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NL INDUSTRIES INC  
Form 10-Q/A  
October 31, 2003

NL INDUSTRIES, INC.

Form 10-Q

For the quarter ended June 30, 2003

SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q/A-1

X QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934 - For the quarterly period ended June 30, 2003

OR

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

Commission file number 1-640

NL INDUSTRIES, INC.

(Exact name of registrant as specified in its charter)

New Jersey  
(State or other jurisdiction of  
incorporation or organization)

13-5267260  
(IRS Employer  
Identification No.)

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

75240-2697  
(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, and (2) has been subject to such filing requirements for the past 90 days. Yes X No

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2). Yes X No

Number of shares of common stock outstanding on July 25, 2003: 47,700,784

This Amendment No. 1 to the Quarterly Report on Form 10-Q for the quarter ended June 30, 2003 of NL Industries, Inc. is filed to revise certain disclosures, and

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reclassify the Company's Consolidated Statement of Income, as requested by the Securities and Exchange Commission. There was no impact on net income as a result of the reclassification of the Consolidated Statement of Income. The revised disclosures are primarily contained in "Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources" and the Company's Consolidated Financial Statements. This Amendment is being filed solely to provide the information referenced above. For the convenience of the reader, the Company is re-filing the entire Quarterly Report as clarified. No other modifications have been made to the Quarterly Report except as described above.

### NL INDUSTRIES, INC. AND SUBSIDIARIES

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### NL INDUSTRIES, INC. AND SUBSIDIARIES

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## CONSOLIDATED BALANCE SHEETS

(In thousands)

ASSETS	June 30, 2003
	-----
Current assets:	
Cash and cash equivalents	\$ 54,360
Restricted cash equivalents	25,349
Restricted marketable debt securities	10,676
Accounts and other receivable	182,196
Receivable from affiliates	148
Refundable income taxes	25,607
Inventories	199,760
Prepaid expenses	4,518
Deferred income taxes	10,929
	-----
Total current assets	513,543
	-----
Other assets:	
Marketable equity securities	45,431
Receivable from affiliate	16,000
Investment in TiO2 manufacturing joint venture	129,209
Prepaid pension cost	17,209
Restricted marketable debt securities	3,099
Other	27,320
	-----
Total other assets	238,268
	-----
Property and equipment:	
Land	31,908
Buildings	165,655
Machinery and equipment	694,995
Mining properties	82,596
Construction in progress	14,600
	-----
	989,754
Less accumulated depreciation and depletion	585,060
	-----
Net property and equipment	404,694
	-----
	\$ 1,156,505
	=====

NL INDUSTRIES, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS (CONTINUED)

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(In thousands)

LIABILITIES AND SHAREHOLDERS' EQUITY	June 30, 2003
	-----
Current liabilities:	
Current maturities of long-term debt	\$ 781
Accounts payable and accrued liabilities	150,549
Payable to affiliates	10,817
Accrued environmental costs	21,198
Income taxes	6,170
Deferred income taxes	1,711
	-----
Total current liabilities	191,226
	-----
Noncurrent liabilities:	
Long-term debt	360,444
Deferred income taxes	146,324
Accrued environmental costs	66,636
Accrued pension cost	45,835
Accrued postretirement benefits cost	24,922
Other	13,954
	-----
Total noncurrent liabilities	658,115
	-----
Minority interest	8,713
	-----
Shareholders' equity:	
Common stock	8,355
Additional paid-in capital	777,819
Retained earnings	120,740
Accumulated other comprehensive loss	(172,458)
Treasury stock	(436,005)
	-----
Total shareholders' equity	298,451
	-----
	\$ 1,156,505
	=====

Commitments and contingencies (Notes 12 and 13)

NL INDUSTRIES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

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(In thousands, except per share data)

	Three months ended June 30,		Six mon Jun
	2003	2002	2003
Revenues and other income:			
Net sales	\$ 266,631	\$ 226,909	\$519,604
Cost of sales	197,649	176,247	386,066
Gross margin	68,982	50,662	133,538
Selling, general and administrative expense	30,975	24,898	60,354
Other operating income (expense):			
Currency transaction gains (losses), net	(2,743)	(2,049)	(3,841)
Disposition of property and equipment	1,116	643	1,055
Noncompete agreement income	-	1,000	333
Litigation settlement gains, net	650	435	650
Corporate expense	(23,202)	(7,491)	(38,517)
Other income	63	5	211
Income from operations	13,891	18,307	33,075
Other income (expense):			
Trade interest income	198	333	361
Other interest and dividend income	838	1,280	1,786
Securities gains (losses), net	218	(12)	2,452
Currency transaction gain	-	6,271	-
Interest expense	(8,367)	(8,078)	(16,352)
Income before income taxes and minority interest	6,778	18,101	21,322
Income tax benefit (expense)	22,191	(3,867)	17,101
Income before minority interest	28,969	14,234	38,423
Minority interest	134	186	158
Net income	\$ 28,835	\$ 14,048	\$ 38,265
Basic and diluted net income per share	\$ .60	\$ .29	\$ .80
Weighted average shares used in the calculation of net income per share:			
Basic	47,698	48,827	47,696

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Dilutive impact of stock options	57	126	54
	-----	-----	-----
Diluted	47,755	48,953	47,750
	=====	=====	=====

NL INDUSTRIES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In thousands)

	Three months ended June 30,		Six mo Ju
	2003	2002	2003
	-----	-----	-----
Net income	\$ 28,835	\$ 14,048	\$ 38,265
	-----	-----	-----
Other comprehensive income (loss), net of tax:			
Marketable securities adjustment:			
Unrealized holding (loss) gain arising			
during the period	(4,424)	4,652	2,669
Less reclassification adjustment for realized gain included in net income	-	-	(1,474)
	-----	-----	-----
	(4,424)	4,652	1,195
Currency translation adjustment	8,826	38,965	12,568
	-----	-----	-----
	-----	-----	-----
Total other comprehensive income	4,402	43,617	13,763
	-----	-----	-----
	-----	-----	-----
Comprehensive income	\$ 33,237	\$ 57,665	\$ 52,028
	=====	=====	=====

NL INDUSTRIES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY

Six months ended June 30, 2003

(In thousands)

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	Common stock	Additional paid-in capital	Retained earnings	Accumulated other comprehensive income	
				Currency translation	Pension liabilities
Balance at December 31, 2002	\$ 8,355	\$ 777,819	\$101,554	\$ (170,670)	\$ (21,447)
Net income	-	-	38,265	-	-
Other comprehensive income, net of tax	-	-	-	12,568	-
Dividends	-	-	(19,079)	-	-
Treasury stock - reissued	-	-	-	-	-
Balance at June 30, 2003	\$ 8,355	\$ 777,819	\$120,740	\$ (158,102)	\$ (21,447)

NL INDUSTRIES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

Six months ended June 30, 2003 and 2002

(In thousands)

	2003
Cash flows from operating activities:	
Net income	\$ 38,265
Depreciation, depletion and amortization	19,681
Deferred income taxes	(3,006)
Distributions from TiO2 manufacturing joint venture, net	800
Net (gains) losses from securities transactions	(2,452)
Other, net	(3,522)
Change in assets and liabilities:	
Accounts and other receivable	(37,409)
Insurance receivable	2,122
Inventories	25,301
Prepaid expenses	3,036
Accounts payable and accrued liabilities	(29,526)
Income taxes	(24,008)
Accrued environmental costs	25,990
Other, net	3,378
Net cash provided by operating activities	18,650
Cash flows from investing activities:	
Capital expenditures	(13,850)
Collection of loans to affiliates	2,000

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Acquisition of business	-
Change in restricted cash equivalents and restricted marketable debt securities, net	658
Other, net	1,538
	-----
Net cash used by investing activities	(9,654)
	-----

NL INDUSTRIES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)

Six months ended June 30, 2003 and 2002

(In thousands)

	2003
	-----
Cash flows from financing activities:	
Dividends paid	\$ (19,079)
Treasury stock:	
Purchased	-
Reissued	175
Indebtedness:	
Borrowings	16,106
Principal payments	(11,615)
Deferred financing costs	-
Other, net	-
	-----
Net cash (used) provided by financing activities	(14,413)
	-----
Cash and cash equivalents:	
Net change from:	
Operating, investing and financing activities	(5,417)
Currency translation	1,686
Acquisition of business	-
	-----
	(3,731)
Balance at beginning of period	58,091
	-----
Balance at end of period	\$ 54,360
	=====
Supplemental disclosures - cash paid for:	
Interest	\$ 16,347
Income taxes, net	7,627
Acquisition of business:	
Cash and cash equivalents	\$ -



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Restricted cash	-
Goodwill and other intangible assets	-
Other noncash assets	-
Liabilities	-
	-----
Cash paid	\$ -
	=====

NL INDUSTRIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 - Organization and basis of presentation:

NL Industries, Inc. ("NL") conducts its titanium dioxide pigments ("TiO2") operations through its wholly owned subsidiary, Kronos Worldwide, Inc. (formerly known as Kronos, Inc.) At June 30, 2003, Valhi, Inc., ("Valhi") and its subsidiaries held approximately 85% of NL's outstanding common stock, and Contran Corporation ("Contran") and its subsidiaries held approximately 90% of Valhi's outstanding common stock. Substantially all of Contran's outstanding voting stock is held by trusts established for the benefit of certain children and grandchildren of Harold C. Simmons, of which Mr. Simmons is sole trustee. Mr. Simmons, the Chairman of the Board and Chief Executive Officer of NL and the Chairman of the Board of each of Contran and Valhi, may be deemed to control each of such companies. See Notes 6 and 7.

The consolidated balance sheet of NL Industries, Inc. and Subsidiaries (collectively, the "Company") at December 31, 2002 has been condensed from the Company's audited consolidated financial statements at that date. The consolidated balance sheet at June 30, 2003 and the consolidated statements of income, comprehensive income, shareholders' equity and cash flows for the interim periods ended June 30, 2003 and 2002 have been prepared by the Company without audit. In the opinion of management all adjustments, consisting only of normal recurring adjustments, necessary to present fairly the consolidated financial position, results of operations and cash flows have been made. 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 and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles in the U.S. ("GAAP") have been condensed or omitted. Certain prior-year amounts have been reclassified to conform to the current year presentation. The accompanying consolidated financial statements should be read in conjunction with the consolidated financial statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2002 (the "2002 Annual Report").

The Company has elected the disclosure alternative prescribed by Statement of Financial Accounting Standards ("SFAS") No. 123, "Accounting for Stock-Based Compensation," as amended by SFAS No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure," and to account for its stock-based employee compensation related to stock options in accordance with Accounting Principles Board Opinion ("APBO") No. 25, "Accounting for Stock Issued to Employees," and its various interpretations. Under APBO No. 25, no compensation cost is generally recognized for fixed stock options in which the exercise price is not less than the market price on the grant date. During the fourth quarter of 2002, following the cash settlement of certain stock options held by

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employees of the Company, the Company commenced accounting for its remaining stock options using the variable accounting method, which requires 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) to be accrued as an expense, with subsequent increases (decreases) in the Company's market price resulting in additional compensation expense (income). Net compensation expense recognized by the Company in accordance with APBO No. 25 in the three and six months ended June 30, 2003 was \$.5 million and nil, respectively, and net compensation expense (income) recognized by the Company in the three and six months ended June 30, 2002 was nil for both periods.

The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of SFAS No. 123 to stock-based employee compensation.

	Three months ended June 30,		Six mo Ju
	2003	2002	2003
(In thousands, except per share am			
Net income - as reported	\$ 28,835	\$ 14,048	\$ 38,265
Add: Stock-based compensation cost, net of tax, included in reported net income	339	-	-
Deduct: Stock-based compensation cost, net of tax, determined under fair value based method for all awards	(121)	(271)	(241)
Net income - pro forma	\$ 29,053	\$ 13,777	\$ 38,024
Net income per basic common share:			
As reported	\$ .60	\$ .29	\$ .80
Pro forma	\$ .61	.28	\$ .80
Net income per diluted common share:			
As reported	\$ .60	\$ .29	\$ .80
Pro forma	\$ .61	\$ .28	\$ .80

The Company adopted SFAS No. 143, "Accounting for Asset Retirement Obligations," effective January 1, 2003. Under SFAS No. 143, the fair value of a liability for an asset retirement obligation covered under the scope of SFAS No. 143 is recognized in the period in which the liability is incurred, with an offsetting increase in the carrying amount of the related long-lived asset. Over time, the liability is accreted to its future value, and the capitalized cost is depreciated over the useful life of the related asset. Upon settlement of the liability, an entity would either settle the obligation for its recorded amount or incur a gain or loss upon settlement.

Under the transition provisions of SFAS No. 143, at the date of adoption on January 1, 2003 the Company recognized (i) an asset retirement cost capitalized as an increase to the carrying value of its property, plant and equipment, (ii) accumulated depreciation on such capitalized cost and (iii) a liability for the asset retirement obligation. Amounts resulting from the initial application of SFAS No. 143 were measured using information, assumptions and interest rates all as of January 1, 2003. The amount recognized as the asset retirement cost was measured as of the date the asset retirement obligation was incurred. Cumulative accretion on the asset retirement obligation, and accumulated depreciation on

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the asset retirement cost, were recognized for the time period from the date the asset retirement cost and liability would have been recognized had the provisions of SFAS No. 143 been in effect at the date the liability was incurred, through January 1, 2003. The difference between the amounts recognized as described above and the associated amounts recognized in the Company's balance sheet as of December 31, 2002 was recognized as a cumulative effect of change in accounting principle as of January 1, 2003. The effect of adopting SFAS No. 143 as of January 1, 2003, as summarized in the table below, did not have a material effect on the Company's consolidated financial position, results of operations or liquidity, and is not separately recognized in the accompanying statement of income.

Increase in carrying value of net property, plant and equipment:

Cost  
Accumulated depreciation  
Decrease in liabilities previously accrued for closure and post closure activities  
Asset retirement obligation recognized

Net impact

At June 30, 2003, the asset retirement obligation was approximately \$.7 million and was included in other noncurrent liabilities. Accretion expense on the asset retirement obligation during the first six months of 2003, included in cost of sales, was nil. If the Company had adopted SFAS No. 143 as of January 1, 2002, the asset retirement obligation would have been approximately \$.5 million at January 1, 2002 and \$.6 million at June 30, 2002, and the effect on the Company's reported net income for the six months ended June 30, 2002 would not have been material.

Note 2 - Earnings per share:

Basic earnings per share is based on the weighted average number of common shares outstanding during each period. Diluted earnings per share is based on the weighted average number of common shares outstanding and the dilutive impact of outstanding stock options.

Note 3 - Other (income) expense:

Operating items

The Company received a \$20 million fee as part of the sale of Rheox in January 1998 in payment for entering into a five-year covenant not to compete in the rheological products business. The Company amortized the fee to income using the straight-line method over the five-year noncompete period beginning January 30, 1998. The agreement became fully amortized in January 2003.

In all periods presented, the Company recognized litigation settlement gains with former insurance carrier groups to settle certain insurance coverage

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claims related to environmental remediation. Income related to these litigation settlement gains are recognized as part of income from operations because the related environmental remediation expense to which the recovery related are also recognized as a component of income from operations. No further material settlements relating to litigation concerning environmental remediation coverage are expected to be received.

Corporate expense include environmental, legal and other costs attributable to formerly owned business units, as well as certain administrative expenses (primarily legal, finance, accounting and tax). Corporate expense for the second quarter and first half of 2003 increased \$15.7 million and \$20.9 million, respectively, from comparable prior-year periods primarily due to higher environmental and legal expenses.

### Nonoperating items

Currency transaction gains in the second quarter of 2002 was a foreign currency transaction gain of \$6.3 million related to the extinguishment of certain intercompany indebtedness with Kronos International, Inc. ("KII"), a wholly-owned subsidiary of the Company.

### Note 4 - Accounts and other receivable:

	June 30, 2003
(In thou	
Trade receivables	\$ 174,914
Insurance claims receivable	436
Recoverable VAT and other receivables	9,437
Allowance for doubtful accounts	(2,591)
	\$ 182,196

### Note 5 - Inventories:

	June 30, 2003
(In thou	
Raw materials	\$ 34,641
Work in process	16,980
Finished products	114,731
Supplies	33,408
	\$ 199,760

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Note 6 - Marketable equity securities:

	June 30, 2003
(In thou	
Available-for-sale marketable equity securities:	
Valhi	\$ 45,302
Tremont Group	-
Tremont	-
Other	129
Aggregate fair value	\$ 45,431

In February 2003 Valhi completed a series of merger transactions pursuant to which, among other things, Tremont Group, Inc. ("Tremont Group") and Tremont Corporation ("Tremont") both became wholly owned subsidiaries of Valhi. Under these merger transactions, (i) Valhi issued 3.5 million shares of its common stock to the Company in return for the Company's 20% ownership interest in Tremont Group and (ii) Valhi issued 3.4 shares of its common stock (plus cash in lieu of fractional shares) to all Tremont stockholders (other than Valhi and Tremont Group) in exchange for each share of Tremont common stock held by such stockholders. The Company received approximately 27,770 shares of Valhi common stock in the second transaction. The number of shares of Valhi common stock issued to the Company in exchange for the Company's 20% ownership interest in Tremont Group was equal to the Company's 20% pro-rata interest in the shares of Tremont common stock held by Tremont Group, adjusted for the same 3.4 exchange ratio. The Valhi common stock owned by the Company is subject to the restrictions on resale pursuant to certain provisions of SEC Rule 144. The Company reported a pre-tax securities transaction gain of approximately \$2.3 million in the first quarter of 2003 which represented the difference between the market value of the shares of Valhi received and the cost basis of the Tremont Group and Tremont shares exchanged. Following these transactions, the Company owned approximately 4.7 million shares of Valhi's outstanding common stock (approximately 4% of Valhi's outstanding shares). The Company will continue to account for its shares of Valhi common stock as available-for-sale marketable equity securities carried at fair value (based on quoted market prices). The shares of Valhi common stock cannot be voted by the Company under Delaware Corporation Law, but the Company does receive dividends from Valhi on these shares, when declared and paid. For financial reporting purposes, Valhi reports its proportional interest in these shares as treasury stock.

Note 7 - Receivable from affiliates:

In May 2001 a wholly owned subsidiary of the Company's majority-owned environmental management subsidiary, NL Environmental Management Services, Inc. ("EMS") loaned \$20.0 million to the Harold C. Simmons Family Trust No. 2 (the "Family Trust"), one of the trusts described in Note 1, under a \$25.0 million revolving credit agreement. The loan was approved by special committees of the Company's and EMS's Boards of Directors. The loan bears interest at prime (4.0% at June 30, 2003), is due on demand with 60 days notice and is collateralized by 13,749 shares, or approximately 35%, of Contran's outstanding Class A voting common stock and 5,000 shares, or 100%, of Contran's Series E Cumulative preferred stock, both of which are owned by the Family Trust. The value of the collateral is dependent, in part, on the value of the Company as Contran's interest in the Company, through its beneficial ownership of Valhi, is one of Contran's more substantial assets. At June 30, 2003, the outstanding loan

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balance was \$16.0 million and \$9.0 million was available for additional borrowing by the Family Trust. The loan was classified as noncurrent at June 30, 2003, as the Company does not expect to demand repayment within one year.

Note 8 - Other noncurrent assets:

	June 30, 2003
(In thousands)	
Deferred financing costs, net	\$ 10,446
Goodwill	6,406
Unrecognized net pension obligations	6,439
Intangible asset, net	2,075
Restricted cash equivalents	-
Other	1,954
	\$ 27,320

Note 9 - Accounts payable and accrued liabilities:

	June 30, 2003
(In thousands)	
Accounts payable	\$ 76,365
Accrued liabilities:	
Employee benefits	32,513
Interest	243
Deferred income	-
Other	41,428
	74,184
	\$ 150,549

Note 10 - Other noncurrent liabilities:

	June 30, 2003
(In thousands)	
Insurance claims and expenses	\$ 6,621
Employee benefits	4,399
Other	2,934
	-----

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\$ 13,954  
=====

Note 11 - Long-term debt:

	June 30, 2003
	----- (In thou
8.875% Senior Secured Notes, (euro)285 million principal amount	\$ 325,784
Revolving credit facility	34,293
Other	1,148
	----- 361,225
Less current maturities	781
	----- \$ 360,444 =====

In March 2003 the Company borrowed (euro)15.0 million (\$16.1 million when borrowed) and in April 2003 the Company repaid NOK 80 million (\$11.0 million when repaid) under the revolving credit facility.

Note 12 - Income taxes:

The difference between the provision for income tax expense attributable to income before income taxes and minority interest and the amount that would be expected using the U.S. federal statutory income tax rate of 35% is presented below.

	Six mon Jun
	----- 2003 ----- (In th
Expected tax expense	\$ 7,463
Non-U.S. tax rates	(385)
Incremental tax on income of companies not included in NL's consolidated U.S. federal income tax return	71
Refund of prior-year German taxes	(24,564)
Valuation allowance	(386)
U.S. state income taxes	407
Other, net	293
	----- \$ (17,101) =====
Income tax (benefit) expense	

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Certain of the Company's tax returns in various U.S. and non-U.S. jurisdictions are being examined and tax authorities have proposed or may propose tax deficiencies, including penalties and interest.

The Company's and EMS' 1998 U.S. federal income tax returns are being examined by the U.S. Internal Revenue Service ("IRS") and the Company and EMS have each granted extensions of the statute of limitations for assessment of tax with respect to their 1998 and 1999 income tax returns until September 30, 2004. Based upon the course of the examination, the Company anticipated that the IRS would propose a substantial tax deficiency, including penalties and interest, related to a restructuring transaction. In an effort to avoid protracted litigation and minimize the hazards of such litigation, the Company applied to take part in an IRS settlement initiative applicable to transactions similar to the restructuring transaction, and in April 2003 the Company received notification from the IRS that it had been accepted into the settlement initiative. Under the initiative, no penalties will be assessed and final settlement with the IRS is to be reached through negotiation and, if necessary, through a specified arbitration procedure. The Company anticipates that settlement of the matter will likely occur in 2004, resulting in payments of federal and state tax and interest ranging from \$33 million to \$45 million. Additional payments in later years may be required as part of the settlement. The Company believes that it has provided adequate accruals to cover the currently expected range of settlement outcomes.

The Company has received preliminary tax assessments for the years 1991 to 1997 from the Belgian tax authorities proposing tax deficiencies, including related interest, of approximately (euro)10.1 million (\$11.6 million at June 30, 2003). The Company has filed protests to the assessments with respect to such years. The Company is in discussions with the Belgian tax authorities and believes that a significant portion of the assessments is without merit. In April 2003 the Company received a notification from the Belgian tax authorities of their intent to assess a tax deficiency related to 1999. The anticipated assessment, including interest, is expected to approximate (euro)13.1 million (\$15.0 million at June 30, 2003). The Company believes the proposed assessment related to 1999 is without merit and in April 2003 filed a written response in opposition to the notification of intent to assess.

In 2002, the Company received a notification from the Norwegian tax authorities of their intent to assess tax deficiencies of approximately NOK 12.2 million (\$1.7 million at June 30, 2003) relating to 1998 through 2000. The Company has objected to this proposed assessment in a written response to the Norwegian tax authorities.

In the first quarter of 2003, Kronos was notified by the German Federal Fiscal Court (the "Court") that the Court had ruled in Kronos' favor concerning a claim for refund suit in which Kronos sought refunds of prior taxes paid during the periods 1990 through 1997. Kronos has filed certain amended German tax returns and expects to file additional amended German tax returns claiming such refunds for all years affected by the Court's decision, which is expected to result in an estimated refund of taxes and interest of approximately \$40 million. Receipt of the German tax refunds is subject to satisfaction of various procedural requirements, including a review and acceptance of the amended German tax returns by the German tax authorities. Certain of these procedural requirements were satisfied in the second quarter of 2003 with respect to a portion of the refund claim, and in July 2003 the German tax authorities refunded Kronos a portion of the total anticipated refund. The portion received in July was (euro)21.5 million (\$24.6 million using June 30, 2003 exchange rates). Kronos has reflected this tax refund in its second quarter 2003 results of operations. The Company expects to receive the remaining refunds over the



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next six to nine months, a portion of which may result in an additional income tax benefit. No assurance can be given that the Company's tax matters will be favorably resolved due to the inherent uncertainties involved in 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 the Company's consolidated financial position, results of operations or liquidity.

At June 30, 2003 the Company had the equivalent of approximately \$470 million of income tax loss carryforwards in Germany with no expiration date. However, the Company has provided a deferred tax valuation allowance against substantially all of these income tax loss carryforwards because the Company currently believes they do not meet the "more-likely-than-not" recognition criteria. In 2002, the German federal government proposed certain changes to its income tax law, including certain changes that would have imposed limitations on the annual utilization of income tax loss carryforwards. Such proposal, if enacted, would have significantly affected the Company's 2003 and future income tax expense and cash tax payments. In April 2003 the German federal government passed a new tax law which does not contain the provision that would have restricted the utilization of tax loss carryforwards. Furthermore, the provisions contained in the new law are not expected to materially impact the Company's income tax expense or cash tax payments.

At June 30, 2003, the Company had net deferred tax liabilities of \$137 million. The Company operates in numerous tax jurisdictions, in certain of which it has temporary differences that net to deferred tax assets (before valuation allowance). The Company has provided a deferred tax valuation allowance of \$197 million at June 30, 2003, principally related to Germany, partially offsetting deferred tax assets which the Company believes do not currently meet the "more-likely-than-not" recognition criteria.

Note 13 - Commitments and contingencies:

### Environmental matters and litigation

Some of the Company's current and former facilities, including several divested secondary lead smelters and former mining locations, 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, potential 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 approximately 70 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. Environmental Protection Agency'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.

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, 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

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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 of 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.

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. 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 policy of the Company is to maintain compliance with applicable environmental laws and regulations at all of its facilities and to strive to improve its environmental performance. It is possible that future developments, such as stricter requirements of environmental laws and enforcement policies thereunder, could adversely affect the Company's production, handling, use, storage, transportation, sale or disposal of such substances as well as the Company's consolidated financial position, results of operations or liquidity.

At June 30, 2003, the Company had accrued approximately \$88 million for those environmental matters which are reasonably estimable. It is not possible to estimate the range of costs for certain sites. The upper end of the range of reasonably possible costs to the Company for sites which it is possible to estimate costs is approximately \$125 million. The Company's estimates of such liabilities have not been discounted to present value, and the Company has not recognized any potential insurance recoveries other than the settlements discussed in Note 3.

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 which 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 which 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 are classified as a noncurrent liability.

At June 30, 2003, there are approximately 15 sites for which the Company 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 the Company actually had any association with the site, or if the Company 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 the Company to allow the Company to estimate a range of loss is unknown and dependent on events outside the control of the Company, such as when the party alleging liability provides information to the Company.

The Company currently believes the disposition of all claims and disputes, individually and in the aggregate, should not have a material adverse effect on the Company's consolidated financial position, results of operations or liquidity.

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At June 30, 2003, the Company had approximately \$24 million in restricted cash, restricted cash equivalents and restricted marketable debt securities held by certain trusts, the assets of which can only be used to pay for certain of the Company's future environmental remediation and other environmental expenditures. Restricted cash decreased approximately \$28 million in the second quarter of 2003 primarily due to a \$30.8 million payment related to the final settlement of the previously-reported Granite City, Illinois lead smelter site. The Company may have to pay up to an additional \$.7 million related to this site upon completion of an EPA audit of certain response costs. No further material expenditures are expected to be made for this site.

### Lead pigment litigation

Since 1987 the Company, other former manufacturers of lead pigments for use in paint and lead-based paint, and the Lead Industries Association have been named as defendants in various legal proceedings seeking damages for personal injury and property damage 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, school districts and certain others have been asserted as class actions. These legal proceedings seek recovery under a variety of theories, including public and private nuisance, negligent product design, failure to warn, strict liability, breach of warranty, conspiracy/concert of action, enterprise liability, market share liability, intentional tort, and fraud and misrepresentation.

The plaintiffs in these actions generally seek to impose on the defendants responsibility for lead paint abatement and asserted 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. Most of these legal proceedings are in various pre-trial stages; some are on appeal following dismissal or summary judgment rulings in favor of the defendants.

The Company believes that these actions are without merit, intends to continue to deny all allegations of wrongdoing and liability and to defend all actions vigorously. The Company has not accrued any amounts for the pending lead pigment litigation. Liability that may result, if any, cannot reasonably be estimated. In addition, various legislation and administrative regulations have, from time to time, been enacted or proposed that seek to (a) impose various obligations on present and former manufacturers of lead pigment and lead-based paint with respect to asserted health concerns associated with the use of such products and (b) effectively overturn the precedent set by court decisions in which the Company and other pigment manufacturers have been successful. Examples of such proposed legislation include bills which would permit civil liability for damages on the basis of market share, rather than requiring plaintiffs to prove that the defendant's product caused the alleged damage, and bills which would revive actions barred by the statute of limitations. The Company currently believes the disposition of all claims and disputes, individually and in the aggregate, should not have a material adverse effect on the Company's consolidated financial position, results of operations or liquidity. Considering the Company's previous involvement in the lead pigment and lead-based paint businesses, the Company expects that additional lead pigment and lead-based paint litigation may be filed against the Company in the future, asserting similar or different legal theories and seeking similar or different types of damages and relief.

### Other litigation

The Company has been named as a defendant in various lawsuits in a variety of jurisdictions, alleging personal injuries as a result of occupational exposure to asbestos, silica and/or mixed dust in connection with formerly owned operations. Approximately 380 of these cases involving a total of approximately

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30,825 plaintiffs and their spouses remain pending, including the Rhines case described below. The Company has not accrued any amounts for this litigation. In addition, from time to time, the Company has received notices regarding asbestos or silica claims purporting to be brought against former subsidiaries of the Company, including notices provided to insurers with which the Company has entered into settlements extinguishing certain insurance policies. These insurers may seek indemnification from the Company.

Rhines, et al. v. A.O. Smith, et al. (Circuit Court of Covington County, Mississippi, Civil Action No. 2002-191C). In June 2003, the Company was served with a complaint in this case brought on behalf of approximately 3,593 plaintiffs against approximately 265 defendants, alleging injury as a result of exposure to asbestos.

The Company's Belgian subsidiary and various of its Belgian employees are the subject of an investigation by Belgian authorities relating to an accident resulting in two fatalities that occurred in its Langerbrugge, Belgium facility in October 2000. The investigation stage, which could ultimately result in civil and criminal sanctions against the Company, was completed in 2002. In May 2003 the Belgian authorities referred the proceedings against the Company's Belgian subsidiary and certain of its Belgian employees to the criminal court for trial. The matter has been set for trial in October 2003.

The Company currently believes the disposition of all claims and disputes, individually and in the aggregate, should not have a material adverse effect on the Company's consolidated financial position, results of operations or liquidity.

For descriptions of certain other legal proceedings, environmental, income tax and other commitments and contingencies related to the Company, reference is made to (i) the 2002 Annual Report, (ii) the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2003, and (iii) Note 12.

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

RESULTS OF OPERATIONS[this has been revised/reformatted]

	Three months ended June 30,		%	Six months ended June 30,	
	2003	2002	Change	2003	2002
	(In millions, except percentages and metrics)				
Net sales	\$266.6	\$226.9	+17%	\$519.6	\$440.0
Cost of sales	197.6	176.2	+12%	386.1	340.0
Gross margin	69.0	50.7	+36%	133.5	100.0
Selling, general and administrative expense	31.0	24.9	+24%	60.4	50.0
Litigation settlement gains, net	.7	.4		.7	.4
Currency transaction gains (losses), net	(2.7)	(2.0)		(3.8)	(2.0)
Disposition of property and equipment	1.1	.6		1.1	.6

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Noncompete agreement					
Income	-	1.0		.3	
Corporate expense	(23.2)	(7.5)		(38.5)	(1
Other operating income	-	-		.2	-
	-----	-----		-----	-----
Income from operations	\$13.9	\$18.3	-24%	\$33.1	\$
	=====	=====		=====	=====

TiO2 operating statistics

Percent change in average

selling prices:

Using actual foreign currency exchange rates	+19%
Impact of changes in foreign currency exchange rates	-12%
In billing currencies	+7%

Sales volume (metric tons in thousands)	121.0	122.6	-1%	239.5	2
Production volume (metric Tons in thousands)	119.5	113.0	+6%	236.7	2

The Company's sales and gross margin increased \$39.7 million (17%) and \$18.3 million (36%), respectively, in the second quarter of 2003 compared to the second quarter of 2002, and increased \$90.3 million (21%) and \$36.7 million (38%), respectively, in the first six months of 2003 compared to the same period in 2002, due primarily to higher average TiO2 selling prices as well as higher TiO2 sales and production volumes partially offset by higher operating costs (particularly energy costs, which increased by approximately \$5.3 million in the year-to-date period). Excluding the effect of fluctuations in the value of the U.S. dollar relative to other currencies, the Company's average TiO2 selling price in billing currencies in the second quarter of 2003 was 7% higher than the second quarter of 2002, with the greatest improvement in European and export markets. The Company's average TiO2 selling prices in billing currencies were 6% higher in the first six months of 2003 compared to the first six months of 2002. When translated from billing currencies to U.S. dollars using actual foreign currency exchange rates prevailing during the respective periods, the Company's average TiO2 selling prices in the second quarter of 2003 increased 19% compared to the second quarter of 2002, and increased 18% in the year-to-date period.

The Company's 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 the Company average TiO2 selling price 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 the Company's 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 accounting principles generally accepted in the United States ("GAAP measure"). The Company discloses percentage changes in its average TiO2 prices in billing currencies because the Company 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

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or lower, respectively, than such percentage changes would be using actual exchange rates prevailing during the respective periods. The difference between the 19% and 18% changes in the Company's average TiO2 selling prices during the second quarter and first six months of 2003 as compared to the same periods in 2002 using actual foreign currency exchange rates prevailing during the respective periods (the GAAP measure) and the 7% and 6%, respectively, percentage changes in the Company's average TiO2 selling price 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 the Company's 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 price 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).

The Company's TiO2 sales volume in the second quarter of 2003 decreased 1% from the record second quarter of 2002. Sales volume in the first six months of 2003, a Kronos record, increased 2% from the same period in 2002. The Company expects sales volumes in the second half of 2003 will be lower than the first half of 2003. The Company's sales volumes for the full year 2003 should be slightly higher than the full year of 2002. The Company's TiO2 production volume in the second quarter of 2003, an all-time quarterly record for NL, was 6% higher than the second quarter of 2002, with operating rates at near full capacity in all periods presented. Production volume for the first half of 2003, also an all-time record for the Company, increased 8% compared to the first six months of 2002. These increases in TiO2 sales and production volume increased gross margin by \$1.9 million and \$3.9 million, respectively, in the second quarter of 2003 compared to the second quarter of 2002, while the increase in average TiO2 selling prices increased gross margin by \$10.5 million (year-to-date impacts of \$6.5 million, \$10.1 million and \$20.6 million, respectively). Finished goods inventories at the end of the second quarter of 2002 represented less than two months of sales.

The Company's cost of sales increased \$21.4 million (12%) in the second quarter of 2003 compared to the second quarter of 2002, and increased \$53.6 million (16%) in the year-to-date period. Kronos' cost of sales as a percentage of net sales decreased from 78% in the second quarter and first six months of 2002 to 74% in the same periods in 2003 primarily due to the higher average selling prices and higher production volume, partially offset by the higher energy costs.

The increase in the Company's gross margin, quantified above, is due to the net effects of the changes in sales and cost of sales during such periods.

The Company's selling, general and administrative expenses in the second quarter of 2003 increased \$6.1 million (24%) as compared to the second quarter of 2002 (and increased \$10.7 million, or 22%, in the year-to-date period) due to higher distribution expenses in the second quarter and first six months of 2003 of \$400,000 and \$2.7 million, respectively, associated with the higher sales volume, as well as the impact of relative changes in foreign currency exchange rates which increased the Company's expenses in the 2003 periods as compared to the same periods in 2002. The Company's selling, general and administrative expenses were approximately 11% to 12% of sales in both the 2002 and 2003 periods.

The Company has substantial operations and assets located outside the United States (primarily in Germany, Belgium, Norway and Canada). As discussed above, a significant amount of the Company's 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. In addition,

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a portion of Company's 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 the Company's 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, increased the Company's sales in the second quarter and first six months of 2003 by a net \$27.7 million and \$54.4 million, respectively, compared to the same periods in 2002. Fluctuations in the value of the U.S. dollar relative to other currencies similarly impacted Kronos' foreign currency-denominated operating expenses. The Company's operating costs that are not denominated in the U.S. dollar, when translated into U.S. dollars, were higher in the second quarter and first six months of 2003 as compared to the same periods of 2002. Overall, the net impact of currency exchange rate fluctuations decreased the Company's income from operations by \$600,000 and \$2.4 million in the second quarter and first six months of 2003 when compared to the year-earlier periods.

The noncompete agreement income relates to a covenant not to compete agreement related to the sale of Rheox in 1998. The agreement became fully amortized in January 2003. The litigation settlement gains in all periods relates to a settlement with former insurance carrier groups. No further material settlements relating to litigation concerning environmental remediation coverage are expected.

Corporate expense for the second quarter and first half of 2003 increased \$15.7 million and \$20.9 million, respectively, from comparable prior-year periods primarily due to higher environmental expenses related to remediation of formerly owned business units and higher legal expenses. Corporate expenses are expected to be higher for full-year 2003 as compared to full-year 2002 due to higher environmental expenses and slightly higher legal expenses associated with the defense of lead pigment litigation.

As a net result of the items discussed above, the Company's income from operations decreased 24% from \$18.3 million in the second quarter of 2002 to \$13.9 million in the second quarter of 2003. For the first six months of 2003, the Company's income from operations was comparable to the \$33.1 million in the first six months of 2002.

The Company expects its average TiO<sub>2</sub> selling prices in 2003 will be higher than 2002. The Company expects sales volume in the second half of 2003 to be lower than the first half of 2003. The Company's sales volume for full year 2003 should be slightly higher than full year 2002. The Company anticipates its production volume for full year 2003 will be higher than full year 2002. The Company's TiO<sub>2</sub> production volume in 2003 is expected to be higher than the Company's 2003 TiO<sub>2</sub> sales volume with finished goods inventories rising modestly. Operating costs in 2003 are expected to be higher than in 2002. The Company's expectations as to the future prospects of the Company and the TiO<sub>2</sub> industry are based upon a number of factors beyond the Company's 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 the Company's expectations, the Company's results of operations could be unfavorably affected.

Other Income (Expense)

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The following table sets forth certain information regarding general corporate income (expense).

	Three months ended June 30,		Difference	Six months ended June 30,	
	2003	2002		2003	2002
	-----				
	(In millions)				
Securities gains, net	\$ .2	\$ -	\$ .2	\$ 2.5	\$ -
Trade Interest income	.2	.3	(.1)	.4	-
Other interest and dividend Income	.8	1.3	(.5)	1.8	2
Currency transaction gains	-	6.3	(6.3)	-	6
Interest expense	(8.4)	(8.1)	(.3)	(16.4)	(14
	-----				
	\$ (7.2)	\$ (.2)	\$ (7.0)	\$ (11.7)	\$ (5
	=====				

Securities gains for the first half of 2003 were higher than the first half of 2002 primarily due to a \$2.3 million first quarter 2003 noncash securities transaction gain related to the exchange of the Company's holdings of Tremont Corporation common stock for shares of Valhi, Inc. common stock as a result of a series of merger transactions Valhi completed in February 2003. See Note 6 to the Consolidated Financial Statements. Interest income was lower in the second quarter and the first half of 2003 as compared to the year earlier periods due to lower levels of available funds invested and lower average yields. The Company expects interest income to be lower for full-year 2003 than full-year 2002 due to lower average yields and lower average levels of funds available for investment.

Foreign currency transaction gains in the second quarter of 2002 related to the extinguishment of certain intercompany indebtedness with Kronos International, Inc. ("KII").

Interest expense in the second quarter and first half of 2003 increased \$.3 million and \$1.8 million from the comparable prior-year periods, primarily due to higher levels of outstanding debt and associated currency effects, partially offset by lower interest rates. Interest expense in the second quarter of 2002 included \$2.0 million related to the early extinguishment of the Company's 11.75% Senior Secured Notes. Assuming no significant change in interest rates, interest expense for full-year 2003 is expected to be higher than full-year 2002 due to higher levels of outstanding indebtedness, partially offset by lower average interest rates.

Provision for income taxes

The Company reduced its deferred income tax valuation allowance by \$.4 million in the first half of 2003 and \$3.0 million in the first half of 2002 primarily as a result of utilization of certain tax attributes for which the



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benefit had not been previously recognized under the "more-likely-than-not" recognition criteria.

Other

Minority interest in all presented periods primarily related to NL Environmental Services, Inc.

Recently adopted accounting principles

As described in Note 1 in the Consolidated Financial Statements, the Company adopted Statement of Financial Accounting Standards No. 143, "Accounting for Asset Retirement Obligations," effective January 1, 2003.

LIQUIDITY AND CAPITAL RESOURCES

The Company's consolidated cash flows from operating, investing and financing activities for the six months ended June 30, 2003 and 2002 are presented below.

	Six m J
	----- 2003 ----- (In
Net cash provided (used) by: [deleted subtotal on the table]	
Operating activities	18.7
Investing activities	(9.7)
Financing activities	(14.4)
	-----
Net cash used by operating, investing, and financing activities	\$ (5.4) =====

Operating activities

The TiO2 industry is cyclical and changes in economic conditions within the industry significantly affect the earnings and operating cash flows of the Company. Certain items included in the determination of net income do not represent current inflows or outflows of cash. For example, certain items included in the determination of net income have an impact on cash flows from operating activities, but the impact of such items on cash will differ from their impact on net income. For example, the amount of income or expense recorded for pension and OPEB assets and obligations (which depend upon a number of factors, including actuarial assumptions used to value obligations) will generally differ from the outflows of cash for such benefits. Similarly the amount of expense recorded for environmental matters will generally differ from the outflows of cash for such matters.

Cash flows from operations is the primary source of liquidity for the Company. Changes in TiO2 pricing, production volume and customer demand, among other things, could significantly affect the liquidity of the Company. Relative changes in assets and liabilities generally result from the timing of

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production, sales, purchases and income tax payments. Such relative changes can significantly impact the comparability of cash flow from operations from period to period, as the income statement impact of such items may occur in a different period from when the underlying cash transaction occurs. For example, raw materials may be purchased in one period, but the payment for such raw materials may occur in a subsequent period. Similarly, inventory may be sold in one period, but the cash collection of the receivable may occur in a subsequent period.

Cash flows from operating activities decreased from \$36.5 million in the first six months of 2002 to \$18.7 million in the first six months of 2003. This \$17.8 million decrease was due primarily to the net effect of (i) higher net income of \$17.8 million, (ii) higher depreciation expense of \$3.9 million, (iii) \$21.1 million of higher refundable income taxes in the first six months of 2003 and (iv) a higher amount of net cash used to fund changes in Kronos' inventories, receivables, payables and accrued environmental of \$13.4 million in the first six months of 2003. Relative changes in accounts receivable are affected by, among other things, the timing of sales and the collection of the resulting receivable. Relative changes in inventories and accounts payable and accrued liabilities and accrued environmental are affected by, among other things, the timing of raw material purchases and the payment for such purchases and the relative difference between production volume and sales volume.

### Investing activities

The Company's capital expenditures were \$13.9 million and \$12.1 million in the first half of 2003 and 2002, respectively. Capital expenditures in first half of 2002 included approximately \$2.2 million related to reconstruction of the Company's Leverkusen, Germany sulfate plant damaged in the March 2001 fire.

In May 2003 the Harold C. Simmons Family Trust No. 2 (the "Family Trust") repaid \$2 million principal amount on the revolving credit agreement. See Note 7 to the Consolidated Financial Statements.

In January 2002, the Company acquired all of the stock and limited liability company units of EWI RE, Inc. and EWI RE, Ltd. (collectively "EWI"), respectively, for an aggregate of \$9.2 million in cash, including capitalized acquisition costs of \$.2 million.

### Financing activities

In March 2003 the Company borrowed (euro)15 million (\$16.1 million when borrowed) and in April 2003 the Company repaid NOK 80 million (\$11.0 million when repaid) under the revolving credit facility.

In March 2002, the Company redeemed \$25 million principal amount of its 11.75% Senior Secured Notes using available cash on hand, and in June 2002 the Company redeemed the remaining \$169 million principal amount of such 11.75% Senior Secured Notes using a portion of the proceeds from the June 2002 issuance of the (euro)285 million principal amount of the KII 8.875% Senior Secured Notes (\$280 million when issued). Also in June 2002, KII's operating subsidiaries in Germany, Belgium and Norway entered into a new three-year (euro)80 million secured revolving credit facility and borrowed (euro)13 million (\$13 million) and NOK 200 million (\$26 million) which, along with available cash, was used to repay and terminate KII's short term notes payable (\$53.2 million when repaid).

Deferred financing costs of \$9.3 million for the KII 8.875% Senior Secured Notes and the European credit facility are being amortized over the life of the respective agreements and are included in other noncurrent assets as of June 30, 2002.

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In the second quarter of 2003, the Company paid a regular quarterly dividend to shareholders of \$.20 per share, aggregating \$9.5 million. Dividends paid during the first half of 2003 totaled \$.40 per share, or \$19.1 million.

In the first half of 2003 and the second quarter of 2002, the Company made no repurchases of common stock. During the first quarter of 2002, the Company purchased approximately 228,000 shares of its common stock in the open market at an aggregate cost of approximately \$3.3 million. The Company is authorized to repurchase approximately 1.3 million additional shares at July 25, 2003. The shares may be purchased over an unspecified period of time and, depending on market conditions, applicable legal requirements, available cash and other factors, the share repurchase program may be suspended at any time and could be terminated prior to completion. The repurchased shares are to be held as treasury shares available for general corporate purposes.

Cash, cash equivalents, restricted cash and restricted marketable debt securities and borrowing availability

At June 30, 2003, the Company had cash and cash equivalents aggregating \$54.4 million, current restricted cash equivalents of \$25.3 million, current restricted marketable debt securities of \$10.7 million and noncurrent restricted marketable debt securities of \$3.1 million. Of such aggregate \$93.5 million amount, \$18 million was held by non-U.S. subsidiaries. Restricted cash decreased approximately \$28 million in the second quarter of 2003 primarily due to a \$30.8 million payment related to the final settlement of the previously-reported Granite City, Illinois lead smelter site. The Company may have to pay up to an additional \$.7 million related to this site upon completion of an EPA audit of certain response costs. No further material expenditures are expected to be made for this site. At June 30, 2003, certain of the Company's subsidiaries had \$102 million available for borrowing with approximately \$57 million available under non-U.S. credit facilities (including \$55 million under the European Credit Facility) and approximately \$45 million under the U.S. Credit Facility. At June 30, 2003, the Company had complied with all financial covenants governing its debt agreements.

Income tax contingencies

See Note 12 to the Consolidated Financial Statements.

Lead pigment litigation, environmental matters and other litigation

See Note 14 to the Consolidated Financial Statements and Part II, Item 1. "Legal Proceedings."

Other

The Company periodically evaluates its liquidity requirements, alternative uses of capital, capital needs and availability of resources in view of, among other things, its dividend policy, its debt service and capital expenditure requirements and estimated future operating cash flows. As a result of this process, the Company in the past has sought, and in the future may seek, to reduce, refinance, repurchase or restructure indebtedness; raise additional capital; repurchase shares of its common stock; modify its dividend policy; restructure ownership interests; sell interests in subsidiaries or other assets; or take a combination of such steps or other steps to manage its liquidity and capital resources. In the normal course of its business, the Company may review opportunities for the acquisition, divestiture, joint venture or other business combinations in the chemicals or other industries, as well as the acquisition of interests in, and loans to, related companies. In the event of any acquisition

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or joint venture transaction, the Company may consider using available cash, issuing equity securities or increasing its indebtedness to the extent permitted by the agreements governing the Company's existing debt.

### Non-GAAP Financial Measures

In an effort to provide investors with additional information regarding the Company's results as determined by GAAP, the Company has disclosed certain non-GAAP information which the Company believes provides useful information to investors:

As discussed above, the Company discloses percentage changes in its average TiO<sub>2</sub> prices in billing currencies, which excludes the effects of foreign currency translation. Such disclosure of the percentage change in the Company's average TiO<sub>2</sub> selling price in billing currencies is considered a "non-GAAP" financial measure under regulations of the SEC. The disclosure of the percentage change in the Company's average TiO<sub>2</sub> selling prices using actual foreign currency exchange rates prevailing during the respective periods is considered the most directly comparable GAAP measure. The Company discloses percentage changes in its average TiO<sub>2</sub> prices in billing currencies because the Company 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.

### Special note regarding forward-looking statements

The statements contained in this Report on Form 10-Q ("Quarterly Report") which are not historical facts, including, but not limited to, statements found under the captions "Results of Operations" and "Liquidity and Capital Resources" above, 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," "will," "should," "could," "anticipates," "expects," or comparable terminology or by discussions of strategy 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 risks and uncertainties, including, but not limited to, the cyclical nature of the titanium dioxide industry, global economic and political conditions, global productive capacity, customer inventory levels, changes in product pricing, changes in product costing, changes in foreign currency exchange rates, competitive technology positions, operating interruptions (including, but not limited to, labor disputes, leaks, fires, explosions, unscheduled downtime, transportation interruptions, war and terrorist activities), the ultimate resolution of pending or possible future lead pigment litigation and legislative developments related to the lead pigment litigation, the outcome of other litigation and tax controversies, and other risks and uncertainties included in this Quarterly Report and in the 2002 Annual Report, and the uncertainties set forth from time to time in the Company's filings with the Securities and Exchange Commission. 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. The Company disclaims any intention or obligation to update publicly or revise such statements whether as a result of new information, future events or otherwise.

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### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

For a discussion of the Company's market risks, refer to the caption "Quantitative and Qualitative Disclosures About Market Risk" in the 2002 Annual Report. There have been no material changes to the information provided that would require additional information with respect to the quarter ended June 30, 2003.

### ITEM 4. CONTROLS AND PROCEDURES

The Company maintains a system of disclosure controls and procedures. The term "disclosure controls and procedures," as defined by regulations of the Securities and Exchange Commission ("SEC"), means controls and other procedures that are designed to ensure that information required to be disclosed in the reports that the Company files or submits to the SEC under the Securities Exchange Act of 1934, as amended (the "Act"), is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by the Company in the reports that it files or submits to the SEC under the Act is accumulated and communicated to the Company's management, including its principal executive officer and its principal financial officer, or persons performing similar functions, as appropriate to allow timely decisions to be made regarding required disclosure. Each of Harold C. Simmons, the Company's Chief Executive Officer, and Gregory M. Swalwell, the Company's Vice President, Finance, have evaluated the Company's disclosure controls and procedures as of June 30, 2003. Based upon their evaluation, these executive officers have concluded that the Company's disclosure controls and procedures are effective as of the date of such evaluation.

The Company also maintains a system of internal controls over financial reporting. The term "internal control over financial reporting," as defined by regulations of the SEC, means a process designed by, or under the supervision of, the Company's principal executive and principal financial officers, or persons performing similar functions, and effected by the Company's board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America ("GAAP"), and includes those policies and procedures that:

- o Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the Company,
- o Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with GAAP, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company, and
- o Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the Company's consolidated financial statements.

There has been no change to the Company's system of internal controls over financial reporting during the quarter ended June 30, 2003 that has materially affected, or is reasonably likely to materially affect, the Company's system of internal controls over financial reporting.

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### PART II. OTHER INFORMATION

#### ITEM 1. LEGAL PROCEEDINGS

Reference is made to Note 14 to the Consolidated Financial Statements, and for descriptions of certain previously reported legal proceedings, reference is made to the 2002 Annual Report and the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2003.

County of Santa Clara v. Atlantic Richfield Company, et al. (Superior Court of the State of California, County of Santa Clara, Case No. CV788657). In July 2003, the trial court granted defendants' motion to dismiss all remaining claims in this previously-described case. The time for appeal has not yet run.

State of Rhode Island v. Lead Industries Association, et al. (Superior Court of Rhode Island, No. 99-5226). In June 2003, the court set April 5, 2004 as the date for the retrial of Phase I of this previously-described case.

Lewis et al. v. Lead Industries Association, et al. (Circuit Court of Cook County, Illinois, County Department, Chancery Division, Case No. 00CH09800). In June 2003, the appellate court affirmed the dismissal of five of the six counts of plaintiffs' complaint in this previously-described case, but reversed the dismissal of the conspiracy count. The time for appeal has not yet run.

Borden, et al. v. The Sherwin-Williams Company, et al. (Circuit Court of Jefferson County, Mississippi, Civil Action No. 2000-587). In June 2003, plaintiffs and defendants jointly moved the court to vacate the previously-described October 2003 trial date.

Quitman County School District v. Lead Industries Association, et al. (Circuit Court of Quitman County, Mississippi, Case No. 2001-0106). In June 2003, the Court set a trial date of September 13, 2004 in this previously-described case.

Thomas v. Lead Industries Association, et al. (Circuit Court, Milwaukee, Wisconsin, Case No. 99-CV-6411). In June 2003, plaintiff appealed the trial court's grant of summary judgment for defendants in this previously-described case.

City of St. Louis v. Lead Industries Association, et al. (Missouri Circuit Court 22nd Judicial Circuit, St. Louis City, Cause No. 002-245, Division 1). In May 2003, plaintiffs filed an amended complaint alleging only a nuisance claim in this previously-described case. Defendants' renewed motion to dismiss and motion for summary judgment are pending. Plaintiffs have moved the Court to set an October 2003 trial date.

City of Milwaukee v. NL Industries, Inc. and Mautz Paint (Circuit Court, Civil Division, Milwaukee County, Wisconsin, Case No. 01CV0030066). In May 2003, the court vacated the previously-described October 2003 trial date. No new trial date has been set. Defendants' motion for summary judgment is pending.

Justice et al. v. Sherwin-Williams, et al. (Superior Court of California, County of San Francisco, No. 314686). This previously-described case has been voluntarily dismissed without prejudice by plaintiffs.

Sabater, et al. v. Lead Industries Association, et al. (Supreme Court of the State of New York, County of Bronx, Index No. 25533/98). Plaintiffs' motion for class certification is pending in this previously-described case.

The Company expects that additional lead pigment litigation and lead-based paint litigation may be filed against the Company in the future asserting

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similar or different legal theories and seeking similar or different types of damages and relief.

Herd v. ASARCO, et al. (Case No. CJ-2001-443), Reeves v. ASARCO, et al. (Case No. CJ-02-8), Carr v. ASARCO, et al. (Case No. CJ-02-59), Edens v. ASARCO et al. (Case No. CJ-02-245, and Koger v. ASARCO et al. (Case No. CJ-02-284). In May 2003, the Company was voluntarily dismissed with prejudice by plaintiffs from these previously-described cases.

Cole, et al. v. ASARCO Incorporated et al. (U.S. District Court for the Northern District of Oklahoma, Case No. 03C V327 EA (J)). In June 2003, the Company was served with a complaint in this purported class action on behalf of two classes of persons living in the Picher/Cardin, Oklahoma, area: (1) a medical monitoring class of persons who have lived in the area since 1994; and (2) a property owner class of residential, commercial and government property owners. Plaintiffs are nine individuals and, in their official capacities, the Mayor of Picher and the Chairman of the Picher/Cardin School Board. Plaintiffs allege causes of action in trespass and nuisance and seek a medical monitoring program, a relocation program, property damages, and punitive damages.

Crawford, et al. v. ASARCO, Incorporated, et al. (Case No. CJ-03-304); Barr, et al. v. ASARCO Incorporated, et al. (Case No. CJ-03-305); Brewer, et al. v. ASARCO Incorporated, et al. (Case No. CJ-03-306); Kloer, et al. v. ASARCO, Incorporated, et al. (Case No. CJ-03-307); Rhoten, et al. v. Asarco Incorporated, et al. (Case No. CJ-03-308) (all in the District Court in and for Ottawa County, State of Oklahoma). In July 2003, the Company was served with complaints in these five cases asserting personal injuries due to exposure to lead from mining waste on behalf of, respectively, two, four, two, three, and four children. Each complaint alleges causes of action in negligence, strict liability, nuisance, and attractive nuisance; and each seeks \$20 million in compensatory and \$20 million in punitive damages. The Company intends to answer each complaint denying all liability and to defend itself vigorously.

United States of America v. NL Industries, Inc., et al., (United States District Court for the Southern District of Illinois, Civ. No. 91-CV 00578). In May 2003, the court entered the previously-described consent decree between the United States and the Company. Pursuant to the consent decree, the Company in June 2003 paid \$30.8 million to the United States, and will pay up to an additional \$.7 million upon completion of an EPA audit of certain response costs.

#### ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

The Company held its Annual Meeting of Shareholders on May 20, 2003. All the nominees for director were elected with the voting results for each as follows:

Director	Shares For
Mr. J. Landis Martin	46,641,822
Mr. George E. Poston	46,425,918
Mr. Glenn R. Simmons	46,641,816
Mr. Harold C. Simmons	46,640,586
General Thomas P. Stafford	46,660,008
Dr. R. Gerald Turner	46,653,138
Mr. Steven L. Watson	45,118,497

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### ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

#### (a) Exhibits

The Company has retained a signed original of any exhibit listed below that contains signatures, and the Company will provide any such exhibit to the SEC or its staff upon request.

10.1 - Intercorporate Services Agreement by and between Contran Corporation and the Registrant effective as of January 1, 2003.

10.2 - Intercorporate Services Agreement by and between Titanium Metals Corporation and the Registrant effective as of January 1, 2003.

99.1 - Certification.

99.2 - Certification.

99.3 - Certification.

#### (b) Reports on Form 8-K

Reports on Form 8-K for the quarter ended June 30, 2003 through the date of this report:

July 14, 2003 - Reported Items 7 and 9.

July 25, 2003 - Reported Items 7 and 9.

### SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

NL INDUSTRIES, INC.  
(Registrant)

Date: October 31, 2003

By /s/ Gregory M. Swalwell  
Gregory M. Swalwell  
Principal Financial and Accounting Officer