock Ownership Plans" ("SOP 93-6"). The Company believes that accounting for its ESOP in accordance with the provisions of SOP 93-6 is preferable as it addresses ESOP issues that were not contemplated in SOP 76-3, including changes to ESOP since its inception, and reflects the fair value of compensation costs in the statement of operations consistent with the preferred method of accounting for other stock-based compensation plans. In accordance with Accounting Principles Board Opinion No. 20, "Accounting Changes", this change in accounting method has been applied retroactively by restating prior financial statements for all affected periods including the quarters ended March 31, 2003, June 30, 2003 and September 30, 2003. The effect of the change was to increase net income by $5 million and earnings per share by $0.05 in both 2002 and 2001, as well as increase net income by $2 million, $1 million and $1 million and earnings per share by $0.02, $0.01 and $0.01 in the quarters ended March 31, 2003, June 30, 2003 and September 30, 2003, respectively. Retained earnings at January 1, 2001 has been increased by $5 million, net of taxes, unearned compensation increased by $2 million and additional paid-in capital decreased by $7 million, for the retroactive effect of this change in accounting. Additionally, the Company has restated prior period basic and diluted earnings (loss) per share information pursuant to the method prescribed by SOP 93-6, which requires the exclusion of unallocated ESOP shares from the determination of the weighted-average number of shares outstanding. The effect of this change was the exclusion of the following number of shares from the weighted-average number of shares outstanding used to calculate earnings per share: 2.7 million shares for 2003, 3.1 million shares for 2002 and 3.4 million shares for 2001.

2. Accounts and notes receivable:

	(Dollars in millions)	
	2003	2002
Trade	$ 326	$ 312
Federal tax receivable	35	35
Insurance receivable	7	9
Other	52	51
Total	420	407
Less allowance for doubtful accounts	5	12
	$ 415	$ 395

3. Inventories

The components of inventories are:

	(Dollars in millions)	
	2003	2002
Finished products	$ 100	$ 87
Raw materials and work-in-process	65	59
Supplies	22	21
	$ 187	$ 167

Inventories valued on the LIFO method were lower than if valued under the average-cost method, which approximates current cost, by $21 million and $20 million at December 31, 2003 and 2002, respectively. The average-cost value of inventories subject to LIFO was $52 and $46 million at December 31, 2003 and 2002, respectively.

4. Goodwill and Other Intangible Assets

Effective January 1, 2002, the Company adopted SFAS 142. Under SFAS 142, goodwill and intangible assets with indefinite useful lives are not amortized but instead are reviewed for impairment at least annually and written down only in periods in which it is determined that the fair value is less than the recorded value. SFAS 142 also requires the impairment review to be performed on a reporting unit basis. The Company identified the following reporting units: BetzDearborn, Pulp and Paper, Aqualon, FiberVisions and Pinova (formerly Rosin and Terpenes). In connection with the Company's transitional review, recorded goodwill was determined to be impaired in the BetzDearborn and the FiberVisions reporting units. In the first quarter of 2002, the Company completed its transitional impairment review of identified reporting units and recognized after-tax impairment losses of $262 million in the BetzDearborn reporting unit and $87 million in the FiberVisions reporting unit as a cumulative effect of a change in accounting principle.

The impairment charges recognized in the BetzDearborn and FiberVisions reporting units were primarily the result of new and stronger competitors and newer technology, which created significant price erosion and competition. In addition, the BetzDearborn reporting unit was negatively impacted by a failure to achieve integration synergies. SFAS 142 requires the Company to compare a reporting unit's book value of net assets, including goodwill, to its fair value. In the case of the BetzDearborn reporting unit, fair value was determined primarily by reference to the negotiated selling price. With respect to the Company' s other reporting units, fair value was estimated using a combination of valuation approaches including the market value and income approaches. In the event that the book value exceeds the fair value, the Company is required to perform a second step to measure the amount of the impairment loss. In the second step, the Company determined the implied value of goodwill by determining the fair value of the assets and liabilities of the BetzDearborn and FiberVisions reporting units. To the extent that the book value of the goodwill exceeded the implied fair value of goodwill for each reporting unit, impairment existed and was recognized.

In addition, an after-tax impairment loss of $19 million was recognized in the first quarter of 2002 relating to the Company's equity investment in CP Kelco, which had an impairment under SFAS 142. After recognition of this impairment, the carrying value for the Company's investment in CP Kelco was zero.

The following table reflects the effect of the adoption of SFAS 142 on net income (loss) and net earnings (loss) per share as if SFAS 142 had been in effect for the periods presented.

	(Dollars in millions, except per share)		
	Year Ended December 31		
	2003	2002	2001
Net income (loss) before cumulative effect of changes in accounting principle:			
As reported	$ 78	$ (243)	$ (53)
Goodwill amortization	-	-	50
Adjusted net income (loss) before cumulative effect of changes in accounting principle:	$ 78	$ (243)	$ (3)
Basic and diluted net earnings (loss) per share before cumulative effect of changes in accounting principle:			
As reported	$ 0.73	$ (2.29)	$ (0.51)
Goodwill amortization	-	-	0.48
Adjusted basic and diluted earnings (loss) per share before cumulative effect of changes in accounting principle	$ 0.73	$ (2.29)	$ (0.03)
Net income (loss):			
As reported	$ 45	$ (611)	$ (53)
Goodwill amortization	-	-	50
Adjusted net income (loss)	$ 45	$ (611)	$ (3)
Basic and diluted net earnings (loss) per share:			
As reported	$ 0.42	$ (5.76)	$ (0.51)
Goodwill amortization	-	-	0.48
Adjusted basic and diluted earnings (loss) per share	$ 0.42	$ (5.76)	$ (0.03)

Accumulated amortization for goodwill upon adoption of SFAS 142 was $185 million. The following table shows changes in the carrying amount of goodwill for the years ended December 31, 2002 and 2003, by operating segment:

		(Dollars in millions)	
	Performance Products	Engineered Materials & Additives	Total
Balance at January 1, 2002	$ 1,725	$ 172	$ 1,897
Discontinued operations			
BetzDearborn	(923)	-	(923)
Total discontinued operations	(923)		(923)
Impairment losses			
BetzDearborn, discontinued operations	(179)	-	(179)
BetzDearborn, cumulative effect	(267)	-	(267)
FiberVisions, cumulative effect	-	(87)	(87)
Total impairment losses	(446)	(87)	(533)
Foreign currency translation	27	-	27
Balance at December 31, 2002	383	85	468
	50	-	
Foreign currency translation			50
Balance at December 31, 2003	$ 433	$ 85	$ 18

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

	Customer Relationships	Trademarks & Tradenames	Other Intangibles	Total
Gross Carrying Amount				
Balance, December 31, 2002	$ 89	$ 72	$ 94	$ 255
Balance, December 31, 2003	89	72	91	252
Accumulated Amortization				
Balance, December 31, 2002	$ 9	$ 8	$ 40	$ 57
Balance, December 31, 2003	12	9	44	65

Total amortization expense for other intangible assets for the years ended December 31, 2003, 2002 and 2001 was $8 million, $11 million and $26 million, respectively, of which $8 million in 2003 and $9 million in 2002 and 2001, respectively, was included in income from continuing operations. Total goodwill amortization expense for the year ended December 31, 2001 was $50 million, of which $15 million was included in income from continuing operations. Estimated amortization expense is $8 million for 2004 and $7 million per year for 2005 through 2008.

5. Short-term Debt

A summary of short-term debt follows:

	(Dollars in millions) 2003	2002
Banks	$ -	$ 1
Current maturities of long-term debt	22	144
	$ 22	$ 145

Bank borrowings represent primarily foreign overdraft facilities and short-term lines of credit, which are generally payable on demand with interest at various rates. Book values of bank borrowings approximate market value because of their short maturity period. At December 31, 2003, Hercules had $17 million of unused short-term lines of credit that may be drawn as needed, with interest at a negotiated spread over lenders' cost of funds. The weighted-average interest rate on short-term borrowings at December 31, 2002 was 2.67%.

6. Long-term Debt

A summary of long-term debt follows:

	(Dollars in millions) 2003	2002
6.60% notes due 2027 (a)	$ 100	$ 100
6.625% notes due 2003 (b)	-	125
11.125% senior notes due 2007 (c)	376	400
8% convertible subordinated debentures due 2010 (d)	3	3
Term notes at various rates from 4.07% to 8.56% due in varying amounts through 2006 (e)	42	50
Term B loan due 2007 (f)	198	200
9.42% junior subordinated deferrable interest debentures due 2029 (g)	363	-
6.5% junior subordinated deferrable interest debentures due 2029 (g)	262	-
Other	4	4
	$ 1,348	$ 882
Current maturities of long-term debt	(22)	(144)
Net long-term debt	$ 1,326	$ 738

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

(b) Par value of $125 million issued June 1993. In conjunction with the execution of the credit agreement on December 20, 2002 (see (f) below), $125 million of the proceeds of the term B loan were placed into an escrow account and used to pay the principal amount upon maturity in June 2003.

(c) The senior notes accrue interest at 11 1/8% per annum, payable semi-annually. The senior notes are guaranteed by each of Hercules' current and future wholly-owned domestic restricted subsidiaries. The senior notes are not redeemable at Hercules' option prior to maturity. The Company is not required to make mandatory redemption or sinking fund payments with respect to the senior notes. If a change of control occurs, each holder of the notes will have the right to require Hercules to repurchase all or any part of that Holder's notes pursuant to a change of control offer on the terms set forth in the indenture. In the change of control offer, Hercules will offer a change of control payment in cash equal to 101% of the aggregate principal amount of the notes repurchased plus accrued and unpaid interest and liquidated damages, if any, on the notes repurchased, to the date of purchase. The notes were subject to a registration rights agreement that required Hercules to file a Registration Statement on Form S-4 with the Securities and Exchange Commission, pursuant to which the Company offered to exchange all of its $400 million aggregate principal amount of 11 1/8% senior notes due 2007 ("old notes") for $400 million aggregate principal amount of 11 1/8% senior notes due 2007 ("new notes"). The form and terms of the new notes are the same as the form and terms of the old notes except that, because the issuance of the new notes was registered under the Securities Act, the new notes do not bear legends restricting their transfer and are not entitled to certain registration rights. The new notes evidence the same debt as the old notes and the new notes and the old notes are governed by the same indenture. Hercules did not receive any proceeds from the exchange offer.

The Company has the right to use available cash to repurchase, repay or otherwise redeem senior notes in an aggregate amount not to exceed $100 million in any fiscal year, subject to certain restrictions based on the Company's leverage ratio. During the fourth quarter ended December 31, 2003, the Company repurchased notes with a book value of $24 million for $29 million, recognizing a loss of $5 million. Subsequently, in 2004, an additional $33 million (book value) of the notes have been repurchased by the Company at a cost of $40 million.

(d) The convertible subordinated debentures are convertible into common stock at $14.90 per share and are redeemable at the option of the Company at varying rates. The annual sinking fund requirement of $5 million, beginning in 1996, has been satisfied through conversions of debentures.

(e) Debt assumed in conjunction with the acquisition of FiberVisions L.L.C., net of repayments through December 31, 2003 and 2002.

(f) On December 20, 2002, the Company completed a refinancing of its then existing senior credit facility with a new senior credit facility (the "Senior Credit Facility"). The Senior Credit Facility consists of a four-year $125 million revolving credit agreement and a $200 million term B loan due May 2007. In addition, the Company has the option of borrowing an additional $50 million to $150 million on terms identical to the term B loan. The incremental term loan will remain available until the earlier of December 20, 2005 or the repayment of the $200 million term B loan. In conjunction with the execution of the credit agreement, $125 million of the proceeds of the term B loan was placed into an escrow account to pay the principal amount of the 6.625% notes in June 2003 and was recognized as restricted cash on the Consolidated Balance Sheet. The 6.625% notes were paid in June 2003 with the proceeds held in the escrow account. Effective December 17, 2003, the Senior Credit Facility was amended, reducing the term B loan interest rate to LIBOR + 2.50% (4.02% at December 31, 2003) from LIBOR + 3.25% and adding strategic foreign subsidiaries of the Company as approved borrowers. The revolving credit agreement bears interest at LIBOR plus an applicable margin, currently 2.75%, which is determinable based on the Company's leverage ratio. Interest rates are reset for one, two, three or six month periods at the Company's option. The Senior Credit Facility is secured by liens on the Company's U.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.

As of December 31, 2003, $49 million of the $125 million revolver was available for use. The Company had outstanding letters of credit associated with the credit facility of $76 million at December 31, 2003.

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 establishes limitations on the permitted amount of annual capital expenditures.

(g) In March 1999, Hercules Trust I ("Trust I"), a subsidiary trust, completed a $362 million underwritten public offering of 14,500,000 9.42% Trust Originated Preferred Securities ("TOPrS"). Trust I invested the proceeds from the sale of the preferred securities and the related common securities in an equal principal amount of 9.42% Junior Subordinated Deferrable Interest Debentures of Hercules due March 2029. The Company used these proceeds to repay long-term debt. Trust I distributes quarterly cash payments it receives from the Company as interest on the debentures to preferred security holders at an annual rate of 9.42% on the liquidation amount of $25 per preferred security. The Company may defer interest payments on the debentures at any time, for up to 20 consecutive quarters. If this occurs, Trust I will also defer distribution payments on the preferred securities. The deferred distributions, however, will accumulate distributions at a rate of 9.42% per annum. Trust I will redeem the preferred securities when the debentures are repaid, or at maturity on March 31, 2029. The Company may redeem the debentures, in whole or, on or after March 17, 2004, in part, before their maturity at a price equal to 100% of the principal amount of the debentures redeemed, plus accrued interest. When the Company redeems any Debentures before their maturity, Trust I will use the cash it receives to redeem preferred securities and common securities as provided in the trust agreement. The Company guarantees the obligations of Trust I on the preferred securities.

In July 1999, the Company and Hercules Trust II ("Trust II"), a subsidiary trust, completed a $350 million underwritten public offering of 350,000 CRESTS Units. Each CRESTS Unit consists of one preferred security of Trust II and one warrant to purchase 23.4192 shares of the Company's common stock at an initial exercise price of $1,000 (equivalent to $42.70 per share). The preferred security component of the CRESTS Units was initially valued at $741.46 per unit and the warrant component of the CRESTS Units was initially valued at $258.54 per warrant. The preferred security and warrant components of each CRESTS Unit may be separated and transferred independently. The warrants may be exercised, subject to certain conditions, at any time before March 31, 2029, unless there is a reset and remarketing event. No reset and remarketing event will occur before July 27, 2004, unless all of the Company's common stock is acquired in a transaction that includes cash for a price above a predetermined level. Trust II used the proceeds from the sale of its preferred securities to purchase junior subordinated deferrable interest debentures of Hercules. The Company pays interest on the debentures, and Trust II pays distributions on its preferred securities quarterly at an annual rate of 6½% of the scheduled liquidation amount of $1,000 per debenture and/or preferred security until the scheduled maturity date and redemption date of June 30, 2029, unless there is a reset and remarketing event. The Company guarantees the obligations of Trust II on the preferred securities. Trust II must redeem the preferred securities when the debentures are redeemed or repaid at maturity. As of December 31, 2003, no warrants had been exercised. The Company used the proceeds from the CRESTS Units offering to repay long-term debt. Issuance costs related to the preferred security component of the CRESTS Units are being amortized over the life of the security and costs related to the warrants were charged to additional paid-in capital.

In May 2003, the FASB issued Statement of Financial Accounting Standards No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity" ("SFAS 150"). SFAS 150 requires certain financial instruments with both debt and equity characteristics to be classified as debt. The statement requires initial and subsequent valuation of this debt at a present or fair market value and was effective July 1, 2003.

In accordance with SFAS 150, the TOPrS and CRESTS Units constitute mandatorily redeemable financial instruments. The Company guarantees the obligations of Hercules Trust I and Hercules Trust II (the "Trusts") on the preferred securities. Upon adoption of SFAS 150 on July 1, 2003, the company-obligated preferred securities of subsidiary trusts have been reclassified prospectively from the mezzanine section to the long-term liabilities section of the Consolidated Balance Sheet. Items previously shown separately on the Consolidated Statement of Operations as preferred security distributions of subsidiary trusts are combined with interest and debt expense in the current period in accordance with the requirements of SFAS 150.

During the fourth quarter of 2003, the Company purchased 46,000 of the CRESTS Units for a total of $34 million, of which $27 million was attributed to the preferred security component and $7 million was attributed to the warrants. The corresponding book value of a similar number of the CRESTS Units junior subordinated deferrable interest debentures was $34 million. Accordingly, the Company recognized a gain of $7 million ($5 million after-tax) in continuing operations. However, the Company has determined that (i) the Trusts are variable interest entities and (ii) the Company is not the primary beneficiary of the Trusts. Accordingly, the Company has de-consolidated the Trusts and recognized an after-tax loss of $5 million as a cumulative effect of a change in accounting principle to defer the above noted gain, effective December 31, 2003, in accordance with the provisions of FASB Interpretation No. 46 (revised December 2003), "Consolidation of Variable Interest Entities" ("FIN 46R"). As a result of the de-consolidation, long-term debt reflects the Company's obligation to the Trusts for the CRESTS Units junior subordinated deferrable interest debentures and TOPrS junior subordinated deferrable interest debentures. The indenture for the CRESTS Units junior subordinated deferrable interest debentures does not provide the ability for the Company to repay, redeem or defease the CRESTS Units junior subordinated deferrable interest debentures through purchasing the CRESTS Units. Accordingly, at December 31, 2003 the outstanding balance of CRESTS Units junior subordinated deferrable interest debentures has not changed as a result of the Company's purchase of the CRESTS Units. The $27 million paid to purchase the CRESTS Units preferred security component is reflected as an increase in the Company's investment in Hercules Trust II, with the corresponding gain on the purchase deferred until Hercules Trust II has been liquidated. The $7 million paid and attributable to the warrants has been recorded as a reduction in additional paid-in-capital.

Long-term debt maturities are $22 million in 2004, $19 million in 2005, $7 million in 2006, $568 million in 2007, $0 million in 2008 and $732 million thereafter.

7. Consolidation of Variable Interest Entities

In January 2003, the Financial Accounting Standards Board ("FASB") issued FASB Interpretation No. 46, "Consolidation of Variable Interest Entities" ("FIN 46"), which is an interpretation of Accounting Research Bulletin No. 51, "Consolidated Financial Statements" ("ARB 51"). FIN 46 addresses the application of ARB 51 to variable interest entities ("VIEs"), and generally requires that assets, liabilities and results of the activity of a VIE be consolidated into the financial statements of the enterprise that is considered the primary beneficiary. The provisions of FIN 46 apply on a prospective basis to VIEs created after January 31, 2003 and were to become effective after June 30, 2003 for VIEs that existed prior to January 31, 2003. On October 8, 2003, the FASB deferred the effective date for VIEs that existed prior to January 31, 2003. FASB Staff Position FIN 46-6 ("FSP FIN 46-6") established the first interim or annual period ending after December 15, 2003 as the new effective date for VIEs that existed prior to January 31, 2003. However, FSP FIN 46-6 permitted early and partial adoption of FIN 46. On December 24, 2003, the FASB issued FASB Interpretation No. 46 (revised December 2003), "Consolidation of Variable Interest Entries" ("FIN 46R"). The Company elected to partially adopt FIN 46 in the quarter ending September 30, 2003 for its VIEs that existed prior to January 31, 2003 (the Company has no VIEs created subsequent to January 31, 2003). The financial statements for the year ended December 31, 2003 reflect the consolidation of two joint venture VIEs, ES FiberVisions Holdings A/S and ES FiberVisions L.P., that were previously accounted for using the equity method of accounting. These entities serve as strategic global marketers of the Company's bicomponent fibers. As of December 31, 2003, the fair value of the assets in these joint ventures was approximately $7 million and the fair values of the associated liabilities and non-controlling interests were approximately $6 million. There are no assets of the Company that serve as collateral for the VIEs and the creditors of the VIEs have no recourse to the general credit of the Company.

8. Income Taxes

The domestic and foreign components of income (loss) before income taxes and equity income (loss) from continuing operations are:

	(Dollars in millions)		
	2003	2002	2001
Domestic	$ (69)	$ (209)	$ (149)
Foreign	164	157	63
Income (loss) before income taxes and equity income (loss)	$ 95	$ (52)	$ (86)

The components of the tax provision from continuing operations are:

	(Dollars in millions)		
	2003	2002	2001
Currently payable			
U.S. federal	$ (28)	$ (39)	$ 24
Foreign	40	17	32
State	1	2	22
Deferred			
Domestic	11	9	(55)
Foreign	(3)	8	(9)
Provision (benefit) for income taxes	$ 21	$ (3)	$ 14

	(Dollars in millions)	
	2003	2002
Depreciation	$ 109	$ 109
Pension	9	6
Investments	139	129
Goodwill	46	54
Accrued expenses	5	6
Other	13	15
Gross deferred tax liabilities	$ 321	$ 319
Postretirement benefits other than pensions	$ (58)	$ (60)
Pension	(80)	(96)
Inventory	(8)	(6)
Goodwill	(8)	(8)
Accrued expenses	(147)	(135)
Loss carryforwards	(373)	(289)
Credit carryforwards	(20)	-
Other	(23)	(8)
Gross deferred tax assets	(717)	(602)
Valuation allowance	362	308
Net deferred tax (assets) liabilities	$ (34)	$ 25

The increase in the loss carryforwards and the related valuation allowance at December 31, 2003 from December 31, 2002 is attributable to the finalization of the taxable nature of the BetzDearborn divestiture and the overall components of the capital loss. In calculating the final tax effect and the related capital loss and valuation allowance, the Company further analyzed the character of the transaction and reflected the results in its deferred tax analysis. In addition, the valuation allowance was increased for net operating losses generated in Belgium and Sweden and offset by a decrease in the valuation allowance for France.

The provision for income taxes attributable to discontinued operations and cumulative effect of changes in accounting principle is:

	(Dollars in millions)		
	2003	2002	2001
Provision on income from discontinued operations	$ 2	$ 21	$ 60
Provision on loss on disposal of discontinued operations	-	51	-
Cumulative effect of changes in accounting principle	18	(4)	-

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

	2003	2002	2001
U.S. statutory income tax rate	35%	35%	35%
Goodwill amortization	-	-	(11)
Valuation allowances	(3)	(2)	(11)
Tax rate differences on subsidiary earnings	(9)	8	13
U.S. tax on foreign dividends and undistributed earnings	8	(4)	(6)
State taxes	1	(4)	(4)
Reserves	-	(20)	(37)
Intellectual property	(9)	-	-
Other	(1)	(7)	5
Effective tax rate	22%	6%	(16%)

Loss carryforwards include both net operating loss carryforwards and capital loss carryforwards. At December 31, 2003, the tax effect of such carryforwards approximated $373 million. Of this amount, $285 million are domestic capital loss carryforwards that expire in 2007 for which full valuation allowances have been established. The 2003 federal net operating loss carryforwards approximate $29 million, for which no valuation allowance has been established. State net operating loss carryforwards approximate $44 million, with expiration dates ranging from 2004 to 2017, for which full valuation allowances have been established. Foreign net operating loss carryforwards approximate $15 million and are offset by valuation allowances of $6 million. Some of these foreign net operating loss carryforwards expire as early as 2004 and others have expiration dates that are indefinite in nature. The tax effect of credit carryforwards approximated $20 million at December 31, 2003, with expiration dates ranging from 2006 to 2008, 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 $195 million and $158 million at December 31, 2003 and 2002, 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.

9. 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. Generally, the plans provide benefits based on years of service and final average salary, typically based on the last three to five years of employment.

Assets of the defined benefit plans are invested in domestic and international corporate equity securities; domestic and international fixed income securities and various derivative and money market securities. The assets of the U.S., the United Kingdom ("U.K.") and the Netherlands defined benefit plans constitute approximately 84%, 4% and 11%, respectively, of the total defined benefit plan assets at December 31, 2003 for plans sponsored by the Company. The projected benefit obligations of the U.S., the U.K., and the Netherlands defined benefit plans constitute approximately

83%, 4% and 9%, respectively, of the total projected benefit obligations at December 31, 2003 for plans sponsored by the Company. The Company also has an unfunded defined benefit pension plan in Germany, with a projected benefit obligation of $35 million at December 31, 2003.

The Company uses a measurement date of December 31 for all material defined benefit pension and other postretirement benefit plans.

The following table sets forth the changes in projected benefit obligations, plan assets, the funded status of the plans and the amounts recognized in the consolidated financial statements for the defined benefit pension and other postretirement benefit plans.

	(Dollars in millions)			
	Pension Benefits		Other Postretirement Benefits	
Change in benefit obligation:	2003	2002	2003	2002
Projected benefit obligation at January 1	$ 1,528	$ 1,495	$ 208	$ 230
Service cost	18	18	1	1
Interest cost	99	99	13	15
Prior service cost/plan amendments	-	1	(11)	(26)
Divestitures	-	(92)	-	-
Transition obligation amortization	-	-	-	(5)
Foreign currency translation	39	28	-	-
Actuarial loss	132	77	16	17
Special benefits	5	4	-	-
Benefits paid from plan assets	(110)	(97)	-	-
Benefits paid from Company assets	(9)	(5)	(21)	(23)
Projected benefit obligation at December 31	$ 1,702	$ 1,528	$ 206	$ 209
Change in plan assets:				
Fair value of plan assets at January 1	$ 1,139	$ 1,286	$ 1	$ 1
Actual return on plan assets	218	(112)	-	-
Divestitures	-	(52)	-	-
Company contributions	55	92	-	-
Participant contributions	1	1	-	-
Foreign currency translation	30	21	-	-
Benefits paid from plan assets	(110)	(97)	(1)	-
Fair value of plan assets at December 31	$ 1,333	$ 1,139	$ -	$ 1
Funded status of the plan:	$ (369)	$ (389)	$ (206)	$ (208)
Unrecognized actuarial loss	677	660	125	120
Unrecognized prior service cost (benefit)	26	29	(39)	(39)
Unrecognized net transition obligation	-	1	1	1
Net amount recognized	$ 334	$ 301	$ (119)	$ (126)

	(Dollars in millions)			
Amounts recognized in the Statement of	Pension Benefits		Other Postretirement Benefits	
Financial Position consist of:	2003	2002	2003	2002
Prepaid benefit cost	$ 402	$ 362	$ -	$ -
Accrued benefit liability	(70)	(61)	(119)	(126)
Additional minimum liability	(554)	(579)	-	-
Intangible asset	23	26	-	-
Accumulated other comprehensive income (pre-tax)	533	553	-	-

Net amount recognized	$ 334	$ 301	$ (119)	$ (126)

Weighted-average assumptions used to determine the benefit obligation at December 31, 2003 and 2002 were:

Weighted-average discount rate	5.98%	6.55%	6.10%	6.75%
Rate of compensation increase	4.22%	4.32%	4.49%	4.50%

	(Dollars in millions)					
	Pension Benefits			Other Postretirement Benefits		
Net periodic benefit cost (credit):	2003	2002	2001	2003	2002	2001
Service cost	$ 18	$ 18	$ 26	$ 1	$ 1	$ 1
Interest cost	99	99	105	13	15	15
Expected return on plan assets	(113)	(126)	(141)	-	(1)	-
Amortization and deferrals	4	6	5	(8)	(5)	(1)
Participant contributions	(1)	(1)	-	-	-	-
Special benefits/terminations	5	8	2	-	-	-
Actuarial losses recognized	21	2	-	7	5	-
Amortization of transition asset	-	-	2	-	-	-
Benefit cost (credit)	$ 33	$ 6	$ (1)	$ 13	$ 15	$ 15

Weighted-average assumptions used to determine net periodic benefit cost (credit):	2003	2002	2001	2003	2002	2001
Weighted-average discount rate	6.53%	6.98%	7.19%	6.75%	7.25%	7.50%
Expected return on plan assets	8.09%	8.60%	8.58%	N/A	N/A	N/A
Rate of compensation increase	4.25%	4.29%	4.26%	4.49%	4.50%	4.50%

In 2003, the Company made contributions to its defined benefit plans totaling $55 million, some of which was required by local funding requirements. The Company presently anticipates making voluntary cash contributions to the U.S. defined benefit plan of approximately $40 million per year over the next few years, including $40 million contributed in January 2004. Additionally, the Company anticipates contributing approximately $5 million to its foreign defined benefit plans in 2004.

At December 31, 2003 the accumulated benefit obligation ("ABO") of the defined benefit pension plans on a consolidated basis was $1,585 million, of which $1,325 million related to the U.S.; $67 million related to the U.K.; $141 million related to the Netherlands; and $32 million related to Germany. At December 31, 2003 and 2002, the ABO of the U.S., the U.K. and German defined benefit pension plans exceeded their funded benefits. The Company is required to recognize an additional liability equal to the sum of such excess plus the prepaid pension asset balance, with a corresponding after-tax charge to other comprehensive income in stockholders' equity. At December 31, 2002, the Company recorded an additional minimum liability ("AML") of $579 million (pre-tax) with an after-tax charge to other comprehensive income of $354 million. At December 31, 2003, the AML decreased $25 million to $554 million (pre-tax) and accordingly, the charge to accumulated other comprehensive income was decreased by $15 million. As of December 31, 2003, the Consolidated Balance Sheet reflects a non-cash, after-tax charge to other comprehensive income of $339 million. The fair value of plan assets for the Netherlands plan slightly exceeded the ABO at December 31, 2003.

Other Postretirement Benefits

The non-pension postretirement benefit plans include group life insurance coverage and health care reimbursement for U.S. and Canadian employees. The projected benefit obligation of the U.S. other postretirement benefit plan constitutes approximately 99% of the Company's consolidated projected benefit obligation at December 31, 2003. The assumed participation rate in these plans for future eligible retirees was 60% 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 accounting for the health care plans anticipates future cost-sharing changes to the written plans that are consistent with the increase in health care cost. The postretirement health care plans include a limit on the Company's share of costs for recent and future retirees. Participants' contributions are immediately used to cover claim payments, and for this reason do not appear as contributions to plan assets. Employees hired after December 31, 2002 are not eligible for retiree life insurance or benefits supplemental to Medicare health care. The Company periodically obtains reimbursement for union retiree claims from a Voluntary Employees' Beneficiary Association Trust established by the Company, while other claims are paid from Company assets.

The accumulated postretirement benefit obligation exceeds plan assets for all of the Company's other postretirement benefit plans.

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. Employees hired after December 31, 2002 are not eligible for retiree life insurance or benefits supplemental to Medicare health care. The defined benefit pension plan provides benefits based on years of service and final average salary.

The following tables present benefit obligations, plan assets and related information for the defined benefit pension and postretirement benefit plans as of December 31, 2003 and 2002.

	(Dollars in millions)			
	Pension Benefits		Other Postretirement Benefits	
Change in benefit obligation:	2003	2002	2003	2002
Projected benefit obligation at January 1	$ 1,309	$ 1,243	$ 207	$ 228
Service cost	12	13	1	1
Interest cost	86	88	13	14
Prior service cost/plan amendments	-	1	(12)	(26)
Divestitures	-	(30)	-	-
Transition obligation amortization	-	-	-	(4)
Actuarial loss	115	80	16	17
Special benefits	5	8	-	-
Benefits paid from plan assets	(98)	(89)	-	-
Benefits paid from Company assets	(8)	(5)	(21)	(23)
Projected benefit obligation at December 31	$ 1,421	$ 1,309	$ 204	$ 207

The accumulated benefit obligations for the U.S. defined benefit pension plans were $1,325 million and $1,227 million at December 31, 2003 and 2002, respectively.

Weighted-average assumptions used to determine the benefit obligations at December 31, 2003 and 2002 were as follows:

	Pension Benefits		Other Postretirement Benefits	
	2003	2002	2003	2002
Weighted-average discount rate	6.10%	6.75%	6.10%	6.75%
Rate of compensation increase	4.50%	4.50%	4.50%	4.50%

The assumed health care cost trend rate was 10% for the years ending December 31, 2003 and 2002 and 7% for the year ending December 31, 2001. The assumed health care cost trend rate will be 8% in 2004, decreasing to 4.5% by 2007 and for subsequent years. A one-percentage point increase or decrease in the assumed health care cost trend rate would increase or decrease the postretirement benefit obligation by approximately $2 million and would not have a material effect on aggregate service and interest cost components.

(Dollars in millions)

	Pension Benefits		Other Postretirement Benefits	
Change in plan assets:	2003	2002	2003	2002
Fair value of plan assets at January 1	$ 966	$ 1,098	$ 1	$ 1
Actual return on plan assets	207	(108)	-	-
Company contributions	40	65	-	-
Benefits paid from plan assets	(98)	(89)	(1)	-
Fair value of plan assets at December 31	$ 1,115	$ 966	$ -	$ 1

Employer contributions totaled $40 million and $65 million for 2003 and 2002, respectively, and benefits paid from pension plan assets were $98 million and $89 million in 2003 and 2002, respectively. Benefits paid from Company assets under the postretirement benefit plans were $21 million and $23 million in 2003 and 2002, respectively.

The asset allocation for the U.S. defined benefit pension plan at December 31, 2003 and 2002 and the target allocation for 2003, by asset category, follows:

	Target Allocation	Percentage of Plan Assets at December 31,	
Asset category:	2003	2003	2002
Equity securities	55-70%	70%	64%
Fixed income	20-35%	23%	36%
Other	5-10%	7%	0%
Totals		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, including Hercules common stock in the amounts of $7 million (0.6% of total plan assets) and $5 million (0.5% of total plan assets) at December 31, 2003 and 2002, respectively. 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. Up to 10% of fixed income assets can be in debt securities that are below investment grade. Other investments primarily include market neutral-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 8.75% in 2003 and 9.25% in 2002. 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 estimated total return for equity securities is 9.0% annually and assumes a 3% risk premium over a 6% projected return for fixed income.

In developing its investment strategy, the Company considered the following factors for its pension plans: 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 the 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 plans. 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.

The funded status of the U.S. defined benefit pension and postretirement benefit plans reconciled to the amount reported in the Consolidated Statements of Financial Position follows:

(Dollars in millions)

	Pension Benefits		Other Postretirement Benefits	
	2003	2002	2003	2002
Fair value of plan assets	$1,115	$ 966	$ -	$ 1
Projected benefit obligation	1,421	1,309	204	207
Funded status of the plan	(306)	(343)	(204)	(206)
Unrecognized actuarial loss	599	610	125	120
Unrecognized prior service cost (benefit)	21	25	(39)	(39)
Net amount recognized	$ 314	$ 292	$(118)	$(125)
Amounts recognized in the Statement of Financial Position consist of:	2003	2002	2003	2002
Prepaid benefit cost	$ 352	$ 327	$ -	$ -
Accrued benefit liability	(38)	(35)	(118)	(125)
Additional minimum liability	(524)	(552)	-	-
Intangible asset	22	25	-	-
Accumulated other comprehensive income (pre-tax)	502	527	-	-
Net amount recognized	$ 314	$ 292	$ (118)	$ (125)

At December 31, 2003 and 2002, the pension plan in the U.S. had a projected benefit obligation in excess of plan assets. The projected benefit obligation, accumulated benefit obligation and fair value of plan assets for the pension plan in the U.S. were as follows:

(Dollars in millions)

	Pension Benefits December 31,		Other Postretirement Benefits December 31,	
	2003	2002	2003	2002
Projected benefit obligation	$ 1,421	$ 1,309	$ 204	$ 207
Accumulated benefit obligation	1,325	1,227	204	207
Fair value of plan assets	1,115	966	-	1

Information about the expected cash flows for the U.S. defined benefit pension and other postretirement benefit plans follows.

(Dollars in millions)

	Pension Benefits			Other Postretirement Benefits
	Qualified Plan	Non-qualified Plan	Total	
Expected employer contributions for 2004	$ 40	$ -	$ 40	$ -
Expected benefit payments				
2004	86	5	91	22
2005	84	5	89	22
2006	83	5	88	21
2007	83	5	88	20
2008	83	5	88	19
2009-2013	437	23	460	82

The above table reflects the total anticipated contributions to be made by the Company in 2004 and future benefit payments expected to be paid from the plan or from the Company's assets, including both the Company's share of the benefit cost and the participants' share of the cost, which is funded by participant contributions to the plan. Benefits expected to be paid in 2004 include $91 million in pension benefits and $22 million in postretirement benefits, of which $86 million is expected to be paid from plan assets.

(Dollars in millions)

	Pension Benefits			Other Postretirement Benefits		
Net periodic benefit cost (credit):	2003	2002	2001	2003	2002	2001
Service cost	$ 12	$ 13	$ 19	$ 1	$ 1	$ 1
Interest cost	86	88	92	13	14	14
Expected return on plan assets	(102)	(117)	(126)	-	-	-
Amortization and deferrals	4	5	4	(8)	(5)	(5)
Special benefits/terminations	5	9	2	-	-	-
Actuarial losses recognized	20	1	1	7	5	4
Amortization of transition asset	-	-	2	-	-	-
Benefit cost (credit)	$ 25	$ (1)	$ (6)	$ 13	$ 15	$ 14
Weighted-average assumptions used to determine net periodic benefit cost (credit):	2003	2002	2001	2003	2002	2001
Weighted-average discount rate	6.75%	7.25%	7.50%	6.75%	7.25%	7.50%
Expected return on plan assets	8.75%	9.25%	9.25%	N/A	N/A	N/A
Rate of compensation increase	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%

U.K. Defined Benefit Pension Plan

The Company provides a defined benefit pension plan to its employees in the U.K. The following tables present the benefit obligation, plan assets and related information for the U.K. defined benefit pension plan as of December 31, 2003 and 2002.

(Dollars in millions)

	Pension Benefits	
Change in benefit obligation:	2003	2002
Projected benefit obligation at January 1	$ 57	$ 93
Service cost	1	1
Interest cost	3	3
Divestitures	-	(45)
Foreign currency translation	7	7
Actuarial loss	4	-

Benefits paid from plan assets		(3)		(2)
Projected benefit obligation at December 31	$	69	$	57

The accumulated benefit obligation for the U.K. plan was $67 million and $55 million, respectively, at December 31, 2003 and 2002.

Weighted-average assumptions used to determine the benefit obligation at December 31, 2003 and 2002 were as follows:

	Pension Benefits	
	2003	2002
Weighted-average discount rate	5.40%	5.50%
Rate of compensation increase	3.70%	3.50%

	(Dollars in millions) Pension Benefits			
	2003		2002	
Fair value of plan assets at January 1	$	45	$	76
Actual return on plan assets		4		(8)
Divestitures		-		(37)
Company contributions		3		10
Foreign currency translation		6		6
Benefits paid from plan assets		(3)		(2)
Fair value of plan assets at December 31	$	55	$	45

Employer contributions totaled $3 million and $10 million for 2003 and 2002, respectively, and benefits paid from plan assets under the U.K. pension plan were $3 million and $2 million in 2003 and 2002, respectively.

The asset allocation for the U.K. defined benefit pension plan at December 31, 2003 and 2002 and the target allocation for 2003 by asset category follows:

	Target Allocation	Percentage of Plan Assets at December 31,	
Asset category:	2003	2003	2002
Equity securities	44-56%	50%	81%
Fixed income	44-56%	50%	19%
Totals		100%	100%

The target asset allocation for the U.K. pension plan is 30% U.K. equity securities, 20% non-U.K. equity securities, 37.5% U.K. government bonds (gilts) and 12.5% corporate bonds. When determining the strategy, the Company recognizes that the value of the plan's liabilities move with gilt yields (and with gilt prices). Investing a proportion of the plan's assets in equity securities introduces incremental market risk. While this risk can lead to volatility in the funding level disclosed at a subsequent actuarial valuation, the Company believes this risk is acceptable in view of the potential benefits to be realized due to the higher expected rates of returns on equity securities over the long term.

The expected long-term rate of return on plan assets was 6.30% for both 2003 and 2002. 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 plan's target asset allocation is 50% equity and 50% fixed income investments (debt and debt-like securities, including preferred securities).

The estimated total return for equity securities is 7.8% annually and assumes a 3% risk premium over a 4.8% projected return for fixed income. Incremental returns from active management combined with the asset allocation and assumed asset class returns form the basis of the expected long-term rate of return on assets.

The Company's U.K. investment policy considers the following factors in the development of its defined benefit 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.

The Company invests the assets of the plan with a Manager of Managers. The Manager of Managers invests the plan's assets with a broad selection of investment managers who each specialize in a different asset class or market. The aim of this approach is to provide a diversified portfolio of managers 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.

The funded status of the U.K. defined benefit pension plan reconciled to the amount reported in the Consolidated Statements of Financial Position follows:

	(Dollars in millions) Pension Benefits	
	2003	2002
Fair value of plan assets	$ 55	$ 45
Projected benefit obligation	69	57
Funded status of the plan	(14)	(12)
Unrecognized actuarial loss	30	26
Unrecognized prior service cost	1	1
Net amount recognized	$ 17	$ 15
Amounts recognized in the Statement of Financial Position consist of:		
Prepaid benefit cost	$ 17	$ 15
Additional minimum liability	(29)	(25)
Intangible asset	1	1
Accumulated other comprehensive income (pre-tax)	28	24
Net amount recognized	$ 17	$ 15

As of December 31, 2003 and 2002, the U.K. pension plan had a projected benefit obligation in excess of plan assets. The projected benefit obligation, accumulated benefit obligation, and fair value of plan assets for the U.K. pension plan were as follows:

	(Dollars in millions) December 31,	
	2003	2002
Projected benefit obligation	$ 69	$ 57
Accumulated benefit obligation	67	55
Fair value of plan assets	55	45

Information about the expected cash flows for the U.K. defined benefit pension plan follows:

	(Dollars in millions) Pension Plan Benefits
Expected employer contributions for 2004	$ 1
Expected benefit payments	

2004	3
2005	3
2006	3
2007	3
2008	3
2009-2013	17

The above table reflects the total contribution that the Company anticipates making in 2004 and the benefit payments that it expects to be paid from the plan assets through the year ending 2013.

	(Dollars in millions) Pension Benefits		
Net periodic benefit cost:	2003	2002	2001
Service cost	$ 1	$ 1	$ 2
Interest cost	3	3	5
Expected return on plan assets	(3)	(3)	(7)
Actuarial loss recognized	1	1	-
Benefit cost	$ 2	$ 2	$ -

Weighted-average assumptions used to determine net periodic benefit cost:	2003	2002	2001
Weighted-average discount rate	5.50%	5.50%	6.25%
Expected return on plan assets	6.30%	6.30%	6.30%
Rate of compensation increase	3.50%	3.50%	2.50%

Netherlands Defined Benefit Pension Plan

The Company provides a defined benefit pension plan to its employees in the Netherlands. The following tables present benefit obligation, plan assets and related information for the Netherlands defined benefits pension plan as of December 31, 2003 and 2002.

	(Dollars in millions) Pension Benefits	
Changes in benefit obligation:	2003	2002
Projected benefit obligation at January 1	$ 114	$ 98
Service cost	3	3
Interest cost	7	5
Divestitures	-	(1)
Foreign currency translation	25	17
Actuarial loss	12	(3)
Benefits paid from plan assets	(7)	(5)
Projected benefit obligation at December 31	$ 154	$ 114

The accumulated benefit obligation for the Netherlands plan was $141 million and $110 million, respectively, at December 31, 2003 and 2002.

Weighted-average assumptions used to determine the benefit obligation at December 31, 2003 and 2002 were:

	Pension Benefits	
	2003	2002
Weighted-average discount rate	5.25%	5.50%
Rate of compensation increase	2.50%	3.00%

	(Dollars in millions) Pension Benefits	
Change in plan assets:	2003	2002
Fair value of plan assets at January 1	$ 110	$ 78
Actual return on plan assets	4	4
Expenses	(1)	(1)
Company contributions	12	17
Participant contributions	1	1
Foreign currency translation	22	16
Benefits paid from plan assets	(7)	(5)
Fair value of plan assets at December 31	$ 141	$ 110

Employer contributions totaled $12 million and $17 million for 2003 and 2002, respectively, and benefits paid from plan assets were $7 million and $5 million in 2003 and 2002, respectively.

The asset allocation for the Company's defined benefit pension plan in the Netherlands at December 31, 2003 and 2002 and the target allocation for 2003, by asset category follows:

	Target Allocation	Percentage of Plan Assets at December 31,	
Asset category:	2003	2003	2002
Equity securities	42-76%	59%	53%
Fixed income	37-47%	41%	47%
Totals		100%	100%

The target asset allocation is 22% U.S. equity securities, 29% European equity securities, 7% Asia Pacific equity securities and 42% fixed income securities valued in euros. U.S. equity securities are invested in a passively managed Standard & Poor's 500 Commingled Trust Fund; European and Asia Pacific equity securities represent investments in actively managed regional funds; 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 6.5% in 2003 and 6.0% in 2002. 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 plan's long-term (policy) target asset allocation is 58% equity and 42% fixed income investments (debt and debt-like securities, including preferred securities). The annual estimated total return for equities is 8.0%; the annual estimated total return for Euro bonds is 5.0%.

In developing an investment strategy, 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 position 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 Company manages the 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. To achieve the stated investment objectives, the Company, from time to time, reviews and confirms the following assertions: that plan assets are fully invested in the capital markets; that equity investments provide greater long-term returns than fixed income investments, although with greater short-term volatility; that prudent diversification across major asset classes provides the potential for enhanced long-term returns and decreased portfolio risk; that investment managers with active mandates can reduce portfolio risk below market risk and potentially add value through security selection strategies; that it is appropriate to retain multiple investment managers provided that such managers offer asset class or style diversification; and that the investment performance of the portfolio, the various asset classes and the individual investment managers be reviewed regularly against policy objectives.

The funded status of the plan reconciled to the amount reported in the Consolidated Statements of Financial Position follows:

	(Dollars in millions)	
	Pension Benefits	
	2003	2002
Fair value of plan assets	$ 141	$ 110
Projected benefit obligation	154	114
Funded status of the plan	(13)	(4)
Unrecognized actuarial loss	38	17
Unrecognized prior service cost	3	3
Net amount recognized	$ 28	$ 16
Amounts recognized in the Statement of Financial Position consist of:		
Prepaid benefit cost	28	16
Net amount recognized	$ 28	$ 16

As of December 31, 2003 and 2002, the pension plan in the Netherlands had a projected benefit obligation in excess of plan assets. The projected benefit obligation, accumulated benefit obligation and fair value of plan assets for the pension plan in the Netherlands were as follows:

	(Dollars in millions)	
	December 31,	
	2003	2002
Projected benefit obligation	$ 154	$ 114
Accumulated benefit obligation	141	110
Fair value of plan assets	141	110

Information about the expected cash flows for the Netherlands defined benefit pension plan follows:

	(Dollars in millions)
	Pension Plan Benefits
Expected employer contributions for 2004	$ 4
Expected benefit payments:	
2004	8
2005	9
2006	10
2007	11
2008	12
2009-2013	62

The above table reflects the total contribution that the Company anticipates making in 2004 and the benefits expected to be paid from the plan assets through the year ending 2013.

	(Dollars in millions)
	Pension Plan Benefits

	2003	2002	2001
Service cost	$ 3	$ 3	$ 3
Interest cost	7	5	5
Expected return on plan assets	(8)	(5)	(7)
Amortization of prior service cost	1	1	-
Benefit Cost	$ 3	$ 4	$ 1

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

	2003	2002	2001
Weighted-average discount rate	5.50%	5.75%	5.75%
Expected return on plan assets	6.50%	6.00%	6.00%
Rate of compensation increase	3.00%	3.00%	3.00%

10. Employee Stock Ownership Plan ("ESOP")

Effective March 1, 2002, the BetzDearborn Inc. Employee Stock Ownership and 401(k) Plan was merged into the Hercules Incorporated Savings and Investment Plan ("SIP Plan"). On April 29, 2002, the Company used a portion of the proceeds from the sale of the BetzDearborn Water Treatment Business to fully prepay the long-term third party debt ("ESOP credit facility") held by the ESOP trust. Concurrent with the prepayment of the ESOP credit facility, the trust borrowed $75 million from the Company under an existing loan agreement. At December 31, 2003, and 2002, the ESOP trust had $65 million and $76 million in long-term debt outstanding, respectively, under the loan agreement; the Company has an offsetting receivable in each year. The Company recognized $24 million in prepayment penalties in 2002 as a result of the prepayment of the ESOP credit facility (see Note 21).

Under the provisions of the SIP Plan, employees may invest 1% to 50% of eligible compensation. The Company's matching contributions, made in the form of Hercules' common stock contributed through the ESOP, are equal to 50% of the first 6% of the employee's contributed compensation and vest immediately. Effective December 31, 2003, the Company changed its method of accounting for the ESOP to the method prescribed by SOP 93-6 (Note 1). Under SOP 93-6, 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 $8 million, $7 million, and $7 million for the years ended December 31, 2003, 2002 and 2001, respectively, is recorded in additional paid-in capital. The unallocated shares held by the trust are reflected in unearned compensation as a reduction in stockholders' equity on the balance sheet of $80 million and $91 million at December 31, 2003 and 2002, respectively. The unallocated shares have a cost basis of $31.625 per share.

	2003	2002
Allocated	1,594,739	1,530,314
Unallocated	2,520,433	2,869,338
Total shares held by ESOP	4,115,172	4,399,652

The ESOP expense was $4 million for each of the years ended December 31, 2003, 2002 and 2001.

11. Long-term Incentive Compensation Plans

Effective January 1, 2003, the Company adopted 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 has 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. Awards under the Company's stock-based compensation plans vest over periods ranging from 1 to a maximum of 5 years; however, vesting can be extended with the approval of the Board of Directors. Therefore, the cost related to stock-based employee compensation included in the determination of net income in 2003 is 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. The Company did not grant any stock options covered by SFAS 123, as amended by SFAS 148, to employees in 2003. However, the Company did make grants of restricted stock to employees in 2003. Restricted stock awards under the Hercules Long-term Incentive Compensation Plan are valued at the quoted market price (fair value) of the Company's stock on the grant date (measurement date). Stock acquired through the Employee Stock Purchase Plan and "above target" restricted stock awarded under the Hercules Management Incentive Compensation Plan is discounted 15% from market price as permitted by IRS regulations and the provisions of the Company's incentive compensation plans. The value of the award and the discount, if any, are amortized into expense over the vesting (restriction) period. Forfeitures are recorded as incurred. The Company recognized $4.3 million, $0.5 million and $1.7 million of expense in 2003, 2002 and 2001, respectively, in connection with restricted stock awards.

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

In 1995, Hercules changed the structure of its long-term incentive compensation plans to place a greater emphasis on shareholder value creation through grants of regular stock options, performance-accelerated stock options and Cash Value Awards (performance-based awards denominated in cash and payable in shares of common or restricted stock, subject to the same restrictions as restricted stock). Restricted stock and other market-based units are awarded with respect to certain programs. The number of awarded shares outstanding was 1,299,214 at December 31, 2003, 351,937 at December 31, 2002 and 189,704 at December 31, 2001, respectively.

At December 31, 2003, under the Company's incentive compensation plans, 2,429,395 shares of common stock were available for grant as stock awards or stock option awards. Stock awards are limited to approximately 15% of the total authorizations. Regular stock options are granted at the market price on the date of grant and are exercisable at various periods from one to five years after date of grant. Performance-accelerated stock options are also granted at the market price on the date of grant and are normally exercisable at nine and one-half years. Exercisability may be accelerated based upon the achievement of predetermined performance goals. Both regular and performance-accelerated stock options expire 10 years after the date of grant.

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

Below is a summary of outstanding stock option grants under the incentive compensation plans during 2001, 2002 and 2003:

	Regular			Performance-Accelerated		
	Number of Shares	Weighted-average Price		Number of Shares	Weighted-average Price	
December 31, 2000	11,149,928	$	31.57	6,084,425	$	43.47
Granted	2,806,525	$	11.58	-	$	-
Exercised	(44,400)	$	15.01	(187,500)	$	14.06
Forfeited	(663,255)	$	25.89	(129,600)	$	43.61
December 31, 2001	13,248,798	$	27.51	5,767,325	$	44.42
Granted	2,031,699	$	11.88	-	$	-
Exercised	(4,275)	$	11.28	-	$	-
Forfeited	(2,068,588)	$	26.91	(578,400)	$	49.00

December 31, 2002	13,207,634	$	25.21	5,188,925	$	43.91
Granted	21,000	$	10.09	-	$	-
Exercised	-	$	0.00	-	$	-
Forfeited	(922,075)	$	32.34	(409,225)	$	46.77
December 31, 2003	12,306,559	$	24.47	4,779,700	$	43.66

The weighted-average fair value of regular stock options granted during 2001, 2002 and 2003 using the Black-Scholes option pricing model was $5.90, $5.09 and $4.67, respectively. During the fourth quarter of 2003, the Company's Compensation Committee granted each of the non-employee directors 3,000 stock options (21,000 in total) under the Omnibus Equity Compensation Plan for Non-Employee Directors. There were no performance-accelerated stock options granted during 2001, 2002 or 2003.

Following is a summary of regular stock options exercisable at December 31, 2001, 2002 and 2003, and their respective weighted-average share prices:

Options Exercisable	Number of Shares	Weighted-average Exercise Price
December 31, 2001	9,471,983	$ 33.04
December 31, 2002	9,150,134	$ 31.05
December 31, 2003	10,973,895	$ 26.09

At December 31, 2001, 2002 and 2003, respectively, there were no performance-accelerated stock options exercisable. Following is a summary of stock options outstanding at December 31, 2003:

		Outstanding Options	
	Number Outstanding at 12/31/2003	Weighted-average Remaining Contractual Life	Weighted-averag
Regular Stock Options			
$8.50 - $11.75	1,484,825	7.72	$11
$11.76 - $15.00	3,227,699	7.95	$11
$15.01 - $22.50	1,862,875	6.16	$17
$22.51 - $33.75	1,675,775	4.69	$25
$33.76 - $40.00	2,708,060	4.25	$38
$40.01 - $60.00	1,347,325	3.10	$49
	12,306,559		
Performance-Accelerated Stock Options			
$24.00 - $36.00	638,400	4.99	$31
$36.01 - $45.00	1,207,355	4.63	$38
$45.01 - $50.00	2,468,720	2.95	$47
$50.01 - $61.00	465,225	2.06	$55
	4,779,700		

The Company's Employee Stock Purchase Plan was originally a qualified non-compensatory plan, which allowed eligible employees to acquire shares of common stock through systematic payroll deductions. The plan was converted to a non-qualified employee stock purchase plan in 2001 and the shares are funded from treasury stock. The plan consists of three-month subscription periods, beginning July 1 of each year. The purchase price is 85% of the fair market value of the common stock on either the first or last day of that subscription period, whichever is lower (the "look-back"). Purchases may range from 2% to 15% of an employee's base salary each pay period, subject to certain limitations. Shares issued at December 31, 2001 under the qualified plan were 1,758,081. Currently, there are no shares of Hercules common stock registered for offer and sale under the qualified plan. The shares issued under the non-qualified plan totaled 833,195 at December 31, 2003. Pursuant to SFAS 123, the look-back constitutes a stock option. The Company estimates and expenses the value of the option for the applicable subscription period using Black-Scholes. The expense attributable to the look-back provision is not significant. The 15% discount on the purchase price of the common stock has been recognized as compensation expense for the non-qualified Employee Stock Purchase Plan.

The following weighted-average assumptions are used in determining the fair value for 2003, 2002 and 2001:

		Employee Stock
2003 Assumptions		
	Regular Plan	Purchase Plan
Dividend yield	0.00%	0.00%
Risk-free interest rate	3.54%	1.00%
Expected life	6 yrs.	3 mos.
Expected volatility	42.79%	35.88%
2002 Assumptions		
Dividend yield	0.00%	0.00%
Risk-free interest rate	4.97%	1.65%
Expected life	6 yrs.	3 mos.
Expected volatility	34.60%	41.97%
2001 Assumptions		
Dividend yield	0.00%	0.00%
Risk-free interest rate	5.15%	3.80%
Expected life	8 yrs.	3 mos.
Expected volatility	35.54%	54.09%

The pro forma effect on net income (loss) and earnings (loss) per share, assuming the Company had applied the fair value recognition provisions of SFAS 123 to stock-based employee compensation for all years reported, is presented in the Summary of Significant Accounting Policies.

12. Asset Retirement Obligations

Effective January 1, 2003, the Company adopted Statement of Financial Accounting Standards No. 143, "Accounting for Asset Retirement Obligations" ("SFAS 143"). SFAS 143 establishes accounting and reporting standards for the recognition and measurement of legal obligations associated with the retirement of tangible long-lived assets. SFAS 143 requires that the fair value of an asset retirement obligation be recorded when incurred. Included within the scope of SFAS 143 are environmental remediation liabilities that resulted from the normal operation of a long-lived asset. The Company has a number of environmental remediation liabilities associated with current and former operations that were incurred during the course of normal operations. The most significant differences in the measurement of these obligations under SFAS 143 are outlined below:

Recording of Full Obligation

SFAS 143 requires that the fair value of an asset retirement obligation be recorded when it is incurred if a reasonable estimate of fair value can be made. Under SFAS 143, uncertainties (probability) in the amount and timing of settlement are incorporated into the fair value measure of the recognized liability, whereas under Statement of Financial Accounting Standards No. 5, "Accounting for Contingencies," and FASB Interpretation 14, "Reasonable Estimation of the Amount of a Loss," uncertainties are considered in determining recognition of a liability.

Present Value of Obligation

SFAS 143 requires that the fair value of the asset retirement obligation be discounted using a credit adjusted risk-free rate.

Capitalization of Costs Related to Environmental Contamination

SFAS 143 requires capitalization of costs as a component of fixed assets to the extent there is a corresponding operating asset. Emerging Issues Task Force Issue No. 90-8, "Capitalization of Costs to Treat Environmental Contamination," permitted capitalization of environmental remediation costs incurred in preparing a property for sale.

With the adoption of SFAS 143, the Company recorded an increase to its environmental remediation liabilities of $28 million with a corresponding increase to property, plant, and equipment of $2 million and a decrease in capitalized environmental remediation costs of $18 million, resulting in an after-tax charge of $28 million ($44 million on a pre-tax basis), or $0.26 per share, as a cumulative effect of a change in accounting principle.

The following table provides a reconciliation of the changes in the asset retirement obligations during the period.

		(Dollars in millions)				
		SFAS 143 Adoption				
	Balance January 1, 2003	Cumulative Effect Adjustment	Capitalized Retirement Obligations	Liabilities Settled	Accretion	Balance December 31, 2003
Capitalized remediation costs	$ 18	$ (18)	$ -	$ -	$ -	$ -
Environmental Remediation Liabilities:						
SFAS 143 ARO sites	(85)	(26)	(2)	12	(2)	(103)
Non-SFAS 143 sites	(3)	-	-	-	-	(3)
	$ (70)	$ (44)	$ (2)	$ 12	$ (2)	$ (106)

Had the Company adopted SFAS 143 effective January 1, 2002, the liability for asset retirement obligations as of that date would have been $122 million.

13. Commitments and Contingencies

Guarantees

In November 2002, the FASB issued FASB Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" ("FIN 45"). The Company has adopted the disclosure requirements of FIN 45 as of December 31, 2002. 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 other restrictions and limitations. The carrying amount recorded for all indemnifications as of December 31, 2003 is $76 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. Approximately $1 million in cash is held in escrow or collateral.

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 Obligations

The Company has directly guaranteed various debt obligations under agreements with third parties related to subsidiaries and affiliates, and/or other unaffiliated companies. At December 31, 2003, the Company had directly guaranteed $19 million of such obligations. This represents the maximum principal amount of potential future payments that the Company could be required to make under the guarantees. Any applicable interest and expenses would generally be added to the amount of obligations.

The Company's Consolidated Financial Statements include $7 million of outstanding directly guaranteed obligations, including $2 million recorded as debt and $5 million recorded as pension liability. The Company has provided approximately $3 million in collateral through a mortgage security related to the pension liability. Existing guarantees for subsidiaries and affiliates arose from liquidity needs in normal operations. The Company will be required to perform on these guarantees in the event of default by the guaranteed party.

The Company guarantees the obligations of Hercules Trust I and Hercules Trust II on the preferred securities (see Note 6).

Intercompany Guarantees

The Company and its subsidiaries have intercompany guarantees between and among themselves, which aggregate approximately $156 million as of December 31, 2003. These guarantees relate to intercompany loans used to facilitate normal business transactions such as the sale and purchase of products. All of the $156 million has 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. Rental expense was $25 million in 2003, $34 million in 2002 and $56 million in 2001.

At December 31, 2003, minimum rental payments under non-cancelable leases aggregated $181 million with offsetting subleases of $48 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 $20 million in 2004, $17 million in 2005, $14 million in 2006, $13 million in 2007, $13 million in 2008 and $56 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.

Hercules has been identified as a potentially responsible party ("PRP") by U.S. federal and state authorities, or by private parties seeking contribution, for the cost of environmental investigation and/or cleanup at numerous sites. The range of the reasonably possible share of costs for the investigation and cleanup of current and former operating sites, and other locations where the Company may have a known liability is between $106 million and $218 million. The actual costs will depend upon numerous factors, including the number of parties found responsible at each environmental site and their ability to pay; the actual methods of remediation required or agreed to; outcomes of negotiations with regulatory authorities; outcomes of litigation; changes in environmental laws and regulations; technological developments; and the years of remedial activity required, which could range from 0 to 30 years.

Hercules becomes aware of sites in which it may be named a PRP in investigatory and/or remedial activities through correspondence from the U.S. Environmental Protection Agency ("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.

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

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

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

On February 8, 2000, the District Court issued a final judgment on the allocation between Hercules and Uniroyal finding Uniroyal liable for 2.6 percent and Hercules liable for 97.4 percent of the costs at issue. Hercules timely appealed that judgment. Oral argument on both appeals was held before the Eighth Circuit on June 12, 2000. On April 10, 2001, the United States Court of Appeals for the Eighth Circuit issued an opinion in the consolidated appeals described above. In that opinion, the Appeals Court reversed the District Court's decision which had held Hercules jointly and severally liable for costs incurred and to be incurred at the Jacksonville site, and remanded the case back to the District Court for several determinations, including a determination of whether the harms at the site giving rise to the government's claims were divisible. The Appeals Court also vacated the District Court's allocation decision holding Hercules liable for 97.4 percent of the costs at issue, ordering that these issues be revisited following further proceedings with respect to divisibility. Finally, the Appeals Court affirmed the judgment of liability against Uniroyal.

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

Alleghany Ballistics Laboratory

The Alleghany Ballistics Laboratory ("ABL") is a government-owned facility, which was operated by Hercules from 1945 to 1995 under contract with the United States Department of the Navy. The Navy has notified Hercules that it would like to negotiate with Hercules with respect to certain environmental liabilities which, the Navy alleges, are attributable to Hercules' past operations at ABL. In recent discussions, the Navy has stated that, pursuant to CERCLA, it has spent a total of $24.8 million and expects to spend an additional $44 million over the next 10 years. The Company is currently investigating the Navy's allegations, including the basis of the Navy's claims, and whether the contracts with the government pursuant to which the Company operated ABL may provide to the Company a defense from some or all of the amounts sought. At this time, however, the Company cannot reasonably estimate its liability, if any, with respect to ABL and, accordingly, has not included this site in the range of its environmental liabilities reported above.

At December 31, 2003, the Company's accrued liability for environmental remediation was $106 million. The extent of liability is evaluated 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. While it is not feasible to predict the outcome of all pending suits and claims, the ultimate resolution of these environmental matters could have a material effect upon the results of operations and the financial position of Hercules, and the resolution of any of these matters during a specific period could have a material effect on the quarterly or annual results of that period.

Litigation

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

Since entering into the agreements referenced in the above paragraph, the Company has continued to receive and settle or otherwise resolve claims on an on-going basis. Between January 1, 2003 and December 31, 2003, the Company received approximately 16,885 new claims, over half of which were included in "consolidated" complaints naming anywhere from one hundred to thousands of plaintiffs and a large number of defendants, but providing little information connecting any specific plaintiff's alleged injuries to any specific defendant's products or premises. It is the Company's belief that a significant majority of these "consolidated" claims will be dismissed for no payment. During that same time period, the Company also received approximately 3,175 other new claims, all of which were included in "consolidated" complaints and 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. With respect to total claims pending, as of January 31, 2004, there were approximately 33,220 unresolved claims, of which approximately 1,080 were premises claims and the rest were products claims. There were also approximately 1,615 unpaid claims which have been settled or are subject to the terms of a settlement agreement. In addition, as of January 31, 2004, there were approximately 11,920 claims (an amount that includes the 3,175 claims noted above) 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.

In June and July 2003, the Company entered into several settlement agreements which will permanently resolve approximately 12,500 claims. Of those claims, approximately 3,600 are categorized as "unresolved" in the above paragraph, and approximately 8,900 are among those claims that have been dismissed without payment or are in the process of being dismissed without payment. The terms of these settlement agreements are confidential. The Company believes that the vast majority of these claims will be permanently dismissed without payment.

The Company's primary and first level excess insurance policies that provided coverage for these asbestos-related matters have exhausted their limits. The Company has not yet reached agreement with its other insurance carriers to fund the cost of defending and resolving its asbestos-related matters. As a result, until the Company's other insurance carriers begin to fund the cost of defending and resolving these matters, the Company will have to fully fund the cost of defending and resolving these matters. Net of insurance payments received or made on its behalf, the Company spent $40 million on these matters during the year ended December 31, 2003, including $7 million of legal expenses. Nonetheless, 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 it and its former subsidiary together have sufficient additional insurance to cover the majority of its current and estimated future asbestos-related liabilities. However, there can be no assurance that such liabilities will be sufficiently covered.

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 study discussed below, the Company's evaluation of potentially available insurance coverage and its review of the relevant case law. 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 below, that the Company's belief of the range of its reasonably possible financial exposure could change as the study referenced below is periodically updated, that its evaluation of potentially available insurance coverage may change depending upon numerous variables including risks inherent in litigation, potential legislation, and the risk that one or more insurance carriers may refuse or be unable to meet its obligations to the Company, and that conclusions resulting from its review of relevant case law may be impacted by future court decisions or legislative or other changes in the law.

The Company is seeking defense and indemnity payments or an agreement to pay from those carriers responsible for excess coverage whose levels of coverage have been or will soon be reached. Although those excess carriers have not yet agreed to defend or indemnify the Company, the Company believes that it is likely that they will ultimately agree to do so, and that the majority of its estimated future asbestos-related costs will ultimately be paid or reimbursed by those carriers. However, since the Company has not yet reached satisfactory agreements with those excess carriers, the Company will be required to completely fund these matters while it seeks reimbursement from those carriers. In order to maximize the likelihood of obtaining insurance payments for these asbestos-related costs, on November 27, 2002, the Company initiated litigation against its excess insurance carriers in a matter captioned Hercules Incorporated v. OneBeacon, et al., Civil Action No. 02C-11-237 (SCD), Superior Court of Delaware, New Castle County. That litigation is proceeding through discovery and motion practice, and trial is currently scheduled in October 2004. Notwithstanding the filing of this litigation, the Company is continuing settlement discussions with several of its key insurers.

The Company commissioned a study of its asbestos-related liabilities by Professor Eric Stallard, who is a Research Professor of Demographic Studies at a major national university and a Member of the American Academy of Actuaries. Professor Stallard is a consultant with broad experience in estimating such liabilities. Based on the results of the study undertaken by Professor Stallard, the Company estimated that its reasonably possible financial exposure for these matters (excluding approximately $1 million for previously settled but unpaid claims) ranged from $220 million to $675 million. Due to inherent uncertainties in estimating the timing and amounts of future payments, this 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 costs as incurred. As stated above, the Company presently believes that the majority of this range of financial exposures will ultimately be funded by insurance proceeds. 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.

Due to the dynamic nature of asbestos litigation and the present uncertainty concerning the participation of its excess insurance carriers, 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 in the above paragraph, 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 exceed 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, the Company presently believes that the majority of any additional liability it may reasonably anticipate will be paid or reimbursed by its insurance carriers. However, there can be no assurance that such liabilities will be reimbursed.

The findings of the study referenced above identify a range of the Company's reasonably possible financial exposure for these asbestos-related matters. The Company increased its accrual for present and future potential asbestos claims before anticipated insurance recoveries at December 31, 2003 to $221 million, reflecting the low end of the range noted above and $1 million for previously settled but unpaid asbestos cases, resulting in a charge of $55 million in the period related to these matters. At December 31, 2003, the Company believes that it is probable that $169 million of the $221 million accrual will be funded by or recovered from insurance carriers. That belief, which is subject to the various assumptions set forth herein, is based on many factors that have been evaluated by the Company, along with its outside insurance coverage counsel, including the indemnity and defense payments that have been made by its now exhausted insurers and by some of its other insurers, the limits of remaining potentially available insurance coverage, and the range of possible outcomes in the Company's insurance coverage litigation taking into account, among other considerations, the facts and status of that litigation and the relevant case law. At December 31, 2003, the Consolidated Balance Sheet reflects a current insurance receivable of $7 million and a long-term insurance receivable of $162 million. The Company does not offset estimated insurance receivables against its estimated liability.

In 2002, the Company recorded a gross accrual of $225 million for present and future potential asbestos claims before anticipated insurance recoveries resulting in a net charge of $65 million related to these matters in the period ended September 30, 2002. At December 31, 2002, the Company had an accrual of $216 million for the gross liability. The Company believes that it is probable that $137 million of the $216 million accrual will be funded by or recovered from insurance carriers. At December 31, 2002, the consolidated balance sheet reflected a current insurance receivable of $9 million and a long-term insurance receivable of $128 million.

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

In August 1999, the Company was sued in an action styled as Cape Composites, Inc. v. Mitsubishi Rayon Co., Ltd., Case No. 99-08260 (U.S. District Court, Central District of California), one of a series of similar purported class action lawsuits brought on behalf of purchasers (excluding government purchasers) of carbon fiber and carbon prepreg in the United States from the named defendants from January 1, 1993 through January 31, 1999. The lawsuits were brought following published reports of a Los Angeles federal grand jury investigation of the carbon fiber and carbon prepreg industries. In these lawsuits, plaintiffs allege violations of Section 1 of the Sherman Antitrust Act for alleged price fixing. In September 1999, these lawsuits were consolidated by the Court into a case captioned Thomas & Thomas Rodmakers v. Newport Adhesives and Composites, Case No. CV-99-07796-GHK (CTx) (U.S. District Court, Central District of California), with all related cases ordered dismissed. This lawsuit is proceeding through discovery and motion practice. On May 2, 2002, the Court granted plaintiffs' Motion to Certify Class. The Company is named in connection with its former Composites Products Division, which was sold to Hexcel Corporation in 1996, denies liability and will vigorously defend this action.

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

In June 2002, a purported class action was filed in Massachusetts under the caption Saul M. Ostroff, et al. v. Newport Adhesives, et al., Civil Action No. 02-2385, Superior Court of Middlesex County. This matter is a purported class action brought on behalf of consumers who purchased merchandise manufactured with carbon fiber, and alleges the same types of price fixing activities alleged in the actions described in the above two paragraphs. In October 2002, the Company was notified that Horizon Sports Technologies had "opted out" of the federal antitrust class action described above (Thomas & Thomas Rodmakers) and filed its own suit against Hercules and the other defendants in that action (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).

Further, in April 2002, a related "Qui Tam" action was unsealed by the U.S. District Court for the Southern District of California. That action is captioned Randall M. Beck, et al. v. Boeing Defense and Space Group, Inc., et al., (Civil Action No. 99 CV 1557 JM JAH), was filed under seal in 1999, and is a "False Claims" action brought pursuant to the False Claims Act (31 U.S.C. Section 729 et seq.). In that action, the relators, in the name of the U.S. Government, allege the same price fixing activities which are the subject of the above-described actions. The relators then allege that those alleged price fixing activities resulted in inflated prices being charged by the defendant carbon fiber manufacturers to defense contractors, who, in turn, submitted claims for payment to the U.S. Government under various government contracts. It is alleged that those claims for payment were "false claims" because the prices charged for the carbon fiber and carbon prepreg were "fixed" contrary to the laws of the United States. By Order dated November 14, 2002, the Court dismissed the relators' complaint without prejudice because the complaint did not meet certain pleading requirements under the Federal Rules of Civil Procedure. The relators filed a First Amended Complaint on January 3, 2003. By Order dated July 29, 2003, the Court dismissed the First Amended Complaint without prejudice for similar reasons and provided the relators thirty days to re-file their complaint; that time period was subsequently extended by sixty days. The relators filed a Second Amended Complaint on or about October 30, 2003. The defendants have filed a motion to have that complaint dismissed, but no decision has yet been issued by the Court. The Company denies liability and will vigorously defend each of these actions.

In connection with the grand jury investigation noted above in the paragraph describing the Cape Composites litigation, in January 2000, the United States Department of Justice ("DOJ"), Antitrust Division, served a grand jury subpoena duces tecum upon Hercules. The Company has been advised that it is one of several manufacturers of carbon fiber and carbon prepreg that have been served with such a subpoena. In December 2003, the Company was advised that the grand jury investigation had been closed.

In November 2002, an action for declaratory judgment was filed in the U.S. District Court for the District of Delaware under the caption of Atofina Chemicals, Inc. and Atofina v. Hercules Incorporated (Civil Action No. 02-1613). In this action, Atofina sought a declaratory judgment that Hercules cannot recover antitrust damages for purchases of monochloracetic acid ("MCAA") that Hercules made outside of the United States or for purchases from producers of MCAA not alleged to have participated in any conspiracy to fix prices and allocate the market for MCAA. In response, Hercules counter-claimed, seeking damages from and injunctive relief against Akzo Nobel Chemicals, Atofina Chemicals, Hoechst AG, Hoechst Celanese, Clariant and others related to the fixing of prices of MCAA and sodium monochloracetate from approximately 1995 through 2000. The lawsuit is in pre-trial proceedings. Hercules has settled with some of the parties. The terms of the settlements are confidential.

By Order dated May 6, 2003, the U.S. District Court for the Middle District of Louisiana remanded to the 18th Judicial District Court for the Parish of Iberville, Louisiana, a total of nine (9) consolidated lawsuits, including two (2) lawsuits in which the Company is a defendant. These two lawsuits, Jerry Oldham, et al. v. The State of Louisiana, et al., Civil Action No. 55,160, 18th Judicial District Court, Parish of Iberville, Louisiana, and John Capone, et al. v. The State of Louisiana, et al., Civil Action No. 56,048C, 18th Judicial District Court, Parish of Iberville, Louisiana, were served on the Company in September 2002 and October 2002, respectively. The Oldham case is a purported class action comprised of as many as 4,000 plaintiffs, and the Capone case is a consolidated action by approximately 50 plaintiffs. Both actions assert claims against the State of Louisiana, the Company, American PetroFina, Hercofina, Ashland Oil, International Minerals and Chemicals, Allemania Chemical, Ashland Chemical and the Parish of Iberville. The purported class members and plaintiffs, who claim to have worked or lived at or around the Georgia Gulf plant in Iberville Parish, allege 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 allege 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. On October 17, 2002, the Company removed these matters to federal court. In January 2003, the U.S. District Court for the Middle District of Louisiana consolidated the Capone and Oldham matters with other lawsuits in which the Company is not a party. Plaintiffs sought remand which, as noted above, was granted by Order dated May 6, 2003. Discovery is continuing. The Company denies any liability and intends to vigorously defend these matters.

On January 31, 2003, the Court granted a Motion for Class Certification in a lawsuit captioned Douglas C. Smith, Individually and on Behalf of All Others Similarly Situated v. Hercules Incorporated and Thomas Gossage, CA No. 01C-08-291 WCC, Superior Court of Delaware, New Castle County. This lawsuit, which was filed on August 31, 2001, on behalf of Mr. Smith and a class of approximately 130 present and former Hercules employees, seeks payments under the "Integration Synergies Incentive Compensation Plan" (the "Plan"), a program put into place by the Company following its acquisition of BetzDearborn Inc. in October 1998. The goal of the Plan was to provide certain financial incentives to specific employees who were deemed to have significant impact on the integration of BetzDearborn Inc. into Hercules Incorporated. The amount to be paid under the Plan was tied to the successful achievement of "synergies," which were defined as the annualized reduction of expenses or improvement of profits realized as a result of the integration of BetzDearborn Inc. into Hercules. The lawsuit essentially alleges that the payments made under the Plan were not adequate and that the Company breached the terms of the Plan. The lawsuit seeks payments of between $25 million and $30 million, although the Company does not believe that any payments are owed to the class members. In February 2003, plaintiffs agreed to dismiss Thomas Gossage from the lawsuit. In June 2003, potential members who had previously signed releases in favor of the Company were provided an opportunity to "opt in" to the class, and the remaining class members were provided an opportunity to "opt out" of the class. As a result of this process, the size of the class has been reduced to approximately 87 members and, as a result, the maximum potential damages payable to the class, even should plaintiffs prevail, should be significantly lower than the amounts noted above. Trial is scheduled for April 2004. The Company denies any liability to the plaintiffs and is vigorously defending this action.

Agent Orange is a defoliant that was manufactured by several companies, including Hercules, 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.

At this time, the Company is a defendant in twenty lawsuits (including two purported class actions) where plaintiffs allege that exposure to Agent Orange caused them to sustain various personal injuries. In addition, in January 2004, the Company was sued in a 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. 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.

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 Ray 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 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 until October 12, 2004, to permit plaintiffs time to pursue additional discovery to support their position that the government contractor defense should not apply to their claims, and to seek reconsideration of the Court's dismissal order.

The Company believes that it has substantial meritorious defenses to all of the Agent Orange-related claims described above, and 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.

On October 6, 2003, the Company received a Notice of Deficiency with respect to the Company's 1996 through 1997 federal income tax returns wherein, among other issues, the IRS is disallowing a capital loss that the Company carried back to 1996 and 1997. The IRS has indicated that it will not settle that issue prior to a final decision after trial on the merits. The IRS has indicated that it is willing to address the other issues included in the Notice of Deficiency through standard IRS administrative appeals procedures without litigation. On December 23, 2003, the Company filed a Petition asking the U.S. Tax Court for a re-determination of the deficiency set forth in the October 6, 2003

Notice of Deficiency. The Company believes that it is remote that the ultimate disposition of these issues will have a material adverse impact on the Company's financial position in light of existing tax reserves and amounts already on deposit with the IRS.

At December 31, 2003, the consolidated balance sheet reflects a current liability of approximately $49 million and a long-term liability of approximately $176 million for litigation and claims. These amounts represent management's best estimate of the probable and reasonably estimable losses related to litigation or claims. The extent of the liability and recovery is evaluated quarterly. While it is not feasible to predict the outcome of all pending suits and claims, the ultimate resolution of these matters could have a material effect upon the financial position of Hercules, and the resolution of any of the matters during a specific period could have a material effect on the quarterly or annual operating results for that period.

14. Company-obligated Preferred Securities of Subsidiary Trusts

The Company has determined that (i) Hercules Trust I and Hercules Trust II (the "Trusts") are variable interest entities and (ii) the Company is not the primary beneficiary of the Trusts pursuant to the provisions of FASB Interpretation No. 46 (revised December 2003), "Consolidation of Variable Interest Entities" ("FIN 46R"). Accordingly, the Company has de-consolidated the Trusts at December 31, 2003. Summarized below is the condensed financial information of the Trusts as of December 31, 2003.

	(Dollars in millions)	
	Hercules Trust I	Hercules Trust II
Non-current assets	363	262
Non-current liabilities	363	262

The non-current assets for Hercules Trust I relates to its investment in the 9.42% junior subordinated deferrable interest debentures of Hercules due March 31, 2029. The non-current assets for Hercules Trust II represent its investment in the 6.50% junior subordinated deferrable interest debentures of Hercules due June 30, 2029.

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, 2003, a total of 26,819,747 shares were reserved for issuance for the following purposes: 8,164 shares for sales to the Savings Plan Trustee; 17,086,259 shares for the exercise of awards under the Stock Option Plan; 2,429,395 shares for awards under incentive compensation plans; 176,492 shares for conversion of debentures and notes; and 7,119,437 shares for exercise of the warrant component of the CRESTS Units.

In 1991, the Board of Directors authorized the Company to repurchase up to 74,650,000 shares under its stock repurchase program. Total shares reacquired pursuant to this program were 66,614,242, at an average price of $37.31 per share. The program was suspended in 1999.

17. Additional Balance Sheet Detail

(Dollars in millions)

	2003	2002
Property, plant and equipment:		
Land	$ 20	$ 21
Buildings and equipment	1,979	1,873
Construction in progress	40	31
Total	2,039	1,925
Accumulated depreciation and amortization	(1,362)	(1,262)
Property, plant and equipment, net	$ 677	$ 663

	(Dollars in millions)	
	2003	2002
Deferred charges and other assets:		
Insurance receivables - non-current	$ 162	$ 128
Tax deposits	117	152
Capitalized software	84	86
Prepaid pension assets	35	21
Investments	51	7
Other	88	127
	$ 537	$ 521

	(Dollars in millions)	
	2003	2002
Accrued expenses:		
Compensation and benefits	$ 57	$ 48
Income taxes payable	14	7
Current deferred income taxes	8	6
Current pension liability	8	5
Severance and other exit costs	6	22
Interest payable	8	10
Current portion of postretirement benefits	23	23
Current portion of litigation accrual	4	4
Current portion of asbestos accrual	45	24
Current portion of environmental accrual	19	27
Other	51	101
	$ 243	$ 277

	(Dollars in millions)	
	2003	2002
Deferred credits and other liabilities:		
Asbestos accrual - non-current	$ 176	$ 193
Environmental accrual - non-current	87	61
Non-current income tax liabilities	99	110
Deferred rent	45	51
Other	87	78
	$ 494	$ 493

18. Severance and Other Exit Costs

The consolidated balance sheet reflects liabilities for employee severance benefits and other exit costs of $6 million and $22 million at December 31, 2003 and 2002, respectively. During 2001, management authorized and committed to a plan to reduce the workforce as part of the comprehensive cost reduction and work process redesign program, incurring $51 million of restructuring charges for employee termination benefits and exit costs related to facility closures. During 2002, the estimate for severance benefits and other exit costs related to facility closures and contract terminations increased $22 million and $3 million, respectively. During 2003, the Company incurred $2 million of additional charges, constituting the final employee termination benefits under this plan. The Company incurred an additional $5 million for employee termination benefits, recognized in accordance with Statement of Financial Accounting Standards No. 112, "Employer's Accounting for Post-employment Benefits," under its Dismissal Salary and Dismissal Wage Plans ("Dismissal Plans"). Under these combined plans, approximately 1,412 employees have left or will leave the Company by June 30, 2004, of which 1,387 employees were terminated pursuant to these plans through December 31, 2003. Approximately 173 employees were terminated during the year ended December 31, 2003. The Company anticipates the remaining 25 employees will leave the Company prior to June 30, 2004. The plans include reductions throughout the Company with the majority of them from support functions.

The restructuring liabilities, as of December 31, 2002, also included amounts relating to the 1998 plan initiated upon the acquisition of BetzDearborn for the restructuring of the BetzDearborn and Pulp and Paper Divisions and corporate realignment due to the divestiture of non-core businesses.

Cash payments during 2003 and 2002 included $21 million and $39 million, respectively, for severance benefits and other exit costs. Severance benefits paid during the current year represent the continuing benefit streams of previously terminated employees as well as those terminated in the current year. During 2002, the Company completed assessments of the remaining expenditures for the 1998 BetzDearborn plan. As a result of these assessments, the estimates for severance benefits and other exit costs were lowered by $5 million in 2002, with corresponding reductions to goodwill of $3 million and to expense of $2 million. During 2003, the remaining balance related to the 1998 plan was reversed against earnings. The lower than planned severance benefits are the result of higher than anticipated attrition, with voluntary resignations not requiring the payment of termination benefits. Actions under the 1998 plan are complete.

A reconciliation of activity with respect to the liabilities established for these plans is as follows:

	(Dollars in millions)	
	2003	2002
Balance at beginning of year	$ 22	$ 43
Additional termination benefits and other exit costs	7	25
Cash payments	(21)	(39)
Reversals against goodwill	-	(3)
Reversals against earnings	(2)	(2)
Transferred with discontinued operations	-	(2)
Balance at end of year	$ 6	$ 22

The balance at the end of 2003 represents severance benefits and other exit costs of which $3 million pertains to the continuing benefit payment streams under the 2001 restructuring plan and $3 million pertains to other severance benefits accounted for under the Company's Dismissal Plans.

Effective January 1, 2003, the Company adopted Statement of Financial Accounting Standards No. 146, "Accounting for Costs Associated with Exit or Disposal Activities" ("SFAS 146"). SFAS 146 addresses financial accounting and reporting for costs associated with exit or disposal activities and nullifies Emerging Issues Task Force Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs in a Restructuring)." SFAS 146 defines the timing of the recognition of costs associated with exit or disposal activities, the types of costs that may be recognized and the methodology for calculating the fair value of such costs. The Company did not recognize any costs associated with exit or disposal activities pursuant to SFAS 146 during the year ended December 31, 2003.

Litigation

19. Other Operating Expense (Income), Net

Other operating expense, net, in 2003 includes $5 million of net charges for severance and other exit costs (see Note 18) and proxy and executive benefit costs of $4 million and $7 million, respectively. The executive benefit costs include approximately $5 million of special pension benefits granted to Dr. William H. Joyce prior to his retirement as the Company's Chief Executive Officer and approximately $2 million for the vesting of Dr. Joyce's previously granted restricted stock units. The Company also recognized net expense of $1 million in 2003 as a result of resolving issues related to prior year transactions.

Other operating expense (income), net, in 2002 includes $11 million of net environmental expense and additional restructuring charges of $25 million associated with the comprehensive cost reduction and work process redesign program announced in September 2001 (see Note 18). Partially offsetting these restructuring charges was $2 million of reversals pertaining to prior year plans. Additionally, the Company recognized $7 million in asset impairment charges in the Performance Products segment. As a result of resolving issues relating to prior year business divestitures, an additional loss of $2 million was recognized. Miscellaneous expenses of $3 million were also incurred during the year.

Other operating expense (income), net, in 2001 includes $74 million in net gains from the sale of the Company's hydrocarbon resins business, select portions of its rosin resins business, its peroxy chemicals business and its 50% interest in Hercules-Sanyo, Inc. In addition, a pension curtailment gain of $5 million was recognized related to the divestiture of the Company's hydrocarbon resins business and select portions of its rosins resins business. As a result of resolving issues relating to a prior year business divestiture, an additional gain of $5 million was recognized. The Company incurred $51 million in restructuring charges associated with the comprehensive cost reduction and work process redesign program (see Note 18). Partially offsetting these restructuring charges was $5 million of reversals pertaining to prior year plans. In addition, the Company recognized $10 million in net environmental expense, $5 million of executive severance charges, $5 million in pre-payment penalties relating to the ESOP credit facility, $3 million in fees related to the 2001 proxy contest and other matters and $1 million of income for other miscellaneous items.

20. Interest and Debt Expense

Interest and debt costs are summarized as follows:

	(Dollars in millions)		
	2003	2002	2001
Costs incurred	$ 131	$ 100	$ 207
Amount capitalized	-	1	3
Amount expensed	$ 131	$ 99	$ 204

Interest and debt costs incurred in 2002 and 2001 exclude interest costs on the Company's preferred securities. These costs were recognized as preferred security distributions of subsidiary trusts prior to 2003. Pursuant to the Company's adoption of SFAS 150 on July 1, 2003, interest and debt costs on the preferred securities has been recognized as interest and debt expense for 2003 (see Note 6).

21. Other Expense, Net

Other expense, net, consists of the following:

	(Dollars in millions)		
	2003	2002	2001

Litigation settlements and accruals, net	$ 24	$ 6	$ 13
Net gains on dispositions	-	(3)	(3)
Debt extinguishment	-	44	-
Repurchase of CREST preferred securities	(7)	-	-
Repurchase of 11.125% senior notes	5	-	-
Asbestos accruals, net	6	65	3
Asset impairment	2	-	-
Foreign currency exchange	1	(2)	(6)
Other, net	(2)	5	1
	$ 29	$ 115	$ 8

Litigation settlements and accruals, net, in all years primarily represent certain other legal expenses and settlements associated with former operations of the Company. Litigation settlements and accruals in 2003 include, among other items, $7 million for expenses related to asbestos litigation, $6 million for worker's compensation related to divested businesses and $5 million for legal costs primarily associated with former operations of the Company. The Company recognized $6 million, $65 million and $3 million in net charges for additional estimated asbestos litigation exposures for years ended December 31, 2003, 2002 and 2001, respectively, (see Note 13). Additionally, in 2002, the Company recognized $44 million for debt prepayment penalties and the write-off of debt issuance costs associated with the repayment of debt with the proceeds from the sale of the BetzDearborn Water Treatment Business (see Notes 6 and 25). Net gains on dispositions include a $3 million gain from the sale of the corporate jet, hangar and artwork in 2002 and a $3 million gain from the sale of the country club in 2001.

The Company recognized a net gain of $7 million ($5 million after tax) on the purchase of 46,000 CRESTS Units preferred securities and a $5 million loss from the repurchase of 11 1/8% senior notes which had a book value of $24 million. With respect to the gain on the CRESTS Units preferred securities, pursuant to the adoption of FIN 46 (R) the Company de-consolidated Hercules Trust II and recognized an after-tax loss of $5 million as a cumulative effect of a change in accounting principle to defer the gain from the purchase of the CRESTS Units preferred securities until Hercules Trust II is liquidated.

22. Earnings (Loss) per Share

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

(Dollars in millions, except per share)

	2003		2002		2001	
	Income (loss)	Earnings (loss) per share	Loss	Loss per share	(Loss) income	(Loss) earnings per share
Basic:						
Continuing operations	$ 74	$ 0.69	$ (47)	$ (0.44)	$ (109)	$ (1.04)
Discontinued operations	4	0.04	(196)	(1.85)	56	0.53
Cumulative effect of changes in accounting principle	(33)	(0.31)	(368)	(3.47)	-	-
Net income (loss)	$ 45	$ 0.42	$ (611)	$ (5.76)	$ (53)	$ (0.51)
Weighted average number of basic shares (millions)	107.8(b)		106.0(b)		104.8(b)	
Diluted:						
Continuing operations	$ 74	$ 0.69	$ (47)	$ (0.44)	$ (109)	$ (1.04)

Discontinued operations	4	0.04	(196)	(1.85)	56	0.53
Cumulative effect of changes in accounting principle	(33)	(0.31)	(368)	(3.47)	-	-
Net income (loss)	$ 45	$ 0.42	$ (611)	$ (5.76)	$ (53)	$ (0.51)
Weighted average number of diluted shares (millions)	107.9 (a,b)		106.0 (a,b)		104.8(a,b)	

(a) For the years ended December 31, 2003, 2002 and 2001, the Company had approximately 0.2 million convertible subordinated debentures. However, the common stock shares into which these debentures are convertible have not been included in the dilutive share calculations for the years 2002 and 2001 because the impact of their inclusion would be anti-dilutive.

(b) The Company has restated its basic and diluted weighted-average number of shares pursuant to the method prescribed by SOP 93-6 which requires the exclusion of unallocated employee stock ownership plan shares from the calculation of shares outstanding (see Note 1).

23. Operations by Industry Segment and Geographic Area

The financial information below regarding the Company's segments, which includes net sales, profit from operations and capital employed, is presented in accordance with Statement of Financial Accounting Standards No. 131, "Disclosures about Segments of an Enterprise and Related Information" ("SFAS 131"). Subsequent to the sale of the BetzDearborn Water Treatment Business on April 29, 2002, the Company realigned its segments. The Company has identified two reportable segments, Performance Products and Engineered Materials and Additives. Historical information has been restated to conform to the current presentation.

Performance Products (Pulp and Paper and Aqualon): Products and services in Pulp and Paper are designed to enhance customers' profitability by improving production yields and overall product quality, and to better enable customers to meet their environmental objectives and regulatory requirements.

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

The products in Aqualon are principally derived from natural resources and are sold as key raw materials to other manufacturers. Principal products and markets include water-soluble polymers used as thickeners, emulsifiers and stabilizers for water-based paints, oil and gas exploration, building materials and personal care products.

Engineered Materials and Additives (*FiberVisions and Pinova):* Products in this segment provide low-cost, technology driven solutions to meet customer needs and market demands. Principal products and markets include polyolefin staple fibers used in disposable diapers, wipes and other hygienic products; industrial fiber products; rosin and hydrocarbon resins for adhesives; food and beverage; flavor and fragrance; and construction specialties.

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

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

Geographic Reporting

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

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

Intersegment sales are eliminated in consolidation.

	(Dollars in millions)			
Industry Segments	**Performance Products**	**Engineered Materials and Additives**	**Corporate**	**Consolidated**
2003				
Net sales	$ 1,483	$ 363	$ -	$ 1,846
Profit (loss) from operations	262	9	(16) (c)	255
Interest and debt expense				131
Preferred security distributions of subsidiary trusts				-
Other expense, net				29
Income before income taxes and equity income (loss)				95
Capital employed (a)	1,189	287	(48) (b)	1,428
Capital expenditures	39	5	4	48
Depreciation and amortization	74	21	5	100
2002*				
Net sales	$ 1,385	$ 320	$ -	$ 1,705
Profit (loss) from operations	243	18	(41)(c)	220
Interest and debt expense				99
Preferred security distributions of subsidiary trusts				58
Other expense, net				115
Loss before income taxes and equity income (loss)				(52)
Capital employed (a)	1,085	235	64(b)	1,384
Capital expenditures	31	9	3	43
Depreciation and amortization	72	18	10	100
2001*				
Net sales	$ 1,351	$ 425	$ -	$ 1,776
Profit (loss) from operations	154	11	19(d)	184
Interest and debt expense				204
Preferred security distributions of subsidiary trusts				58
Other expense, net				8
Loss before income taxes and equity income (loss)				(86)

Capital employed (a)	479	116	2,697(b)	3,292
Capital expenditures	35	10	7	52
Depreciation and amortization	80	32	22	134

*Prior year information has been restated for the Company's change in method of accounting for its Employee Stock Ownership Plan (see Note 1).

Geographic Areas	**United States**	**Europe**	**Americas (e)**	**Asia Pacific**	**Total**
2003					
Net Sales	$ 885	$ 693	$ 94	$ 174	$ 1,846
Property, plant and equipment, net	344	303	12	18	677
2002					
Net Sales (f)	$ 870	$ 586	$ 89	$ 160	$ 1,705
Property, plant and equipment, net	350	280	12	21	663
2001					
Net Sales (f)	$ 928	$ 587	$ 104	$ 157	$ 1,776
Property, plant and equipment, net	523	302	41	37	903

(a) Represents total segment assets net of operating liabilities. The 2001 figures do not include the capital employed by the divested Water Treatment Business.

(b) Includes assets and liabilities not specifically allocated to business segments, primarily intangibles and other long-term assets, net of liabilities, except the 2001 balance which also includes goodwill.

(c) Includes net environmental charges, restructuring charges relating to the 2001 cost reduction program (see Note 18), and years 2002 and 2001 include additional loss recognition relating to prior year business divestitures. Partially offsetting these charges were restructuring reversals pertaining to prior year plans (see Note 18).

(d) Includes environmental charges, legal and insurance expenses, pre-payment penalties relating to the ESOP credit facility (see Note 10) and restructuring charges relating to the 2001 cost reduction program (see Note 18). Partially offsetting these charges were net gains from the sale of the hydrocarbon resins business, select portions of the rosins resins business and the peroxy chemicals business, restructuring reversals pertaining to prior year plans, a pension curtailment gain and an additional gain recognition relating to a prior year business divestiture.

(e) Excluding operations in the United States of America.

(f) Excludes sales of the divested BetzDearborn Water Treatment Business.

24. Derivative Financial Instruments and Risk Management

The Company enters into forward-exchange contracts and currency options to reduce currency exposure.

Notional Amounts and Credit Exposure of Derivatives

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

Interest Rate Risk Management

From time to time, the Company uses interest rate swap agreements to manage interest costs and risks associated with changing rates. The Company had no interest rate swap agreements at the end of 2003 and 2002.

Foreign Exchange Risk Management

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 and British pound sterling. Some of the contracts involved the exchange of two foreign currencies, according to local needs in foreign subsidiaries. The term of the currency derivatives is rarely more than three months. At December 31, 2003 and 2002, the Company had outstanding forward-exchange contracts to purchase foreign currencies aggregating $0.1 million and $17.8 million and to sell foreign currencies aggregating $6.5 million and $18.8 million, respectively. Cross-currency trades entered into by non-U.S. dollar denominated entities aggregated $376 million and $238 million at December 31, 2003 and 2002 respectively. The foreign exchange contracts outstanding at December 31, 2003 matured on or before March 1, 2004.

Fair Values

The following table presents the carrying amounts and fair values of the Company's financial instruments at December 31, 2003 and 2002:

	(Dollars in millions)			
	2003		2002	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Investment securities (available for sale)	$ 1	$ 1	$ 2	$ 2
Long-term debt	(1,326)	(1,364)	(738)	(777)
Company-obligated preferred securities of subsidiary trusts	-	-	(624)	(517)
Foreign exchange contracts	-	1	-	-

Fair values of derivative contracts are indicative of cash that would have been required had settlement been made at December 31, 2003 and 2002.

Basis of Valuation

Investment securities: Quoted market prices.

Long-term debt: Present value of expected cash flows related to existing borrowings discounted at rates currently available to the Company for long-term borrowings with similar terms and remaining maturities.

Company-obligated preferred securities of subsidiary trusts: Year-end interest rates and Company common stock price.

Foreign exchange contracts: Year-end exchange rates.

Currency swaps: Year-end interest and exchange rates.

Interest rate swap contracts: Bank or market quotes or discounted cash flows using year-end interest rates.

25. Acquisitions, Divestitures and Other Subsequent Events

On December 1, 2003, Hercules completed the acquisition of Jiangmen Quantum Hi-Tech Biotechnical Engineering Co. Ltd. ("Quantum"). Quantum is the leading producer of carboxymethylcellulose (CMC) products in China. Located in Jiangmen City, Guangdong Province, the plant has current production capacity of 6,000 MT (metric tons) with room to expand. Quantum's leading key markets include food, toothpaste, ceramics and paper, with annual sales of approximately $10 million. The Company has concluded the acquisition is a business combination as defined in Statement of Financial Accounting Standards No. 141, "Business Combinations." The Company is in the process of identifying and valuing all the acquired assets and liabilities, including all intangible assets meeting the criteria for separate recognition.

On April 29, 2002, Hercules completed the sale of the Water Treatment Business to GESM, a unit of General Electric Company. The sale price was $1.8 billion in cash, resulting in net after-tax proceeds of approximately $1.7 billion. The Company used the net proceeds to prepay debt under its senior credit facility and ESOP credit facility (see Notes 6 and 10). Pursuant to SFAS 144 (as adopted on January 1, 2002), the Water Treatment Business has been treated as a discontinued operation as of February 12, 2002, and accordingly, all financial information has been restated. The loss from discontinued operations for the year ended December 31, 2002 includes an after-tax loss on the disposal of the business of $230 million. The Paper Process Chemicals Business, representing approximately one-third of the business of BetzDearborn Inc. when it was originally acquired in 1998, was fully integrated into and continues to be reported within Pulp and Paper.

Summarized below are the results of operations and cash flows of the Water Treatment Business for the years ended December 31, 2002 and 2001.

	(Dollars in millions) Year Ended December 31, 2002 [1]	2001
Net Sales	$ 269	$ 844
Profit from operations	53	118
Income before income taxes	55	116
Tax provision	21	60
Income from operations	34	56
Loss from disposal of business, including a provision for income taxes of $51 million for 2002	(230)	-
(Loss) income from discontinued operations	$ (196)	$ 56

[1] Results of operations for the period are through April 28, 2002.

Cash Flow from Discontinued Operations

	(Dollars in millions) 2002	2001
Net cash provided by operations	$ 28	$ 209
Capital expenditures	(3)	(11)
Net cash flow from discontinued operations	$ 25	$ 198

The major classes of assets and liabilities included in the consolidated balance sheet at the time of disposal were as follows:

(Dollars in millions)

Assets		**Liabilities**	
Accounts receivables, net	$ 161	Accounts payable	$ 55
Inventory	76	Accrued expenses	35
Fixed assets	217	Other liabilities	178
Goodwill and other intangible assets	1,419		$ 268
Other assets	19		
	$ 1,892		

On May 1, 2001, the Company completed the sale of its hydrocarbon resins business and select portions of its rosin resins business to a subsidiary of Eastman Chemical Company, receiving proceeds of approximately $244 million. On May 31, 2001, the Company completed the sale of its peroxy chemicals business to GEO Specialty Chemicals, Inc., receiving proceeds of approximately $92 million. Additionally, on May 25, 2001, the Company completed the sale of its interest in Hercules-Sanyo, Inc., a toner resin joint venture, to Sanam Corporation, a wholly-owned subsidiary of Sanyo Chemicals Industries, Ltd., the Company's joint venture partner, receiving proceeds of approximately $8 million.

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 million.

26. Condensed Consolidating Financial Information of Guarantor Subsidiaries

The 11 1/8% senior notes due 2007 issued on November 14, 2000 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 December 2002 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 and 6.625% notes, redeemed in 2003, 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, 2003, 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 and the 11 1/8% notes due 2007.

Aqualon Company	Hercules Credit, Inc.
Athens Holding Inc.	Hercules Euro Holdings, L.L.C.
Covington Holdings, Inc.	Hercules Finance Company
East Bay Realty Services, Inc.	Hercules Flavor, Inc.
FiberVisions Incorporated	Hercules Hydrocarbon Holdings, Inc.
FiberVisions, L.L.C.	Hercules International Limited, L.L.C.
FiberVisions L.P.	Hercules Paper Holdings, Inc.
FiberVisions Products, Inc.	Hercules Shared Services Corporation
Hercules Country Club, Inc.	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. For companies acquired during 1998, the goodwill and fair values of the assets and liabilities acquired have been presented on a "push-down" accounting basis. Additionally, prior year information has been restated for the Company's change in accounting for its Employee Stock Ownership Plan (see Note 1).

Condensed Consolidating Statement of Operations
Twelve Months Ended December 31, 2003

(Dollars in millions)

		Unconsolidated			
		Guarantor	Non-Guarantor	Eliminations &	
	Parent	Subsidiaries	Subsidiaries	Adjustments	Consolidated
Net sales	$509	$445	$1,024	$ (132)	$1,846
Cost of sales	332	320	643	(128)	1,167
Selling, general, and administrative expenses	84	84	192	-	360
Research and development	17	17	5	-	39
Goodwill and intangible asset amortization	6	2	-	-	8
Other operating expenses (income), net	9	4	4	-	17
Profit (loss) from operations	61	18	180	(4)	255
Interest and debt expense (income), net	174	(59)	16	-	131
Preferred security distributions of subsidiary trusts	-	-	-	-	-
Other (expense) income, net	(23)	(5)	(1)	-	(29)
(Loss) income before income taxes and equity income (loss)	(136)	72	163	(4)	95
(Benefit) provision for income taxes	(52)	29	46	(2)	21
Equity income (loss) of affiliated companies	-	(1)	1	-	-
Equity income (loss) from consolidated subsidiaries	158	15	2	(175)	-
Net income (loss) from continuing operations	74	57	120	(177)	74
Net income on discontinued operations, net of tax	4	-	-	-	4
Net income (loss) before cumulative effect of change in accounting principle	78	57	120	(177)	78
Cumulative effect of change in accounting principle, net of tax	(33)	-	-	-	(33)
Net income (loss)	$ 45	$ 57	$ 120	$ (177)	$ 45

Condensed Consolidating Statement of Operations
Twelve Months Ended December 31, 2002

(Dollars in millions)

		Unconsolidated			
		Guarantor	Non-Guarantor	Eliminations &	
	Parent	Subsidiaries	Subsidiaries	Adjustments	Consolidated
Net sales	$536	$423	$890	$(144)	$1,705
Cost of sales	333	294	557	(144)	1,040
Selling, general, and administrative expenses	94	73	181	-	348
Research and development	19	17	6	-	42
Goodwill and intangible asset amortization	5	3	1	-	9

Other operating (income) expense, net	(11)	31	26	-	46
Profit (loss) from operations	96	5	119	-	220
Interest and debt expense (income), net	215	(75)	(41)	-	99
Preferred security distributions of subsidiary trusts	-	-	58	-	58
Other (expense) income, net	(120)	-	4	1	(115)
(Loss) income before income taxes and equity income (loss)	(239)	80	106	1	(52)
(Benefit) provision for income taxes	(59)	35	21	-	(3)
Equity income (loss) of affiliated companies	-	2	-	-	2
Equity income (loss) from consolidated subsidiaries	133	(115)	5	(23)	-
Net (loss) income from continuing operations	(47)	(68)	90	(22)	(47)
Net (loss) income on discontinued operations, net of tax	(196)	18	12	(30)	(196)
Net (loss) income before cumulative effect of change in accounting principle	(243)	(50)	102	(52)	(243)
Cumulative effect of change in accounting principle, net of tax	(368)	(233)	(135)	368	(368)
Net (loss) income	$ (611)	$(283)	$ (33)	$316	$ (611)

Condensed Consolidating Statement of Operations
Twelve Months Ended December 31, 2001

	(Dollars in millions)				
	Parent	Unconsolidated Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations & Adjustments	Consolidated
Net sales	$587	$565	$888	$ (264)	$1,776
Cost of sales	381	442	574	(264)	1,133
Selling, general, and administrative expenses	77	118	203	-	398
Research and development	29	16	8	-	53
Goodwill and intangible asset amortization	3	11	10	-	24
Other operating (income) expense, net	(60)	34	10	-	(16)
Profit (loss) from operations	157	(56)	83	-	184
Interest and debt expense (income), net	342	(108)	(30)	-	204
Preferred security distributions of subsidiary trusts	-	-	58	-	58
Other (expense) income, net	(13)	11	(6)	-	(8)
(Loss) income before income taxes and equity income (loss)	(198)	63	49	-	(86)
(Benefit) provision for income taxes	(28)	28	14	-	14
Equity income (loss) of affiliated companies	-	1	(10)	-	(9)
Equity income (loss) from consolidated subsidiaries	61	(10)	1	(52)	-
Net (loss) income before continuing operations	(109)	26	26	(52)	(109)
Net income (loss) from discontinued operations, net of tax	56	16	32	(48)	56
Net (loss) income before cumulative effect of change accounting principle	(53)	42	58	(100)	(53)

Cumulative effect of change in accounting principle, net of tax	-	-	-	-	-
Net (loss) income	$(53)	$ 42	$ 58	$ (100)	$(53)

Condensed Consolidating Balance Sheet
December 31, 2003

	(Dollars in millions)				
	Unconsolidated				
Assets	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations & Adjustments	Consolidated
Current assets					
Cash and cash equivalents	$ 9	$ 2	$ 114	$ -	$ 125
Restricted cash	-	-	-	-	-
Accounts and notes receivable, net	121	55	239	-	415
Intercompany receivable	70	21	32	(123)	-
Inventories	46	58	97	(14)	187
Deferred income taxes	94	-	9	(10)	93
Total current assets	340	136 -	491 -	(147)	820
Property, plant and equipment, net	168	167	342	-	677
Investments in subsidiaries and advances, net	2,248	92	51	(2,391)	-
Goodwill and other intangible assets, net	223	90	392	-	705
Long-term deferred income taxes	133	-	13	(119)	27
Deferred charges and other assets	460	10	67	-	537
Total assets	$ 3,572	$ 495	$ 1,356	$ (2,657)	$ 2,766
Liabilities and Stockholders' Equity					
Current liabilities					
Accounts payable	$ 56	$ 18	$ 118	$ -	$ 192
Accrued expenses	142	52	59	(10)	243
Intercompany payable	8	73	42	(123)	-
Short-term debt	2	-	20	-	22
Total current liabilities	208	143	239	(133)	457
Long-term debt	1,300	-	26	-	1,326
Deferred income taxes	-	119	78	(119)	78
Other postretirement benefits and other liabilities	696	73	70	-	839
Company-obligated preferred securities of subsidiary trusts	-	-	-	-	-
Intercompany notes payable (receivable)	1,302	(1,090)	(213)	1	-
Stockholders' equity	66	1,250	1,156	(2,406)	66
Total liabilities and stockholders' equity	$ 3,572	$ 495	$ 1,356	$ (2,657)	$ 2,766

Condensed Consolidating Balance Sheet
December 31, 2002

	(Dollars in millions)				
	Unconsolidated				
		Guarantor	Non-Guarantor	Eliminations &	Consolidated

Assets	Parent	Subsidiaries	Subsidiaries	Adjustments	
Current assets					
Cash and cash equivalents	$ 131	$ 7	$ 71	$ -	$ 209
Restricted cash	125	-	-	-	125
Accounts and notes receivable, net	122	55	218	-	395
Intercompany receivable	80	23	27	(130)	-
Inventories	46	53	79	(11)	167
Deferred income taxes	28	22	(4)	-	46
Total current assets	532	160	- 391	- (141)	942
Property, plant and equipment, net	177	162	324	-	663
Investments in subsidiaries and advances, net	2,351	67	51	(2,469)	-
Goodwill and other intangible assets, net	234	91	341	-	666
Long-term deferred income taxes	-	-	15	-	15
Deferred charges and other assets	431	13	77	-	521
Total assets	$ 3,725	$ 493	$ 1,199	$ (2,610)	$ 2,807
Liabilities and Stockholders' Equity					
Current liabilities					
Accounts payable	$ 55	$ 18	$ 103	$ -	$ 176
Accrued expenses	95	113	69	-	277
Intercompany payable	11	76	43	(130)	-
Short-term debt	126	-	19	-	145
Total current liabilities	287	207	234	(130)	598
Long-term debt	701	-	37	-	738
Deferred income taxes	(105)	116	69	-	80
Other postretirement benefits and other liabilities	742	74	74	-	890
Company-obligated preferred securities of subsidiary trusts	-	-	624	-	624
Intercompany notes payable (receivable)	2,223	(1,039)	(1,184)	-	-
Stockholders' equity	(123)	1,135	1,345	(2,480)	(123)
Total liabilities and stockholders' equity	$3,725	$ 493	$ 1,199	$ (2,610)	$ 2,807

Condensed Consolidating Statement of Cash Flows
Twelve Months Ended December 31, 2003

	(Dollars in millions)				
		Unconsolidated		Eliminations	
		Guarantor	Non-Guarantor	&	
	Parent	Subsidiaries	Subsidiaries	Adjustments	Consolidated
Net Cash Provided By (Used In) Operations	$ 13	$ 53	$ 129	$ (172)	$ 23
Cash Flow From Investing Activities:					
Capital expenditures	(13)	(13)	(22)	-	(48)
Proceeds of investment and fixed asset disposals	4	1	5	-	10
Acquisitions, net of cash acquired	-	-	(10)	-	(10)
Decrease in restricted cash	125	-	-	-	125
Investment in trust preferred securities	(27)	-	-	-	(27)
Other, net	(2)	1	(1)	-	(2)
Net cash provided by (used in) investing activities	87	(11)	(28)	-	48
Cash Flow From Financing Activities:					
Long-term debt repayments	(151)	-	(14)	-	(165)
Change in short-term debt	-	-	(1)	-	(1)
Change in intercompany, non-current	(66)	(47)	(104)	217	-

Repurchase of warrants	(7)	-	-	-	(7)
Common stock issued	2	-	-	-	2
Dividends paid	-	-	45	(45)	-
Net cash (used in) provided by financing activities	(222)	(47)	(74)	172	(171)
Effect of exchange rate changes on cash	-	-	16	-	16
Net (decrease) increase in cash and cash equivalents	(122)	(5)	43	-	(84)
Cash and cash equivalents at beginning of year	131	7	71	-	209
Cash and cash equivalents at end of year	$ 9	$ 2	$ 114	$ -	$ 125

Condensed Consolidating Statement of Cash Flows
Twelve Months Ended December 31, 2002

(Dollars in millions)

	Parent	Unconsolidated Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations & Adjustments	Consolidated
Net Cash (Used In) Provided By Operations	$ (340)	$ (142)	$ 353	$ (86)	$(215)
Cash Flow From Investing Activities:					
Capital expenditures	(17)	(8)	(18)	-	(43)
Proceeds of investment and fixed asset disposals	1,813	2	1	-	1,816
Increase in restricted cash	(125)	-	-	-	(125)
Other, net	11	-	-	-	11
Net cash provided by (used in) investing activities	1,682	(6)	(17)	-	1,659
Cash Flow From Financing Activities:					
Long-term debt proceeds	450	-	-	-	450
Long-term debt repayments	(1,680)	(83)	(13)	-	(1,776)
Change in short-term debt	(4)	-	(4)	-	(8)
Payment of debt issuance costs and underwriting fees	(5)	-	-	-	(5)
Change in intercompany, non-current	15	221	(285)	49	-
Common stock issued	5	-	-	-	5
Dividends paid	-	-	(37)	37	-
Net cash (used in) provided by financing activities	(1,219)	138	(339)	86	(1,334)
Net cash flow provided by discontinued operations	-	5	20	-	25
Effect of exchange rate changes on cash	-	-	(2)	-	(2)
Net increase (decrease) in cash and cash equivalents	123	(5)	15	-	133
Cash and cash equivalents at beginning of year	8	12	56	-	76
Cash and cash equivalents at end of year	$ 131	$ 7	$ 71	$ -	$ 209

Condensed Consolidating Statement of Cash Flows
Twelve Months Ended December 31, 2001

(Dollars in millions)

	Parent	Unconsolidated Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations & Adjustments	Consolidated
Net Cash (Used In) Provided By Operations	$ (442)				