

FERRO CORP
Form 10-Q
December 08, 2006

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q**

(Mark One)

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

For the quarterly period ended March 31, 2006

or

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

For the transition period from _____ to _____

**Commission File Number 1-584
FERRO CORPORATION**

(Exact name of registrant as specified in its charter)

Ohio

(State of Corporation)

34-0217820

(IRS Employer Identification No.)

1000 Lakeside Avenue

Cleveland, OH

(Address of Principal executive offices)

44114

(Zip Code)

216-641-8580

(Telephone Number)

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). YES NO
At November 30, 2006, there were 42,801,687 shares of Ferro Common Stock, par value \$1.00, outstanding.

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Ferro Corporation and Consolidated Subsidiaries
Condensed Consolidated Statements of Income**

	Three months ended March 31,	
	2006	2005
	(Dollars in thousands, except per share amounts)	
Net sales	\$ 505,153	\$ 461,674
Cost of sales	397,246	368,716
Selling, general and administrative expenses	79,104	83,561
Other expense (income):		
Interest expense	13,250	11,028
Foreign currency transactions, net	321	767
Miscellaneous expense (income), net	2,656	(1,828)
Income (loss) before taxes	12,576	(570)
Income tax expense (benefit)	4,138	(1,153)
Income from continuing operations	8,438	583
Loss on disposal of discontinued operations, net of tax	126	65
Net income	8,312	518
Dividends on preferred stock	328	387
Net income available to common shareholders	\$ 7,984	\$ 131
Per common share data		
Basic earnings:		
From continuing operations	\$ 0.19	\$ 0.00
From discontinued operations	0.00	0.00
	\$ 0.19	\$ 0.00
Diluted earnings:		
From continuing operations	\$ 0.19	\$ 0.00
From discontinued operations	0.00	0.00
	\$ 0.19	\$ 0.00
Dividends	\$ 0.145	\$ 0.145

See accompanying notes to Condensed Consolidated Financial Statements

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Condensed Consolidated Balance Sheets**

	March 31, 2006	December 31, 2005
	(Dollars in thousands)	
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 16,537	\$ 17,413
Accounts and trade notes receivable, net	211,861	182,390
Notes receivable	126,541	112,744
Inventories	232,682	215,257
Deposits for precious metals	79,000	19,000
Deferred income taxes	41,190	40,732
Other current assets	26,766	23,183
Total current assets	734,577	610,719
Property, plant and equipment, net	525,676	531,139
Intangibles, net	412,483	410,666
Deferred income taxes	61,974	61,130
Other non-current assets	52,208	54,890
Total assets	\$ 1,786,918	\$ 1,668,544
LIABILITIES and SHAREHOLDERS EQUITY		
Current liabilities:		
Loans payable and current portion of long-term debt	\$ 7,896	\$ 7,555
Accounts payable	246,544	236,282
Income taxes	4,919	5,474
Accrued payrolls	31,159	25,112
Accrued expenses and other current liabilities	93,399	92,461
Total current liabilities	383,917	366,884
Long-term debt, less current portion	640,951	546,168
Post-retirement and pension liabilities	223,184	230,320
Deferred income taxes	14,538	14,002
Other non-current liabilities	22,758	22,611
Total liabilities	1,285,348	1,179,985
Series A convertible preferred stock	18,507	20,468
Shareholders equity	483,063	468,091
Total liabilities and shareholders equity	\$ 1,786,918	\$ 1,668,544

See accompanying notes to Condensed Consolidated Financial Statements

Table of Contents**Ferro Corporation and Consolidated Subsidiaries
Condensed Consolidated Statements of Cash Flows**

	Three months ended March 31,	
	2006	2005
	(Dollars in thousands)	
Cash flows from operating activities		
Net cash used for continuing operations	\$ (78,479)	\$ (8,428)
Net cash used for discontinued operations	(208)	(274)
Net cash used for operating activities	(78,687)	(8,702)
Cash flows from investing activities		
Capital expenditures for plant and equipment	(8,247)	(9,162)
Acquisitions, net of cash acquired		(798)
Proceeds from sale of assets and businesses	835	38
Other investing activities	(246)	(274)
Net cash used for investing activities	(7,658)	(10,196)
Cash flows from financing activities		
Net borrowings under short term facilities	341	1,541
Proceeds from revolving credit facility	276,400	217,500
Principal payments on revolving credit facility	(181,400)	(192,874)
Cash dividends paid	(6,466)	(6,529)
Debt issue costs paid	(4,750)	
Other financing activities	1,027	1,103
Net cash provided by financing activities	85,152	20,741
Effect of exchange rate changes on cash	317	(161)
(Decrease) increase in cash and cash equivalents	(876)	1,682
Cash and cash equivalents at beginning of period	17,413	13,939
Cash and cash equivalents at end of period	\$ 16,537	\$ 15,621
Cash paid during the period for:		
Interest	\$ 14,096	\$ 12,595
Income taxes	\$ 1,545	\$ 1,716

See accompanying notes to Condensed Consolidated Financial Statements

Table of Contents**Ferro Corporation and Consolidated Subsidiaries****Notes to Condensed Consolidated Financial Statements****1. Basis of presentation**

These unaudited condensed consolidated financial statements of Ferro Corporation and its consolidated subsidiaries (Company) have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements, and therefore should be read in conjunction with the consolidated financial statements and notes thereto included in the Company s Annual Report on Form 10-K for the year ended December 31, 2005. The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported in the condensed consolidated financial statements. Actual amounts could differ from these estimates. In the opinion of management, all adjustments that are necessary for a fair presentation have been made and are of a normal recurring nature unless otherwise noted. Due to differing business conditions, various Company initiatives, and some seasonality, the results for the three months ended March 31, 2006, are not necessarily indicative of the results expected in subsequent quarters or for the full year.

2. Accounting pronouncement adopted in the three months ended March 31, 2006

Before January 1, 2006, the Company accounted for stock-based compensation under Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, as permitted by Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation, (FAS No. 123). Accordingly, the Company recognized no compensation expense, because under the award plans the stock option exercise price may not be less than the per share fair market value of the Company s stock on the date of grant.

On January 1, 2006, the Company adopted Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment , (FAS No. 123R). This statement requires the Company to recognize over the requisite service periods compensation costs for the estimated grant-date fair value of stock-based awards that are expected to ultimately vest and to adjust expected vesting rates to actual results as these become known.

The Company s condensed consolidated financial statements as of and for the three months ended March 31, 2006, reflect the impact of FAS No. 123R, and, in accordance with the modified prospective transition method, the condensed consolidated financial statements for the prior period do not include the impact of FAS No. 123R. Under the modified prospective transition method, the Company has recognized compensation expense that includes (a) compensation cost for all stock-based compensation granted, but not yet vested, as of the date of adoption, and (b) compensation cost for all stock-based compensation granted on or subsequent to adoption.

The adoption of FAS No. 123R reduced pre-tax income from continuing operations by \$0.7 million and net income by \$0.5 million for the three months ended March 31, 2006. The adoption of FAS No. 123R also reduced basic and diluted earnings per share by \$0.01 for the three months ended March 31, 2006, and required the classification of realized tax benefits, related to the excess of the deductible compensation cost over the amount recognized, as a financing activity rather than as an operating activity in the condensed consolidated statement of cash flows.

The following table contains pro forma disclosures regarding the effect on the Company s net income and basic and diluted earnings per share for the three months ended March 31, 2005, had the Company applied a fair value method of accounting for stock-based compensation in accordance with FAS No. 123.

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	Three months ended March 31, 2005 (Dollars in thousands, except per share amounts)	
Income available to common shareholders from continuing operations as reported	\$	196
Add: Stock-based employee compensation expense included in reported income, net of tax		36
Deduct: Total stock-based employee compensation expense determined under fair value methods for all awards, net of tax		(789)
Loss attributable to common shareholders from continuing operations pro forma	\$	(557)
Basic earnings per share from continuing operations as reported	\$	0.00
Basic loss per share from continuing operations pro forma	\$	(0.01)
Diluted earnings per share from continuing operations as reported	\$	0.00
Diluted loss per share from continuing operations pro forma	\$	(0.01)

There was no impact on pro forma expense from discontinued operations for the period presented.

For the purpose of computing pro forma net income, the fair value of stock options was estimated at their grant date using the Black-Scholes option pricing model. This model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable, characteristics that are not present in the Company's option grants. If the model permitted consideration of the unique characteristics of employee stock options, the resulting estimate of the fair value of the stock options could be different and would likely be lower.

3. Newly issued accounting pronouncement

In September 2006, the FASB issued Statement No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans* an amendment of FASB Statements No. 87, 88, 106, and 132(R), (FAS No. 158). This statement will require the Company to:

Recognize the overfunded or underfunded status of defined benefit post retirement plans as an asset or liability in its consolidated balance sheets and to recognize changes in that funded status through comprehensive income in the year in which the changes occur;

Recognize as a component of other comprehensive income, net of tax, the actuarial gains or losses and prior service costs or benefits that arise during the period but are not recognized as components of net periodic cost;

Measure defined benefit plan assets and obligations as of the balance sheet date; and

Disclose additional information concerning the delayed recognition of actuarial gains or losses and prior service costs or benefits.

The Company will be required to adopt the recognition and disclosure provisions of FAS No. 158 as of December 31, 2006. Upon adoption of the recognition provisions of FAS No. 158, the Company anticipates adjustments to increase the accrued benefit liability by approximately \$26.0 million and increase the accumulated other comprehensive loss, net of tax, by approximately \$16.9 million.

The Company will be required to adopt the measurement provisions of FAS No. 158 as of December 31, 2008. The Company is currently evaluating the requirements of the measurement provisions of FAS No. 158 and has not yet determined the impact, if any, this may have on its consolidated financial statements.

4. Shareholders' equity

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Comprehensive income (loss) represents net income adjusted for foreign currency translation adjustments, minimum pension liability adjustments, and unrealized gain (loss) adjustments associated with investments in marketable equity securities that are available for sale. Comprehensive income (loss) was \$17.2 million and \$(12.7) million for the three months ended March 31, 2006 and 2005, respectively. Accumulated other comprehensive loss at March 31, 2006, and December 31, 2005, was \$107.0 million and \$116.0 million, respectively.

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Transactions involving benefit plans increased shareholders' equity by \$4.2 million and \$2.1 million for the three months ended March 31, 2006 and 2005, respectively.

5. Inventories

Inventories are comprised of the following:

	March 31, 2006	December 31, 2005
	(Dollars in thousands)	
Raw materials	\$ 66,942	\$ 62,488
Work in process	39,376	34,122
Finished goods	140,680	133,060
FIFO cost (approximates replacement cost)	246,998	229,670
LIFO reserve	(14,316)	(14,413)
Total	\$ 232,682	\$ 215,257

6. Financing and long-term debt

Long-term debt consists of the following:

	March 31, 2006	December 31, 2005
	(Dollars in thousands)	
\$200,000 Senior Notes, 9.125%, due 2009 (a)	\$ 199,000	\$ 198,909
\$25,000 Debentures, 7.625%, due 2013 (a)	24,880	24,877
\$25,000 Debentures, 7.375%, due 2015 (a)	24,966	24,965
\$50,000 Debentures, 8.0%, due 2025 (a)	49,555	49,550
\$55,000 Debentures, 7.125%, due 2028 (a)	54,537	54,532
Revolving credit facility	281,100	186,100
Capitalized lease obligations	7,203	7,364
Other notes	1,460	1,560
	642,701	547,857
Less current portion	1,750	1,689
Total	\$ 640,951	\$ 546,168

(a) Net of unamortized discounts.

Revolving Credit and Term Loan Facilities

At March 31, 2006, the Company had borrowed \$281.1 million under a \$300 million revolving credit facility that was scheduled to expire in September 2006 (Prior Revolving Credit Facility). The average interest rates for borrowings against the Prior Revolving Credit Facility at March 31, 2006, and December 31, 2005, were 6.8% and 6.4%, respectively.

The Prior Revolving Credit Facility contained financial covenants relating to total debt, fixed charges and EBITDA, cross default provisions with other debt obligations, and customary operating covenants that limited the Company's ability to engage in certain activities, including significant acquisitions. In addition, when the Company's senior credit rating was downgraded below Ba2 by Moody's Investor Services, Inc. (Moody's) in March 2006, the Company and its domestic material subsidiaries were required to grant security interests in their tangible and intangible assets (with the exception of the receivables sold as part of the Company's asset securitization program), pledge 100% of the stock of domestic material subsidiaries and pledge 65% of the stock of foreign material subsidiaries, in each case, in favor of the lenders under the Prior Revolving Credit Facility. This lien grant and pledge of stock was substantially completed in April 2006. Liens on principal domestic manufacturing properties and the stock of domestic subsidiaries were also granted to and shared with the holders of the Company's senior notes and debentures, as required by their indentures.

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In March 2006, the Company obtained a waiver from the lenders in the Prior Revolving Credit Facility to extend reporting requirements through June 2006 for the 2004, 2005 and 2006 periods. The extension gave the Company time to put in place the New Credit Facility as described below.

In March 2006, the Company accepted a commitment from a syndicate of lenders to underwrite a \$700 million credit facility (the New Credit Facility) and, in June 2006, finalized the agreement. The New Credit Facility is comprised of a five year, \$250 million multi-currency senior revolving credit facility and a six year, \$450 million senior delayed-draw term loan facility. Under the terms of the New Credit Facility, the Company can request that the revolving credit facility be increased by \$50 million at no additional fee.

The New Credit Facility was entered into to replace the Prior Revolving Credit Facility that was scheduled to expire in September 2006. In addition, the financing, through the term loan facility, provided capital resources sufficient to refinance the \$200 million of senior notes and \$155 million of debentures that could have become immediately due and payable due to defaults associated with the Company's delayed Securities and Exchange Commission (SEC) financial filings for 2005. Because one of the purposes of the term loan facility is to fund the potential acceleration of the senior notes and debentures, the term facility contains certain restrictions including, but not limited to, the following:

\$355 million of the facility is reserved to repay the senior notes and debentures;

\$95 million of the facility is immediately available for refunding indebtedness other than the senior notes and debentures;

The Company may access up to \$55 million of the \$355 million reserved to repay the senior notes and debentures if these obligations have not already been paid in full and no event of default for these obligations exists and is continuing; and

The Company may draw on the delayed-draw facility for up to one year with any unused commitment under the term facility terminating on June 6, 2007.

At the close of the New Credit Facility in June 2006, the Company drew \$95 million of the term loan facility to partially repay the Prior Revolving Credit Facility. In addition, during the third quarter of 2006, the Company drew down another \$155 million of the term loan facility to repay \$155 million of outstanding debentures, as bondholders accelerated payment on these obligations due to the previously mentioned 2005 SEC financial reporting delays. See further discussion under Senior Notes and Debentures below. The Company is required to make quarterly principal payments equal to 0.25% of the amount borrowed under the term loan facility beginning no later than July 2007.

The New Credit Facility bears interest at a rate equal to, at the Company's option, either (1) LIBOR or (2) the Alternate Base Rate which is the higher of the Prime Rate and the Federal Funds Effective Rate plus 0.5%; plus, in each case, applicable margins. For the revolving credit facility, the applicable margin is based on the Company's index debt rating. The New Credit Facility is secured by substantially all of the Company's assets, including the assets and 100% of the shares of the Company's material domestic subsidiaries and 65% of the shares of the Company's first tier foreign subsidiaries, but excluding trade receivables sold pursuant to the Company's accounts receivable sales programs. These liens are shared with the holders of the Company's senior notes, as required under the respective indenture.

The New Credit Facility contains customary operating covenants that limit the Company's ability to engage in certain activities, including limitations on additional loans and investments; creation of additional liens; prepayments, redemptions and repurchases of debt; and mergers, acquisitions and asset sales. The Company is also subject to customary financial covenants including a leverage ratio and a fixed charge coverage ratio. Additional covenants of the New Credit Facility require the Company to file its 2006 Forms 10-Q by December 29, 2006. Failure to satisfy certain of these covenants, either immediately or after a brief period allowing the company to satisfy the covenant, would result in an event of default. If any event of default should occur and be continuing and a waiver not have been obtained, the obligations under the New Credit Facility may become immediately due and payable at the option of providers of more than 50% of the credit facility commitment.

Senior Notes and Debentures

At March 31, 2006, the Company had \$355.0 million principal amount outstanding under debentures and senior notes, which had an estimated fair market value of \$351.0 million. Fair market value represents a third party's indicative bid prices

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for these obligations. The Company's senior credit rating was Ba1 by Moody's and BB by Standard & Poor's Rating Group (S&P) at December 31, 2005. In March 2006, the Company's senior credit rating was downgraded to B1 by Moody's. Moody's then withdrew its ratings. Moody's cited the absence of audited financials for a sustained period of time and the concern that there may be additional delays in receiving audited financial statements for 2005. Moody's also noted that the Company's business profile is consistent with a rating in the Ba category, according to Moody's rating methodology for the chemical industry. Moody's indicated it could reassign ratings to the Company once it has filed audited financials for 2004 and 2005 with the SEC. Also in March 2006, S&P lowered its rating to B+. S&P cited delays in filing, a recent absence of transparency with regard to current results and near term prospects, and a diminished business profit that resulted in weak operating margins and earnings. Although there are negative implications to these actions, the Company anticipates that it will continue to have access to sufficient liquidity, albeit at higher borrowing costs.

Moody's rating downgrade triggered the springing lien in the Company's Prior Revolving Credit Facility. Under the terms of the Company's senior unsecured notes and debentures, the holders of the Company's notes became equally secured with the revolving credit lenders with security interests in the Company's principal domestic manufacturing facilities and the pledge of 100% of the stock of the Company's domestic subsidiaries.

The indentures under which the senior notes and the debentures were issued contain operating covenants that limit the Company's ability to engage in certain activities, including limitations on consolidations, mergers, and transfers of assets; and sale and leaseback transactions. The indentures contain cross-default provisions with other debt obligations that exceed \$10 million of principal outstanding. In addition, the terms of the indentures require, among other things, the Company to file with the Trustee copies of its annual reports on Form 10-K, quarterly reports on Form 10-Q and an Officers' Certificate relating to the Company's compliance with the terms of the indentures within 120 days after the end of its fiscal year. The Company has been in default on these reporting requirements since it delayed filing its Form 10-Q for the second quarter of 2004 due to the restatement of its 2003 and first quarter 2004 results. As the Company anticipated and planned for, in March and April 2006, the Company received notices of default from a holder and the Trustee of the senior notes and debentures of which \$355 million was outstanding. The notices of default related only to reporting requirements and the related Officers' Certificate. Under the terms of the indentures, the Company had 90 days from the notices of default in which to cure the deficiencies identified in the notices of default or obtain waivers, or events of default would have occurred and the holders of the senior notes or debentures or the Trustee could declare the principal immediately due and payable. At the end of these periods, the deficiencies had not been cured and waivers had not been obtained. During July and August 2006, the bondholders accelerated the payment of the principal amount of the debentures, of which \$155 million was outstanding, and the Company financed the accelerated repayments by use of the aforementioned \$450 million term loan facility.

As of the date of this filing, the \$200 million senior notes currently remain outstanding, although they could be declared immediately due and payable. In the event the bondholders of the senior notes provide a notice of acceleration prior to the Company curing the existing reporting default, the Company believes it has sufficient liquidity resources, primarily through the term loan facility, to fully satisfy any potential acceleration. In addition, the senior notes are redeemable at the option of the Company at any time for the principal amount of the senior notes then outstanding plus the sum of any accrued but unpaid interest and the present value of any remaining scheduled interest payments. The senior notes are redeemable at the option of the holders only upon a change in control of the Company combined with a rating by either Moody's or S&P below investment grade as defined in the indenture. Currently, the rating by S&P of the senior notes is below investment grade.

Asset Securitization Program

The Company has a \$100 million program to sell (securitize), on an ongoing basis, a pool of its U.S. trade accounts receivable. This program serves to accelerate cash collections of the Company's trade accounts receivable at favorable financing costs and helps manage the Company's liquidity requirements. In June 2006, the Company amended the program to extend it up to June 2, 2009, to cure a default resulting from a credit rating downgrade, and to modify the reporting requirements to more closely match those in the New Credit Facility. While the Company expects to maintain a satisfactory U.S. asset securitization program to help meet the Company's liquidity requirements, factors beyond the Company's control such as prevailing economic, financial and market conditions may prevent the

Company from doing so.

Under this program, certain of the Company's receivables are sold to Ferro Finance Corporation (FFC), a wholly-owned unconsolidated qualified special purpose entity (QSPE), as defined by Statement of Financial Accounting Standards No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, (FAS No. 140).

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FFC finances its acquisition of trade accounts receivable assets by issuing beneficial interests to multi-seller receivables securitization companies (commercial paper conduits). At December 31, 2005, \$1.0 million had been advanced to the Company, net of repayments, under this program. During the three months ended March 31, 2006, \$259.6 million of accounts receivable were sold under this program and \$259.4 million of receivables were collected and remitted to FFC and the commercial paper conduits, resulting in a net increase in advances of \$0.2 million and total advances outstanding at March 31, 2006, of \$1.2 million.

The Company on behalf of FFC and the commercial paper conduits provides normal collection and administration services with respect to the receivables. In accordance with FAS No. 140, no servicing asset or liability is reflected on the Company s consolidated balance sheet. FFC and the commercial paper conduits have no recourse to the Company s other assets for failure of debtors to pay when due as the assets transferred are legally isolated in accordance with the bankruptcy laws of the United States. Under FAS No. 140 and FASB Interpretation No. 46R, Consolidation of Variable Interest Entities, neither the amounts advanced nor the corresponding receivables sold are reflected in the Company s consolidated balance sheet as the trade receivables have been de-recognized with an appropriate accounting loss recognized in the Company s consolidated statements of income.

The Company holds a note receivable from FFC to the extent that cash proceeds from the sale of accounts receivable to FFC have not yet been received by the Company. The note receivable balance was \$126.2 million as of March 31, 2006, and \$111.9 million as of December 31, 2005. The Company, on a monthly basis, measures the fair value of the note receivable using management s best estimate of the undiscounted expected future cash collections on the outstanding receivables sold. Actual cash collections may differ from these estimates and would directly affect the fair value of the retained interests.

Liquidity

The Company s level of debt and debt service requirements could have important consequences to its business operations and uses of cash flows. In addition, a reduction in overall demand for the Company s products could adversely affect cash flows. At September 30, 2006, the Company had a \$250 million revolving credit facility of which \$74.1 million was available. This liquidity, along with liquidity from other financing arrangements, available cash flows from operations, and asset sales, should allow the Company to meet its funding requirements and other commitments.

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Information concerning the calculation of basic and diluted earnings per share is shown below:

	Three months ended March 31,	
	2006	2005
	(In thousands, except per share amounts)	
Basic earnings per share computation:		
Net income available to common shareholders	\$ 7,984	\$ 131
Add back: Loss from discontinued operations	126	65
	\$ 8,110	\$ 196
Weighted-average common shares outstanding	42,337	42,281
Basic earnings per share from continuing operations	\$ 0.19	\$ 0.00
Diluted earnings per share computation:		
Net income available to common shareholders	\$ 7,984	\$ 131
Add back: Loss from discontinued operations	126	65
Plus: Convertible preferred stock		
	\$ 8,110	\$ 196
Weighted-average common shares outstanding	42,337	42,281
Assumed conversion of convertible preferred stock		
Assumed satisfaction of performance share conditions	10	
Assumed exercise of stock options		55
Weighted-average diluted shares outstanding	42,347	42,336
Diluted earnings per share from continuing operations	\$ 0.19	\$ 0.00

The convertible preferred shares were anti-dilutive for the three months ended March 31, 2006 and 2005, and thus not included in the diluted shares outstanding. The stock options were anti-dilutive for the three months ended March 31, 2006, and thus not included in the diluted shares outstanding.

8. Restructuring and cost reduction programs

The following table summarizes the activities relating to the Company's reserves for restructuring and cost reduction programs:

	Severance	Other Costs	Total
	(Dollars in thousands)		
Balance, December 31, 2005	\$ 2,232	\$ 66	\$ 2,298

Gross charges	147		147
Non-cash items	(90)		(90)
Cash payments	(649)	(27)	(676)
Balance, March 31, 2006	\$ 1,640	\$ 39	\$ 1,679

Charges in the three months ended March 31, 2006, relate to the Company's various restructuring and cost reduction initiatives. Total gross charges for the three months ended March 31, 2006, were \$0.1 million which were included in selling, general and administrative expenses.

The remaining reserve balance for restructuring and cost reduction initiatives primarily represents cash payments expected to be made over the following twelve months except where certain legal or contractual restrictions on the Company's ability to complete the initiatives within that time frame exist. The Company will continue to evaluate further steps to reduce costs and improve efficiencies.

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Discontinued operations relate to the Powder Coatings, Petroleum Additives and Specialty Ceramics businesses that were sold in 2002 and 2003. There were no sales, income before taxes, or related tax expense from discontinued operations in the three months ended March 31, 2006 or 2005.

Disposal of discontinued operations resulted in pre-tax losses of \$0.2 million and \$0.1 million for the three months ended March 31, 2006 and 2005, respectively. The related tax benefits were \$0.1 million and less than \$0.1 million for the three months ended March 31, 2006 and 2005, respectively. The loss on disposal of discontinued operations includes ongoing legal costs and reserve adjustments directly related to discontinued operations. In connection with certain divestitures, the Company has continuing obligations with respect to environmental remediation. The Company had accruals of \$3.1 million as of March 31, 2006, and December 31, 2005, for these matters. These amounts are based on management's best estimate of the nature and extent of soil and/or groundwater contamination, as well as expected remedial actions as determined by agreements with relevant authorities, where applicable, and existing technologies.

There were no cash flows from investing or financing activities related to discontinued operations for the three months ended March 31, 2006 or 2005.

10. Contingent liabilities

In February 2003, the Company was requested to produce documents in connection with an investigation by the United States Department of Justice into possible antitrust violations in the heat stabilizer industry. In April 2006, the Company was notified by the Department of Justice that the Government had closed its investigation and that the Company was relieved of any obligation to retain documents that were responsive to the Government's earlier document request. Before closing its investigation, the Department of Justice took no action against the Company or any current or former employee of the Company. The Company was previously named as a defendant in several lawsuits alleging civil damages and requesting injunctive relief relating to the conduct the Government was investigating. The Company is vigorously defending itself in those actions and believes it would have a claim for indemnification by the former owners of its heat stabilizer business if the Company were found liable. Because these actions are in their preliminary stages, the outcomes of these lawsuits cannot be determined at this time.

In a July 23, 2004, press release, Ferro announced that its Polymer Additives business performance in the second quarter of 2004 fell short of expectations and that its Audit Committee would investigate possible inappropriate accounting entries in Ferro's Polymer Additives business. A consolidated putative securities class action lawsuit arising from and related to the July 23, 2004, announcement is currently pending in the United States District Court for the Northern District of Ohio against Ferro, its deceased former Chief Executive Officer, its Chief Financial Officer, and a former operating Vice President of Ferro. This claim is based on alleged violations of Federal securities laws. Ferro and the named executives consider these allegations to be unfounded, are vigorously defending this action and have notified Ferro's directors and officers liability insurer of the claim. Because this action is in its preliminary stage, the outcome of this litigation cannot be determined at this time.

Also following the July 23, 2004, press release, four derivative lawsuits were commenced and subsequently consolidated in the United States District Court for the Northern District of Ohio. These lawsuits alleged breach of fiduciary duties and mismanagement-related claims. On March 21, 2006, the Court dismissed the consolidated derivative action without prejudice. On April 8, 2006, plaintiffs filed a motion seeking relief from the judgment dismissing the derivative lawsuit and seeking to further amend their complaint following discovery, which was denied. On April 13, 2006, plaintiffs also filed a Notice of Appeal to the Sixth Circuit Court of Appeals. The Directors and named executives consider the allegations contained in the derivative actions to be unfounded, have vigorously defended this action and will defend against the new filings. The Company has notified Ferro's directors and officers liability insurer of the claim. Because this appeal is in the preliminary stage, the outcome of this litigation cannot be determined at this time.

On June 10, 2005, a putative class action lawsuit was filed against Ferro, and certain former and current employees alleging breach of fiduciary duty with respect to ERISA plans. In October 2006, the parties reached a settlement in principle that would result in the dismissal of the lawsuit with prejudice in exchange for the settlement amount of \$4.0 million, which would be paid by the Company's liability insurer subject to the Company's satisfaction of the

remaining retention amount under the insurance policy. The Company and the individual defendants expressly deny any and all liability. The United States District Court granted

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preliminary approval of the settlement on November 3, 2006. Several contingent events must be satisfied before the settlement becomes final. Management does not expect the ultimate outcome of the lawsuit to have a material effect on the financial position, results of operations or cash flows of the Company.

On October 15, 2004, the Belgian Ministry of Economic Affairs Commercial Policy Division (the Ministry) served on Ferro's Belgian subsidiary a mandate requiring the production of certain documents related to an alleged cartel among producers of butyl benzyl phthalate (BBP) from 1983 to 2002. Subsequently, German and Hungarian authorities initiated their own national investigations in relation to the same allegations. Ferro's Belgian subsidiary acquired its BBP business from Solutia Europe S.A./N.V. (SOLBR) in August 2000. Ferro promptly notified SOLBR of the Ministry's actions and requested SOLBR to indemnify and defend Ferro and its Belgian subsidiary with respect to these investigations. In response to Ferro's notice, SOLBR exercised its right under the 2000 acquisition agreement to take over the defense and settlement of these matters, subject to reservation of rights. In December 2005, the Hungarian authorities imposed a de minimus fine on Ferro's Belgian subsidiary, and the Company expects the German and Belgian authorities also to assess fines for the alleged conduct. Management cannot predict the amount of fines that will ultimately be assessed and cannot predict the degree to which SOLBR will indemnify Ferro's Belgian subsidiary for such fines.

In October 2005, the Company disclosed to the New Jersey Department of Environmental Protection (NJDEP) that it had identified potential violations of the New Jersey Water Pollution Control Act, and the Company commenced an investigation and committed to report any violations and to undertake any necessary remedial actions. In September 2006, the Company entered into an agreement with the NJDEP under which the Company paid the State of New Jersey a civil administrative penalty of \$0.2 million in full settlement of the violations.

There are various other lawsuits and claims pending against the Company and its consolidated subsidiaries. In the opinion of management, the ultimate liabilities, if any, and expenses resulting from such lawsuits and claims will not materially affect the consolidated financial position, results of operations, or cash flows of the Company.

At March 31, 2006, and December 31, 2005, the Company had bank guarantees and standby letters of credit issued by financial institutions, which totaled \$23.5 million and \$21.8 million, respectively. These agreements primarily relate to the Company's insurance programs, natural gas contracts, potential environmental remediation liabilities, foreign tax payments, and support of an unconsolidated affiliate's borrowing facility. If the Company fails to perform its obligations, the guarantees and letters of credit may be drawn down by their holders, and the Company would be liable to the financial institutions for the amounts drawn.

11. Stock-based compensation

In April 2003, shareholders of the Company approved the 2003 Long-Term Incentive Compensation Plan (the Plan). The purpose of the Plan is to promote the Company's long-term financial interests and growth by attracting, retaining and motivating high quality executive personnel and directors and aligning their interests with those of our shareholders. The Plan authorizes several different types of long-term incentives, including stock options, stock appreciation rights, restricted shares, performance shares and common stock awards. The shares of common stock to be issued under the Plan may be either authorized but unissued shares or shares held as treasury stock. Generally, the Company issues treasury stock to satisfy the requirements of common stock under the Plan. The effective date of the Plan was January 1, 2003. The number of shares of common stock reserved for awards under the Plan is 3,250,000 shares. At March 31, 2006, there were 334,175 shares available for grant.

Previous Employee Stock Option Plans and a 1997 Performance Share Plan authorized different types of long-term incentives, including stock options, stock appreciation rights, performance shares and common stock awards. No further grants may be made under Ferro's previous Employee Stock Option Plans or under Ferro's 1997 Performance Share Plan. However, any outstanding awards or grants made under these plans will continue until the end of their specified term.

Stock Options

The Compensation Committee of the Board of Directors (the Committee) awards stock options under the Plan. The Committee generally grants stock options during regularly scheduled meetings. The exercise price of stock options granted may not be less than the per share fair market value of the Company's common stock on the date of the grant.

Stock options

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have a term of 10 years and vest evenly over four years on the anniversary of the grant date. In the case of death, retirement, disability or change in control, the stock options become 100% vested and exercisable.

Compensation expense related to stock options for the three months ended March 31, 2006, was \$0.7 million, which was included in selling, general and administrative expenses.

The fair value of each stock option is estimated on the date of grant using the Black-Scholes option pricing model that uses the assumptions noted in the following table. These assumptions are judgmental in nature and impact the timing and amount of compensation expense. The Company uses historical data to estimate option exercise and employee termination within the valuation model and adjusts the assumptions each year based upon new information. The Company uses historical exercise experience to estimate the expected life of stock options. The risk-free interest rate is based upon the yield of U.S. Treasury bonds with remaining terms equal to the expected life of the stock option. The expected volatility is based upon historical daily price observations of the Company's common stock over a 3-year period.

	Range
Expected life, in years	6.80 to 8.20
Risk-free interest rate	3.50% to 5.94%
Expected volatility	28.07% to 37.30%
Expected dividend yield	2.18% to 3.00%

A summary of the stock option activity for the three months ended March 31, 2006, is as follows:

	Number of Shares	Weighted Average Exercise Price	Weighted- Average Remaining Contractual Term (In years)	Aggregate Intrinsic Value
Outstanding at January 1, 2006	4,829,900	\$ 22.23		
Granted	537,000	20.68		
Exercised	(135,010)	15.75		
Forfeited	(62,847)	20.33		
Outstanding at March 31, 2006	5,169,043	\$ 22.26	5.90	\$ 1,013,000
Exercisable at March 31, 2006	3,915,089	\$ 22.57	4.90	\$ 840,000

The weighted-average grant-date fair value of stock options granted during the three months ended March 31, 2006 and 2005, was \$6.01 and \$5.10, respectively.

The aggregate intrinsic value in the table above represents the total pretax difference between the Company's closing fair market value per share on the last trading day of the quarter and the option exercise price, multiplied by the number of shares that would have been received by the option holders had they exercised all their in-the-money stock options at March 31, 2006. Under FAS No.123R, the Company does not record the aggregate intrinsic value for financial accounting purposes and the value changes daily based on the changes in the fair market value of the Company's common stock.

Information related to stock options exercised follows:

**Three months ended
March 31,
2006 2005
(Dollars in thousands)**

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Proceeds from the exercise of stock options	\$2,126	\$1,301
Intrinsic value of stock options exercised	466	434
Income tax benefit related to stock options exercised	163	152
	14	

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A summary of the status of the Company's nonvested stock options as of March 31, 2006, and changes during the three months ended March 31, 2006, is presented below:

	Shares		Weighted-Average Grant-Date Fair Value
Nonvested at January 1, 2006	1,117,031	\$	6.19
Granted	537,000		6.01
Vested	(353,202)		6.81
Forfeited	(46,875)		
Nonvested at March 31, 2006	1,253,954	\$	5.99

As of March 31, 2006, there was \$7.0 million of total unrecognized compensation cost related to nonvested stock-based compensation granted under the Company's stock option plans. The Company expects the compensation cost to be recognized over a weighted average period of 2.9 years. The total fair value of options vested during the three months ended March 31, 2006, was \$2.8 million.

Performance Shares

The Company maintains multiple performance share plans (PSPs) whereby awards, expressed as shares of the Company's common stock, are earned only if the Company meets specific performance targets over a three-year period. Generally, the plans have a term of three years and management establishes a new plan annually. Therefore, there typically are three plans outstanding at a given point in time. On the grant date, the Company issues restricted common stock to the participants and these shares are held for the benefit of the participants until the end of the performance period. Participants are entitled to receive dividends on the restricted shares during the performance period.

The Company pays 50% cash and 50% common stock for the value of any earned performance shares. The portions of the awards to be paid in cash are treated as liabilities and are therefore remeasured at the current fair value each reporting period based upon the fair value of the Company's common stock. The awards that are settled with common stock are treated for accounting purposes as equity awards, and therefore, the amount of employee compensation recorded over the performance period is equal to the fair value on the grant date. Compensation expense for all performance share awards is adjusted for the achievement of the plan's performance conditions based upon management's best estimate using available facts and circumstances.

The following table identifies the potential number of common shares to be issued and the common stock price on the date of grant. For the portion of the awards that are treated as liabilities, the awards were remeasured at the common stock closing market price at March 31, 2006 of \$20.00.

Award	Potential Number of Shares to be Issued	Common Stock Price at Grant Date
2004 - 2006	118,100	\$ 26.50
2005 - 2007	127,900	\$ 19.39
2006 - 2008	118,200	\$ 19.61

The potential compensation amounts related to the awards issued are reduced during the performance period by forfeitures and non-attainment of performance conditions. On August 3, 2006 the Company settled the awards for the 2003 - 2005 plan based upon the common stock price of \$19.56 per share, which by the terms of the PSP, represents the average closing price of a share of common for the first ten days of the last month of the performance period. The

Company issued 13,728 non-restricted shares of common stock and paid participants in that plan a total of \$0.3 million.

During the three months ended March 31, 2006 and 2005, the Company recorded \$0.2 million and \$0.2 million of compensation expense, respectively. At March 31, 2006, the Company had accrued \$1.1 million of compensation related to the performance share awards. Performance share awards in the amount of 118,200 and 127,900 shares at weighted-average common stock prices of \$19.61 and \$19.39 per share were granted during the three months ended March 31, 2006 and 2005, respectively. As of March 31, 2006, the estimated future compensation expense related to the outstanding performance shares aggregated \$1.8 million. The Company expects to recognize this compensation over the remaining performance period of 2.8 years.

Table of Contents**12. Retirement benefits**

Information concerning net periodic benefit costs of the pension and other postretirement benefit plans of the Company is as follows:

	Pension benefits		Other benefits	
	Three months ended		Three months ended	
	March 31,		March 31,	
	2006	2005	2006	2005
	(Dollars in thousands)			
Components of net periodic cost:				
Service cost	\$ 4,332	\$ 3,973	\$ 217	\$ 200
Interest cost	6,870	6,654	843	790
Expected return on plan assets	(6,316)	(5,606)		
Amortization of prior service cost	22	24	(91)	(140)
Net amortization and deferral	2,007	1,669		(58)
Net periodic benefit cost	\$ 6,915	\$ 6,714	\$ 969	\$ 792

In February 2006, the Company announced changes to certain of its postretirement benefit plans. In the second quarter of 2006, the Company will record a net curtailment gain of \$2.5 million related to the Company's April 1, 2006, curtailment of its retirement benefit accumulations for its largest defined benefit plan, which covers certain salaried and hourly employees in the United States. Also as a result of this curtailment, in the second quarter of 2006, the Company will reduce its additional minimum pension liability by \$4.3 million, net of tax, as a credit to Other Comprehensive Income in shareholders' equity. Because of this benefit curtailment, other components of net periodic pension costs for 2006 will be reduced from previously anticipated amounts by \$5.7 million, primarily in the second half of the year. The affected employees now receive benefits in the Company's defined contribution plan that previously covered only U.S. salaried employees hired after 2003. These changes do not affect current retirees or former employees.

Additionally, in the second quarter of 2006, the Company will record a net curtailment gain of \$2.5 million related to the Company's limiting of eligibility for retiree medical and life insurance coverage for nonunion employees. Other components of net periodic benefit costs for 2006 will be reduced from previously anticipated amounts by \$0.7 million, primarily in the second half of the year. Only employees age 55 or older with 10 or more years of service as of December 31, 2006, will be eligible for postretirement medical and life insurance benefits. Moreover, these benefits will be available only to those employees who retire by December 31, 2007, after having advised the Company of their retirement plans by March 31, 2007.

The Company also sponsors unfunded nonqualified defined benefit retirement plans for certain employees. The Company will record settlement losses for these plans of \$4.8 million in the second quarter of 2006, related primarily to a lump sum payment to the beneficiary of its deceased former Chief Executive Officer, and \$0.1 million in the third quarter. Also as a result of these settlements, in the second quarter of 2006, the Company will reduce its additional minimum pension liability by \$3.3 million, net of tax, as a credit to Other Comprehensive Income in shareholders' equity. Because of these settlements, other components of net periodic pension costs for 2006 will be reduced from previously anticipated amounts by \$0.8 million, primarily in the second half of the year.

In November 2006, the Company announced restructuring activities that will result in closing the Company's Niagara Falls, New York, manufacturing facility by the end of 2007. In the first quarter of 2007, the Company will record a net curtailment loss of \$0.3 million for pension benefits and a net curtailment gain of \$4.2 million for other benefits related to this closing.

13. Income taxes

Income tax expense for the three months ended March 31, 2006, was \$4.1 million compared to a benefit of \$1.2 million in the prior year. The 2006 tax expense represents 32.9% of pre-tax income. The tax benefit in 2005 was

a result of a pre-tax loss as well as the favorable mix of income by subsidiary and country, and a relatively low level of dividends repatriated from outside of the U.S.

Table of Contents**14. Reporting for segments**

The Company has six reportable segments: Performance Coatings, Electronic Materials, Color and Glass Performance Materials, Polymer Additives, Specialty Plastics and Other, which is comprised of two business units, Pharmaceuticals and Fine Chemicals, which do not meet the quantitative thresholds for separate disclosure. The Company uses the criteria outlined in Statement of Financial Accounting Standards No. 131, Disclosures about Segments of an Enterprise and Related Information, to identify segments which management has concluded are its seven major business units. Further, the Company has concluded that it is appropriate to aggregate its Tile and Porcelain Enamel business units into one reportable segment, Performance Coatings, based on their similar economic and operating characteristics.

The accounting policies of the segments are consistent with those described for the Company's consolidated financial statements in the summary of significant accounting policies contained in the Company's Annual Report on Form 10-K for the year ended December 31, 2005. Net sales to external customers are presented in the following table. Inter-segment sales were not material.

	Three months ended March 31,	
	2006	2005
	(Dollars in thousands)	
Performance Coatings	\$ 126,109	\$ 118,716
Electronic Materials	107,366	78,168
Color and Glass Performance Materials	94,612	92,619
Polymer Additives	82,723	76,308
Specialty Plastics	71,724	70,861
Other	22,619	25,002
Total consolidated sales	\$ 505,153	\$ 461,674

The Company measures segment income for reporting purposes as net operating profit before interest and taxes. Net segment income also excludes unallocated corporate expenses and charges associated with employment cost reduction programs. Reconciliation of segment income (loss) to income (loss) before taxes from continuing operations follows:

	Three months ended March 31,	
	2006	2005
	(Dollars in thousands)	
Performance Coatings	\$ 8,995	\$ 7,796
Electronic Materials	8,182	(237)
Color and Glass Performance Materials	12,866	10,923
Polymer Additives	4,562	4,820
Specialty Plastics	5,946	3,592
Other	1,597	815
Total segment income	42,148	27,709
Unallocated expenses	(13,345)	(18,312)
Interest expense	(13,250)	(11,028)
Foreign currency	(321)	(767)
Miscellaneous net	(2,656)	1,828

Income (loss) before taxes from continuing operations	\$ 12,576	\$ (570)
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Geographic revenues are based on the region in which the customer invoice is generated. The United States of America is the single largest country for customer sales. No other single country represents more than 10% of the Company's consolidated sales. Net sales by geographic region are as follows:

	Three months ended March 31,	
	2006	2005
	(Dollars in thousands)	
United States	\$ 248,671	\$ 226,062
International	256,482	235,612
Total net sales	\$ 505,153	\$ 461,674

15. Financial instruments

The Company consigns, from various financial institutions, precious metals (primarily silver, gold, platinum and palladium, collectively "metals") used in the production of certain products for customers. Under these consignment arrangements, the financial institutions provide the Company with metals for a specified period of one year or less in duration, for which the Company pays a fee. Under these arrangements, the financial institutions own the metals, and accordingly, the Company does not report these consigned materials as part of its inventory on its consolidated balance sheet. These agreements are cancelable by either party at the end of each consignment period, however, because the Company has access to a number of consignment arrangements with available capacity, consignment needs can be shifted among the other participating institutions. At March 31, 2006, the Company had 5.2 million troy ounces of metals (primarily silver) on consignment for periods of less than one year with a market value of \$100.9 million. At December 31, 2005, the Company had 5.9 million troy ounces of metals on consignment for periods of less than one year with a market value of \$99.3 million. Beginning in the fourth quarter of 2005, certain participating institutions required cash deposits to provide additional collateral beyond the underlying precious metals. At March 31, 2006, and December 31, 2005, the Company had outstanding deposits of \$79.0 million, and \$19.0 million, respectively.

16. Property, plant and equipment

Property, plant and equipment is reported net of accumulated depreciation of \$609.6 million at March 31, 2006, and \$595.0 million at December 31, 2005.

17. Subsequent events***New Credit Facility***

In March 2006, the Company accepted a commitment from a syndicate of lenders to underwrite a \$700 million credit facility (the "New Credit Facility") and, in June 2006, finalized the agreement. The New Credit Facility is comprised of a five year, \$250 million multi-currency senior revolving credit facility and a six year, \$450 million senior delayed-draw term loan facility. Under the terms of the New Credit Facility, the Company can request that the revolving credit facility be increased by \$50 million at no additional fee.

The New Credit Facility was entered into to replace the Prior Revolving Credit Facility that was scheduled to expire in September 2006. In addition, the financing, through the term loan facility, provided capital resources sufficient to refinance the \$200 million of senior notes and \$155 million of debentures that could have become immediately due and payable due to defaults associated with the Company's delayed SEC financial filings for 2005. Because one of the purposes of the term loan facility is to fund the potential acceleration of the senior notes and debentures, the term facility contains certain restrictions including, but not limited to, the following:

\$355 million of the facility is reserved to repay the senior notes and debentures;

\$95 million of the facility is immediately available for refunding indebtedness other than the senior notes and debentures;

The Company may access up to \$55 million of the \$355 million reserved to repay the senior notes and debentures if these obligations have not already been paid in full and no event of default for these obligations exists and is continuing; and

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The Company may draw on the delayed-draw facility for up to one year with any unused commitment under the term facility terminating on June 6, 2007.

At the close of the New Credit Facility in June 2006, the Company drew \$95 million of the term loan facility to partially repay the Prior Revolving Credit Facility. In addition, during the third quarter of 2006, the Company drew down another \$155 million of the term loan facility to repay \$155 million of outstanding debentures, as bondholders accelerated payment on these obligations due to the previously mentioned 2005 SEC financial reporting delays. See further discussion under *Accelerated Repayment of Debentures* below. The Company is required to make quarterly principal payments equal to 0.25% of the amount borrowed under the term loan facility beginning no later than July 2007.

The New Credit Facility bears interest at a rate equal to, at the Company's option, either (1) LIBOR or (2) the Alternate Base Rate which is the higher of the Prime Rate and the Federal Funds Effective Rate plus 0.5%; plus, in each case, applicable margins based on the Company's index debt rating. The New Credit Facility is secured by substantially all of the Company's assets, including the assets and 100% of the shares of the Company's material domestic subsidiaries and 65% of the shares of the Company's first tier foreign subsidiaries, but excluding trade receivables sold pursuant to the Company's accounts receivable sales programs. These liens are shared with the holders of the Company's senior notes, as required under the respective indenture.

The New Credit Facility contains customary operating covenants that limit the Company's ability to engage in certain activities, including limitations on additional loans and investments; creation of additional liens; prepayments, redemptions and repurchases of debt; and mergers, acquisitions and asset sales. The Company is also subject to customary financial covenants including a leverage ratio and a fixed charge coverage ratio. Additional covenants of the New Credit Facility require the Company to file its 2006 Forms 10-Q by December 29, 2006. Failure to satisfy certain of these covenants, either immediately or after a brief period allowing the company to satisfy the covenant, would result in an event of default. If any event of default should occur and be continuing and a waiver not have been obtained, the obligations under the New Credit Facility may become immediately due and payable at the option of providers of more than 50% of the credit facility commitment.

Accelerated Repayment of Debentures

As the Company anticipated and planned for, in March and April 2006, the Company received notices of default from a holder and the Trustee of the senior notes and debentures of which \$355 million was outstanding. The notices of default related to reporting requirements. Under the terms of the indentures, the Company had 90 days from the notices of default to cure the deficiencies identified in the notices of default or obtain waivers, or events of default would have occurred and the holders or the bondholders of the senior notes or debentures could declare the principal immediately due and payable. At the end of these periods, the deficiencies had not been cured and waivers had not been obtained. During July and August 2006, the bondholders accelerated the payment of the principal amount of the debentures, of which \$155 million was outstanding, and the Company financed the accelerated repayments by use of the \$450 million term loan portion of the New Credit Facility.

Asset Securitization Program

In June 2006, the Company amended the asset securitization program to extend it up to June 2, 2009, to cure a default resulting from a credit rating downgrade, and to modify the reporting requirements to more closely match those in the New Credit Facility. While the Company expects to maintain a satisfactory U.S. asset securitization program to help meet the Company's liquidity requirements, factors beyond the Company's control such as prevailing economic, financial and market conditions may prevent the Company from doing so.

Legal Proceedings

In February 2003, the Company was requested to produce documents in connection with an investigation by the United States Department of Justice into possible antitrust violations in the heat stabilizer industry. In April 2006, the Company was notified by the Department of Justice that the Government had closed its investigation and that the Company was relieved of any obligation to retain documents that were responsive to the Government's earlier document request.

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Four derivative lawsuits were commenced in 2004 and subsequently consolidated into a single action in the United States District Court for the Northern District of Ohio. These lawsuits alleged breach of fiduciary duties and mismanagement-related claims. On March 31, 2006, the Court dismissed the consolidated derivative action without prejudice. On April 8, 2006, plaintiffs filed a motion seeking relief from the judgment dismissing the derivative lawsuit and seeking to further amend their complaint following discovery, which was denied. On April 13, 2006, plaintiffs also filed a Notice of Appeal to the Sixth Circuit Court of Appeals.

In October 2005, the Company disclosed to the New Jersey Department of Environmental Protection (NJDEP) that it had identified potential violations of the New Jersey Water Pollution Control Act, and the Company commenced an investigation and committed to report any violations and to undertake any necessary remedial actions. In September 2006, the Company entered into an agreement with the NJDEP under which the Company paid the State of New Jersey a civil administrative penalty of \$0.2 million in full settlement of the violations.

On June 10, 2005, a putative class action lawsuit was filed against Ferro, and certain former and current employees alleging breach of fiduciary duty with respect to ERISA plans. In October 2006, the parties reached a settlement in principle that would result in the dismissal of the lawsuit with prejudice in exchange for the settlement amount of \$4.0 million, which would be paid by the Company's liability insurer subject to the Company's satisfaction of the remaining retention amount under the insurance policy. The United States District Court granted preliminary approval of the settlement on November 3, 2006. Several contingent events must be satisfied before the settlement becomes final.

Specialty Plastics

In May 2006, the Company announced that it had entered into a non-binding letter of intent to divest its Specialty Plastics business unit and had entered into negotiations with a potential buyer. In October 2006, the Company announced that it had discontinued negotiations with the potential buyer and will continue to operate the Specialty Plastics business.

Restructuring Activities

In November 2006, the Company announced that it plans to restructure certain operations of the Company's Electronic Materials and Color and Glass Performance Materials segments. The restructuring in the Electronic Materials business will result in closing the Company's Niagara Falls, New York, manufacturing facility by the end of 2007 and moving production to other existing Ferro manufacturing locations. The restructuring of the Color and Glass Performance Materials business is part of a larger restructuring of the Company's European operations that was announced in July 2006. This portion of the restructuring program primarily involves the proposed transfer of decorative colors production from Frankfurt, Germany to Colditz, Germany.

These restructuring programs are expected to result in pre-tax charges of \$28 million to \$32 million. Approximately \$24 million of the charges are expected to be incurred in the quarter ended December 31, 2006. Of this amount, approximately \$17 million will be non-cash charges including asset impairments, accelerated depreciation and the write-off of intangibles. In addition, the Company expects to incur between \$1 million and \$2 million in accelerated depreciation during the fourth quarter for other portions of its European restructuring activities. The remainder of the total restructuring charges from these actions, including net curtailment gains from pension and other post retirement benefit plans, will be recorded in future quarters, with the bulk of the charges expected to be incurred in the quarters ended March 31, 2007, and June 30, 2007.

2006 Long-Term Incentive Plan

In November 2006, shareholders of the Company approved the 2006 Long-Term Incentive Plan (the Plan). The Plan authorizes several different types of long-term incentives. The available incentives include stock options, stock appreciation rights, restricted shares, performance shares, other common stock based awards, and dividend equivalent rights. The shares of common stock to be issued under the Plan may be either authorized but unissued shares or shares held as treasury stock. The Plan has an effective date of September 28, 2006, and provides for 3,000,000 common shares to be reserved.

Table of Contents**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations*****Overview***

Net income for the three months ended March 31, 2006, increased to \$8.3 million from \$0.5 million for the three months ended March 31, 2005. Earnings in the current quarter reflect the improved results across the business, particularly in Electronic Materials where customer demand rebounded from a weak first quarter in 2005.

In June 2003, the Company completed the sale of its Petroleum Additives and Specialty Ceramics business units, and accordingly, for all periods presented, each of these businesses has been reported as a discontinued operation. The discussion presented below under Results of Operations focuses on the Company's results from continuing operations.

Outlook

Through the remainder of 2006, the Company expects business conditions to support year over year improvements in sales and operating profit compared to 2005. Economic conditions are expected to remain generally positive through the balance of 2006 in all major regions. However, some softening of demand related to U.S. automotive and construction demand is expected in the second half of 2006. Due to seasonal market factors coupled with holidays during the fourth quarter, the Company generally has higher revenues in the first half of the year than in the second half of the year, and profitability typically has been higher in the first six months. The Company expects these seasonal trends to be repeated in 2006.

The Company continues to pursue a reduction in costs through a number of restructuring initiatives. The restructuring of the Company's European manufacturing operations related to the Performance Coatings and Color and Glass Performance Materials segments and certain of its manufacturing sites in the Electronic Materials segments will continue. Restructuring charges are expected to total between \$28 million and \$32 million, although these estimates are subject to further refinement. The Company expects charges of approximately \$24 million, including asset impairment charges, write-offs of intangibles and severance costs, to be incurred in the quarter ending December 31, 2006.

Factors that could adversely affect the Company's future financial performances are contained within Risk Factors included under Item 1A in the Company's Annual Report on Form 10-K for the period ended December 31, 2005.

Results of Operations***Comparison of the three months ended March 31, 2006 and 2005***

Sales for the three months ended March 31, 2006, of \$505.2 million increased 9 percent from the comparable 2005 period. Sales growth in Electronic Materials was especially strong compared to a weak first quarter in 2005. The impact of weakening currencies, particularly the Euro, negatively impacted revenue by approximately three percentage points as compared to the prior year period. This decline was more than offset by improvements in volume and average selling prices.

Gross margins were 21.4% of sales compared with 20.1% for the prior year period. The increase was primarily driven by higher volumes and improved average selling prices in the Electronic Materials segment, compared to a weak first quarter in 2005. Also, gross margins for the three months ended March 31, 2006, included only minimal restructuring costs, while \$1.2 million of restructuring charges were incurred during the corresponding 2005 period.

Selling, administrative and general (SG&A) expenses were \$79.1 million for the three months ended March 31, 2006, compared with \$83.6 million for the same period in 2005. The primary drivers for the decline in SG&A expenses were expense controls across the Company and a reduction in total charges incurred for restructuring initiatives and the accounting investigations and restatement. During the first quarter of 2006, the Company recorded charges of \$4.8 million in SG&A expense related to restructuring initiatives and the accounting investigations and restatement. Charges related to these items that were included in SG&A expense in the first quarter of 2005 were \$6.1 million.

Interest expense was \$13.3 million for the quarter ended March 31, 2006, an increase of \$2.3 million from \$11.0 million in the same 2005 period. The increase was driven by higher average outstanding borrowings, coupled with higher average interest rates on the Company's variable rate borrowings.

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Net foreign currency loss for the three months ended March 31, 2006, was \$0.3 million as compared to a loss of \$0.8 million for the three months ended March 31, 2005. The Company has and continues to use certain foreign currency instruments to offset the effect of changing exchange rates on foreign subsidiary earnings and short-term transaction exposures. The carrying values of such contracts are adjusted to market value and resulting gains or losses are charged to income or expense in the period.

Miscellaneous expense for the quarter ended March 31, 2006, was \$2.7 million compared to miscellaneous income of \$1.8 million in the first three months of 2005. The primary driver of the change was the marked-to-market adjustment of supply contracts for natural gas. Net marked-to-market charges in the first quarter of 2006 were \$2.9 million compared to net gains of \$2.4 million in the quarter ended March 31, 2005.

Income tax expense for the three months ended March 31, 2006, was \$4.1 million compared to a benefit of \$1.2 million in the prior year. The 2006 tax expense represents 32.9% of pre-tax income. The tax benefit in 2005 was a result of a pre-tax loss as well as the favorable mix of income by subsidiary and country, and a relatively low level of dividends repatriated from outside of the U.S.

There were no businesses reported as discontinued operations in the quarter ended March 31, 2006. The Company, however, recorded a loss of \$0.1 million, net of tax, in both the first quarter of 2006 and the first quarter of 2005 related to certain post-closing matters associated with businesses sold in prior periods.

Income from continuing operations for the three months ended March 31, 2006, totaled \$8.4 million compared with net income of \$0.6 million for the three months ended March 31, 2005. Diluted earnings per share were \$0.19 for the three months ended March 31, 2006, versus breakeven diluted earnings for the three months ended March 31, 2005.

Performance Coatings Segment Results. Net sales for the Performance Coatings segment increased 6.2% to \$126.1 million in the first three months of 2006 as compared to \$118.7 million in the first quarter of 2005. Segment income increased to \$9.0 million from \$7.8 million in 2005. The revenue increase was driven primarily by growth in North America, Europe and Latin America, offset partially by a decline in the Asia/Pacific region. The sales decline in Asia/Pacific primarily was driven by natural gas supply disruptions that resulted in lower purchasing levels at some of the Company's Indonesian customers, and a slowing of economic growth in Thailand. The increase in segment income reflects improved average selling prices and higher volumes, particularly in porcelain enamels, partially offset by higher raw material costs.

Electronic Materials Segment Results. Net sales for the Electronic Materials segment increased 37.4% to \$107.4 million as compared to \$78.2 million in the first quarter of 2005. Segment income increased to \$8.2 million as compared to a loss of \$0.2 million in 2005. The revenue increase was driven by increased demand from manufacturers of multilayer capacitors, compared to a 2005 quarter when these customers were lowering their inventories. In addition, demand from manufacturers of solar cells continued to increase. Revenue also increased as a result of increases in precious metal prices, which are generally passed through to customers. The increased demand was reflected in improved average selling prices and higher volume for the quarter. Segment income primarily increased due to improved volume and higher average selling prices.

Color and Glass Performance Materials Segment Results. Net sales for the Color and Glass Performance Materials segment were \$94.6 million, an increase of 2.2% versus \$92.6 million in the first quarter of 2005. Segment income of \$12.9 million in the first quarter of 2006 was 17.8% higher than the same period in 2005 when segment income was \$10.9 million. Revenues benefited from higher average selling prices that more than offset lower volume and adverse currency translation effects, primarily related to the Euro. Sales growth was the strongest in Europe. Segment income increased due to higher average selling prices that improved margins.

Polymer Additives Segment Results. Net sales for the Polymer Additives segment were \$82.7 million, an increase of 8.4% versus \$76.3 million in the first quarter of 2005. Segment income declined to \$4.6 million from \$4.8 million in 2005. The revenue increase was driven by higher sales in North America, and to a lesser extent in Europe. Improved volumes within the segment during the first quarter of 2006 more than offset negative currency translation effects. Although price increases exceeded raw material cost increases for the quarter, they were not sufficient to fully offset increased manufacturing costs, and as a result, segment income declined.

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Specialty Plastics Segment Results. Net sales for the Specialty Plastics segment were \$71.7 million, an increase of 1.2% versus \$70.9 million in the first quarter of 2005. Segment income increased to \$5.9 million from \$3.6 million in 2005. The revenue increase was driven by improved average selling prices, largely offset by a decline in volume and negative currency translation effects. Segment income increased largely due to higher pricing and relatively stable raw materials costs.

Other Segment Results. Net sales in the Other segment were \$22.6 million for the first quarter of 2006, a decline of 9.5% versus \$25.0 million in the prior year. Segment income nearly doubled to \$1.6 million from \$0.8 million in the first quarter of 2005.

Geographic Sales. Sales in the United States were \$248.7 million for the three months ended March 31, 2006, an increase of 10.0% compared with sales of \$226.1 million for the three months ended March 31, 2005. Electronics markets, particularly those related to multilayer capacitors and solar cell manufacture, were particularly strong in the quarter.

International sales were \$256.5 million for the three months ended March 31, 2006, an increase of 8.9% compared with sales of \$235.6 million for the three months ended March 31, 2005. Sales in the Europe, Asia Pacific, and Latin America regions all grew compared to the first quarter of 2005. Unfavorable currency exchange rate differences reduced the growth in international sales.

Cash Flows. Net cash used for continuing operations for the three months ended March 31, 2006, was \$78.5 million, compared with \$8.4 million of cash used for continuing operations during the same period in 2005. The increase in net cash used for operating activities is primarily due to a greater increase in working capital during the first quarter of 2006, compared to the prior year. The 2006 working capital increase was due to a \$43.3 million increase in accounts and notes receivable resulting from increases in net sales and average days sales outstanding, a \$17.4 million increase in inventories, and a \$60.0 million increase in deposit requirements under the Company's precious metals consignment program. Net income, amortization and depreciation, and increases in payables and accruals partially offset the other items.

Net cash used for investing activities was \$7.7 million for the three months ended March 31, 2006, compared with \$10.2 million used for investing activities for the same period in 2005. The cash used for investing activities is primarily a result of the capital expenditures made by the Company during the first quarter of 2006 and the first quarter of 2005.

Net cash provided by financing activities was \$85.2 million in the three months ended March 31, 2006, compared with net cash provided by financing activities of \$20.7 million during the same period in 2005. During the first quarter of 2006, net long-term debt borrowing increased, accounting for the majority of the cash provided by financing activities.

Net cash used for operating activities of discontinued operations was \$0.2 million in the first quarter of 2006, compared to \$0.3 million in the first three months of 2005.

Liquidity and Capital Resources

The Company's liquidity requirements include primarily debt service, working capital requirements, capital investments, post-retirement obligations and dividend payments. The Company expects to be able to meet its liquidity requirements from a variety of sources, including cash flow from operations and use of its credit facilities. At March 31, 2006, the Company had a \$300 million revolving credit facility that was scheduled to expire in September 2006, as well as \$200 million of senior notes due in 2009 and \$155 million of debentures with varying maturities beyond 2012. The Company also had an accounts receivable securitization facility under which the Company could receive advances of up to \$100 million, subject to the level of qualifying accounts receivable. The accounts receivable securitization facility was due to mature in June 2006.

Subsequent to March 31, 2006, the Company replaced and/or modified its existing facilities to secure future financial liquidity. The \$300 million revolving credit facility was replaced by a \$700 million credit facility, consisting of a \$250 million multi-currency senior revolving credit facility expiring in 2011 and a \$450 million senior delayed-draw term loan facility expiring in 2012. See further discussion under *Revolving Credit and Term Loan Facility* below. In addition, the Company extended its \$100 million accounts receivable securitization facility to June 2009. See further discussion under *Off Balance Sheet Arrangements* below. For further information regarding the

Company's credit facilities, refer to Note 6 to the Company's Condensed Consolidated Financial Statements under Item 1 herein.

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The Company's senior credit rating was Ba1 by Moody's Investor Service, Inc. (Moody's) and BB by Standard & Poor's Rating Group (S&P) at December 31, 2005. In March 2006, Moody's lowered its rating to B1 and then withdrew its ratings, and S&P lowered its rating to B+. The rating agencies may, at any time, based on various factors including changing market, political or economic conditions, reconsider the current rating of the Company's outstanding debt. Based on rating agency disclosures, Ferro understands that ratings changes within the general industrial sector are evaluated based on quantitative, qualitative and legal analyses. Factors considered by the rating agencies include: industry characteristics, competitive position, management, financial policy, profitability, capital structure, cash flow production and financial flexibility. Moody's and S&P have disclosed that the Company's ability to improve earnings, reduce the Company's level of indebtedness and strengthen cash flow protection measures, whether through asset sales, increased free cash flows from operations or otherwise, will be factors in their ratings determinations going forward.

Revolving Credit and Term Loan Facility

In March 2006, the Company accepted a commitment from a syndicate of lenders to underwrite a \$700 million credit facility (the New Credit Facility) and, in June 2006, finalized the agreement. The New Credit Facility is comprised of a five year, \$250 million multi-currency senior revolving credit facility and a six year, \$450 million senior delayed-draw term loan facility. Under the terms of the New Credit Facility, the Company can request that the revolving credit facility be increased by \$50 million at no additional fee.

The New Credit Facility was entered into to replace the prior revolving credit facility that was scheduled to expire in September 2006. In addition, the financing, through the term loan facility, provided capital resources sufficient to refinance the \$200 million of senior notes and \$155 million of debentures that could have become immediately due and payable due to defaults associated with the Company's delayed Securities and Exchange Commission (SEC) financial filings for 2005. Because one of the purposes of the term loan facility is to fund the potential acceleration of the senior notes and debentures, the term facility contains certain restrictions including, but not limited to, the following:

\$355 million of the facility is reserved to repay the senior notes and debentures;

\$95 million of the facility is immediately available for refunding indebtedness other than the senior notes and debentures;

The Company may access up to \$55 million of the \$355 million reserved to repay the senior notes and debentures if these obligations have not already been paid in full and no event of default for these obligations exists and is continuing; and

The Company may draw on the delayed-draw facility for up to one year with any unused commitment under the term facility terminating on June 6, 2007.

At the close of the New Credit Facility in June 2006, the Company drew \$95 million of the term loan facility to partially repay the old revolving credit facility. In addition, during the third quarter of 2006, the Company drew down another \$155 million of the term loan facility to repay \$155 million of outstanding debentures, as bondholders accelerated payment on these obligations due to the previously mentioned 2005 SEC financial reporting delays. See further discussion under Senior Notes and Debentures below. The Company is required to make quarterly principal payments equal to 0.25% of the amount borrowed under the term loan facility beginning no later than July 2007.

The New Credit Facility is secured by substantially all of the Company's assets, including the assets and 100% of the shares of the Company's material domestic subsidiaries and 65% of the shares of the Company's first tier foreign subsidiaries, but excluding trade receivables sold pursuant to the Company's accounts receivable sales programs (see below). These liens are shared with the holders of the Company's senior notes, as required under the respective indenture. The New Credit Facility contains customary operating covenants that limit the Company's ability to engage in certain activities, including limitations on additional loans and investments; creation of additional liens; prepayments, redemptions and repurchases of debt; and mergers, acquisitions and asset sales. The Company is also subject to customary financial covenants including a leverage ratio and a fixed charge coverage ratio. Additional

covenants of the New Credit Facility require the Company to file its 2006 Forms 10-Q by December 29, 2006. Failure to satisfy certain of these covenants, either immediately or after a brief period allowing the company to satisfy the covenant, would result in an event of default. If any event of default should occur and be continuing and a waiver not have been obtained, the obligations under the New Credit Facility may become immediately due and payable at the option of providers of more than 50% of the credit facility commitment.

Table of Contents*Senior Notes and Debentures*

The indentures under which the senior notes and the debentures were issued contain operating covenants that limit the Company's ability to engage in certain activities including limitations on consolidations, mergers, and transfers of assets; and sale and leaseback transactions. The indentures contain cross-default provisions with other debt obligations that exceed \$10 million of principal outstanding. In addition, the terms of the indentures require, among other things, the Company to file with the Trustee copies of its annual reports on Form 10-K, quarterly reports on Form 10-Q and an Officers' Certificate relating to the Company's compliance with the terms of the indenture within 120 days after the end of its fiscal year. The Company has been in default on these reporting requirements since it delayed filing its Form 10-Q for the second quarter of 2004 due to the restatement of its 2003 and first quarter 2004 results. As the Company anticipated and planned for, in March and April 2006, the Company received notices of default from a holder and the Trustee of the senior notes and debentures of which \$355 million was outstanding. The notices of default related only to reporting requirements and the related Officers' Certificate. Under the terms of the indentures, the Company had 90 days from the notices of default to cure the deficiencies identified in the notices of default or obtain waivers, or events of default would have occurred and the holders or the Trustee of the senior notes or debentures could declare the principal immediately due and payable. At the end of these periods, the deficiencies had not been cured and waivers had not been obtained. During July and August 2006, the bondholders accelerated the payment of the principal amount of the debentures, of which \$155 million was outstanding, and the Company financed the accelerated repayments by use of the aforementioned \$450 million term loan facility.

As of the date of this filing, the \$200 million senior notes currently remain outstanding, although they could be declared immediately due and payable. In the event the bondholders of the senior notes provide a notice of acceleration prior to the Company curing the existing reporting default, the Company believes it has sufficient liquidity resources, primarily through the term loan facility, to fully satisfy any potential acceleration. In addition, the senior notes are redeemable at the option of the Company at any time for the principal amount of the senior notes then outstanding plus the sum of any accrued but unpaid interest and the present value of any remaining scheduled interest payments. The senior notes are redeemable at the option of the holders only upon a change in control of the Company combined with a rating by either Moody's or S&P below investment grade as defined in the indenture. Currently, the rating by S&P of the senior notes is below investment grade.

Off Balance Sheet Arrangements

Asset Securitization Program. The Company has a \$100 million program to sell (securitize), on an ongoing basis, a pool of its trade accounts receivable. This program serves to accelerate cash collections of the Company's trade accounts receivable at favorable financing costs and helps manage the Company's liquidity requirements. In June 2006, the Company amended the program to extend it up to June 2, 2009, to cure a default resulting from a credit rating downgrade, and to modify the reporting requirements to more closely match those in the New Credit Facility. While the Company expects to maintain a satisfactory U.S. asset securitization program to help meet the Company's liquidity requirements, factors beyond the Company's control such as prevailing economic, financial and market conditions may prevent the Company from doing so.

Under this program, certain of the Company's receivables are sold to Ferro Finance Corporation (FFC), a wholly-owned unconsolidated qualified special purpose entity (QSPE), as defined by Statement of Financial Accounting Standards No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, (FAS No. 140). FFC finances its acquisition of trade accounts receivables assets by issuing beneficial interests to multi-seller receivables securitization companies (commercial paper conduits). At December 31, 2005, \$1.0 million had been advanced to the Company, net of repayments, under this program. During the three months ended March 31, 2006, \$259.6 million of accounts receivable were sold under this program and \$259.4 million of receivables were collected and remitted to FFC and the commercial paper conduits, resulting in a net increase in advances of \$0.2 million and total advances outstanding at March 31, 2006, of \$1.2 million.

Consignment Arrangements. The Company consigns, from various financial institutions, precious metals (primarily silver, gold, platinum and palladium, collectively metals) used in the production of certain products for customers. Under these consignment arrangements, the financial institutions provide the Company with metals for a specified period of one year or less in duration, for which the Company pays a fee. Under these arrangements, the financial

institutions own the metals, and accordingly, the Company does not report these consigned materials as part of its inventory on its consolidated balance sheet. These agreements are cancelable by either party at the end of each consignment period, however, because the

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Company has access to a number of consignment arrangements with available capacity, consignment needs can be shifted among the other participating institutions. At March 31, 2006, the Company had 5.2 million troy ounces of metals (primarily silver) on consignment for periods of less than one year with a market value of \$100.9 million. Beginning in the fourth quarter of 2005, certain participating institutions required cash deposits to provide additional collateral beyond the underlying precious metals. At March 31, 2006, the Company had outstanding deposits of \$79.0 million. The Company expects, by year end, to reduce the amount of material under consignment requiring cash deposits and anticipates that substantially all of the deposits will be returned in the first quarter of 2007. The Company expects the requirement by various financial institutions for cash deposits will be eliminated during 2007.

Other Financing Arrangements

In addition, the Company maintains other lines of credit and receivable sales programs to provide global flexibility for the Company's liquidity requirements. Most of these facilities, including receivable sales programs, are uncommitted lines for the Company's international operations.

Liquidity

The Company's level of debt and debt service requirements could have important consequences to its business operations and uses of cash flows. In addition, a reduction in overall demand for the Company's could adversely affect cash flows. At September 30, 2006, the Company had a \$250 million revolving credit facility of which \$74.1 million was available. This liquidity, along with liquidity from other financing arrangements, available cash flows from operations, and asset sales, should allow the Company to meet its funding requirements and other commitments.

Critical Accounting Policies

Please refer to the Company's Annual Report on Form 10-K for the year ended December 31, 2005, for a detailed description of Critical Accounting Policies.

Newly Adopted Accounting Pronouncement

On January 1, 2006, the Company adopted FASB Statement No. 123 (revised 2004), Share-Based Payment, (FAS No. 123R), utilizing the modified prospective method as described in FAS No. 123R. Under the modified prospective transition method, the Company recognizes compensation expense based on the fair value at grant date of all stock-based awards granted after the effective date and all unvested awards granted prior to the effective date. Prior to adoption, the Company accounted for stock options under Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, and accordingly, the Company recognized no compensation expense when the stock option exercise price equaled the per share fair market value of the Company's stock on the date of grant.

The Company uses the Black-Scholes option pricing model to calculate the fair value of its stock options that is used as the basis for determining stock-based compensation expense. The Black-Scholes option pricing model requires assumptions regarding the volatility of the Company's stock, the expected life of the stock option, and the Company's dividend yield. The Company primarily uses historical data to determine the assumptions used in the Black-Scholes option pricing model and has no reason to believe that future data is likely to differ materially from historical data. However, changes in the assumptions to reflect future stock price volatility, future dividend payments and future stock option exercise experience could result in a change in the assumptions used to value stock options in the future and may result in a material change to the fair value calculation of its stock options.

The Company recognized \$0.7 million in stock-based compensation expense related to stock options during the three months ended March 31, 2006. Unvested, and therefore unrecognized, stock-based compensation expense related to stock options was \$7.0 million at March 31, 2006, and had a total weighted average remaining term of 2.9 years.

Risk Factors

Certain statements contained here and in future filings with the SEC reflect the Company's expectations with respect to future performance and constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These statements are subject to a

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variety of uncertainties, unknown risks and other factors concerning the Company's operations and business environment, which are difficult to predict and are beyond the control of the Company. Please refer to the Company's Annual Report on Form 10-K for the year ended December 31, 2005, for a detailed description of such uncertainties, risks and other factors under the heading "Risk Factors."

Item 3. Quantitative and Qualitative Disclosures About Market Risk

The Company's exposure to market risks is primarily limited to fluctuations in interest rates, foreign currency exchange rates, and costs of raw materials and natural gas.

Ferro's exposure to interest rate risk relates primarily to its debt portfolio, including obligations under the accounts receivable securitization program. The Company's interest rate risk management objective is to limit the effect of interest rate changes on earnings, cash flows and overall borrowing costs, while preserving flexibility regarding utilization of excess cash. In managing the percentage of fixed versus variable rate debt, consideration is given to the interest rate environment and forecasted cash flows. This policy limits exposure from rising interest rates and allows the Company to benefit during periods of falling rates. The Company's interest rate exposure is generally dependent on the amounts outstanding under the revolving credit facility and the asset securitization program. Based on the amount of variable-rate indebtedness outstanding at March 31, 2006, a 1% increase or decrease in interest rates would have resulted in a \$2.9 million corresponding change in annual interest expense. At March 31, 2006, the Company had \$354.4 million carrying value of fixed rate debt outstanding with an average effective interest rate of 8.6%, substantially all maturing after 2008. The fair value of these debt securities was approximately \$352.5 million at March 31, 2006. During July and August 2006, the bondholders accelerated the payment of the principal amount of the Company's fixed-rate debentures, of which \$155 million was outstanding. The debentures were repaid through use of the term loan portion of the New Credit Facility (see further information included under Liquidity and Capital Resources under Item 2 of this Form 10-Q), which increased the level of floating-rate debt.

Ferro manages its currency risks principally by entering into forward contracts to mitigate the impact of currency fluctuations on transaction and other exposures. At March 31, 2006, the Company held forward contracts with a notional amount of \$112.6 million and an aggregate fair value of \$0.1 million. A 10% appreciation of the U.S. dollar would have resulted in a \$0.2 million increase in the fair value of these contracts in the aggregate at March 31, 2006. A 10% depreciation of the U.S. dollar would have resulted in a \$0.3 million decrease in the fair value of these contracts in the aggregate at March 31, 2006.

The Company is also subject to cost changes with respect to its raw materials and natural gas purchases. The Company attempts to mitigate the effect on margins from raw materials cost increases with price increases to the Company's customers. In addition, the Company purchases portions of its natural gas requirements under fixed price contracts, over short time periods, to reduce the volatility of this cost. At March 31, 2006, contracts for 0.9 million MMBTU's of natural gas had a fair value of \$(0.8) million. A 10% increase or decrease in the forward prices of natural gas would have resulted in a \$0.8 million corresponding change in the fair value of the contracts as of March 31, 2006. The Company also hedges a portion of its exposure to changes in the pricing of certain nickel and zinc commodities using derivative financial instruments. The hedges are accomplished principally through swap arrangements that allow the Company to fix the pricing of the commodities for future purchases. At March 31, 2006, nickel and zinc contracts for 3,079 metric tons had a fair value of \$1.8 million. A 10% increase or decrease in the forward prices of nickel and zinc would have resulted in a \$0.9 million corresponding change in the fair value of the contracts as of March 31, 2006.

Item 4. Controls and Procedures

For a discussion of the Company's Controls and Procedures, see Item 9A in the Company's Annual Report on Form 10-K for the year ended December 31, 2005, which is incorporated herein by reference.

Evaluation of Disclosure Controls and Procedures

The Company's management, under the supervision and with the participation of the Chief Executive Officer and the Chief Financial Officer, evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures as of March 31, 2006. Based on that evaluation, management concluded that the disclosure controls and procedures were not effective as of March 31, 2006.

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Procedures were undertaken in order for management to conclude that reasonable assurance exists regarding the reliability of the Condensed Consolidated Financial Statements contained in this filing. Accordingly, management believes that the Condensed Consolidated Financial Statements included in this Form 10-Q present fairly, in all material respects, the financial position, results of operations and cash flows for the periods presented.

Changes in Internal Control over Financial Reporting

As disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2005, the Company initiated a number of remediation activities during 2006 that materially improved, or were reasonably likely to improve, the Company's internal control over financial reporting. During the quarterly period ended March 31, 2006, the following remediation activities were taken in response to the material weaknesses identified by management:

Simplified attainment matrices underlying a major incentive compensation program; and

Continued migration of the Company's various stand-alone information systems to the global SAP platform with the objective of having one integrated system with improved corporate oversight.

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PART II OTHER INFORMATION

Item 1. Legal Proceedings

The information regarding legal proceedings included in Note 10 and Note 17 to the Condensed Consolidated Financial Statements is incorporated herein by reference.

Item 1A. Risk Factors

There are no changes to the risk factors disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2005.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

No change.

Item 3. Defaults Upon Senior Securities

The Company's prior revolving credit agreement required the Company and its material subsidiaries, as the result of Moody's rating downgrade in March 2006, to grant, within 30 days from the rating downgrade, security interests in their tangible and intangible assets (with the exception of the receivables sold as part of the Company's asset securitization program), pledge 100% of the stock of domestic material subsidiaries and pledge 65% of the stock of foreign material subsidiaries, in each case, in favor of the lenders under the senior credit facility. This lien grant and pledge of stock was substantially completed in April 2006. Liens on principal domestic manufacturing properties and the stock of domestic subsidiaries were also granted to and shared with the holders of the Company's senior notes and debentures, as required by their indentures. In June 2006, the Company replaced the prior revolving credit agreement with a new credit facility.

In March and April 2006, the Company received notices of default from a holder and the Trustee of the Company's senior notes and debentures, listed below, with an aggregate principal amount of \$355 million. The notices of default related to reporting requirements. The carrying value of the notes and debentures was not materially different from the principal amounts originally issued. Under the terms of the indentures, the Company had 90 days from the notices of default to cure the deficiencies identified in the notices of default or obtain waivers, or events of default would have occurred and the holders of the senior notes or debentures or the Trustee could declare the principal immediately due and payable. At the end of these periods, the deficiencies had not been cured and waivers had not been obtained. During July and August 2006, the bondholders accelerated the payment of the principal amount of the debentures, of which \$155 million was outstanding, and the Company financed the accelerated repayments by use of the term loan portion of the aforementioned new credit facility.

Notes and debentures included in the notices of default:

\$200 million 9.125% Senior Notes due January 1, 2009

\$25 million 7.625% Debentures due May 1, 2013

\$25 million 7.375% Debentures due November 1, 2015

\$50 million 8.0% Debentures due June 15, 2025

\$55 million 7.125% Debentures due April 1, 2028

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

Not applicable.

Item 5. Other Information

None.

Item 6. Exhibits

The exhibits listed in the attached Exhibit Index are filed pursuant to Item 6(a) of Form 10-Q.

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SIGNATURES

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

FERRO CORPORATION
(Registrant)

Date: December 8, 2006

(2,231

)

Corporate activities

3,777

4,425

8,529

9,886

Interest income

(101

)

(74

)

(238

)

(174

)

Interest expense

2,608

2,117

7,031

6,281

Other expense

527

248

1,308

922

Restructuring charges

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175

255

999

817

Impairment recoveries

—

(24,467

)

(35

)

(29,098

)

Total costs and expenses

308,563

273,247

932,296

916,215

Income from continuing operations before income taxes

49,600

65,852

66,972

113,465

Income tax expense

10,806

20,010

15,282

32,929

Income from continuing operations

38,794

45,842

51,690

80,536

Income (loss) from discontinued operations

(246

)

(101

)

403

(408

)

Net income

38,548

45,741

52,093

80,128

Net income attributable to non-redeemable noncontrolling
interest

(1,287

)

(1,084

)

(890

)

(747

)

Net loss attributable to redeemable noncontrolling interest

128

—

289

—

Net income attributable to Viad

\$

37,389

\$

44,657

\$

51,492

\$

79,381

Diluted income (loss) per common share:

Continuing operations attributable to Viad common stockholders

\$

1.84

\$

2.19

\$

2.49

\$

3.91

Discontinued operations attributable to Viad common stockholders

(0.01

)

—

0.02

(0.02

)

Net income attributable to Viad common stockholders

\$

1.83

\$

2.19

\$

2.51

\$

3.89

Weighted-average outstanding and potentially dilutive common

shares

20,387

20,436

20,427

20,382

Basic income (loss) per common share:

Continuing operations attributable to Viad common stockholders

\$

1.85

\$

2.19

\$

2.50

\$

3.91

Discontinued operations attributable to Viad common stockholders

(0.01

)

—

0.02

(0.02

)

Net income attributable to Viad common stockholders

\$

1.84

\$

2.19

\$

2.52

\$

3.89

Weighted-average outstanding common shares

20,145

20,166

20,187

20,130

Dividends declared per common share

\$

0.10

\$

0.10

\$

0.30

\$

0.30

Amounts attributable to Viad common stockholders

Income from continuing operations

\$

37,635

\$

44,758

\$

51,089

\$

79,789

Income (loss) from discontinued operations

(246

)

(101

)

403

(408

)

Net income

\$

37,389

\$

44,657

\$

51,492

\$

79,381

Refer to Notes to Condensed Consolidated Financial Statements.

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VIAD CORP

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

(in thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Net income	\$38,548	\$45,741	\$52,093	\$80,128
Other comprehensive income (loss):				
Unrealized gains on investments, net of tax ⁽¹⁾	—	48	—	143
Unrealized foreign currency translation adjustments, net of tax ⁽¹⁾	3,340	9,115	(7,864)	18,820
Change in net actuarial gain, net of tax ⁽¹⁾	(1,570)	103	(721)	385
Change in prior service cost, net of tax ⁽¹⁾	186	(67)	6	(201)
Adoption of ASU 2016-01	—	—	(616)	—
Comprehensive income	40,504	54,940	42,898	99,275
Comprehensive income attributable to non-redeemable noncontrolling interest	(1,287)	(1,084)	(890)	(747)
Comprehensive loss attributable to redeemable noncontrolling interest	128	—	289	—
Comprehensive income attributable to Viad	\$39,345	\$53,856	\$42,297	\$98,528

⁽¹⁾The tax effect on other comprehensive income (loss) is not significant.
Refer to Notes to Condensed Consolidated Financial Statements.

VIAD CORP

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(in thousands)	Nine Months Ended September 30,	
	2018	2017
Cash flows from operating activities		
Net income	\$52,093	\$80,128
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	44,364	42,499
Deferred income taxes	3,182	318
(Income) loss from discontinued operations	(403)	408
Restructuring charges	999	817
Impairment recoveries	(35)	(29,098)
(Gains) losses on dispositions of property and other assets	(135)	465
Share-based compensation expense	5,056	9,484
Other non-cash items, net	3,553	3,603
Change in operating assets and liabilities (excluding the impact of acquisitions):		
Receivables	(21,289)	(25,966)
Inventories	(2,792)	(726)
Current contract costs	(11,928)	(6,122)
Accounts payable	12,972	18,998
Restructuring liabilities	(1,330)	(1,748)
Accrued compensation	(12,275)	(7,455)
Contract liabilities	28,045	9,742
Income taxes payable	(9,580)	16,058
Other assets and liabilities, net	11,113	3,238
Net cash provided by operating activities	101,610	114,643
Cash flows from investing activities		
Capital expenditures	(69,596)	(39,493)
Proceeds from insurance	—	31,570
Cash paid for acquired businesses, net	—	(1,661)
Proceeds from dispositions of property and other assets	1,320	734
Net cash used in investing activities	(68,276)	(8,850)
Cash flows from financing activities		
Proceeds from borrowings	101,336	60,574
Payments on debt and capital lease obligations	(113,429)	(128,808)
Dividends paid on common stock	(6,128)	(6,119)
Debt issuance costs	—	(5)
Common stock purchased for treasury	(10,240)	(1,272)
Proceeds from exercise of stock options	84	—
Net cash used in financing activities	(28,377)	(75,630)
Effect of exchange rate changes on cash and cash equivalents	(3,210)	2,418
Net change in cash and cash equivalents	1,747	32,581

Cash and cash equivalents, beginning of year	53,723	20,900
Cash and cash equivalents, end of period	\$55,470	\$53,481

Refer to Notes to Condensed Consolidated Financial Statements.

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VIAD CORP

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 1. Overview and Basis of Presentation

Nature of Business

We are an international experiential services company with operations principally in the United States, Canada, the United Kingdom, continental Europe, and the United Arab Emirates. We are committed to providing unforgettable experiences to our clients and guests. We operate through three reportable business segments: GES U.S., GES International (collectively, “GES”), and Pursuit.

GES

GES is a global, full-service provider for live events. GES’ clients include event organizers and corporate brand marketers. Event organizers schedule and run the event from start to finish. Corporate brand marketers include exhibitors and domestic and international corporations that want to promote their brands, services and innovations, feature new products, and build business relationships. GES serves corporate brand marketers when they exhibit at shows and when GES is engaged to manage their global exhibit program or produce their proprietary corporate events.

Services and Products Offered

GES offers a full suite of services and products for event organizers and corporate brand marketers through three main lines of business:

- **Core Services.** GES provides official contracting services and products, including the design and production of experiences, material handling, rigging, electrical, and other on-site services.
- **Audio-Visual.** GES offers a variety of high-impact multi-media services and technology, including video and lighting production, digital studio services, entertainment services and talent coordination, projection mapping, and computer rental and support.
- **Event Technology.** GES offers a comprehensive range of event technology services, including event accommodation solutions, registration and data analytics, and event management tools.

Markets Served

GES provides the above services and products across four live event markets: Exhibitions, Conferences, Corporate Events, and Consumer Events (collectively, “Live Events”).

- **Exhibitions** facilitate business-to-business and business-to-consumer sales and marketing.
- **Conferences** facilitate attendee education and may also include an expo or trade show to further facilitate attendee education and to facilitate business-to-business and business-to-consumer sales and marketing.
- **Corporate events** facilitate attendee education of the sponsoring company’s products or product ecosystem.

Consumer events entertain, educate, or create an experience, typically around a specific genre.
Pursuit

Pursuit is a collection of iconic natural and cultural destination travel experiences that enjoy perennial demand. Pursuit offers guests distinctive and world renowned experiences through its collection of unique hotels, lodges, recreational attractions, and transportation services.

Services and Products Offered

Pursuit comprises four lines of business: Attractions, including food and beverage services and retail operations; Hospitality, including food and beverage services and retail operations; Transportation; and Travel Planning. Services offered by these lines of business (or a subset of these) include accommodations, admissions, transportation, and travel planning. Products offered include food and beverage and retail.

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Markets Served

Pursuit provides the above services and products across the following geographic markets:

• **Banff Jasper Collection.** The Banff Jasper Collection is a leading travel and tourism provider in the Canadian Rockies in Alberta, Canada with two lodging properties in Banff National Park, one lodging property in Jasper National Park, five world-class recreational attractions, food and beverage services, retail operations, sightseeing and transportation services.

• **Alaska Collection.** The Alaska Collection is a leading travel and tourism provider in Alaska with two lodging properties and a sightseeing excursion in Denali National Park and Preserve, a lodge in Talkeetna, Alaska's top-rated wildlife and glacier cruise, and two lodging properties located near Kenai Fjords National Park. The Alaska Collection also provides food and beverage services and retail operations.

• **Glacier Park Collection.** The Glacier Park Collection is an operator of seven lodging properties, 12 retail shops, and 11 dining outlets in and around Glacier National Park in Montana, and Waterton Lakes National Park in Alberta, Canada, with a leading share of rooms in that market.

FlyOver:

o FlyOver Canada, located in Vancouver, British Columbia, is a recreational attraction that provides a virtual flight ride experience that combines motion seating, spectacular media, and visual effects including wind, scents, and mist to give the unforgettable experience of flying across Canada.

o FlyOver Iceland is a recreational attraction under construction in Reykjavik, Iceland that will provide a virtual flight ride experience over some of Iceland's most spectacular scenery and natural wonders with the same effects as FlyOver Canada. The new attraction is expected to open in 2019.

Basis of Presentation

Viad's accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") and with the instructions to Form 10-Q and Article 10 of Regulation S-X for interim financial information. Accordingly, these financial statements do not include all of the information required by GAAP or SEC rules and regulations for complete financial statements. These financial statements reflect all adjustments (consisting of normal recurring adjustments) necessary for a fair presentation of the results for the interim periods presented. Interim results are not necessarily indicative of the results for the full year. We have recast certain prior period amounts to conform to the current period presentation due to the adoption of new accounting standards. These unaudited condensed consolidated financial statements should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2017, filed with the SEC on February 28, 2018 ("2017 Form 10-K").

The condensed consolidated financial statements include the accounts of Viad and its subsidiaries. We have eliminated all significant intercompany account balances and transactions in consolidation.

Impact of Recent Accounting Pronouncements

The following table provides a brief description of recent accounting pronouncements:

Standard	Description	Date of adoption	Effect on the financial statements
Standards Not Yet Adopted			
ASU 2016-02, Leases (Topic 842)	<p>The amendment requires lessees to recognize on their balance sheet a right-of-use asset and a lease liability for leases with lease terms greater than one year. The amendment requires additional disclosures about leasing arrangements, and previously allowed for only a modified retrospective approach to adoption.</p> <p>Subsequent to the issuance of ASU 2016-02, the FASB issued additional updates, which do not change the core principle of the guidance stated in ASU 2016-02. Rather, the updates provide additional (and optional) transition methods including the election under ASU 2018-11, which allows companies to not restate comparative periods when initially applying the transition requirements. Early adoption is permitted.</p>	January 1, 2019	We are currently evaluating the potential impact the adoption of this new guidance will have on our financial position or results of operations including analyzing our existing operating leases. We do not expect our Consolidated Statement of Operations to be materially impacted. We expect the most significant impact will relate to facility and equipment leases, which are currently recorded as operating leases. Based on our leases in place as of September 30, 2018, we currently anticipate recognizing an additional right-of-use asset and lease liability on the balance sheet of approximately \$60 million upon adoption of the standard on January 1, 2019. We expect to adopt ASU 2018-11, which allows companies to use an optional transition method under which a cumulative adjustment to retained earnings is recorded in the period of adoption and prior periods are not restated. We are continuing our assessment, which may identify other impacts.
ASU 2018-14, Compensation – Retirement Benefits – Defined Benefit Plans – General (Topic 715-20) Disclosure Framework – Changes to the Disclosure Requirements for Defined Benefit Plans	<p>The amendment modifies and clarifies the disclosure requirements for employers that sponsor defined benefit pension or other postretirement plans. Early adoption is permitted and is to be applied on a retrospective basis to all periods presented.</p>	January 1, 2021	We are currently evaluating the potential impact of the adoption of this new guidance on our disclosures.
ASU 2018-15, Intangibles – Goodwill	The amendment aligns the requirements for capitalizing	January 1, 2020	We are currently evaluating the potential impact of the adoption of this new guidance on our

<p>and Other – Internal-Use Software (Subtopic 350-40) Customer’s Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract</p>	<p>implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software. The amendment also requires an entity to expense the capitalized implementation costs of a hosting arrangement that is a service contract over the term of the hosting arrangement. Early adoption is permitted and may be applied on either a retrospective or prospective basis.</p>	<p>consolidated financial statements and related disclosures.</p>
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Standard	Description	Date of adoption	Effect on the financial statements
Standards Recently Adopted			
ASU 2014-09, Revenue from Contracts with Customers (Topic 606)	The standard established a new recognition model that requires revenue to be recognized in a manner to depict the transfer of goods or services to a customer at an amount that reflects the consideration expected to be received in exchange for those goods or services.	January 1, 2018	We adopted ASU 2014-09 and its related amendments (collectively, "Topic 606") on January 1, 2018 using the modified retrospective transition method. We determined that the cumulative effect of initially applying the new standard as an adjustment to the opening balance of retained earnings was not material (less than \$0.2 million) and, therefore, we made no adjustment.
			The adoption of this standard did not have a material impact on our consolidated financial statements. The impact primarily related to the deferral of certain commissions which were previously expensed as incurred but are now capitalized and amortized over the period of contract performance, and the deferral of certain costs incurred in connection with trade shows which were previously expensed as incurred but are now capitalized and expensed upon the completion of the show. The new guidance resulted in expanded disclosures and processes to identify performance obligations. See additional transition disclosures immediately following this table and Note 2 – Revenue and Related Contract Costs and Contract Liabilities.
ASU 2016-01, Financial Instruments – Overall: Recognition and Measurement of Financial Assets and Financial Liabilities	The amendment includes a requirement for equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income.	January 1, 2018	We adopted this guidance prospectively in the first quarter of 2018 and recorded a cumulative-effect adjustment of \$0.6 million to increase beginning retained earnings.
ASU 2017-04, Intangibles - Goodwill and Other (Topic 350) – Simplifying the Test for Goodwill Impairment	The amendment eliminates the requirement to estimate the implied fair value of goodwill if it is determined that the carrying amount of a reporting unit exceeds its fair value. Goodwill impairment will now be recognized by the amount by which a reporting unit's carrying value exceeds its fair value, not to	January 1, 2018	We early adopted this new guidance on January 1, 2018 on a prospective basis. As a result, we expect the adoption to reduce the complexity surrounding the analysis of goodwill impairment during our annual goodwill impairment tests as of October 31, 2018, or if an event occurs or circumstances change that would more-likely-than-not reduce the fair value of a reporting unit below its carrying value.

exceed the carrying amount of goodwill. Early adoption was permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017.

<p>ASU 2017-07, Compensation - Retirement Benefits (Topic 715) – Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost</p>	<p>The amendment requires an employer to disaggregate the service cost components from the other components of net benefit cost. The service cost components are required to be presented in operating income and the other components of net benefit cost are required to be presented outside of operating income.</p>	<p>January 1, 2018</p>	<p>We adopted this new standard retrospectively on January 1, 2018. As a result, we recorded the nonservice cost component of net periodic benefit cost within other expense and reclassified from operating expenses (cost of services and corporate activities) to other expense \$0.2 million for the three months ended September 30, 2017 and \$0.9 million for the nine months ended September 30, 2017 to conform to current period presentation. For additional details on the impact this adoption had on our results of operations, see the disclosures immediately following this table.</p>
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<p>ASU 2018-02, Income Statement – Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income</p>	<p>The amendment addresses the effect of the Tax Cuts and Jobs Act (the “Tax Act”) on items within accumulated other comprehensive income (“AOCI”). Under current GAAP, the effects of changes in tax rates and laws on deferred tax balances are recorded as a component of income tax expense in the period in which the law was enacted. When deferred tax balances related to items originally recorded in AOCI are adjusted, certain tax effects become stranded in AOCI. This amendment allows a reclassification from AOCI to retained earnings for stranded tax effects. Early adoption was permitted.</p>	<p>September 30, 2018</p>	<p>We early adopted this new standard during the third quarter of 2018. As a result, we reclassified the income tax effects of the Tax Act of \$1.6 million from AOCI to retained earnings, with no net effect to total stockholders' equity. Refer to Note 16 – Income Taxes for additional information.</p>
<p>ASU 2018-05, Income Taxes (Topic 740) – Amendments to SEC paragraphs pursuant to SEC Staff Accounting Bulletin No. 118</p>	<p>This statement amends ASC 740 to incorporate the requirements of SEC Staff Accounting Bulletin No. 118, which provides guidance on accounting for the tax effects of the Tax Act for SEC registrants who do not have the necessary information available, prepared, or analyzed in reasonable detail to complete the accounting for certain income tax effects of the Tax Act.</p>	<p>Upon issuance</p>	<p>We recognized the provisional tax impacts of the Tax Act in the fourth quarter of 2017. During the three months ended September 30, 2018, we recorded a tax benefit of \$3.1 million to the provisional estimate included in the financial statements as of December 31, 2017 for the impact of the Tax Act. This amount is comprised of a reduction to our estimated taxes for the deemed mandatory repatriation of post-1986 undistributed foreign subsidiary earnings and profits and for the corporate tax rate reduction attributable to the return to provision adjustment for deferred taxes. We continue to anticipate finalizing our analysis during the fourth quarter of 2018. Refer to Note 16 – Income Taxes for additional information.</p>

Prior to January 1, 2018, we presented revenue in our Condensed Consolidated Statements of Operations in three separate line items as follows:

	Three Months Ended September 30, 2017	Nine Months Ended September 30, 2017
(in thousands)		

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Revenue:		
Exhibition and event services	\$ 198,868	\$ 750,111
Exhibits and environments	33,251	119,988
Pursuit services	106,980	159,581
Total revenue	\$ 339,099	\$ 1,029,680

In connection with the adoption of Topic 606, we changed the presentation of revenue in our Condensed Consolidated Statements of Operations and now present total services revenue and total products revenue. As a result, we changed the prior reporting period to conform to the current period presentation as follows:

	Three Months Ended September 30, 2017	Nine Months Ended September 30, 2017
(in thousands)		
Revenue:		
Services	\$ 286,752	\$ 896,574
Products	52,347	133,106
Total revenue	\$ 339,099	\$ 1,029,680

As a result of the change in presentation of revenue in the Condensed Consolidated Statements of Operations, we also made the following conforming changes to the presentation of cost of services and cost of products. The following table also summarizes the impact of adopting ASU 2017-07 on our Condensed Consolidated Statements of Operations:

	Three Months Ended September 30, 2017			
	As Previously Reported	Reclassifications to Conform with Revenue Presentation	ASU 2017-07	As Newly Reported
(in thousands)				
Cost of services	\$254,963	\$ (9,007)	\$ (199)	\$245,757
Cost of products	\$37,070	\$ 9,007	\$ —	\$46,077
Corporate activities	\$4,474	\$ —	\$ (49)	\$4,425
Other expense	\$—	\$ —	\$ 248	\$248

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(in thousands)	Nine Months Ended September 30, 2017			
	As Previously Reported	Reclassifications to Conform with Revenue Presentation	ASU 2017-07	As Newly Reported
Cost of services	\$813,456	\$ (4,436)	\$ (716)	\$808,304
Cost of products	\$117,072	\$ 4,436	\$ —	\$121,508
Corporate activities	\$10,092	\$ —	\$ (206)	\$9,886
Other expense	\$—	\$ —	\$ 922	\$922

Significant Accounting Policies

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reported period. Estimates and assumptions are used in accounting for, among other things, the fair value of our reporting units used to perform annual impairment testing of recorded goodwill; allowances for uncollectible accounts receivable; provisions for income taxes, including uncertain tax positions; valuation allowances related to deferred tax assets; liabilities for losses related to self-insured liability claims; liabilities for losses related to environmental remediation obligations; sublease income associated with restructuring liabilities; assumptions used to measure pension and postretirement benefit costs and obligations; assumptions used to determine share-based compensation costs under the fair value method; assumptions used to determine the redemption value of redeemable noncontrolling interests; and allocation of purchase price of acquired businesses. Actual results could differ from these and other estimates.

Revenue Recognition

Beginning January 1, 2018, revenue is measured based on a specified amount of consideration in a contract with a customer, net of commissions paid to customers and amounts collected on behalf of third parties. We recognize revenue when a performance obligation is satisfied by transferring control of a product or service to a customer.

GES' service revenue is primarily derived through its comprehensive range of services to event organizers and corporate brand marketers including Core Services, Audio-Visual, and Event Technology. GES' service revenue is earned over time over the duration of the exhibition, conference or corporate event, which generally lasts one to three days; however we use the practical expedient of recognizing service revenue at the close of the event when we have the right to invoice. GES' product revenue is derived from the build of exhibits and environments and graphics. GES' product revenue is recognized at a point in time upon delivery of the product.

Pursuit's service revenue is derived through its accommodations, admissions, transportation, and travel planning services. Pursuit's product revenue is derived through food and beverage and retail sales. Pursuit's revenue is recognized at the time services are performed or upon delivery of the product. Pursuit's service revenue is recognized over time as the customer simultaneously receives and consumes the benefits. Pursuit's product revenue is recognized at a point in time.

The impact of adopting Topic 606 on our unaudited Condensed Consolidated Statement of Operations was \$1.0 million reduction to cost of services and \$0.7 million increase to net income for the three months ended September 30, 2018 and \$2.6 million reduction to cost of services and \$1.9 million increase to net income for the nine months ended September 30, 2018.

Noncontrolling Interests

Non-redeemable noncontrolling interest represents the portion of equity in a subsidiary that is not attributable, directly or indirectly, to us. Our non-redeemable noncontrolling interest relates to the 20% equity ownership interest that we do not own in Glacier Park, Inc. We report non-redeemable noncontrolling interest within stockholders' equity in the Condensed Consolidated Balance Sheets. The amount of consolidated net income attributable to Viad and the non-redeemable noncontrolling interest is presented in the Condensed Consolidated Statements of Operations.

Noncontrolling interests with redemption features that are not solely within our control are considered redeemable noncontrolling interests. Our redeemable noncontrolling interest relates to our 54.5% equity ownership interest in Esja Attractions ehf. ("Esja"). The Esja shareholders agreement contains a put option that gives the minority Esja shareholders the right to sell (or "put") their Esja shares to us based on a calculated formula within a predefined term. This redeemable noncontrolling interest is considered temporary equity and we report it between liabilities and stockholders' equity in the Condensed Consolidated Balance Sheets. The amount of the net

income or loss attributable to redeemable noncontrolling interests is recorded in the Condensed Consolidated Statements of Operations and the accretion of the redemption value is recorded as an adjustment to retained earnings and is included in our earnings (loss) per share. Refer to Note 20 – Redeemable Noncontrolling Interest for additional information.

Insurance Recoveries

Receipts from insurance up to the amount of the recognized losses are considered recoveries and are accounted for when they are probable of receipt. Anticipated proceeds in excess of the recognized loss are considered a gain contingency. A contingency gain for anticipated insurance proceeds in excess of losses already recognized is not recognized until all contingencies relating to the insurance claim have been resolved.

Insurance proceeds allocated to business interruption gains are reported as cash flows from operating activities, and proceeds allocated to impairment recoveries are reported as cash flows from investing activities. Insurance proceeds used for capitalizable costs are classified as cash flows from investing activities, and proceeds used for non-capitalizable costs are classified as operating activities.

Note 2. Revenue and Related Contract Costs and Contract Liabilities

GES' performance obligations consist of services or product(s) outlined in a contract. While multi-year contracts are often signed for recurring events, the obligations for each occurrence are well defined and conclude upon the occurrence of each event. The obligations are typically the provision of services and/or sale of a product in connection with an exhibition, conference, or other event. Revenue for services is recognized when we have a right to invoice at the close of the exhibition, conference, or corporate event, which typically lasts one to three days. Revenue for consumer events is recognized over the duration of the event. Revenue for products is recognized either upon delivery to the customer's location, upon delivery to an event, or when we have the right to invoice, generally at the close of the exhibition, conference, or corporate event. Payment terms are generally within 30-60 days and contain no significant financing components.

Pursuit's performance obligations are short-term in nature. They include the provision of a hotel room, an attraction admission, a chartered or ticketed bus or van ride, the fulfillment of travel planning itineraries, and/or the sale of food, beverage, or retail products. Revenue is recognized when the service has been provided or the product has been delivered. When credit is extended, payment terms are generally within 30 days and contain no significant financing components.

Contract Liabilities

Customer deposits are typically received by GES and Pursuit prior to transferring the related product or service to the customer. These deposits are recorded as a contract liability and recognized as revenue upon satisfaction of the related contract performance obligation(s). GES also provides customer rebates and volume discounts to certain event organizers that are recorded as contract liabilities and are recognized as a reduction of revenue. These amounts are included in the Condensed Consolidated Balance Sheets under the caption "Contract liabilities."

Changes to contract liabilities are as follows:

(in thousands)

Balance at January 1, 2018	\$31,981
Cash additions	147,231
Revenue recognized	(120,477)

Foreign exchange translation adjustment	(475)
Balance at September 30, 2018	\$58,260
Contract Costs	

GES capitalizes certain incremental costs incurred in obtaining and fulfilling contracts. Capitalized costs principally relate to direct costs of materials and services incurred in fulfilling services of future exhibitions, conferences, and events, and also include up-front incentives and commissions incurred upon contract signing. Costs associated with preliminary contract activities (i.e. proposal activities) are expensed as incurred. Capitalized contract costs are expensed upon the transfer of the related goods or services and are included in cost of services or cost of products, as applicable. The deferred incremental costs of obtaining and fulfilling contracts are included in the Condensed Consolidated Balance Sheets under the captions “Current contract costs” and “Other investments and assets.” These amounts were previously reported in inventories under “Work in process.”

We elected to apply the following practical expedients related to performance obligations:

Not to disclose (i) the amount of consideration allocated to the remaining performance obligations (ii) an explanation of when we expect to recognize that amount as revenue as of December 31, 2017 and (iii) the value of unsatisfied performance obligations for contracts with an original duration of one year or less because the vast majority of our contract liabilities relate to future exhibitions and events that will occur within the next 12 months.

Changes to contract costs are as follows:

(in thousands)

Balance at January 1, 2018	\$16,878
Additions	53,580
Expenses	(40,641)
Cancelled	(109)
Foreign exchange translation adjustment	(539)
Balance at September 30, 2018	\$29,169

As of September 30, 2018, capitalized contract costs consisted of \$1.8 million to obtain contracts and \$27.4 million to fulfill contracts. We did not recognize an impairment loss with respect to capitalized contract costs for the nine months ended September 30, 2018.

Disaggregation of Revenue

The following tables disaggregate GES and Pursuit revenue by major product line, timing of revenue recognition, and markets served:

GES

(in thousands)	Three Months Ended September 30, 2018			
	GES U.S.	GES		Total
		International	Intersegment Eliminations	
Services:				
Core services	\$154,640	\$ 35,937	\$ —	\$190,577
Audio-visual	17,309	4,423	—	21,732
Event technology	4,874	1,745	—	6,619
Intersegment eliminations	—	—	(2,479)	(2,479)
Total services	176,823	42,105	(2,479)	216,449
Products:				
Core products	14,876	14,785	—	29,661
Total revenue	\$191,699	\$ 56,890	\$ (2,479)	\$246,110

Timing of revenue recognition:

Services transferred over time	\$176,823	\$ 42,106	\$ (2,479)	\$216,450
Products transferred over time ⁽¹⁾	10,281	3,226	—	13,507
Products transferred at a point in time	4,595	11,558	—	16,153
Total revenue	\$191,699	\$ 56,890	\$ (2,479)	\$246,110

Markets:				
Exhibitions	\$ 108,348	\$ 41,925	\$ —	\$ 150,273
Conferences	41,367	4,918	—	46,285
Corporate events	34,093	8,190	—	42,283
Consumer events	7,891	1,857	—	9,748
Intersegment eliminations	—	—	(2,479)	(2,479)
Total revenue	\$ 191,699	\$ 56,890	\$ (2,479)	\$ 246,110

⁽¹⁾GES' graphics product revenue is recognized over time as it is considered a part of the single performance obligation satisfied over time.

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(in thousands)	Nine Months Ended September 30, 2018			
	GES U.S.	GES International	Intersegment Eliminations	Total
Services:				
Core services	\$ 511,322	\$ 132,407	\$ —	\$ 643,729
Audio-visual	55,134	14,144	—	69,278
Event technology	23,443	7,866	—	31,309
Intersegment eliminations	—	—	(12,173)	(12,173)
Total services	589,899	154,417	(12,173)	732,143
Products:				
Core products	46,907	50,088	—	96,995
Total revenue	\$ 636,806	\$ 204,505	\$ (12,173)	\$ 829,138
Timing of revenue recognition:				
Services transferred over time	\$ 589,899	\$ 154,418	\$ (12,173)	\$ 732,144
Products transferred over time ⁽¹⁾	30,957	13,043	—	44,000
Products transferred at a point in time	15,950	37,044	—	52,994
Total revenue	\$ 636,806	\$ 204,505	\$ (12,173)	\$ 829,138
Markets:				
Exhibitions	\$ 364,016	\$ 150,623	\$ —	\$ 514,639
Conferences	163,782	28,805	—	192,587
Corporate events	89,347	21,620	—	110,967
Consumer events	19,661	3,457	—	23,118
Intersegment eliminations	—	—	(12,173)	(12,173)
Total revenue	\$ 636,806	\$ 204,505	\$ (12,173)	\$ 829,138

⁽¹⁾GES' graphics product revenue is recognized over time as it is considered a part of the single performance obligation satisfied over time.

Pursuit

(in thousands)	Three Months Ended September 30, 2018	Nine Months Ended September 30, 2018
Services:		
Accommodations	\$ 24,623	\$ 35,358
Admissions	51,316	78,375
Transportation	7,602	14,292
Travel planning	651	1,450
Intersegment eliminations	(554)	(1,260)
Total services revenue	83,638	128,215
Products:		
Food and beverage	16,074	23,998
Retail operations	12,341	17,917
Total products revenue	28,415	41,915
Total revenue	\$ 112,053	\$ 170,130
Timing of revenue recognition:		
Services transferred over time	\$ 83,638	\$ 128,215
Products transferred at a point in time	28,415	41,915
Total revenue	\$ 112,053	\$ 170,130
Markets:		
Banff Jasper Collection	\$ 58,525	\$ 94,133
Alaska Collection	25,546	36,373
Glacier Park Collection	23,418	30,684
FlyOver	4,564	8,940
Total revenue	\$ 112,053	\$ 170,130

Balance Sheet Reclassifications

In connection with the adoption of Topic 606, effective January 1, 2018, we made the following reclassifications to separately present contract costs and contract liabilities on the Condensed Consolidated Balance Sheet as of December 31, 2017:

(in thousands)	December 31, 2017		
	As Previously Reported	Reclassifications	As Adjusted
Cash and cash equivalents	\$53,723	—	\$53,723
Accounts receivable, net	104,811	—	104,811
Inventories ⁽¹⁾	30,372	(12,822)	17,550
Current contract costs ⁽¹⁾	—	13,436	13,436
Other current assets ⁽¹⁾	21,030	(1,289)	19,741
Property and equipment, net	305,571	—	305,571
Other investments and assets ⁽¹⁾	47,512	675	48,187
Deferred income taxes	23,548	—	23,548
Goodwill	270,551	—	270,551
Other intangible assets, net	62,781	—	62,781
Total assets	\$919,899	—	\$919,899
Accounts payable	\$77,380	—	\$77,380
Customer deposits ⁽²⁾	33,415	(33,415)	—
Contract liabilities ⁽²⁾	—	31,981	31,981
Accrued compensation	30,614	—	30,614
Other current liabilities ⁽²⁾	38,720	1,434	40,154
Debt and capital lease obligations, current and long-term	209,192	—	209,192
Pension and postretirement benefits	28,135	—	28,135
Other deferred items and liabilities	52,858	—	52,858
Total liabilities	470,314	—	470,314
Redeemable noncontrolling interest	6,648	—	6,648
Total stockholders' equity ⁽³⁾	442,937	—	442,937
Total liabilities and stockholders' equity	\$919,899	—	\$919,899

⁽¹⁾Contract costs primarily consist of deferred core services costs (including labor and vendor purchases) required to service future exhibitions, conferences and other events, and commission expenses incurred to obtain contracts. All such costs were previously included in “Inventories” and in certain other assets. As a result of the changes noted above, deferred core services costs related to exhibitions and events that are scheduled to occur longer than one year in the future are currently included in “Other investments and assets”. The impact of this change reduced total current assets at December 31, 2017 by \$0.7 million. The amount of deferred core services costs included in “Other investments and assets” at September 30, 2018 was \$4.4 million.

⁽²⁾In connection with the adoption of Topic 606, we elected to more prominently present contract liabilities on the Consolidated Balance Sheets. Consequently, customer deposits of \$33.4 million as of December 31, 2017, have been reclassified to “Contract liabilities” and to other certain current liabilities to conform to the current period presentation.

⁽³⁾

We determined that the cumulative effect of initially applying Topic 606 as an adjustment to the opening balance of retained earnings was not material, and therefore we made no adjustment.

Note 3. Share-Based Compensation

The following table summarizes share-based compensation expense:

(in thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Performance unit incentive plan (“PUP”)	\$1,607	\$3,941	\$3,125	\$7,184
Restricted stock	609	672	1,779	2,069
Restricted stock units	78	124	152	231
Share-based compensation before income tax benefit	2,294	4,737	5,056	9,484
Income tax benefit	(580)	(1,752)	(1,276)	(3,524)
Share-based compensation, net of income tax benefit	\$1,714	\$2,985	\$3,780	\$5,960

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We did not record any share-based compensation expense through restructuring charges during the three and nine months ended September 30, 2018 or 2017.

The following table summarizes the activity of the outstanding share-based compensation awards:

	PUP Awards		Restricted Stock		Restricted Stock Units	
	Weighted-Average		Weighted-Average		Weighted-Average	
	Grant Date		Grant Date		Grant Date	
	Shares	Fair Value	Shares	Fair Value	Shares	Fair Value
Balance at December 31, 2017	239,338	\$ 32.80	206,899	\$ 33.16	12,750	\$ 30.94
Granted	76,925	\$ 52.03	49,608	\$ 52.34	3,898	\$ 52.54
Vested	(75,761)	\$ 27.29	(72,934)	\$ 27.41	(4,300)	\$ 27.35
Forfeited	(693)	\$ 51.22	(6,500)	\$ 39.95	(258)	\$ 37.69
Balance at September 30, 2018	239,809	\$ 40.65	177,073	\$ 40.66	12,090	\$ 39.04

Viad Corp Omnibus Incentive Plan

We grant share-based compensation awards to our officers, directors, and certain key employees pursuant to the 2017 Viad Corp Omnibus Incentive Plan (the “2017 Plan”). The 2017 Plan has a 10-year life and provides for the following types of awards: (a) incentive and non-qualified stock options; (b) restricted stock and restricted stock units; (c) performance units or performance shares; (d) stock appreciation rights; (e) cash-based awards; and (f) certain other stock-based awards. In June 2017, we registered 1,750,000 shares of common stock issuable under the 2017 Plan. As of September 30, 2018, there were 1,666,111 shares available for future grant under the 2017 Plan.

PUP Awards

The vesting of PUP award shares is based upon achievement of certain performance-based criteria. The performance period of the shares is three years.

During the nine months ended September 30, 2018, we granted PUP awards with a grant date fair value of \$4.0 million of which \$1.6 million are payable in shares. Liabilities related to PUP awards were \$7.6 million as of September 30, 2018 and \$11.0 million as of December 31, 2017. In March 2018, PUP awards granted in 2015 vested and we distributed cash payouts of \$5.9 million. In March 2017, PUP awards granted in 2014 vested and we distributed cash payouts of \$3.7 million.

Restricted Stock

As of September 30, 2018, the unamortized cost of outstanding restricted stock awards was \$3.1 million, which we expect to recognize over a weighted-average period of approximately 1.2 years. We repurchased 21,767 shares for \$1.2 million during the nine months ended September 30, 2018 and 26,916 shares for \$1.3 million during the nine months ended September 30, 2017 related to tax withholding requirements on vested share-based awards.

Restricted Stock Units

Aggregate liabilities related to restricted stock units were \$0.4 million as of September 30, 2018 and \$0.5 million as of December 31, 2017. In February 2018, the 2015 restricted stock units vested and we distributed \$0.2 million in cash payouts. In February 2017, portions of the 2012 and 2014 restricted stock units vested and we distributed \$0.3 million in cash payouts.

Stock Options

The following table summarizes stock option activity:

		Weighted-Average	
	Shares	Exercise Price	
Options outstanding and exercisable at December 31, 2017	63,773	\$	16.62
Exercised	(5,084)	\$	16.62
Options outstanding and exercisable at September 30, 2018	58,689	\$	16.62

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Note 4. Acquisition of Business

Esja

On November 3, 2017, we acquired the controlling interest (54.5% of the common stock) in Esja, a private corporation in Reykjavik, Iceland. Through Esja, we are developing and will operate a new FlyOver Iceland attraction, which we expect to open in 2019. The purchase price was €8.2 million (approximately \$9.5 million) in cash, and the shareholders agreement includes a put option that gives the minority Esja shareholders the right to sell (or “put”) their Esja shares to us based on a calculated formula within a predefined term. The noncontrolling interest’s carrying value is determined by the fair value of the noncontrolling interest as of the acquisition date, the noncontrolling interest’s share of the subsequent net income or loss, and the accretion of the redemption value of the put option. As of the transaction date, the fair value of the noncontrolling interest was estimated to be \$6.7 million. The fair value of the noncontrolling interest was finalized as of March 31, 2018. During the three months ended September 31, 2018, we made a purchase price allocation adjustment to goodwill of \$0.1 million. Refer to Note 20 – Redeemable Noncontrolling Interest for additional information.

Under the acquisition method of accounting, the purchase price is allocated to the assets acquired and liabilities assumed based on their estimated fair values. The excess purchase price over fair value of net assets acquired is recorded as goodwill. Goodwill is included in the Pursuit business group and the primary factor that contributed to the purchase price resulting in the recognition of goodwill relates to future expected income from operations after opening in 2019. Goodwill is deductible for tax purposes. Transaction costs associated with the Esja acquisition were \$0.1 million in 2018 and 2017, which are included in corporate activities in the Condensed Consolidated Statements of Operations.

The Esja results of operations have been included in the condensed consolidated financial statements from the date of acquisition. Esja had operating losses, representing start-up costs, of \$0.4 million during the three months ended September 30, 2018 and \$0.8 million during the nine months ended September 30, 2018.

Note 5. Inventories

The components of inventories consisted of the following:

(in thousands)	September 30, 2018	December 31, 2017
Raw materials	\$ 18,703	\$ 17,550
Work in process ⁽¹⁾	—	—
Inventories	\$ 18,703	\$ 17,550

⁽¹⁾Upon the adoption of Topic 606, the deferred incremental costs of obtaining and fulfilling contracts that were previously reported in Inventories under “Work in process” are currently reported under “Current contract costs” and “Other investments and assets.” Refer to Note 2 – Revenue and Related Contract Costs and Contract Liabilities for additional information.

Note 6. Other Current Assets

Other current assets consisted of the following:

(in thousands)	September 30, 2018	December 31, 2017
Income tax receivable	\$ 6,809	\$ 4,237
Prepaid vendor payments	6,225	5,048
Prepaid software maintenance	4,350	3,386
Prepaid insurance	3,708	2,610
Prepaid taxes	819	912
Prepaid rent	791	730
Prepaid other	2,858	2,172
Other	147	646
Other current assets	\$ 25,707	\$ 19,741

Note 7. Property and Equipment

Property and equipment consisted of the following:

(in thousands)	September 30, 2018	December 31, 2017
Land and land interests	\$ 33,349	\$ 32,544
Buildings and leasehold improvements	248,873	222,118
Equipment and other	377,703	351,676
Gross property and equipment	659,925	606,338
Accumulated depreciation	(327,920)	(300,767)
Property and equipment, net	\$ 332,005	\$ 305,571

Depreciation expense was \$13.3 million for the three months ended September 30, 2018 and \$35.9 million for the nine months ended September 30, 2018. Depreciation expense was \$12.5 million for the three months ended September 30, 2017 and \$32.9 million for nine months ended September 30, 2017.

Property and equipment acquired under capital leases increased \$2.9 million during the nine months ended September 30, 2018 and \$1.1 million during the nine months ended September 30, 2017. Property and equipment purchased through accounts payable and accrued liabilities increased \$4.4 million during the nine months ended September 30, 2018 and \$0.8 million for the nine months ended September 30, 2017.

Note 8. Other Investments and Assets

Other investments and assets consisted of the following:

(in thousands)	September 30, 2018	December 31, 2017
Cash surrender value of life insurance	\$ 23,142	\$ 23,947
Self-insured liability receivable	10,442	10,442
Contract costs ⁽¹⁾	4,373	3,442
Workers' compensation insurance security deposits	—	3,550
Other mutual funds	2,900	2,637
Other	3,670	4,169
Other investments and assets	\$ 44,527	\$ 48,187

⁽¹⁾Upon the adoption of Topic 606, the deferred incremental costs of obtaining and fulfilling contracts that were previously reported in Inventories under "Work in process" are currently reported under "Current contract costs" and "Other investments and assets." Refer to Note 2 – Revenue and Related Contract Costs and Contract Liabilities for

additional information.

Note 9. Goodwill and Other Intangible Assets

The changes in the carrying amount of goodwill are as follows:

(in thousands)	GES			Total
	GES U.S.	International	Pursuit	
Balance at December 31, 2017	\$148,277	\$ 38,840	\$83,434	\$270,551
Foreign currency translation adjustments	—	(1,268)	(2,479)	(3,747)
Purchase price allocation adjustments	—	—	(73)	(73)
Balance at September 30, 2018	\$148,277	\$ 37,572	\$80,882	\$266,731

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Other intangible assets consisted of the following:

(in thousands)	Useful Life (Years)	September 30, 2018			December 31, 2017		
		Gross Carrying Value	Accumulated Amortization	Net Carrying Value	Gross Carrying Value	Accumulated Amortization	Net Carrying Value
Intangible assets subject to amortization:							
Customer contracts and relationships	7.9	\$68,386	\$ (29,747)	\$ 38,639	\$68,798	\$ (23,696)	\$ 45,102
Operating contracts and licenses	25.7	9,703	(1,434)	8,269	9,951	(1,094)	8,857
Tradenames	6.4	8,620	(3,612)	5,008	8,633	(2,873)	5,760
Non-compete agreements	1.7	5,294	(3,868)	1,426	5,363	(3,007)	2,356
Other	8.1	1,691	(788)	903	896	(650)	246
Total amortized intangible assets		93,694	(39,449)	54,245	93,641	(31,320)	62,321
Indefinite-lived intangible assets:							
Business licenses		460	—	460	460	—	460
Other intangible assets		\$94,154	\$ (39,449)	\$ 54,705	\$94,101	\$ (31,320)	\$ 62,781

Intangible asset amortization expense was \$2.9 million for the three months ended September 30, 2018 and \$8.4 million for the nine months ended September 30, 2018. Intangible asset amortization expense was \$3.3 million for the three months ended September 30, 2017 and \$9.6 million for the nine months ended September 30, 2017.

The estimated future amortization expense related to intangible assets subject to amortization held at September 30, 2018 is as follows:

(in thousands)	
Year ending December 31,	
Remainder of 2018	\$2,611
2019	9,962
2020	8,467
2021	7,477
2022	5,942
Thereafter	19,786
Total	\$54,245

Note 10. Other Current Liabilities

Other current liabilities consisted of the following:

(in thousands)	September 30, 2018	December 31, 2017
Continuing operations:		
Self-insured liability	\$ 6,219	\$ 6,208
Commissions payable	5,536	3,235
Accrued sales and use taxes	4,931	2,431
Accrued employee benefit costs	4,043	2,915
Accrued income tax payable	3,130	7,518
Accrued dividends	2,084	2,094
Current portion of pension and postretirement liabilities	1,921	2,109
Deferred rent	1,714	1,679
Accommodation services deposits ⁽¹⁾	1,584	2,540
Accrued professional fees	844	1,020
Accrued restructuring	542	722
Accrued rebates ⁽²⁾	—	—
Other taxes	2,149	2,750
Other	4,407	3,852
Total continuing operations	39,104	39,073
Discontinued operations:		
Environmental remediation liabilities	633	648
Self-insured liability	309	337
Other	86	96
Total discontinued operations	1,028	1,081
Total other current liabilities	\$ 40,132	\$ 40,154

⁽¹⁾With the adoption of Topic 606, we present customer deposits as “Contract liabilities” as they are received prior to transferring the related product or service to the customer. We recognize revenue upon satisfaction of the related contract performance obligation(s). We reclassified \$2.5 million of GES’ events accommodation services deposits out of “Contract liabilities” to “Other current liabilities” on the December 31, 2017 Condensed Consolidated Balance Sheet as they do not represent “Contract liabilities” but rather deposits from hotel guests that are passed on to the hotels. Refer to Note 2 – Revenue and Related Contract Costs and Contract Liabilities for additional information.

⁽²⁾With the adoption of Topic 606, we reclassified \$1.1 million of accrued rebates to “Contract liabilities” on the December 31, 2017 Condensed Consolidated Balance Sheet as they represent future performance obligations. Refer to Note 2 – Revenue and Related Contract Costs and Contract Liabilities for additional information.

Note 11. Other Deferred Items and Liabilities

Other deferred items and liabilities consisted of the following:

(in thousands)	September 30, 2018	December 31, 2017
Continuing operations:		
Self-insured liability	\$ 12,685	\$ 12,918
Self-insured excess liability	10,442	10,442
Foreign deferred tax liability	8,538	8,267
Accrued compensation	6,999	9,740
Deferred rent	3,113	3,855
Accrued restructuring	1,535	1,827
Other	2,162	1,305
Total continuing operations	45,474	48,354
Discontinued operations:		
Self-insured liability	2,419	2,557
Environmental remediation liabilities	1,698	1,728
Other	234	219
Total discontinued operations	4,351	4,504
Total other deferred items and liabilities	\$ 49,825	\$ 52,858

Note 12. Debt and Capital Lease Obligations

The components of long-term debt and capital lease obligations consisted of the following:

(in thousands, except interest rates)	September 30, 2018	December 31, 2017
Revolving credit facility and term loan 3.8% weighted-average interest rate at		
September 30, 2018 and 3.1% at December 31, 2017, due through 2019 ⁽¹⁾	\$ 188,704	\$ 207,322
Brewster Inc. revolving credit facility 3.2% weighted-average interest rate at		
September 30, 2018 ⁽¹⁾	7,750	—
Less unamortized debt issuance costs	(583)	(984)
Total debt	195,871	206,338
Capital lease obligations 4.3% weighted-average interest rate at September 30,		
2018 and 3.8% at December 31, 2017, due through 2021	4,303	2,854
Total debt and capital lease obligations	200,174	209,192
Current portion ⁽²⁾	(155,756)	(152,599)
Long-term debt and capital lease obligations	\$ 44,418	\$ 56,593

- (1) Represents the weighted-average interest rate in effect at the respective periods for the revolving credit facilities and term loan borrowings, including any applicable margin. The interest rates do not include amortization of debt issuance costs or commitment fees.
- (2) Borrowings under the revolving credit facilities are classified as current because all borrowed amounts are due within one year.

Effective December 22, 2014, we entered into a \$300 million Amended and Restated Credit Agreement (the “2014 Credit Agreement”). The 2014 Credit Agreement provides for a senior credit facility in the aggregate amount of \$300 million, which consists of a \$175 million revolving credit facility (the “2014 Credit Facility”) and a \$125 million term loan (the “2014 Term Loan”). The 2014 Credit Agreement has a maturity date of December 22, 2019. Proceeds from the loans made under the 2014 Credit Agreement were used to refinance certain of our outstanding debt and for general corporate purposes in the ordinary course of business.

Effective February 24, 2016, we executed an amendment (“Amendment No. 1”) to the 2014 Credit Agreement. Amendment No. 1 modified the terms of the financial covenants and the negative covenants related to acquisitions, restricted payments, and indebtedness. The overall maximum leverage ratio and minimum fixed charge coverage ratio were amended to 3.50 to 1.00 and 1.75 to 1.00, respectively.

Effective October 24, 2018, we entered into a Second Amended and Restated Credit Agreement (the “2018 Credit Agreement”) that amended and restated the 2014 Credit Agreement in its entirety. The 2018 Credit Agreement has a maturity date of October 24, 2023 and provides for a \$450 million revolving credit facility (“2018 Credit Facility”). Proceeds from the 2018 Credit Facility will be used

to refinance our outstanding debt under the 2014 Credit Agreement and will provide us with additional funds for our operations, growth initiatives, acquisitions, and other general corporate purposes in the ordinary course of business. The 2018 Credit Facility may be increased up to an additional \$250 million under certain circumstances. It has a \$20 million sublimit for letters of credit. Borrowings and letters of credit can be denominated in U.S. dollars, Euros, Canadian dollars, or British pounds. Our lenders under the 2018 Credit Facility have a first perfected security interest in all of our personal property including GES, GES Event Intelligence Services, Inc., CATC Alaska Tourism Corporation (“CATC”), ON Event Services, LLC (“ON Services”), our 54.5% interest in Esja, and 65% of the capital stock of our top-tier foreign subsidiaries (other than Esja). Financial covenants include an interest coverage ratio of not less than 3.00 to 1.00 and a leverage ratio of not greater than 3.50 to 1.00, with a step-up of 4.00 to 1.00 for four quarters for a material acquisition of \$50 million or more. Dividends are permitted up to \$15 million in any calendar year. In addition, we can declare and pay dividends or repurchase our common stock up to \$20 million per calendar year. Dividends and repurchases above those thresholds are permitted as long as our pro forma leverage ratio is less than or equal to 2.75 to 1.00. Unsecured debt is allowed provided we are in compliance with the leverage ratio. In addition, the unsecured debt must mature after the 2018 Credit Facility, cannot have scheduled principal payments while the 2018 Credit Facility is in place, and any debt covenants for unsecured debt cannot be more restrictive than the 2018 Credit Facility. Significant other covenants include limitations on investments, additional indebtedness, sales and dispositions of assets, and liens on property.

As of September 30, 2018, our fixed charge coverage ratio was 2.71 to 1.00, our leverage ratio was 1.61 to 1.00, and we were in compliance with all covenants under the 2014 Credit Agreement.

Effective December 28, 2016, Brewster Inc., part of Pursuit, entered into a credit agreement (the “Brewster Credit Agreement”) with a \$38 million revolving credit facility (the “Brewster Revolver”). The Brewster Credit Agreement was used in connection with the FlyOver Canada acquisition in December 2016. Effective December 6, 2017, we amended the Brewster Revolver to reduce the amount to \$20 million and extend the maturity date to December 28, 2018. Effective May 18, 2018, we executed a second amendment to the Brewster Revolver to increase the amount to \$30 million. The additional loan capacity will be used for potential future acquisitions in Canada and other general corporate purposes. The lender under the Brewster Revolver has a first perfected security interest in all of Brewster Inc.’s personal property and a guaranty from Brewster Inc.’s immediate parent, Brewster Travel Canada Inc. (secured by its present and future personal property), Viad, and all of its current or future subsidiaries that are required to be guarantors under Viad’s 2014 Credit Agreement and 2018 Credit Agreement. The fees on the unused portion of the Brewster Revolver are currently 0.25% annually.

As of September 30, 2018, our total debt and capital lease obligations were \$200.2 million, consisting of outstanding borrowings under the 2014 Term Loan of \$65.6 million, the 2014 Credit Facility of \$123.1 million, the Brewster Revolver of \$7.8 million, and capital lease obligations of \$4.3 million, offset in part by unamortized debt issuance costs of \$0.6 million. As of September 30, 2018, capacity remaining under the 2014 Credit Facility was \$48.3 million, reflecting borrowings of \$123.1 million and \$3.6 million in outstanding letters of credit. As of September 30, 2018, Brewster Inc. had \$22.2 million of capacity remaining under the Brewster Revolver.

Borrowings under the 2014 Credit Facility and the 2018 Credit Facility (of which GES, GES Event Intelligence Services, Inc., CATC, and ON Services are guarantors) are indexed to the prime rate or the London Interbank Offered Rate, plus appropriate spreads tied to our leverage ratio. Commitment fees and letters of credit fees are also tied to our leverage ratio. The fees on the unused portion of the 2014 Credit Facility were 0.35% annually as of September 30, 2018.

The estimated fair value of total debt was \$195.3 million as of September 30, 2018 and \$203.2 million as of December 31, 2017. The fair value of debt was estimated by discounting the future cash flows using rates currently available for debt of similar terms and maturity, which is a Level 2 measurement. Refer to Note 13 – Fair Value

Measurements.

Cash paid for interest on debt was \$6.2 million for the nine months ended September 30, 2018 and \$5.5 million for the nine months ended September 30, 2017.

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Note 13. Fair Value Measurements

The fair value of an asset or liability is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value guidance requires an entity to maximize the use of quoted prices and other observable inputs and minimize the use of unobservable inputs when measuring fair value, and also establishes a fair value hierarchy, which prioritizes the inputs to valuation techniques used to measure fair value as follows:

Level 1 - Quoted prices in active markets for identical assets or liabilities.

Level 2 - Observable inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.

Level 3 - Unobservable inputs to the valuation methodology that are significant to the measurement of fair value.

Money market mutual funds and certain other mutual fund investments are measured at fair value on a recurring basis using Level 1 inputs. The fair value information related to these assets is summarized in the following tables:

(in thousands)	September 30, 2018	Fair Value Measurements at Reporting Date Using Significant		
		Quoted Prices in Active Markets Inputs (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Money market funds ⁽¹⁾	\$ 120	\$ 120	\$ —	\$ —
Other mutual funds ⁽²⁾	2,900	2,900	—	—
Total assets at fair value on a recurring basis	\$ 3,020	\$ 3,020	\$ —	\$ —

(in thousands)	December 31, 2017	Fair Value Measurements at Reporting Date Using Quoted Prices		
		in Active Markets Inputs (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)

Assets:					
Money market funds ⁽¹⁾	\$ 119	\$ 119	\$	—	\$ —
Other mutual funds ⁽²⁾	2,637	2,637	—	—	—
Total assets at fair value on a recurring basis	\$ 2,756	\$ 2,756	\$	—	\$ —

⁽¹⁾Money market funds are included in “Cash and cash equivalents” in the Condensed Consolidated Balance Sheets.

These investments are classified as available-for-sale and are recorded at fair value. There have been no realized gains or losses related to these investments and we have not experienced any redemption restrictions with respect to any of the money market mutual funds.

⁽²⁾Other mutual funds are included in “Other investments and assets” in the Condensed Consolidated Balance Sheets.

Upon the adoption of ASU 2016-01, unrealized gains on equity securities that were previously classified as available-for-sale are recognized in net income rather than “Accumulated other comprehensive income (loss)” (“AOCI”). We adopted this guidance prospectively on January 1, 2018 and recognized a cumulative-effect adjustment of \$0.6 million to beginning retained earnings, which represents unrealized gains of \$1.0 million (\$0.6 million after tax) as of December 31, 2017 that were included in AOCI in the Condensed Consolidated Balance Sheets. Refer to Note 14 – Stockholders’ Equity for additional information.

The carrying values of cash and cash equivalents, receivables, and accounts payable approximate fair value due to the short-term maturities of these instruments. Refer to Note 12 – Debt and Capital Lease Obligations for the estimated fair value of debt obligations.

Note 14. Stockholders' Equity

The following represents a reconciliation of the carrying amounts of stockholders' equity attributable to Viad and the non-redeemable noncontrolling interest for the nine months ended September 30, 2018 and 2017:

	Total Viad	Non-redeemable	Total
	Stockholders'	Noncontrolling	Stockholders'
(in thousands)	Equity	Interest	Equity
Balance at December 31, 2017	\$ 429,131	\$ 13,806	\$ 442,937
Net income	51,492	890	52,382
Dividends on common stock (\$0.30 per share)	(6,128)	—	(6,128)
Common stock purchased for treasury	(10,240)	—	(10,240)
Employee benefit plans	6,046	—	6,046
Unrealized foreign currency translation adjustment, net of tax	(7,864)	—	(7,864)
Other changes to AOCI, net of tax	(715)	—	(715)
Adoption of ASU 2018-02 ⁽¹⁾	1,680	—	1,680
Other, net	(34)	—	(34)
Balance at September 30, 2018	\$ 463,368	\$ 14,696	\$ 478,064

⁽¹⁾ Upon the adoption of ASU 2018-02, we recorded a cumulative-effect adjustment from AOCI to beginning retained earnings.

	Total Viad	Non-redeemable	Total
	Stockholders'	Noncontrolling	Stockholders'
(in thousands)	Equity	Interest	Equity
Balance at December 31, 2016	\$ 357,355	\$ 13,283	\$ 370,638
Net income	79,381	747	80,128
Dividends on common stock (\$0.30 per share)	(6,119)	—	(6,119)
Common stock purchased for treasury	(1,272)	—	(1,272)
Employee benefit plans	5,916	—	5,916
Unrealized foreign currency translation adjustment, net of tax	18,820	—	18,820
Other changes to AOCI, net of tax	327	—	327
Other, net	56	—	56
Balance at September 30, 2017	\$ 454,464	\$ 14,030	\$ 468,494

Changes in AOCI by component are as follows:

	Accumulated			
	Unrealized Gains on Investments	Cumulative Foreign Currency Translation Adjustments	Unrecognized Net Actuarial Loss and Prior Service Credit, Net	Other Comprehensive Income (Loss)
(in thousands)				
Balance at December 31, 2017	\$ 616	\$ (12,026)	\$ (11,158)	\$ (22,568)
Adoption of ASU 2016-01 ⁽¹⁾	(616)	—	—	(616)
Other comprehensive income before reclassifications	—	(7,864)	—	(7,864)
Amounts reclassified from AOCI, net of tax	—	—	(715)	(715)
Net other comprehensive income (loss)	(616)	(7,864)	(715)	(9,195)
Balance at September 30, 2018	\$ —	\$ (19,890)	\$ (11,873)	\$ (31,763)

⁽²⁾Upon the adoption of ASU 2016-01, we recorded a cumulative-effect adjustment from unrealized gains on investments to beginning retained earnings.

Amounts reclassified that relate to our defined benefit pension and postretirement plans include the amortization of prior service costs and actuarial net losses recognized during the nine months ended September 30, 2018 and 2017. These costs are recorded as components of net periodic cost for each period presented. Refer to Note 17 – Pension and Postretirement Benefits for additional information.

Amounts reclassified that relate to unrealized gains on equity securities classified as available-for-sale include \$1.0 million (\$0.6 million after tax) as of December 31, 2017. Upon the adoption of ASU 2016-01, unrealized gains on equity securities are recognized in net income. Refer to Note 13 – Fair Value Measurements for additional information.

Noncontrolling interests with redemption features that are not solely within our control are considered redeemable noncontrolling interests. Redeemable noncontrolling interest is considered temporary equity and is reported between liabilities and stockholders' equity in the Condensed Consolidated Balance Sheets. Refer to Note 20 – Redeemable Noncontrolling Interest for additional information.

Note 15. Income Per Share

The components of basic and diluted income per share are as follows:

(in thousands, except per share data)	Three Months Ended		Nine Months Ended	
	September 30, 2018	September 30, 2017	September 30, 2018	September 30, 2017
Net income attributable to Viad (diluted)	\$37,389	\$44,657	\$51,492	\$79,381
Less: Allocation to non-vested shares	(338)	(539)	(493)	(993)
Adjustment to the redemption value of redeemable noncontrolling interest	(84)	—	(174)	—
Net income allocated to Viad common stockholders (basic)	\$36,967	\$44,118	\$50,825	\$78,388
Basic weighted-average outstanding common shares	20,145	20,166	20,187	20,130
Additional dilutive shares related to share-based compensation	242	270	240	252
Diluted weighted-average outstanding shares	20,387	20,436	20,427	20,382
Income per share:				
Basic income attributable to Viad common stockholders	\$1.84	\$2.19	\$2.52	\$3.89
Diluted income attributable to Viad common stockholders ⁽¹⁾	\$1.83	\$2.19	\$2.51	\$3.89

⁽¹⁾Diluted income (loss) per share amount cannot exceed basic income (loss) per share.

Note 16. Income Taxes

The effective tax rate was 21.8% for the three months ended September 30, 2018 and 30.4% for the three months ended September 30, 2017. The effective tax rate was 22.8% for the nine months ended September 30, 2018 and 29.0% for the nine months ended September 30, 2017.

The income tax provision was computed based on our estimated effective tax rate and forecasted income by jurisdiction expected for the full year, including the impact of any unusual, infrequent, or nonrecurring items. The effective tax rate for the nine months ended September 30, 2018 was more than the federal statutory rate of 21% primarily due to foreign income taxed at higher rates and certain non-deductible business expenses, offset in part by \$3.1 million tax benefits recognized in the quarter for the updated estimate of our provision for the impact of the Tax Act. The effective tax rate for the nine months ended September 30, 2017 was less than the federal statutory rate of 35% primarily due to foreign income taxes at lower rates, the excess tax benefit on share-based compensation, and the release of a valuation allowance. During the three months ended September 30, 2018, we recorded a tax benefit of \$3.1 million to the provisional estimate included in the financial statements as of December 31, 2017 for the impact of the Tax Act. The \$3.1 million is comprised of \$2.6 million reduction of our estimated taxes for the deemed mandatory repatriation of post-1986 undistributed foreign subsidiary earnings and profits and \$0.5 million for the corporate tax

rate reduction attributable to the return to provision adjustment for deferred taxes. We expect to finalize our analysis of the impact of the Tax Act and record any adjustments within the one-year period provided under SEC Staff Accounting Bulletin 118.

Cash paid for income taxes was \$20.2 million for the nine months ended September 30, 2018 and \$10.9 million for the nine months ended September 30, 2017.

Note 17. Pension and Postretirement Benefits

The components of net periodic benefit cost of our pension and postretirement benefit plans for the three months ended September 30, 2018 and 2017 consist of the following:

(in thousands)	Domestic Plans				Foreign	
	Pension Plans		Postretirement Benefit Plans		Pension Plans	
	2018	2017	2018	2017	2018	2017
Service cost	\$ 13	\$ 8	\$ 4	\$ 22	\$ 138	\$ 138
Interest cost	198	197	129	92	91	120
Expected return on plan assets	(65)	(55)	—	—	(126)	(156)
Amortization of prior service credit	—	—	(51)	(107)	—	—
Recognized net actuarial loss	124	106	187	3	38	48
Net periodic benefit cost	\$ 270	\$ 256	\$ 269	\$ 10	\$ 141	\$ 150

The components of net periodic benefit cost of our pension and postretirement benefit plans for the nine months ended September 30, 2018 and 2017 consist of the following:

(in thousands)	Domestic Plans				Foreign	
	Pension Plans		Postretirement Benefit Plans		Pension Plans	
	2018	2017	2018	2017	2018	2017
Service cost	\$ 48	\$ 56	\$ 60	\$ 69	\$ 418	\$ 396
Interest cost	585	604	337	311	273	348
Expected return on plan assets	(145)	(162)	—	—	(382)	(450)
Amortization of prior service credit	—	—	(154)	(323)	—	—
Recognized net actuarial loss	370	336	304	123	120	137
Net periodic benefit cost	\$ 858	\$ 834	\$ 547	\$ 180	\$ 429	\$ 431

We expect to contribute \$1.1 million to our funded pension plans, \$1.0 million to our unfunded pension plans, and \$1.1 million to our postretirement benefit plans in 2018. During the nine months ended September 30, 2018, we contributed \$0.9 million to our funded pension plans, \$0.5 million to our unfunded pension plans, and \$0.8 million to our postretirement benefit plans.

Note 18. Restructuring Charges

GES

As part of our efforts to drive efficiencies and simplify our business operations, we have taken certain restructuring actions designed to reduce our cost structure primarily within GES. These actions include combining separate business units within GES U.S. and consolidating facilities and operations in the U.S., Canada, and the United Kingdom. As a result, we recorded restructuring charges primarily consisting of severance and related benefits as a

result of workforce reductions and charges related to the consolidation and downsizing of facilities representing the remaining operating lease obligations (net of estimated sublease income) and related costs.

Other Restructurings

We recorded restructuring charges in connection with certain reorganization activities within Pursuit. These charges primarily consist of severance and related benefits due to headcount reductions.

Changes to the restructuring liability by major restructuring activity are as follows:

	GES Severance & Employee	Facilities	Other Restructurings Severance & Employee	Total
(in thousands)	Benefits	Facilities	Benefits	Total
Balance at December 31, 2017	\$1,551	\$ 807	\$ 191	\$2,549
Restructuring charges	869	—	130	999
Cash payments	(1,052)	(97)	(181)	(1,330)
Adjustment to liability	438	(451)	(128)	(141)
Balance at September 30, 2018	\$1,806	\$ 259	\$ 12	\$2,077

As of September 30, 2018, we expect to pay the liabilities related to severance and employee benefits by the end of 2020. Additionally, for GES the liability related to future lease payments will be paid over the remaining lease terms. Refer to Note 21 – Segment Information, for information regarding restructuring charges by segment.

Note 19. Litigation, Claims, Contingencies, and Other

We are plaintiffs or defendants to various actions, proceedings, and pending claims, some of which involve, or may involve, compensatory, punitive, or other damages. Litigation is subject to many uncertainties and it is possible that some of the legal actions, proceedings, or claims could be decided against us. Although the amount of liability as of September 30, 2018 with respect to these matters is not ascertainable, we believe that any resulting liability, after taking into consideration amounts already provided for and insurance coverage, will not have a material effect on our business, financial position, or results of operations.

We are subject to various U.S. federal, state, and foreign laws and regulations governing the prevention of pollution and the protection of the environment in the jurisdictions in which we have or had operations. If we fail to comply with these environmental laws and regulations, civil and criminal penalties could be imposed and we could become subject to regulatory enforcement actions in the form of injunctions and cease and desist orders. As is the case with many companies, we also face exposure to actual or potential claims and lawsuits involving environmental matters relating to our past operations. As of September 30, 2018, we had recorded environmental remediation liabilities of \$2.3 million related to previously sold operations. Although we are a party to certain environmental disputes, we believe that any resulting liabilities, after taking into consideration amounts already provided for and insurance coverage, will not have a material effect on our financial position or results of operations.

As of September 30, 2018, on behalf of our subsidiaries, we had certain obligations under guarantees to third parties. These guarantees are not subject to liability recognition in the condensed consolidated financial statements and relate to leased facilities entered into by our subsidiary operations. We would generally be required to make payments to the respective third parties under these guarantees in the event that the related subsidiary could not meet its own payment obligations. The maximum potential amount of future payments that we would be required to make under all guarantees existing as of September 30, 2018 would be \$17.3 million. These guarantees relate to our leased facilities through October 2027. There are no recourse provisions that would enable us to recover from third parties any payments made under the guarantees. Furthermore, there are no collateral or similar arrangements whereby we could recover payments.

A significant number of our employees are unionized and we are a party to approximately 100 collective-bargaining agreements, with approximately one-third requiring renegotiation each year. If we are unable to reach an agreement with a union during the collective-bargaining process, the union may call for a strike or work stoppage, which may, under certain circumstances, adversely impact our business and results of operations. We believe that relations with our employees are satisfactory and that collective-bargaining agreements expiring in 2018 will be renegotiated in the ordinary course of business without having a material adverse effect on our operations. We entered into showsite and warehouse agreements with the Chicago Teamsters Local 727, effective January 1, 2014, and those agreements are scheduled to expire on December 31, 2018. We are in informal discussions with all relevant parties to renew those agreements in a manner that will be reasonable and equitable to employees, customers, and shareholders. Although our labor relations are currently stable, disruptions pending the outcome of the Chicago Teamsters Local 727 negotiations could occur, as they could with any collective-bargaining agreement negotiation, with the possibility of an adverse impact on the operating results of GES.

Our business contributes to various multi-employer pension plans based on obligations arising under collective-bargaining agreements covering our union-represented employees. Based upon the information available from plan administrators, we believe that several of these multi-employer plans are underfunded. The Pension Protection Act of 2006 requires pension plans underfunded at certain levels to reduce, over defined time periods, the underfunded status. In addition, under current laws, the termination of a plan, or a voluntary withdrawal from a plan by us, or a shrinking contribution base to a plan as a result of the insolvency or withdrawal of other contributing employers to such plan, would require us to make payments to such plan for our proportionate share of the plan's unfunded vested liabilities. As of September 30, 2018, the amount of additional funding, if any, that we would be required to make related to multi-employer pension plans is not ascertainable.

We are self-insured up to certain limits for workers' compensation, employee health benefits, automobile, product and general liability, and property loss claims. The aggregate amount of insurance liabilities (up to our retention limit) related to our continuing operations was \$18.9 million as of September 30, 2018 which includes \$13.7 million related to workers' compensation liabilities, and \$5.2 million related to general/auto liability claims. We have also retained and provided for certain workers' compensation insurance liabilities in conjunction with previously sold businesses of \$2.7 million as of September 30, 2018. The estimated employee health benefit claims incurred but not yet reported was \$1.7 million as of September 30, 2018. Provisions for losses for claims incurred, including estimated claims incurred but not yet reported, are made based on our historical experience, claims frequency, and other factors. A change in the assumptions used could result in an adjustment to recorded liabilities. We have purchased insurance for amounts in excess of the self-insured levels, which generally range from \$0.2 million to \$0.5 million on a per claim basis. We do not maintain a self-insured retention pool fund as claims are paid from current cash resources at the time of settlement. Our net cash payments in connection with these insurance liabilities were \$1.4 million for the three months ended September 30, 2018 and \$1.3

million for the three months ended September 30, 2017 and \$4.1 million for the nine months ended September 30, 2018 and \$3.8 million for the nine months ended September 30, 2017.

In addition, as of September 30, 2018, we have recorded insurance liabilities of \$10.4 million related to continuing operations, which represents the amount for which we remain the primary obligor after self-insured insurance limits, without taking into consideration the above-referenced insurance coverage. Of this total, \$6.9 million related to workers' compensation liabilities and \$3.5 million related to general/auto liability claims which are recorded in other deferred items and liabilities in the Condensed Consolidated Balance Sheets with a corresponding receivable in other investments.

Note 20. Redeemable Noncontrolling Interest

On November 3, 2017, we acquired the controlling interest (54.5% of the common stock) in Esja, a private corporation in Reykjavik, Iceland. Through Esja, we are developing and will operate a new FlyOver Iceland attraction.

The minority Esja shareholders have the right to sell (or "put") their Esja shares to us based on a multiple of 5.0x EBITDA as calculated on the trailing 12 months from the most recently completed quarter before the put option exercise. The put option is only exercisable after 36 months of business operation (the "Reference Date") and if the FlyOver Iceland attraction has earned a minimum of €3.25 million in unadjusted EBITDA during the most recent fiscal year and during the trailing 12-month period prior to exercise (the "Put Option Condition"). The put option is exercisable during a period of 12 months following the Reference Date (the "Option Period") and if the Put Option Condition has been met. If the Put Option Condition has not been met during the first Option Period, the Reference Date will be extended for an additional 12 months up to three times. If after 72 months, the FlyOver Iceland attraction has not achieved the Put Option Condition, the put option expires. If the Put Option Condition is met during any of the Option Periods, yet the shares are not exercised prior to the end of the 12-month Option Period, the put option will expire.

The noncontrolling interest's carrying value is determined by the fair value of the noncontrolling interest as of the acquisition date and the noncontrolling interest's share of the subsequent net income or loss. This value is benchmarked against the redemption value of the sellers' put option. The carrying value is adjusted to the redemption value, provided that it does not fall below the initial carrying value, as determined by the purchase price allocation. We have made a policy election to reflect any changes caused by such an adjustment to retained earnings, rather than to current earnings.

Changes in the redeemable noncontrolling interest is as follows:

(in thousands)	
Balance at December 31, 2017	\$6,648
Net loss attributable to redeemable noncontrolling interest	(289)
Adjustment to the redemption value	174
Foreign currency translation adjustment	(405)
Balance at September 30, 2018	\$6,128

Note 21. Segment Information

We measure the profit and performance of our operations on the basis of segment operating income (loss) which excludes restructuring charges and recoveries and impairment charges and recoveries. Intersegment sales are eliminated in consolidation and intersegment transfers are not significant. Corporate activities include expenses not allocated to operations. Depreciation and amortization and share-based compensation expense are the only significant non-cash items for the reportable segments.

Our reportable segments, with reconciliations to consolidated totals, are as follows:

(in thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Revenue:				
GES:				
U.S.	\$ 191,699	\$ 184,761	\$ 636,806	\$ 684,003
International	56,890	54,040	204,505	203,222
Intersegment eliminations	(2,479)	(6,682)	(12,173)	(17,126)
Total GES	246,110	232,119	829,138	870,099
Pursuit	112,053	106,980	170,130	159,581
Total revenue	\$ 358,163	\$ 339,099	\$ 999,268	\$ 1,029,680
Segment operating income (loss):				
GES:				
U.S.	\$ 2,287	\$ (2,664)	\$ 21,569	\$ 40,002
International	(1,127)	(2,858)	9,176	8,524
Total GES	1,160	(5,522)	30,745	48,526
Pursuit	55,408	53,860	53,770	53,523
Segment operating income	56,568	48,338	84,515	102,049
Corporate eliminations ⁽¹⁾	18	18	51	50
Corporate activities	(3,777)	(4,425)	(8,529)	(9,886)
Operating income	52,809	43,931	76,037	92,213
Interest income	101	74	238	174
Interest expense	(2,608)	(2,117)	(7,031)	(6,281)
Other expense ⁽²⁾	(527)	(248)	(1,308)	(922)
Restructuring recoveries (charges):				
GES U.S.	(162)	435	(402)	364
GES International	(13)	(689)	(467)	(1,043)
Pursuit	—	—	(140)	—
Corporate	—	(1)	10	(138)
Impairment recoveries:				
Pursuit	—	24,467	35	29,098
Income from continuing operations before income taxes	\$ 49,600	\$ 65,852	\$ 66,972	\$ 113,465

⁽¹⁾ Corporate eliminations represent the elimination of depreciation expense recorded by Pursuit associated with previously eliminated intercompany profit realized by GES for renovations to Pursuit's Banff Gondola.

⁽²⁾ We adopted ASU 2017-07 on January 1, 2018, which requires retrospective adoption. As a result, we recorded the nonservice cost component of net periodic benefit cost within other expense for the three and nine months ended September 30, 2018, and we reclassified \$0.2 million from operating expenses to other expense for the three months

ended September 30, 2017 and \$0.9 million for the nine months ended September 30, 2017 to conform with current period presentation. Refer to Note 1 – Overview and Basis of Presentation for additional details on the impact of this adoption on our Condensed Consolidated Statements of Operations.

Note 22. Common Stock Repurchases

We previously announced our Board of Directors' authorization to repurchase shares of our common stock from time to time at prevailing market prices. During the nine months ended September 30, 2018, we repurchased 175,091 shares on the open market for \$9.1 million. As of September 30, 2018, 265,449 shares remain available for repurchase. We repurchased 21,767 shares for \$1.2 million during the nine months ended September 30, 2018 and 26,916 shares for \$1.3 million during the nine months ended September 30, 2017 related to tax withholding requirements on vested share based awards.

Note 23. Subsequent Event

Effective October 24, 2018, we entered into the 2018 Credit Agreement, which provides for the \$450 million 2018 Credit Facility. The following terms are included in the 2018 Credit Facility:

- May be increased up to an additional \$250 million under certain circumstances;
 - Maintain an interest coverage ratio of not less than 3.00 to 1.00;
 - Maintain a leverage ratio of not greater than 3.50 to 1.00, with a step-up of 4.00 to 1.00 for four quarters for a material acquisition of \$50 million or more;
 - Dividends are permitted up to \$15 million in any calendar year. In addition, we can declare and pay dividends or repurchase our common stock up to \$20 million per calendar year. Dividends and repurchases above those thresholds are permitted as long as our pro forma leverage ratio is less than or equal to 2.75 to 1.00; and
 - Unlimited unsecured debt provided we are in compliance with the leverage ratio. The unsecured debt must mature outside the credit facility, cannot have scheduled principal payments while the 2018 Credit Facility is in place, and debt covenants cannot be more restrictive than the 2018 Credit Facility.
- Refer to Note 12 – Debt and Capital Lease Obligations for additional information.

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

Forward-Looking Statements

This Form 10-Q contains a number of forward-looking statements. Words, and variations of words, such as “will,” “may,” “expect,” “would,” “could,” “might,” “intend,” “plan,” “believe,” “estimate,” “anticipate,” “deliver,” “seek,” “aim,” “potential,” and similar expressions are intended to identify our forward-looking statements. Similarly, statements that describe our business strategy, outlook, objectives, plans, intentions or goals also are forward-looking statements. These forward-looking statements are not historical facts, and are subject to a host of risks and uncertainties, many of which are beyond our control, that could cause actual results to differ materially from those in the forward-looking statements.

Important factors that could cause actual results to differ materially from those described in our forward-looking statements include, but are not limited to, the following:

- our ability to successfully integrate and achieve established financial and strategic goals from acquisitions;
- our dependence on large exhibition event clients;
- the importance of key members of our account teams to our business relationships;
- the competitive nature of the industries in which we operate;
- travel industry disruptions;
- transportation disruptions and increases in transportation costs;
- seasonality of our businesses;
- terrorist attacks, natural disasters and other catastrophic events;
- fluctuations in general economic conditions;
- the impact of recent U.S. tax legislation;
- our exposure to currency exchange rate fluctuations;
- our multi-employer pension plan funding obligations;
- our exposure to labor cost increases and work stoppages related to unionized employees;
- our exposure to cybersecurity attacks and threats;
- compliance with laws governing the collection, storage, handling and transfer of personal data and our exposure to legal claims and fines for data breaches or improper handling of such data;
- unanticipated delays and cost overruns of our capital projects, and our ability to achieve established financial and strategic goals of such projects;
- adverse effects of show rotation on our periodic results and operating margins;
- the effects of the United Kingdom's exit from the European Union; and
 - liabilities relating to prior and discontinued operations.

For a more complete discussion of the risks and uncertainties that may affect our business or financial results, please see Item 1A, “Risk Factors,” of our most recent annual report on Form 10-K filed with the SEC on February 28, 2018. We disclaim and do not undertake any obligation to update or revise any forward-looking statement except as required by applicable law or regulation.

The following Management's Discussion and Analysis (“MD&A”) should be read in conjunction with our 2017 Form 10-K and the condensed consolidated financial statements and related notes included in this Form 10-Q. The MD&A is intended to assist in understanding our financial condition and results of operations.

Overview

We are an international experiential services company with operations principally in the United States, Canada, the United Kingdom, continental Europe, and the United Arab Emirates. We are committed to providing unforgettable experiences to our clients and guests. We operate through three reportable business segments: GES U.S., GES International, (collectively, “GES”), and Pursuit.

GES

GES is a global, full-service provider for Live Events that produces exhibitions, conferences, corporate events, and consumer events. GES offers a comprehensive range of live event services including a full suite of audio-visual services from creative and technology to content and design, along with online tools powered by next generation technologies that help clients easily manage the complexities of their events.

GES’ clients include event organizers and corporate brand marketers. Event organizers schedule and run the event from start to finish. Corporate brand marketers include exhibitors and domestic and international corporations that want to promote their brands, services and innovations, feature new products, and build business relationships. GES serves corporate brand marketers when they exhibit at events and when GES is engaged to manage their global exhibit program or produce their proprietary corporate events.

Seasonality

GES' show rotation refers to shows that occur less frequently than annually, as well as annual shows that shift quarters from one year to the next. GES' exhibition and event activity can vary significantly from quarter to quarter and year to year depending on the frequency and timing of shows.

Pursuit

Pursuit is a collection of iconic natural and cultural destination travel experiences that enjoy perennial demand. Pursuit offers guests distinctive and world renowned experiences through its collection of unique hotels, lodges, world-class recreational attractions, and sightseeing and ground transportation services.

Pursuit comprises four lines of business: Attractions, including food and beverage services and retail operations; Hospitality, including food and beverage services and retail operations; Transportation; and Travel Planning. These four lines of business work together, driving economies of scope and meaningful scale in and around the iconic destinations of Banff, Jasper, and Waterton Lakes National Parks and Vancouver in Canada, and Glacier, Denali, and Kenai Fjords National Parks in the United States.

Seasonality

Pursuit experiences peak activity during the summer months. During 2017, 87% of Pursuit's revenue was earned in the second and third quarters.

Results of Operations

Financial Highlights

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2018	2017	Change Percentage	2018	2017	Change Percentage
(in thousands, except per share data)						
Revenue	\$358,163	\$339,099	5.6 %	\$999,268	\$1,029,680	(3.0)%
Net income attributable to Viad	\$37,389	\$44,657	(16.3)%	\$51,492	\$79,381	(35.1)%
Segment operating income ⁽¹⁾	\$56,568	\$48,338	17.0 %	\$84,515	\$102,049	(17.2)%
Diluted income per common share						

from continuing operations attributable

to Viad common stockholders \$1.84 \$2.19 (16.0)% \$2.49 \$3.91 (36.3)%
 Three months ended September 30, 2018 compared with the three months ended September 30, 2017

• Total revenue increased \$19.1 million or 5.6%, primarily due to positive show rotation of approximately \$28 million at GES and underlying growth at Pursuit, offset in part by nonrecurring business produced in the 2017 third quarter and an unfavorable foreign exchange impact of \$3.4 million.

- Net income attributable to Viad decreased \$7.3 million, primarily due to impairment recoveries of \$17.8 million, after-tax, received during the 2017 third quarter related to the Mount Royal Hotel fire at

Pursuit, offset in part by a reduction in performance-based incentives.

• Total segment operating income⁽¹⁾ increased \$8.2 million primarily due to the increase in revenue as well as a reduction in performance-based incentives.

Nine months ended September 30, 2018 compared with the nine months ended September 30, 2017

• Total revenue decreased \$30.4 million or 3.0%, primarily due to negative show rotation of approximately \$43 million at GES, offset in part by a favorable foreign exchange impact of \$8.3 million and continued underlying growth at Pursuit.

• Net income attributable to Viad decreased \$27.9 million, primarily due to impairment recoveries of \$21.2 million, after-tax, and favorable tax matters of \$1.2 million, each of which was recorded in 2017, as well as lower segment operating income at GES.

• Total segment operating income⁽¹⁾ decreased \$17.5 million, primarily due to the decrease in revenue at GES, offset in part by a reduction in performance-based incentives.

⁽¹⁾ Refer to Note 21 – Segment Information of the Notes to Condensed Consolidated Financial Statements for a reconciliation of the non-GAAP financial measure, segment operating income, to the most directly comparable GAAP measure.

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Foreign Exchange Rate Variances

We conduct our foreign operations primarily in Canada, the United Kingdom, the Netherlands, Germany, and to a lesser extent, in certain other countries.

The following tables summarize the foreign exchange rate variance effects (or “FX Impact”) on revenue and segment operating income (loss) from our significant international operations for the three and nine months ended September 30, 2018 and 2017:

Three months ended September 30, 2018 compared with the three months ended September 30, 2017

	Revenue Weighted-Average			Segment Operating Income (Loss) Weighted-Average		
	Exchange Rates		FX Impact (in thousands)	Exchange Rates		FX Impact (in thousands)
	2018	2017		2018	2017	
GES:						
Canada (CAD)	\$0.77	\$0.80	\$ (452)	\$0.77	\$0.80	\$ 7
United Kingdom (GBP)	\$1.31	\$1.32	(125)	\$1.30	\$1.31	(39)
Europe (EUR)	\$1.17	\$1.19	(99)	\$1.16	\$1.18	(21)
			(676)			(53)
Pursuit:						
Canada (CAD)	\$0.77	\$0.80	(2,692)	\$0.76	\$0.80	(1,492)
			\$ (3,368)			\$ (1,545)

Nine months ended September 30, 2018 compared with the nine months ended September 30, 2017

	Revenue Weighted-Average			Segment Operating Income (Loss) Weighted-Average		
	Exchange Rates		FX Impact (in thousands)	Exchange Rates		FX Impact (in thousands)
	2018	2017		2018	2017	
GES:						
Canada (CAD)	\$0.78	\$0.76	\$ 1,047	\$0.77	\$0.76	\$ 154
United Kingdom (GBP)	\$1.35	\$1.28	6,931	\$1.33	\$1.28	(3)
Europe (EUR)	\$1.19	\$1.11	1,627	\$1.19	\$1.12	138
			9,605			289
Pursuit:						
Canada (CAD)	\$0.77	\$0.78	(1,319)	\$0.77	\$0.78	(1,535)
			\$ 8,286			\$ (1,246)

Revenue and segment operating income for the three and nine months ended September 30, 2018 were primarily impacted by variances of the British pound, the Canadian dollar, and the Euro relative to the U.S. dollar. Future changes in exchange rates may impact overall expected profitability and historical period-to-period comparisons when revenue and segment operating income are translated into U.S. dollars.

Analysis of Revenue and Operating Results by Reportable Segment

GES

The following tables present a comparison of GES' reported revenue and segment operating income to organic revenue⁽¹⁾ and organic segment operating income⁽¹⁾ for the three and nine months ended September 30, 2018 and 2017.

(in thousands)	Three Months Ended September 30, 2018				Three Months Ended September 30, 2017				Change		
	As		FX		As		As				
	Reported	Acquisition Impact	Organic ⁽¹⁾		Reported	Acquisition Impact	Organic ⁽¹⁾	Reported	Organic ⁽¹⁾		
Revenue:											
GES:											
U.S.	\$191,699	\$ —	\$ —	\$191,699	\$184,761	\$ —	\$184,761	3.8 %	3.8 %		
International	56,890	—	(676)	57,566	54,040	—	54,040	5.3 %	6.5 %		
Intersegment eliminations	(2,479)	—	—	(2,479)	(6,682)	—	(6,682)	62.9 %	62.9 %		
Total GES	\$246,110	\$ —	\$(676)	\$246,786	\$232,119	\$ —	\$232,119	6.0 %	6.3 %		
Segment operating income (loss) ⁽²⁾:											
GES:											
U.S.	\$2,287	\$ —	\$ —	\$2,287	\$(2,664)	\$ —	\$(2,664)	**	**		
International	(1,127)	—	(53)	(1,074)	(2,858)	—	(2,858)	60.6 %	62.4 %		
Total GES	\$1,160	\$ —	\$(53)	\$1,213	\$(5,522)	\$ —	\$(5,522)	**	**		

(in thousands)	Nine Months Ended September 30, 2018				Nine Months Ended September 30, 2017				Change		
	As		FX		As		As				
	Reported	Acquisition Impact	Organic ⁽¹⁾		Reported	Acquisition Impact	Organic ⁽¹⁾	Reported	Organic ⁽¹⁾		
Revenue:											
GES:											
U.S.	\$636,806	\$ —	\$ —	\$636,806	\$684,003	\$ —	\$684,003	(6.9)%	(6.9)%		
International	204,505	—	9,605	194,900	203,222	—	203,222	0.6 %	(4.1)%		
Intersegment eliminations	(12,173)	—	—	(12,173)	(17,126)	—	(17,126)	28.9 %	28.9 %		
Total GES	\$829,138	\$ —	\$9,605	\$819,533	\$870,099	\$ —	\$870,099	(4.7)%	(5.8)%		
Segment operating income ⁽²⁾:											
GES:											
U.S.	\$21,569	\$ —	\$ —	\$21,569	\$40,002	\$ —	\$40,002	(46.1)%	(46.1)%		
International	9,176	—	289	8,887	8,524	—	8,524	7.6 %	4.3 %		
Total GES	\$30,745	\$ —	\$289	\$30,456	\$48,526	\$ —	\$48,526	(36.6)%	(37.2)%		

** Change is greater than +/- 100%

(1)

Organic revenue and organic segment operating income (loss) are non-GAAP financial measures that adjust for the impacts of exchange rate variances and acquisitions, if any, until such acquisitions are included in the entirety of both comparable periods presented. For more information about organic revenue and organic segment operating income, see the “Non-GAAP Measures” section of this MD&A.

⁽²⁾Refer to Note 21 – Segment Information of the Notes to Condensed Consolidated Financial Statements for a reconciliation of the non-GAAP financial measure, segment operating income (loss), to the most directly comparable GAAP measure.

Three months ended September 30, 2018 compared with the three months ended September 30, 2017

GES U.S.

GES U.S. revenue increased \$6.9 million or 3.8%, primarily due to positive show rotation of approximately \$19 million and U.S. base same-show revenue growth of 5.3%, offset in part by nonrecurring business produced in the 2017 third quarter. Base same-show revenue represented 29.1% of GES U.S. revenue.

GES U.S. operating income increased \$5.0 million primarily due to a reduction in performance-based incentives and the increase in revenue.

GES International

GES International revenue increased \$2.9 million or 5.3%, primarily due to positive show rotation of approximately \$9 million, offset in part by nonrecurring business produced in the 2017 third quarter and an unfavorable FX Impact of \$0.7 million. Organic revenue* increased \$3.5 million or 6.5%.

GES International operating loss improved \$1.7 million or 60.6% to a loss of \$1.1 million, primarily due to a reduction in performance-based incentives and the increase in revenue. Organic operating loss* improved \$1.8 million or 62.4% to a loss of \$1.1 million.

Nine months ended September 30, 2018 compared with the nine months ended September 30, 2017

GES U.S.

GES U.S. revenue decreased \$47.2 million or 6.9%, primarily due to negative show rotation of approximately \$38 million and certain nonrecurring business produced in 2017, offset in part by U.S. base same-show revenue growth of 3.3%. Base same-show revenue represented 35.1% of GES U.S. revenue.

GES U.S. operating income decreased \$18.4 million or 46.1%, primarily due to lower revenue, an increase in wages, and selective investments in additional resources to capitalize on continued growth opportunities, offset in part by a reduction in performance-based incentives.

GES International

GES International revenue increased \$1.3 million or 0.6%, primarily due to a favorable FX Impact of \$9.6 million, offset in part by negative show rotation of approximately \$5 million and certain nonrecurring business produced in 2017. Organic revenue* decreased \$8.3 million or 4.1%.

GES International operating income increased \$0.7 million or 7.6%, primarily due to a reduction in performance-based incentives. Organic operating income* increased \$0.4 million or 4.3%.

* Refer to footnote (1) in the above table for more information about the non-GAAP financial measures of organic revenue and organic segment operating income.

2018 Outlook

Although GES has a diversified revenue base and long-term contracts for future shows, its revenue is affected by general economic and industry-specific conditions. The prospects for individual shows tend to be driven by the success of the industry related to those shows. In general, the exhibition and event industry is experiencing modest growth; however, we have experienced declines in certain retail-sector events and auto shows.

For the 2018 full year, we expect GES' revenue will be down low-single digits compared to 2017. Show rotation is expected to have a net negative impact on full year revenue of \$35 million to \$40 million compared to 2017. We expect GES U.S. base same-show revenue to increase at a low single digit rate. We anticipate a favorable FX Impact of approximately \$8.5 million on GES' 2018 full year revenue and no impact to GES' operating income. The expected FX Impact assumes that the U.S. dollar to the British pound exchange rate will be \$1.30 and the U.S. dollar to the Canadian dollar exchange rate will be \$0.77 during the remainder of 2018. For more information about segment operating income, see the "Non-GAAP Measures" section of this MD&A.

We are executing a strategic growth plan to position GES as the preferred global, full-service provider for Live Events, with further reach to corporate events, consumer events, conferences, and exhibitions. To support this strategy, since 2014, we have acquired two leading audio-visual production businesses and four leading event technology businesses that complement, enhance, and expand our current business and offer higher-margin growth opportunities. We continue to pursue additional opportunities to acquire businesses with proven products and services to create the most comprehensive suite of services for the Live Events industry. We are making selective investments in additional resources to capitalize on continued growth opportunities in the under-penetrated category of corporate events and in cross-selling new services.

Additionally, we remain focused on improving GES' profitability through continued efforts to effectively manage labor costs by driving productivity gains through rigorous and strategic pre-show planning and on-site labor management that reduces the ratio of labor costs to revenue. Improving this metric is a top priority as we continue to develop and enhance tools to support and systematize show site labor planning, measurement, and benchmarking.

Pursuit

The following tables present a comparison of Pursuit's reported revenue and segment operating income (loss) to organic revenue⁽³⁾ and organic segment operating income (loss)⁽³⁾ for the three and nine months ended September 30, 2018 and 2017.

(in thousands)	Three Months Ended September 30, 2018				Three Months Ended September 30, 2017				Change	
	As Reported	Acquisitions ⁽²⁾	FX Impact	Organic ⁽³⁾	As Reported	Acquisitions ⁽²⁾	Organic ⁽³⁾	As Reported	Organic ⁽³⁾	
Revenue⁽¹⁾:										
Pursuit:										
Attractions	\$60,650	\$ —	\$(2,121)	\$62,771	\$59,059	\$ —	\$59,059	2.7 %	6.3 %	
Hospitality	43,178	—	(361)	43,539	39,577	—	39,577	9.1 %	10.0 %	
Transportation	6,093	—	(207)	6,300	6,252	—	6,252	(2.5)%	0.8 %	
Travel Planning	2,676	—	(26)	2,702	2,874	—	2,874	(6.9)%	(6.0)%	
Intra-Segment Eliminations & Other										
	(544)	—	23	(567)	(782)	—	(782)	30.4%	27.5 %	
Total Pursuit	\$112,053	\$ —	\$(2,692)	\$114,745	\$106,980	\$ —	\$106,980	4.7 %	7.3 %	
Segment operating income⁽⁴⁾:										
Total Pursuit	\$55,408	\$(351)	\$(1,492)	\$57,251	\$53,860	\$ —	\$53,860	2.9 %	6.3 %	

(in thousands)	Nine Months Ended September 30, 2018				Nine Months Ended September 30, 2017				Change	
	As Reported	Acquisitions ⁽²⁾	FX Impact	Organic ⁽³⁾	As Reported	Acquisitions ⁽²⁾	Organic ⁽³⁾	As Reported	Organic ⁽³⁾	
Revenue⁽¹⁾:										
Pursuit:										
Attractions	\$93,796	\$ —	\$(1,182)	\$94,978	\$88,910	\$ —	\$88,910	5.5 %	6.8 %	
Hospitality	61,324	—	(162)	61,486	55,279	—	55,279	10.9 %	11.2 %	
Transportation	12,351	—	23	12,328	11,906	—	11,906	3.7 %	3.5 %	
Travel Planning	3,905	—	2	3,903	4,334	—	4,334	(9.9)%	(9.9)%	
Intra-Segment Eliminations & Other										
	(1,246)	—	—	(1,246)	(848)	—	(848)	(46.9)%	(46.9)%	
Total Pursuit	\$170,130	\$ —	\$(1,319)	\$171,449	\$159,581	\$ —	\$159,581	6.6 %	7.4 %	
Segment operating income⁽⁴⁾:										
Total Pursuit	\$53,770	\$(788)	\$(1,535)	\$56,093	\$53,523	\$ —	\$53,523	0.5 %	4.8 %	

- (1) Revenue by line of business does not agree to Note 2 – Revenue and Related Contract Costs and Contract Liabilities in the Notes to Condensed Consolidated Financial Statements (Part I, Item 1 of this Form 10-Q) as the amounts in the above table include product revenue from food and beverage and retail operations within each line of business.
- (2) Acquisitions for the three and nine months ended September 30, 2018 include FlyOver Iceland (acquired November 2017).
- (3) Organic revenue and organic segment operating income are non-GAAP financial measures that adjust for the impacts of exchange rate variances and acquisitions, if any, until such acquisitions are included in the entirety of both comparable periods presented. For more information about organic revenue and organic segment operating income, see the “Non-GAAP Measures” section of this MD&A.
- (4) Refer to Note 21 – Segment Information of the Notes to Condensed Consolidated Financial Statements for a reconciliation of the non-GAAP financial measure, segment operating income, to the most directly comparable GAAP measure.

Three months ended September 30, 2018 compared with the three months ended September 30, 2017

Pursuit revenue increased \$5.1 million or 4.7%, primarily driven by revenue management and refresh efforts across Pursuit's attractions and hospitality properties and the re-opening of the Mount Royal Hotel, offset in part by an unfavorable FX Impact of \$2.7 million. Organic revenue* increased \$7.8 million or 7.3%.

Pursuit operating income increased \$1.5 million or 2.9%, primarily due to the increase in revenue, offset in part by an unfavorable FX impact of \$1.5 million. Organic operating income* increased \$3.4 million or 6.3%.

Nine months ended September 30, 2018 compared with the nine months ended September 30, 2017

Pursuit revenue increased \$10.5 million or 6.6%, primarily driven by revenue management and refresh efforts across Pursuit's attractions and hospitality properties and the re-opening of the Mount Royal Hotel, offset in part by an unfavorable FX Impact of \$1.3 million. Organic revenue* increased \$11.9 million or 7.4%.

Pursuit operating income increased \$0.2 million primarily due to the increase in revenue, offset in part by an unfavorable FX impact of \$1.5 million and additional costs to support continued growth of the business. Organic operating income* increased \$2.6 million or 4.8%.

* Refer to footnote (3) in the above tables for more information about the non-GAAP financial measures of organic revenue and organic segment operating income.

Performance Measures

We evaluate the performance of Pursuit's attractions business utilizing the number of passengers and total attractions revenue per passenger. The number of passengers allows us to assess the volume of visitor activity at each attraction during the period. Total attractions revenue per passenger is calculated as total attractions revenue divided by the total number of passengers at all Pursuit attractions during the period. Total attractions revenue includes ticket sales and ancillary revenue generated by attractions, such as food and beverage and retail revenue. Total attractions revenue per passenger measures the total spend per visitor that attraction properties are able to capture, which is important to the profitability of the attractions business.

We use the following key business metrics, common in the hospitality industry, to evaluate Pursuit's hospitality business:

• **Revenue per Available Room.** RevPAR is calculated as total rooms revenue divided by the total number of room nights available for all comparable Pursuit hospitality properties during the period. Total rooms revenue does not include non-rooms revenue, which consists of ancillary revenue generated by hospitality properties, such as food and beverage and retail revenue. RevPAR measures the period-over-period change in rooms revenue per available room for comparable hospitality properties. RevPAR is affected by average daily rate and occupancy, which have different implications on profitability.

• **Average Daily Rate.** ADR is calculated as total rooms revenue divided by the total number of room nights sold for all comparable Pursuit hospitality properties during the period. ADR is used to assess the pricing levels that the hospitality properties are able to realize. Increases in ADR lead to increases in rooms revenue with no substantial effect on variable costs, therefore having a greater impact on margins than increases in occupancy.

• **Occupancy.** Occupancy is calculated as the total number of room nights sold divided by the total number of room nights available for all comparable Pursuit hospitality properties during the period. Occupancy measures the utilization of the available capacity at the hospitality properties. Increases in occupancy result in increases in rooms revenue and additional variable operating costs (including housekeeping services, utilities, and room amenity costs),

as well as increases in ancillary non-rooms revenue (including food and beverage and retail revenue).

The following table provides Pursuit's same-store key performance indicators for the three and nine months ended September 30, 2018 and 2017. The same-store metrics indicate the performance of all Pursuit's properties and attractions that we owned and operated at full capacity, considering seasonal closures, for the entirety of both periods presented. For Pursuit properties and attractions located in Canada, comparisons to the prior year are on a constant U.S. dollar basis, using the current year quarterly average exchange rates for previous periods, to eliminate the FX Impact. We believe this same-store constant currency basis provides better comparability between reporting periods.

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2018	2017	% Change	2018	2017	% Change
Same-Store Key Performance Indicators ⁽¹⁾						
Attractions:						
Passengers	1,333,204	1,361,934	(2.1)%	2,163,596	2,186,673	(1.1)%
Revenue per passenger	\$45	\$42	7.1 %	\$43	\$40	7.5 %
Hospitality:						
Room nights available	107,696	108,015	(0.3)%	201,687	201,994	(0.2)%
RevPAR	\$203	\$198	2.5 %	\$156	\$151	3.3 %
ADR	\$232	\$225	3.1 %	\$208	\$201	3.5 %
Occupancy	87.4 %	87.9 %	(0.5)%	75.3 %	74.9 %	0.4 %

⁽¹⁾ Same-Store Key Performance Indicators exclude the Mount Royal Hotel hospitality property, which was closed from December 2016 through June 2018 due to fire damage.

Attractions. The decrease in same-store passengers for the three and nine months ended September 30, 2018 was primarily due to forest fires that affected tourism in Banff and Jasper National Parks. Poor air quality and visibility due to smoke resulted in lower year-on-year passenger volumes at our attractions. The increase in revenue per passenger for the three and nine months ended September 30, 2018 was primarily driven by our revenue management efforts.

Hospitality. The increase in RevPAR during the three and nine months ended September 30, 2018 was primarily due to stronger ADR, offset in part by lower occupancy during the 2018 third quarter driven by forest fires that reduced occupancy at certain hospitality properties near Glacier National Park. The increase in ADR was primarily driven by our revenue management and refresh efforts.

During 2017, Pursuit derived approximately 64% of its revenue and 86% of its segment operating income from its Canadian operations, which are largely dependent on foreign customer visitation. Accordingly, the strengthening or weakening of the Canadian dollar, relative to other currencies, could affect customer volumes and the results of operations. Additionally, Pursuit is affected by consumer discretionary spending on tourism activities.

2018 Outlook

For the 2018 full year, we expect Pursuit's revenue to increase at mid- to high-single digit rate. We expect Pursuit's full year revenue to be favorably impacted by approximately \$4.5 million from the re-opening of the Mount Royal Hotel in July 2018, as well as continued focus on revenue management and refresh efforts across our attractions and hospitality portfolio. We expect to incur start-up costs related to the development of our FlyOver Iceland attraction, which is expected to open in 2019, of approximately \$1 million during 2018 (\$0.8 million of which was incurred during the first nine months of 2018). We anticipate an unfavorable FX Impact of approximately \$1.5 million on

Pursuit's 2018 revenue and operating income.

Business Interruption Gain

(in thousands)	Three Months Ended September 30,			Nine Months Ended September 30,		
	2018	2017	Percentage Change 2018 vs. 2017	2018	2017	Percentage Change 2018 vs. 2017
Business interruption gain	\$(35)	\$(1,091)	96.8	\$(602)	\$(2,231)	73.0

Business interruption gains are related to the recovery of lost profits from the Mount Royal Hotel, which was damaged by a fire and closed from December 2016 through June 2018.

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Corporate Activities

(in thousands)	Three Months Ended September 30,			Nine Months Ended September 30,		
	2018	2017	Percentage Change 2018 vs. 2017	2018	2017	Percentage Change 2018 vs. 2017
Corporate activities	\$3,777	\$4,425	(14.6)%	\$8,529	\$9,886	(13.7)%

The decrease in corporate activities during the three and nine months ended September 30, 2018 was primarily due to a decrease in performance-based compensation expense.

Other Expense

(in thousands)	Three Months Ended September 30,			Nine Months Ended September 30,		
	2018	2017	Percentage Change 2018 vs. 2017	2018	2017	Percentage Change 2018 vs. 2017
Other expense	\$ 527	\$ 248	**	\$1,308	\$922	41.9%

** Change is greater than +/- 100%

On January 1, 2018, we adopted ASU 2017-07, which requires retrospective adoption. As a result, we recorded the nonservice cost component of net periodic benefit cost within other expense for the three and nine months ended September 30, 2018, and we reclassified \$0.2 million for the three months ended September 30, 2017 and \$0.9 million for the nine months ended September 30, 2017 from operating expenses to other expense to conform to current period presentation. Refer to Note 17 – Pension and Postretirement Benefits.

Impairment Recoveries

(in thousands)	Three Months Ended September 30,			Nine Months Ended September 30,		
	2018	2017	Percentage Change 2018 vs. 2017	2018	2017	Percentage Change 2018 vs. 2017
Impairment recoveries	\$—	\$(24,467)	(100.0)%	\$(35)	\$(29,098)	99.9%

The impairment recoveries recorded during the three and nine months ended September 30, 2017 were related to insurance proceeds received as a partial settlement for fire damage to the Mount Royal Hotel.

Income Taxes

The effective tax rate was 21.8% for the three months ended September 30, 2018 and 30.4% for the three months ended September 30, 2017. The effective tax rate was 22.8% for the nine months ended September 30, 2018 and 29.0% for the nine months ended September 30, 2017. The decrease in the effective rate for 2018 was primarily due to

a \$3.1 million benefit related to reductions in our estimated repatriation tax and the re-measurement of our deferred tax assets, as well as the lower federal tax rate due to Tax Reform, partially offset by increased non-deductible expenses, a higher effective state tax rate, and our mix of domestic versus foreign income, which is taxed at higher rates.

Discontinued Operations

(in thousands)	Three Months Ended September 30,			Nine Months Ended September 30,		
	2018	2017	Percentage Change 2018 vs. 2017	2018	2017	Percentage Change 2018 vs. 2017
Income (loss) from discontinued operations	\$ (246)	\$ (101)	**	\$ 403	\$ (408)	**

** Change is greater than +/- 100%

The loss from discontinued operations for the three months ended September 30, 2018 and 2017 was primarily related to legal expenses associated with previously sold operations. The income from discontinued operations for the nine months ended September 30, 2018 was primarily related to a favorable legal settlement related to previously sold operations. The loss from discontinued

operations for the nine months ended September 30, 2017 was primarily related to legal expenses associated with previously sold operations, offset in part by a reduction in an uncertain tax position due to the lapse of statute.

Liquidity and Capital Resources

Cash and cash equivalents were \$55.5 million as of September 30, 2018, as compared to \$53.7 million as of December 31, 2017. During the nine months ended September 30, 2018, we generated net cash from operating activities of \$101.6 million. We believe that our existing sources of liquidity will be sufficient to fund operations and capital commitments for at least the next 12 months.

As of September 30, 2018, approximately \$46.0 million of our cash and cash equivalents was held outside of the United States, consisting of \$23.7 million in Canada, \$9.1 million in the Netherlands, \$4.7 in the United Arab Emirates, \$4.4 million in the United Kingdom, and \$1.7 million in certain other countries. In addition, there is \$2.4 million in Iceland related to our investment in Esja, which will be used to develop the FlyOver Iceland attraction.

Cash Flows

Operating Activities

(in thousands)	Nine Months Ended September 30,	
	2018	2017
Net income	\$52,093	\$80,128
Depreciation and amortization	44,364	42,499
Deferred income taxes	3,182	318
(Income) loss from discontinued operations	(403)	408
Impairment recoveries	(35)	(29,098)
Other non-cash items	9,473	14,369
Changes in assets and liabilities	(7,064)	6,019
Net cash provided by operating activities	\$101,610	\$114,643

Net cash provided by operating activities decreased \$13.0 million, primarily due to an unfavorable change in working capital.

Investing Activities

(in thousands)	Nine Months Ended September 30,	
	2018	2017
Capital expenditures	\$(69,596)	\$(39,493)
Proceeds from insurance	—	31,570
Cash paid for acquired businesses, net	—	(1,661)
Proceeds from dispositions of property and other assets	1,320	734
Net cash used in investing activities	\$(68,276)	\$(8,850)

Net cash used in investing activities increased \$59.4 million primarily due to an increase in capital expenditures in 2018. In addition, we received \$31.6 million of Mount Royal Hotel fire-related insurance proceeds in 2017.

Financing Activities

(in thousands)	Nine Months Ended	
	September 30,	
	2018	2017
Proceeds from borrowings	\$ 101,336	\$ 60,574
Payments on debt and capital lease obligations	(113,429)	(128,808)
Dividends paid on common stock	(6,128)	(6,119)
Debt issuance costs	—	(5)
Common stock purchased for treasury	(10,240)	(1,272)
Proceeds from exercise of stock options	84	—
Net cash used in financing activities	\$(28,377)	\$(75,630)

Net cash used in financing activities decreased \$47.3 million primarily due to net debt payments of \$12.1 million during the nine months ended September 30, 2018 compared to \$68.2 million during the nine months ended September 30, 2017, offset in part by the repurchase of treasury shares of \$10.2 million in 2018 compared to \$1.3 million in 2017.

Debt and Capital Lease Obligations

Refer to Note 12 – Debt and Capital Lease Obligations of the Notes to Condensed Consolidated Financial Statements for further discussion, which discussion is incorporated by reference herein.

Share Repurchases

Our Board of Directors has authorized us to repurchase shares of our common stock from time to time at prevailing market prices. During the nine months ended September 30, 2018, we repurchased 175,091 shares on the open market for \$9.1 million. No shares were repurchased on the open market during 2017. As of September 30, 2018, 265,449 shares remained available for repurchase. The Board of Directors' authorization does not have an expiration date. We repurchased 21,767 shares for \$1.2 million during the nine months ended September 30, 2018 and 26,916 shares for \$1.3 million during 2017 related to tax withholding requirements on vested share-based awards.

Off-Balance Sheet Arrangements

We have not entered into any off-balance sheet arrangements with unconsolidated special-purpose or other entities that would materially affect our financial position, results of operations, liquidity, or capital resources. Furthermore, we do not have any relationships with special-purpose or other entities that provide off-balance sheet financing; liquidity, market risk, or credit risk support; or engage in leasing or other services that may expose us to liability or risks of loss that are not reflected in the condensed consolidated financial statements and related notes. Refer to Note 12 – Debt and Capital Lease Obligations and Note 19 – Litigation, Claims, Contingencies, and Other of the Notes to Condensed Consolidated Financial Statements (Part I, Item 1 of this quarterly report on Form 10-Q) for further information, which information is incorporated by reference herein.

Critical Accounting Policies and Estimates

Critical accounting policies are those policies that are most important to the portrayal of our financial position and results of operations, and that require us to make the most difficult and subjective judgements, often as a result of the need to make estimates of matters that are inherently uncertain. Following is our revenue recognition policy, which we

revised upon the adoption of Topic 606. Refer to “Management’s Discussion and Analysis of Financial Condition and Results of Operations” (Part II, Item 7) of our Annual Report on Form 10-K for the year ended December 31, 2017, for a discussion of all our other critical accounting policies and estimates.

Revenue recognition – Beginning January 1, 2018, revenue is measured based on a specified amount of consideration in a contract with a customer, net of commissions paid to customers and amounts collected on behalf of third parties. We recognize revenue when a performance obligation is satisfied by transferring control of a product or service to a customer.

GES’ service revenue is primarily derived through its comprehensive range of services to event organizers and corporate brand marketers including Core Services, Audio-Visual, and Event Technology. GES’ service revenue is earned over time over the duration of the exhibition, conference or corporate event, which generally lasts one to three days; however we use the practical expedient of recognizing service revenue at the close of the event when we have the right to invoice. GES’ product revenue is derived from the build of exhibits and environments and graphics. GES’ product revenue is recognized at a point in time upon delivery of the product.

Pursuit's service revenue is derived through its accommodations, admissions, transportation, and travel planning services. Pursuit's product revenue is derived through food and beverage and retail sales. Pursuit's revenue is recognized at the time services are performed or upon delivery of the product. Pursuit's service revenue is recognized over time as the customer simultaneously receives and consumes the benefits. Pursuit's product revenue is recognized at a point in time.

Impact of Recent Accounting Pronouncements

Refer to Note 1 – Overview and Basis of Presentation of the Notes to Condensed Consolidated Financial Statements for further information.

Non-GAAP Measures

In addition to disclosing financial results that are determined in accordance with U.S. generally accepted accounting principles ("GAAP"), we also disclose non-GAAP financial measures of Segment operating income, organic revenue, and organic segment operating income (collectively, the "Non-GAAP Measures"). The presentation of the Non-GAAP Measures is supplemental to, but not as a substitute for, other measures of financial performance reported in accordance with GAAP. As not all companies use identical calculations, the Non-GAAP Measures may not be comparable to similarly titled measures used by other companies. We believe that the presentation of the Non-GAAP Measures provides useful information to investors regarding our results of operations for trending, analyzing, and benchmarking the performance and value of our business.

“Segment operating income” is net income attributable to Viad before income (loss) from discontinued operations, corporate activities, interest expense and interest income, income taxes, restructuring charges, impairment recoveries, and the reduction for income attributable to noncontrolling interest. Segment operating income is used to measure the profit and performance of our operating segments to facilitate period-to-period comparisons. Refer to Note 21 – Segment Information of the Notes to Condensed Consolidated Financial Statements for a reconciliation of segment operating income to income from continuing operations before income taxes.

“Organic revenue” and “organic segment operating income” are revenue and segment operating income (as defined above), respectively, without the impact of exchange rate variances and acquisitions, if any, until such acquisitions are included in the entirety of both comparable periods. The impact of exchange rate variances is calculated as the difference between current period activity translated at the current period's exchange rates and the comparable prior period's exchange rates. We believe the presentation of “organic” results permits investors to better understand our performance without the effects of exchange rate variances or acquisitions and to facilitate period-to-period comparisons and analysis of our operating performance. Refer to the “Results of Operations” section of this MD&A for reconciliations of organic revenue and organic segment operating income to the most directly comparable GAAP measures.

The Non-GAAP Measures are considered useful operating metrics as potential variations arising from taxes, debt service costs, impairment recoveries, changes in accounting principles, and the effects of discontinued operations are eliminated, thus resulting in additional measures considered to be indicative of our ongoing operations and segment performance. Although the Non-GAAP Measures are used as financial measures to assess the performance of the business, the use of these measures is limited because these measures do not consider material costs, expenses, and other items necessary to operate our business. These items include debt service costs, expenses related to U.S. federal, state, local and foreign income taxes, impairment recoveries, and the effects of accounting changes and discontinued operations. Since the Non-GAAP Measures do not consider the above items, a user of our financial information should consider net income attributable to Viad as an important measure of financial performance because it provides a more complete measure of our performance.

Forward-Looking Non-GAAP Financial Measure

We also provide segment operating income as a forward-looking Non-GAAP Measure within the “Results of Operations” section of this MD&A. We do not provide a reconciliation of this forward-looking Non-GAAP Measure to the most directly comparable GAAP financial measure because, due to variability and difficulty in making accurate forecasts and projections and/or certain information not being ascertainable or accessible, not all of the information necessary for a quantitative reconciliation of this forward-looking Non-GAAP Measure to the most directly comparable GAAP financial measure is available without unreasonable efforts. Consequently, any attempt to disclose such reconciliation would imply a degree of precision that investors could find confusing or misleading. It is probable that this forward-looking Non-GAAP Measure may be materially different from the corresponding GAAP Measure.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Our market risk exposure relates to fluctuations in foreign exchange rates and interest rates. Foreign exchange risk is the risk that fluctuating exchange rates will adversely affect our financial condition or results of operations. Interest rate risk is the risk that changing interest rates will adversely affect our earnings or financial position.

Our foreign operations are primarily in Canada, the United Kingdom, the Netherlands, Germany, and to a lesser extent, in certain other countries. The functional currency of our foreign subsidiaries is their local currency. Accordingly, for purposes of consolidation, we translate the assets and liabilities of our foreign subsidiaries into U.S. dollars at the foreign exchange rates in effect at the balance sheet date. The unrealized gains or losses resulting from the translation of these foreign denominated assets and liabilities are included as a component of accumulated other comprehensive income (loss) in the Condensed Consolidated Balance Sheets. As a result, significant fluctuations in foreign exchange rates relative to the U.S. dollar may result in material changes to our net equity position reported in the Condensed Consolidated Balance Sheets. We do not currently hedge our equity risk arising from the translation of foreign denominated assets and liabilities. We recorded cumulative unrealized foreign currency translation losses in stockholders' equity of \$19.9 million as of September 30, 2018 and \$12.0 million as of December 31, 2017. We recorded unrealized foreign currency translation losses in other comprehensive income of \$7.9 million during the nine months ended September 30, 2018 and unrealized foreign currency translation gains of \$18.8 million during the nine months ended September 30, 2017, in each case, net of tax.

For purposes of consolidation, revenue, expenses, gains, and losses related to our foreign operations are translated into U.S. dollars at the average foreign exchange rates for the period. As a result, our consolidated results of operations are exposed to fluctuations in foreign exchange rates as revenue and segment operating income of our foreign operations, when translated, may vary from period to period, even when the functional currency amounts have not changed. Such fluctuations may adversely impact overall expected profitability and historical period-to-period comparisons. We do not currently hedge our earnings exposure arising from the translation of our foreign revenue and segment operating income. Refer to "Management's Discussion and Analysis of Financial Condition and Results of Operations" for a discussion on the "Foreign Exchange Rate Variances."

We are exposed to foreign exchange transaction risk, as our foreign subsidiaries have certain revenue transactions denominated in currencies other than the functional currency of the respective subsidiary. From time to time, we utilize forward contracts to mitigate the impact on earnings related to these transactions due to fluctuations in foreign exchange rates. As of September 30, 2018 and December 31, 2017, we did not have any foreign currency forward contracts outstanding.

We are exposed to short-term and long-term interest rate risk on certain of our debt obligations. We do not currently use derivative financial instruments to hedge cash flows for such obligations.

Item 4. Controls and Procedures

We have established disclosure controls and procedures that are designed to ensure that information required to be disclosed in our reports filed or submitted under the Securities Exchange Act of 1934, as amended (the "Exchange Act") is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms, and such information is accumulated and communicated to our management, including our Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"), as appropriate to allow timely decisions regarding required disclosure. Management, together with our CEO and CFO, evaluated the effectiveness of our disclosure controls and procedures as of September 30, 2018. Based on this evaluation, the CEO and CFO concluded that our disclosure controls and procedures were effective as of September 30, 2018.

There were no changes in our internal control over financial reporting during the three months ended September 30, 2018 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

Refer to Note 19 – Litigation, Claims, Contingencies, and Other of the Notes to Condensed Consolidated Financial Statements (Part I, Item 1 of this Form 10-Q) for information regarding our legal proceedings that is incorporated by reference herein.

Item 1A. Risk Factors

In addition to other information set forth in this report, careful consideration should be given to the factors discussed in Part I, Item 1A – Risk Factors and Part II, Item 7 – Management’s Discussion and Analysis of Financial Condition and Results of Operations of our 2017 Form 10-K, which could materially affect our business, financial condition and/or future results.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

The following table summarizes the total number of shares of our common stock that were repurchased during the three months ended September 30, 2018 pursuant to publicly announced plans or programs, as well as certain previously owned shares of common stock that were surrendered by employees, former employees, and non-employee directors for tax withholding requirements on vested share-based awards.

ISSUER PURCHASES OF EQUITY SECURITIES

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares That May Yet Be Purchased Under the Plans or Programs
July 1, 2018 - July 31, 2018	—	\$ —	—	265,449
August 1, 2018 - August 31, 2018	397	\$ 59.35	—	265,449
September 1, 2018 - September 30, 2018	2,133	\$ 61.45	—	265,449
Total	2,530	\$ 61.12	—	265,449

In November 2012, our Board of Directors authorized us to repurchase shares of our common stock from time to time at prevailing market prices. During the nine months ended September 30, 2018, 175,091 shares were repurchased on the open market for \$9.1 million. The Board’s authorization has no expiration date.

Effective October 24, 2018, we entered into the 2018 Credit Agreement that provides for the \$450 million 2018 Credit Facility. The terms of the 2018 Credit Facility allow us to make dividends or repurchases of our common stock up to \$20 million per calendar year. Stock dividends and repurchases above the \$20 million are permitted as long as our pro forma leverage ratio is less than or equal to 2.75 to 1.00. Dividends are permitted up to an additional \$15 million in any calendar year. For additional information on the 2018 Credit Facility, refer to Note 12 – Debt and Capital Lease Obligations and Note 23 – Subsequent Events of the Notes to Consolidated Financial Statements.

Item 6. Exhibits

Exhibit Number	Exhibit Description	Incorporated by Reference Period		
		Form	Ending Exhibit	Filing Date
4.1	<u>\$450,000,000 Second Amended and Restated Credit Agreement, dated as of October 24, 2018, by and among Viad Corp, JPMorgan Chase Bank, N.A., as administrative agent, and the lenders party thereto.</u>	8-K	4.1	10/25/2018
31.1	<u>Certification of Chief Executive Officer of Viad Corp pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, for the period ended September 30, 2018.</u> *			
31.2	<u>Certification of Chief Financial Officer of Viad Corp pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, for the period ended September 30, 2018.</u> *			
32.1	<u>Certifications of Chief Executive Officer and Chief Financial Officer of Viad Corp pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, for the period ended September 30, 2018.</u> **			
101.INS	* XBRL Instance Document.			
101.SCH	* XBRL Taxonomy Extension Schema Document.			
101.CAL	* XBRL Taxonomy Extension Calculation Linkbase Document.			
101.DEF	* XBRL Taxonomy Extension Definition Linkbase Document.			
101.LAB	* XBRL Taxonomy Extension Label Linkbase Document.			
101.PRE	* XBRL Taxonomy Extension Presentation Linkbase Document.			

* Filed herewith.

**Furnished herewith.

SIGNATURES

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

VIAD CORP
(Registrant)

November 2, 2018 By: /s/ Leslie S. Striedel
(Date) Leslie S. Striedel
 Chief Accounting Officer (Duly Authorized Officer)