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VALHI INC /DE/
Form 10-K
March 24, 2006

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

X ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE
ACT OF 1934 - For the fiscal year ended December 31, 2005

Commission file number 1-5467

VALHI, INC.

(Exact name of Registrant as specified in its charter)

Delaware

87-0110150

(State or other jurisdiction of
incorporation or organization)

(IRS Employer
Identification No.)

5430 LBJ Freeway, Suite 1700, Dallas, Texas

75240-2697

(Address of principal executive offices)

(Zip Code)

Registrant's telephone number, including area code:

(972) 233-1700

Securities registered pursuant to Section 12(b) of the Act:

Title of each class -----	Name of each exchange on which registered -----
Common stock (\$.01 par value per share)	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:

None.

Indicate by check mark:

If the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No X

If the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No X

Whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes X No

If disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. Yes X No

Whether the Registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer (as defined in Rule 12b-2 of the Act). Large

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accelerated filer Accelerated filer X non-accelerated filer .

Whether the Registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes No X .

The aggregate market value of the 9.4 million shares of voting common stock held by nonaffiliates of Valhi, Inc. as of June 30, 2005 (the last business day of the Registrant's most recently-completed second fiscal quarter) approximated \$164.5 million.

As of February 28, 2006, 115,919,578 shares of the Registrant's common stock were outstanding.

Documents incorporated by reference

The information required by Part III is incorporated by reference from the Registrant's definitive proxy statement to be filed with the Commission pursuant to Regulation 14A not later than 120 days after the end of the fiscal year covered by this report.

[INSIDE FRONT COVER]

A chart showing, as of December 31, 2005, (i) Valhi's 83% ownership of NL Industries, Inc., 57% ownership of Kronos Worldwide, Inc., 100% ownership of Waste Control Specialists LLC, 100% ownership of Tremont LLC and 4% ownership of Titanium Metals Corporation ("TIMET"), (ii) NL's 36% ownership of Kronos Worldwide and 70% ownership of CompX International Inc., (iii) Tremont's 35% ownership of TIMET and (x) TIMET's 18% ownership of CompX.

PART I

ITEM 1. BUSINESS

As more fully described on the condensed organizational chart on the opposite page, Valhi, Inc. (NYSE: VHI), has operations through majority-owned subsidiaries or less than majority-owned affiliates in the chemicals, component products, waste management and titanium metals industries. Information regarding the Company's business segments and the companies conducting such businesses is set forth below. Business and geographic segment financial information is included in Note 2 to the Company's Consolidated Financial Statements, which information is incorporated herein by reference. The Company is based in Dallas, Texas.

Chemicals

Kronos Worldwide, Inc.

Kronos is a leading global producer and marketer of value-added titanium dioxide pigments ("TiO2"), which are used for imparting whiteness, brightness and opacity to a diverse range of customer applications and end-use markets, including coatings, plastics, paper and other industrial and consumer "quality-of-life" products. Kronos has production facilities in Europe

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and North America. Sales of TiO₂ represent about 90% of Kronos' total sales in 2005, with sales of other products that are complementary to Kronos' TiO₂ business comprising the remainder.

Component Products
CompX International Inc.

CompX is a leading manufacturer of precision ball bearing slides, security products and ergonomic computer support systems used in office furniture, computer-related applications and a variety of other industries. CompX has production facilities in North America and Asia.

Waste Management
Waste Control Specialists LLC

Waste Control Specialists owns and operates a facility in West Texas for the processing, treatment, storage and disposal of hazardous, toxic and certain types of low-level and mixed low-level radioactive wastes. Waste Control Specialists is seeking additional regulatory authorizations to expand its treatment, storage and disposal capabilities for low-level and mixed low-level radioactive wastes.

Titanium Metals
Titanium Metals Corporation

Titanium Metals Corporation ("TIMET") is a leading global producer of titanium sponge, melted products (ingot and slab) and mill products for commercial and military aerospace, industrial and other markets, including new applications for titanium in the automotive and other emerging markets. TIMET is the only producer with major titanium production facilities in both the U.S. and Europe, the world's principal markets for titanium consumption.

Valhi, a Delaware corporation, is the successor of the 1987 merger of LLC Corporation and another entity. Contran Corporation holds, directly or through subsidiaries, approximately 92% 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, of which Mr. Simmons is the sole trustee, or is held by Mr. Simmons or persons or other entities related to Mr. Simmons. Consequently, Mr. Simmons may be deemed to control such companies. NL (NYSE: NL), Kronos (NYSE: KRO), CompX (NYSE: CIX) and TIMET (NYSE: TIE) each currently file periodic reports with the Securities and Exchange Commission ("SEC"). The information set forth below with respect to such companies has been derived from such reports.

As provided by the safe harbor provisions of the Private Securities Litigation Reform Act of 1995, the Company cautions that the statements in this Annual Report on Form 10-K relating to matters that are not historical facts, including, but not limited to, statements found in this Item 1 - "Business," Item 1A - "Risk Factors," Item 3 - "Legal Proceedings," Item 7 - "Management's

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Discussion and Analysis of Financial Condition and Results of Operations" and Item 7A - "Quantitative and Qualitative Disclosures About Market Risk," are forward-looking statements that represent management's beliefs and assumptions based on currently available information. Forward-looking statements can be identified by the use of words such as "believes," "intends," "may," "should," "could," "anticipates," "expected" or comparable terminology, or by discussions of strategies or trends. Although the Company believes that the expectations reflected in such forward-looking statements are reasonable, it cannot give any assurances that these expectations will prove to be correct. Such statements by their nature involve substantial risks and uncertainties that could significantly impact expected results, and actual future results could differ materially from those described in such forward-looking statements. While it is not possible to identify all factors, the Company continues to face many risks and uncertainties. Among the factors that could cause actual future results to differ materially from those described herein are the risks and uncertainties discussed in this Annual Report and those described from time to time in the Company's other filings with the SEC including, but not limited to, the following:

- o Future supply and demand for the Company's products,
- o The extent of the dependence of certain of the Company's businesses on certain market sectors (such as the dependence of TIMET's titanium metals business on the commercial aerospace industry),
- o The cyclical nature of certain of the Company's businesses (such as Kronos' TiO₂ operations and TIMET's titanium metals operations),
- o The impact of certain long-term contracts on certain of the Company's businesses (such as the impact of TIMET's long-term contracts with certain of its customers and such customers' performance thereunder and the impact of TIMET's long-term contracts with certain of its vendors on its ability to reduce or increase supply or achieve lower costs),
- o Customer inventory levels (such as the extent to which Kronos' customers may, from time to time, accelerate purchases of TiO₂ in advance of anticipated price increases or defer purchases of TiO₂ in advance of anticipated price decreases, or the relationship between inventory levels of TIMET's customers and such customers' current inventory requirements and the impact of such relationship on their purchases from TIMET),
- o Changes in raw material and other operating costs (such as energy costs),
- o The possibility of labor disruptions,
- o 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, TiO₂),
- o Competitive products and substitute products,
- o Possible disruption of business or increases in the cost of doing business resulting from terrorist activities or global conflicts,
- o Customer and competitor strategies,
- o The impact of pricing and production decisions,
- o Competitive technology positions,
- o The introduction of trade barriers,
- o Fluctuations in currency exchange rates (such as changes in the exchange rate between the U.S. dollar and each of the euro, the Norwegian kroner and the Canadian dollar),
- o Operating interruptions (including, but not limited to, labor disputes, leaks, natural disasters, fires, explosions, unscheduled or unplanned downtime and transportation interruptions),
- o The timing and amounts of insurance recoveries,
- o The ability of the Company to renew or refinance credit facilities,
- o Uncertainties associated with new product development (such as TIMET's ability to develop new end-uses for its titanium products),

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- o The ultimate outcome of income tax audits, tax settlement initiatives or other tax matters,
- o The ultimate ability to utilize income tax attributes, the benefit of which has been recognized under the "more-likely-than-not" recognition criteria (such as Kronos' ability to utilize its German net operating loss carryforwards),
- o 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 former operation of the Company),
- o Government laws and regulations and possible changes therein (such as changes in government regulations which might impose various obligations on present and former manufacturers of lead pigment and lead-based paint, including NL, with respect to asserted health concerns associated with the use of such products),
- o The ultimate resolution of pending litigation (such as NL's lead pigment litigation and litigation surrounding environmental matters of NL and Tremont), and
- o Possible future litigation.

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

CHEMICALS - KRONOS WORLDWIDE, INC.

General. Kronos is a leading global producer and marketer of value-added TiO₂, inorganic chemical products used for imparting whiteness, brightness and opacity to a diverse range of customer applications and end-use markets, including coatings, plastics, paper, fibers, food, ceramics and cosmetics. TiO₂ is considered a "quality-of-life" product with demand affected by gross domestic product in various regions of the world. TiO₂, the largest commercially used whitening pigment by volume, derives its value from its whitening properties and opacifying ability (commonly referred to as hiding power). As a result of TiO₂'s high refractive index rating, it can provide more hiding power than any other commercially produced white pigment. In addition, TiO₂ demonstrates excellent resistance to chemical attack, good thermal stability and resistance to ultraviolet degradation. TiO₂ is supplied to customers in either a powder or slurry form.

Approximately one-half of Kronos' 2005 TiO₂ sales volumes were to Europe, with about 38% to North America and the balance to export markets. Kronos believes it is the second-largest producer of TiO₂ in Europe, with an estimated 20% share of European TiO₂ sales volumes in 2005. Kronos has an estimated 15% share of North American TiO₂ sales volumes.

Per capita consumption of TiO₂ in the United States and Western Europe far exceeds that in other areas of the world and these regions are expected to continue to be the largest consumers of TiO₂. Significant markets for TiO₂ consumption could emerge in Eastern Europe, the Far East or China, as the economies in these regions continue to develop to the point that quality-of-life products, including TiO₂, experience greater demand.

Products and operations. TiO₂ is produced in two crystalline forms: rutile and anatase. Both the chloride and sulfate production processes (discussed below) produce rutile TiO₂. Chloride process rutile is preferred for the majority of customer applications. From a technical standpoint, chloride process rutile has a bluer undertone and higher durability than sulfate process rutile TiO₂. Although many end-use applications can use either form of TiO₂, chloride

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process rutile TiO₂ is the preferred form for use in coatings and plastics, the two largest end-use markets. Anatase TiO₂, which is produced only through the sulfate production process, represents a much smaller percentage of annual global TiO₂ production and is preferred for use in selected paper, ceramics, rubber tires, man-made fibers, food and cosmetics.

Kronos believes that there are no effective substitutes for TiO₂. Extenders, such as kaolin clays, calcium carbonate and polymeric opacifiers, are used in a number of end-use markets as white pigments, however the opacity in these products is not able to duplicate the performance characteristics of TiO₂, and Kronos believes these products are unlikely to replace TiO₂.

Kronos currently produces over 40 different TiO₂ grades, sold under the Kronos trademark, which provide a variety of performance properties to meet customers' specific requirements. Kronos' major customers include domestic and international paint, plastics and paper manufacturers.

Kronos and its distributors and agents sell and provide technical services for its products to over 4,000 customers in over 100 countries with the majority of sales in Europe and North America. TiO₂ is distributed by rail and truck in either dry or slurry form. Kronos and its predecessors have produced and marketed TiO₂ in North America and Europe for over 80 years. Kronos believes that it has developed considerable expertise and efficiency in the manufacture, sale, shipment and service of its products in domestic and international markets.

Sales of TiO₂ represented about 90% of Kronos' total sales in 2005. Sales of other products, complementary to Kronos' TiO₂ business, are comprised of the following:

- o Kronos owns an ilmenite mine in Norway operated pursuant to a governmental concession with an unlimited term. Ilmenite is a raw material used directly as a feedstock by some sulfate-process TiO₂ plants, including all of Kronos' European sulfate-process plants. The mine has estimated reserves that are expected to last at least 50 years. Ilmenite sales to third-parties represented approximately 5% of chemicals sales in 2005.
- o Kronos manufactures and sells iron-based chemicals, which are by-products and processed by-products of the TiO₂ pigment production process. These co-product chemicals are marketed through Kronos' Ecochem division, and are used primarily as treatment and conditioning agents for industrial effluents and municipal wastewater as well as in the manufacture of iron pigments, cement and agricultural products. Sales of iron based products were about 4% of chemical sales in 2005.
- o Kronos manufactures and sells certain titanium chemical products (titanium oxychloride and titanyl sulfate), which are side-stream products from the production of TiO₂. Titanium oxychloride is used in specialty applications in the formulation of pearlescent pigments, production of electroceramic capacitors for cell phones and other electronic devices. Titanyl sulfate products are used primarily in pearlescent pigments. Sales of these products were about 1% of chemical sales in 2005.

Manufacturing process, properties and raw materials. Kronos manufactures TiO₂ using both the chloride process and the sulfate process. Approximately 73% of Kronos' current production capacity is based on the chloride process. The chloride process is a continuous process in which chlorine is used to extract rutile TiO₂. The chloride process typically has lower manufacturing costs than the sulfate process due to higher yield and production of less waste and lower energy requirements and labor costs. Because much of the chlorine is recycled and feedstock bearing a higher titanium content is used, the chloride process produces less waste than the sulfate process. The sulfate process is a batch

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chemical process that uses sulfuric acid to extract TiO₂. Sulfate technology can produce either anatase or rutile pigment. Once an intermediate TiO₂ pigment has been produced by either the chloride or sulfate process, it is "finished" into products with specific performance characteristics for particular end-use applications through proprietary processes involving various chemical surface treatments and intensive micronizing (milling). Due to environmental factors and customer considerations, the proportion of TiO₂ industry sales represented by chloride-process pigments has increased relative to sulfate-process pigments, and, in 2005, industry-wide chloride-process production facilities represented approximately 64% of industry capacity.

During 2005, Kronos operated four TiO₂ facilities in Europe (one in each of Leverkusen, Germany, Nordenham, Germany, Langerbrugge, Belgium and Fredrikstad, Norway). In North America, Kronos operates a TiO₂ facility in Varennes, Quebec and, through a manufacturing joint venture discussed below, has a one-half interest in a TiO₂ plant in Lake Charles, Louisiana. TiO₂ is produced using the chloride process at the Leverkusen, Langerbrugge, Varennes and Lake Charles facilities and is produced using the sulfate process in Nordenham, Leverkusen, Fredrikstad and Varennes. Kronos owns an ilmenite mine in Norway operated pursuant to a governmental concession with an unlimited term, and Kronos also owns a TiO₂ slurry facility in Louisiana and leases various corporate and administrative offices in the U.S. and various sales offices in the U.S. and Europe. Kronos' co-products are produced at its Norwegian, Belgian and German facilities, and its titanium chemicals are produced at its Belgian and Canadian facilities.

All of Kronos' principal production facilities are owned, except for the land under the Leverkusen and Fredrikstad facilities. The Fredrikstad plant is located on public land and is leased until 2013, with an option to extend the lease for an additional 50 years. Kronos leases the land under its Leverkusen TiO₂ production facility pursuant to a lease expiring in 2050. The Leverkusen facility, which is owned by Kronos and which represents about one-third of Kronos' current TiO₂ production capacity, is located within an extensive manufacturing complex owned by Bayer AG. Rent for such land lease associated with the Leverkusen facility is periodically established by agreement with Bayer AG for periods of at least two years at a time. Under a separate supplies and services agreement expiring in 2011, Bayer provides some raw materials, including chlorine, auxiliary and operating materials, utilities and services necessary to operate the Leverkusen facility.

Kronos believes the transportation access to its facilities, which are generally maintained by the applicable local government, are adequate for Kronos' purposes.

Kronos produced a new company record 492,000 metric tons of TiO₂ in 2005, compared to the prior records of 484,000 metric tons in 2004 and 476,000 metric tons in 2003. Such production amounts include Kronos' one-half interest in the joint-venture owned Louisiana plant discussed below. Kronos' average production capacity utilization rates in all three years were near full capacity. Kronos' production capacity has increased by approximately 30% over the past ten years due to debottlenecking programs, with only moderate capital expenditures. Kronos believes its annual attainable production capacity for 2006 is approximately 510,000 metric tons, with some slight additional capacity available in 2007 through its continued debottlenecking efforts.

The primary raw materials used in the TiO₂ chloride production process are titanium-containing feedstock, chlorine and coke. Chlorine and coke are available from a number of suppliers. Titanium-containing feedstock suitable for use in the chloride process is available from a limited, but increasing, number of suppliers around the world, principally in Australia, South Africa, Canada, India and the United States. Kronos purchased approximately 430,000 metric tons of chloride feedstock in 2005, of which the vast majority was slag. Kronos

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purchased chloride process grade slag in 2005 from a subsidiary of Rio Tinto plc UK - Richards Bay Iron and Titanium Limited of South Africa under a long-term supply contract that expires at the end of 2007. Natural rutile ore is purchased primarily from Iluka Resources, Limited (Australia) under a long-term supply contract that expires at the end of 2009. Kronos does not expect to encounter difficulties obtaining long-term extensions to existing supply contracts prior to the expiration of the contracts. Raw materials purchased under these contracts and extensions thereof are expected to meet Kronos' chloride process feedstock requirements over the next several years.

The primary raw materials used in the TiO₂ sulfate production process are titanium-containing feedstock, derived primarily from rock and beach sand ilmenite, and sulfuric acid. Sulfuric acid is available from a number of suppliers. Titanium-containing feedstock suitable for use in the sulfate process is available from a limited number of suppliers around the world. Currently, the principal active sources are located in Norway, Canada, Australia, India and South Africa. As one of the few vertically-integrated producers of sulfate-process pigments, Kronos owns and operates a rock ilmenite mine in Norway which provided all of Kronos' feedstock for its European sulfate-process pigment plants in 2005. Kronos produced approximately 816,000 metric tons of ilmenite in 2005, of which approximately 317,000 metric tons were used internally by Kronos, with the remainder sold to third parties. For its Canadian sulfate-process plant, Kronos also purchases sulfate grade slag (approximately 29,000 metric tons in 2005), primarily from Q.I.T. Fer et Titane Inc. of Canada, a subsidiary of Rio Tinto plc UK, under a long-term supply contract that expires at the end of 2009. Raw materials purchased under these contracts and extensions thereof are expected to meet Kronos' sulfate process feedstock requirements over the next several years.

Kronos' raw material contracts contain fixed quantities that Kronos is required to purchase, although these contracts allow for an upward or downward adjustment in the quantity purchased. The quantities under these contracts do not require Kronos to purchase feedstock in excess of amounts that Kronos would reasonably consume in any given year. The pricing under these agreements is generally negotiated annually.

The number of sources of, and availability of, certain raw materials is specific to the particular geographic region in which a facility is located. As noted above, Kronos purchases titanium-bearing ore from three different suppliers in different countries under multiple-year contracts. Political and economic instability in certain countries from which Kronos purchases its raw material supplies could adversely affect the availability of such feedstock. Should Kronos' vendors not be able to meet their contractual obligations or should Kronos be otherwise unable to obtain necessary raw materials, Kronos may incur higher costs for raw materials or may be required to reduce production levels, which may have a material adverse effect on Kronos' consolidated financial position, results of operations or liquidity.

The following table summarizes our raw materials procured or mined in 2005.

Production Process/Raw Material -----	Quantities o Procure ----- (In thousands
Chloride process plants -	
purchased slag or natural rutile ore	
Sulfate process plants:	

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Raw ilmenite ore mined internally
Purchased slag

TiO₂ manufacturing joint venture. Subsidiaries of Kronos and Huntsman Holdings LLC each own a 50%-interest in a manufacturing joint venture. The joint venture owns and operates a chloride-process TiO₂ plant in Lake Charles, Louisiana. Production from the plant is shared equally by Kronos and Huntsman pursuant to separate offtake agreements.

A supervisory committee composed of four members, two of whom are appointed by each of Kronos and Huntsman, directs the business and affairs of the joint venture, including production and output decisions. Two general managers, one appointed and compensated by each of Kronos and Huntsman, manage the operations of the joint venture acting under the direction of the supervisory committee.

Kronos is required to purchase one-half of the TiO₂ produced by the joint venture. Because Kronos does not control the joint venture, the joint venture is not consolidated in Kronos' financial statements. Kronos accounts for its interest in the joint venture by the equity method. The manufacturing joint venture operates on a break-even basis, and accordingly Kronos does not report any equity in earnings of the joint venture. With the exception of raw material costs and packaging costs for the pigment grades produced, Kronos and Huntsman share all costs and capital expenditures of the joint venture equally. Kronos' share of the net costs of the joint venture is reported as cost of sales as the related TiO₂ acquired from the joint venture is sold. See Note 7 to the Consolidated Financial Statements.

Competition. The TiO₂ industry is highly competitive. Kronos competes primarily on the basis of price, product quality and technical service, and the availability of high performance pigment grades. Although certain TiO₂ grades are considered specialty pigments, the majority of Kronos' grades and substantially all of Kronos' production are considered commodity pigments with price generally being the most significant competitive factor. Kronos believes that it is the leading seller of TiO₂ in several countries, including Germany, with an estimated 12% share of worldwide TiO₂ sales volumes in 2005. Overall, Kronos is the world's fifth-largest producer of TiO₂.

Kronos' principal competitors are E.I. du Pont de Nemours & Co. ("DuPont"), Millennium Chemicals, Inc., Huntsman, Tronox Incorporated, and Ishihara Sangyo Kaisha, Ltd. These five largest competitors have estimated individual shares of TiO₂ production capacity ranging from 4% to 24%, and an estimated aggregate 70% share of worldwide TiO₂ production volumes. DuPont has about one-half of total North American TiO₂ production capacity and is Kronos' principal North American competitor.

Worldwide capacity additions in the TiO₂ market resulting from construction of greenfield plants require significant capital expenditures and substantial lead time (typically three to five years in Kronos' experience). Kronos is not aware of any greenfield plant under construction in the United States, Europe or any other part of the world. However, a competitor has announced its intention to build a greenfield facility in China, but it is not clear when construction will begin and it is not likely that any product would be available until 2010, at the earliest. During 2004, certain competitors either idled or shut down facilities. However, Kronos does expect that industry capacity will increase as Kronos and its competitors continue to debottleneck their existing facilities. Based on the factors described above, Kronos expects that the average annual increase in industry capacity from announced debottlenecking projects will be less than the average annual demand growth for TiO₂ during the next three to five years. However, no assurance can be given that future increases in the TiO₂ industry production capacity and future average annual demand growth rates for TiO₂ will conform to Kronos' expectations. If actual developments differ from

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Kronos' expectations, Kronos' and the TiO₂ industry's performances could be unfavorably affected.

Research and development. Kronos' expenditures for research and development, process technology and quality assurance activities were approximately \$7 million in 2003, \$8 million in 2004 and \$9 million in 2005. Research and development activities are conducted principally at Kronos' Leverkusen, Germany facility. Such activities are directed primarily towards improving both the chloride and sulfate production processes, improving product quality and strengthening Kronos' competitive position by developing new pigment applications.

Kronos continually seeks to improve the quality of its grades, and has been successful at developing new grades for existing and new applications to meet the needs of customers and increase product life cycle. Since 1999, 13 new grades have been added for plastics, coatings, fiber and paper laminate applications.

Patents and trademarks. Patents held for products and production processes are important to Kronos and its continuing business activities. Kronos seeks patent protection for its technical developments, principally in the United States, Canada and Europe, and from time to time enters into licensing arrangements with third parties. Kronos' existing patents generally have a term of 20 years from the date of filing, and have remaining terms ranging from one to 20 years. Kronos seeks to protect its intellectual property rights, including its patent rights, and from time to time Kronos is engaged in disputes relating to the protection and use of intellectual property relating to its products.

Kronos' major trademarks, including Kronos, are protected by registration in the United States and elsewhere with respect to those products it manufactures and sells. Kronos also relies on unpatented proprietary know-how and continuing technological innovation and other trade secrets to develop and maintain its competitive position. Kronos' proprietary chloride production process is an important part of Kronos' technology, and Kronos' business could be harmed if Kronos should fail to maintain confidentiality of its trade secrets used in this technology.

Customer base and annual seasonality. Kronos believes that neither its aggregate sales nor those of any of its principal product groups are concentrated in or materially dependent upon any single customer or small group of customers. Kronos' ten largest customers accounted for approximately 26% of its sales during 2005. Neither Kronos' business as a whole nor that of any of its principal product groups is seasonal to any significant extent. Due in part to the increase in paint production in the spring to meet spring and summer painting season demand, TiO₂ sales are generally higher in the first half of the year than in the second half of the year.

Employees. As of December 31, 2005, Kronos employed approximately 2,415 persons (excluding employees of the Louisiana joint venture), with 50 employees in the United States, 420 employees in Canada and 1,945 employees in Europe.

Hourly employees in production facilities worldwide, including the TiO₂ joint venture, are represented by a variety of labor unions, with labor agreements having various expiration dates. In Europe, Kronos' union employees are covered by master collective bargaining agreements in the chemicals industry that are renewed annually. In Canada, Kronos' union employees are covered by a collective bargaining agreement that expires in June 2007. Kronos believes its labor relations are good.

Regulatory and environmental matters. Kronos' operations are governed by various environmental laws and regulations. Certain of Kronos' operations are, or have been, engaged in the handling, manufacture or use of substances or

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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 past and current operations and products of Kronos have the potential to cause environmental or other damage. Kronos has implemented and continues to implement various policies and programs in an effort to minimize these risks. Kronos' policy is to maintain compliance with applicable environmental laws and regulations at all of its facilities and to strive to improve its environmental performance. It is possible that future developments, such as stricter requirements of environmental laws and enforcement policies thereunder, could adversely affect Kronos' production, handling, use, storage, transportation, sale or disposal of such substances as well as Kronos' consolidated financial position, results of operations or liquidity.

Kronos' U.S. manufacturing operations are governed by federal environmental and worker health and safety laws and regulations, principally the Resource Conservation and Recovery Act ("RCRA"), the Occupational Safety and Health Act,, the Clean Air Act, the Clean Water Act, the Safe Drinking Water Act, the Toxic Substances Control Act ("TSCA"), and the Comprehensive Environmental Response, Compensation and Liability Act, as amended by the Superfund Amendments and Reauthorization Act ("CERCLA"), as well as the state counterparts of these statutes. Kronos believes that the Louisiana TiO2 plant owned by the joint venture and a Louisiana TiO2 slurry facility owned by Kronos are in substantial compliance with applicable requirements of these laws or compliance orders issued thereunder. Kronos has no other U.S. plants.

While the laws regulating operations of industrial facilities in Europe vary from country to country, a common regulatory framework is provided by the European Union ("EU"). Germany and Belgium are members of the EU and follow its initiatives. Norway, although not a member of the EU, generally patterns its environmental regulations after the EU. Kronos believes it has obtained all required permits and is in substantial compliance with applicable EU requirements.

At Kronos' sulfate plant facilities in Germany, Kronos recycles weak sulfuric acid either through contracts with third parties or using its own facilities. At Kronos' Norwegian plant, Kronos ships its spent acid to a third party location where it is treated and disposed. Kronos' Canadian sulfate plant neutralizes its spent acid and sells its gypsum byproduct to a local wallboard manufacturer. Kronos has a contract with a third party to treat certain sulfate-process effluents at its German sulfate process plants. With regard to the German plants, either party may terminate the contract after giving three or four years advance notice, depending on the contract.

From time to time, Kronos' facilities may be subject to environmental regulatory enforcement under U.S. and foreign statutes. Resolution of such matters typically involves the establishment of compliance programs. Occasionally, resolution may result in the payment of penalties, but to date such penalties have not involved amounts having a material adverse effect on Kronos' consolidated financial position, results of operations or liquidity. Kronos believes that all of its plants are in substantial compliance with applicable environmental laws.

Kronos' capital expenditures related to its ongoing environmental compliance, protection and improvement programs in 2005 were approximately \$4 million, and are currently expected to approximate \$6 million in 2006.

COMPONENT PRODUCTS - COMPX INTERNATIONAL INC.

General. CompX is a leading manufacturer of precision ball bearing slides, security products (cabinet locks and other locking mechanisms) and ergonomic computer support systems used in office furniture, computer-related applications

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and a variety of other industries. CompX's products are principally designed for use in medium- to high-end product applications, where design, quality and durability are critical to CompX's customers. CompX believes that it is among the world's largest producers of precision ball bearing slides, security products and ergonomic computer support systems. In 2005, precision ball bearing slides, security products and ergonomic computer support systems accounted for approximately 42%, 43% and 15%, respectively, of sales related to its continuing operations.

In January 2005, CompX completed the disposition of all of the net assets of its Thomas Regout operations conducted in the Netherlands. Thomas Regout's results of operations are classified as discontinued operations in the Company's Consolidated Financial Statements. In August 2005, CompX completed the acquisition of a components products business for aggregate cash consideration of \$7.3 million, net of cash acquired. See Notes 3 and 22 to the Consolidated Financial Statements.

Products, product design and development. Precision ball bearing slides manufactured to stringent industry standards are used in such applications as office furniture, computer-related equipment, tool storage cabinets, imaging equipment, file cabinets, desk drawers, automated teller machines, refrigerators and other applications. These products include CompX's patented Integrated Slide Lock in which a file cabinet manufacturer can reduce the possibility of multiple drawers being opened at the same time, the adjustable patented Ball Lock which reduces the risk of heavily-filled drawers, such as auto mechanic tool boxes, from opening while in movement, and the and the Self-Closing Slide, which is designed to assist in closing a drawer and is used in applications such as bottom mount freezers.

Security products are used in various applications including ignition systems, office furniture, vending and gaming machines, parking meters, electrical circuit panels, storage compartments, security devices for laptop and desktop computers as well as mechanical and electronic locks for the toolbox, medical and other industries. Some of these products may include CompX's KeSet high security system, which has the ability to change the keying on a single lock 64 times without removing the lock from its enclosure and its patented high security TuBar locking system. CompX believes that it is a North American market leader in the manufacture and sale of cabinet locks and other locking mechanisms.

Ergonomic computer support systems include articulating computer keyboard support arms (designed to attach to desks in the workplace and home office environments to alleviate possible strains and stress and maximize usable workspace), CPU storage devices which minimize adverse effects of dust and moisture and a number of complimentary accessories, including ergonomic wrist rest aids, mouse pad supports and flat screen computer monitor support arms. These products include CompX's Leverlock keyboard arm, which is designed to make the adjustment of an ergonomic keyboard arm easier. In addition, CompX offers its engineering and design capabilities for the design and manufacture of products on a proprietary basis for key customers.

CompX's precision ball bearing slides are sold under the CompX Precision Slides, CompX Waterloo, Waterloo Furniture Components, CompX DurISlide and CompX Dynaslide brand names. Security products are sold under the CompX Security Products, National Cabinet Lock, Fort Lock, Timberline Lock, Chicago Lock, STOCK LOCKS, KeSet and TuBar brand names. Ergonomic products are sold under the CompX ErgonomX brand name. CompX believes that its brand names are well recognized in the industry.

Sales, marketing and distribution. CompX sells components to original equipment manufacturers ("OEMs") and to distributors through a dedicated sales force. The majority of CompX's sales are to OEMs, while the balance represents

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standardized products sold through distribution channels. Sales to large OEM customers are made through the efforts of factory-based sales and marketing professionals and engineers working in concert with field salespeople and independent manufacturers' representatives. Manufacturers' representatives are selected based on special skills in certain markets or relationships with current or potential customers.

A significant portion of CompX's sales are made through distributors. CompX has a significant market share of cabinet lock sales to the locksmith distribution channel. CompX supports its distributor sales with a line of standardized products used by the largest segments of the marketplace. These products are packaged and merchandised for easy availability and handling by distributors and the end users. Based on CompX's successful STOCK LOCKS inventory program, similar programs have been implemented for distributor sales of ergonomic computer support systems and to some extent precision ball bearing slides. CompX also operates a small tractor/trailer fleet associated with its Canadian facilities to provide an industry-unique service response to major customers for those Canadian manufactured products.

CompX does not believe it is dependent upon one or a few customers, the loss of which would have a material adverse effect on its operations. In 2005, the ten largest customers accounted for about 43% of component products sales (2004 - 43%; 2003 - 44%). In 2004 and 2005, one customer accounted for 11% and 10%, respectively, of CompX's sales. No single customer accounted for more than 10% of CompX's sales in 2003.

Manufacturing and operations. At December 31, 2005, CompX operated six manufacturing facilities in North America related to its continuing operations (two in Illinois and one in each of South Carolina, Michigan, Wisconsin and Canada) and two facilities in Taiwan. Precision ball bearing slides are manufactured in the facilities located in Canada, Michigan and Taiwan. Security products are manufactured in the facilities located in South Carolina and Illinois. Ergonomic products are manufactured in the facility located in Canada. Other component products are manufactured at the Wisconsin facility acquired in 2005. All of such facilities are owned by CompX except for one of the facilities in Taiwan, which is leased. CompX also leases a distribution center in California. CompX believes that all its facilities are well maintained and satisfactory for their intended purposes.

Raw materials. Coiled steel is the major raw material used in the manufacture of precision ball bearing slides and ergonomic computer support systems. Plastic resins for injection molded plastics are also an integral material for ergonomic computer support systems. Purchased components and zinc, are the principal raw materials used in the manufacture of security products. These raw materials are purchased from several suppliers and are readily available from numerous sources.

CompX occasionally enters into raw material purchase arrangements to mitigate the short-term impact of future increases in raw material costs. While these arrangements do not commit CompX to a minimum volume of purchases, they generally provide for stated unit prices based upon achievement of specified volume purchase levels. This allows CompX to stabilize raw material purchase prices, provided the specified minimum monthly purchase quantities are met. Materials purchased outside of these arrangements are sometimes subject to unanticipated and sudden price increases. Due to the competitive nature of the markets served by CompX's products, it is often difficult to recover such increases in raw material costs through increased product selling prices or raw material surcharges. Consequently, overall operating margins can be affected by such raw material cost pressures.

Competition. The office furniture and security products markets are highly competitive. CompX competes primarily on the basis of product design, including

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ergonomic and aesthetic factors, product quality and durability, price, on-time delivery, service and technical support. CompX focuses its efforts on the middle- and high-end segments of the market, where product design, quality, durability and service are placed at a premium.

CompX competes in the precision ball bearing slide market primarily on the basis of product quality and price with two large manufacturers and a number of smaller domestic and foreign manufacturers. CompX competes in the security products market with a variety of relatively small domestic and foreign competitors. CompX competes in the ergonomic computer support system market primarily on the basis of product quality, features and price with one major producer and a number of smaller domestic manufacturers, and primarily on the basis of price with a number of foreign manufacturers. Although CompX believes that it has been able to compete successfully in its markets to date, price competition from foreign-sourced products continues to intensify and there can be no assurance that CompX will be able to continue to successfully compete in all of its existing markets in the future.

Patents and trademarks. CompX holds a number of patents relating to its component products, certain of which are believed to be important to CompX and its continuing business activity. CompX's patents generally have a term of 20 years, and have remaining terms ranging from less than 3 years to 18 years at December 31, 2005. CompX's major trademarks and brand names, including CompX, CompX Precision Slides, CompX Security Products, CompX Waterloo, CompX ErgonomX, National Cabinet Lock, KeSet, Fort Lock, Timberline Lock, Chicago Lock, ACE II, TuBar, STOCK LOCKS, ShipFast, Waterloo Furniture Components Limited, CompX DurISlide, and CompX Dynaslide, are protected by registration in the United States and elsewhere with respect to the products CompX manufactures and sells. CompX believes such trademarks are well recognized in the component products industry.

Regulatory and environmental matters. CompX's operations are subject to federal, state, local and foreign laws and regulations relating to the use, storage, handling, generation, transportation, treatment, emission, discharge, disposal and remediation of, and exposure to, hazardous and non-hazardous substances, materials and wastes. CompX's operations are also subject to federal, state, local and foreign laws and regulations relating to worker health and safety. CompX believes that it is in substantial compliance with all such laws and regulations. The costs of maintaining compliance with such laws and regulations have not significantly impacted CompX to date, and CompX has no significant planned costs or expenses relating to such matters. There can be no assurance, however, that compliance with future laws and regulations will not require CompX to incur significant additional expenditures, or that such additional costs would not have a material adverse effect on CompX's consolidated financial condition, results of operations or liquidity.

Employees. As of December 31, 2005, CompX employed approximately 1,230 persons, including 750 in the United States, 330 in Canada and 150 in Taiwan. Approximately 70% of CompX's employees in Canada are represented by a labor union covered by a collective bargaining agreement which provides for annual wage increases from 1% to 2.5% over the term of the contract. A new collective bargaining agreement was ratified in December 2005 that expires in January 2009. Wage increases for these Canadian employees historically have also been in line with overall inflation indices. CompX believes that its labor relations are satisfactory.

WASTE MANAGEMENT - WASTE CONTROL SPECIALISTS LLC

General. Waste Control Specialists LLC, formed in 1995, completed construction in early 1997 of the initial phase of its facility in West Texas for the processing, treatment, storage and disposal of certain hazardous and toxic wastes, and the first of such wastes were received for disposal in 1997.

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Subsequently, Waste Control Specialists has expanded its permitting authorizations to include the processing, treatment and storage of low-level and mixed low-level radioactive wastes and the disposal of certain types of exempt low-level radioactive wastes.

Facility, operations, services and customers. Waste Control Specialists has been issued permits by the Texas Commission on Environmental Quality ("TCEQ"), formerly the Texas Natural Resource Conservation Commission, and the U.S. Environmental Protection Agency ("EPA") to accept hazardous and toxic wastes governed by RCRA and TSCA. The ten-year RCRA and TSCA permits, which initially expired in November 2004, were administratively extended while the agencies complete their review for renewal. The final renewal will be for a new ten-year period and are subject to additional renewals by the agencies assuming Waste Control Specialists remains in compliance with the provisions of the permits.

In November 1997, the Texas Department of State Health Services ("TDSHS"), formerly the Texas Department of Health, issued a license to Waste Control Specialists for the treatment and storage, but not disposal, of low-level and mixed low-level radioactive wastes. The current provisions of this license generally enable Waste Control Specialists to accept such wastes for treatment and storage from U.S. commercial and federal facility generators, including the Department of Energy ("DOE") and other governmental agencies. Waste Control Specialists accepted the first shipments of such wastes in 1998. Waste Control Specialists has also been issued a permit by the TCEQ to establish a research, development and demonstration facility in which third parties could use the facility to develop and demonstrate new technologies in the waste management industry, including possibly those involving low-level and mixed low-level radioactive wastes. Waste Control Specialists has also obtained additional authority that allows Waste Control Specialists to dispose of certain categories of low-level radioactive materials, including naturally-occurring radioactive material ("NORM") and exempt-level materials (radioactive materials that do not exceed certain specified radioactive concentrations and which are exempt from licensing). Although there are other categories of low-level and mixed low-level radioactive wastes which continue to be ineligible for disposal under the increased authority, Waste Control Specialists intends to pursue additional regulatory authorizations to expand its storage, treatment and disposal capabilities for low-level and mixed low-level radioactive wastes. There can be no assurance that any such additional permits or authorizations will be obtained.

The facility is located on a 1,338-acre site in West Texas owned by Waste Control Specialists. The 1,338 acres are permitted for 5.4 million cubic yards of airspace landfill capacity for the disposal of RCRA and TSCA wastes. Waste Control Specialists owns approximately 13,500 additional acres of land surrounding the permitted site, a small portion of which is located in New Mexico. This presently undeveloped additional acreage is available for future expansion assuming appropriate permits could be obtained. The 1,338-acre site has, in Waste Control Specialists' opinion, superior geological characteristics which make it an environmentally-desirable location. The site is located in a relatively remote and arid section of West Texas. The ground is composed of triassic red bed clay for which the possibility of leakage into any underground water table is considered highly remote. In addition, based in part on extensive drilling by the oil and gas industry in the area and its own test wells, Waste Control Specialists does not believe there are any underground aquifers or other usable sources of water below the site.

While the West Texas facility operates as a final repository for wastes that cannot be further reclaimed and recycled, it also serves as a staging and processing location for material that requires other forms of treatment prior to final disposal as mandated by the U.S. EPA or other regulatory bodies. The 20,000 square foot treatment facility provides for waste treatment/stabilization, warehouse storage, treatment facilities for hazardous,

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toxic and mixed low-level radioactive wastes, drum to bulk, and bulk to drum materials handling and repackaging capabilities. Treatment operations involve processing wastes through one or more chemical or other treatment methods, depending upon the particular waste being disposed and regulatory and customer requirements. Chemical treatment uses chemical oxidation and reduction, chemical precipitation of heavy metals, hydrolysis and neutralization of acid and alkaline wastes, and results in the transformation of wastes into inert materials through one or more chemical processes. Certain of such treatment processes may involve technology which Waste Control Specialists may acquire, license or subcontract from third parties.

Once treated and stabilized, wastes are either (i) placed in Waste Control Specialists' landfill disposal site, (ii) stored onsite in drums or other specialized containers or (iii) shipped to third-party facilities for final disposition. Only wastes which meet certain specified regulatory requirements can be disposed of by placing them in the landfill, which is fully-lined and includes a leachate collection system.

Waste Control Specialists takes delivery of wastes collected from customers and transported on behalf of customers, via rail or highway, by independent contractors to the West Texas site. Such transportation is subject to regulations governing the transportation of hazardous wastes issued by the U.S. Department of Transportation.

Waste Control Specialists' target customers are industrial companies, including chemical, aerospace and electronics businesses and governmental agencies, including the DOE, which generate hazardous, mixed low-level radioactive and other wastes. Waste Control Specialists employs its own salespeople to market its services to potential customers.

Competition. The hazardous waste industry (other than low-level and mixed low-level radioactive waste) currently has excess industry capacity caused by a number of factors, including a relative decline in the number of environmental remediation projects generating hazardous wastes and efforts on the part of generators to reduce the volume of waste and/or manage it onsite at their facilities. These factors have led to reduced demand and increased price pressure for non-radioactive hazardous waste management services. While Waste Control Specialists believes its broad range of permits for the treatment and storage of low-level and mixed-level radioactive waste streams provides certain competitive advantages, a key element of Waste Control Specialists' long-term strategy to provide "one-stop shopping" for hazardous, low-level and mixed low-level radioactive wastes includes obtaining additional regulatory authorizations for the disposal of a broad range of low-level and mixed low-level radioactive wastes.

Competition within the hazardous waste industry is diverse. Competition is based primarily on pricing and customer service. Price competition is expected to be intense with respect to RCRA- and TSCA-related wastes. Principal competitors are Energy Solutions, LLC, American Ecology Corporation and Perma-Fix Environmental Services, Inc. These competitors are well established and have significantly greater resources than Waste Control Specialists, which could be important competitive factors. However, Waste Control Specialists believes it may have certain competitive advantages, including its environmentally-desirable location, broad level of local community support, a rail transportation network leading to the facility and capability for future site expansion.

Employees. At December 31, 2005, Waste Control Specialists employed approximately 120 persons.

Regulatory and environmental matters. While the waste management industry has benefited from increased governmental regulation, the industry itself has

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become subject to extensive and evolving regulation by federal, state and local authorities. The regulatory process requires businesses in the waste management industry to obtain and retain numerous operating permits covering various aspects of their operations, any of which could be subject to revocation, modification or denial. Regulations also allow public participation in the permitting process. Individuals as well as companies may oppose the grant of permits. In addition, governmental policies and the exercise of broad discretion by regulators are by their nature subject to change. It is possible that Waste Control Specialists' ability to obtain any desired applicable permits on a timely basis, and to retain those permits, could in the future be impaired. The loss of any individual permit could have a significant impact on Waste Control Specialists' financial condition, results of operations or liquidity, especially because Waste Control Specialists owns and operates only one disposal site. For example, adverse decisions by governmental authorities on permit applications submitted by Waste Control Specialists could result in the abandonment of projects, premature closing of the facility or operating restrictions. Waste Control Specialists' RCRA and TSCA permits and its license from the TDSHS, as amended, are expected to expire in 2015, and such permits and licenses can be renewed subject to compliance with the requirements of the application process and approval by the TCEQ or TDSHS, as applicable.

Prior to June 2003, the state law in Texas (where Waste Control Specialists' disposal facility is located) prohibited the applicable Texas regulatory agency from issuing a license for the disposal of a broad range of low-level and mixed low-level radioactive waste to a private enterprise operating a disposal facility in Texas. In June 2003, a new Texas state law was enacted that allows the Texas Commission on Environmental Quality ("TCEQ") to issue a low-level radioactive waste disposal license to a private entity, such as Waste Control Specialists. Waste Control Specialists has applied for such a disposal license with the TCEQ, and Waste Control Specialists was the only entity to submit an application for such a disposal license. The application was declared administratively complete by the TCEQ in February 2005. The regulatorially required merit review has been completed, and the TCEQ began its technical review of the application in May 2005. The length of time that it will take to complete the review and act upon the license application is uncertain, although Waste Control Specialists does not currently expect the agency will issue any final decision on the license application before late 2007. There can be no assurance that Waste Control Specialists will be successful in obtaining any such license.

In June 2004, Waste Control Specialists applied to the TDSHS for a license to dispose of byproduct 11.e(2) waste material. Waste Control Specialists can currently treat and store byproduct material, but may not dispose of it. The length of time that TDSHS will take to review and act upon the license application is uncertain, but Waste Control Specialists currently expects the TDSHS will issue a final decision on the license application sometime during 2006. There can be no assurance that Waste Control Specialists will be successful in obtaining any such license.

Federal, state and local authorities have, from time to time, proposed or adopted other types of laws and regulations with respect to the waste management industry, including laws and regulations restricting or banning the interstate or intrastate shipment of certain wastes, imposing higher taxes on out-of-state waste shipments compared to in-state shipments, reclassifying certain categories of hazardous wastes as non-hazardous and regulating disposal facilities as public utilities. Certain states have issued regulations which attempt to prevent waste generated within that particular state from being sent to disposal sites outside that state. The U.S. Congress has also, from time to time, considered legislation which would enable or facilitate such bans, restrictions, taxes and regulations. Due to the complex nature of the waste management industry regulation, implementation of existing or future laws and regulations by different levels of government could be inconsistent and difficult to

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foresee. Waste Control Specialists will attempt to monitor and anticipate regulatory, political and legal developments which affect the waste management industry, but there can be no assurance that Waste Control Specialists will be able to do so. Nor can Waste Control Specialists predict the extent to which legislation or regulations that may be enacted, or any failure of legislation or regulations to be enacted, may affect its operations in the future.

The demand for certain hazardous waste services expected to be provided by Waste Control Specialists is dependent in large part upon the existence and enforcement of federal, state and local environmental laws and regulations governing the discharge of hazardous wastes into the environment. The waste management industry could be adversely affected to the extent such laws or regulations are amended or repealed or their enforcement is lessened.

Because of the high degree of public awareness of environmental issues, companies in the waste management business may be, in the normal course of their business, subject to judicial and administrative proceedings. Governmental agencies may seek to impose fines or revoke, deny renewal of, or modify any applicable operating permits or licenses. In addition, private parties and special interest groups could bring actions against Waste Control Specialists alleging, among other things, a violation of operating permits.

TITANIUM METALS - TITANIUM METALS CORPORATION

General. TIMET is a leading global producer of titanium sponge, melted products (ingot and slab) and mill products. TIMET is the only producer with major titanium production facilities in both the United States and Europe, the world's principal markets for titanium consumption. TIMET estimates that in 2005 it accounted for approximately 18% of worldwide industry shipments of titanium mill products and approximately 8% of worldwide titanium sponge production. Demand for titanium is also increasing in emerging markets with such diverse uses as offshore oil and gas production installations, automotive, geothermal facilities and architectural applications.

Titanium was first manufactured for commercial use in the 1950s. Titanium's unique combination of corrosion resistance, elevated-temperature performance and high strength-to-weight ratio makes it particularly desirable for use in commercial and military aerospace applications where these qualities are essential design requirements for certain critical parts such as wing supports and jet engine components. While aerospace applications have historically accounted for a substantial portion of the worldwide demand for titanium, the number of non-aerospace end-use markets for titanium has expanded substantially. Today, numerous industrial uses for titanium include chemical plants, industrial power plants, desalination plants and pollution control equipment. TIMET is currently the only major producer of titanium sponge, a key raw material, in the United States.

Industry conditions. The titanium industry historically has derived a substantial portion of its business from the aerospace industry. Demand for titanium products within the commercial aerospace sector is derived from both jet engine components (e.g., blades, discs, rings and engine cases) and airframe components (e.g., bulkheads, tail sections, landing gear, wing supports and fasteners). The commercial aerospace sector has a significant influence on titanium companies, particularly mill product producers such as TIMET.

The following table illustrates TIMET's estimates of titanium industry mill product shipments during 2004 and 2005:

Year ended December 31,

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	2004 ----	2005 ----
	(metric tons)	
Mill product shipments to:		
Commercial aerospace sector	20,900	24,000
Military sector	4,700	6,200
Industrial sector	32,300	35,600
Emerging markets sector	2,300	2,700
	-----	-----
Aggregate mill product shipments to all sectors	60,200 =====	68,500 =====

TIMET's business is more dependent on commercial aerospace demand than is the overall titanium industry, as approximately 59% of TIMET's mill product shipment volume in 2005 was to the commercial aerospace sector, whereas, as indicated by the above table, approximately 35% of the overall titanium industry's shipment volume in 2005 was to the commercial aerospace sector.

The cyclical nature of the commercial aerospace industry has been the principal driver of the historical fluctuations in the performance of most titanium companies. Over the past 20 years, the titanium industry had cyclical peaks in mill product shipments in 1989, 1997 and 2001 and cyclical lows in 1983, 1991, 1999 and 2003. Prior to 2004, demand for titanium reached its highest level in 1997 when industry mill product shipments reached approximately 60,700 metric tons. However, since 1997, industry mill product shipments have fluctuated significantly, primarily due to a continued change in demand for titanium from the commercial aerospace sector. TIMET estimates that industry shipments approximated 60,200 metric tons in 2004 and 68,500 metric tons in 2005. TIMET currently expects total industry mill product shipments will increase by only 5% to 10% in 2006 as compared to 2005, due to tightness of raw material supply.

The Airline Monitor, a leading aerospace publication, traditionally issues forecasts for commercial aircraft deliveries each January and July. According to The Airline Monitor, large commercial aircraft deliveries for the 1996 to 2005 period peaked in 1999 with 889 aircraft, including 254 wide body aircraft that use substantially more titanium than their narrow body counterparts. Large commercial aircraft deliveries totaled 650 (including 152 wide bodies) in 2005. The following table summarizes The Airline Monitor's most recently issued forecast (January 2006) for large commercial aircraft deliveries over the next five years:

Year ----	Forecasted deliveries -----		% increase (decrease) over previous year -----
	Total -----	Wide bodies -----	Total -----
2006	840	193	29%
2007	920	217	9%
2008	985	259	7%
2009	1,030	294	5%
2010	1,030	314	-

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The latest forecast from The Airline Monitor reflects a significant increase from earlier forecasts, in large part due to record levels of new orders placed for Boeing and Airbus models during 2005. Total order bookings for Boeing and Airbus in 2005 aggregated 2,109 planes. Expectations are that new orders in 2006 will be significantly lower than 2005. However, the strong bookings in 2005 have increased the order backlog for both Boeing and Airbus in support of this increased forecast.

Deliveries of titanium generally precede aircraft deliveries by about one year, although this varies considerably by titanium product. This correlates to TIMET's cycle, which historically precedes the cycle of the aircraft industry and related deliveries. Although persistently high oil prices have had an adverse impact on the commercial airline industry, global commercial airline traffic increased in 2005 compared to 2004. TIMET estimates that industry mill product shipments into the commercial aerospace sector will increase 15% to 20% as compared to 2005.

Wide body planes tend to use a higher percentage of titanium in their airframes, engines and parts than narrow body planes. Newer models of planes tend to use a higher percentage of titanium than older models. Newer wide body models such as the Airbus A380 superjumbo jet and the Boeing 787 Dreamliner are expected to use an even greater quantity of titanium than previous wide body models.

Titanium shipments into the military sector are largely driven by government defense spending in North America and Europe. Military aerospace programs were the first to utilize titanium's unique properties on a large scale, beginning in the 1950s. Titanium shipments to military aerospace markets reached a peak in the 1980s before falling to historical lows in the early 1990s after the end of the Cold War. In recent years, titanium has become an accepted use in ground combat vehicles as well as in Naval applications. The importance of military markets to the titanium industry is expected to continue to rise in coming years as defense spending budgets increase in reaction to terrorist activities and global conflicts.

Several of today's active U.S. military programs, including the C-17, F/A-18, F-16 and F-15 are expected to continue in production through the end of the current decade. However, a recent Quadrennial Defense Review (QDR) recommends that the U.S. Air Force stop procurement of the C-17 with the 180 planes it now has on order, but this recommendation still must go through the federal budget process. Without further orders, the C-17 production line will close in 2008.

In addition to these established U.S. programs, new U.S. programs offer growth opportunities for increased titanium consumption. The F/A-22 Raptor was given full-rate production approval in April 2005. According to The Teal Group, a leading independent aerospace publication, the U.S. Air Force would like to purchase 381 aircraft, but the Department of Defense is now planning for only 179. However, additional F/A-22 Raptors may be manufactured for sale to foreign nations.

In October 2001, Lockheed-Martin Corporation was awarded the contract for construction of the F-35 Joint Strike Fighter ("JSF"). The JSF is expected to enter low-rate initial production in late 2006, with delivery of the first production aircraft in 2009. Although no specific delivery patterns have been established, procurement is expected to extend over the next 30 to 40 years and to include as many as 3,000 to 4,000 planes, including sales to foreign nations. European military programs also have active aerospace programs offering the possibility for increased titanium consumption. Production levels for the Saab Gripen, Eurofighter Typhoon, Dassault Rafale and Dassault Mirage 2000 are all forecasted to remain steady through the end of the decade.

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Utilization of titanium on military ground combat vehicles for armor applique and integrated armor or structural components continues to gain acceptance within the military market segment. Titanium armor components provide the necessary ballistic performance while achieving a mission critical vehicle performance objective of reduced weight. In order to counteract increased threat levels, titanium is being utilized on vehicle upgrade programs in addition to new builds. Based on active programs, as well as programs currently under evaluation, TIMET believes there will be additional usage of titanium on ground combat vehicles that will provide continued growth in the military market sector. In armor and armament, TIMET sells plate and sheet products for fabrication into applique plate for protection application of the entire ground combat vehicle as well as the primary vehicle structure.

Since titanium's initial applications, the number of end-use markets for titanium has significantly expanded. Established industrial uses for titanium include chemical plants, power plants, desalination plants and pollution control equipment. Rapid growth of the Chinese and other Southeast Asian economies has brought unprecedented demand for titanium-intensive industrial equipment. In November 2005, TIMET entered into a joint venture with XI'AN BAOTIMET VALINOX TUBES CO. LTD. to produce welded titanium tubing in the Peoples Republic of China. BAOTIMET's production facilities will be located in, China, and production is expected to begin in early 2007.

Titanium continues to gain acceptance in many emerging market applications, including automotive, energy (including oil and gas) and architecture. Although titanium is generally higher cost than other competing metals, in many cases customers find the physical properties of titanium to be attractive from the standpoint of weight, performance, longevity, design alternatives, life cycle value and other factors. TIMET continues to explore opportunities in these emerging market applications through marketing initiatives, research and development and proprietary alloys designed to provide more cost effective alternatives for these markets.

Although TIMET estimates that emerging market demand presently represents only about 4% of the 2005 total industry demand for titanium mill products, TIMET believes emerging market demand, in the aggregate, could grow at double-digit rates over the next several years. TIMET continues to actively pursue these markets and was able to grow its mill product shipments into emerging markets by more than 50% during 2005 as compared to 2004. Beginning in 2005, TIMET no longer includes armor and armament related sales as part of its emerging markets sector, as titanium usage has become widely accepted for such applications.

The automotive market continues to be an attractive emerging market due to its potential for sustainable long-term growth. TIMET Automotive is focused on developing and marketing proprietary alloys and processes specifically suited for automotive applications. Titanium is now used in several consumer car applications as well as in numerous motorcycles. At the present time, titanium is primarily used for exhaust systems, suspension springs, engine valves, connecting rods and turbocharger compressor wheels in consumer and commercial vehicles. In exhaust systems, titanium provides for significant weight savings, while its corrosion resistance provides life-of-vehicle durability. In suspension spring applications, titanium's low modulus of elasticity allows the spring's height to be reduced by 20% to 40% compared to a steel spring, which, when combined with the titanium's low density, permits 30% to 60% weight savings over steel spring suspension systems. Titanium engine components provide mass-reduction benefits that directly improve vehicle performance and fuel economy. The application of titanium to turbocharger compressor wheels is part of a solution to meet U.S. and European Union government-regulated diesel engine emissions requirements. TIMET proprietary alloys provide cost effective optimized performance for the various target applications. The decision to select titanium components for consumer car, truck and motorcycle components

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remains highly cost sensitive; however, TIMET believes titanium's acceptance in consumer vehicles will expand as the automotive industry continues to better understand the benefits titanium offers.

The oil and gas market utilizes titanium for down-hole logging tools, critical riser components, fire water systems and saltwater-cooling systems. Additionally, as offshore development of new oil and gas fields moves into the ultra deep-water depths, market demand for titanium's light-weight, high-strength and corrosion-resistance properties is creating new opportunities for the material. TIMET has a group dedicated to developing the expansion of titanium use in this market and in other non-aerospace applications.

Products and operations. TIMET is a vertically integrated titanium manufacturer whose products include (i) titanium sponge, the basic form of titanium metal used in titanium products, (ii) melted products (ingot, electrodes and slab), the result of melting sponge and titanium scrap, either alone or with various other alloys, (iii) mill products that are forged and rolled from ingot or slab, including long products (billet and bar), flat products (plate, sheet and strip) and pipe and (iv) fabrications (spools, pipefittings, manifolds, vessels, etc.) that are cut, formed, welded and assembled from titanium mill products.

Titanium sponge (so called because of its appearance) is the commercially pure, elemental form of titanium metal. The first step in TIMET's sponge production involves the chlorination of titanium-containing rutile ores (derived from beach sand) with chlorine and petroleum coke to produce titanium tetrachloride. Titanium tetrachloride is purified and then reacted with magnesium in a closed system, producing titanium sponge and magnesium chloride as co-products. TIMET's titanium sponge production facility in Nevada incorporates vacuum distillation process ("VDP") technology, which removes the magnesium and magnesium chloride residues by applying heat to the sponge mass while maintaining a vacuum in the chamber. The combination of heat and vacuum boils the residues from the sponge mass, and then the mass is mechanically pushed out of the distillation vessel, sheared and crushed, while the residual magnesium chloride is electrolytically separated and recycled.

Titanium ingot is a cylindrical solid shape that, in TIMET's case, weighs up to 8 metric tons. Titanium slab is a rectangular solid shape that, in TIMET's case, weighs up to 16 metric tons. Each ingot or slab is formed by melting titanium sponge, scrap or both, usually with various other alloys such as vanadium, aluminum, molybdenum, tin and zirconium. The melting process for ingot and slab is closely controlled and monitored utilizing computer control systems to maintain product quality and consistency and to meet customer specifications. In most cases, TIMET uses its ingot, electrodes and slab as the starting material for further processing into mill products. However, it also sells ingot and slab to third parties. Titanium scrap is a by-product of the forging, rolling, milling and machining operations, and significant quantities of scrap are generated in the production process for finished titanium products and components.

TIMET sends certain products either to TIMET's service centers or to outside vendors for further processing before being shipped to customers. TIMET's customers either process TIMET's products for their ultimate end-use or for sale to third parties.

During the production process and following the completion of manufacturing, TIMET performs extensive testing on its products. The inspection process is critical to ensuring that TIMET's products meet the high quality requirements of its customers, particularly in aerospace component production. TIMET certifies that its products meet customer specification at the time of shipment for substantially all customer orders.

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TIMET currently is reliant on several outside processors (one of which is owned by a competitor) to perform certain rolling, finishing and other processing steps in the U.S., and certain melting and forging steps in France. In France, the processor is also a joint venture partner in TIMET's 70%-owned subsidiary. During the past several years, TIMET has made significant strides toward reducing the reliance on competitor-owned sources for these services, so that any interruption in these functions should not have a material adverse effect on TIMET's business, results of operations, financial position or liquidity.

Distribution. TIMET sells its products through its own sales force based in the U.S. and Europe and through independent agents and distributors worldwide. TIMET's distribution system also includes eight TIMET-owned service centers (five in the U.S. and three in Europe), which sell TIMET's products on a just-in-time basis. The service centers primarily sell value-added and customized mill products including bar, sheet, plate, tubing and strip. TIMET believes its service centers provide a competitive advantage because of their ability to foster customer relationships, customize products to suit specific customer requirements and respond quickly to customer needs.

Raw materials. The principal raw materials used in the production of titanium ingot, slab and mill products are titanium sponge, titanium scrap and alloys. During 2005, TIMET's raw material usage requirements in the production of its melted and mill products were provided by internally produced sponge (29%), purchased sponge (25%), titanium scrap (40%) and other alloys (6%).

The primary raw materials used in the production of titanium sponge are titanium-containing rutile ore, chlorine, magnesium and petroleum coke. Rutile ore is currently available from a limited number of suppliers around the world, principally located in Australia, South Africa and Sri Lanka. TIMET purchases the majority of its supply of rutile ore from Australia. TIMET believes the availability of rutile ore will be adequate for the foreseeable future and does not anticipate any interruptions of its rutile supplies. However, there can be no assurance that TIMET will not experience interruptions.

Chlorine is currently obtained from a single supplier near TIMET's sponge plant in Nevada. While TIMET does not presently anticipate any chlorine supply problems, there can be no assurances the chlorine supply will not be interrupted. In the event of supply disruption, TIMET has taken steps to mitigate this risk, including establishing the feasibility of certain equipment modifications to enable it to utilize material from alternative chlorine suppliers or to purchase and utilize an intermediate product which will allow TIMET to eliminate the purchase of chlorine if needed. Magnesium and petroleum coke are generally available from a number of suppliers.

During 2005, TIMET was the only major U.S. producer of titanium sponge and one of only six major worldwide producers (the others are located in Russia, Kazakhstan, the Ukraine and two in Japan). Additionally, there are two smaller sponge producers located in China. However, TIMET cannot supply all of its needs for all grades of titanium sponge internally and is dependent, therefore, on third parties for a substantial portion of its sponge requirements. Titanium melted and mill products require varying grades of sponge and/or scrap depending on the customers' specifications and expected end use. Presently, TIMET and certain companies in Japan are the only producers of premium quality sponge that currently have complete approval for all significant demanding aerospace applications. Over the past few years, sponge producers in Russia and Kazakhstan have progressed in their efforts to obtain approval for the use of their sponge into all aerospace applications. This qualification process is likely to continue for several more years. Historically, TIMET has purchased sponge predominantly from producers in Kazakhstan and Japan. In 2002, TIMET entered into a sponge supply agreement, effective through 2007, which requires minimum annual purchases by TIMET. TIMET has no other long-term sponge supply

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agreements. Since 2000, TIMET has also purchased sponge from the U.S. Defense Logistics Agency ("DLA") stockpile; however, the DLA stockpile became fully depleted during 2005. TIMET expects to continue to purchase sponge from a variety of sources during 2006.

TIMET utilizes titanium scrap at its melting locations that is either generated internally, purchased from certain of its customers under various buyback arrangements or purchased externally on the open market. Such scrap consists of alloyed and commercially pure solids and turnings. Internally produced scrap is generated in TIMET's factories during both melting and mill product processing. Scrap obtained through customer buyback arrangements provides a "closed loop" arrangement resulting in greater supply and cost stability. Externally purchased scrap comes from a wide range of sources, including customers, collectors, processors and brokers. TIMET anticipates that 30% to 35% of the scrap it will utilize during 2006 will be purchased from external suppliers, as compared to 35% to 40% for 2005, due to TIMET's successful efforts to increase its closed loop arrangements. TIMET also occasionally sells scrap, usually in a form or grade it cannot economically recycle.

Market forces can significantly impact the supply or cost of externally produced scrap. The amount of scrap generated in the supply chain varies during the titanium business cycles. During the middle of the cycle, scrap generation and consumption are in relative equilibrium, minimizing disruptions in supply or significant changes in available supply and market prices for scrap. Increasing or decreasing cycles tend to cause significant changes in both the supply and market price of scrap. Early in the titanium cycle, when the demand for titanium melted and mill products begins to increase, TIMET's requirements (and those of other titanium manufacturers) precede the increase in scrap generation by downstream customers and the supply chain, placing upward pressure on the market price of scrap. The opposite situation occurs when demand for titanium melted and mill products begins to decline, resulting in greater availability or supply and placing downward pressure on the market price of scrap. As a net purchaser of scrap, TIMET is susceptible to price increases during periods of increasing demand. This phenomenon normally results in higher selling prices for melted and mill products, which tends to offset the increased material costs.

All of TIMET's major competitors utilize scrap as a raw material in their melt operations. In addition to use by titanium manufacturers, titanium scrap is used in steel-making operations during production of interstitial-free steels, stainless steels and high-strength-low-alloy steels. Recent strong demand for these steel products, especially from China, has produced a significant increase in demand for titanium scrap at a time when titanium scrap generation rates are at low levels, partly due to lower commercial aircraft build rates over the past few years. These events created a significantly tightened supply of titanium scrap during 2004 and 2005, and TIMET expects this trend to continue during 2006. For TIMET, this will translate to lower availability and higher cost for externally purchased scrap in the near-term.

In 2005, TIMET was somewhat limited in its ability to raise prices for the portion of its business that is subject to long-term pricing agreements. TIMET's ability to offset these increased material costs with higher selling prices should improve in 2006, as many of TIMET's long-term agreements have either expired or have been renegotiated for 2006 with price adjustments that take into account raw material cost fluctuations. Additionally, the expected increase in commercial aircraft build rates over the next several years, as previously discussed, could have the effect of lessening the shortage of titanium scrap. Further, several titanium producers, including TIMET, have recently announced plans to expand their respective sponge producing capabilities. Although these expansions should help reduce the current imbalance of global supply and demand for raw materials, TIMET does not believe the raw material shortage will be fully relieved at any time in the near future and therefore expects relatively

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high prices for raw materials to continue for at least the near term.

Various alloys used in the production of titanium products are also available from a number of suppliers. However, the recent high level of global demand for steel products has also resulted in a significant increase in the costs for several alloys, such as vanadium and molybdenum. The cost of these alloys during 2005 was significantly higher than at any point during the past 10 years. Vanadium and molybdenum costs peaked in the spring of 2005 and finished the year well below those levels. Although availability is not expected to be a concern and TIMET has negotiated certain price and cost protection with suppliers and customers, there is no assurance that such alloy costs will not continue to fluctuate significantly in the near future.

Properties. TIMET currently has manufacturing facilities in the United States in Nevada, Ohio, Pennsylvania and California, and also has two facilities in the United Kingdom and one facility in France. TIMET's sponge is produced at the Nevada facility while ingot, slab and mill products are produced at all of the facilities. The facilities in Nevada, Ohio and Pennsylvania, and one of the facilities in the United Kingdom, are owned, and all of the remainder are leased.

In addition to its U.S. sponge capacity discussed below, TIMET's worldwide melting capacity presently aggregates approximately 44,650 metric tons (estimated 22% of world capacity), and its mill product capacity aggregates approximately 22,600 metric tons (estimated 18% of world capacity). Of TIMET's worldwide melting capacity, 35% is represented by electron beam cold hearth melting furnaces, 63% by vacuum arc remelting ("VAR") furnaces and 2% by a vacuum induction melting furnace.

TIMET has operated its major production facilities at varying levels of practical capacity during the past three years. Overall in 2005, the plants operated at approximately 80% of practical capacity, as compared to 73% in 2004 and 56% in 2003. In 2006, TIMET's plants are expected to operate at approximately 88% of practical capacity. However, practical capacity and utilization measures can vary significantly based upon the mix of products produced.

TIMET's VDP sponge facility is expected to operate at its full annual practical capacity of 8,600 metric tons during 2006, which is comparable with 2005. VDP sponge is used principally as a raw material for TIMET's melting facilities in the U.S. and Europe. The raw materials processing facility in Morgantown, Pennsylvania primarily processes scrap used as melting feedstock, either in combination with sponge or separately. In May 2005, TIMET announced plans to expand its existing titanium sponge facility in Nevada. This expansion, which TIMET currently expects to complete by the first quarter of 2007, will provide the capacity to produce an additional 4,000 metric tons of sponge annually, an increase of approximately 42% over current Nevada sponge production capacity levels. TIMET currently estimates the capital cost for the project will approximate \$38 million.

TIMET's U.S. melting facilities in Nevada, Pennsylvania and California produce ingot and slab, which are either used as feedstock for TIMET's mill products operations or sold to third parties. These melting facilities are expected to operate at approximately 82%, 92% and 55%, respectively, of aggregate annual practical capacity in 2006, compared to 70%, 91% and 59%, respectively, in 2005.

Titanium mill products are produced by TIMET in the U.S. at its forging and rolling facility in Ohio, which receives ingot or slab principally from TIMET's U.S. melting facilities. TIMET's U.S. forging and rolling facility is expected to operate at approximately 82% of annual practical capacity in 2006, up from 68% in 2005. Capacity utilization will vary depending on mix across TIMET's

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individual mill product lines.

One of TIMET's facilities in the United Kingdom produces VAR ingot used primarily as feedstock at the same facility. The forging operations process the ingot into billet product for sale to third parties or into an intermediate product for further processing into bar or plate at its other facility in the United Kingdom. TIMET's United Kingdom melting and mill products production in 2006 is expected to operate at approximately 91% and 85%, respectively, of annual practical capacity, compared to 73% and 69%, respectively, in 2005.

The capacity of TIMET's facility in France is to a certain extent dependent upon the level of activity in the other owner of such business, which may from time to time provide TIMET with capacity in excess of that which the other owner is contractually required to provide. During 2005, TIMET utilized 119% of the maximum annual capacity the other owner was contractually required to provide in 2005, and TIMET expects this amount to approximate 102% for 2006.

Customer agreements. TIMET has long-term agreements with certain major aerospace customers, including, among others, The Boeing Company, Rolls-Royce plc and its German and U.S. affiliates, United Technologies Corporation ("UTC," Pratt & Whitney and related companies), Societe Nationale d