VALHI INC /DE/
Form 10-Q
May 08, 2006

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarter ended March 31, 2006 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

Indicate by check mark:

Whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes 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 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 .

Number of shares of the Registrant's common stock outstanding on April 28, 2006: 115,703,678.

VALHI, INC. AND SUBSIDIARIES

INDEX

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

VALHI, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands)

ASSETS	December 31, 2005
Current assets:	
Cash and cash equivalents	$ 274,963
Restricted cash equivalents	6,007
Marketable securities	11,755
Accounts and other receivables, net	218,766
Refundable income taxes	1,489
Receivable from affiliates	34
Inventories, net	283,157
Prepaid expenses	9,981
Deferred income taxes	10,502
Total current assets	816,654
Other assets:	
Marketable securities	258,705
Investment in affiliates	270,632
Unrecognized net pension obligations	11,916
Prepaid pension cost	3,529
Goodwill	361,783
Other intangible assets	3,432
Deferred income taxes	213,726
Other	61,639
Total other assets	1,185,362
Property and equipment:	
Land	37,876
Buildings	220,110
Equipment	827,690
Mining properties	19,969
Construction in progress	15,771
	1,121,416
Less accumulated depreciation	545,055

Net property and equipment	576,361
Total assets	$2,578,377

VALHI, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS (CONTINUED)

(In thousands)

LIABILITIES AND STOCKHOLDERS' EQUITY	December 31, 2005
Current liabilities:	
Current maturities of long-term debt	$ 1,615
Accounts payable	105,650
Accrued liabilities	129,429
Payable to affiliates	13,754
Income taxes	24,680
Deferred income taxes	4,313
Total current liabilities	279,441
Noncurrent liabilities:	
Long-term debt	715,820
Accrued pension costs	140,742
Accrued OPEB costs	32,279
Accrued environmental costs	49,161
Deferred income taxes	400,964
Other	39,328
Total noncurrent liabilities	1,378,294
Minority interest	125,049
Stockholders' equity:	
Common stock	1,207
Additional paid-in capital	108,810
Retained earnings	786,268
Accumulated other comprehensive income:	
Marketable securities	4,194
Currency translation	11,157
Pension liabilities	(78,101)
Treasury stock	(37,942)

Total stockholders' equity	795,593
Total liabilities, minority interest and stockholders' equity	$2,578,377

Commitments and contingencies (Notes 11 and 13)

See accompanying Notes to Condensed Consolidated Financial Statements.

VALHI, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

Three months ended March 31, 2005 and 2006

(In thousands, except per share data)

(Unaudited)

	2005
Revenues and other income:	
Net sales	$341,247
Other income, net	26,637
Equity in earnings of:	
Titanium Metals Corporation ("TIMET")	16,801
Other	112
Total revenues and other income	384,797
Costs and expenses:	
Cost of sales	251,982
Selling, general and administrative	54,431
Interest	17,879
Total costs and expenses	324,292
Income before income taxes	60,505
Provision for income taxes	29,946

Minority interest in after-tax earnings	5,497
Income from continuing operations	25,062
Discontinued operations, net of tax	(272)
Net income	$ 24,790
Basic and diluted earnings per share:	
Income from continuing operations	$ .21
Discontinued operations	-
Net income	$ .21
Cash dividends per share	$ .10
Shares used in the calculation of per share amounts:	
Basic earnings per common share	120,223
Dilutive impact of outstanding stock options	349
Diluted earnings per share	120,572

See accompanying Notes to Condensed Consolidated Financial Statements.

VALHI, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

Three months ended March 31, 2005 and 2006

(In thousands)

(Unaudited)

	2005
Net income	$24,790
Other comprehensive income (loss), net of tax:	
Marketable securities adjustment	(168)
Currency translation adjustment	(11)

Total other comprehensive income (loss), net	(179)

Comprehensive income	$24,611
	=======

See accompanying Notes to Condensed Consolidated Financial Statements.

VALHI, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

Three months ended March 31, 2005 and 2006

(In thousands)

(Unaudited)

	20
	--
Cash flows from operating activities:	
Net income	$ 24
Depreciation and amortization	19
Goodwill impairment	
Securities transactions, net	(14
Benefit plan expense less then cash funding:	
Defined benefit pension expense	(1
Other postretirement benefit expense	
Deferred income taxes:	
Continuing operations	20
Discontinued operations	
Minority interest:	
Continuing operations	5
Discontinued operations	
Other, net	
Equity in:	
TIMET	(16
Other	
Net distributions from (contributions to):	
Manufacturing joint venture	
Other	
Change in assets and liabilities:	
Accounts and other receivables	(44
Inventories	(14
Accounts payable and accrued liabilities	12
Accounts with affiliates	
Income taxes	7
Other, net	(8

Net cash used in operating activities	(10

Cash flows from investing activities:	
Capital expenditures	(12
Purchases of:	
Kronos common stock	
CompX common stock	
TIMET common stock	(11
Marketable securities	(12
Proceeds from disposal of:	
Business unit	18
Kronos common stock	19
Marketable securities	2
Loans to affiliate:	
Loans	(11
Collections	10
Cash of disposed business unit	(4
Change in restricted cash equivalents, net	2
Other, net	

Net cash provided by (used in) investing activities	1

VALHI, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)

Three months ended March 31, 2005 and 2006

(In thousands)

(Unaudited)

	2005

Cash flows from financing activities:	
Indebtedness:	
Borrowings	$ -
Principal payments	(82)
Deferred financing costs paid	(28)
Valhi dividends paid	(12,424)
Distributions to minority interest	(1,477)
Treasury stock acquired	-
NL common stock issued	2,413
Issuance of Valhi common stock and other, net	742

Net cash provided by (used in) financing activities	(10,856)

Cash and cash equivalents - net change from:	
Operating, investing and financing activities	(19,948)

Currency translation	(280)
Cash and equivalents at beginning of period	267,829
Cash and equivalents at end of period	$247,601
Supplemental disclosures:	
Cash paid (received) for:	
Interest, net of amounts capitalized	$ 6,224
Income taxes, net	6,117
Noncash investing activity - note receivable received upon disposal of business unit	$ 4,179

See accompanying Notes to Condensed Consolidated Financial Statements.

VALHI, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

Three months ended March 31, 2006

(In thousands)

(Unaudited)

				Accumulated other comprehensive i		
	Common stock	Additional paid-in capital	Retained earnings	Marketable securities	Currency translation	Pens liabil
Balance at December 31, 2005	$1,207	$108,810	$786,268	$4,194	$11,157	$(78,
Net income	-	-	22,864	-	-	-
Dividends	-	-	(12,060)	-	-	-
Other comprehensive income (loss), net	-	-	-	(113)	3,314	
Treasury stock:						
Acquired	-	-	-	-	-	-
Retired	(3)	(248)	(4,651)	-	-	
Other, net	1	17	-	-	-	-
Balance at March 31, 2006	$1,205	$108,579	$792,421	$ 4,081	$14,471	$(78,

See accompanying Notes to Condensed Consolidated Financial Statements.

VALHI, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2006

(Unaudited)

Note 1 - Organization and basis of presentation:

The Condensed Consolidated Balance Sheet of Valhi, Inc. and Subsidiaries (collectively, the "Company") at December 31, 2005 has been derived from the Company's audited Condensed Consolidated Financial Statements at that date. The Consolidated Balance Sheet at March 31, 2006, and the Condensed Consolidated Statements of Income, Comprehensive Income, Stockholders' Equity and Cash Flows for the interim periods ended March 31, 2005 and 2006, have been prepared by the Company, without audit, in accordance with accounting principles generally accepted in the United States of America ("GAAP"). In the opinion of management, all adjustments, consisting only of normal recurring adjustments, necessary to state fairly the consolidated financial position, results of operations and cash flows have been made. As permitted by regulations of the SEC, the Condensed Consolidated Balance Sheet data as of December 31, 2005 does not include all disclosures required by GAAP.

The results of operations for the interim periods are not necessarily indicative of the operating results for a full year or of future operations. Certain information normally included in financial statements prepared in accordance with GAAP has been condensed or omitted. The accompanying Condensed Consolidated Financial Statements should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended December 31, 2005, as filed with the Securities and Exchange Commission on March 24, 2006 (the "2005 Annual Report").

Contran Corporation holds, directly or through subsidiaries, approximately 92% of Valhi's outstanding common stock at March 31, 2006. 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 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.

Note 2 - Business segment information:

Business segment	Entity	% owned by Valhi at March 31, 2006
Chemicals	Kronos Worldwide, Inc.	95%
Component products	CompX International Inc.	70%
Waste management	Waste Control Specialists LLC	100%
Titanium metals	TIMET	37%

The Company's ownership of Kronos includes 59% held directly by Valhi and 36% held directly by NL Industries, Inc., an 83%-owned subsidiary of Valhi. During the first quarter of 2006, Valhi purchased approximately 829,000 shares of Kronos common stock in market transactions for an aggregate of $22.4 million.

The acquisition of these shares of common stock were accounted for by the purchase method (step acquisition).

The Company's ownership of CompX is principally held directly by CompX Group, Inc, a majority-owned subsidiary of NL. NL owns 82.4% of CompX Group, and TIMET owns the remaining 17.6% of CompX Group. CompX Group's sole asset consists of shares of CompX common stock representing approximately 83% of the total number of CompX shares outstanding, and the percentage ownership of CompX shown above includes NL's ownership interest in CompX Group multiplied by CompX Group's ownership interest in CompX, or 68%. NL also owns an additional 2% of CompX directly. During the first quarter of 2006, NL purchased approximately 26,500 shares of CompX common stock in market transactions for an aggregate of $404,000. The acquisition of these shares of common stock were accounted for by the purchase method (step acquisition).

The company's ownership of TIMET includes 33% owned directly by Tremont LLC, a wholly-owned subsidiary of the Company, and 4% owned directly by Valhi. In addition, TIMET owns directly an additional 3% of CompX, .5% of NL and less than .1% of Kronos, and TIMET accounts for such CompX, NL and Kronos shares, as well as its shares of CompX Group, as available-for-sale marketable securities carried at fair value. The Combined Master Retirement Trust ("CMRT"), a collective investment trust sponsored by Contran to permit the collective investment by certain master trusts which fund certain employee benefits plans sponsored by Contran and certain of its affiliates, owned an additional 10% of TIMET's outstanding common stock at March 31, 2006. Because the Company does not consolidate either TIMET or the CMRT, the shares of CompX Group, CompX, NL and Kronos owned by TIMET, and the shares of TIMET held by the CMRT, are not considered as part of the Company's investments in such companies.

Kronos (NYSE: KRO), NL (NYSE: NL), CompX (NYSE: CIX) and TIMET (NYSE: TIE) each file periodic reports with the Securities and Exchange Commission ("SEC") pursuant to the Securities Exchange Act of 1934, as amended.

	Three mo Ma 2005 (In m
Net sales:	
Chemicals	$291.9
Component products	46.8
Waste management	2.5
Total net sales	$341.2
Operating income:	
Chemicals	$ 43.6
Component products	4.1
Waste management	(2.8)
Total operating income	44.9
Equity in:	
TIMET	16.8
Other	.1

General corporate items:	
Interest and dividend income	10.2
Securities transaction gains, net	14.6
Insurance recoveries	-
General expenses, net	(8.2)
Interest expense	(17.9)
Income before income taxes	$ 60.5

Segment results reported herein may differ from amounts separately reported by the Company's various subsidiaries and affiliates due to purchase accounting adjustments and related amortization or differences in the way the Company defines operating income.

Note 3 - Marketable securities:

	December 31, 2005
	(In thousa
Current assets (available for sale):	
Restricted debt securities	$ 9,265
Other debt securities	2,490
Total	$ 11,755
Noncurrent assets (available-for-sale):	
The Amalgamated Sugar Company LLC	$250,000
Restricted debt securities	2,572
Other debt securities and common stocks	6,133
Total	$258,705

Note 4 - Accounts and other receivables, net:

	December 31, 2005

	(In thousa
Accounts receivable	$211,156
Notes receivable	4,267
Accrued interest and dividends receivable	6,158
Allowance for doubtful accounts	(2,815)
Total	$218,766

Note 5 - Inventories, net:

	December 31, 2005
	(In thousa
Raw materials:	
Chemicals	$ 52,343
Component products	7,022
Total raw materials	59,365
In-process products:	
Chemicals	17,959
Component products	9,898
Total in-process products	27,857
Finished products:	
Chemicals	150,675
Component products	5,542
Total finished products	156,217
Supplies (primarily chemicals)	39,718
Total inventories, net	$283,157

Note 6 - Accrued liabilities:

	December 31, 2005
	(In thousa
Current:	
Employee benefits	$ 48,341
Environmental costs	16,565
Deferred income	5,101
Interest	1,067
Other	58,355
Total	$129,429
Noncurrent:	
Insurance claims and expenses	$ 24,257
Employee benefits	4,998
Asset retirement obligations	1,381
Deferred income	573
Other	8,119
Total	$ 39,328

Note 7 - Other assets:

	December 31, 2005
	(In thousa
Investment in affiliates:	
TIMET:	
Common stock	$138,677
Preferred stock	183
	138,860
TiO2 manufacturing joint venture	115,308
Other	16,464
Total	$270,632
Other noncurrent assets:	
IBNR receivables	$ 16,735
Deferred financing costs	8,278
Waste disposal site operating permits, net	14,133
Loans and other receivables	2,502

Restricted cash equivalents	382
Other	19,609
Total	$ 61,639

At March 31, 2006, the Company held 28.0 million shares of TIMET with a quoted market price of $48.55 per share, or an aggregate market value of $1.4 billion. In February 2006, TIMET effected a 2:1 split of its common stock. Such stock split had no financial statement impact to the Company, and the Company's ownership interest in TIMET did not change as a result of such split.

At March 31, 2006, TIMET reported total assets of $989.9 million and stockholders' equity of $639.2 million. TIMET's total assets at March 31, 2006 include current assets of $619.7 million, property and equipment of $262.9 million, marketable securities of $46.1 million and investment in joint ventures of $28.6 million. TIMET's total liabilities at March 31, 2006 include current liabilities of $180.2 million, accrued OPEB and pension costs aggregating $74.9 million and long-term debt of $48.8 million. During the first quarter of 2006, TIMET reported net sales of $286.9 million, operating income of $95.1 million and net income attributable to common stockholders of $56.8 million (2005 - net sales of $155.2 million, operating income of $19.4 million and net income attributable to common stockholders of $38.1 million).

Note 8 - Other income, net:

	Three m M 2005 (In tho
Securities earnings:	
Dividends and interest	$10,175
Securities transactions, net	14,607
Total securities earnings	24,782
Currency transactions, net	874
Insurance recoveries	-
Other, net	981
Total other income, net	$26,637

Note 9 - Long-term debt:

	December 31, 2005

	(In thousa
Valhi - Snake River Sugar Company	$250,000
Subsidiaries:	
Kronos International 8.875% Senior Secured Notes	449,298
Kronos U.S. bank credit facility	11,500
Kronos Canadian bank credit facility	-
Other	6,637
Total debt of subsidiaries	467,435
Total debt	717,435
Less current maturities	1,615
Total long-term debt	$715,820

During the first quarter of 2006, Kronos borrowed an aggregate of Cdn. $5.0 million ($4.3 million) under its Canadian revolving credit facility, and also borrowed an additional net $18.3 million under its U.S. bank credit facility.

In April 2006, Kronos' wholly owned subsidiary, Kronos International, called all of its 8.875% Senior Secured Notes for redemption on May 11, 2006 at 104.437%% of their aggregate principal amount of euro 375 million (including such call premium, an aggregate of $470.2 million at March 31, 2006 exchange rates). Funds for such redemption were provided by Kronos International's issuance of an aggregate of euro 400 million principal amount of 6.5% Senior Secured Notes due April 2013, issued on April 11, 2006 at 99.306% of their principal amount. The new Senior Secured Notes were issued pursuant to an indenture that contains covenants, restrictions and collateral substantially identical to the covenants, restrictions and collateral of the 8.875% Senior Secured Notes. The Company expects to recognize a $21 million pre-tax charge in the second quarter of 2006 related to the early extinguishment of KII's 8.875% Senior Secured Notes, consisting of the call premium on such Notes and the net write-off of deferred financing costs and existing unamortized premium related to such Notes.

Note 10 - Accounts with affiliates:

	December 31, 2005
	(In thousa
Current receivables from affiliates:	
Contran - income taxes, net	$ 33
Other	1
Total	$ 34

Payables to affiliates:	
Louisiana Pigment Company	$ 9,803
Contran - trade items	3,940
Other, net	11
Total	$13,754

Note 11 - Provision for income taxes:

	Three mon Marc 2005 (In mil
Expected tax expense	$21.2
Incremental U.S. tax and rate differences on equity in earnings	4.8
Non-U.S. tax rates	-
Nondeductible expenses	1.2
Adjustment of prior year income taxes, net	-
Income tax on distribution of shares of Kronos common stock	.7
Excess of book basis over tax basis of shares of Kronos common stock sold	1.6
U.S. state income taxes, net	.3
Other, net	.1
	$29.9
Comprehensive provision for income taxes (benefit) allocated to:	
Income from continuing operations	$29.9
Discontinued operations	(.4)
Other comprehensive income:	
Marketable securities	.9
Currency translation	(.2)
	$30.2

Certain of the Company's U.S. and non-U.S. tax returns are being examined and tax authorities have or may propose tax deficiencies, including penalties and interest. For example:

- o Kronos received a preliminary tax assessment related to 1993 from the

Belgian tax authorities proposing tax deficiencies, including related interest, of approximately euro 6 million ($7 million at March 31, 2006). Kronos filed a protest to this assessment, and believes that a significant portion of the assessment is without merit. The Belgian tax authorities have filed a lien on the fixed assets of Kronos' Belgian TiO2 operations in connection with this assessment.

- The Norwegian tax authorities have notified Kronos of their intent to assess tax deficiencies of approximately kroner 12 million ($2 million) relating to the years 1998 through 2000. Kronos has objected to this proposed assessment.

No assurance can be given that these tax matters will be resolved in the Company's favor in view of the inherent uncertainties involved in settlement initiatives and court and tax proceedings. The Company believes that it has provided adequate accruals for additional taxes and related interest expense which may ultimately result from all such examinations and believes that the ultimate disposition of such examinations should not have a material adverse effect on its consolidated financial position, results of operations or liquidity.

Note 12 - Minority interest:

	December 31, 2005	
		(In thousa
Minority interest in net assets:		
NL Industries	$ 51,177	
Kronos Worldwide	28,167	
CompX International	45,630	
Subsidiary of Kronos	75	
Total	$125,049	

	Three mon Marc 2005	
		(In tho
Minority interest in net earnings - Continuing operations:		
NL Industries	$3,228	
Kronos Worldwide	1,534	
CompX International	701	
Subsidiary of Kronos	4	
Subsidiary of NL	30	
Total	$5,497	

Note 13 - Commitments and contingencies:

Lead pigment litigation - NL.

NL's former operations included the manufacture of lead pigments for use in paint and lead-based paint. NL, other former manufacturers of lead pigments for use in paint and lead-based paint, and the Lead Industries Association (which discontinued business operations prior to 2005) have been named as defendants in various legal proceedings seeking damages for personal injury, property damage and governmental expenditures allegedly caused by the use of lead-based paints. Certain of these actions have been filed by or on behalf of states, large U.S. cities or their public housing authorities and school districts, and certain others have been asserted as class actions. These lawsuits seek recovery under a variety of theories, including public and private nuisance, negligent product design, negligent failure to warn, strict liability, breach of warranty, conspiracy/concert of action, aiding and abetting, enterprise liability, market share or risk contribution liability, intentional tort, fraud and misrepresentation, violations of state consumer protection statutes, supplier negligence and similar claims.

The plaintiffs in these actions generally seek to impose on the defendants responsibility for lead paint abatement and health concerns associated with the use of lead-based paints, including damages for personal injury, contribution and/or indemnification for medical expenses, medical monitoring expenses and costs for educational programs. A number of cases are inactive or have been dismissed or withdrawn. Most of the remaining cases are in various pre-trial stages. Some are on appeal following dismissal or summary judgment rulings in favor of either the defendants or the plaintiffs. In addition, various other cases are pending (in which NL is not a defendant) seeking recovery for injuries allegedly caused by lead pigment and lead-based paint. Although NL is not a defendant in these cases, the outcome of these cases may have an impact on additional cases being filed against NL in the future.

NL believes these actions are without merit, intends to continue to deny all allegations of wrongdoing and liability and to defend against all actions vigorously. NL has never settled any of these cases, nor have any final adverse judgments against NL been entered. NL has not accrued any amounts for pending lead pigment and lead-based paint litigation. Liability that may result, if any, cannot currently be reasonably estimated. There can be no assurance that NL will not incur liability in the future in respect of this pending litigation in view of the inherent uncertainties involved in court and jury rulings in pending and possible future cases. If any such future liability were to be incurred, it could have a material adverse effect on the Company's consolidated financial statements, results of operations and liquidity.

In one of these lead pigment cases (State of Rhode Island v. Lead Industries Association), a trial before a Rhode Island state court jury began in September 2002 on the question of whether lead pigment in paint on Rhode Island buildings is a public nuisance. In October 2002, the trial judge declared a mistrial in the case when the jury was unable to reach a verdict on the question, with the jury reportedly deadlocked 4-2 in the defendants' favor. In November 2005, the State of Rhode Island began a retrial of the case on the State's claims of public nuisance, indemnity and unjust enrichment against NL and three other defendants. Following the State's presentation of its case, the trial court dismissed the State's claims of indemnity and unjust enrichment. The public nuisance claim was sent to the jury in February 2006, and the jury found that NL and two other defendants substantially contributed to the creation of a public nuisance as a result of the collective presence of lead pigments in paints and coatings on buildings in Rhode Island. The jury also found that NL and the two other defendants should be ordered to abate the public nuisance. Following the jury verdict, the trial court dismissed the State's claim for punitive damages. A hearing on the abatement remedy will be held before the judge. The extent, nature and cost of such remedy is not currently known, and will be determined only following additional preceedings. Various matters remain pending before the trial court, including NL's motion to dismiss. NL intends to appeal any adverse judgment which the trial court may enter against NL.

The Rhode Island case is unique in that this is the first time that an adverse verdict has been entered against NL. Given the number of meritorious issues which NL believes can be appealed in this case, NL currently believes that it is not probable that NL will ultimately be found liable in this matter. In addition, liability that might result to NL, if any, with respect to this and the other lead pigment litigation can not currently be reasonably estimated. However, legal proceedings are subject to inherent uncertainties, and there is no assurance that any appeal would be successful. Therefore, it is reasonably possible that NL would in the near term conclude that it was probable NL had incurred some liability in this Rhode Island matter that would result in the recognition of a loss contingency accrual. Such potential liability could have a material adverse impact on net income for the interim or annual period during which such liability is recognized, and a material adverse impact on the Company's financial condition and liquidity. Various other cases in which NL is a defendant are also pending in other jurisdictions, and new cases could be filed against NL, the resolution of which could also result in recognition of a loss contingency accrual that could have a material adverse impact on net income for the interim or annual period during which such liability is recognized, and a material adverse impact on the Company's financial condition and liquidity. An estimate of the potential impact on the Company's results of operations, financial condition or liquidity related to these matters can not currently be reasonably estimated.

Environmental matters and litigation.

General. The Company's operations are governed by various environmental laws and regulations. Certain of the Company's businesses are and have been engaged in the handling, manufacture or use of substances or compounds that may be considered toxic or hazardous within the meaning of applicable environmental laws and regulations. As with other companies engaged in similar businesses, certain past and current operations and products of the Company have the potential to cause environmental or other damage. The Company has implemented and continues to implement various policies and programs in an effort to minimize these risks. The Company's policy is to maintain compliance with applicable environmental laws and regulations at all of its plants and to strive to improve its environmental performance. From time to time, the Company may be subject to environmental regulatory enforcement under U.S. and foreign statutes, resolution of which typically involves the establishment of compliance programs. It is possible that future developments, such as stricter requirements of environmental laws and enforcement policies thereunder, could adversely affect the Company's production, handling, use, storage, transportation, sale or disposal of such substances. The Company believes all of its plants are in substantial compliance with applicable environmental laws.

Certain properties and facilities used in the Company's former businesses, including divested primary and secondary lead smelters and former mining locations of NL, are the subject of civil litigation, administrative proceedings or investigations arising under federal and state environmental laws. Additionally, in connection with past disposal practices, the Company has been named as a defendant, potentially responsible party ("PRP") or both, pursuant to the Comprehensive Environmental Response, Compensation and Liability Act, as amended by the Superfund Amendments and Reauthorization Act ("CERCLA"), and similar state laws in various governmental and private actions associated with waste disposal sites, mining locations, and facilities currently or previously owned, operated or used by the Company or its subsidiaries, or their predecessors, certain of which are on the U.S. EPA's Superfund National Priorities List or similar state lists. These proceedings seek cleanup costs, damages for personal injury or property damage and/or damages for injury to natural resources. Certain of these proceedings involve claims for substantial amounts. Although the Company may be jointly and severally liable for such costs, in most cases it is only one of a number of PRPs who may also be jointly and severally liable.

Environmental obligations are difficult to assess and estimate for numerous reasons including the complexity and differing interpretations of governmental regulations, the number of PRPs and the PRPs' ability or willingness to fund such allocation of costs, their financial capabilities and the allocation of costs among PRPs, the solvency of other PRPs, the multiplicity of possible solutions, and the years of investigatory, remedial and monitoring activity required. In addition, the imposition of more stringent standards or requirements under environmental laws or regulations, new developments or changes respecting site cleanup costs or allocation of such costs among PRPs, solvency of other PRPs, the results of future testing and analysis undertaken with respect to certain sites or a determination that the Company is potentially responsible for the release of hazardous substances at other sites, could result in expenditures in excess of amounts currently estimated by the Company to be required for such matters. In addition, with respect to other PRPs and the fact that the Company may be jointly and severally liable for the total remediation cost at certain sites, the Company could ultimately be liable for amounts in excess of its accruals due to, among other things, reallocation of costs among PRPs or the insolvency of one or more PRPs. No assurance can be given that actual costs will not exceed accrued amounts or the upper end of the range for sites for which estimates have been made, and no assurance can be given that costs will not be incurred with respect to sites as to which no estimate presently can be made. Further, there can be no assurance that additional environmental matters will not arise in the future. If any such future liability were to be incurred, it could have a material adverse effect on the Company's consolidated financial statements, results of operations and liquidity.

The Company records liabilities related to environmental remediation obligations when estimated future expenditures are probable and reasonably estimable. Such accruals are adjusted as further information becomes available or circumstances change. Estimated future expenditures are generally not discounted to their present value. Recoveries of remediation costs from other parties, if any, are recognized as assets when their receipt is deemed probable. At March 31, 2006, no receivables for such recoveries had been recognized.

The exact time frame over which the Company makes payments with respect to its accrued environmental costs is unknown and is dependent upon, among other things, the timing of the actual remediation process that in part depends on factors outside the control of the Company. At each balance sheet date, the Company makes an estimate of the amount of its accrued environmental costs that will be paid out over the subsequent 12 months, and the Company classifies such amount as a current liability. The remainder of the accrued environmental costs is classified as a noncurrent liability.

A summary of the activity in the Company's accrued environmental costs during the first quarter of 2006 is presented in the table below.

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Balance at the beginning of the period	
Additions charged to expense, net	
Payments, net	
Balance at the end of the period	
Amounts recognized in the balance sheet at the end of the period:	
Current liability	
Noncurrent liability	
Total	

NL. On a quarterly basis, NL evaluates the potential range of its liability at sites where it has been named as a PRP or defendant. At March 31, 2006, NL had accrued $52.9 million for those environmental matters which NL believes are reasonably estimable. NL believes it is not possible to estimate the range of costs for certain sites. The upper end of the range of reasonably possible costs to NL for sites for which NL believes it is possible to estimate costs is approximately $79 million. NL's estimates of such liabilities have not been discounted to present value.

At March 31, 2006, there are approximately 20 sites for which NL is unable to estimate a range of costs. For these sites, generally the investigation is in the early stages, and it is either unknown as to whether or not NL actually had any association with the site, or if NL had association with the site, the nature of its responsibility, if any, for the contamination at the site and the extent of contamination. The timing on when information would become available to NL to allow NL to estimate a range of loss is unknown and dependent on events outside the control of NL, such as when the party alleging liability provides information to NL. On certain of these sites that had previously been inactive, NL has received general and special notices of liability from the EPA alleging that NL, along with other PRPs, is liable for past and future costs of remediating environmental contamination allegedly caused by former operations conducted at such sites. These notifications may assert that NL, along with other PRPs, is liable for past clean-up costs that could be material to NL if liability for such amounts ultimately were determined against NL.

Tremont. Prior to 2005, Tremont, entered into a voluntary settlement agreement with the Arkansas Department of Environmental Quality and certain other PRPs pursuant to which Tremont and the other PRPs will undertake certain investigatory and interim remedial activities at a former mining site located in Hot Springs County, Arkansas. Tremont had entered into an agreement with another PRP for this site, Halliburton Energy Services, Inc., that provides for, among other things, the interim sharing of remediation costs associated with the site pending a final allocation of costs and an agreed-upon procedure through arbitration to determine such final allocation of costs. On December 9, 2005, Halliburton and DII Industries, LLC, another PRP of this site, filed suit in the United States District Court for the Southern District of Texas, Houston Division, Case No. H-05-4160, against NL, Tremont and certain of its subsidiaries, M-I, L.L.C., Milwhite, Inc. and Georgia-Pacific Corporation seeking (i) to recover response and remediation costs incurred at the site, (ii) a declaration of the parties' liability for response and remediation costs incurred at the site, (iii) a declaration of the parties' liability for response and remediation costs to be incurred in the future at the site and (iv) a declaration regarding the obligation of Tremont to indemnify Halliburton and DII for costs and expenses attributable to the site. On December 27, 2005, a subsidiary of Tremont filed suit in the United States District Court for the Western District of Arkansas, Hot Springs Division, Case No. 05-6089, against Georgia-Pacific, seeking to recover response costs it has incurred and will incur at the site. Subsequently, plaintiffs in the Houston litigation agreed to stay that litigation by entering into with NL, Tremont and its affiliates an amendment to the arbitration agreement previously agreed upon for resolving the allocation of costs at the site. Tremont has also agreed with Georgia Pacific to stay the Arkansas litigation pending further developments in the Houston litigation. Tremont has based its accrual for this site based upon the agreed-upon interim cost sharing allocation. Tremont currently expects that the nature and extent of any final remediation measures that might be imposed with respect to this site will not be known until 2008. Currently, no reasonable estimate can be made of the cost of any such final remediation measures, and accordingly Tremont has accrued no amounts at March 31, 2006 for any such cost. The amount accrued at March 31, 2006 ($3.6 million) represents Tremont's estimate of the probable and reasonably estimable costs to be incurred through 2008 with respect to the interim remediation measures.

TIMET. At March 31, 2006, TIMET had accrued approximately $3.0 million for environmental cleanup matters, principally related to TIMET's facility in Nevada. The upper end of the range of reasonably possible costs related to these matters is approximately $5.2 million.

Other. The Company has also accrued approximately $7.5 million at March 31, 2006 in respect of other environmental cleanup matters. Such accrual is near the upper end of the range of the Company's estimate of reasonably possible costs for such matters.

Other litigation.

Reference is made to the 2005 Annual Report for a discussion of certain other legal proceedings to which the Company is a party.

NL has been named as a defendant in various lawsuits in a variety of jurisdictions, alleging personal injuries as a result of occupational exposure primarily to products manufactured by formerly-owned operations of NL containing asbestos, silica and/or mixed dust. Approximately 500 of these types of cases remain pending, involving a total of approximately 10,600 plaintiffs and their spouses following the administrative dismissal by a trial court in Ohio of approximately 1,500 plaintiffs in March 2006. NL has not accrued any amounts for this litigation because liability that NL might incur, if any, cannot currently be reasonably estimated. To date, NL has not been adjudicated liable in any of these matters. Based on information available to NL, including facts concerning its historical operations, the rate of new claims, the number of claims from which NL has been dismissed and NL's prior experience in the defense of these matters, NL believes that the range of reasonably possible outcomes of these matters will be consistent with NL's historical costs with respect to these matters (which are not material), and no reasonably possible outcome is expected to involve amounts that are material to NL. NL has and will continue to vigorously seek dismissal from each claim and/or a finding of no liability by NL in each case. In addition, from time to time, NL has received notices regarding asbestos or silica claims purporting to be brought against former subsidiaries of NL, including notices provided to insurers with which NL has entered into settlements extinguishing certain insurance policies. These insurers may seek indemnification from NL.

In April 2006, NL was served with a complaint in Murphy, et al. v. NL Industries, Inc., et al. (United States District Court, District of New Jersey, Case No. 2:06-cv-01535-WHW-SDW). The plaintiffs, three former minority shareholders of NL Environmental Management Services, Inc. ("EMS"), seek damages related to their equity investment in EMS. The defendants named in the complaint are Contran, Valhi, NL, EMS and certain current or former officers or directors of NL or EMS. EMS was formed in 1988 as a majority-owned environmental management subsidiary that contractually assumed certain of NL's environmental liabilities. In June 2005, EMS received notices from the three minority shareholders indicating that they were exercising their right, which became exercisable on June 1, 2005, to require EMS to purchase their preferred shares in EMS as of June 30, 2005 for a formula-determined amount as provided in EMS' certificate of incorporation. In accordance with the certificate of incorporation, EMS made a determination in good faith of the amount payable to the three former minority shareholders to purchase their shares of EMS stock. In June 2005 EMS set aside funds as payment for the shares of EMS. As of March 2006, however, the shareholders had not tendered their shares or received any of such funds. The plaintiffs claim that, in preparing the valuation of the plaintiffs' preferred shares for purchase by EMS, the defendants engaged in a pattern of racketeering activity and conspired to conduct a pattern of racketeering in violation of United States and New Jersey laws. In addition, the plaintiffs allege that the defendants have committed minority shareholder oppression, fraud, breach of fiduciary duty, civil conspiracy, aiding and abetting fraud, aiding and abetting breach of fiduciary duty, breach of contract and tortuous interference with economic relations under New Jersey laws. The defendants believe that these claims are without merit and intend to deny all allegations of wrongdoing and liability and to defend against all such claims vigorously.

In addition to the litigation described above, the Company and its affiliates are also involved in various other environmental, contractual, product liability, patent (or intellectual property), employment and other claims and disputes incidental to its present and former businesses. In certain cases, the Company has insurance coverage for such items, although the Company does not currently expect any additional material insurance coverage for its environmental claims.

The Company currently believes that the disposition of all claims and disputes, individually or in the aggregate, should not have a material adverse effect on its consolidated financial position, results of operations and liquidity beyond the accruals already provided for.

Insurance coverage claims.

Reference is made to the 2005 Annual Report for a discussion of certain litigation involving NL and certain of its former insurance carriers. Additional information regarding such litigation, or new litigation, is below.

OneBeacon American Insurance Company v. NL Industries, Inc., et. al. (Supreme Court of the State of New York, County of New York, Index No. 603429-05). In March 2006, NL's motion to dismiss was denied by the trial court. In April 2006, NL filed a notice of appeal of the trial court's ruling.

NL Industries, Inc. v. OneBeacon America Insurance Company, et. al. (District Court for Dallas County, Texas, Case No. 05-11347). In December 2005, NL filed a motion to remand the case to state court.

In February 2006, NL was served with a complaint in Certain Underwriters at Lloyds, London v. Millennium Holdings LLC et. al. (Supreme Court of the State of New York, County of New York, Index No. 06/60026). The plaintiff, a former insurance carrier of NL, seeks a declaratory judgment of its obligations to NL under insurance policies issued to NL by plaintiff with respect to certain lead pigment lawsuits. In April 2006, NL filed a motion to dismiss.

In April 2006, NL filed an action against American Re Insurance Company and certain other former insurance companies, captioned NL Industries, Inc. v. American Re Insurance Company, et. al. (Dallas County Court at Law, Texas, Case No. CC-06-04523-E) asserting that American Re Insurance and the other named defendants have breached their obligations to NL under such insurance policies and seeking a declaratory judgment of each defendant's obligations to NL under such policies.

The issue of whether insurance coverage for defense costs or indemnity or both will be found to exist for NL's lead pigment litigation depends upon a variety of factors, and there can be no assurance that such insurance coverage will be available. NL has not considered any potential insurance revoceries for lead pigment or environmental litigation matters in determining related accruals.

Note 14 - Employee benefit plans:

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

	Three months March 3
	2005
	(In thousa
Service cost	$ 1,987
Interest cost	5,803
Expected return on plan assets	(5,744)
Amortization of prior service cost	154
Amortization of net transition obligations	140
Recognized actuarial losses	1,150
Total	$ 3,490

Postretirement benefits other than pensions. The components of net periodic OPEB cost are presented in the table below.

	Three months March 3
	2005
	(In thousa
Service cost	$ 55
Interest cost	483
Amortization of prior service credit	(232)
Recognized actuarial losses (gains)	(142)
Total	$ 164

Contributions. Contributions the Company expects to contribute to its various defined benefit pension and OPEB plans in 2006 are disclosed in the 2005 Annual Report.

Note 15 - Discontinued operations, net of tax:

Discontinued operations relates to CompX's former Thomas Regout operations in The Netherlands. In January 2005, CompX completed the sale of such operations for net proceeds that were approximately $860,000 less than previously estimated (primarily due to higher expenses associated with the disposal of the Thomas Regout operations).Discontinued operations in the first quarter of 2005 includes a charge related to such higher expenses($272,000, net of income tax benefit and minority interest).

Note 16 - Accounting principles newly adopted in 2006:

Inventory costs. The Company adopted Statement of Financial Accounting Standards ("SFAS") No. 151, Inventory Costs, an amendment of ARB No. 43, Chapter 4, on January 1, 2006 for inventory costs incurred on or after such date. SFAS No. 151 requires that the allocation of fixed production overhead costs to inventory shall be based on normal capacity. Normal capacity is not defined as a fixed amount; rather, normal capacity refers to a range of production levels expected to be achieved over a number of periods under normal circumstances, taking into account the loss of capacity resulting from planned maintenance shutdowns. The amount of fixed overhead allocated to each unit of production is not increased as a consequence of idle plant or production levels below the low end of normal capacity, but instead a portion of fixed overhead costs is charged to expense as incurred. Alternatively, in periods of production above the high end of normal capacity, the amount of fixed overhead costs allocated to each unit of production is decreased so that inventories are not measured above cost. SFAS No. 151 also clarifies existing GAAP to require that abnormal freight and wasted materials (spoilage) are to be expensed as incurred. The Company's production cost accounting had already complied with the requirements of SFAS No. 151, and therefore adoption of SFAS No. 151 did not have an effect on its consolidated financial statements.

Stock options. As permitted by regulations of the SEC, the Company adopted SFAS No. 123R, Share-Based Payment, as of January 1, 2006. SFAS No. 123R, among other things, eliminates the alternative in existing GAAP to use the intrinsic value method of accounting for stock-based employee compensation under Accounting Principles Board Opinion ("APBO") No. 25, Accounting for Stock Issued to Employees. The Company is now generally required to recognize the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award, with the cost recognized over the period during which an employee is required to provide services in exchange for the award (generally, the vesting period of the award). No compensation cost will be recognized in the aggregate for equity instruments for which the employee does not render the requisite service (generally, if the instrument is forfeited before it has vested). The grant-date fair value will be estimated using option-pricing models (e.g. Black-Sholes or a lattice model). Under the transition alternatives permitted under SFAS No. 123R, the Company will apply the new standard to all new awards granted on or after January 1, 2006, and to all awards existing as of December 31, 2005 which are subsequently modified, repurchased or cancelled (referred to as the modified prospective method in SFAS No. 123R). Additionally, as of January 1, 2006, the Company recognizes compensation cost previously measured under SFAS No. 123 for the portion of any non-vested award existing as of December 31, 2005 over the remaining vesting period. The number of non-vested awards as of December 31, 2005 with respect to options granted by Valhi and its subsidiaries and affiliates is not material, and therefore the effect of adopting SFAS No. 123R, in so far as it relates to the recognition of compensation cost for existing stock options in the Company's consolidated statements of income, did not have a material effect on the Company's Consolidated Financial Statements. Should Valhi or its subsidiaries and affiliates, however, either grant a significant number of options or modify, repurchase or cancel existing options in the future, the Company could in the future recognize material amounts of compensation cost related to such options in its consolidated financial statements.

Also upon adoption of SFAS No. 123R, the cash income tax benefit resulting from the exercise of stock options in excess of the cumulative income tax benefit related to such options previously recognized for GAAP financial reporting purposes in the Company's consolidated statements of income, if any, will be reflected as a cash inflow from financing activities in the Company's consolidated statements of cash flows, and the Company's cash flows from operating activities will reflect the effect of cash paid for income taxes exclusive of such cash income tax benefit. The aggregate amount of such income tax benefits recognized as a component of cash flows from financing activities was not significant in the first quarter of 2006.

SFAS No. 123R also requires certain expanded disclosures regarding the Company's stock options, and such expanded disclosures were provided in the 2005 Annual Report.

Prior to January 1, 2006, the Company accounted for stock-based employee compensation in accordance with APBO No. 25 and its various interpretations. Under APBO No. 25, no compensation cost was generally recognized for fixed stock options in which the exercise price was greater than or equal to the market price on the grant date. Prior to 2005, and following the cash settlement of certain stock options held by employees of NL, NL and the Company commenced accounting for NL's remaining stock options using the variable accounting method because NL could not overcome the presumption that it would not similarly cash settle its remaining stock options. Under the variable accounting method, the intrinsic value of all unexercised stock options (including those with an exercise price at least equal to the market price on the date of grant) are accrued as an expense over their vesting period, with subsequent increases (decreases) in the market price of the underlying common stock resulting in additional compensation expense (income). Following adoption of SFAS No. 123R effective January 1, 2006, the Company will continue to account for NL's remaining stock options in a manner similar to the variable accounting method of APBO No. 25, as required by the guidance of SFAS No. 123R.

Net compensation expense related to stock-based employee compensation recognized by the Company was approximately $120,000 in the first quarter of 2005, and net compensation income was approximately $600,000 in the first quarter of 2006. Had Valhi and its subsidiaries and affiliates accounted for their respective stock-based employee compensation related to stock options in accordance with the fair value-based recognition provisions of SFAS No. 123R for all awards granted subsequent to January 1, 1995, the effect on the Company's results of operations in the first quarter of 2005 there would not have been a material effect on the Company's results of operations in the first quarter of 2005.

Note 17 - Stockholders' equity:

In March 2005, the Company's board of directors authorized the repurchase of up to 5.0 million shares of Valhi's common stock in open market transactions, including block purchases, or in privately negotiated transactions, which may include transactions with affiliates of Valhi. The stock may be purchased from time to time as market conditions permit. The stock repurchase program does not include specific price targets or timetables and may be suspended at any time.

Depending on market conditions, the program could be terminated prior to completion. The Company will use its cash on hand to acquire the shares. Repurchased shares will be retired and cancelled or may be added to Valhi's treasury and used for employee benefit plans, future acquisitions or other corporate purposes.

During the first quarter of 2006, the Company purchased an aggregate of 275,000 shares of its common stock in market transactions for an aggregate of $4.9 million. At March 31, 2006, these treasury shares had been cancelled, and the aggregate $4.9 million cost of such treasury shares cancelled was allocated to common stock at par value, additional paid-in capital and retained earnings in accordance with GAAP. As of March 31, 2006, 1.2 million shares were available for purchases under such authorization.

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

RESULTS OF OPERATIONS

General

The Company reported income from continuing operations of $22.9 million, or $.20 per diluted share, in the first quarter of 2006 compared to income of $25.1 million, or $.21 per diluted share, in the first quarter of 2005.

The decrease in the Company's diluted earnings per share from the first quarter of 2005 to the first quarter of 2006 is due primarily to the net effects of (i) lower chemicals operating income at Kronos in 2006, (ii) higher component products operating income at CompX in 2006, (iii) certain securities transaction gains realized in the first quarter of 2005, (iv) certain income tax benefits recognized by TIMET in 2005 and (v) higher operating income for TIMET in 2006. The Company currently believes its net income in calendar 2006 will be lower than 2005 due primarily to lower expected chemicals operating income.

Income from continuing operations in the first quarter of 2006 includes income of $.01 per diluted share related to certain insurance recoveries of NL. Income from continuing operations in the first quarter of 2005 include (i) certain securities transaction gains of NL of $.05 per diluted share and (ii) income related to certain income benefits recognized by TIMET of $.07 per diluted share. Such amounts are more fully described below or in the 2005 Annual Report.

As provided by the safe harbor provisions of the Private Securities Litigation Reform Act of 1995, the Company cautions that the statements in this Quarterly Report on Form 10-Q relating to matters that are not historical facts, 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 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 Quarterly Report and those described from time to time in the Company's other filings with the SEC including, but not limited to, the following:

- Future supply and demand for the Company's products,
- 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),
- The cyclicality of certain of the Company's businesses (such as Kronos' TiO_2 operations and TIMET's titanium metals operations),
- 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),
- Customer inventory levels (such as the extent to which Kronos' customers may, from time to time, accelerate purchases of TiO_2 in advance of anticipated price increases or defer purchases of TiO_2 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),
- Changes in raw material and other operating costs (such as energy costs),
- The possibility of labor disruptions,
- General global economic and political conditions (such as changes in the level of gross domestic product in various regions of the world and the impact of such changes on demand for, among other things, TiO_2),
- Competitive products and substitute products,
- Possible disruption of business or increases in the cost of doing business resulting from terrorist activities or global conflicts,
- Customer and competitor strategies,
- The impact of pricing and production decisions,
- Competitive technology positions,
- The introduction of trade barriers,
- Fluctuations in currency exchange rates (such as changes in the exchange rate between the U.S. dollar and each of the euro, the Norwegian kroner and the Canadian dollar),
- Operating interruptions (including, but not limited to, labor disputes, leaks, natural disasters, fires, explosions, unscheduled or unplanned downtime and transportation interruptions),
- The timing and amounts of insurance recoveries,
- The ability of the Company to renew or refinance credit facilities,
- Uncertainties associated with new product development (such as TIMET's ability to develop new end-uses for its titanium products),
- The ultimate outcome of income tax audits, tax settlement initiatives or other tax matters,
- 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),
- 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

Relative changes in Kronos' TiO2 sales and operating income during the 2005 and 2006 periods presented are primarily due to (i) relative changes in TiO2 sales and production volumes, (ii) relative changes in TiO2 average selling prices and (iii) relative changes in foreign currency exchange rates. Selling prices (in billing currencies) for TiO2, Kronos' principal product, were generally: increasing in the first six months of 2005, decreasing during the second half of 2005 and increasing during the first quarter of 2006.

	Three months ended March 31, 2005	Three months ended March 31, 2006
	(In $ millions)	
Net sales	$291.9	$304.
Operating income	43.6	32.
Ti02 operating statistics:		
Sales volumes*	114	12
Production volumes*	122	12
Percent change in Ti02 average selling prices:		
Using actual foreign currency exchange rates -3% Impact of changes in foreign currency exchange rates		

In billing currencies

* Thousands of metric tons

Kronos' sales increased $12.4 million (4%) in the first quarter of 2006 as compared to the first quarter of 2005 due to the net effects of higher average TiO2 selling prices, higher TiO2 sales volumes and the unfavorable net effect of fluctuations in foreign currency exchange rates, which decreased chemicals sales by approximately $16 million, as further discussed below. Excluding the effect of fluctuations in the value of the U.S. dollar relative to other currencies, Kronos' average TiO2 selling prices in billing currencies in the first quarter of 2006 were 2% higher as compared to the first quarter of 2005. When translated from billing currencies to U.S. dollars using actual foreign currency exchange rates prevailing during the respective periods, Kronos' average TiO2 selling prices in the first quarter of 2006 were 3% lower compared to the first quarter of 2005.

Kronos' sales are denominated in various currencies, including the U.S. dollar, the euro, other major European currencies and the Canadian dollar. The disclosure of the percentage change in Kronos' average TiO2 selling prices in billing currencies (which excludes the effects of fluctuations in the value of the U.S. dollar relative to other currencies) is considered a "non-GAAP" financial measure under regulations of the SEC. The disclosure of the percentage change in Kronos' average TiO2 selling prices using actual foreign currency exchange rates prevailing during the respective periods is considered the most directly comparable financial measure presented in accordance with GAAP ("GAAP measure"). Kronos discloses percentage changes in its average TiO2 prices in billing currencies because Kronos believes such disclosure provides useful information to investors to allow them to analyze such changes without the impact of changes in foreign currency exchange rates, thereby facilitating period-to-period comparisons of the relative changes in average selling prices in the actual various billing currencies. Generally, when the U.S. dollar either strengthens or weakens against other currencies, the percentage change in average selling prices in billing currencies will be higher or lower, respectively, than such percentage changes would be using actual exchange rates prevailing during the respective periods. The difference between the 3% decrease in Kronos' average TiO2 selling prices during the first quarter of 2006 as compared to the first quarter of 2005 using actual foreign currency exchange rates prevailing during the respective periods (the GAAP measure), and the 2% increase in Kronos' average TiO2 selling prices in billing currencies (the non-GAAP measure) during such periods is due to the effect of changes in foreign currency exchange rates. The above table presents in a tabular format (i) the percentage change in Kronos' average TiO2 selling prices using actual foreign currency exchange rates prevailing during the respective periods (the GAAP measure), (ii) the percentage change in Kronos' average TiO2 selling prices in billing currencies (the non-GAAP measure) and (iii) the percentage change due to changes in foreign currency exchange rates (or the reconciling item between the non-GAAP measure and the GAAP measure).

Kronos' TiO2 sales volumes in the first quarter of 2005 increased 9% compared to the first quarter of 2005, due primarily to higher sales volumes in the United States and slightly higher sales volumes in Europe and in export markets offsetting the effect of lower sales volumes in Canada. Demand for TiO2 has remained strong in the first quarter of 2006, and while Kronos believes that the strong demand is largely attributable to the end-use demand of its customers, it is possible that some portion of the strong demand resulted from customers increasing their inventory levels in advance of implementation of announced or anticipated price increases. Kronos' operating income comparisons were favorably impacted by higher production levels, which increased 4% in the first quarter of 2006 as compared to the same period in 2005. Kronos' operating rates were near full capacity in both periods, and Kronos' sales and production volumes in the first quarter of 2006 were new records for Kronos for a first quarter. Kronos' operating income comparisons were negatively impacted by higher raw material and other operating costs (including energy).

Kronos has substantial operations and assets located outside the United States (primarily in Germany, Belgium, Norway and Canada). A significant amount of Kronos' sales generated from its non-U.S. operations are denominated in currencies other than the U.S. dollar, principally the euro, other major European currencies and the Canadian dollar. A portion of Kronos' sales generated from its non-U.S. operations are denominated in the U.S. dollar. Certain raw materials, primarily titanium-containing feedstocks, are purchased in U.S. dollars, while labor and other production costs are denominated primarily in local currencies. Consequently, the translated U.S. dollar value of Kronos' foreign sales and operating results are subject to currency exchange rate fluctuations which may favorably or adversely impact reported earnings and may affect the comparability of period-to-period operating results. Overall, fluctuations in the value of the U.S. dollar relative to other currencies, primarily the euro, decreased TiO_2 sales by a net $16 million in the first quarter of 2006 as compared to the first quarter of 2005. Fluctuations in the value of the U.S. dollar relative to other currencies similarly impacted Kronos' foreign currency-denominated operating expenses. Kronos' operating costs that are not denominated in the U.S. dollar, when translated into U.S. dollars, were lower in the first quarter of 2006 as compared to the same period in 2005. Overall, currency exchange rate fluctuations resulted in a net $5 million decrease in Kronos' operating income in the first quarter of 2006 as compared to the first quarter of 2005.

On September 22, 2005, the chloride-process TiO_2 facility operated by Kronos' 50%-owned joint venture, Louisiana Pigment Company ("LPC"), temporarily halted production due to Hurricane Rita. Although storm damage to core processing facilities was not extensive, a variety of factors, including loss of utilities, limited access and availability of employees and raw materials, prevented the resumption of partial operations until October 9, 2005 and full operations until late 2005. The joint venture expects the majority of its property damage and unabsorbed fixed costs for periods in which normal production levels were not achieved will be covered by insurance, and Kronos believes insurance will cover its lost profits (subject to applicable deductibles) resulting from its share of the lost production from LPC. Insurance proceeds from the lost profit for product that Kronos was not able to sell as a result of the loss of production from LPC are expected to be recognized by Kronos during the remainder of 2006, although the amount and timing of such insurance recoveries is not presently determinable. The effect on Kronos' financial results will depend on the timing and amount of insurance recoveries.

Kronos' efforts to debottleneck its production facilities to meet long-term demand continue to prove successful. Such debottlenecking efforts included, among other things, the addition of finishing capacity in the German chloride-process facility and equipment upgrades and enhancements in several locations to allow for reduced downtime for maintenance activities. 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 additional capacity expected to be available in 2007 through its continued debottlenecking efforts.

Kronos expects its operating income in 2006 will continue to be somewhat lower than 2005. Kronos' expectations as to the future prospects of Kronos and the TiO_2 industry are based upon a number of factors beyond Kronos' control, including worldwide growth of gross domestic product, competition in the marketplace, unexpected or earlier-than-expected capacity additions and technological advances. If actual developments differ from Kronos' expectations, Kronos' results of operations could be unfavorably affected.

Chemicals operating income, as presented above, is stated net of amortization of Valhi's purchase accounting adjustments made in conjunction with its acquisitions of its interest in NL and Kronos. Such adjustments result in additional depreciation and amortization expense beyond amounts separately reported by Kronos. Such additional non-cash expenses reduced chemicals operating income, as reported by Valhi, by $4.4 million in the first quarter of 2005 and $4.0 million in the first quarter of 2006.

Component products

	Three months ended March 31, 2005	200
	(In millions)	
Net sales	$46.8	$47.
Operating income	4.1	5.

Component product sales increased slightly in the first quarter of 2006 as compared to the same quarter of 2005 as higher volumes of security product sales were offset by decreases in sales for certain other products resulting from increased competition. Sales comparisons were also positively impacted by volumes associated with an acquisition of a small components products business in August 2005. Component products operating income increased due to the favorable impact of CompX's continued focus on reducing costs across all segments and a favorable change in product mix resulting from increases in sales of certain higher margin security products.

CompX has substantial operations and assets located outside the United States in Canada and Taiwan. A portion of CompX's sales generated from its non-U.S. operations are denominated in currencies other than the U.S. dollar, principally the Canadian dollar and the New Taiwan dollar. In addition, a portion of CompX's sales generated from its non-U.S. operations (principally in Canada) are denominated in the U.S. dollar. Most raw materials, labor and other production costs for such non-U.S. operations are denominated primarily in local currencies. Consequently, the translated U.S. dollar values of CompX's foreign sales and operating results are subject to currency exchange rate fluctuations which may favorably or unfavorably impact reported earnings and may affect comparability of period-to-period operating results. During the first quarter of 2006, currency exchange rate fluctuations did not have a significant effect on compon