

KRONOS INTERNATIONAL INC
Form 10-Q
August 03, 2010

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarter ended June 30, 2010
Commission file number 333-100047

KRONOS INTERNATIONAL, INC.
(Exact name of Registrant as specified in its charter)

DELAWARE
(State or other jurisdiction of
incorporation or organization)

22-2949593
(IRS Employer Identification No.)

5430 LBJ Freeway, Suite 1700
Dallas, Texas 75240-2697
(Address of principal executive offices)

Registrant's telephone number, including area code: (972) 233-1700

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 and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes No

* The registrant has not yet been phased into the interactive data requirements

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company (as defined in Rule 12b-2 of the Securities Exchange Act of 1934). Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

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

Number of shares of the Registrant's common stock outstanding on July 30, 2010: 2,968.

The Registrant is a wholly owned subsidiary of Kronos Worldwide, Inc. (File No. 1-31763) and meets the conditions set forth in General Instructions H(1)(a) and H(1)(b) of Form 10-Q for reduced disclosure format.

KRONOS INTERNATIONAL, INC. AND SUBSIDIARIES

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Items 2, 3, 4 and 5 of Part II are omitted because there is no information to report.

KRONOS INTERNATIONAL, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(In millions)

ASSETS	December 31, 2009	June 30, 2010 (Unaudited)
Current assets:		
Cash and cash equivalents	\$29.4	\$26.3
Restricted cash	1.7	1.2
Accounts and other receivables	141.5	174.3
Inventories	207.7	172.0
Prepaid expenses and other	6.3	5.3
Deferred income taxes	.1	.1
Total current assets	386.7	379.2
Other assets:		
Deferred financing costs, net	5.8	4.1
Deferred income taxes	185.5	181.8
Other	5.2	4.6
Total other assets	196.5	190.5
Property and equipment:		
Land	45.1	39.0
Buildings	181.6	156.6
Equipment	862.3	747.7
Mining properties	115.7	104.0
Construction in progress	7.9	14.3
	1,212.6	1,061.6
Less accumulated depreciation and amortization	781.9	694.2
Net property and equipment	430.7	367.4
Total assets	\$1,013.9	\$937.1

KRONOS INTERNATIONAL, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS (CONTINUED)

(In millions)

LIABILITIES AND STOCKHOLDER'S EQUITY	December 31, 2009	June 30, 2010 (Unaudited)
Current liabilities:		
Current maturities of long-term debt	\$2.1	\$20.5
Accounts payable and accrued liabilities	163.4	153.1
Income taxes	3.6	3.7
Deferred income taxes	4.7	3.8
Total current liabilities	173.8	181.1
Noncurrent liabilities:		
Long-term debt	594.4	498.7
Deferred income taxes	11.6	9.2
Accrued pension cost	108.6	91.9
Other	22.1	21.1
Total noncurrent liabilities	736.7	620.9
Stockholder's equity:		
Common stock	.3	.3
Additional paid-in capital	1,962.1	1,969.1
Retained deficit	(1,471.6)	(1,422.3)
Notes receivable from affiliates	(235.6)	(245.5)
Accumulated other comprehensive loss	(151.8)	(166.5)
Total stockholder's equity	103.4	135.1
Total liabilities and stockholder's equity	\$1,013.9	\$937.1

Commitments and contingencies (Notes 6 and 9)

See accompanying Notes to Condensed Consolidated Financial Statements.

KRONOS INTERNATIONAL, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In millions)

	Three months ended		Six months ended	
	June 30,		June 30,	
	2009	2010	2009	2010

(Unaudited)

Net sales	\$ 196.7	\$ 256.6	\$ 368.3	\$ 485.4
Cost of sales	197.7	201.6	375.7	389.2
Gross margin	(1.0)	55.0	(7.4)	96.2
Selling, general and administrative expense	26.5	30.7	53.2	60.8
Currency transaction gains (losses), net	(.7)	(1.7)	5.8	.3
Other operating income, net	1.2	3.1	2.6	5.0
Income (loss) from operations	(27.0)	25.7	(52.2)	40.7
Other income (expense):				
Interest income	.1	-	.1	-
Interest expense	(10.0)	(9.5)	(19.3)	(19.5)
Income (loss) before income taxes	(36.9)	16.2	(71.4)	21.2
Income tax expense (benefit)	(10.8)	7.2	(21.2)	(28.1)
Net income (loss)	\$(26.1)	\$9.0	\$(50.2)	\$ 49.3

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See accompanying Notes to Condensed Consolidated Financial Statements.

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KRONOS INTERNATIONAL, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDER'S EQUITY AND COMPREHENSIVE INCOME (LOSS)

Six months ended June 30, 2010

(In millions)

	Common stock	Additional paid-in capital	Retained deficit	Notes receivable from affiliates (Unaudited)	Accumulated other comprehensive loss	Total stockholder's equity	Comprehensive income (loss)
Balance at December 31, 2009	\$.3	\$ 1,962.1	\$(1,471.6)	\$(235.6)	\$ (151.8)	\$ 103.4	
Net income	-	-	49.3	-		49.3	\$ 49.3
Other comprehensive loss, net of tax	-	-	-	-	(14.7)	(14.7)	(14.7)
Intercompany interest – Kronos Worldwide, Inc.	-	7.0	-	(9.9)	-	(2.9)	-
Balance at June 30, 2010	\$.3	\$ 1,969.1	\$(1,422.3)	\$(245.5)	\$ (166.5)	\$ 135.1	
Comprehensive income							\$ 34.6

See accompanying Notes to Condensed Consolidated Financial Statements.

KRONOS INTERNATIONAL, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In millions)

	Six months ended June 30,	
	2009	2010
	(Unaudited)	
Cash flows from operating activities:		
Net income (loss)	\$(50.2)	\$49.3
Depreciation and amortization	19.8	19.5
Deferred income taxes	(23.9)	(32.6)
Defined benefit pension plan expense greater (less) than cash funding	(2.7)	1.2
Other, net	.5	1.9
Change in assets and liabilities:		
Accounts and other receivables	(15.2)	(57.9)
Inventories	114.1	8.0
Prepaid expenses	(.4)	.2
Accounts payable and accrued liabilities	(11.6)	3.8
Income taxes	2.7	.9
Accounts with affiliates	3.3	5.2
Other, net	.3	2.4
Net cash provided by operating activities	36.7	1.9
Cash flows from investing activities:		
Capital expenditures	(13.3)	(11.9)
Change in restricted cash, net	.5	.4
Net cash used in investing activities	(12.8)	(11.5)
Cash flows from financing activities:		
Indebtedness:		
Borrowings	29.1	38.1
Principal payments	(.7)	(28.5)
Net cash provided by financing activities	28.4	9.6
Cash and cash equivalents - net change from:		
Operating, investing and financing activities	52.3	-
Currency translation	2.2	(3.1)
Balance at beginning of period	10.8	29.4
Balance at end of period	\$65.3	\$26.3

Supplemental disclosures:

Cash paid for (received):

Interest	\$18.8	\$18.1
Income taxes	(.8)	2.9
Accrual for capital expenditures	.7	3.8
Capital lease obligation incurred	3.6	-

See accompanying Notes to Condensed Consolidated Financial Statements.

KRONOS INTERNATIONAL, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2010

(Unaudited)

Note 1 - Organization and basis of presentation:

Organization – We are a wholly-owned subsidiary of Kronos Worldwide, Inc. ("Kronos") (NYSE: KRO). We are incorporated in the state of Delaware, U.S.A., with our seat of management in Leverkusen, Germany. At June 30, 2010, Valhi, Inc. (NYSE: VHI) held approximately 59% of Kronos' outstanding common stock and NL Industries, Inc. (NYSE: NL) held an additional 36% of Kronos' common stock. Valhi owns approximately 83% of NL's outstanding common stock. Approximately 93% of Valhi's outstanding common stock is held by subsidiaries of Contran Corporation. Substantially all of Contran's outstanding voting stock is held by trusts established for the benefit of certain children and grandchildren of Harold C. Simmons (for which Mr. Simmons is sole trustee), or is held directly by Mr. Simmons or other persons or entities related to Mr. Simmons. Consequently, Mr. Simmons may be deemed to control each of these companies.

Basis of presentation – The unaudited Condensed Consolidated Financial Statements contained in this Quarterly Report have been prepared on the same basis as the audited Consolidated Financial Statements in our Annual Report on Form 10-K for the year ended December 31, 2009 that we filed with the Securities and Exchange Commission ("SEC") on March 9, 2010 (the "2009 Annual Report"). In our opinion, we have made all necessary adjustments (which include only normal recurring adjustments) in order to state fairly, in all material respects, our consolidated financial position, results of operations and cash flows as of the dates and for the periods presented. We have condensed the Consolidated Balance Sheet and Statement of Stockholder's Equity and Comprehensive Income (Loss) at December 31, 2009 contained in this Quarterly Report as compared to our audited Consolidated Financial Statements at that date, and we have omitted certain information and footnote disclosures (including those related to the Consolidated Balance Sheet at December 31, 2009) normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP"). Our results of operations for the interim periods ended June 30, 2010 may not be indicative of our operating results for the full year. The Condensed Consolidated Financial Statements contained in this Quarterly Report should be read in conjunction with our 2009 Consolidated Financial Statements contained in our 2009 Annual Report.

Unless otherwise indicated, references in this report to "we," "us" or "our" refer to Kronos International, Inc. and its subsidiaries taken as a whole.

Note 2 – Accounts and other receivables:

	December 31, 2009	June 30, 2010
	(In millions)	
Trade receivables	\$126.8	\$152.8
Recoverable VAT and other receivables	15.3	20.8
Refundable income taxes	.4	.1
Receivable from affiliate - Kronos Canada	1.6	2.5
Allowance for doubtful accounts	(2.6)	(1.9)
Total	\$141.5	\$174.3

Note 3 - Inventories:

	December 31, 2009	June 30, 2010
	(In millions)	
Raw materials	\$46.8	\$39.9
Work in process	13.3	9.3
Finished products	98.9	81.7
Supplies	48.7	41.1
Total	\$207.7	\$172.0

Note 4 - Accounts payable and accrued liabilities:

	December 31, 2009	June 30, 2010
	(In millions)	
Accounts payable	\$69.9	\$65.9
Employee benefits	18.7	19.3
Accrued sales discounts and rebates	19.3	9.1
Payable to affiliates:		
Kronos (US), Inc.	30.2	32.8
Kronos Canada, Inc.	.2	.4
Accrued interest	7.9	6.9
Other	17.2	18.7
Total	\$163.4	\$153.1

Note 5 - Long-term debt:

	December 31, 2009	June 30, 2010
	(In millions)	
Long term debt:		
6.5% Senior Secured Notes	\$574.6	\$493.3
Revolving credit facility	13.0	18.6
Other	8.9	7.3
Total debt	596.5	519.2
Less current maturities	2.1	20.5
Total long-term debt	\$594.4	\$498.7

Revolving credit facility - During the first six months of 2010, we borrowed a net euro 6.0 million (\$10.3 million when borrowed/repaid) under our bank credit facility. The average interest rate on these borrowings at June 30, 2010 was 4.15%. Our revolving credit facility currently matures in May 2011. We have commenced discussions with the lenders in such facility regarding an extension of the facility, and we expect to have a new agreement of extension in place prior to such maturity date.

In May 2010, we satisfied certain specified financial covenants in our revolving credit facility, and as a result the maximum borrowing availability under such facility returned to the full euro 80 million facility size at that time. In addition, in August 2010 we satisfied the financial ratio of net secured debt to earnings before income taxes, interest and depreciation as defined in the credit facility, and as a result two financial covenants added to such credit facility in September 2009 became no longer effective, and the interest rate on outstanding borrowings under such credit facility will prospectively be reduced from LIBOR plus a margin ranging from 3% to 4% to LIBOR plus 1.75%.

Restrictions and other. Our credit facility described above requires the borrower to maintain minimum levels of equity, requires the maintenance of certain financial ratios, limits dividends and additional indebtedness and contains other provisions and restrictive covenants customary in lending transactions of this type. We are in compliance with all of our debt covenants at June 30, 2010. We believe we will be able to comply with the financial covenants contained in our credit facility through the maturity of the facility; however if future operating results differ materially from our expectations we may be unable to maintain compliance.

The terms of the indenture governing the 6.5% Senior Secured Notes limit our ability to pay dividends and make other restricted payments. At June 30, 2010, the maximum amount of dividends and other restricted payments that we could make (the "Restricted Payment Basket") was \$9.2 million. The indenture currently prohibits us from utilizing such Restricted Payment Basket because we have not met a specified financial ratio contained in this indenture; such prohibition will continue until such time as we meet the specified financial ratio.

Note 6 - Income taxes:

	Six months ended June 30,	
	2009	2010
	(In millions)	
Expected tax expense (benefit), at U.S. federal statutory income tax rate of 35%	\$(25.0)	\$7.4
Non-U.S. tax rates	2.2	(.8)
Nondeductible expenses	1.5	.7
German tax attribute adjustment	-	(35.2)
Change in reserve for uncertain tax positions	.7	.6
Prior year adjustment	-	(.7)
Other, net	(.6)	(.1)
Total	\$(21.2)	\$(28.1)

Certain of our non-U.S. tax returns are being examined and tax authorities may propose tax deficiencies, including interest and penalties. We cannot guarantee that these tax matters will be resolved in our favor due to the inherent uncertainties involved in settlement initiatives and court and tax proceedings. We believe we have adequate accruals for additional taxes and related interest expense which could ultimately result from tax examinations. We believe the ultimate disposition of tax examinations should not have a material adverse effect on our consolidated financial position, results of operations or liquidity. We do not currently believe that our unrecognized tax benefits will change

significantly within the next twelve months.

As a consequence of a European Court ruling that resulted in a favorable resolution of certain income tax issues in Germany, during the first quarter of 2010 the German tax authorities agreed to an increase in our German net operating loss carryforwards. Accordingly, we recognized a non-cash income tax benefit of \$35.2 million in the first quarter of 2010.

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Note 7 – Employee benefit plans:

The components of net periodic defined benefit pension cost are presented in the table below.

	Three months ended		Six months ended	
	June 30,		June 30,	
	2009	2010	2009	2010
	(In millions)			
Service cost	\$1.4	\$1.9	\$2.7	\$4.0
Interest cost	4.4	4.2	8.7	8.7
Expected return on plan assets	(2.9)	(2.9)	(5.7)	(6.1)
Amortization of prior service cost	.1	.1	.2	.3
Amortization of net transition obligations	-	.1	.1	.1
Recognized actuarial losses	1.1	1.1	2.1	2.3
Total	\$4.1	\$4.5	\$8.1	\$9.3

Contributions – We expect our 2010 contributions for our pension plans to be consistent with the amount disclosed in our 2009 Annual Report.

Note 8 – Other noncurrent liabilities:

	December	
	31, 2009	June 30, 2010
	(In millions)	
Reserve for uncertain tax positions	\$9.5	\$10.2
Employee benefits	9.2	7.9
Other	3.4	3.0
Total	\$22.1	\$21.1

Note 9 – Commitments and contingencies:

Litigation matters – From time-to-time we are involved in various environmental, contractual, product liability, patent (or intellectual property), employment and other claims and disputes incidental to our operations. In certain cases, we have insurance coverage for these items. We currently believe the disposition of all claims and disputes, individually or in the aggregate, should not have a material adverse effect on our consolidated financial position, results of operations or liquidity beyond the accruals we have already provided for.

Please refer to our 2009 Annual Report and our Quarterly Report on Form 10-Q for the quarter ended March 31, 2010 for a discussion of certain other legal proceedings to which we are a party.

Note 10 – Financial instruments:

The following table summarizes the valuation of our short-term investments and financial instruments recorded on a fair value basis under ASC Topic 820, Fair Value Measurements and Disclosures as of December 31, 2009 and June 30, 2010:

	Total	Fair Value Measurements		
		Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
		(in millions)		
Currency forward contracts				
December 31, 2009	\$1.6	\$1.6	\$-	\$ -
June 30, 2010	(2.7)	(2.7)	-	-

Certain of our sales generated by our operations are denominated in U.S. dollars. We periodically use currency forward contracts to manage a nominal portion of currency exchange rate risk associated with trade receivables denominated in a currency other than the holder's functional currency or similar exchange rate risk associated with future sales. We have not entered into these contracts for trading or speculative purposes in the past, nor do we currently anticipate entering into such contracts for trading or speculative purposes in the future. The fair value of the currency forward contracts is determined using Level 1 inputs based on the currency spot forward rates quoted by banks or currency dealers. At June 30, 2010, we had currency forward contracts to exchange:

- an aggregate euro 10.6 million for an equivalent value of Norwegian kroner at exchange rates ranging from kroner 8.47 to kroner 9.08 per euro. These contracts with DnB Nor Bank ASA mature from July 2010 through December 2010 at a rate of euro 1.6 million to euro 1.8 million per month, subject to early redemption provisions at our option. At June 30, 2010, the actual exchange rate was kroner 7.97 per euro; and
- an aggregate \$52.1 million for an equivalent value of Norwegian kroner at exchange rates ranging from kroner 5.88 to kroner 6.60 per U.S. dollar. These contracts with DnB Nor Bank ASA mature from July 2010 through July 2011 at a rate of \$2.3 million to \$5.5 million per month. At June 30, 2010 the actual exchange rate was Kroner 6.44 per U.S. dollar.

The estimated fair value of our currency forward contracts at June 30, 2010 was a \$2.7 million net liability, which is included in our Condensed Consolidated Balance Sheet as (i) \$1.1 million recognized as part of Prepaid Expenses and Other and (ii) \$3.8 million recognized as a part of Accounts Payable and Accrued Liabilities. There is also a corresponding \$2.7 million currency transaction loss in our Condensed Consolidated Statement of Operations. We are not currently using hedge accounting for our outstanding currency forward contracts at June 30, 2010, and we did not use hedge accounting for any of such contracts we previously held earlier in 2010 and 2009.

The following table presents the financial instruments that are not carried at fair value but which require fair value disclosure.

	December 31, 2009		June 30, 2010	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Cash, cash equivalents and restricted cash	\$31.1	\$31.1	\$27.5	\$27.5
Long-term debt (excluding capitalized leases):				
Fixed rate with market quotes -				
6.5% Senior Secured Notes	\$574.6	\$466.2	\$493.3	\$422.0
Variable rate bank revolving credit facility	13.0	13.0	18.6	18.6

At June 30, 2010, the estimated market price of the 6.5% Senior Secured Notes was approximately euro 853 per euro 1,000 principal amount. The fair value of our 6.5% Senior Secured Notes is based upon quoted market prices at each balance sheet date; these quoted market prices represent Level 2 inputs because the markets in which the Senior Secured Notes trade are not active. The fair value of variable interest rate debt is deemed to approximate book value. Due to their near-term maturities, the carrying amounts of accounts receivable and accounts payable are considered equivalent to fair value.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

RESULTS OF OPERATIONS:

Business and results of operations overview

We are a leading global producer and marketer of value-added titanium dioxide pigments ("TiO₂"). TiO₂ is used for a variety of manufacturing applications, including plastics, paints, paper and other industrial products. For the six months ended June 30, 2010, approximately three-fourths of our sales volumes were into European markets. Our production facilities are located throughout Europe.

We reported net income of \$9.0 million in the second quarter of 2010 as compared to net loss of \$26.1 million in the second quarter of 2009. For the first six months of 2010, we reported net income of \$49.3 million, compared to a net loss of \$50.2 million in the first six months of 2009. Our net income increased in the second quarter and first six months of 2010 as compared to the same periods of 2009 primarily due to (i) the net effects of higher income from operations in 2010 resulting principally from higher sales and production volumes in the 2010 periods and (ii) a non-cash deferred income tax benefit of \$35.2 million recognized in the first quarter of 2010.

Forward-looking information

This report contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, as amended. Statements in this Quarterly Report on Form 10-Q that are not historical facts are forward-looking in nature and represent management's beliefs and assumptions based on currently available information. Statements in this report including, but not limited to, statements found in Item 2 - "Management's Discussion and Analysis of Financial Condition and Results of Operations," are forward-looking statements that represent our management's beliefs and assumptions based on currently available information. In some cases you can identify forward-looking statements by the use of words such as "believes," "intends," "may," "should," "could," "anticipates," "expects" or comparable terminology, or by discussions of strategies or trends. Although we believe the expectations reflected in forward-looking statements are reasonable, we do not know if these expectations will be correct. Such statements by their nature involve substantial risks and uncertainties that could significantly impact expected results. Actual future results could differ materially from those predicted. The factors that could cause our actual future results to differ materially from those described herein are the risks and uncertainties discussed in this Quarterly Report and those described from time to time in our other filings with the SEC including, but are not limited to, the following:

- Future supply and demand for our products
- The extent of the dependence of certain of our businesses on certain market sectors
 - The cyclical nature of our businesses
- Customer inventory levels (such as the extent to which our customers may, from time to time, accelerate purchases of TiO₂ in advance of anticipated price increases or defer purchases of TiO₂ in advance of anticipated price decreases)
 - Changes in raw material and other operating costs (such as energy costs)
- General global economic and political conditions (such as changes in the level of gross domestic product in various regions of the world and the impact of such changes on demand for TiO₂)
 - Competitive products and substitute products
 - Customer and competitor strategies
 - Potential consolidation or solvency of our competitors
 - The impact of pricing and production decisions
 - Competitive technology positions
- Possible disruption of our business or increases in the cost of doing business resulting from terrorist activities or global conflicts
 - The introduction of trade barriers
- Fluctuations in currency exchange rates (such as changes in the exchange rate between the U.S. dollar and each of the euro and the Norwegian krone)
- Operating interruptions (including, but not limited to, labor disputes, leaks, natural disasters, fires, explosions, unscheduled or unplanned downtime and transportation interruptions)
 - The timing and amounts of insurance recoveries
 - Our ability to renew or refinance credit facilities
 - Our ability to maintain sufficient liquidity
- The ultimate outcome of income tax audits, tax settlement initiatives or other tax matters
- Our ability to utilize income tax attributes, the benefits of which have been recognized under the more-likely-than-not recognition criteria
- Environmental matters (such as those requiring compliance with emission and discharge standards for existing and new facilities)
 - Government laws and regulations and possible changes therein
 - The ultimate resolution of pending litigation
 - Possible future litigation

Should one or more of these risks materialize (or the consequences of such a development worsen), or should the underlying assumptions prove incorrect, actual results could differ materially from those forecasted or expected. We disclaim any intention or obligation to update or revise any forward-looking statement whether as a result of changes in information, future events or otherwise.

Results of operations

We consider TiO₂ to be a “quality of life” product, with demand affected by gross domestic product (or “GDP”) and overall economic conditions in our markets located in various regions of the world. Over the long-term, we expect that demand for TiO₂ will grow by 2% to 3% per year, consistent with our expectations for the long-term growth in GDP. However, even if we and our competitors maintain consistent shares of the worldwide market, demand for TiO₂ in any interim or annual period may not change in the same proportion as the change in GDP, in part due to relative changes in the TiO₂ inventory levels of our customers. We believe our customers’ inventory levels are partly influenced by their expectation for future changes in TiO₂ selling prices. The majority of our TiO₂ grades and substantially all of our production are considered commodity pigment products; we compete for sales primarily on the basis of price.

The factors having the most impact on our reported operating results are:

- Our TiO₂ selling prices,
- Our TiO₂ sales and production volumes,
- Currency exchange rates (particularly the exchange rate for the U.S. dollar relative to the euro and Norwegian krone) and
 - Manufacturing costs, particularly raw materials, maintenance and energy-related expenses.

Our key performance indicators are our TiO₂ average selling prices, and our level of TiO₂ sales and production volumes. TiO₂ selling prices generally follow industry trends and prices will increase or decrease generally as a result of competitive market pressures.

Quarter ended June 30, 2009 compared to the
Quarter ended June 30, 2010

	2009		Three months ended June 30, 2010			
			(Dollars in millions)			
Net sales	\$196.7	100	%	\$256.6	100	%
Cost of sales	197.7	101		201.6	79	
Gross margin	(1.0)	(1)		55.0	21	
Other operating income and expenses, net	26.0	13		29.3	11	
Income (loss) from operations	\$(27.0)	(14)	%	\$25.7	10	%
					%	
					Change	
TiO ₂ operating statistics:						
Sales volumes*	76			97	28	%
Production volumes*	56			89	59	%
Percent change in net sales:						
TiO ₂ product pricing					7	%
TiO ₂ sales volumes					28	
TiO ₂ product mix					(2)	
Changes in currency exchange rates					(3)	

Total	30	%
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* Thousands of metric tons

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Net sales – Net sales increased 30% or \$59.9 million compared to the second quarter of 2009 primarily due to a 28% increase in sales volumes along with a 7% increase in average TiO₂ selling prices, partially offset by the negative impact of currency exchange rates. We estimate the unfavorable effect of changes in currency exchange rates decreased our net sales by approximately \$6 million, or 3%, as compared to the same period in 2009. TiO₂ selling prices will increase or decrease generally as a result of competitive market pressures and changes in the relative level of supply and demand. We currently expect average selling prices in the third quarter of 2010 to be higher than the average selling prices in the second quarter of 2010.

Our 28% increase in sales volumes in the second quarter of 2010 is due to higher demand in the European and export market segments resulting from the improvement in current economic conditions. We expect demand will continue to remain above 2009 levels for the remainder of the year.

Cost of sales - Cost of sales increased \$3.9 million or 2% in the second quarter of 2010 compared to 2009 due to the net impact of a 28% increase in sales volumes, a 59% increase in TiO₂ production volumes, lower utility costs of \$2.6 million and an increase in maintenance costs of \$6.0 million. In addition, cost of sales in the second quarter of 2010 was negatively impacted by approximately \$4 million as a result of higher production costs in 2010 at our ilmenite mines in Norway. Cost of sales as a percentage of net sales decreased to 79% in the second quarter of 2010 compared to 101% in the second quarter of 2009 primarily due to the significantly higher production volumes in 2010, as we implemented temporary plant curtailments during the first half of 2009 in order to reduce our finished goods inventories to an appropriate level and due to higher selling prices in the second quarter of 2010. Such temporary plant curtailments resulted in approximately \$28 million of unabsorbed fixed production costs which were charged directly to cost of sales in the second quarter of 2009.

Income (loss) from operations – Income (loss) from operations increased by \$52.7 million from an operating loss of \$27.0 million in the second quarter of 2009 to an operating income of \$25.7 million in the second quarter of 2010. Income (loss) from operations as a percentage of net sales increased to 10% in the second quarter of 2010 from (14)% in the same period for 2009. This increase is driven by the improvement in gross margin, which increased to 21% for the second quarter of 2010 compared to (1)% for the second quarter of 2009. Our gross margin has increased primarily because of higher sales volumes, higher selling prices and lower manufacturing costs per ton resulting from higher production volumes. However, changes in currency exchange rates have negatively affected our gross margin and income (loss) from operations. We estimate that changes in currency exchange rates decreased income (loss) from operations by approximately \$1 million in the second quarter of 2010 as compared to the same period in 2009.

Interest expense – Interest expense decreased \$.5 million from \$10.0 million in the second quarter of 2009 to \$9.5 million in the second quarter of 2010 due to decreased average borrowings under our revolving credit facilities which offset the effect of higher interest rates on our revolving credit facility. The interest expense we recognize will vary with fluctuations in the euro exchange rate.

Provision for income taxes (benefit) – Our provision for income taxes was \$7.2 million in the second quarter of 2010 compared to an income tax benefit of \$10.8 million in the same period last year. This increase in provision for income taxes was primarily due to improved income from operations in the second quarter of 2010 compared to the second quarter of 2009. See Note 6 to our Condensed Consolidated Financial Statements for a tabular reconciliation of our statutory income tax expense (benefit) to our actual tax benefit.

We have substantial net operating loss carryforwards in Germany (the equivalent of \$941 million for German corporate purposes and \$288 million for German trade tax purposes at December 31, 2009), which amounts exclude the adjustment to such carryforwards recognized in the first quarter of 2010 (See Note 6 to our Condensed Consolidated Financial Statements). At June 30, 2010, we have concluded that no deferred income tax asset valuation allowance is required to be recognized with respect to such carryforwards, principally because (i) such carryforwards have an indefinite carryforward period, (ii) we have utilized a portion of such carryforwards during the most recent three-year period and (iii) we currently expect to utilize the remainder of such carryforwards over the long term. However, prior to the complete utilization of such carryforwards, particularly if we were to generate losses in our German operations for an extended period of time, it is possible that we might conclude the benefit of such carryforwards would no longer meet the more-likely-than-not recognition criteria, at which point we would be required to recognize a valuation allow