

NL INDUSTRIES INC  
Form 10-Q  
August 09, 2012  
[Table of Contents](#)

**UNITED STATES**  
**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 quarterly period ended June 30, 2012

Commission file number 1-640

**NL INDUSTRIES, INC.**

(Exact name of registrant as specified in its charter)

New Jersey  
(State or other jurisdiction of

13-5267260  
(IRS Employer

Edgar Filing: NL INDUSTRIES INC - Form 10-Q

incorporation or organization)

5430 LBJ Freeway, Suite 1700

Identification No.)

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

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

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

Number of shares of the registrant's common stock outstanding on July 31, 2012: 48,668,884.

**Table of Contents****NL INDUSTRIES, INC. AND SUBSIDIARIES****INDEX**

|   | <b>Page<br/>number</b> |
|---|------------------------|
| <b>Part I. FINANCIAL INFORMATION</b>  |                        |
| Item 1. Financial Statements  |                        |
| <u>Condensed Consolidated Balance Sheets December 31, 2011; June 30, 2012 (unaudited)</u>   | 3                      |
| <u>Condensed Consolidated Statements of Income (unaudited) Three and six months ended June 30, 2011 and 2012</u>                      | 5                      |
| <u>Condensed Consolidated Statements of Comprehensive Income (Loss) (unaudited) Three and six months ended June 30, 2011 and 2012</u> | 6                      |
| <u>Condensed Consolidated Statement of Stockholders Equity (unaudited) Six months ended June 30, 2012</u>                             | 7                      |
| <u>Condensed Consolidated Statements of Cash Flows (unaudited) Six months ended June 30, 2011 and 2012</u>                            | 8                      |
| <u>Notes to Condensed Consolidated Financial Statements (unaudited)</u>   | 10                     |
| Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>                                  | 25                     |
| Item 3. <u>Quantitative and Qualitative Disclosure About Market Risk</u>  | 46                     |
| Item 4. <u>Controls and Procedures</u>  | 46                     |
| <b>Part II. OTHER INFORMATION</b>   |                        |
| Item 1. <u>Legal Proceedings</u>  | 48                     |
| Item 1A. <u>Risk Factors</u>  | 48                     |
| Item 6. <u>Exhibits</u>   | 49                     |
| Items 2, 3, 4 and 5 of Part II are omitted because there is no information to report  |                        |

**Table of Contents**

**NL INDUSTRIES, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**

(In thousands)

|                                      | December 31,<br>2011 | June 30,<br>2012<br>(unaudited) |
|--------------------------------------|----------------------|---------------------------------|
| <b>ASSETS</b>                        |                      |                                 |
| Current assets:                      |                      |                                 |
| Cash and cash equivalents            | \$ 11,652            | \$ 7,480                        |
| Restricted cash and cash equivalents | 3,337                | 3,502                           |
| Accounts and other receivables, net  | 15,160               | 18,209                          |
| Inventories, net                     | 19,578               | 19,210                          |
| Prepaid expenses and other           | 1,364                | 1,713                           |
| Deferred income taxes                | 7,213                | 7,213                           |
| <b>Total current assets</b>          | <b>58,304</b>        | <b>57,327</b>                   |
| Other assets:                        |                      |                                 |
| Marketable securities                | 311,419              | 195,907                         |
| Investment in Kronos Worldwide, Inc. | 281,257              | 320,689                         |
| Goodwill                             | 47,553               | 47,593                          |
| Assets held for sale                 | 6,649                | 6,649                           |
| Other assets, net                    | 4,258                | 3,547                           |
| <b>Total other assets</b>            | <b>651,136</b>       | <b>574,385</b>                  |
| Property and equipment:              |                      |                                 |
| Land                                 | 11,639               | 11,617                          |
| Buildings                            | 27,301               | 27,278                          |
| Equipment                            | 129,685              | 128,238                         |
| Construction in progress             | 1,477                | 2,215                           |
|                                      | 170,102              | 169,348                         |
| Less accumulated depreciation        | 118,300              | 117,522                         |
| <b>Net property and equipment</b>    | <b>51,802</b>        | <b>51,826</b>                   |
| <b>Total assets</b>                  | <b>\$ 761,242</b>    | <b>\$ 683,538</b>               |

**Table of Contents****NL INDUSTRIES, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED BALANCE SHEETS****CONDENSED CONSOLIDATED BALANCE SHEETS (CONTINUED)****(In thousands)**

|   | <b>December 31,<br/>2011</b> | <b>June 30,<br/>2012<br/>(unaudited)</b> |
|---|------------------------------|--|
| <b>LIABILITIES AND EQUITY</b>                       |                              |  |
| <b>Current liabilities:</b>                         |                              |  |
| Current maturities of long-term debt                | \$ 10,000                    | \$ 6,100                                 |
| Accounts payable                                    | 8,184                        | 7,398                                    |
| Accrued and other current liabilities               | 13,994                       | 14,042                                   |
| Accrued environmental remediation and related costs | 7,301                        | 9,160                                    |
| Income taxes  | 1,327                        | 277                                      |
| <b>Total current liabilities</b>                    | <b>40,806</b>                | <b>36,977</b>                            |
| <b>Noncurrent liabilities:</b>                      |                              |  |
| Long-term debt                                      | 27,285                       | 21,926                                   |
| Accrued pension costs                               | 16,743                       | 14,526                                   |
| Accrued postretirement benefit (OPEB) costs         | 4,373                        | 4,198                                    |
| Accrued environmental remediation and related costs | 34,336                       | 44,519                                   |
| Deferred income taxes                               | 192,492                      | 163,996                                  |
| Other   | 19,215                       | 18,449                                   |
| <b>Total noncurrent liabilities</b>                 | <b>294,444</b>               | <b>267,614</b>                           |
| <b>Equity:</b>                                      |                              |  |
| <b>NL Stockholders' equity:</b>                     |                              |  |
| Common stock  | 6,082                        | 6,083                                    |
| Additional paid-in capital                          | 300,067                      | 300,246                                  |
| Retained earnings                                   | 113,555                      | 148,411                                  |
| Accumulated other comprehensive loss                | (4,724)                      | (86,892)                                 |
| <b>Total NL stockholders' equity</b>                | <b>414,980</b>               | <b>367,848</b>                           |
| Noncontrolling interest in subsidiary               | 11,012                       | 11,099                                   |
| <b>Total equity</b>                                 | <b>425,992</b>               | <b>378,947</b>                           |
| <b>Total liabilities and equity</b>                 | <b>\$ 761,242</b>            | <b>\$ 683,538</b>                        |

Commitments and contingencies (Notes 11 and 12)

See accompanying Notes to Condensed Consolidated Financial Statements.



**Table of Contents****NL INDUSTRIES, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF INCOME****(In thousands, except per share data)**

|   | Three months ended<br>June 30, |           | Six months ended<br>June 30, |           |
|---|--------------------------------|-----------|------------------------------|-----------|
|   | 2011                           | 2012      | 2011                         | 2012      |
|   | (unaudited)                    |           |                              |           |
| Net sales   | \$ 35,241                      | \$ 37,598 | \$ 70,018                    | \$ 73,129 |
| Cost of sales   | 25,405                         | 27,573    | 51,502                       | 53,630    |
| Gross margin  | 9,836                          | 10,025    | 18,516                       | 19,499    |
| Selling, general and administrative expense   | 5,900                          | 6,096     | 12,056                       | 12,661    |
| Other operating income (expense):   |                                |           |                              |           |
| Insurance recoveries  | 99                             | 282       | 458                          | 1,407     |
| Litigation settlement gain  |                                | 14,964    |                              | 14,964    |
| Patent litigation settlement gain   |                                |           | 7,468                        |           |
| Patent litigation expense   |                                |           | (227)                        |           |
| Facility consolidation expense  | (792)                          |           | (1,798)                      |           |
| Corporate expense and other, net  | (12,273)                       | (4,949)   | (15,673)                     | (21,116)  |
| Income (loss) from operations   | (9,030)                        | 14,226    | (3,312)                      | 2,093     |
| Equity in earnings of Kronos Worldwide, Inc.  | 27,061                         | 19,624    | 45,390                       | 61,236    |
| Other income (expense):   |                                |           |                              |           |
| Interest and dividends  | 825                            | 836       | 1,421                        | 1,551     |
| Interest expense  | (335)                          | (248)     | (824)                        | (572)     |
| Income before taxes   | 18,521                         | 34,438    | 42,675                       | 64,308    |
| Provision for income taxes  | 1,389                          | 8,193     | 7,858                        | 16,816    |
| Net income  | 17,132                         | 26,245    | 34,817                       | 47,492    |
| Noncontrolling interest in net income of subsidiary                                 | 213                            | 272       | 731                          | 470       |
| Net income attributable to NL stockholders  | \$ 16,919                      | \$ 25,973 | \$ 34,086                    | \$ 47,022 |
| Amounts attributable to NL stockholders:  |                                |           |                              |           |
| Basic and diluted net income per share  | \$ .35                         | \$ .53    | \$ .70                       | \$ .97    |
| Cash dividend per share   | \$ .125                        | \$ .125   | \$ .25                       | \$ .25    |
| Weighted-average shares outstanding used in the calculation of net income per share | 48,660                         | 48,666    | 48,654                       | 48,664    |

See accompanying Notes to Condensed Consolidated Financial Statements.

Table of Contents

## NL INDUSTRIES, INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(In thousands)

|  | Three months ended<br>June 30, |             | Six months ended<br>June 30, |             |
|--|--------------------------------|-------------|------------------------------|-------------|
|  | 2011                           | 2012        | 2011                         | 2012        |
|  | (Unaudited)                    |             |                              |             |
| Net income   | \$ 17,132                      | \$ 26,245   | \$ 34,817                    | \$ 47,492   |
| Other comprehensive income (loss), net of tax:               |                                |             |                              |             |
| Currency translation adjustment                              | 519                            | (8,527)     | 3,195                        | (4,390)     |
| Marketable securities adjustment                             | 73,387                         | (52,742)    | 88,782                       | (78,617)    |
| Pension plans  | 446                            | 566         | 906                          | 1,131       |
| OPEB plan  | (147)                          | (138)       | (293)                        | (276)       |
| Total other comprehensive income (loss)                      | 74,205                         | (60,841)    | 92,590                       | (82,152)    |
| Comprehensive income (loss)                                  | 91,337                         | (34,596)    | 127,407                      | (34,660)    |
| Comprehensive income attributable to noncontrolling interest | (237)                          | (173)       | (797)                        | (486)       |
| Comprehensive income (loss) attributable to NL stockholders  | \$ 91,100                      | \$ (34,769) | \$ 126,610                   | \$ (35,146) |

See accompanying Notes to Condensed Consolidated Financial Statements.

- 6 -



Table of Contents

**NL INDUSTRIES, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY**

Six months ended June 30, 2012

(In thousands)

|  | NL Stockholders' Equity |                                  |                      |  |   | Total<br>equity |
|--|-------------------------|----------------------------------|----------------------|--|---|-----------------|
|  | Common<br>stock         | Additional<br>paid-in<br>capital | Retained<br>earnings | Accumulated<br>other<br>comprehensive<br>loss<br>(unaudited) | Noncontrolling<br>interest in<br>subsidiary |                 |
| Balance at December 31, 2011           | \$ 6,082                | \$ 300,067                       | \$ 113,555           | \$ (4,724)   | \$ 11,012                                   | \$ 425,992      |
| Net income                             |                         |                                  | 47,022               |  | 470   | 47,492          |
| Other comprehensive income (loss), net |                         |                                  |                      | (82,168)   | 16  | (82,152)        |
| Issuance of NL common stock            | 1                       | 74                               |                      |  |   | 75              |
| Dividends                              |                         |                                  | (12,166)             |  | (409)                                       | (12,575)        |
| Other, net                             |                         | 105                              |                      |  | 10  | 115             |
| Balance at June 30, 2012               | \$ 6,083                | \$ 300,246                       | \$ 148,411           | \$ (86,892)  | \$ 11,099                                   | \$ 378,947      |

See accompanying Notes to Condensed Consolidated Financial Statements.

**Table of Contents****NL INDUSTRIES, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(In thousands)**

|   | <b>Six months ended</b> |               |
|---|-------------------------|---------------|
|   | <b>June 30,</b>         |               |
|   | <b>2011</b>             | <b>2012</b>   |
|   | <b>(unaudited)</b>      |               |
| <b>Cash flows from operating activities:</b>                  |                         |               |
| Net income  | \$ 34,817               | \$ 47,492     |
| Depreciation and amortization                                 | 3,442                   | 2,889         |
| Deferred income taxes   | 7,168                   | 15,822        |
| Equity in Kronos Worldwide, Inc.                              | (45,390)                | (61,236)      |
| Distributions from Kronos Worldwide, Inc.                     | 27,295                  | 10,566        |
| <b>Benefit plan expense greater (less) than cash funding:</b> |                         |               |
| Defined benefit pension plans                                 | (126)                   | 104           |
| Other postretirement benefits                                 | (282)                   | (320)         |
| Litigation settlement gain                                    |                         | (14,964)      |
| Other, net  | 364                     | 282           |
| <b>Change in assets and liabilities:</b>                      |                         |               |
| Accounts and other receivables, net                           | (3,128)                 | (2,734)       |
| Inventories, net  | (2,329)                 | 150           |
| Prepaid expenses and other                                    | (1,041)                 | 127           |
| Accrued environmental remediation and related costs           | 6,844                   | 12,042        |
| Accounts payable and accrued liabilities                      | (5,751)                 | (2,349)       |
| Income taxes  | 869                     | (1,576)       |
| Accounts with affiliates                                      | (36)                    | 592           |
| Other noncurrent assets and liabilities, net                  | (758)                   | (2,387)       |
| <b>Net cash provided by operating activities</b>              | <b>21,958</b>           | <b>4,500</b>  |
| <b>Cash flows from investing activities:</b>                  |                         |               |
| Capital expenditures  | (1,328)                 | (2,211)       |
| Proceeds from real estate-related litigation settlement       |                         | 15,603        |
| Change in restricted cash equivalents                         | 802                     | (284)         |
| <b>Proceeds from the sale of:</b>                             |                         |               |
| Marketable securities   | 116                     |               |
| Fixed assets  | 100                     | 30            |
| Purchase of marketable securities                             | (242)                   |               |
| <b>Net cash provided by (used in) investing activities</b>    | <b>(552)</b>            | <b>13,138</b> |

Table of Contents

## NL INDUSTRIES, INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)

(In thousands)

|   | Six months ended |             |
|---|------------------|-------------|
|   | 2011             | 2012        |
|   | June 30,         |             |
|   | (unaudited)      |             |
| Cash flows from financing activities:                   |                  |             |
| Cash dividends paid                                     | \$ (12,165)      | \$ (12,166) |
| Distributions to noncontrolling interests in subsidiary | (406)            | (409)       |
| Proceeds from issuance of common stock:                 |                  |             |
| NL common stock   | 342              |             |
| CompX common stock                                      | 139              |             |
| Indebtedness:   |                  |             |
| Borrowings  | 4,600            | 13,050      |
| Repayments  | (22,400)         | (22,300)    |
| Other, net  | 32               | (57)        |
| Net cash used in financing activities                   | (29,858)         | (21,882)    |
| Cash and cash equivalents net change from:              |                  |             |
| Operating, investing and financing activities           | (8,452)          | (4,244)     |
| Effect of exchange rate changes on cash                 | (5)              | 72          |
| Cash and cash equivalents at beginning of period        | 15,461           | 11,652      |
| Cash and cash equivalents at end of period              | \$ 7,004         | \$ 7,480    |
| Supplemental disclosures:                               |                  |             |
| Cash paid (received) for:                               |                  |             |
| Interest  | \$ 1,667         | \$ 431      |
| Income taxes, net                                       | (247)            | 1,977       |
| Non-cash investing activity:                            |                  |             |
| Accrual for capital expenditures                        | 146              | 510         |

See accompanying Notes to Condensed Consolidated Financial Statements.

**Table of Contents**

**NL INDUSTRIES, INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**June 30, 2012**

**(unaudited)**

**Note 1 Organization and basis of presentation:**

**Organization** At June 30, 2012, (i) Valhi, Inc. (NYSE: VHI) held approximately 83% of our outstanding common stock and (ii) Contran Corporation and its subsidiaries held an aggregate of approximately 95% of Valhi's outstanding common stock. 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 the sole trustee), or is held by Mr. Simmons or other persons or companies related to Mr. Simmons. Consequently, Mr. Simmons may be deemed to control Contran, Valhi and us.

**Basis of presentation** Consolidated in this Quarterly Report are the results of our majority-owned subsidiary, CompX International Inc. We also own 30% of Kronos Worldwide, Inc. CompX (NYSE MKT: CIX) and Kronos (NYSE: KRO) each file periodic reports with the Securities and Exchange Commission (SEC).

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, 2011 that we filed with the SEC on March 5, 2012 (the 2011 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 Stockholders' Equity at December 31, 2011 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, 2011) 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, 2012 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 2011 Consolidated Financial Statements contained in our 2011 Annual Report.

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

**Table of Contents****Note 2 Accounts and other receivables, net:**

|                                 | December 31,<br>2011 | June 30,<br>2012 |
|---------------------------------|----------------------|------------------|
|                                 | (In thousands)       |                  |
| Trade receivables CompX         | \$ 14,647            | \$ 17,781        |
| Accrued insurance recoveries    | 586                  | 179              |
| Affiliate receivable            | 214                  |                  |
| Other receivables               | 106                  | 87               |
| Refundable income taxes         | 8                    | 493              |
| Allowance for doubtful accounts | (401)                | (331)            |
| <b>Total</b>                    | <b>\$ 15,160</b>     | <b>\$ 18,209</b> |

Accrued insurance recoveries are discussed in Note 12.

**Note 3 Inventories, net:**

|                 | December 31,<br>2011 | June 30,<br>2012 |
|-----------------|----------------------|------------------|
|                 | (In thousands)       |                  |
| Raw materials   | \$ 6,757             | \$ 6,872         |
| Work in process | 7,437                | 7,431            |
| Finished goods  | 5,384                | 4,907            |
| <b>Total</b>    | <b>\$ 19,578</b>     | <b>\$ 19,210</b> |

**Note 4 Marketable securities:**

|  | Fair value<br>measurement<br>level | Market<br>value   | Cost<br>basis<br>(in thousands) | Unrealized<br>gains |
|--|------------------------------------|-------------------|---------------------------------|---------------------|
| <b>December 31, 2011:</b>                  |                                    |                   |                                 |                     |
| Noncurrent assets<br>(available-for-sale): |                                    |                   |                                 |                     |
| Valhi common stock                         | 1                                  | \$ 289,711        | \$ 24,347                       | \$ 265,364          |
| TIMET common stock                         | 1                                  | 21,708            | 7,351                           | 14,357              |
| <b>Total</b>                               |                                    | <b>\$ 311,419</b> | <b>\$ 31,698</b>                | <b>\$ 279,721</b>   |
| <b>June 30, 2012:</b>                      |                                    |                   |                                 |                     |
| Noncurrent assets<br>(available-for-sale): |                                    |                   |                                 |                     |
| Valhi common stock                         | 1                                  | \$ 179,518        | \$ 24,347                       | \$ 155,171          |
| TIMET common stock                         | 1                                  | 16,389            | 7,351                           | 9,038               |
| <b>Total</b>                               |                                    | <b>\$ 195,907</b> | <b>\$ 31,698</b>                | <b>\$ 164,209</b>   |

## Edgar Filing: NL INDUSTRIES INC - Form 10-Q

Our marketable securities include investments in the publicly-traded shares of related parties: Valhi and Titanium Metals Corporation (TIMET). Contran, Mr. Harold Simmons and persons and other entities related to Mr. Simmons own a majority of Valhi's and TIMET's outstanding common stock. We account for our investments in Valhi and TIMET common stocks as available-for-sale marketable equity securities and any unrealized gains or losses on the securities are recognized through other comprehensive income. All of our marketable securities at December 31, 2011 and June 30, 2012 were carried at fair value based on quoted market prices, representing a Level 1 input within the fair value hierarchy.

- 11 -

**Table of Contents**

At December 31, 2011 and June 30, 2012, we held approximately 14.4 million shares of Valhi's common stock and 1.4 million shares of TIMET common stock. At June 30, 2012, the quoted market price of Valhi's and TIMET's common stock was \$12.49 and \$11.31 per share, respectively. At December 31, 2011, such quoted market prices were \$20.16 and \$14.98 per share, respectively. In May 2012, Valhi implemented a 3-for-1 split of its common stock. We have adjusted all share and per-share disclosures related to our investment in Valhi stock for all periods prior to May 2012 to give effect to the stock split. The stock split had no financial statement impact to us, and our ownership interest in Valhi did not change as a result of the split.

The Valhi and TIMET common stock we own is subject to the restrictions on resale pursuant to certain provisions of the SEC Rule 144. In addition, as a majority-owned subsidiary of Valhi we cannot vote our shares of Valhi common stock under Delaware Corporation Law, but we do receive dividends from Valhi on these shares, when declared and paid.

**Note 5 Investment in Kronos Worldwide, Inc.:**

At December 31, 2011 and June 30, 2012, we owned approximately 35.2 million shares of Kronos common stock. At June 30, 2012, the quoted market price of Kronos' common stock was \$15.79 per share, or an aggregate market value of \$556.1 million. At December 31, 2011, the quoted market price was \$18.04 per share, or an aggregate market value of \$635.3 million.

The change in the carrying value of our investment in Kronos during the first six months of 2012 is summarized below:

|   | Amount<br>(In millions) |
|---|-------------------------|
| Balance at the beginning of the period                                  | \$ 281.3                |
| Equity in earnings of Kronos  | 61.2                    |
| Dividends received from Kronos  | (10.6)                  |
| Other, principally equity in other comprehensive income items of Kronos | (11.2)                  |
| <b>Balance at the end of the period</b>                                 | <b>\$ 320.7</b>         |

Selected financial information of Kronos is summarized below:

|   | December 31,<br>2011 | June 30,<br>2012  |
|---|----------------------|-------------------|
|   | (In millions)        |                   |
| Current assets                                    | \$ 865.0             | \$ 1,188.7        |
| Property and equipment, net                       | 485.5                | 466.9             |
| Investment in TiO <sub>2</sub> joint venture      | 89.2                 | 108.6             |
| Other noncurrent assets                           | 384.2                | 351.6             |
| <b>Total assets</b>                               | <b>\$ 1,823.9</b>    | <b>\$ 2,115.8</b> |
| Current liabilities                               | \$ 328.0             | \$ 392.0          |
| Long-term debt                                    | 362.9                | 475.3             |
| Accrued pension and postretirement benefits       | 140.3                | 131.9             |
| Other noncurrent liabilities                      | 68.4                 | 62.6              |
| Stockholders' equity                              | 924.3                | 1,054.0           |
| <b>Total liabilities and stockholders' equity</b> | <b>\$ 1,823.9</b>    | <b>\$ 2,115.8</b> |

**Table of Contents**

|                        | Three months ended<br>June 30, |          | Six months ended<br>June 30, |            |
|------------------------|--------------------------------|----------|------------------------------|------------|
|                        | 2011                           | 2012     | 2011                         | 2012       |
|                        | (In millions)                  |          | (In millions)                |            |
| Net sales              | \$ 537.5                       | \$ 545.3 | \$ 957.9                     | \$ 1,106.6 |
| Cost of sales          | 340.5                          | 382.0    | 614.5                        | 681.8      |
| Income from operations | 144.2                          | 110.6    | 246.6                        | 320.0      |
| Net income             | 89.0                           | 64.5     | 149.3                        | 201.4      |

**Note 6 Other noncurrent assets:**

|  | December 31,   | June 30, |
|--|----------------|----------|
|  | 2011           | 2012     |
|  | (In thousands) |          |
| Patents and other intangible assets, net | \$ 2,045       | \$ 1,719 |
| Restricted cash                          | 1,551          | 1,670    |
| Other                                    | 662            | 158      |
| Total                                    | \$ 4,258       | \$ 3,547 |

**Note 7 Accrued and other current liabilities:**

|   | December 31,   | June 30,  |
|---|----------------|-----------|
|   | 2011           | 2012      |
|   | (In thousands) |           |
| Employee benefits                       | \$ 8,954       | \$ 7,672  |
| Professional fees and legal settlements | 2,704          | 2,719     |
| Payable to affiliates:                  |                |           |
| Accrued interest payable to TIMET       |                | 78        |
| Income taxes payable to Valhi           |                | 378       |
| Other                                   | 20             | 19        |
| Other                                   | 2,316          | 3,176     |
| Total                                   | \$ 13,994      | \$ 14,042 |



**Table of Contents****Note 8 Long-term debt:**

|  | December 31,<br>2011 | June 30,<br>2012 |
|--|----------------------|------------------|
|  | (In thousands)       |                  |
| <b>NL:</b>   |                      |                  |
| Promissory note payable to Valhi                                 | \$ 4,100             | \$               |
| Promissory note issued in conjunction with litigation settlement | 9,000                | <b>5,100</b>     |
| Subtotal   | 13,100               | <b>5,100</b>     |
| <b>Subsidiary debt:</b>  |                      |                  |
| CompX credit facility  | 1,955                | <b>1,946</b>     |
| CompX promissory note payable to TIMET                           | 22,230               | <b>20,980</b>    |
| Subtotal   | 24,185               | <b>22,926</b>    |
| Total debt   | 37,285               | <b>28,026</b>    |
| Less current maturities  | 10,000               | <b>6,100</b>     |
| <b>Total long-term debt</b>                                      | <b>\$ 27,285</b>     | <b>\$ 21,926</b> |

*NL* During the first six months of 2012, we repaid a net \$4.1 million under our promissory note with Valhi. The interest rate on our outstanding borrowings from Valhi during the first six months of 2012 was 6.00%.

Following the May 2012 third and final closing associated with certain real property we formerly owned in New Jersey, we prepaid an aggregate \$3.9 million under the promissory note issued in conjunction with a litigation settlement. The interest rate on the outstanding balance of this indebtedness was 3.25% as of and for the six-month period ended June 30, 2012. See Note 12.

*CompX* CompX repaid an aggregate of \$1.3 million on the promissory note payable to TIMET during the first six months of 2012, including a principal prepayment of \$1.0 million. The average interest rate on the promissory note payable to TIMET as of and for the six-month period ended June 30, 2012 was 1.5%. The average interest rate on the revolving bank credit facility for the six-month period ended June 30, 2012 was 3.8% and at June 30, 2012 the rate was 3.4%.

**Note 9 Other noncurrent liabilities:**

|                                     | December 31,<br>2011 | June 30,<br>2012 |
|-------------------------------------|----------------------|------------------|
|                                     | (In thousands)       |                  |
| Reserve for uncertain tax positions | \$ 16,832            | <b>\$ 16,832</b> |
| Insurance claims and expenses       | 594                  | 572              |
| Other                               | 1,789                | <b>1,045</b>     |
| Total                               | \$ 19,215            | <b>\$ 18,449</b> |

**Table of Contents****Note 10 Employee benefit plans:**

**Defined benefit plans** The components of net periodic defined benefit pension cost (income) are presented in the table below.

|                                | Three months ended<br>June 30, |        | Six months ended<br>June 30, |          |
|--------------------------------|--------------------------------|--------|------------------------------|----------|
|                                | 2011                           | 2012   | 2011                         | 2012     |
|                                | (In thousands)                 |        |                              |          |
| Interest cost                  | \$ 704                         | \$ 643 | \$ 1,391                     | \$ 1,271 |
| Expected return on plan assets | (979)                          | (915)  | (1,954)                      | (1,829)  |
| Recognized actuarial losses    | 220                            | 331    | 437                          | 662      |
| Total                          | \$ (55)                        | \$ 59  | \$ (126)                     | \$ 104   |

**Postretirement benefits** The components of net periodic postretirement benefits other than pension cost are presented in the table below.

|                                      | Three months ended<br>June 30, |          | Six months ended<br>June 30, |          |
|--------------------------------------|--------------------------------|----------|------------------------------|----------|
|                                      | 2011                           | 2012     | 2011                         | 2012     |
|                                      | (In thousands)                 |          |                              |          |
| Interest cost                        | \$ 59                          | \$ 40    | \$ 118                       | \$ 79    |
| Amortization of prior service credit | (200)                          | (175)    | (400)                        | (349)    |
| Recognized actuarial gain            |                                | (25)     |                              | (50)     |
| Total                                | \$ (141)                       | \$ (160) | \$ (282)                     | \$ (320) |

**Contributions** We currently expect our 2012 contributions to our defined benefit pension plans and other postretirement plans to be approximately \$3.4 million.

**Note 11 Income tax provision:**

|   | Six months ended<br>June 30, |         |
|---|------------------------------|---------|
|   | 2011                         | 2012    |
|   | (In millions)                |         |
| Expected tax provision at U.S. federal statutory income tax rate of 35% | \$ 14.9                      | \$ 22.5 |
| Non-U.S. tax rates  | (.9)                         | (.4)    |
| Incremental U.S. tax and rate differences on equity in earnings         | (4.8)                        | (5.0)   |
| U.S. state income taxes, net  | .3                           | .3      |
| Tax rate change   | (1.4)                        |         |
| Other, net  | (.2)                         | (.6)    |
| Total   | \$ 7.9                       | \$ 16.8 |

Tax authorities are examining certain of our U.S. and non-U.S. tax returns and have or may propose tax deficiencies, including penalties and interest. We cannot guarantee 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



## **Table of Contents**

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.

In 2011 and 2012, Kronos received notices of re-assessment from the Canadian federal and provincial tax authorities related to the years 2002 through 2004. Kronos objects to the re-assessments and believes the position is without merit. Accordingly, the re-assessments are being appealed. If the full amount of the proposed adjustment were ultimately to be assessed against Kronos, the cash tax liability would be approximately \$15.2 million. Kronos believes that it has adequate accruals for this matter.

In the first six months of 2011, CompX recognized a \$2.1 million provision for deferred income taxes related to the undistributed earnings of its Canadian subsidiary attributable to the \$7.5 million litigation settlement gain discussed in Note 12.

We currently estimate that our unrecognized tax benefits will not change materially during the next twelve months.

### **Note 12 Commitments and contingencies:**

#### ***Lead pigment litigation***

Our former operations included the manufacture of lead pigments for use in paint and lead-based paint. We, other former manufacturers of lead pigments for use in paint and lead-based paint (together, the former pigment manufacturers), and the Lead Industries Association (LIA), which discontinued business operations in 2002, have been named as defendants in various legal proceedings seeking damages for personal injury, property damage and governmental expenditures allegedly caused by the use of lead-based paints. Certain of these actions have been filed by or on behalf of states, counties, cities or their public housing authorities and school districts, and certain others have been asserted as class actions. These lawsuits seek recovery under a variety of theories, including public and private nuisance, negligent product design, negligent failure to warn, strict liability, breach of warranty, conspiracy/concert of action, aiding and abetting, enterprise liability, market share or risk contribution liability, intentional tort, fraud and misrepresentation, violations of state consumer protection statutes, supplier negligence and similar claims.

The plaintiffs in these actions generally seek to impose on the defendants responsibility for lead paint abatement and health concerns associated with the use of lead-based paints, including damages for personal injury, contribution and/or indemnification for medical expenses, medical monitoring expenses and costs for educational programs. To the extent the plaintiffs seek compensatory or punitive damages in these actions, such damages are generally unspecified. In some cases, the damages are unspecified pursuant to the requirements of applicable state law. A number of cases are inactive or have been dismissed or withdrawn. Most of the remaining cases are in various pre-trial stages. Some are on appeal following dismissal or summary judgment rulings in favor of either the defendants or the plaintiffs. In addition, various other cases (in which we are not a defendant) are pending that seek recovery for injury allegedly caused by lead pigment and lead-based paint. Although we are not a defendant in these cases, the outcome of these cases may have an impact on cases that might be filed against us in the future.

## **Table of Contents**

We believe that these actions are without merit, and we intend to continue to deny all allegations of wrongdoing and liability and to defend against all actions vigorously. We do not believe it is probable that we have incurred any liability with respect to all of the lead pigment litigation cases to which we are a party, and liability to us that may result, if any, in this regard cannot be reasonably estimated, because:

we have never settled any of the market share, risk contribution, intentional tort, fraud, nuisance, supplier negligence, breach of warranty, conspiracy, misrepresentation, aiding and abetting, enterprise liability, or statutory cases,

no final, non-appealable adverse verdicts have ever been entered against us, and

we have never ultimately been found liable with respect to any such litigation matters, including over 100 cases over a twenty-year period for which we were previously a party and for which we have been dismissed without any finding of liability.

Accordingly, we have not accrued any amounts for any of the pending lead pigment and lead-based paint litigation cases. In addition, we have determined that liability to us which may result, if any, cannot be reasonably estimated because there is no prior history of a loss of this nature on which an estimate could be made and there is no substantive information available upon which an estimate could be based.

New cases may continue to be filed against us. We cannot assure you that we will not incur liability in the future in respect of any of the pending or possible litigation in view of the inherent uncertainties involved in court and jury rulings. In the future, if new information regarding such matters becomes available to us (such as a final, non-appealable adverse verdict against us or otherwise ultimately being found liable with respect to such matters), at that time we would consider such information in evaluating any remaining cases then-pending against us as to whether it might then have become probable we have incurred liability with respect to these matters, and whether such liability, if any, could have become reasonably estimable. The resolution of any of these cases could result in the recognition of a loss contingency accrual that could have a material adverse impact on our net income for the interim or annual period during which such liability is recognized and a material adverse impact on our consolidated financial condition and liquidity.

## **Environmental matters and litigation**

Our operations are governed by various environmental laws and regulations. Certain of our businesses are and have been engaged in the handling, manufacture or use of substances or compounds that may be considered toxic or hazardous within the meaning of applicable environmental laws and regulations. As with other companies engaged in similar businesses, certain of our past and current operations and products have the potential to cause environmental or other damage. We have implemented and continue to implement various policies and programs in an effort to minimize these risks. Our policy is to maintain compliance with applicable environmental laws and regulations at all of our plants and to strive to improve environmental performance. From time to time, we may be subject to environmental regulatory enforcement under U.S. and non-U.S. statutes, the resolution of which typically involves the establishment of compliance programs. It is possible that future developments, such as stricter requirements of environmental laws and enforcement policies, could adversely affect our

---

**Table of Contents**

production, handling, use, storage, transportation, sale or disposal of such substances. We believe that all of our facilities are in substantial compliance with applicable environmental laws.

Certain properties and facilities used in our former operations, including divested primary and secondary lead smelters and former mining locations, are the subject of civil litigation, administrative proceedings or investigations arising under federal and state environmental laws and common law. Additionally, in connection with past operating practices, we are currently involved as a defendant, potentially responsible party (PRP) or both, pursuant to the Comprehensive Environmental Response, Compensation and Liability Act, as amended by the Superfund Amendments and Reauthorization Act (CERCLA), and similar state laws in various governmental and private actions associated with waste disposal sites, mining locations, and facilities that we or our predecessors, our subsidiaries or their predecessors currently or previously owned, operated or used, certain of which are on the United States Environmental Protection Agency's (EPA) Superfund National Priorities List or similar state lists. These proceedings seek cleanup costs, damages for personal injury or property damage and/or damages for injury to natural resources. Certain of these proceedings involve claims for substantial amounts. Although we may be jointly and severally liable for these costs, in most cases we are only one of a number of PRPs who may also be jointly and severally liable, and among whom costs may be shared or allocated. In addition, we are also a party to a number of personal injury lawsuits filed in various jurisdictions alleging claims related to environmental conditions alleged to have resulted from our operations.

Obligations associated with environmental remediation and related matters are difficult to assess and estimate for numerous reasons including the:

complexity and differing interpretations of governmental regulations,

number of PRPs and their ability or willingness to fund such allocation of costs,

financial capabilities of the PRPs and the allocation of costs among them,

solvency of other PRPs,

multiplicity of possible solutions,

number of years of investigatory, remedial and monitoring activity required,

uncertainty over the extent, if any, to which our former operations might have contributed to the conditions allegedly giving rise to such personal injury, property damage, natural resource and related claims and

number of years between former operations and notice of claims and lack of information and documents about the former operations. In addition, the imposition of more stringent standards or requirements under environmental laws or regulations, new developments or changes regarding site cleanup costs or the allocation of costs among PRPs, solvency of other PRPs, the results of future testing and analysis undertaken with respect to certain sites or a determination that we are potentially responsible for the release of hazardous substances at other sites, could cause our expenditures to exceed our current estimates. We cannot assure you that actual costs will not exceed accrued amounts or the upper end of the range for sites for which estimates have been made, and we cannot assure you that costs will not be incurred for sites where no estimates presently can be

**Table of Contents**

made. Further, additional environmental and related matters may arise in the future. If we were to incur any future liability, this could have a material adverse effect on our consolidated financial statements, results of operations and liquidity.

We record liabilities related to environmental remediation and related matters when estimated future expenditures are probable and reasonably estimable. We adjust such accruals as further information becomes available to us or as circumstances change. Unless the amounts and timing of such estimated future expenditures are fixed and reasonably determinable, we generally do not discount estimated future expenditures to their present value due to the uncertainty of the timing of the pay out. We recognize recoveries of costs from other parties, if any, as assets when their receipt is deemed probable. At June 30, 2012 or December 31, 2011, we have not recognized any receivables for recoveries.

We do not know and cannot estimate the exact time frame over which we will make payments for our accrued environmental and related costs. The timing of payments depends upon a number of factors, including but not limited to the timing of the actual remediation process; which in turn depends on factors outside of our control. At each balance sheet date, we estimate the amount of our accrued environmental and related costs which we expect to pay within the next twelve months, and we classify this estimate as a current liability. We classify the remaining accrued environmental costs as a noncurrent liability.

Changes in the accrued environmental costs during the first six months of 2012 are as follows:

|   | <b>Amount<br/>(In thousands)</b> |
|---|----------------------------------|
| Balance at the beginning of the period                            | <b>\$ 41,637</b>                 |
| Additions charged to expense, net                                 | <b>14,009</b>                    |
| Payments, net   | <b>(1,967)</b>                   |
| <br>  |                                  |
| Balance at the end of the period                                  | <b>\$ 53,679</b>                 |
| <br>  |                                  |
| Amounts recognized in the balance sheet at the end of the period: |                                  |
| Current liability   | <b>\$ 9,160</b>                  |
| Noncurrent liability  | <b>44,519</b>                    |
| <br>  |                                  |
| Total   | <b>\$ 53,679</b>                 |

On a quarterly basis, we evaluate the potential range of our liability for environmental remediation and related costs at sites where we have been named as a PRP or defendant. At June 30, 2012, we had accrued approximately \$54 million, related to approximately 50 sites, which are associated with remediation and related matters that we believe are at the present time and/or in their current phase reasonably estimable. The upper end of the range of reasonably possible costs to us for remediation and related matters for which we believe it is possible to estimate costs is approximately \$83 million, including the amount currently accrued.

We believe that it is not possible to estimate the range of costs for certain sites. At June 30, 2012, there were approximately 5 sites for which we are not currently able to estimate a range of costs. For these sites,

## **Table of Contents**

generally the investigation is in the early stages, and we are unable to determine whether or not we actually had any association with the site, the nature of our responsibility, if any, for the contamination at the site and the extent of contamination at and cost to remediate the site. The timing and availability of information on these sites is dependent on events outside of our control, such as when the party alleging liability provides information to us. At certain of these previously inactive sites, we have received general and special notices of liability from the EPA and/or state agencies alleging that we, sometimes with other PRPs, are liable for past and future costs of remediating environmental contamination allegedly caused by former operations. These notifications may assert that we, along with any other alleged PRPs, are liable for past and/or future clean-up costs. As further information becomes available to us for any of these sites which would allow us to estimate a range of costs, we would at that time adjust our accruals. Any such adjustment could result in the recognition of an accrual that would have a material effect on our consolidated financial statements, results of operations and liquidity.

### **Insurance coverage claims**

We are involved in certain legal proceedings with a number of our former insurance carriers regarding the nature and extent of the carriers obligations to us under insurance policies with respect to certain lead pigment and asbestos lawsuits. The issue of whether insurance coverage for defense costs or indemnity or both will be found to exist for our lead pigment and asbestos litigation depends upon a variety of factors and we cannot assure you that such insurance coverage will be available.

We have agreements with three former insurance carriers pursuant to which the carriers reimburse us for a portion of our future lead pigment litigation defense costs, and one such carrier reimburses us for a portion of our future asbestos litigation defense costs. We are not able to determine how much we will ultimately recover from these carriers for defense costs incurred by us because of certain issues that arise regarding which defense costs qualify for reimbursement. While we continue to seek additional insurance recoveries, we do not know if we will be successful in obtaining reimbursement for either defense costs or indemnity. Accordingly, we recognize insurance recoveries in income only when receipt of the recovery is probable and we are able to reasonably estimate the amount of the recovery.

For a complete discussion of certain litigation involving us and certain of our former insurance carriers, refer to our 2011 Annual Report.

### **CompX**

Prior to March 9, 2011, CompX was involved in certain patent litigation with a competitor, and in March 2011, CompX entered into a confidential settlement agreement with them. Under the terms of the agreement, the competitor paid CompX's Canadian subsidiary approximately \$7.5 million in cash (which was recognized as a litigation settlement gain in the first quarter of 2011), and agreed to cross-license certain patents and to withdraw certain legal proceedings against the other party.



---

**Table of Contents**

**Other litigation**

We have been named as a defendant in various lawsuits in several jurisdictions, alleging personal injuries as a result of occupational exposure primarily to products manufactured by our former operations containing asbestos, silica and/or mixed dust. In addition, some plaintiffs allege exposure to asbestos from working in various facilities previously owned and/or operated by us. There are 1,125 of these types of cases pending, involving a total of approximately 2,050 plaintiffs. In addition, the claims of approximately 8,075 plaintiffs have been administratively dismissed or placed on the inactive docket in Ohio, Indiana and Texas state courts. We do not expect these claims will be re-opened unless the plaintiffs meet the courts' medical criteria for asbestos-related claims. We have not accrued any amounts for this litigation because of the uncertainty of liability and inability to reasonably estimate the liability, if any. To date, we have not been adjudicated liable in any of these matters. Based on information available to us, including:

facts concerning historical operations,

the rate of new claims,

the number of claims from which we have been dismissed and

our prior experience in the defense of these matters,

we believe that the range of reasonably possible outcomes of these matters will be consistent with our historical costs (which are not material). Furthermore, we do not expect any reasonably possible outcome would involve amounts material to our consolidated financial position, results of operations or liquidity. We have sought and will continue to vigorously seek dismissal and/or a finding of no liability from each claim. In addition, from time to time, we have received notices regarding asbestos or silica claims purporting to be brought against former subsidiaries, including notices provided to insurers with which we have entered into settlements extinguishing certain insurance policies. These insurers may seek indemnification from us.

For a discussion of other legal proceedings to which we are a party, refer to our 2011 Annual Report.

In May 2012, we reached an agreement with the New Jersey governmental authority and the real estate developer pursuant to which we received an aggregate of \$15.6 million cash for the third and final closing contemplated by the October 2008 settlement agreement associated with certain real property NL formerly owned in New Jersey, as more fully described in Note 19 in our 2011 Annual Report. Upon receipt of these cash proceeds, our equitable lien on a portion of such property was released. For financial reporting purposes, we have accounted for the consideration received in each of the first, second and third closings contemplated by the October 2008 settlement agreement by the full accrual method of accounting for real estate sales (since the settlement agreement arose out of a dispute concerning the adequacy of the condemnation proceeds of our former real property in New Jersey). Under this method, we recognized a pre-tax gain of \$15 million in the second quarter of 2012, based on the excess of the \$15.6 million cash proceeds received over our carrying value of the property from which our equitable lien was released. Similarly, the cash received in the third closing is reflected as an investing activity in our Condensed Consolidated Statement of Cash Flows.

In addition to the litigation described above, we and our affiliate are also involved in various other environmental, contractual, product liability, patent (or intellectual property), employment and other claims and disputes incidental to present and former businesses. In certain cases, we have insurance coverage for these items, although we do not expect additional material insurance coverage for environmental matters.

**Table of Contents**

We currently believe the disposition of all of these various other claims and disputes, individually and in the aggregate, should not have a material adverse effect on our consolidated financial position, results of operations or liquidity beyond the accruals already provided.

**Note 13 Financial instruments and fair value measurements:**

See Note 4 for information on how we determine fair value of our marketable securities.

The following table presents the financial instruments that are not carried at fair value but which require fair value disclosure at December 31, 2011 and June 30, 2012:

|   | December 31, 2011 |            | June 30, 2012   |            |
|---|-------------------|------------|-----------------|------------|
|   | Carrying Amount   | Fair Value | Carrying Amount | Fair Value |
|   | (in millions)     |            |                 |            |
| Cash, cash equivalents and restricted cash    | \$ 16.5           | \$ 16.5    | \$ 12.7         | \$ 12.7    |
| Notes payable to affiliates                   | 26.3              | 26.3       | 21.0            | 21.0       |
| CompX bank credit facility                    | 2.0               | 2.0        | 1.9             | 1.9        |
| Promissory note payable                       | 9.0               | 9.0        | 5.1             | 5.1        |
| Noncontrolling interest in CompX common stock | 11.0              | 24.0       | 11.1            | 20.6       |
| NL stockholders' equity                       | 415.0             | 631.2      | 367.8           | 606.9      |

The fair value of our noncurrent marketable securities, noncontrolling interest in CompX and NL stockholders' equity are based upon quoted market prices at each balance sheet date, which represent Level 1 inputs as defined by ASC Topic 820-10-35. The fair value of our promissory note payable and our variable interest rate debt represent Level 2 inputs and are 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.

Certain of our sales generated by CompX's non-U.S. operations are denominated in U.S. dollars. CompX periodically uses currency forward contracts to manage a portion of currency exchange rate market risk associated with receivables, or similar exchange rate risk associated with future sales, denominated in a currency other than the holder's functional currency. CompX has not entered into these contracts for trading or speculative purposes in the past, nor does it anticipate entering into such contracts for trading or speculative purposes in the future. Most of the currency forward contracts meet the criteria for hedge accounting under GAAP and are designated as cash flow hedges. For these currency forward contracts, gains and losses representing the effective portion of our hedges are deferred as a component of accumulated other comprehensive income, and

**Table of Contents**

are subsequently recognized in earnings at the time the hedged item affects earnings. Occasionally CompX enters into currency forward contracts which do not meet the criteria for hedge accounting. For these contracts, we mark-to-market the estimated fair value of the contracts at each balance sheet date based on quoted market prices for the forward contracts, with any resulting gain or loss recognized in income as part of net currency transactions. The quoted market prices for the forward contracts are a Level 1 input.

At June 30, 2012, CompX held a series of contracts to exchange an aggregate of U.S. \$8.8 million for an equivalent value of Canadian dollars at an exchange rate of \$1.03 per U.S. dollar. These contracts qualified for hedge accounting and mature through December 2012. The exchange rate was Cdn. \$1.02 per U.S. dollar at June 30, 2012. The estimated fair value of the contracts based on quoted market prices was an asset of approximately \$62,000 at June 30, 2012. At December 31, 2011, CompX held a series of contracts to exchange an aggregate of U.S. \$17.9 million for an equivalent value of Canadian dollars at exchange rates ranging from Cdn. \$1.03 to Cdn. \$0.99 per U.S. dollar. These contracts qualified for hedge accounting and mature through December 2012. The exchange rate was Cdn. \$1.02 per U.S. dollar at December 31, 2011. The estimated fair value of the contracts based on quoted market prices was a liability of approximately \$19,000 at December 31, 2011.

As discussed in our 2011 Annual Report, potential additional cash consideration related to the Furniture Components ergonomics healthcare product line acquired in July 2011, in an amount ranging from nil to approximately \$1.5 million, is payable in the first quarter of 2013. The payment is contingent upon the achievement of certain acquired product line sales targets during 2012. The estimated fair value of such accrued contingent consideration has been determined using a probability-weighted discounted cash flow methodology (Level 3 inputs), using a discount rate of approximately 4%. During the first six months of 2012, the amount of the accrued contingent consideration increased only for interest, which was not material.

**Note 14 Recent accounting standards:**

In June 2011 the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2011-05, *Presentation of Comprehensive Income*. ASU 2011-05 eliminates the option of presenting comprehensive income as a component of the Consolidated Statement of Stockholders' Equity and instead requires comprehensive income to be presented as a component of the Consolidated Statement of Income or in a separate Consolidated Statement of Comprehensive Income immediately following the Consolidated Statement of Income. In accordance with ASU 2011-05, we now present our comprehensive income in a separate Condensed Consolidated Statement of Comprehensive Income. Additionally, ASU 2011-05 would have required us to present on the face of our financial statements the effect of reclassifications out of accumulative other comprehensive income on the components of net income and other comprehensive income. However, in December 2011 the FASB issued ASU 2011-12, *Comprehensive Income (Topic 220): Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05*. ASU 2011-12 defers the effective date for the requirement to present on the face of our financial statements the effects of reclassifications out of accumulated other comprehensive income on the components of net income and other comprehensive income. Adoption of ASU 2011-05, as amended by ASU 2011-12, did not have a material effect on our Condensed Consolidated Financial Statements.

**Table of Contents**

In December 2011 the FASB issued ASU 2011-11 *Disclosures about Offsetting Assets and Liabilities*. ASU 2011-11 requires entities to disclose both gross information and net information about both instruments and transactions eligible for offset in the balance sheet and instruments and transactions subject to an agreement similar to a master netting arrangement. This standard will be effective for annual and interim periods beginning with our first quarter 2013 report. We do not believe the adoption of this standard will have a material effect on our Condensed Consolidated Financial Statements.

---

**Table of Contents**

**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 primarily a holding company. We operate in the component products industry through our majority-owned subsidiary, CompX International Inc. We also own a non-controlling interest in Kronos Worldwide, Inc. Both CompX (NYSE MKT: CIX) and Kronos (NYSE: KRO) file periodic reports with the Securities and Exchange Commission (SEC).

CompX is a leading manufacturer of engineered components utilized in a variety of applications and industries. Through its Security Products division, CompX manufactures mechanical and electronic cabinet locks and other locking mechanisms used in postal, office and institutional furniture, transportation, vending, tool storage and general cabinetry applications. CompX's Furniture Components division manufactures precision ball bearing slides and ergonomic computer support systems used in office and institutional furniture, home appliances, tool storage, healthcare and a variety of other applications. CompX also manufactures stainless steel exhaust systems, gauges and electronic and mechanical throttle controls for the performance boat industry through its Marine Components division.

We account for our 30% non-controlling interest in Kronos by the equity method. Kronos is a leading global producer and marketer of value-added titanium dioxide pigments (TiO<sub>2</sub>). TiO<sub>2</sub> is used for a variety of manufacturing applications including plastics, paints, paper and other industrial products.

**Forward-looking information**

This report contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Statements in this Quarterly Report on Form 10-Q that are not historical facts are forward-looking in nature and represents management's beliefs and assumptions based on currently available information. Statements found in this report including, but not limited to, the 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 these forward-looking statements by the use of words such as believes, intends, may, should, could, anticipates, expects or comparable terminology, or by discussion 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, which include, 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 (such as Kronos TiO<sub>2</sub> Operations);

Customer inventory levels;

**Table of Contents**

Changes in raw material and other operating costs (such as energy, ore and steel costs) and our ability to pass those costs on to our customers or offset them with reductions in other operating costs;

Changes in the availability of raw material (such as ore);

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, among other things, TiO<sub>2</sub> and component products);

Possible disruption of Kronos or CompX's business, or increases in our cost of doing business resulting from terrorist activities or global conflicts;

Competitive products and prices, including increased competition from low-cost manufacturing sources (such as China);

Customer and competitor strategies;

Potential consolidation of Kronos competitors;

Demand for office furniture;

Substitute products;

The impact of pricing and production decisions;

Competitive technology positions;

Potential difficulties in upgrading or implementing new manufacturing and accounting software systems;

The introduction of trade barriers;

The impact of current or future government regulations (including employee healthcare benefit related regulations);

Fluctuations in currency exchange rates (such as changes in the exchange rate between the U.S. dollar and each of the euro, the Norwegian krone and the Canadian dollar), or possible disruptions to our business resulting from potential instability resulting from uncertainties associated with the euro;

## Edgar Filing: NL INDUSTRIES INC - Form 10-Q

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 maintain sufficient liquidity;

The extent to which our subsidiaries were to become unable to pay us dividends;

CompX s and Kronos ability to renew or refinance debt;

CompX s ability to comply with covenants contained in its revolving bank credit facility;

The ultimate outcome of income tax audits, tax settlement initiatives or other tax matters;

Potential difficulties in integrating completed or future acquisitions;

Decisions to sell operating assets other than in the ordinary course of business;

Uncertainties associated with the development of new product features;

Our ability to utilize income tax attributes or changes in income tax rates related to such 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 or new developments regarding environmental remediation at sites related to our former operations);

Government laws and regulations and possible changes therein (such as changes in government regulations which might impose various obligations on former manufacturers of lead pigment and lead-based paint, including us, with respect to asserted health concerns associated with the use of such products);

## **Table of Contents**

The ultimate resolution of pending litigation (such as our lead pigment and environmental matters) and

Possible future litigation.

Should one or more of these risks materialize or if the consequences of such a development worsen, or should the underlying assumptions prove incorrect, actual results could differ materially from those currently 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**

### *Net income overview*

#### *Quarter Ended June 30, 2012 Compared to Quarter Ended June 30, 2011*

Our net income attributable to NL stockholders was \$26.0 million, or \$.53 per share, in the second quarter of 2012 compared to \$16.9 million, or \$.35 per share, in the second quarter of 2011. As more fully described below, our net income per share increased from 2011 to 2012 primarily due to the net effect of:

litigation settlement gain of \$15.0 million recognized in 2012 related to the settlement of condemnation proceedings on real property we formerly owned,

lower equity in earnings of Kronos in 2012 due to Kronos lower income from operations in the second quarter of 2012, and

lower environmental remediation and related expense in 2012.

Our 2012 net income attributable to NL stockholders includes the following:

income of \$.20 per share, net of income taxes, related to the litigation settlement gain, and

a charge of \$.02 per share included in our equity in Kronos related to Kronos charge for the early extinguishment of its remaining 6.5% Senior Notes due 2013 consisting of a call premium, interest from the indenture discharge date to the redemption date and the write-off of unamortized deferred financing costs and original issue discount associated with the redeemed Senior Notes.

#### *Six Months Ended June 30, 2012 Compared to Six Months Ended June 30, 2011*

Our net income attributable to NL stockholders was \$47.0 million, or \$.97 per share, in the first six months of 2012 compared to net income of \$34.1 million, or \$.70 per share, in the first six months of 2011. As more fully described below, our income per share increased from 2011 to 2012 primarily due to the net effect of:

higher equity in earnings of Kronos in 2012 due to Kronos higher income from operations in 2012,

litigation settlement gain of \$15.0 million recognized in 2012 related to the settlement of condemnation proceedings on real property we formerly owned,





**Table of Contents**

lower income from operations from component products in 2012 primarily due to a first quarter 2011 litigation gain of CompX as discussed below,

higher environmental remediation and related expense in 2012, and

higher insurance recoveries in 2012.

Our 2012 net income attributable to NL stockholders includes the following:

income of \$.20 per share, net of income taxes, related to the litigation settlement gain,

income of \$.02 per share, net of income taxes, related to insurance recoveries we recognized, and

a charge of \$.02 per share included in our equity in Kronos related to Kronos charge for the early extinguishment of its remaining 6.5% Senior Notes due 2013 consisting of a call premium, interest from the indenture discharge date to the redemption date and the write-off of unamortized deferred financing costs and original issue discount associated with the redeemed Senior Notes.

Our 2011 net income attributable to NL stockholders includes the following:

income of \$.06 per share, net of noncontrolling interest and income taxes, related to a CompX litigation settlement, and

a charge of \$.01 per share included in our equity in Kronos in 2011 consisting of a call premium and the write-off of unamortized deferred financing costs and original issue discount associated with Kronos March 2011 redemption of a portion of its Senior Notes.

***Income (loss) from operations***

The following table shows the components of our income (loss) from operations.

|                                      | Three months ended                |                  |             | Six months ended                  |                  |             |
|--------------------------------------|-----------------------------------|------------------|-------------|-----------------------------------|------------------|-------------|
|                                      | June 30,<br>2011<br>(In millions) | June 30,<br>2012 | %<br>Change | June 30,<br>2011<br>(In millions) | June 30,<br>2012 | %<br>Change |
| CompX                                | \$ 3.1                            | \$ 3.9           | 26%         | \$ 11.9                           | \$ 6.8           | (43)%       |
| Insurance recoveries                 | .1                                | .3               | 200%        | .5                                | 1.4              | 180%        |
| Litigation settlement gain           |                                   | 15.0             | 100%        |                                   | 15.0             | 100%        |
| Corporate expense and other, net     | (12.2)                            | (5.0)            | (59)%       | (15.7)                            | (21.1)           | 34%         |
| <b>Income (loss) from operations</b> | <b>\$ (9.0)</b>                   | <b>\$ 14.2</b>   |             | <b>\$ (3.3)</b>                   | <b>\$ 2.1</b>    |             |

Amounts attributable to CompX relate to its components products business, while the other amounts generally relate to NL. Each of these items is further discussed below.

**Table of Contents**

The following table shows the components of our income (loss) before income taxes exclusive of our income from operations.

|                              | Three months ended<br>June 30, |                       |  | %<br>Change | Six months ended<br>June 30, |                       |  | %<br>Change |
|------------------------------|--------------------------------|-----------------------|--|-------------|------------------------------|-----------------------|--|-------------|
|                              | 2011<br>(In millions)          | 2012<br>(In millions) |  |             | 2011<br>(In millions)        | 2012<br>(In millions) |  |             |
| Equity in earnings of Kronos | \$ 27.1                        | \$ 19.6               |  | (28)%       | \$ 45.4                      | \$ 61.2               |  | 35%         |
| Interest and dividend income | .8                             | .8                    |  |             | 1.4                          | 1.6                   |  | 14%         |
| Interest expense             | (.3)                           | (.2)                  |  | (33)%       | (.8)                         | (.6)                  |  | (25)%       |

**CompX International Inc.**

|                                   | Three months ended<br>June 30, |                       |  | %<br>Change | Six months ended<br>June 30, |                       |  | %<br>Change |
|-----------------------------------|--------------------------------|-----------------------|--|-------------|------------------------------|-----------------------|--|-------------|
|                                   | 2011<br>(In millions)          | 2012<br>(In millions) |  |             | 2011<br>(In millions)        | 2012<br>(In millions) |  |             |
| Net sales                         | \$ 35.2                        | \$ 37.6               |  | 7%          | \$ 70.0                      | \$ 73.1               |  | 4%          |
| Cost of sales                     | 25.4                           | 27.6                  |  | 9%          | 51.5                         | 53.6                  |  | 4%          |
| Gross margin                      | 9.8                            | 10.0                  |  |             | 18.5                         | 19.5                  |  |             |
| Operating costs and expenses      | (5.9)                          | (6.1)                 |  | 3%          | (12.1)                       | (12.7)                |  | 5%          |
| Patent litigation settlement gain |                                |                       |  |             | 7.5                          |                       |  | (100)%      |
| Patent litigation expense         |                                |                       |  |             | (.2)                         |                       |  | (100)%      |
| Facility consolidation expense    | (.8)                           |                       |  | (100)%      | (1.8)                        |                       |  | (100)%      |
| Income from operations            | \$ 3.1                         | \$ 3.9                |  |             | \$ 11.9                      | \$ 6.8                |  |             |

## Percentage of net sales:

|                        |     |     |  |     |     |
|------------------------|-----|-----|--|-----|-----|
| Cost of sales          | 72% | 73% |  | 74% | 73% |
| Gross margin           | 28% | 27% |  | 26% | 27% |
| Income from operations | 9%  | 10% |  | 17% | 9%  |

**Net sales** Net sales increased 7% in the second quarter of 2012 and increased 4% in the first six months of 2012 as compared to the same periods in 2011. Net sales increased in 2012 primarily due to \$1.1 million and \$2.3 million in new ergonomic healthcare product line sales in the quarter and six month period, respectively, related to the Furniture Components business acquired in July 2011, as well as from general growth in customer demand (or higher sales volumes) within the Security Products and Marine Components business units. Relative changes in selling prices did not have a material impact on net sales comparisons.

**Cost of sales and gross margin** Cost of goods sold increased \$2.2 million, or 9%, in the second quarter of 2012 as compared to the second quarter of 2012, and increased by \$2.1 million, or 4%, in the year-to-date period. The increase in cost of goods sold was primarily due to the increase in sales over the comparative periods although certain other items noted below impacted cost of goods sold resulting in a decrease in our gross margin percentage of 1% for the quarter and an increase of less than 1% for the year-to-date period.

**Table of Contents**

The gross margin comparison for the quarter was primarily impacted by higher medical self-insurance costs. The gross margin comparison for the first six months was impacted by the net effects of (i) lower fixed manufacturing costs (mostly in the first quarter), including lower depreciation expense, primarily as a result of the 2011 facility consolidation, (ii) a net positive impact relating to relative changes in currency exchange rates, (iii) higher raw material costs (primarily in the first quarter of 2012) and (iv) higher medical self-insurance costs.

**Litigation** The litigation settlement gain in 2011 of approximately \$7.5 million (attributable to CompX's Furniture Components division) is discussed in Note 12 to our Condensed Consolidated Financial Statements.

**Facility consolidation costs** In the second quarter and first six months of 2011, the Furniture Components business recorded approximately \$1.0 million and \$1.8 million, respectively, in relocation costs as a result of consolidating two of our precision slides facilities.

**Income from operations** Income from operations increased to \$3.9 million in the second quarter of 2012 compared to \$3.1 million in the second quarter of 2011 primarily due to facility consolidation costs incurred in the second quarter of 2011.

Income from operations decreased to \$6.8 million in the first six months of 2012 compared to \$11.9 million in the same period of 2011. Income from operations in the six month comparative period decreased primarily due to the net effects of the litigation settlement gain recorded in the first quarter of 2011, facility consolidation costs incurred in 2011, and the 2012 impact of improved production efficiencies related to the facility consolidation.

**Currency** Our Furniture Components business has substantial operations and assets located outside the United States (in Canada and Taiwan). The majority of sales generated from our non-U.S. operations are denominated in the U.S. dollar, with the remainder denominated in non-U.S. currencies, principally the Canadian dollar and the New Taiwan dollar. Most raw materials, labor and other production costs for our non-U.S. operations are denominated primarily in local currencies. Consequently, the translated U.S. dollar values of our non-U.S. sales and operating results are subject to currency exchange rate fluctuations which may favorably or unfavorably impact reported earnings and may affect comparability of period-to-period operating results. In addition to the impact of the translation of sales and expenses over time, our non-U.S. operations also generate currency transaction gains and losses which primarily relate to the difference between the currency exchange rates in effect when non-U.S. currency sales or operating costs are initially accrued and when such amounts are settled with the non-local currency. Our Furniture Component business's net sales were negatively impacted while its income from operations was positively impacted by currency exchange rates in the following amounts as compared to the impact of currency exchange rates during the corresponding periods in the prior year:

**Table of Contents****Impact of changes in currency exchange rates**

Three months ended June 30, 2012 vs. June 30, 2011

|                        | 2011 | Transaction gains<br>recognized<br>2012 | Change<br>(In thousands) | Translation<br>loss -<br>impact of<br>rate changes | Total currency<br>impact<br>2012 vs.<br>2011 |
|------------------------|------|---|--------------------------|--|--|
| <b>Impact on:</b>      |      |   |                          |  |  |
| Net sales              | \$   | \$                                      | \$                       | \$ (110)   | \$ (110)                                     |
| Income from operations | 89   | 56                                      | (33)                     | 331  | 298  |

**Impact of changes in currency exchange rates**

Six months ended June 30, 2012 vs. June 30, 2011

|                        | 2011 | Transaction gains<br>recognized<br>2012 | Change<br>(In thousands) | Translation<br>loss -<br>impact of<br>rate changes | Total currency<br>impact<br>2012 vs.<br>2011 |
|------------------------|------|---|--------------------------|--|--|
| <b>Impact on:</b>      |      |   |                          |  |  |
| Net sales              | \$   | \$                                      | \$                       | \$ (158)   | \$ (158)                                     |
| Income from operations | 43   | (51)                                    | (94)                     | 432  | 338  |

The negative impact on sales relates to sales denominated in non-U.S. dollar currencies translated into lower U.S. dollar sales due to a weakening of the local currency in relation to the U.S. dollar. The positive impact on income from operations results from the U.S. dollar denominated sales of non-U.S. operations converted into higher local currency amounts due to the strengthening of the U.S. dollar. This positively impacted our gross margin as it results in more local currency generated from sales to cover the costs of non-U.S. operations which are denominated in local currency.

**Results by Reporting Unit**

CompX's product offerings consist of a significantly large number of products that have a wide variation in selling price and manufacturing cost, which results in certain practical limitations on our ability to quantify the impact of changes in individual product sales quantities and selling prices on our net sales, cost of goods sold and gross profit. In addition, small variations in period-to-period net sales, cost of goods sold and gross profit can result from changes in the relative mix of our products sold. The key performance indicator for CompX's reporting units is the level of their income from operations (see discussion below).

**Table of Contents**

|  | Three months ended |                  | %<br>Change            | Six months ended |                  | %<br>Change  |
|--|--------------------|------------------|------------------------|------------------|------------------|--------------|
|  | June 30,           |                  |                        | June 30,         |                  |              |
|  | 2011               | 2012             | (Dollars in thousands) | 2011             | 2012             |              |
| Net sales:                                 |                    |                  |                        |                  |                  |              |
| Security Products                          | \$ 18,396          | \$ 19,248        | 5%                     | \$ 36,185        | \$ 37,442        | 3%           |
| Furniture Components                       | 14,146             | 15,452           | 9%                     | 29,041           | 30,555           | 5%           |
| Marine Components                          | 2,699              | 2,898            | 7%                     | 4,792            | 5,132            | 7%           |
| <b>Total net sales</b>                     | <b>\$ 35,241</b>   | <b>\$ 37,598</b> | <b>7%</b>              | <b>\$ 70,018</b> | <b>\$ 73,129</b> | <b>4%</b>    |
| Gross margin:                              |                    |                  |                        |                  |                  |              |
| Security Products                          | \$ 5,971           | \$ 5,912         | (1)%                   | \$ 11,816        | \$ 11,601        | (2)%         |
| Furniture Components                       | 3,340              | 3,517            | 5%                     | 5,927            | 6,979            | 18%          |
| Marine Components                          | 524                | 596              | 14%                    | 773              | 919              | 19%          |
| <b>Total gross margin</b>                  | <b>\$ 9,835</b>    | <b>\$ 10,025</b> | <b>2%</b>              | <b>\$ 18,516</b> | <b>\$ 19,499</b> | <b>5%</b>    |
| Income from operations:                    |                    |                  |                        |                  |                  |              |
| Security Products                          | \$ 3,788           | \$ 3,669         | (3)%                   | \$ 7,361         | \$ 7,141         | (3)%         |
| Furniture Components                       | 765                | 1,771            | 132%                   | 7,640            | 3,096            | (59)%        |
| Marine Components                          | (57)               | 102              | 279%                   | (412)            | (148)            | 64%          |
| Corporate operating expense                | (1,358)            | (1,613)          | (19)%                  | (2,691)          | (3,251)          | (21)%        |
| <b>Total income from operations</b>        | <b>\$ 3,138</b>    | <b>\$ 3,929</b>  | <b>25%</b>             | <b>\$ 11,898</b> | <b>\$ 6,838</b>  | <b>(43)%</b> |
| Gross margin as a percentage of net sales: |                    |                  |                        |                  |                  |              |
| Security Products                          | 32%                | 31%              |                        | 33%              | 31%              |              |
| Furniture Components                       | 24%                | 23%              |                        | 20%              | 23%              |              |
| Marine Components                          | 19%                | 21%              |                        | 16%              | 18%              |              |
| <b>Total gross margin</b>                  | <b>28%</b>         | <b>27%</b>       |                        | <b>26%</b>       | <b>27%</b>       |              |
| Income from operations margin:             |                    |                  |                        |                  |                  |              |
| Security Products                          | 21%                | 19%              |                        | 20%              | 19%              |              |
| Furniture Components                       | 5%                 | 11%              |                        | 26%              | 10%              |              |
| Marine Components                          | (2)%               | 4%               |                        | (9)%             | (3)%             |              |
| <b>Total income from operations margin</b> | <b>9%</b>          | <b>10%</b>       |                        | <b>17%</b>       | <b>9%</b>        |              |

*Security Products.* Security Products net sales increased 5% in the second quarter and 3% in the first six months of 2012 compared to the same period last year. The increase in sales is primarily due to improved economic conditions in North America.

As a percentage of net sales, gross margin decreased approximately 1% in the second quarter and 2% in the first six months of 2012 as compared to the prior year. The decrease in gross margin percentage for the quarter was primarily the result of higher medical self-insurance claims in 2012 of \$244,000. The decrease in gross margin percentage for the first six months of 2012 was primarily the result of higher raw material costs of \$380,000 (primarily in the first quarter 2012) and higher medical self-insurance claims of \$179,000 in 2012.

**Table of Contents**

As a percentage of net sales, income from operations margin decreased in both periods of 2012 as compared to the same periods in the prior year primarily due to the items noted above that impacted gross margin.

*Furniture Components.* Furniture Components net sales increased 9% in the second quarter of 2012 compared to the same period last year, and increased 5% in the first six months of 2012 in relation to the same period in the prior year. Net sales were positively impacted by \$1.1 million and \$2.3 million in the second quarter and first six months of 2012, respectively, relating to the July 2011 acquisition of an ergonomics healthcare component products business. This increase in sales was partially offset by a decrease in overall demand for other Furniture Components products due to a decrease in customer office furniture related projects.

As a percentage of net sales, 2012 gross margin decreased approximately 1% in the second quarter and improved 3% in the six month period as compared to the prior year. The impact of the decrease in gross margin percentage for the second quarter of 2012 compared to the second quarter of 2011 was not significant. The improvement in gross margin percentage for the first six months of 2012 was primarily the result of a \$430,000 reduction in fixed manufacturing costs, including lower depreciation expense, relating to higher fixed manufacturing costs in the first quarter of 2011 associated with the facility consolidation and a positive \$350,000 net impact of relative changes in currency exchange rates. The impact of the acquired ergonomics component business on gross margin percentage for the second quarter and for the first six months of 2012 was not significant.

Furniture Components income from operations for the second quarter of 2011 includes \$795,000 of facility consolidation costs. Excluding the 2011 facility consolidation costs, the income from operations margins for the second quarters of 2012 and 2011 are comparable at 11%. Furniture Components income from operations for the first six months of 2011 includes: (i) a patent litigation settlement gain of \$7.5 million, (ii) patent litigation expenses of \$227,000, and (iii) facility consolidation costs of approximately \$1.8 million. Excluding the patent litigation settlement gain, patent litigation expenses and facility consolidation costs, income from operations increased 3% in the first six months of 2012 compared to the first six months of 2011 primarily due to the items noted above that impacted gross margin.

*Marine Components.* Marine Components net sales increased \$199,000, or 7%, and increased \$340,000, or 7%, in the second quarter and first six months of 2012 compared to the same periods in the prior year, respectively. As a percentage of net sales, gross margin and income from operations increased for the second quarter and first six months of 2012 compared to the respective 2011 periods primarily due to increased leverage of fixed costs as a result of the higher sales and lower intangible amortization expense due to intangibles that became fully amortized in 2011.

*Outlook.* Consistent with the current state of the North American economy, overall demand from our customers continues to be subject to instability. While we experienced an increase in demand across most of our markets during the first six months of 2012, demand from several of our significant office furniture industry customers was weak but was more than offset by \$2.3 million in sales during the first six months from the ergonomic healthcare components business acquired in July 2011. Due to the current economic situation, it is uncertain (i) whether sales to our office furniture industry customers will improve during the remainder of 2012, (ii) what the ongoing impact on sales of the acquired ergonomics components business will be or (iii) the extent that sales will grow across our other customers during the remainder of 2012. While changes in market demand are not within our control,

## **Table of Contents**

we are focused on the areas we can impact. Staffing levels are continuously evaluated in relation to sales order rates which may result in headcount adjustments, to the extent possible, to match staffing levels with demand. We expect our continuous lean manufacturing and cost improvement initiatives, such as the 2011 consolidation of our Furniture Components facilities, to positively impact our productivity and result in a more efficient infrastructure. Additionally, we continue to seek opportunities to gain market share in markets we currently serve, to expand into new markets and to develop new product features in order to mitigate the impact of changes in demand as well as broaden our sales base.

Volatility in the costs of commodity raw materials is ongoing. Our primary commodity raw materials are steel, brass, alloyed zinc and stainless steel, which together represent approximately 18% of our total cost of goods sold. We generally seek to mitigate the impact of fluctuations in commodity raw material costs on our margins through improvements in production efficiencies or other operating cost reductions as well as occasionally executing larger quantity strategic purchases of these raw materials, which may result in higher inventory balances for a period of time. In the event we are unable to offset commodity raw material cost increases with other cost reductions, it may be difficult to recover those cost increases through increased product selling prices or surcharges due to the competitive nature of the markets served by our products. Additionally, significant surcharges may negatively affect our margins as they typically only recover the increased cost of the raw material without adding margin dollars resulting in a lower margin percentage. Consequently, overall operating margins may be negatively affected by commodity raw material cost pressures.

During the first six months of 2012, the value of the U.S. dollar did not change significantly in comparison to the Canadian dollar or the New Taiwan dollar, which are the primary currencies of our non-U.S. operations. However, the U.S. dollar could weaken during the remainder of 2012, which may have a negative impact on our 2012 results in comparison to 2011. When practical, we will seek to mitigate the negative impact of changes in currency exchange rates on our results by entering into currency hedging contracts. However, such strategies cannot fully mitigate the negative impact of changes in currency exchange rates. See Note 13 to the Condensed Financial Statements for currency hedging contracts in place at June 30, 2012.

### ***General corporate and other items***

***Insurance recoveries*** We have agreements with certain insurance carriers pursuant to which the carriers reimburse us for a portion of our past lead pigment and asbestos litigation defense costs. Insurance recoveries include amounts we received from these insurance carriers.

The agreements with certain of our insurance carriers also include reimbursement for a portion of our future litigation defense costs. We are not able to determine how much we will ultimately recover from these carriers for defense costs incurred by us because of certain issues that arise regarding which defense costs qualify for reimbursement. Accordingly, these insurance recoveries are recognized when the receipt is probable and the amount is determinable. See Note 12 to our Condensed Consolidated Financial Statements.

***Litigation settlement gain*** In May 2012, we reported a \$15 million pre-tax gain related to the third and final closing associated with certain real property we formerly owned in New Jersey. See Note 12 to our Condensed Consolidated Financial Statements.



**Table of Contents**

**Corporate expense** Corporate expenses were \$4.9 million in the second quarter of 2012, \$7.3 million lower than in the second quarter of 2011 primarily due to lower environmental remediation and related costs, offset in part by higher litigation and related costs in 2012. Included in corporate expense in the second quarters of 2011 and 2012 are:

litigation and related costs of \$2.1 million in 2012 compared to \$1.2 million in 2011, and

environmental remediation and related costs of \$1.2 million in 2012 compared to \$9.7 million in 2011.

Corporate expenses were \$21.1 million in the first six months of 2012, \$5.4 million or 34% higher than in the first six months of 2011 due to higher environmental remediation and related expense partially offset by lower litigation and related costs in 2012. Included in corporate expense in the first six months of are:

litigation and related costs of \$4.0 million in 2012 compared to \$3.0 million in 2011, and

environmental remediation and related expense of \$14.0 million in 2012 compared to \$9.9 million in 2011.

The level of our litigation and related expenses varies from period to period depending upon, among other things, the number of cases in which we are currently involved, the nature of such cases and the current stage of such cases (e.g. discovery, pre-trial motions, trial or appeal, if applicable). See Note 12 to the Condensed Consolidated Financial Statements. If our current expectations regarding the number of cases in which we expect to be involved during 2012 or the nature of such cases were to change, our corporate expenses could be higher than we currently estimate.

Obligations for environmental remediation costs are difficult to assess and estimate and it is possible that actual costs for environmental remediation will exceed accrued amounts or that costs will be incurred in the future for sites in which we cannot currently estimate our liability. If these events were to occur in 2012, our corporate expenses would be higher than we currently estimate. In addition, we adjust our environmental accruals as further information becomes available to us or as circumstances change. Such further information or changed circumstances could result in an increase in our accrued environmental costs. See Note 12 to the Condensed Consolidated Financial Statements.

Overall, we expect our general corporate expenses for all of calendar 2012 will be higher than 2011 due to higher expected litigation and related expenses and higher environmental remediation and related costs. If our current expectations regarding the number of cases or sites in which we expect to be involved during 2012, or if the nature of such cases or sites were to change, our corporate expenses could be higher than we currently estimate and involve amounts that are material.

**Provision for income taxes** We recognized an income tax expense of \$8.2 million in the second quarter of 2012 compared to \$1.4 million in the second quarter of 2011, and \$16.8 million in the first six months of 2012 as compared to \$7.9 million in the first six months of 2011. This increase in income tax expense in both 2012 periods is primarily due to increased earnings.

**Table of Contents**

Our income tax expense in the first six months of 2011 includes a \$2.1 million provision recognized for deferred income taxes related to the undistributed earnings of our Canadian subsidiary attributable to the \$7.5 million litigation settlement gain discussed in Note 12 and a \$1.4 million benefit related to newly enacted state legislation in the second quarter of 2011 that changed our state apportionment. See Note 11 to our Condensed Consolidated Financial Statements.

**Noncontrolling interest in subsidiary** Noncontrolling interest in net income of subsidiary increased \$.1 million in the second quarter of 2012 compared to the same period in 2011, and decreased \$.3 million in the first six months of 2012 as compared to the first six months of 2011. The noncontrolling interest we recognize in each period is directly related to the level of earnings at CompX for the period.

**Equity in earnings of Kronos Worldwide, Inc.**

|  | Three months ended<br>June 30, |                 | %<br>Change  | Six months ended<br>June 30, |                   | %<br>Change  |
|--|--------------------------------|-----------------|--------------|------------------------------|-------------------|--------------|
|  | 2011<br>(In millions)          | 2012            |              | 2011<br>(In millions)        | 2012              |              |
| <b>Kronos:</b>                               |                                |                 |              |                              |                   |              |
| Net sales                                    | \$ 537.5                       | \$ <b>545.3</b> | <b>1%</b>    | \$ 957.9                     | \$ <b>1,106.6</b> | <b>16%</b>   |
| Cost of sales                                | 340.5                          | <b>382.0</b>    | <b>12%</b>   | 614.5                        | <b>681.8</b>      | <b>11%</b>   |
| Gross margin                                 | \$ 197.0                       | \$ 163.3        |              | \$ 343.4                     | \$ 424.8          |              |
| Income from operations                       | \$ 144.2                       | \$ <b>110.6</b> | <b>(23)%</b> | \$ 246.6                     | \$ <b>320.0</b>   | <b>30%</b>   |
| Interest and dividend income                 | 1.7                            | <b>2.0</b>      | <b>18%</b>   | 3.4                          | <b>4.3</b>        | <b>26%</b>   |
| Loss on prepayment of debt                   |                                | <b>(7.2)</b>    | <b>100%</b>  | (3.3)                        | <b>(7.2)</b>      | <b>118%</b>  |
| Interest expense                             | (8.5)                          | <b>(6.7)</b>    | <b>(21)%</b> | (18.1)                       | <b>(13.0)</b>     | <b>(28)%</b> |
|  | 137.4                          | <b>98.7</b>     |              | 228.6                        | <b>304.1</b>      |              |
| Income tax expense                           | 48.4                           | <b>34.2</b>     | <b>(29)%</b> | 79.3                         | <b>102.7</b>      | <b>30%</b>   |
| Net income                                   | \$ 89.0                        | \$ 64.5         |              | \$ 149.3                     | \$ 201.4          |              |
| <b>Percentage of net sales:</b>              |                                |                 |              |                              |                   |              |
| Cost of sales                                | 63%                            | <b>70%</b>      |              | 64%                          | <b>62%</b>        |              |
| Income from operations                       | 27%                            | <b>20%</b>      |              | 26%                          | <b>29%</b>        |              |
| Equity in earnings of Kronos Worldwide, Inc. | \$ 27.1                        | \$ <b>19.6</b>  |              | \$ 45.4                      | \$ <b>61.2</b>    |              |
| <b>TiO<sub>2</sub> operating statistics:</b> |                                |                 |              |                              |                   |              |
| Sales volumes*                               | 146                            | <b>123</b>      | <b>(16)%</b> | 271                          | <b>253</b>        | <b>(7)%</b>  |
| Production volumes*                          | 142                            | <b>118</b>      | <b>(17)%</b> | 275                          | <b>258</b>        | <b>(6)%</b>  |
| <b>Change in TiO<sub>2</sub> net sales:</b>  |                                |                 |              |                              |                   |              |
| TiO <sub>2</sub> product pricing             |                                |                 | <b>24%</b>   |                              |                   | <b>28%</b>   |
| TiO <sub>2</sub> sales volumes               |                                |                 | <b>(16)</b>  |                              |                   | <b>(7)</b>   |
| TiO <sub>2</sub> product mix                 |                                |                 | <b>(2)</b>   |                              |                   | <b>(1)</b>   |
| Changes in currency exchange rates           |                                |                 | <b>(5)</b>   |                              |                   | <b>(4)</b>   |
| Total  |                                |                 | <b>1%</b>    |                              |                   | <b>16%</b>   |

\* Thousands of metric tons



---

**Table of Contents**

The key performance indicators for Kronos are TiO<sub>2</sub> average selling prices and TiO<sub>2</sub> sales and production volumes.

**Current industry conditions** Throughout 2011 and continuing into the first quarter of 2012, Kronos' production facilities operated at full practical capacity rates. During the second quarter of 2012, Kronos operated its facilities at approximately 86% of practical capacity, primarily in order to align production and inventory levels with decreased demand. Kronos also increased TiO<sub>2</sub> selling prices throughout 2011. As a result, average selling prices in the second quarter 2012 were 24% higher as compared to the second quarter of 2011, and average selling prices at the end of the second quarter of 2012 were comparable to selling prices at the end of 2011. Global customer demand for TiO<sub>2</sub> products also remained strong throughout much of 2011. Although Kronos experienced a softening of demand in the fourth quarter of 2011 as a result of customer destocking, customer demand in the first quarter of 2012 rebounded from the softness experienced in the fourth quarter of 2011. Aggregate global demand for TiO<sub>2</sub> softened again in the second quarter of 2012 in line with global economic conditions, although markets in North America and certain export markets continue to show relative strength. Kronos expects demand for TiO<sub>2</sub> products will increase as economic conditions improve in the various regions of the world.

**Net sales** Kronos' net sales in the second quarter of 2012 increased 1%, or \$7.8 million, compared to the second quarter of 2011 primarily due to the net effects of a 24% increase in average TiO<sub>2</sub> selling prices (which increased net sales by approximately \$129 million) and a 16% decrease in sales volume (which decreased net sales by approximately \$86 million).

Kronos' net sales in the six months ended June 30, 2012 increased 16%, or \$148.7 million, compared to the six months ended June 30, 2011 primarily due to the net effects of a 28% increase in average TiO<sub>2</sub> selling prices (which increased net sales by approximately \$268 million) and a 7% decrease in sales volumes (which decreased net sales by approximately \$67 million).

TiO<sub>2</sub> selling prices will increase or decrease generally as a result of competitive market pressures, changes in the relative level of supply and demand as well as changes in raw material and other manufacturing costs. Based on the increases in its TiO<sub>2</sub> selling prices Kronos implemented throughout 2011 and the current conditions in the TiO<sub>2</sub> industry, Kronos currently expects its average selling prices for the remainder of 2012 to continue to be higher than the comparable periods in 2011.

Kronos' sales volumes decreased 16% in the second quarter of 2012 as compared to the second quarter of 2011 due to lower customer demand, primarily in European and certain export markets. In addition, Kronos estimates the unfavorable effect of changes in currency exchange rates decreased net sales by approximately \$27 million, or 5%, as compared to the second quarter of 2011.

Kronos' sales volumes decreased 7% in the first six months of 2012 as compared to the first six months of 2011 due to decreased customer demand, primarily in European and certain export markets. In addition, Kronos estimates the unfavorable effect of changes in currency exchange rates decreased net sales by approximately \$36 million, or 4%, as compared to the first six months of 2011.

**Cost of sales** Kronos' cost of sales increased \$41.5 million or 12% in the second quarter of 2012 compared to 2011 due to the net impact of higher raw material costs of approximately \$90 million (primarily feedstock ore and petroleum coke), a 16% decrease in sales volumes, a 17% decrease in TiO<sub>2</sub>

---

**Table of Contents**

production volumes, an increase in maintenance costs of \$2.9 million and currency fluctuations (primarily the euro). Cost of sales as a percentage of net sales increased to 70% in the second quarter of 2012 compared to 63% in the second quarter of 2011, primarily due to the net effect of higher raw material costs, lower production volumes and higher average selling prices.

Kronos cost of sales increased \$67.3 million or 11% in the six months ended June 30, 2012 compared to this same period in 2011 due to the net impact of higher raw material costs of approximately \$117 million (primarily feedstock ore and petroleum coke), a 7% decrease in sales volume, a 6% decrease in production volume, an increase in maintenance costs of \$3.8 million and currency fluctuations (primarily the euro). Cost of sales as a percentage of net sales decreased to 62% in the first six months of 2012 compared to 64% in the same period in 2011 primarily due to the net effects of higher average selling prices, higher raw material costs and lower production volumes. Additionally, the first half of 2012 reflects the benefit of lower raw material costs (as compared to current costs) in the first quarter of 2012 as lower cost raw materials purchased at the end of 2011 were used in the production process. Kronos expects further increases in its manufacturing costs during the remainder of 2012, as discussed below.

**Gross margin and income from operations** Kronos income from operations decreased by \$33.6 million from \$144.2 million in the second quarter of 2011 to \$110.6 million in the second quarter of 2012. Income from operations as a percentage of net sales decreased to 20% in the second quarter of 2012 from 27% in the same period of 2011. This decrease was driven by the decline in gross margin, which decreased to 30% for the second quarter of 2012 compared to 37% for the second quarter of 2011.

Kronos income from operations increased by \$73.4 million from \$246.6 million in the first six months of 2011 to \$320.0 million in the first six months of 2012. Income from operations as a percentage of net sales increased to 29% in the first six months of 2012 from 26% in the same period of 2011. This increase was driven by the improvement in gross margin, which increased to 38% for the first six months of 2012 compared to 36% for the same period in 2011.

As discussed and quantified above, Kronos gross margin has increased primarily due to the net effects of higher selling prices, higher manufacturing costs (primarily raw materials), lower sales volumes and lower production volumes. Additionally, changes in currency exchange rates have negatively affected Kronos gross margin and income from operations. Kronos estimates that changes in currency exchange rates decreased income from operations by approximately \$1 million in the second quarter of 2012 as compared to the same period in 2011 and by approximately \$3 million in the first six months of 2012 as compared to the same period in 2011.

**Other non-operating income (expense)** In June 2012, Kronos entered into a new \$400 million term loan. Kronos used a portion of the net proceeds of the term loan to redeem the remaining outstanding 6.5% Senior Secured Notes due April 2013 ( 279.2 million principal amount outstanding). As a result, Kronos recognized an aggregate \$7.2 million pre-tax charge in the second quarter of 2012 related to the early extinguishment of debt, consisting of the call premium paid, interest from the June 14, 2012 indenture discharge date to the July 20, 2012 redemption date and the write-off of unamortized deferred financing costs and original issue discount associated with the redeemed Senior Notes.

## **Table of Contents**

In March 2011, Kronos redeemed 80 million of its 6.5% Senior Secured Notes and borrowed under its European revolving credit facility in order to fund the redemption. As a result, Kronos recognized a \$3.3 million pre-tax interest charge related to the prepayment of the 6.5% Senior Secured Notes in the first quarter of 2011 consisting of the call premium and the write-off of unamortized deferred financing costs and original issue discount associated with the redeemed Senior Notes.

Kronos' interest expense decreased \$1.8 million from \$8.5 million in the second quarter of 2011 to \$6.7 million in the second quarter of 2012 and decreased \$5.1 million from \$18.1 million in the six months ended June 30, 2011 to \$13.0 million in the six months ended June 30, 2012. The decrease in interest expense was primarily due to lower average debt levels of Kronos' 6.5% Senior Notes resulting from the March 2011 redemption and open market purchases in the third and fourth quarters of 2011. As discussed above, the remaining Senior Notes were derecognized in June 2012.

Kronos expects interest expense for the remainder of 2012 to be comparable to the same periods in 2011 due to the net effect of higher average outstanding debt levels associated with borrowings under the new term loan and European revolver, and lower average interest rates on outstanding borrowings, as the term loan and European revolver bear interest at a lower average interest rate compared to the redeemed 6.5% Senior Notes.

**Income tax provision** Kronos' income tax provision was \$34.2 million in the second quarter of 2012 compared to an income tax provision of \$48.4 million in the same period last year. This decrease is primarily due to Kronos' decreased earnings. Kronos' income tax provision was \$102.7 million in the first six months of 2012 compared to \$79.3 million in the same period last year. This increase in provision for income taxes was primarily due to improved income from operations in the first six months of 2012 compared to the same period in 2011.

Kronos has substantial net operating loss carryforwards in Germany (the equivalent of \$799 million and \$188 million for German corporate and trade tax purposes, respectively, at December 31, 2011). At June 30, 2012, Kronos 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) Kronos has utilized a portion of such carryforwards during the most recent three-year period and (iii) it currently expects to utilize the remainder of such carryforwards over the long term. However, prior to the complete utilization of such carryforwards, particularly if the economic recovery were to be short-lived or Kronos were to generate losses in its German operations for an extended period of time, it is possible that Kronos might conclude the benefit of such carryforwards would no longer meet the more-likely-than-not recognition criteria, at which point it would be required to recognize a valuation allowance against some or all of the then-remaining tax benefit associated with the carryforwards.

## **Effects of Currency Exchange Rates**

Kronos has substantial operations and assets located outside the United States (primarily in Germany, Belgium, Norway and Canada). The majority of its sales from non-U.S. operations are denominated in currencies other than the U.S. dollar, principally the euro, other major European currencies and the Canadian dollar. A portion of Kronos' sales generated from its non-U.S. operations is denominated in the U.S. dollar. Certain raw materials used worldwide, primarily titanium-containing feedstocks, are purchased in U.S. dollars, while labor and other production costs are purchased primarily in local currencies. Consequently, the translated U.S. dollar value of Kronos' non-U.S. sales and operating results are subject to currency exchange rate

**Table of Contents**

fluctuations which may favorably or unfavorably impact reported earnings and may affect the comparability of period-to-period operating results. In addition to the impact of the translation of sales and expenses over time, Kronos non-U.S. operations also generate currency transaction gains and losses which primarily relate to the difference between the currency exchange rates in effect when non-local currency sales or operating costs are initially accrued and when such amounts are settled with the non-local currency.

Overall, Kronos estimates that fluctuations in currency exchange rates had the following effects on its sales and income from operations for the periods indicated.

**Impact of changes in currency exchange rates****Three months ended June 30, 2012 vs. June 30, 2011**

|                        | Transaction gains recognized |      |        | Translation loss-impact of rate changes<br>(In millions) | Total currency impact<br>2012 vs. 2011 |
|------------------------|------------------------------|------|--------|--|--|
|                        | 2011                         | 2012 | Change |  |  |
| <b>Impact on:</b>      |                              |      |        |  |  |
| Net sales              | \$                           | \$   | \$     | \$ (27)  | \$ (27)                                |
| Income from operations | 1                            | 1    |        | (1)  | (1)                                    |

**Impact of changes in currency exchange rates****Six months ended June 30, 2012 vs. June 30, 2011**

|                        | Transaction gains recognized |      |        | Translation loss-impact of rate changes<br>(In millions) | Total currency impact<br>2012 vs. 2011 |
|------------------------|------------------------------|------|--------|--|--|
|                        | 2011                         | 2012 | Change |  |  |
| <b>Impact on:</b>      |                              |      |        |  |  |
| Net sales              | \$                           | \$   | \$     | \$ (36)  | \$ (36)                                |
| Income from operations | 2                            | 1    | (1)    | (2)  | (3)                                    |

**Outlook**

During the first quarter of 2012 Kronos operated its production facilities at full practical capacity levels, consistent with operating rates throughout 2011. During the second quarter of 2012, Kronos operated its facilities at approximately 86% of practical capacity, primarily to align its production and inventory levels with decreased demand. In order to continue to manage production and inventory levels, Kronos currently expects to operate its facilities at 90% to 95% of its attainable practical production capacity of 550,000 metric tons for all of 2012. In addition, Kronos currently expects its sales volumes for all of 2012 to be lower as compared to 2011 and its 2012 sales volumes to exceed its 2012 production volumes.

Kronos implemented significant increases in TiO<sub>2</sub> selling prices throughout 2011 and raised prices in certain markets in the first half of 2012. Kronos average TiO<sub>2</sub> selling prices were 24% higher in the second quarter of 2012 as compared to the second quarter of 2011, and its average selling prices at the end of the second quarter of 2012 were comparable to prices at the end of 2011. Based on the increases in Kronos TiO<sub>2</sub> selling

## **Table of Contents**

prices it implemented throughout 2011 and the current conditions in the TiO<sub>2</sub> industry, Kronos currently expects average selling prices for the remainder of 2012 to continue to be higher than the comparable periods in 2011. Kronos' ability to implement additional selling price increases for the remainder of 2012 will depend principally upon product demand levels.

During the remainder of 2012, Kronos expects to see a continuation of the significantly higher feedstock ore costs that Kronos experienced in the second quarter, driven by tight ore supplies and higher-than-historical increases in petroleum coke and energy costs. Overall, Kronos currently expects its per metric ton cost of TiO<sub>2</sub> it produces in 2012 will increase approximately 50% to 60% as compared to 2011, primarily due to higher feedstock ore costs. Kronos' cost of sales per metric ton of TiO<sub>2</sub> sold in calendar 2012 is consequently expected to be significantly higher as compared to calendar 2011. However, Kronos' cost of sales per metric ton of TiO<sub>2</sub> sold in the first half of 2012 is lower as compared to its expected cost of sales per metric ton of TiO<sub>2</sub> sold in the remainder of 2012, as a substantial portion of the TiO<sub>2</sub> products Kronos sold in the first quarter of 2012 was produced with lower-cost feedstock ore.

Overall, Kronos expects that income from operations in the second half of 2012 will likely be lower as compared to the same period in 2011, as the favorable effects of higher selling prices will be more than offset by the unfavorable effect of lower sales volumes and higher production costs.

Kronos' expectations as to the future of the TiO<sub>2</sub> industry are based upon a number of factors beyond its control, including worldwide growth of gross domestic product, competition in the marketplace, continued operation of competitors, unexpected or earlier-than-expected capacity additions or reductions and technological advances. If actual developments differ from its expectations, Kronos' results of operations could be unfavorably affected.

## **LIQUIDITY AND CAPITAL RESOURCES**

### **Consolidated cash flows**

#### *Operating activities*

Trends in cash flows from operating activities, excluding the impact of deferred taxes and relative changes in assets and liabilities, are generally similar to trends in our income from operations. Net cash provided by operating activities was \$4.5 million in the first six months of 2012 compared to net cash provided by operating activities of \$22.0 million in the first six months of 2011.

The \$17.5 million decrease in cash provided by operating activities includes the net effect of:

lower dividends received from Kronos in 2012 of \$16.7 million primarily due to Kronos' special dividend of \$.50 per share in the first six months of 2011,

lower results from operations in 2012 attributable to CompX of \$5.1 million, primarily due to the \$7.5 million received from CompX's litigation settlement in 2011,

higher cash received from insurance recoveries in 2012 of \$1.5 million,

lower amounts paid for environmental remediation and related expense in 2012 of \$1.1 million,



**Table of Contents**

lower amount of net cash used for relative changes in receivables, inventories, payables and accrued liabilities in 2012 of \$5.9 million,

higher cash paid for income taxes in 2012 of \$2.2 million due to our higher earnings, and

lower cash paid for interest in 2012 of \$1.2 million due to the interest payment on our note payable to affiliate in March 2011 which included deferred interest for all of 2010. See Note 8 to our Condensed Consolidated Financial Statements.

We do not have complete access to CompX's cash flows in part because we do not own 100% of CompX. A detail of our consolidated cash flows from operating activities is presented in the table below. Intercompany dividends have been eliminated. The reference to NL Parent in the table below is a reference to NL Industries, Inc., as the parent company of CompX and our wholly-owned subsidiaries.

|  | Six months ended<br>June 30, |               |
|--|------------------------------|---------------|
|  | 2011                         | 2012          |
|  | (In millions)                |               |
| Net cash provided by operating activities: |                              |               |
| CompX                                      | \$ 2.8                       | \$ 1.6        |
| NL Parent and wholly-owned subsidiaries    | 21.8                         | 5.6           |
| Eliminations                               | (2.6)                        | (2.7)         |
| <b>Total</b>                               | <b>\$ 22.0</b>               | <b>\$ 4.5</b> |

Relative changes in working capital can have a significant effect on cash flows from operating activities. Generally, we expect our average days sales outstanding to increase from December to June as the result of a seasonal increase in sales during the second quarter as compared to the fourth quarter. Overall, our June 30, 2012 days sales outstanding compared to December 31, 2011 is in line with our expectations. The decrease in days in inventory was the result of an increase in sales volume in the first six months of 2012 without a significant change in inventory due to our operational focus on continuously improving our inventory management. For comparative purposes, we have provided December 31, 2010 and June 30, 2011 numbers below.

|                        | December 31,<br>2010 | June 30,<br>2011 | December 31,<br>2011 | June 30,<br>2012 |
|------------------------|----------------------|------------------|----------------------|------------------|
| Days sales outstanding | 41 days              | 46 days          | 39 days              | 42 days          |
| Days in inventory      | 70 days              | 74 days          | 71 days              | 63 days          |

**Investing and financing activities**

Net cash provided by investing activities totaled \$13.1 million in the first six months of 2012.

During 2012:

we received \$15.6 million from the final closing contained in a settlement agreement related to condemnation proceedings on certain real property we owned in New Jersey, and

we paid \$2.2 million in capital expenditures, substantially all of which related to CompX.



---

**Table of Contents**

Net cash used in financing activities totaled \$21.9 million in the first six months of 2012.

During 2012:

we repaid a net \$4.1 million on a promissory note with Valhi,

we prepaid an aggregate \$3.9 million under a promissory note issued in conjunction with a litigation settlement, and

CompX repaid an aggregate of \$1.3 million on the promissory note payable to TIMET, including a principal prepayment of \$1.0 million.

During each of the first six months of 2012 and 2011 we paid \$12.2 million, or \$.25 per share, in dividends. Distributions to noncontrolling interests consist of CompX dividends paid to shareholders other than us.

Provisions contained in certain of CompX's and Kronos' credit agreements could result in the acceleration of the applicable indebtedness prior to its stated maturity for reasons other than defaults from failing to comply with typical financial covenants. For example, certain credit agreements allow the lender to accelerate the maturity of the indebtedness upon a change of control (as defined) of the borrower. In addition, certain credit agreements could result in the acceleration of all or a portion of the indebtedness following a sale of assets outside the ordinary course of business. Although CompX has no current expectations to borrow on the revolving credit facility to fund working capital, capital expenditures, debt service or dividends (if declared), lower future operating results could reduce or eliminate the amount available to borrow and restrict future dividends.

NL, CompX and Kronos are each in compliance with all of their respective debt covenants at June 30, 2012. Our ability and the ability of our affiliates to borrow funds under our credit facilities in the future will, in some instances, depend in part on compliance with specified financial ratios and satisfaction of certain financial covenants contained in the applicable credit agreements. We believe each of NL, CompX and Kronos will be able to comply with its respective financial covenants contained in their credit facilities through the maturity date of the respective facilities; however if future operating results differ materially from our current expectations, we, CompX or Kronos might not be able to maintain compliance.

**Future cash requirements**

***Liquidity***

Our primary source of liquidity on an ongoing basis is our cash flow from operating activities and credit facilities with affiliates and banks as further discussed below. We generally use these amounts to (i) fund capital expenditures (substantially all of which relate to CompX), (ii) pay ongoing environmental remediation and legal expenses and (iii) provide for the payment of debt service and dividends (if declared).

At June 30, 2012, we had an aggregate of \$12.7 million of restricted and unrestricted cash and cash equivalents. A detail by entity is presented in the table below. Of the \$5.2 million aggregate cash and cash equivalents held by CompX, \$4.7 million was held by its non-U.S. subsidiaries.

**Table of Contents**

|   | <b>Amount<br/>(In millions)</b> |
|---|---------------------------------|
| CompX                                   | <b>\$ 5.2</b>                   |
| NL Parent and wholly-owned subsidiaries | <b>7.5</b>                      |
| <b>Total</b>                            | <b>\$ 12.7</b>                  |

In addition, at June 30, 2012 we owned 14.4 million shares of Valhi common stock and 1.4 million shares of TIMET common stock with an aggregate market value of \$195.9 million. See Note 4 to the Condensed Consolidated Financial Statements. We also owned 35.2 million shares of Kronos common stock at June 30, 2012 with an aggregate market value of \$556.1 million. See Note 5 to the Condensed Consolidated Financial Statements.

We routinely compare our liquidity requirements and alternative uses of capital against the estimated future cash flows we expect to receive from our subsidiaries and affiliates. As a result of this process, we have in the past and may in the future seek to raise additional capital, incur debt, repurchase indebtedness in the market or otherwise, modify our dividend policies, consider the sale of our interests in our subsidiaries, affiliates, business, marketable securities or other assets, or take a combination of these and other steps, to increase liquidity, reduce indebtedness and fund future activities. Such activities have in the past and may in the future involve related companies.

We periodically evaluate acquisitions of interests in or combinations with companies (including related companies) perceived by management to be undervalued in the marketplace. These companies may or may not be engaged in businesses related to our current businesses. We intend to consider such acquisition activities in the future and, in connection with this activity, may consider issuing additional equity securities and increasing indebtedness. From time to time, we also evaluate the restructuring of ownership interests among our respective subsidiaries and related companies.

Based upon our expectations of our operating performance, and the anticipated demands on our cash resources we expect to have sufficient liquidity to meet our short-term obligations (defined as the twelve-month period ending June 30, 2013). If actual developments differ from our expectations, our liquidity could be adversely affected. In this regard, Valhi has agreed to loan us up to \$40 million on a revolving basis. At June 30, 2012 we had a borrowing availability of \$40 million. The amount of any such outstanding loan Valhi would make to us is at Valhi's discretion. In addition, CompX had an outstanding balance of \$1.9 million on its revolving credit facility with a borrowing availability of \$28.1 million and CompX could borrow all such available balance without violating any debt covenants. See Note 8 to the Condensed Consolidated Financial Statements.

*Capital Expenditures*

Firm purchase commitments for capital projects in process at June 30, 2012 approximated \$1.2 million. CompX's 2012 capital investments are limited to those expenditures required to meet expected customer demand and those required to properly maintain its facilities.

*Dividends*

Because our operations are conducted primarily through subsidiaries and affiliates, our long-term ability to meet parent company-level corporate obligations is largely dependent on the receipt of dividends or other

**Table of Contents**

distributions from our subsidiaries and affiliates. In May 2012, Valhi implemented a 3-for-1 stock split of its common stock and declared a regular quarterly dividend of \$.05 per share post stock split. A detail of annual dividends we would expect to receive from our subsidiaries and affiliates in 2012, based on the number of shares of common stock we own for these subsidiaries and affiliates at June 30, 2012 and their current regular quarterly dividend rate, is presented in the table below. Following Valhi's May 2012 3-for-1 stock split, Valhi increased its regular quarterly dividend from \$.125 per share (pre-split) to \$.05 per share (post-split). The amount shown in the table below for Valhi reflects the \$.125 per share (pre-split) dividend we actually received from Valhi in the first quarter.

|  | Share held at<br>June 30, 2012<br>(in<br>millions) | Quarterly<br>Dividend Rate | Annual Expected<br>Dividend<br>(in millions) |
|--|--|----------------------------|--|
| Kronos                                 | 35.2   | \$ .15                     | \$ 21.1                                      |
| CompX                                  | 10.8   | .125                       | 5.4  |
| Valhi                                  | 14.4   | .05                        | 2.8  |
| TIMET                                  | 1.4  | .075                       | .4   |
| <b>Total expected annual dividends</b> |  |                            | <b>\$ 29.7</b>                               |

*Investments in our subsidiaries and affiliates and other acquisitions*

We have in the past and may in the future purchase the securities of our subsidiaries and affiliates or third-parties in market or privately-negotiated transactions. We base our purchase decisions on a variety of factors, including an analysis of the optimal use of our capital, taking into account the market value of the securities and the relative value of expected returns on alternative investments. In connection with these activities, we may consider issuing additional equity securities or increasing our indebtedness. We may also evaluate the restructuring of ownership interests of our businesses among our subsidiaries and related companies.

*Off-balance sheet financing arrangements*

Other than operating lease commitments discussed in our 2011 Annual Report, we are not party to any material off-balance sheet financing arrangements.

*Commitments and contingencies*

We are subject to certain commitments and contingencies, as more fully described in Note 19 to our 2011 Annual Report, or in Note 12 to our Consolidated Financial Statements or in Part II, Item 1 of this report, including certain legal proceedings. In addition to such legal proceedings, various legislation and administrative regulations have, from time to time, been proposed that seek to (i) impose various obligations on present and former manufacturers of lead pigment and lead-based paint (including us) with respect to asserted health concerns associated with the use of such products and (ii) effectively overturn court decisions in which we and other pigment manufacturers have been successful. Examples of such proposed legislation include bills which would permit civil liability for damages on the basis of market share, rather than requiring plaintiffs to prove that the defendant's product caused the alleged damage and bills which would revive actions barred by the statute of limitations. While no legislation or regulations have been enacted to date that are expected to have a material adverse effect on our consolidated financial position, results of operations or liquidity, enactment of such legislation could have such an effect.

---

**Table of Contents**

**Recent accounting pronouncements**

See Note 14 to our Condensed Consolidated Financial Statements.

**Critical accounting policies and estimates**

For a discussion of our critical accounting policies, refer to Part I, Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations in our 2011 Annual Report. There have been no changes in our critical accounting policies during the first six months of 2012.

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK**

We are exposed to market risk, including currency exchange rates, interest rates and security prices. There have been no material changes in these market risks since we filed our 2011 Annual Report, and we refer you to Part I, Item 7A. Quantitative and Qualitative Disclosure About Market Risk in our 2011 Annual Report. See also Note 13 to our Condensed Consolidated Financial Statements.

**ITEM 4. CONTROLS AND PROCEDURES**

***Evaluation of disclosure controls and procedures*** We maintain a system of disclosure controls and procedures. The term disclosure controls and procedures, as defined by Exchange Act Rule 13a-15(e), means controls and other procedures that are designed to ensure that information required to be disclosed in the reports that we file or submit to the SEC under the Securities Exchange Act of 1934, as amended (the Act), is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information we are required to disclose in the reports we file or submit to the SEC under the Act is accumulated and communicated to our management, including our principal executive officer and our principal financial officer, or persons performing similar functions, as appropriate to allow timely decisions to be made regarding required disclosure. Each of Harold C. Simmons, our Chief Executive Officer, and Gregory M. Swalwell, our Vice President, Finance and Chief Financial Officer, have evaluated the design and effectiveness of our disclosure controls and procedures as of June 30, 2012. Based upon their evaluation, these executive officers have concluded that our disclosure controls and procedures are effective as of June 30, 2012.

***Internal control over financial reporting*** We also maintain internal control over financial reporting. The term internal control over financial reporting, as defined by Exchange Act Rule 13a-15(f), means a process designed by, or under the supervision of, our principal executive and principal financial officers, or persons performing similar functions, and effected by our board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP, and includes those policies and procedures that:

pertain to the maintenance of records that in reasonable detail accurately and fairly reflect transactions and dispositions of our assets;

provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with GAAP, and that receipts and expenditures are made only in accordance with authorizations of our management and directors and

**Table of Contents**

provide reasonable assurance regarding prevention or timely detection of an unauthorized acquisition, use or disposition of assets that could have a material effect on our Condensed Consolidated Financial Statements.

As permitted by the SEC, our assessment of internal control over financial reporting excludes (i) internal control over financial reporting of equity method investees and (ii) internal control over the preparation of our financial statement schedules required by Article 12 of Regulation S-X. However, our assessment of internal control over financial reporting with respect to equity method investees did include our controls over the recording of amounts related to our investment that are recorded in our Condensed Consolidated Financial Statements, including controls over the selection of accounting methods for our investments, the recognition of equity method earnings and losses and the determination, valuation and recording of our investment account balances.

***Changes in internal control over financial reporting*** There has been no change to our internal control over financial reporting during the quarter ended June 30, 2012 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**Table of Contents**

**PART II. OTHER INFORMATION**

**Item 1. Legal Proceedings**

In addition to the matters discussed below, refer to Note 12 to our Condensed Consolidated Financial Statements, to our 2011 Annual Report and to our Quarterly Report on Form 10-Q for the quarter ended March 31, 2012.

*County of Santa Clara v. Atlantic Richfield Company, et al.* (Superior Court of the State of California, County of Santa Clara, Case No. 1-00-CV-788657). Trial has been rescheduled to March 2013.

*Lewis, et al. v. Lead Industries Association, et al.* (Circuit Court of Cook County, Illinois, County Department, Chancery Division, Case No. 00CH09800). In June 2012, the trial court judge granted plaintiffs the right to appeal his decertification order.

In July 2012, we were served in *EPEC Polymers, Inc., v. NL Industries, Inc.*, (United States District Court for the District of New Jersey, Case 3:12-cv-03842-PGS-TJB). The Plaintiff, a landowner of property located across the Raritan River from our former Sayreville, New Jersey operation, claims that contaminants from NL's former Sayreville operation came to be located on its land. The complaint seeks compensatory and punitive damages and alleges, among other things, trespass, private nuisance, negligence, strict liability, and claims under CERCLA and the New Jersey Spill Act. We intend to deny liability and will defend vigorously against all of the claims.

In July 2012, NL entered into an administrative settlement with the USEPA to resolve its purported liability for the remediation of a portion of a site associated with the former Jewett White Lead facility in Staten Island, New York.

In July 2012, NL entered into an administrative settlement with USEPA pursuant to which NL will perform remediation at its former Carter White Lead facility in Omaha, Nebraska, which is scheduled for completion by the end of 2012. The current property owners are responsible for long-term maintenance of the remedy.

**Item 1A. Risk Factors**

For a discussion of the risk factors related to our businesses, refer to Part I, Item 1A., Risk Factors, in our 2011 Annual Report. There have been no material changes to such risk factors during the Six months ended June 30, 2012.



**Table of Contents**

**Item 6. Exhibits**

|         |   |
|---------|---|
| 10.1    | Credit Agreement, dated June 13, 2012, by and among Kronos Worldwide, Inc. and Wells Fargo Bank, National Association - incorporated by reference to Exhibit 10.1 of Kronos Worldwide, Inc. s Current Report on Form 8-K dated June 13, 2012 filed on June 18, 2012.  |
| 10.2    | Guaranty and Security Agreement, dated June 13, 2012, among Kronos Worldwide, Inc., Kronos Louisiana, Inc., Kronos (US), Inc., Kronos International, Inc. and Wells Fargo Bank, National Association - incorporated by reference to Exhibit 10.2 of Kronos Worldwide, Inc. s Current Report on Form 8-K dated June 13, 2012 filed on June 18, 2012.                                 |
| 10.3    | Intercreditor Agreement dated as of June 18, 2012, by and between Wells Fargo Capital Finance and Wells Fargo Bank, National Association, and acknowledged by Kronos Worldwide, Inc., Kronos Louisiana, Inc. and Kronos (US), Inc. - incorporated by reference to Exhibit 10.3 of Kronos Worldwide, Inc. s Current Report on Form 8-K/A dated June 13, 2012 filed on June 19, 2012. |
| 10.4    | Satisfaction and Discharge of Indenture, Release, Assignment and Transfer, dated as of June 14, 2012, issued by The Bank of New York Mellon, formerly known as The Bank of New York, a New York banking corporation - incorporated by reference to Exhibit 10.4 of Kronos Worldwide, Inc. s Current Report on Form 8-K dated June 13, 2012 filed on June 18, 2012.                  |
| 31.1    | Certification   |
| 31.2    | Certification   |
| 32.1    | Certification   |
| 101.INS | XBRL Instance Document  |
| 101.SCH | XBRL Taxonomy Extension Schema  |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase  |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase   |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase  |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase   |

**Table of Contents**

**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.

NL INDUSTRIES, INC.  
(Registrant)

Date: August 8, 2012

/s/ Gregory M. Swalwell  
Gregory M. Swalwell  
(Vice President, Finance and

Chief Financial Officer,

Principal Financial Officer)

Date: August 8, 2012

/s/ Tim C. Hafer  
Tim C. Hafer  
(Vice President and Controller,

Principal Accounting Officer)