KRONOS WORLDWIDE INC
Form 10-Q
August 07, 2013
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# UNITED STATES

# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# FORM 10-Q

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)**

**OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the quarter ended June 30, 2013**

**Commission file number 1-31763**

# KRONOS WORLDWIDE, INC.

**(Exact name of Registrant as specified in its charter)**

| | |
|---|---|
| **DELAWARE** | **76-0294959** |
| **(State or other jurisdiction of** | **(IRS Employer** |

| | |
|---|---|
| **incorporation or organization)** | **Identification No.)** |

**5430 LBJ Freeway, Suite 1700**

**Dallas, Texas 75240-2697**

**(Address of principal executive offices)**

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

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

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

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

| | | | |
|---|---|---|---|
| Large accelerated filer | ¨ | Accelerated filer | x |
| Non-accelerated filer | ¨ | Smaller reporting company | ¨ |

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

Number of shares of the Registrant s common stock outstanding on July 31, 2013: 115,913,598.

**KRONOS WORLDWIDE, INC. AND SUBSIDIARIES**

**INDEX**



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

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**KRONOS WORLDWIDE, INC. AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED BALANCE SHEETS**

**(In millions)**

| | December 31, 2012 | June 30, 2013 (unaudited) |
|---|---|---|
| **ASSETS** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 282.7 | **$ 102.0** |
| Restricted cash | 2.7 | **2.2** |
| Accounts and other receivables | 285.8 | **360.5** |
| Inventories | 638.3 | **449.8** |
| Prepaid expenses and other | 9.8 | **6.9** |
| Deferred income taxes | 4.1 | **4.1** |
| Total current assets | 1,223.4 | **925.5** |
| Other assets: | | |
| Investment in $TiO_2$ manufacturing joint venture | 109.9 | **95.2** |
| Marketable equity securities | 21.6 | **23.8** |
| Deferred income taxes | 120.5 | **165.3** |
| Other | 29.1 | **24.6** |
| Total other assets | 281.1 | **308.9** |
| Property and equipment: | | |
| Land | 45.2 | **44.2** |
| Buildings | 238.9 | **232.6** |
| Equipment | 1,082.9 | **1,058.7** |
| Mining properties | 131.3 | **124.3** |
| Construction in progress | 37.3 | **50.8** |
| | 1,535.6 | **1,510.6** |
| Less accumulated depreciation and amortization | 1,013.1 | **1,002.7** |
| Net property and equipment | 522.5 | **507.9** |
| Total assets | $ 2,027.0 | **$ 1,742.3** |

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**KRONOS WORLDWIDE, INC. AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED BALANCE SHEETS (CONTINUED)**

**(In millions)**

| | December 31, 2012 | June 30, 2013 (unaudited) |
|---|---|---|
| **LIABILITIES AND STOCKHOLDERS EQUITY** | | |
| Current liabilities: | | |
| Current maturities of long-term debt | $ 21.2 | **$ 20.9** |
| Accounts payable and accrued liabilities | 273.2 | **239.9** |
| Income taxes | 23.1 | **4.2** |
| Deferred income taxes | 10.9 | **10.7** |
| Total current liabilities | 328.4 | **275.7** |
| Noncurrent liabilities: | | |
| Long-term debt | 378.9 | **286.9** |
| Deferred income taxes | 24.0 | **18.1** |
| Accrued pension cost | 189.2 | **180.4** |
| Accrued postretirement benefit cost | 14.1 | **13.7** |
| Other | 30.3 | **30.6** |
| Total noncurrent liabilities | 636.5 | **529.7** |
| Stockholders equity: | | |
| Common stock | 1.2 | **1.2** |
| Additional paid-in capital | 1,399.1 | **1,399.2** |
| Retained deficit | (141.1) | **(250.9)** |
| Accumulated other comprehensive loss | (197.1) | **(212.6)** |
| Total stockholders equity | 1,062.1 | **936.9** |
| Total liabilities and stockholders equity | $ 2,027.0 | **$ 1,742.3** |

Commitments and contingencies (Notes 8 and 12)

See accompanying Notes to Condensed Consolidated Financial Statements.

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**KRONOS WORLDWIDE, INC. AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

**(In millions, except per share data)**

| | Three months ended June 30, | | Six months ended June 30, | |
|---|---|---|---|---|
| | 2012 | 2013 | 2012 | 2013 |
| | | (unaudited) | | |
| Net sales | $ 545.3 | **$ 481.1** | $ 1,106.6 | **$ 944.7** |
| Cost of sales | 382.0 | **471.5** | 681.8 | **931.2** |
| Gross margin | 163.3 | **9.6** | 424.8 | **13.5** |
| Selling, general and administrative expense | 47.1 | **49.3** | 95.9 | **98.7** |
| Currency transaction gains (losses), net | .4 | **(2.9)** | .5 | **(1.1)** |
| Other operating expense, net | (6.0) | **(5.1)** | (9.4) | **(8.3)** |
| Income (loss) from operations | 110.6 | **(47.7)** | 320.0 | **(94.6)** |
| Other income (expense): | | | | |
| Interest and dividend income | 2.0 | **.3** | 4.3 | **.6** |
| Loss on prepayment of debt | (7.2) | | (7.2) | **(6.6)** |
| Interest expense | (6.7) | **(5.7)** | (13.0) | **(12.1)** |
| Income (loss) before income taxes | 98.7 | **(53.1)** | 304.1 | **(112.7)** |
| Income tax expense (benefit) | 34.2 | **(19.2)** | 102.7 | **(37.7)** |
| Net income (loss) | $ 64.5 | **$ (33.9)** | $ 201.4 | **$ (75.0)** |
| Net income (loss) per basic and diluted share | $ .56 | **$ (.29)** | $ 1.74 | **$ (.65)** |
| Cash dividends per share | $ .15 | **$ .15** | $ .30 | **$ .30** |
| Weighted-average shares used in the calculation of net income (loss) per share | 115.9 | **115.9** | 115.9 | **115.9** |

See accompanying Notes to Condensed Consolidated Financial Statements.

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**KRONOS WORLDWIDE, INC. AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)**

**(In millions)**

| | Three months ended June 30, | | Six months ended June 30, | |
|---|---|---|---|---|
| | 2012 | 2013 | 2012 | 2013 |
| | (unaudited) | | | |
| Net income (loss) | $ 64.5 | **$ (33.9)** | $ 201.4 | **$ (75.0)** |
| Other comprehensive income (loss), net of tax: | | | | |
| Marketable securities adjustment | (10.7) | **(2.5)** | (17.9) | **1.2** |
| Currency translation adjustment | (39.1) | **5.7** | (22.5) | **(21.6)** |
| Pension plans | 1.8 | **2.5** | 3.5 | **5.0** |
| OPEB plans | (.1) | **(.1)** | (.1) | **(.1)** |
| Total other comprehensive income (loss) | (48.1) | **5.6** | (37.0) | **(15.5)** |
| Comprehensive income (loss) | $ 16.4 | **$ (28.3)** | $ 164.4 | **$ (90.5)** |

See accompanying Notes to Condensed Consolidated Financial Statements.

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**KRONOS WORLDWIDE, INC. AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY**

**Six months ended June 30, 2013**

**(In millions)**

| | Common stock | Additional paid-in capital | Retained deficit | Accumulated other comprehensive loss | Total stockholders equity |
|---|---|---|---|---|---|
| | | | (unaudited) | | |
| Balance at December 31, 2012 | $ 1.2 | $ 1,399.1 | $ (141.1) | $ (197.1) | $ 1,062.1 |
| Net loss | | | (75.0) | | (75.0) |
| Other comprehensive loss, net | | | | (15.5) | (15.5) |
| Issuance of common stock | | .1 | | | .1 |
| Dividends paid | | | (34.8) | | (34.8) |
| Balance at June 30, 2013 | $ 1.2 | $ 1,399.2 | $ (250.9) | $ (212.6) | $ 936.9 |

See accompanying Notes to Condensed Consolidated Financial Statements.

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**KRONOS WORLDWIDE, INC. AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

**(In millions)**

| | Six months ended June 30, 2012 | Six months ended June 30, 2013 |
|---|---|---|
| | (unaudited) | |
| Cash flows from operating activities: | | |
| Net income (loss) | $ 201.4 | **$ (75.0)** |
| Depreciation and amortization | 23.9 | **25.0** |
| Deferred income taxes | 28.2 | **(53.3)** |
| Loss on prepayment of debt | 7.2 | **6.6** |
| Call premium and interest paid on Senior Notes redeemed | (6.2) | |
| Benefit plan expense greater (less) than cash funding: | | |
| Defined benefit pension plans | (.6) | **.2** |
| Other postretirement benefits | .1 | **.1** |
| Distributions from (contributions to) $TiO_2$ manufacturing joint venture, net | (19.4) | **14.7** |
| Other, net | 2.4 | **6.2** |
| Change in assets and liabilities: | | |
| Accounts and other receivables | (167.4) | **(93.7)** |
| Inventories | (218.0) | **176.6** |
| Prepaid expenses | (.5) | **2.7** |
| Accounts payable and accrued liabilities | 45.5 | **(1.2)** |
| Income taxes | (.2) | **(4.4)** |
| Accounts with affiliates | 34.7 | **(20.4)** |
| Other, net | 1.9 | **.8** |
| Net cash used in operating activities | (67.0) | **(15.1)** |
| Cash flows from investing activities: | | |
| Capital expenditures | (31.9) | **(33.8)** |
| Change in restricted cash equivalents | (2.0) | **.4** |
| Loans to Valhi: | | |
| Loans | (68.6) | |
| Collections | 49.8 | |
| Proceeds from sale of marketable securities mutual funds | 21.1 | |
| Other, net | | **(.1)** |
| Net cash used in investing activities | (31.6) | **(33.5)** |
| Cash flows from financing activities: | | |
| Indebtedness: | | |
| Borrowings | 501.4 | **204.5** |
| Principal payments | (353.1) | **(300.6)** |
| Dividends paid | (34.8) | **(34.8)** |
| Deferred financing fees | (4.5) | |
| Net cash provided by (used in) financing activities | 109.0 | **(130.9)** |

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**KRONOS WORLDWIDE, INC. AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)**

**(In millions)**

| | Six months ended June 30, 2012 | 2013 |
|---|---|---|
| | (unaudited) | |
| Cash and cash equivalents net change from: | | |
| Operating, investing and financing activities | 10.4 | **(179.5)** |
| Currency translation | (1.3) | **(1.2)** |
| Balance at beginning of period | 82.5 | **282.7** |
| Balance at end of period | $ 91.6 | **$ 102.0** |
| Supplemental disclosures: | | |
| Cash paid for: | | |
| Interest (including call premium paid) | $ 22.0 | **$ 11.4** |
| Income taxes | 72.1 | **34.2** |
| Accrual for capital expenditures | 3.2 | **4.4** |

See accompanying Notes to Condensed Consolidated Financial Statements.

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**KRONOS WORLDWIDE, INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**June 30, 2013**

**(unaudited)**

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

*Organization* We are a majority-owned subsidiary of Valhi, Inc. (NYSE: VHI). At June 30, 2013, Valhi held approximately 50% of our outstanding common stock and NL Industries, Inc. (NYSE: NL) held an additional 30% of our common stock. Valhi owns approximately 83% of NL s outstanding common stock. Approximately 93% of Valhi s outstanding common stock is held by Contran Corporation and its subsidiaries. Substantially all of Contran s outstanding voting stock is held by trusts established for the benefit of certain children and grandchildren of Harold C. Simmons (for which Mr. Simmons is the sole trustee), or is held directly by Mr. Simmons or other persons or entities related to Mr. Simmons. Consequently, Mr. Simmons may be deemed to control Contran, Valhi and us.

*Basis of presentation* The unaudited Condensed Consolidated Financial Statements contained in this Quarterly Report have been prepared on the same basis as the audited Consolidated Financial Statements in our Annual Report on Form 10-K for the year ended December 31, 2012 that we filed with the Securities and Exchange Commission (SEC) on March 12, 2013 (2012 Annual Report). In our opinion, we have made all necessary adjustments (which include only normal recurring adjustments) in order to state fairly, in all material respects, our consolidated financial position, results of operations and cash flows as of the dates and for the periods presented. We have condensed the Consolidated Balance Sheet and Statement of Stockholders Equity at December 31, 2012 contained in this Quarterly Report as compared to our audited Consolidated Financial Statements at that date, and we have omitted certain information and footnote disclosures (including those related to the Consolidated Balance Sheet at December 31, 2012) normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). Our results of operations for the interim periods ended June 30, 2013 may not be indicative of our operating results for the full year. The Condensed Consolidated Financial Statements contained in this Quarterly Report should be read in conjunction with our 2012 Consolidated Financial Statements contained in our 2012 Annual Report.

Unless otherwise indicated, references in this report to we, us or our refer to Kronos Worldwide, Inc. and its subsidiaries (NYSE: KRO) taken as a whole.

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**Note 2 Accounts and other receivables:**

| | December 31, 2012 | June 30, 2013 |
|---|---|---|
| | (In millions) | |
| Trade receivables | $ 229.7 | **$ 317.2** |
| Recoverable VAT and other receivables | 38.9 | **39.2** |
| Refundable income taxes | 18.3 | **5.1** |
| Allowance for doubtful accounts | (1.1) | **(1.0)** |
| Total | $ 285.8 | **$ 360.5** |

**Note 3 Inventories, net:**

| | December 31, 2012 | June 30, 2013 |
|---|---|---|
| | (In millions) | |
| Raw materials | $ 151.5 | **$ 99.7** |
| Work in process | 27.3 | **19.8** |
| Finished products | 394.8 | **264.6** |
| Supplies | 64.7 | **65.7** |
| Total | $ 638.3 | **$ 449.8** |

**Note 4 Marketable securities:**

Our marketable securities consist of investments in the publicly-traded shares of related parties: Valhi, NL and CompX International Inc. NL owns a majority of CompX s outstanding common stock. All of our marketable securities are accounted for as available-for-sale securities, which are carried at fair value using quoted market prices in active markets for each marketable security, and represent a Level 1 input within the fair value hierarchy. See Note 13. Because we have classified all of our marketable securities as available-for-sale, any unrealized gains or losses on the securities are recognized through other comprehensive income, net of deferred income taxes.

| Marketable security | Fair value measurement level | Market value | Cost basis | Unrealized gains |
|---|---|---|---|---|
| | | (In millions) | | |
| **As of December 31, 2012:** | | | | |
| Valhi common stock | 1 | $ 21.5 | $ 15.3 | $ 6.2 |
| NL and CompX common stocks | 1 | .1 | .1 | |
| Total | | $ 21.6 | $ 15.4 | $ 6.2 |
| **As of June 30, 2013:** | | | | |
| Valhi common stock | 1 | **$ 23.7** | **$ 15.3** | **$ 8.4** |

| | | | | |
|---|---|---|---|---|
| NL and CompX common stocks | 1 | **.1** | **.1** | |
| Total | | **$ 23.8** | **$ 15.4** | **$ 8.4** |

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At December 31, 2012 and June 30, 2013, we held approximately 1.7 million shares of Valhi s common stock with a quoted per share market price of $12.50 and $13.74, respectively. We also held a nominal number of shares of CompX and NL common stocks.

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

**Note 5 Other noncurrent assets:**

| | December 31, 2012 | June 30, 2013 |
|---|---|---|
| | (In millions) | |
| Deferred financing costs, net | $ 7.0 | **$ 3.7** |
| Restricted cash | 7.5 | **7.1** |
| Pension asset | 5.1 | **5.9** |
| Other | 9.5 | **7.9** |
| Total | $ 29.1 | **$ 24.6** |

**Note 6 Accounts payable and accrued liabilities:**

| | December 31, 2012 | June 30, 2013 |
|---|---|---|
| | (In millions) | |
| Accounts payable | $ 161.3 | **$ 154.6** |
| Employee benefits | 29.6 | **24.1** |
| Accrued sales discounts and rebates | 14.9 | **9.3** |
| Accrued interest | .2 | **.1** |
| Payable to affiliates: | | |
| Income taxes, net Valhi | 18.1 | **2.3** |
| Louisiana Pigment Company, L.P. | 23.5 | **19.9** |
| Other | 25.6 | **29.6** |
| Total | $ 273.2 | **$ 239.9** |

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**Note 7 Long-term debt:**

| | December 31, 2012 | June 30, 2013 |
|---|---|---|
| | (In millions) | |
| Term loan | $ 384.5 | **$ 98.6** |
| Note payable to Contran | | **180.0** |
| Revolving European credit facility | 13.2 | **26.1** |
| Other | 2.4 | **3.1** |
| Total debt | 400.1 | **307.8** |
| Less current maturities | 21.2 | **20.9** |
| Total long-term debt | $ 378.9 | **$ 286.9** |

*Term loan* In February 2013, we voluntarily prepaid an aggregate $290 million principal amount of our term loan. We recognized a non-cash pre-tax interest charge of $6.6 million in the first quarter of 2013 related to this prepayment consisting of the write-off of the unamortized original issue discount costs and deferred financing costs associated with such prepayment. Funds for such prepayment were provided by $100 million of our cash on hand as well as borrowings of $190 million under a new loan from Contran as described below. As a result of this prepayment, the remaining $100 million principal amount of the term loan is not repayable until final maturity of the term loan in June 2018. The average interest rate on the term loan as of and for the six months ended June 30, 2013 was 7% and 6.8%, respectively. The carrying amount of the term loan includes unamortized original issue discount of $1.4 million at June 30, 2013. In July 2013, we voluntarily prepaid the remaining $100 million principal amount outstanding under our term loan, using $50 million of our cash on hand as well as borrowings of $50 million under our revolving North American credit facility.

*Note payable to Contran* As discussed above, in February 2013 we entered into a promissory note with Contran that allows us to borrow up to $290 million. This new loan from Contran contains terms and conditions similar to the terms and conditions of the term loan, except that the loan from Contran is unsecured and contains no financial maintenance covenant. The independent members of our board of directors approved the terms and conditions of the loan from Contran. The note requires quarterly principal payments of $5.0 million which commenced in March 2013, with any remaining outstanding principal due by June 2018. Voluntary principal prepayments are permitted at any time without penalty. The note bears interest at LIBOR (with LIBOR no less than 1%) plus 5.125%, or the base rate (as defined in the agreement) plus 4.125%. We are required to use the base rate method until such time as both (1) the term loan discussed above has been fully repaid and (2) the European credit facility has been amended on terms satisfactory to Contran, at which time we would have the option to use either the base rate or LIBOR rate methods. The average interest rate on these borrowings as of and for the period from issuance to June 30, 2013 was 7.375%.

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*Revolving European credit facility* - During the first six months of 2013, we borrowed 10 million ($12.8 million when borrowed) and made no repayments under our European credit facility. The average interest rate on these borrowings as of and for the six months ended June 30, 2013 was 2.03% and 2.02%, respectively. At June 30, 2013, the equivalent of $130.5 million was available for borrowing under this facility.

*Revolving North American credit facility* We had no borrowings or repayments under our North American credit facility for the six months ended June 30, 2013. At June 30, 2013 we had no outstanding borrowings under this revolving facility and approximately $119.5 million was available for borrowing.

*Canada* At June 30, 2013, an aggregate of Cdn. $7.5 million letters of credit were outstanding under our Canadian subsidiary s loan agreement with the Bank of Montreal which exists solely for the issuance of up to Cdn. $10.0 million in letters of credit.

In January 2013, we borrowed Cdn. $1.8 million (USD $1.8 million) under our Canadian subsidiary s agreement with an economic development agency of the Province of Quebec, Canada which was recorded net of Cdn. $.5 million (USD $.5 million) imputed interest.

*Restrictions and other* Our European credit facility described above requires the borrower to maintain minimum levels of equity, requires the maintenance of certain financial ratios, limits dividends and additional indebtedness and contains other provisions and restrictive covenants customary in lending transactions of this type. Our term loan, North American revolving credit facility and note payable to Contran also contain restrictive covenants. At June 30, 2013, there were no restrictions on our ability to pay dividends.

We are in compliance with all of our debt covenants at June 30, 2013.

**Note 8 Income taxes:**

| | **Three months ended June 30,** | | **Six months ended June 30,** | |
|---|---|---|---|---|
| | **2012** | **2013** | **2012** | **2013** |
| | **(In millions)** | | | |
| Expected tax expense (benefit), at U.S. Federal statutory income tax rate of 35% | $ 34.5 | **$ (18.5)** | $ 106.4 | **$ (39.4)** |
| Non-U.S. tax rates | (4.0) | **2.9** | (11.7) | **2.5** |
| Incremental tax (benefit) on earnings (losses) of non-U.S. companies | 1.7 | **(3.3)** | 5.7 | **(4.7)** |
| Nondeductible expenses | 1.6 | **(.2)** | 1.9 | **2.1** |
| U.S. state income taxes and other, net | .4 | **(.1)** | .4 | **1.8** |
| Total | $ 34.2 | **$ (19.2)** | $ 102.7 | **$ (37.7)** |

| | Three months ended June 30, | | Six months ended June 30, | |
|---|---|---|---|---|
| | 2012 | 2013 | 2012 | 2013 |
| | (In millions) | | | |
| Comprehensive provision for income taxes (benefit) allocable to: | | | | |
| Net income (loss) | $ 34.2 | **$ (19.2)** | $ 102.7 | **$ (37.7)** |
| Other comprehensive income (loss): | | | | |
| Marketable securities | (6.5) | **(1.4)** | (10.0) | **.7** |
| Currency translation | (1.7) | **2.5** | (1.7) | **(1.3)** |
| Pension plans | .8 | **1.1** | 1.5 | **2.2** |
| OPEB plans | (.1) | **(.1)** | (.1) | **(.1)** |
| Total | $ 26.7 | **$ (17.1)** | $ 92.4 | **$ (36.2)** |

Tax authorities are examining certain of our U.S. and non-U.S. tax returns and have or may propose tax deficiencies, including penalties and interest. Because of the inherent uncertainties involved in settlement initiatives and court and tax proceedings, we cannot guarantee that these matters will be resolved in our favor, and therefore our potential exposure, if any, is also uncertain. In 2011 and 2012, we received notices of re-assessment from the Canadian federal and provincial tax authorities related to the years 2002 through 2004. We object to the re-assessments and believe the position is without merit. Accordingly, we are appealing the re-assessments and in connection with such appeal we were required to post letters of credit aggregating Cdn. $7.5 million (see Note 7). If the full amount of the proposed adjustment were ultimately to be assessed against us, the cash tax liability would be approximately $15.6 million. We believe we have adequate accruals for additional taxes and related interest expense which could ultimately result from tax examinations. We believe the ultimate disposition of tax examinations should not have a material adverse effect on our consolidated financial position, results of operations or liquidity. We currently estimate that our unrecognized tax benefits may change by $3 million during the next twelve months related to certain adjustments to our prior year returns.

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**Note 9 Employee benefit plans:**

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

| | Three months ended June 30, 2012 | 2013 | Six months ended June 30, 2012 | 2013 |
|---|---|---|---|---|
| | (In millions) | | | |
| Service cost | $ 2.6 | **$ 3.2** | $ 5.2 | **$ 6.5** |
| Interest cost | 5.8 | **5.3** | 11.6 | **10.8** |
| Expected return on plan assets | (4.6) | **(4.9)** | (9.2) | **(10.0)** |
| Amortization of prior service cost | .4 | **.4** | .8 | **.8** |
| Amortization of net transition obligations | .1 | **.1** | .2 | **.2** |
| Recognized actuarial losses | 2.0 | **3.1** | 4.0 | **6.2** |
| Total | $ 6.3 | **$ 7.2** | $ 12.6 | **$ 14.5** |

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

| | Three months ended June 30, 2012 | 2013 | Six months ended June 30, 2012 | 2013 |
|---|---|---|---|---|
| | (In millions) | | | |
| Service cost | $ | **$ .1** | $ .1 | **$ .2** |
| Interest cost | .2 | **.1** | .3 | **.2** |
| Amortization of prior service credit | (.1) | **(.1)** | (.3) | **(.3)** |
| Recognized actuarial loss | .1 | **.1** | .2 | **.2** |
| Total | $ .2 | **$ .2** | $ .3 | **$ .3** |

*Contributions* We expect our 2013 contributions for our pension and other postretirement plans to be approximately $28 million.

**Note 10 Other noncurrent liabilities:**

| | December 31, 2012 | June 30, 2013 |
|---|---|---|
| | (In millions) | |
| Reserve for uncertain tax positions | $ 13.4 | **$ 14.3** |
| Employee benefits | 11.3 | **10.7** |
| Other | 5.6 | **5.6** |
| Total | $ 30.3 | **$ 30.6** |

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**Note 11 Accumulated other comprehensive loss:**

Changes in accumulated other comprehensive loss for the three and six months ended June 30, 2012 and 2013 are presented in the table below.

| | Three months ended June 30, 2012 | Three months ended June 30, 2013 | Six months ended June 30, 2012 | Six months ended June 30, 2013 |
|---|---|---|---|---|
| | (In millions) | | | |
| Accumulated other comprehensive loss, net of tax: | | | | |
| Marketable securities: | | | | |
| Balance at beginning of period | $ (2.1) | **$ 7.9** | $ 5.1 | **$ 4.2** |
| Other comprehensive income (loss) unrealized gains (losses) arising during the year | (10.7) | **(2.5)** | (17.9) | **1.2** |
| Balance at end of period | $ (12.8) | **$ 5.4** | $ (12.8) | **$ 5.4** |
| Currency translation: | | | | |
| Balance at beginning of period | $ (75.2) | **$ (90.8)** | $ (91.8) | **$ (63.5)** |
| Other comprehensive gain (loss) | (39.1) | **5.7** | (22.5) | **(21.6)** |
| Balance at end of period | $ (114.3) | **$ (85.1)** | $ (114.3) | **$ (85.1)** |
| Defined benefit pension plans: | | | | |
| Balance at beginning of period | $ (97.5) | **$ (134.8)** | $ (99.2) | **$ (137.3)** |
| Other comprehensive income amortization of prior service cost and net losses included in net periodic pension cost | 1.8 | **2.5** | 3.5 | **5.0** |
| Balance at end of period | $ (95.7) | **$ (132.3)** | $ (95.7) | **$ (132.3)** |
| OPEB plans: | | | | |
| Balance at beginning of period | $ .1 | **$ (.5)** | $ .1 | **$ (.5)** |
| Other comprehensive loss amortization of prior service credit and net losses included in net periodic OPEB cost | (.1) | **(.1)** | (.1) | **(.1)** |
| Balance at end of period | $ | **$ (.6)** | $ | **$ (.6)** |
| Total accumulated other comprehensive loss: | | | | |
| Balance at beginning of period | $ (174.7) | **$ (218.2)** | $ (185.8) | **$ (197.1)** |
| Other comprehensive gain (loss) | (48.1) | **5.6** | (37.0) | **(15.5)** |
| Balance at end of period | $ (222.8) | **$ (212.6)** | $ (222.8) | **$ (212.6)** |

See Note 9 for amounts related to our defined benefit pension plans and OPEB plans.

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**Note 12 Commitments and contingencies:**

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

Please refer to our 2012 Annual Report for a discussion of certain other legal proceedings to which we are a party.

**Note 13 Financial instruments:**

The following table summarizes the valuation of our financial instruments recorded on a fair value basis as of December 31, 2012 and June 30, 2013:

| | | Fair Value Measurements | | |
|---|---|---|---|---|
| | **Total** | **Quoted Prices in Active Markets (Level 1)** | **Significant Other Observable Inputs (Level 2)** | **Significant Unobservable Inputs (Level 3)** |
| | | **(In millions)** | | |
| **Asset (liability)** | | | | |
| **December 31, 2012** | | | | |
| Currency forward contracts | $ 1.8 | $ 1.8 | $ | $ |
| Noncurrent marketable securities (See Note 4) | 21.6 | 21.6 | | |
| **June 30, 2013** | | | | |
| Currency forward contracts | **$ (2.0)** | **$ (2.0)** | **$** | **$** |
| Noncurrent marketable securities (See Note 4) | **23.8** | **23.8** | | |

Certain of our sales generated by our non-U.S. operations are denominated in U.S. dollars. We periodically use currency forward contracts to manage a very nominal portion of currency exchange rate risk associated with trade receivables denominated in a currency other than the holder s functional currency or similar exchange rate risk associated with future sales. We have not entered into these contracts for trading or speculative purposes in the past, nor do we currently anticipate entering into such contracts for trading or speculative purposes in the future. Derivatives used to hedge forecasted transactions and specific cash flows associated with financial assets and liabilities denominated in currencies other than the U.S. dollar and which meet the criteria for hedge accounting are designated as cash flow hedges. Consequently, the effective portion of gains and losses is deferred as a component of accumulated other comprehensive income and is recognized in earnings at the time the hedged item affects earnings. Contracts that do not meet the criteria for hedge accounting are marked-to-market at each balance sheet date with any resulting gain or loss recognized in income currently as part of net currency transactions. The fair value of the currency forward contracts is determined using Level 1 inputs based on the currency spot forward rates quoted by banks or currency dealers.

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At June 30, 2013, we had currency forward contracts to exchange:

- an aggregate of $54.0 million for an equivalent value of Canadian dollars at an exchange rate ranging from Cdn. $1.02 to Cdn. $1.06 per U.S. dollar. These contracts with Wells Fargo Bank, N.A. mature from July 2013 through December 2014 at a rate of $3.0 million per month, subject to early redemption provisions at our option;

- an aggregate $35.0 million for an equivalent value of Norwegian kroner at exchange rates ranging from kroner 5.84 to kroner 6.14 per U.S. dollar. These contracts with DnB Nor Bank ASA mature at a rate of $5.0 million per month in certain months from August 2013 through April 2014; and

- an aggregate 22.0 million for an equivalent value of Norwegian kroner at exchange rates ranging from kroner 7.50 to kroner 8.07 per euro. These contracts with DnB Nor Bank ASA mature at a rate ranging from 2.0 million to 5.0 million per month in certain months from July 2013 through April 2014.

The estimated fair value of our currency forward contracts at June 30, 2013 was a net loss of $2.0 million, of which $.3 million is recognized as part of accounts and other receivables and $2.3 million is recognized as part of accounts payable and accrued liabilities. There is also a corresponding $2.0 million currency transaction loss recognized in our Condensed Consolidated Statement of Operations. We are not currently using hedge accounting for our outstanding currency forward contracts at June 30, 2013, and we did not use hedge accounting for any of such contracts we previously held in 2012.

The following table presents the financial instruments that are not carried at fair value but which require fair value disclosure as of December 31, 2012 and June 30, 2013.

| | December 31, 2012 | | June 30, 2013 | |
|---|---|---|---|---|
| | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| | (In millions) | | | |
| Cash, cash equivalents and restricted cash | $ 292.9 | $ 292.9 | **$ 111.3** | **$ 111.3** |
| Notes payable and long-term debt: | | | | |
| Variable rate: | | | | |
| Term loan | 384.5 | 396.8 | **98.6** | **100.4** |
| Note payable to Contran | | | **180.0** | **180.0** |
| European credit facility | 13.2 | 13.2 | **26.1** | **26.1** |
| Common stockholders equity | 1,062.1 | 2,260.2 | **936.9** | **1,882.4** |

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At December 31, 2012 and June 30, 2013, the estimated market price of our term loan was $1,017.5 per $1,000 principal amount and $1,004.4 per $1,000 principal amount, respectively. The fair value of our term loan is based on quoted market prices; however, these quoted market prices represent Level 2 inputs because the markets in which the term loan trades were not active. The fair values of our note payable to Contran and our European credit facility represent Level 2 inputs, and are deemed to approximate book value. The fair value of our common stockholders equity is based upon quoted market prices at each balance sheet date, which represent Level 1 inputs. Due to their near-term maturities, the carrying amounts of accounts receivable and accounts payable are considered equivalent to fair value.

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

**RESULTS OF OPERATIONS:**

**Business overview**

We are a leading global producer and marketer of value-added titanium dioxide pigments ($TiO_2$). $TiO_2$ is used for a variety of manufacturing applications, including coatings, plastics, paper and other industrial and specialty products. For the six months ended June 30, 2013, approximately one-half of our sales volumes were into European markets. Our production facilities are located in Europe and North America.

We consider $TiO_2$ to be a quality of life product, with demand affected by gross domestic product, or GDP, and overall economic conditions in our markets located in various regions of the world. Over the long-term, we expect demand for $TiO_2$ will grow by 2% to 3% per year, consistent with our expectations for the long-term growth in GDP. However, even if we and our competitors maintain consistent shares of the worldwide market, demand for $TiO_2$ in any interim or annual period may not change in the same proportion as the change in GDP, in part due to relative changes in the $TiO_2$ inventory levels of our customers. We believe that our customers inventory levels are influenced in part by their expectations for future changes in $TiO_2$ market selling prices as well as their expectations for future availability of product. Although certain of our $TiO_2$ grades are considered specialty pigments, the majority of our grades and substantially all of our production are considered commodity pigment products, with price and availability being the most significant competitive factors along with quality and customer service.

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

- our $TiO_2$ sales and production volumes,
- $TiO_2$ selling prices,
- currency exchange rates (particularly the exchange rate for the U.S. dollar relative to the euro, Norwegian krone and the Canadian dollar) and
- manufacturing costs, particularly raw materials, maintenance and energy-related expenses.

Our key performance indicators are our $TiO_2$ average selling prices and our $TiO_2$ sales and production volumes. $TiO_2$ selling prices generally follow industry trends and prices will increase or decrease generally as a result of competitive market pressures.

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**Executive summary**

We reported a net loss of $33.9 million, or $.29 per share, in the second quarter of 2013 as compared to net income of $64.5 million, or $.56 per share, in the second quarter of 2012. For the first six months of 2013, we reported a net loss of $75.0 million, or $.65 per share, compared to net income of $201.4 million, or $1.74 per share, in the first six months of 2012. We had a net loss in the second quarter of 2013 compared to net income in the second quarter of 2012 principally due to a loss from operations resulting from the unfavorable effects of lower average selling prices and higher raw material costs in 2013. We had a net loss in the first half of 2013 compared to net income in the first half of 2012 principally due to a loss from operations resulting from the unfavorable effects of lower average selling prices, lower production volumes and higher raw material costs in 2013.

Our results in the first six months of 2013 include a first quarter non-cash pre-tax charge of $6.6 million ($4.3 million, or $.04 per share, net of income tax benefit) related to the voluntary prepayment of $290 million principal amount of our term loan, consisting of the write-off of original issue discount costs and deferred financing costs associated with such prepayment. Our results in the first six months of 2012 include an aggregate second quarter charge of $7.2 million ($4.7 million, or $.04 per share, net of income tax benefit) associated with the June 2012 redemption of the remaining 279.2 million principal amount of our Senior Notes, consisting of the call premium paid, interest from the June 14, 2012 indenture discharge date to the July 20, 2012 redemption date and the write-off of unamortized deferred financing costs and original issue discount.

**Forward-looking information**

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

- Future supply and demand for our products
- The extent of the dependence of certain of our businesses on certain market sectors
- The cyclicality of our business
- Customer and producer inventory levels
- Unexpected or earlier-than-expected industry capacity expansion

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- Changes in raw material and other operating costs (such as ore and energy costs)
- Changes in the availability of raw materials (such as ore)
- General global economic and political conditions (such as changes in the level of gross domestic product in various regions of the world and the impact of such changes on demand for $TiO_2$)
- Competitive products and substitute products
- Customer and competitor strategies
- Potential consolidation of our competitors
- Potential consolidation of our customers
- The impact of pricing and production decisions
- Competitive technology positions
- The introduction of trade barriers
- Possible disruption of our business, or increases in our cost of doing business, resulting from terrorist activities or global conflicts
- Fluctuations in currency exchange rates (such as changes in the exchange rate between the U.S. dollar and each of the euro, the Norwegian krone and the Canadian dollar), or possible disruptions to our business resulting from potential instability resulting from uncertainties associated with the euro
- Operating interruptions (including, but not limited to, labor disputes, leaks, natural disasters, fires, explosions, unscheduled or unplanned downtime, transportation interruptions and cyber attacks)
- Our ability to renew or refinance credit facilities
- Our ability to maintain sufficient liquidity
- The ultimate outcome of income tax audits, tax settlement initiatives or other tax matters

- Our ability to utilize income tax attributes, the benefits of which have been recognized under the more-likely-than-not recognition criteria
- Environmental matters (such as those requiring compliance with emission and discharge standards for existing and new facilities)
- Government laws and regulations and possible changes therein
- The ultimate resolution of pending litigation
- Possible future litigation.

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

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**Results of operations**

***Quarter ended June 30, 2013 compared to the quarter ended June 30, 2012***

| | Three months ended June 30, | | | |
|---|---|---|---|---|
| | 2012 | | 2013 | |
| | (Dollars in millions) | | | |
| Net sales | $ 545.3 | 100% | **$ 481.1** | **100%** |
| Cost of sales | 382.0 | 70 | **471.5** | **98** |
| Gross margin | 163.3 | 30 | **9.6** | **2** |
| Other operating income and expense, net | 52.7 | 10 | **57.3** | **12** |
| Income (loss) from operations | $ 110.6 | 20% | **$ (47.7)** | **(10)%** |

| | | | % Change |
|---|---|---|---|
| $TiO_2$ operating statistics: | | | |
| Sales volumes* | 123 | **144** | **17%** |
| Production volumes* | 118 | **124** | **5%** |
| Percentage change in net sales: | | | |
| $TiO_2$ product pricing | | | **(24)%** |
| $TiO_2$ sales volumes | | | **17** |
| $TiO_2$ product mix | | | **(5)** |
| Changes in currency exchange rates | | | |
| Total | | | **(12)%** |

* Thousands of metric tons

*Current industry conditions* - In May 2013, we announced price increases for our $TiO_2$ products in all of our markets, implementation of which began in June 2013. As a result, after about a year of decreasing selling prices within the $TiO_2$ industry, our selling prices have generally stabilized, with increases in some accounts. Our average selling prices at the end of the second quarter of 2013 were 1% lower than at the end of the first quarter of 2013, and were 8% lower than at the end of 2012. Demand for $TiO_2$ products has increased in the second quarter, primarily in European and export markets, as customers have generally depleted their inventories during the second half of 2012 and the first quarter of 2013 in response to general global economic uncertainty.

While we operated our production facilities at full practical capacity rates in the first quarter of 2012, we operated our facilities at reduced rates during the remainder of 2012 (approximately 86% of practical capacity in the second quarter, approximately 71% in the third quarter and approximately 80% in the fourth quarter) to align production levels and inventories to current and anticipated near-term customer demand levels. We continued to operate our production facilities at reduced capacity rates in the first half of 2013 (approximately 92% of practical capacity in the first quarter and approximately 90% in the second quarter).

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We experienced significantly higher costs for our raw materials such as third party feedstock ore and petroleum coke in 2012. We operate two ilmenite mines in Norway, the production from which provides all of the feedstock for our European sulfate process facilities as well as third party ilmenite ore sales. Overall, the cost per metric ton of $TiO_2$ we produced during 2012 was approximately 50% higher as compared to 2011, primarily due to the higher feedstock ore costs procured from third parties and unabsorbed fixed production costs resulting from reduced production volumes. However, as a substantial portion of the $TiO_2$ products we sold in the first half of 2012 was produced with lower-cost feedstock ore purchased in 2011, our cost of sales per metric ton in the first quarter of 2012 (and to a lesser-extent the second quarter of 2012) was significantly lower as compared to the cost per metric ton for products we sold in the third and fourth quarters of 2012. We have seen some moderation in the cost of $TiO_2$ feedstock ore procured from third parties in 2013, but such reductions will not be fully reflected in our cost of sales until the second half of 2013. Consequently, our cost of sales per metric ton of $TiO_2$ sold in the first half of 2013 (particularly in the first quarter) was significantly higher than what we expect our cost of sales per metric ton of $TiO_2$ to be in the remainder of 2013, as a substantial portion of the $TiO_2$ products we sold in the first quarter (and to a lesser-extent the second quarter) of 2013 was produced with the higher-cost feedstock ore procured in 2012.

*Net sales* - Net sales in the second quarter of 2013 decreased 12%, or $64.2 million, compared to the second quarter of 2012 primarily due to the net effects of a 24% decrease in average $TiO_2$ selling prices (which decreased net sales by approximately $131 million) and a 17% increase in sales volumes (which increased net sales by approximately $93 million). $TiO_2$ selling prices will increase or decrease generally as a result of competitive market pressures, changes in the relative level of supply and demand as well as changes in raw material and other manufacturing costs.

Our sales volumes increased 17% in the second quarter of 2013 as compared to the second quarter of 2012 due to higher customer demand, primarily in European and certain export markets. In addition, we estimate the unfavorable effect of changes in currency exchange rates decreased our net sales by approximately $3 million as compared to the second quarter of 2012.

*Cost of sales* - Cost of sales increased $89.5 million or 23% in the second quarter of 2013 compared to 2012 due to the net impact of higher raw material costs of approximately $26 million (primarily feedstock ore), a 17% increase in sales volumes, a 5% increase in $TiO_2$ production volumes and currency fluctuations (primarily the euro). Our cost of sales per metric ton of $TiO_2$ sold in the second quarter of 2013 was somewhat higher than $TiO_2$ sold in the second quarter of 2012, as a portion of the $TiO_2$ products we sold in the second quarter of 2012 was produced with lower-cost feedstock ore purchased in 2011, while a portion of the $TiO_2$ products we sold in the second quarter of 2013 was produced with higher-cost feedstock ore purchased in 2012. Overall and as discussed above, the cost per metric ton of $TiO_2$ we produced during 2012 was approximately 50% higher as compared to 2011, primarily due to the higher feedstock ore costs and unabsorbed fixed production costs resulting from reduced production volumes. Cost of sales as a percentage of net sales increased to 98% in the second quarter of 2013 compared to 70% in the same period of 2012 primarily due to the effects of lower average selling prices and higher raw materials costs, as discussed and quantified above.

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Unionized employees in our Canadian $TiO_2$ production facility are covered by a collective bargaining agreement that expired June 15, 2013. The Canadian facility represents approximately 19% of our worldwide $TiO_2$ production capacity. The union employees represented by the Confederation des Syndicat National (CSN) rejected our revised global offer, and we declared a lockout of unionized employees upon the expiration of the existing contract. As of the date of this report, no agreement has been reached with the CSN and the unionized employees remain locked out. We are currently operating our Canadian plant at approximately 15% of the plant s capacity with non-union management employees, and have implemented a strategy to reduce the financial impact of operating the plant during the lockout. We currently expect minimal interruptions in meeting customer demand, as orders are being filled with inventory on hand or through production from our other facilities. There is no assurance that we will be able to reach an agreement with the CSN on the terms of a new collective bargaining agreement, or reach an agreement on terms that will not have a material adverse effect on our results of operations.

*Gross margin and income (loss) from operations* - Income (loss) from operations decreased by $158.3 million from income of $110.6 million in the second quarter of 2012 to a loss of $47.7 million in the second quarter of 2013. Income (loss) from operations as a percentage of net sales decreased to (10)% in the second quarter of 2013 from 20% in the same period of 2012. This decrease was driven by the decline in gross margin, which decreased to 2% for the second quarter of 2013 compared to 30% for the second quarter of 2012. As discussed and quantified above, our gross margin has decreased primarily due to the net effects of lower selling prices, higher manufacturing costs (primarily raw materials), higher sales volumes and higher production volumes. Additionally, changes in currency exchange rates have negatively affected our gross margin and income from operations. We estimate that changes in currency exchange rates decreased income from operations by approximately $2 million in the second quarter of 2013 as compared to the same period in 2012.

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

Interest expense decreased $1.0 million from $6.7 million in the second quarter of 2012 to $5.7 million in the second quarter of 2013 primarily due to lower average debt levels in 2013.

Interest and dividend income decreased $1.7 million to $.3 million in the second quarter of 2013 primarily due to lower balances available for investment, principally related to our loan to Valhi which was completely repaid in December 2012. Interest income on our loan to Valhi was $1.7 million in the second quarter of 2012.

*Income tax provision (benefit)* - We recognized an income tax benefit of $19.2 million in the second quarter of 2013 compared to an income tax provision of $34.2 million in the same period last year. This difference is primarily due to our decreased earnings. See Note 8 to our Condensed Consolidated Financial Statements.

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We have substantial net operating loss carryforwards in Germany (the equivalent of $744 million and $100 million for German corporate and trade tax purposes, respectively, at December 31, 2012). At June 30, 2013, we have concluded that no deferred income tax asset valuation allowance is required to be recognized with respect to such carryforwards, principally because (i) such carryforwards have an indefinite carryforward period, (ii) we have utilized a portion of such carryforwards during the most recent three-year period and (iii) we currently expect to utilize the remainder of such carryforwards over the long term. However, prior to the complete utilization of such carryforwards, particularly if we were to generate losses in our German operations for an extended period of time, it is possible that we might conclude the benefit of such carryforwards would no longer meet the more-likely-than-not recognition criteria, at which point we would be required to recognize a valuation allowance against some or all of the then-remaining tax benefit associated with the carryforwards.

***Six months ended June 30, 2013 compared to the six months ended June 30, 2012***

| | Six months ended June 30, | | | |
|---|---|---|---|---|
| | 2012 | | 2013 | |
| | (Dollars in millions) | | | |
| Net sales | $ 1,106.6 | 100% | **$ 944.7** | **100%** |
| Cost of sales | 681.8 | 62 | **931.2** | **99** |
| Gross margin | 424.8 | 38 | **13.5** | **1** |
| Other operating income and expense, net | 104.8 | 9 | **108.1** | **11** |
| Income (loss) from operations | $ 320.0 | 29% | **$ (94.6)** | **(10)%** |

| | 2012 | 2013 | % Change |
|---|---|---|---|
| $TiO_2$ operating statistics: | | | |
| Sales volumes* | 253 | **276** | **9%** |
| Production volumes* | 258 | **246** | **(5)%** |
| Percentage change in net sales: | | | |
| $TiO_2$ product pricing | | | **(22)%** |
| $TiO_2$ sales volumes | | | **9** |
| $TiO_2$ product mix | | | **(2)** |
| Changes in currency exchange rates | | | |
| Total | | | **(15)%** |

* Thousands of metric tons

*Net sales* - Net sales in the six months ended June 30, 2013 decreased 15%, or $161.9 million, compared to the six months ended June 30, 2012 primarily due to the net effects of a 22% decrease in average $TiO_2$ selling prices (which decreased net sales by approximately $243 million) and a 9% increase in sales volumes (which increased net sales by approximately $100 million). $TiO_2$ selling prices will increase or decrease generally as a result of competitive market pressures, changes in the relative level of supply and demand as well as changes in raw material and other manufacturing costs.

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Our sales volumes increased 9% in the first six months of 2013 as compared to the first six months of 2012 due to increased customer demand, primarily in European and certain export markets partially offset by decreased demand in North American markets. Our sales volumes in the first six months of 2013 were a new record for a first-half year for us. We estimate the unfavorable effect of changes in currency exchange rates decreased our net sales by approximately $2 million as compared to the first six months of 2012.

*Cost of sales* - Cost of sales increased $249.4 million or 37% in the six months ended June 30, 2013 compared to this same period in 2012 due to the net impact of higher raw material costs of approximately $136 million (primarily feedstock ore), a 9% increase in sales volumes, a 5% decrease in $TiO_2$ production volumes and currency fluctuations (primarily the euro). Our cost of sales per metric ton of $TiO_2$ sold in the first half of 2013 was significantly higher than $TiO_2$ sold in the first half of 2012, as a substantial portion of the $TiO_2$ products we sold in the first quarter of 2012 (and a portion of the $TiO_2$ products we sold in the second quarter of 2012) was produced with lower-cost feedstock ore purchased in 2011, while a substantial portion of the $TiO_2$ products we sold in the first quarter of 2013 (and a portion of the $TiO_2$ products we sold in the second quarter of 2013) was produced with higher-cost feedstock ore purchased in 2012. Overall, and as discussed above, the cost per metric ton of $TiO_2$ we produced during 2012 was approximately 50% higher as compared to 2011, primarily due to the higher feedstock ore costs and unabsorbed fixed production costs resulting from reduced production volumes. Cost of sales as a percentage of net sales increased to 99% in the first six months of 2013 compared to 62% in the same period of 2012 primarily due to the effects of higher raw materials costs as discussed above and a 5% decrease in $TiO_2$ production volumes.

*Gross margin and income (loss) from operations* - Income (loss) from operations decreased by $414.6 million from income of $320.0 million in the first six months of 2012 to a loss of $94.6 million in the first six months of 2013. Income (loss) from operations as a percentage of net sales decreased to (10)% in the first six months of 2013 from 29% in the same period of 2012. This decrease was driven by the decline in gross margin, which decreased to 1% for the first six months of 2013 compared to 38% for the same period in 2012. As discussed and quantified above, our gross margin has decreased primarily due to the net effects of lower selling prices, higher manufacturing costs (primarily raw materials), higher sales volumes and lower production volumes. Additionally, changes in currency exchange rates have negatively affected our gross margin and income from operations. We estimate that changes in currency exchange rates decreased income from operations by approximately $8 million in the first six months of 2013 as compared to the same period in 2012.

*Other non-operating expense* - We recognized an aggregate $6.6 million pre-tax charge, consisting of the write-off of unamortized original issue discount costs and deferred financing costs, in the first quarter of 2013 related to the voluntary prepayment of $290 million of our term loan. See Note 7 to our Condensed Consolidated Financial Statements.

As discussed above, we recognized an aggregate $7.2 million pre-tax charge in the second quarter of 2012 related to the early extinguishment of our remaining Senior Secured Notes.

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Interest expense decreased $.9 million from $13.0 million in the six months ended June 30, 2012 to $12.1 million in the six months ended June 30, 2013 primarily due to lower average debt levels in 2013.

Interest and dividend income decreased $3.7 million to $.6 million in the six months ended June 30, 2013 primarily due to lower balances available for investment, principally related to our loan to Valhi which was completely repaid in December 2012. Interest income on our loan to Valhi was $3.4 million in the six months ended June 30, 2012.

*Income tax provision (benefit)* - We recognized an income tax benefit of $37.7 million in the first six months of 2013 compared to an income tax provision of $102.7 million in the same period last year. This difference is primarily due to our decreased earnings. See Note 8 to our Condensed Consolidated Financial Statements for a tabular reconciliation of our statutory income tax provision to our actual tax provision.

**Effects of Currency Exchange Rates**

We have substantial operations and assets located outside the United States (primarily in Germany, Belgium, Norway and Canada). The majority of our sales from non-U.S. operations are denominated in currencies other than the U.S. dollar, principally the euro, other major European currencies and the Canadian dollar. A portion of our sales generated from our non-U.S. operations is denominated in the U.S. dollar. Certain raw materials used worldwide, primarily titanium-containing feedstocks, are purchased in U.S. dollars, while labor and other production costs are purchased primarily in local currencies. Consequently, the translated U.S. dollar value of our non-U.S. sales and operating results are subject to currency exchange rate fluctuations which may favorably or unfavorably impact reported earnings and may affect the comparability of period-to-period operating results. In addition to the impact of the translation of sales and expenses over time, our non-U.S. operations also generate currency transaction gains and losses which primarily relate to the difference between the currency exchange rates in effect when non-local currency sales or operating costs are initially accrued and when such amounts are settled with the non-local currency.

Overall, we estimate that fluctuations in currency exchange rates had the following effects on our sales and income from operations for the periods indicated.

**Impact of changes in currency exchange rates**