

NL INDUSTRIES INC  
Form 10-Q  
August 08, 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarter ended June 30, 2017

Commission file number 1-640

NL INDUSTRIES, INC.

(Exact name of Registrant as specified in its charter)

New Jersey 13-5267260  
(State or other jurisdiction of (IRS Employer Identification No.)

incorporation or organization)

5430 LBJ Freeway, Suite 1700

Dallas, Texas 75240-2697

(Address of principal executive offices)

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

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

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

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 7(a)(2)(B) of the Securities Act).

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

Number of shares of the Registrant's common stock outstanding on July 31, 2017: 48,714,884.

NL INDUSTRIES, INC. AND SUBSIDIARIES

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## NL INDUSTRIES, INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands)

|                                      | December<br>31,<br>2016 | June 30,<br>2017<br>(unaudited) |
|--------------------------------------|-------------------------|---------------------------------|
| <b>ASSETS</b>                        |                         |                                 |
| Current assets:                      |                         |                                 |
| Cash and cash equivalents            | \$93,162                | \$ 90,063                       |
| Restricted cash and cash equivalents | 3,791                   | 3,223                           |
| Accounts and other receivables, net  | 10,586                  | 12,373                          |
| Inventories, net                     | 14,974                  | 15,317                          |
| Prepaid expenses and other           | 986                     | 904                             |
| <b>Total current assets</b>          | <b>123,499</b>          | <b>121,880</b>                  |
| Other assets:                        |                         |                                 |
| Notes receivable from affiliate      | 27,400                  | 39,500                          |
| Marketable securities                | 49,731                  | 42,831                          |
| Investment in Kronos Worldwide, Inc. | 120,346                 | 188,969                         |
| Goodwill                             | 27,156                  | 27,156                          |
| Other assets, net                    | 3,276                   | 3,472                           |
| <b>Total other assets</b>            | <b>227,909</b>          | <b>301,928</b>                  |
| Property and equipment:              |                         |                                 |
| Land                                 | 5,146                   | 5,146                           |
| Buildings                            | 22,811                  | 22,827                          |
| Equipment                            | 66,112                  | 66,244                          |
| Construction in progress             | 1,098                   | 1,538                           |
|                                      | 95,167                  | 95,755                          |
| Less accumulated depreciation        | 61,583                  | 62,466                          |
| <b>Net property and equipment</b>    | <b>33,584</b>           | <b>33,289</b>                   |
| <b>Total assets</b>                  | <b>\$384,992</b>        | <b>\$ 457,097</b>               |

## NL INDUSTRIES, INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED BALANCE SHEETS (CONTINUED)

(In thousands)

|   | December<br>31,<br>2016 | June 30,<br>2017<br>(unaudited) |
|---|-------------------------|---------------------------------|
| <b>LIABILITIES AND EQUITY</b>                       |                         |                                 |
| <b>Current liabilities:</b>                         |                         |                                 |
| Accounts payable                                    | \$5,026                 | \$4,638                         |
| Accrued and other current liabilities               | 10,624                  | 8,390                           |
| Accrued environmental remediation and related costs | 13,350                  | 13,101                          |
| Payable to affiliates                               | 1,717                   | 717                             |
| Income taxes  | 26                      | 28                              |
| <b>Total current liabilities</b>                    | <b>30,743</b>           | <b>26,874</b>                   |
| <b>Noncurrent liabilities:</b>                      |                         |                                 |
| Long-term debt from affiliate                       | 500                     | 500                             |
| Accrued pension costs                               | 12,874                  | 12,563                          |
| Accrued postretirement benefits (OPEB) costs        | 2,310                   | 2,153                           |
| Accrued environmental remediation and related costs | 103,308                 | 106,058                         |
| Deferred income taxes                               | 27,445                  | 49,464                          |
| Other   | 13,542                  | 13,515                          |
| <b>Total noncurrent liabilities</b>                 | <b>159,979</b>          | <b>184,253</b>                  |
| <b>Equity:</b>                                      |                         |                                 |
| <b>NL stockholders' equity:</b>                     |                         |                                 |
| Common stock  | 6,088                   | 6,089                           |
| Additional paid-in capital                          | 300,674                 | 300,869                         |
| Retained earnings                                   | 104,004                 | 153,521                         |
| Accumulated other comprehensive loss                | (232,846)               | (231,549 )                      |
| <b>Total NL stockholders' equity</b>                | <b>177,920</b>          | <b>228,930</b>                  |
| <b>Noncontrolling interest in subsidiary</b>        | <b>16,350</b>           | <b>17,040</b>                   |
| <b>Total equity</b>                                 | <b>194,270</b>          | <b>245,970</b>                  |
| <b>Total liabilities and equity</b>                 | <b>\$384,992</b>        | <b>\$457,097</b>                |

Commitments and contingencies (Note 13)

See accompanying notes to Condensed Consolidated Financial Statements.

## NL INDUSTRIES, INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)

|   | Three months<br>ended<br>June 30,<br>2016 |          | Six months ended<br>June 30,<br>2016 |          |
|---|---|----------|--------------------------------------|----------|
|   | 2017                                      | 2016     | 2017                                 | 2016     |
|   | (unaudited)                               |          |                                      |          |
| Net sales   | \$27,107                                  | \$30,002 | \$54,182                             | \$59,950 |
| Cost of sales   | 18,621                                    | 20,494   | 37,491                               | 40,757   |
| Gross margin  | 8,486                                     | 9,508    | 16,691                               | 19,193   |
| Selling, general and administrative expense           | 4,769                                     | 4,907    | 9,621                                | 10,066   |
| Other operating income (expense):                     |   |          |                                      |          |
| Insurance recoveries                                  | 233                                       | 66       | 323                                  | 116      |
| Corporate expense                                     | (3,329)                                   | (3,410)  | (8,978)                              | (8,909)  |
| Income (loss) from operations                         | 621                                       | 1,257    | (1,585)                              | 334      |
| Equity in earnings (losses) of Kronos Worldwide, Inc. | 497                                       | 59,745   | (653)                                | 70,920   |
| Other income (expense):                               |   |          |                                      |          |
| Interest and dividend income                          | 377                                       | 881      | 730                                  | 1,577    |
| Interest expense                                      | -   | (7)      | -                                    | (14)     |
| Income (loss) before income taxes                     | 1,495                                     | 61,876   | (1,508)                              | 72,817   |
| Income tax expense (benefit)                          | 330                                       | 20,278   | (492)                                | 22,457   |
| Net income (loss)                                     | 1,165                                     | 41,598   | (1,016)                              | 50,360   |
| Noncontrolling interest in net income of subsidiary   | 320                                       | 431      | 608                                  | 843      |
| Net income (loss) attributable to NL stockholders     | \$845                                     | \$41,167 | \$(1,624)                            | \$49,517 |
| Amounts attributable to NL stockholders:              |   |          |                                      |          |
| Basic and diluted net income (loss) per share         | \$.02                                     | \$.85    | \$(.03)                              | \$1.02   |
| Weighted average shares used in the calculation       |   |          |                                      |          |
| of net income (loss) per share                        | 48,699                                    | 48,710   | 48,695                               | 48,708   |



See accompanying notes to Condensed Consolidated Financial Statements.

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## NL INDUSTRIES, INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENT OF EQUITY

Six months ended June 30, 2017

(In thousands)

|  | Common<br>stock | Additional<br>paid-in<br>capital<br>(unaudited) | Retained<br>earnings | Accumulated<br>other<br>comprehensive<br>income (loss) | Noncontrolling<br>interest in<br>subsidiary | Total<br>equity |
|--|-----------------|---|----------------------|--|---|-----------------|
| Balance at December 31, 2016           | \$6,088         | \$ 300,674                                      | \$ 104,004           | \$ (232,846 )  | \$ 16,350                                   | \$ 194,270      |
| Net income                             | —               | —   | 49,517               | —  | 843   | 50,360          |
| Other comprehensive income, net of tax | —               | —   | —                    | 1,297  | —   | 1,297           |
| Issuance of NL common stock            | 1               | 82  | —                    | —  | —   | 83              |
| Dividends                              | —               | —   | —                    | —  | (166 )                                      | (166 )          |
| Other, net                             | —               | 113   | —                    | —  | 13  | 126             |
| Balance at June 30, 2017               | \$6,089         | \$ 300,869                                      | \$ 153,521           | \$ (231,549 )  | \$ 17,040                                   | \$ 245,970      |

See accompanying notes to Condensed Consolidated Financial Statements.

## NL INDUSTRIES, INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

|   | Six months ended<br>June 30, |                 |
|---|------------------------------|-----------------|
|   | 2016                         | 2017            |
|   | (unaudited)                  |                 |
| <b>Cash flows from operating activities:</b>                                    |                              |                 |
| Net income (loss)   | \$(1,016 )                   | \$50,360        |
| Depreciation and amortization   | 1,889                        | 1,861           |
| Deferred income taxes   | (534 )                       | 21,309          |
| Equity in earnings (losses) of Kronos Worldwide, Inc.                           | 653                          | (70,920)        |
| Dividends received from Kronos Worldwide, Inc.                                  | 10,566                       | 10,566          |
| Cash funding of benefit plans in excess of net benefit plan expense             | (146 )                       | (23 )           |
| Other, net  | 328                          | 280             |
| <b>Change in assets and liabilities:</b>  |                              |                 |
| Accounts and other receivables, net   | (3,710 )                     | (1,814 )        |
| Inventories, net  | 851                          | (417 )          |
| Prepaid expenses and other  | (605 )                       | 81              |
| Accounts payable and accrued liabilities  | (2,491 )                     | (2,581 )        |
| Income taxes  | (4 )                         | (1 )            |
| Accounts with affiliates  | 8                            | (985 )          |
| Accrued environmental remediation and related costs                             | 1,980                        | 2,500           |
| Other noncurrent assets and liabilities, net                                    | (166 )                       | (33 )           |
| <b>Net cash provided by operating activities</b>                                | <b>7,603</b>                 | <b>10,183</b>   |
| <b>Cash flows from investing activities:</b>                                    |                              |                 |
| Capital expenditures  | (1,684 )                     | (1,611 )        |
| <b>Promissory notes receivable from affiliate:</b>                              |                              |                 |
| Loans   | -                            | (39,300)        |
| Collections   | -                            | 27,200          |
| Other, net  | -                            | 2               |
| <b>Net cash used in investing activities</b>                                    | <b>(1,684 )</b>              | <b>(13,709)</b> |
| <b>Cash flows from financing activities -</b>                                   |                              |                 |
| Distributions to noncontrolling interests in subsidiary                         | (166 )                       | (166 )          |
| <b>Cash and cash equivalents and restricted cash and cash equivalents - net</b> |                              |                 |
| <b>change from:</b>   |                              |                 |
| Operating, investing and financing activities                                   | 5,753                        | (3,692 )        |
| Balance at beginning of period  | 100,981                      | 98,242          |

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|  |           |          |
|--|-----------|----------|
| Balance at end of period                 | \$106,734 | \$94,550 |
| Supplemental disclosure - cash paid for: |           |          |
| Interest                                 | \$-       | \$14     |
| Income taxes, net                        | \$55      | 2,157    |

See accompanying notes to Condensed Consolidated Financial Statements.

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NL INDUSTRIES, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2017

(unaudited)

Note 1 – Organization and basis of presentation:

Organization – At June 30, 2017, Valhi, Inc. (NYSE: VHI) held approximately 83% of our outstanding common stock and a wholly-owned subsidiary of Contran Corporation held approximately 93% of Valhi’s outstanding common stock. All of Contran’s outstanding voting stock is held by a family trust established for the benefit of Lisa K. Simmons and Serena Simmons Connelly and their children for which Ms. Simmons and Ms. Connelly are co-trustees, or is held directly by Ms. Simmons and Ms. Connelly or entities related to them. Consequently, Ms. Simmons and Ms. Connelly may be deemed to control Contran, Valhi and us.

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

The unaudited Condensed Consolidated Financial Statements contained in this Quarterly Report have been prepared on the same basis as the audited Consolidated Financial Statements in our Annual Report on Form 10-K for the year ended December 31, 2016 that we filed with the SEC on March 10, 2017 (the 2016 Annual Report). In our opinion, we have made all necessary adjustments (which include only normal recurring adjustments) in order to state fairly, in all material respects, our consolidated financial position, results of operations and cash flows as of the dates and for the periods presented. We have condensed the Consolidated Balance Sheet at December 31, 2016 contained in this Quarterly Report as compared to our audited Consolidated Financial Statements at that date, and we have omitted certain information and footnote disclosures (including those related to the Consolidated Balance Sheet at December 31, 2016) normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). Our results of operations for the interim periods ended June 30, 2017 may not be indicative of our operating results for the full year. The Condensed Consolidated Financial Statements contained in this Quarterly Report should be read in conjunction with our 2016 Consolidated Financial Statements contained in our 2016 Annual Report.

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

Note 2 – Accounts and other receivables, net:

|          |          |
|----------|----------|
| December |          |
| 31,      | June 30, |
| 2016     | 2017     |

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|                                 | (In thousands) |          |
|---------------------------------|----------------|----------|
| Trade receivables - CompX       | \$10,417       | \$12,225 |
| Accrued insurance recoveries    | 104            | 86       |
| Other receivables               | 135            | 132      |
| Allowance for doubtful accounts | (70 )          | (70 )    |
| Total                           | \$10,586       | \$12,373 |

Accrued insurance recoveries are discussed in Note 13.

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## Note 3 – Inventories, net:

|                   | December        |                 |
|-------------------|-----------------|-----------------|
|                   | 31,             | June 30,        |
|                   | 2016            | 2017            |
|                   | (In thousands)  |                 |
| Raw materials     | \$2,743         | \$2,891         |
| Work in process   | 8,988           | 9,786           |
| Finished products | 3,243           | 2,640           |
| <b>Total</b>      | <b>\$14,974</b> | <b>\$15,317</b> |

## Note 4 – Marketable securities:

|                          | Fair value  |                |             |
|--------------------------|-------------|----------------|-------------|
|                          | measurement | Market         | Unrealized  |
|                          | level       | value          | gain (loss) |
|                          |             | (In thousands) |             |
| <b>December 31, 2016</b> |             |                |             |
| Valhi common stock 1     |             | \$49,731       | \$ 25,384   |
| <b>June 30, 2017</b>     |             |                |             |
| Valhi common stock 1     |             | \$42,831       | \$ 18,484   |

At December 31, 2016 and June 30, 2017, we held approximately 14.4 million shares of common stock of our immediate parent company, Valhi. See Note 1. We account for our investment in Valhi common stock as available-for-sale marketable equity securities and any unrealized gains or losses on the securities are recognized through other comprehensive income, net of deferred income taxes. Our shares of Valhi common stock are carried at fair value based on quoted market prices, representing a Level 1 input within the fair value hierarchy. At December 31, 2016 and June 30, 2017, the quoted per share market price of Valhi common stock was \$3.46 and \$2.98, respectively.

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

## Note 5 – Investment in Kronos Worldwide, Inc.:

At December 31, 2016 and June 30, 2017, we owned approximately 35.2 million shares of Kronos common stock. At June 30, 2017, the quoted market price of Kronos' common stock was \$18.22 per share, or an aggregate market value of \$641.7 million. At December 31, 2016, the quoted market price was \$11.94 per share, or an aggregate market



value of \$420.5 million.

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The change in the carrying value of our investment in Kronos during the first six months of 2017 is summarized below.

|  | Amount<br>(In<br>millions) |
|--|----------------------------|
| Balance at the beginning of the period               | \$ 120.3                   |
| Equity in earnings of Kronos                         | 70.9                       |
| Dividends received from Kronos                       | (10.6 )                    |
| Equity in Kronos' other comprehensive income (loss): |                            |
| Marketable securities                                | (.1 )                      |
| Currency translation                                 | 7.2                        |
| Interest rate swap                                   | .1                         |
| Defined benefit pension plans                        | 1.2                        |
| Balance at the end of the period                     | \$ 189.0                   |

Selected financial information of Kronos is summarized below:

|  | December      |                  |
|--|---------------|------------------|
|  | 31,<br>2016   | June 30,<br>2017 |
|  | (In millions) |                  |
| Current assets                               | \$650.4       | \$800.0          |
| Property and equipment, net                  | 434.0         | 466.4            |
| Investment in TiO <sub>2</sub> joint venture | 78.9          | 70.5             |
| Other noncurrent assets                      | 16.3          | 136.0            |
| Total assets                                 | \$1,179.6     | \$1,472.9        |
| Current liabilities                          | \$182.1       | \$210.9          |
| Long-term debt                               | 335.4         | 350.8            |
| Accrued pension and postretirement benefits  | 234.2         | 253.1            |
| Other noncurrent liabilities                 | 32.9          | 37.3             |
| Stockholders' equity                         | 395.0         | 620.8            |
| Total liabilities and stockholders' equity   | \$1,179.6     | \$1,472.9        |

| Three months<br>ended<br>June 30,<br>2016 |      | Six months<br>ended<br>June 30,<br>2017 |      |
|---|------|---|------|
| 2016                                      | 2017 | 2016                                    | 2017 |
| (In millions)                             |      |   |      |

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|                              |         |         |         |         |
|------------------------------|---------|---------|---------|---------|
| Net sales                    | \$356.1 | \$441.4 | \$674.5 | \$811.2 |
| Cost of sales                | 300.6   | 311.6   | 578.6   | 578.0   |
| Income from operations       | 10.5    | 70.1    | 10.2    | 122.4   |
| Income tax expense (benefit) | 3.9     | (131.1) | 2.5     | (120.1) |
| Net income (loss)            | 1.7     | 196.5   | (2.1 )  | 233.3   |

## Note 6 – Other noncurrent assets, net:

|                 | December<br>31,<br>2016 | June<br>30,<br>2017 |
|-----------------|-------------------------|---------------------|
|                 | (In thousands)          |                     |
| Restricted cash | \$ 1,289                | \$ 1,264            |
| Pension asset   | 1,037                   | 1,251               |
| Other           | 950                     | 957                 |
| <b>Total</b>    | <b>\$ 3,276</b>         | <b>\$ 3,472</b>     |

## Note 7 – Accrued and other current liabilities:

|                   | December<br>31,<br>2016 | June<br>30,<br>2017 |
|-------------------|-------------------------|---------------------|
|                   | (In thousands)          |                     |
| Employee benefits | \$ 8,375                | \$ 6,000            |
| Professional fees | 613                     | 686                 |
| Other             | 1,636                   | 1,704               |
| <b>Total</b>      | <b>\$ 10,624</b>        | <b>\$ 8,390</b>     |

## Note 8 – Long-term debt:

During the first half of 2017, our wholly owned subsidiary, NLKW Holding, LLC had no borrowings or repayments under its \$50 million secured revolving credit facility with Valhi. At June 30, 2017, we had outstanding borrowings of \$0.5 million under such facility, and the remaining \$49.5 million was available for future borrowing under this facility. Outstanding borrowings under such credit facility bear interest at the prime rate plus 1.875% per annum, and the average interest rate as of and for the six months ended June 30, 2017 was 6.125% and 5.80%, respectively. We are in compliance with all of the covenants contained in such facility at June 30, 2017.

## Note 9 – Employee benefit plans:

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

| Three months<br>ended |      | Six months ended |      |
|-----------------------|------|------------------|------|
| June 30,<br>2016      | 2017 | June 30,<br>2016 | 2017 |

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|                                | (In thousands) |       |         |         |
|--------------------------------|----------------|-------|---------|---------|
| Interest cost                  | \$601          | \$506 | \$1,193 | \$1,012 |
| Expected return on plan assets | (736)          | (689) | (1,471) | (1,378) |
| Recognized actuarial losses    | 477            | 394   | 908     | 788     |
| Total                          | \$342          | \$211 | \$630   | \$422   |

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

|                                      | Three<br>months<br>ended<br>June 30,<br>2016 |               | Six months<br>ended<br>June 30,<br>2017 |                |
|--------------------------------------|--|---------------|---|----------------|
|                                      | 2016   | 2017          | 2016                                    | 2017           |
|                                      | (In thousands)                               |               |   |                |
| Interest cost                        | \$24   | \$20          | \$48                                    | \$40           |
| Amortization of prior service credit | (136)  | -             | (271)                                   | -              |
| Recognized actuarial gains           | (38 )  | (54)          | (76 )                                   | (108)          |
| <b>Total</b>                         | <b>\$(150)</b>                               | <b>\$(34)</b> | <b>\$(299)</b>                          | <b>\$(68 )</b> |

Contributions – We currently expect our 2017 contributions to our defined benefit pension plans and other postretirement plans to be approximately \$1.4 million.

Note 10 – Other noncurrent liabilities:

|                                     | December<br>31,<br>2016 |                 | June 30,<br>2017 |
|-------------------------------------|-------------------------|-----------------|------------------|
|                                     | (In thousands)          |                 |                  |
| Reserve for uncertain tax positions | \$12,186                | \$12,186        |                  |
| Insurance claims and expenses       | 589                     | 625             |                  |
| Other                               | 767                     | 704             |                  |
| <b>Total</b>                        | <b>\$13,542</b>         | <b>\$13,515</b> |                  |

## Note 11 – Income taxes:

|  | Three months ended |        | Six months ended |        |
|--|--------------------|--------|------------------|--------|
|  | June 30, 2016      | 2017   | June 30, 2016    | 2017   |
|  | (In millions)      |        |                  |        |
| Expected tax expense (benefit), at U.S. federal    |                    |        |                  |        |
| statutory income tax rate of 35%                   | \$0.6              | \$21.7 | \$(0.5)          | \$25.5 |
| Rate differences on equity in earnings (losses) of |                    |        |                  |        |
| Kronos   |                    |        |                  |        |
| Nontaxable income                                  | -                  | -      | (.2)             | (.2)   |
| U.S. state income taxes and other, net             | (.2)               | (.1)   | -                | .1     |
| Income tax expense (benefit)                       | \$ .3              | \$20.3 | \$(.5)           | \$22.5 |
| Comprehensive provision for income taxes           |                    |        |                  |        |
| (benefit) allocable to:                            |                    |        |                  |        |
| Net income (loss)                                  | \$ .3              | \$20.3 | \$(.5)           | \$22.5 |
| Other comprehensive income (loss):                 |                    |        |                  |        |
| Marketable securities                              | 2.0                | (1.6)  | 1.2              | (2.5)  |
| Currency translation                               | (.5)               | 1.6    | 1.0              | 2.5    |
| Interest rate swap                                 | (.1)               | (.1)   | (.4)             | -      |
| Pension plans                                      | .5                 | .2     | .9               | .7     |
| OPEB plans   | -                  | .1     | (.1)             | -      |
| Total  | \$2.2              | \$20.5 | \$2.1            | \$23.2 |

In accordance with GAAP, we recognize deferred income taxes on our undistributed equity in earnings (losses) of Kronos. Because we and Kronos are part of the same U.S. federal income tax group, any dividends we receive from Kronos are nontaxable to us. Accordingly, we do not recognize and we are not required to pay income taxes on dividends from Kronos. We received aggregate dividends from Kronos of \$10.6 million in the first half of 2016 and 2017. The amounts shown in the above table of our income tax rate reconciliation for rate differences on equity in earnings (losses) of Kronos represents the net tax (benefit) associated with such non-taxability of the dividends we receive from Kronos, as it relates to the amount of deferred income taxes we recognize on our undistributed equity in earnings (losses) of Kronos.

Kronos has substantial net operating loss (NOL) carryforwards in Germany and Belgium, the benefit of which Kronos had previously recognized under the more-likely-than-not recognition criteria. In the second quarter of 2015, Kronos determined such losses did not meet the more-likely-than-not recognition criteria, and as a result Kronos recognized a

non-cash deferred income tax expense as a valuation allowance against its net deferred income tax assets in such jurisdictions. Kronos continued to conclude such losses did not meet the more-likely-than-not recognition criteria through March 31, 2017. During 2016, Kronos recognized an aggregate \$2.2 million non-cash income tax benefit as the result of a net decrease in such deferred income tax valuation allowance, as the impact of utilizing a portion of its German NOLs during such period more than offset the impact of additional losses recognized by its Belgian operations during such period. During the first six months of 2017, Kronos recognized an aggregate non-cash income tax benefit of \$12.7 million as a result of a net decrease in such deferred income tax asset valuation allowance, due to utilizing a portion of both the German and Belgian NOLs during such period, including \$7.7 million in the second quarter of 2017. At June 30, 2017, Kronos concluded it now has sufficient positive evidence under the more-likely-than-not recognition criteria to support reversal of the entire valuation allowance related to its German and Belgian operations. As discussed below, a large portion of the remaining valuation allowance is reversed as of June 30, 2017, but a portion of the remaining valuation allowance will be reversed in the second half of 2017. Such sufficient positive evidence at June 30, 2017 includes, among other things, the existence of cumulative profits in the most recent twelve consecutive quarters (Germany) or profitability in recent quarters during which such profitability was trending upward throughout such period (Belgium), the ability



to demonstrate future profitability in Germany and Belgium for a sustainable period, and the indefinite carryforward period for the German and Belgian NOLs. Accordingly our equity in income from Kronos in the second quarter of 2017 includes our share of an aggregate non-cash income tax benefit of \$149.9 million recognized by Kronos related to such reversal at June 30, 2017 (\$141.9 million related to Germany, and \$8.0 million related to Belgium). Such second quarter 2017 income tax benefit associated with the reversal of the German and Belgian valuation allowance excludes the non-cash income tax benefit of \$7.7 million, also recognized in the second quarter, as discussed above. In accordance with the ASC 740-270 guidance regarding accounting for income taxes at interim dates, the amount of the valuation allowance reversed at June 30, 2017 (\$149.9 million) relates to Kronos' change in judgment regarding the realizability of the related deferred income tax asset as it relates to future years (i.e. 2018 and after). A change in judgment regarding the realizability of deferred tax assets as it relates to the current year is considered in determining the estimated annual effective tax rate for the year. Accordingly, the remaining \$20 million (which relates to the expected profitability of Kronos' German and Belgian operations in calendar 2017), will be reversed in the third and fourth quarters of 2017 and our share of such reversal will be included in our equity in income from Kronos for such periods.

Tax authorities are examining certain of Kronos' U.S. and non-U.S. tax returns and have or may propose tax deficiencies, including penalties and interest. Because of the inherent uncertainties involved in settlement initiatives and court and tax proceedings, Kronos cannot guarantee that these matters will be resolved in its favor, and therefore Kronos' potential exposure, if any, is also uncertain. As a result of ongoing audits in certain jurisdictions, in 2008 Kronos filed Advance Pricing Agreement Requests with the tax authorities in the U.S., Canada and Germany. These requests have been under review with the respective tax authorities since 2008 and prior to 2016, it was uncertain whether an agreement would be reached between the tax authorities and whether Kronos would agree to execute and finalize such agreements. During 2016, Contran, as the ultimate parent of Kronos' U.S. Consolidated income tax group, executed and finalized an Advance Pricing Agreement with the U.S. Internal Revenue Service and Kronos' Canadian subsidiary executed and finalized an Advance Pricing Agreement with the Competent Authority for Canada (collectively, the "U.S.-Canada APA") effective for tax years 2005 - 2015. Pursuant to the terms of the U.S.-Canada APAs, the U.S. and Canadian tax authorities agreed to certain prior year changes to taxable income of Kronos' U.S. and Canadian subsidiaries. As a result of such agreed-upon changes, Kronos' Canadian subsidiary will incur a cash income tax payment of approximately CAD \$3 million (USD \$2.3 million) related to the U.S.-Canada APA, but such payment was fully offset by previously provided accruals. Kronos currently expects the Advance Pricing Agreement between Canada and Germany (collectively, the "Canada-Germany APA") to be executed and finalized within the next twelve months. Kronos believes it has adequate accruals to cover any cash income tax payment which might result from the finalization of the Canada-Germany APA, and accordingly Kronos does not expect the execution of such APA to have a material adverse effect on its consolidated financial position, results of operations or liquidity.

We believe we have adequate accruals for additional taxes and related interest expense which could ultimately result from tax examinations. We believe the ultimate disposition of tax examinations should not have a material adverse effect on our consolidated financial position, results of operating or liquidity. We currently estimate that our unrecognized tax benefits will not change materially during the next twelve months.

## Note 12 – Accumulated other comprehensive income (loss):

Changes in accumulated other comprehensive income (loss) attributable to NL stockholders, including amounts resulting from our investment in Kronos Worldwide (see Note 5), are presented in the table below.

|   | Three months ended<br>June 30,<br>2016 |             | Six months ended<br>June 30,<br>2017 |             |
|---|--|-------------|--------------------------------------|-------------|
|   | 2016                                   | 2017        | 2016                                 | 2017        |
|   | (In thousands)                         |             |                                      |             |
| Accumulated other comprehensive loss, net of tax: |  |             |                                      |             |
| Marketable securities:                            |  |             |                                      |             |
| Balance at beginning of period                    | \$(1,336 )                             | \$18,751    | \$195                                | \$20,473    |
| Other comprehensive loss - unrealized             |  |             |                                      |             |
| gains (losses) arising during the year            | 3,730                                  | (2,869 )    | 2,199                                | (4,591 )    |
| Balance at end of period                          | \$2,394                                | \$15,882    | \$2,394                              | \$15,882    |
| Currency translation:                             |  |             |                                      |             |
| Balance at beginning of period                    | \$(169,553)                            | \$(174,088) | \$(172,384)                          | \$(175,859) |
| Other comprehensive income (loss)                 | (980 )                                 | 2,925       | 1,851                                | 4,696       |
| Balance at end of period                          | \$(170,533)                            | \$(171,163) | \$(170,533)                          | \$(171,163) |
| Interest rate swap:                               |  |             |                                      |             |
| Balance at beginning of period                    | \$(1,016 )                             | \$(278 )    | \$(445 )                             | \$(390 )    |
| Other comprehensive income (loss):                |  |             |                                      |             |
| Unrealized losses arising during the year         | (269 )                                 | (178 )      | (952 )                               | (177 )      |
| Less reclassification adjustment for              |  |             |                                      |             |
| amounts included in interest expense              | 112                                    | 94          | 224                                  | 205         |
| Balance at end of period                          | \$(1,173 )                             | \$(362 )    | \$(1,173 )                           | \$(362 )    |
| Defined benefit pension plans:                    |  |             |                                      |             |
| Balance at beginning of period                    | \$(71,905 )                            | \$(75,843 ) | \$(72,712 )                          | \$(76,710 ) |
| Other comprehensive income -                      |  |             |                                      |             |
| amortization of net losses included               |  |             |                                      |             |
| in net periodic pension cost                      | 823                                    | 393         | 1,630                                | 1,260       |
| Balance at end of period                          | \$(71,082 )                            | \$(75,450 ) | \$(71,082 )                          | \$(75,450 ) |
| OPEB plans:                                       |  |             |                                      |             |
| Balance at beginning of period                    | \$(144 )                               | \$(408 )    | \$(12 )                              | \$(360 )    |
| Other comprehensive loss -                        | (132 )                                 | (48 )       | (264 )                               | (96 )       |

amortization of prior service credit and  
 net gains included in net periodic OPEB cost

|                          |          |          |          |          |
|--------------------------|----------|----------|----------|----------|
| Balance at end of period | \$(276 ) | \$(456 ) | \$(276 ) | \$(456 ) |
|--------------------------|----------|----------|----------|----------|

Total accumulated other comprehensive loss:

|                                |             |             |             |             |
|--------------------------------|-------------|-------------|-------------|-------------|
| Balance at beginning of period | \$(243,954) | \$(231,866) | \$(245,358) | \$(232,846) |
|--------------------------------|-------------|-------------|-------------|-------------|

|                            |       |     |       |       |
|----------------------------|-------|-----|-------|-------|
| Other comprehensive income | 3,284 | 317 | 4,688 | 1,297 |
|----------------------------|-------|-----|-------|-------|

|                          |             |             |             |             |
|--------------------------|-------------|-------------|-------------|-------------|
| Balance at end of period | \$(240,670) | \$(231,549) | \$(240,670) | \$(231,549) |
|--------------------------|-------------|-------------|-------------|-------------|

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

Note 13 – Commitments and contingencies:

General

We are involved in various environmental, contractual, product liability, patent (or intellectual property), employment and other claims and disputes incidental to our current and former businesses. At least quarterly our management discusses and evaluates the status of any pending litigation or claim to which we are a party or which has been asserted against us. The factors considered in such evaluation include, among other things, the nature of such pending cases and claims, the status of such pending cases and claims, the advice of legal counsel and our experience in similar cases and claims (if any). Based on such evaluation, we make a determination as to whether we believe (i) it is probable a loss has been incurred, and if so if the amount of such loss (or a range of loss) is reasonably estimable, or (ii) it is reasonably possible but not probable a loss has been incurred, and if so if the amount of such loss (or a range of loss) is reasonably estimable, or (iii) the probability a loss has been incurred is remote.

Lead pigment litigation

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

The plaintiffs in these actions generally seek to impose on the defendants responsibility for lead paint abatement and health concerns associated with the use of lead-based paints, including damages for personal injury, contribution and/or indemnification for medical expenses, medical monitoring expenses and costs for educational programs. To the extent the plaintiffs seek compensatory or punitive damages in these actions, such damages are generally unspecified. In some cases, the damages are unspecified pursuant to the requirements of applicable state law. A number of cases are inactive or have been dismissed or withdrawn. Most of the remaining cases are in various pre-trial stages. Some are on appeal following dismissal or summary judgment rulings or a trial verdict in favor of either the defendants or the plaintiffs.

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

- we have never settled any of the market share, intentional tort, fraud, nuisance, supplier negligence, breach of warranty, conspiracy, misrepresentation, aiding and abetting, enterprise liability, or statutory cases,
- no final, non-appealable adverse verdicts have ever been entered against us, and
- we have never ultimately been found liable with respect to any such litigation matters, including over 100 cases over a twenty-year period for which we were previously a party and for which we have been dismissed without any finding of liability.

Accordingly, we have not accrued any amounts for any of the pending lead pigment and lead—based paint litigation cases filed by or on behalf of states, counties, cities or their public housing authorities and school districts, or those asserted as class actions. In addition, we have determined that liability to us which may result, if any, cannot be reasonably estimated because there is no prior history of a loss of this nature on which an estimate could be made and there is no substantive information available upon which an estimate could be based.

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In one of these lead pigment cases, in April 2000 we were served with a complaint in County of Santa Clara v. Atlantic Richfield Company, et al. (Superior Court of the State of California, County of Santa Clara, Case No. 1-00-CV-788657) brought by a number of California government entities against the former pigment manufacturers, the LIA and certain paint manufacturers. The County of Santa Clara sought to recover compensatory damages for funds the plaintiffs have expended or would in the future expend for medical treatment, educational expenses, abatement or other costs due to exposure to, or potential exposure to, lead paint, disgorgement of profit, and punitive damages. In July 2003, the trial judge granted defendants' motion to dismiss all remaining claims. Plaintiffs appealed and the intermediate appellate court reinstated public nuisance, negligence, strict liability, and fraud claims in March 2006. A fourth amended complaint was filed in March 2011 on behalf of The People of California by the County Attorneys of Alameda, Ventura, Solano, San Mateo, Los Angeles and Santa Clara, and the City Attorneys of San Francisco, San Diego and Oakland. That complaint alleged that the presence of lead paint created a public nuisance in each of the prosecuting jurisdictions and sought its abatement. In July and August 2013, the case was tried. In January 2014, the Judge issued a judgment finding us, The Sherwin Williams Company and ConAgra Grocery Products Company jointly and severally liable for the abatement of lead paint in pre-1980 homes, and ordered the defendants to pay an aggregate \$1.15 billion to the people of the State of California to fund such abatement. In February 2014, we filed a motion for a new trial, and in March 2014 the court denied the motion. Subsequently in March 2014, we filed a notice of appeal with the Sixth District Court of Appeal for the State of California and the appeal is proceeding with the appellate court. The California Sixth District Court of Appeal has scheduled on August 24, 2017 the oral argument in the appeal of the lower court decision. NL believes that this judgment is inconsistent with California law and is unsupported by the evidence, and we will defend vigorously against all claims.

The Santa Clara case is unusual in that this is the second time that an adverse verdict in the lead pigment litigation has been entered against NL (the first adverse verdict against NL was ultimately overturned on appeal). We have concluded that the likelihood of a loss in this case has not reached a standard of "probable" as contemplated by ASC 450, given (i) the substantive, substantial and meritorious grounds on which the adverse verdict in the Santa Clara case will be appealed, (ii) the uniqueness of the Santa Clara verdict (i.e. no final, non-appealable verdicts have ever been rendered against us, or any of the other former lead pigment manufacturers, based on the public nuisance theory of liability or otherwise), and (iii) the rejection of the public nuisance theory of liability as it relates to lead pigment matters in many other jurisdictions (no jurisdiction in which a plaintiff has asserted a public nuisance theory of liability has ever successfully been upheld). In addition, liability that may result, if any, cannot be reasonably estimated, as NL continues to have no basis on which an estimate of liability could be made, as discussed above. However, as with any legal proceeding, there is no assurance that any appeal would be successful, and it is reasonably possible, based on the outcome of the appeals process, that NL may in the future incur some liability resulting in the recognition of a loss contingency accrual that could have a material adverse impact on our results of operations, financial position and liquidity.

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

Environmental matters and litigation

Our operations are governed by various environmental laws and regulations. Certain of our businesses are and have been engaged in the handling, manufacture or use of substances or compounds that may be considered toxic or hazardous within the meaning of applicable environmental laws and regulations. As with other companies engaged in similar businesses, certain of our past and current operations and products have the potential to cause environmental or other damage. We have implemented and continue to implement various policies and programs in an effort to minimize these risks. Our policy is to maintain compliance with applicable environmental laws and

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regulations at all of our plants and to strive to improve environmental performance. From time to time, we may be subject to environmental regulatory enforcement under U.S. and non-U.S. statutes, the resolution of which typically involves the establishment of compliance programs. It is possible that future developments, such as stricter requirements of environmental laws and enforcement policies, could adversely affect our production, handling, use, storage, transportation, sale or disposal of such substances. We believe that all of our facilities are in substantial compliance with applicable environmental laws.

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

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

- complexity and differing interpretations of governmental regulations,
- number of PRPs and their ability or willingness to fund such allocation of costs,
- financial capabilities of the PRPs and the allocation of costs among them,
- solvency of other PRPs,
- multiplicity of possible solutions,
  - number of years of investigatory, remedial and monitoring activity required,
- uncertainty over the extent, if any, to which our former operations might have contributed to the conditions allegedly giving rise to such personal injury, property damage, natural resource and related claims, and
- number of years between former operations and notice of claims and lack of information and documents about the former operations.

In addition, the imposition of more stringent standards or requirements under environmental laws or regulations, new developments or changes regarding site cleanup costs or the allocation of costs among PRPs, solvency of other PRPs, the results of future testing and analysis undertaken with respect to certain sites or a determination that we are potentially responsible for the release of hazardous substances at other sites, could cause our expenditures to exceed our current estimates. We do not know if actual costs will exceed accrued amounts or the upper end of the range for sites for which estimates have been made, and we do not know if costs will be incurred for sites where no estimates presently can be made. Further, additional environmental and related matters may arise in the future. If we were to incur any future liability, this could have a material adverse effect on our consolidated financial statements, results of operations and liquidity.

We record liabilities related to environmental remediation and related matters (including costs associated with damages for personal injury or property damage and/or damages for injury to natural resources) when estimated future



expenditures are probable and reasonably estimable. We adjust such accruals as further information becomes available to us or as circumstances change. Unless the amounts and timing of such estimated future expenditures are

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fixed and reasonably determinable, we generally do not discount estimated future expenditures to their present value due to the uncertainty of the timing of the payout. We recognize recoveries of costs from other parties, if any, as assets when their receipt is deemed probable. At December 31, 2016 and June 30, 2017, we have not recognized any receivables for recoveries.

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

Changes in the accrued environmental remediation and related costs during the first six months of 2017 are as follows:

|   | Amount<br>(In<br>thousands) |
|---|-----------------------------|
| Balance at the beginning of the period                  | \$ 116,658                  |
| Additions charged to expense, net                       | 3,147                       |
| Payments, net   | (646 )                      |
| <b>Balance at the end of the period</b>                 | <b>\$ 119,159</b>           |
| <b>Amounts recognized in the Condensed Consolidated</b> |                             |
| <b>Balance Sheet at the end of the period:</b>          |                             |
| Current liability                                       | \$ 13,101                   |
| Noncurrent liability                                    | 106,058                     |
| <b>Balance at the end of the period</b>                 | <b>\$ 119,159</b>           |

On a quarterly basis, we evaluate the potential range of our liability for environmental remediation and related costs at sites where we have been named as a PRP or defendant, including sites for which our wholly-owned environmental management subsidiary, NL Environmental Management Services, Inc. (EMS), has contractually assumed our obligations. At June 30, 2017, we had accrued approximately \$119 million related to approximately 41 sites associated with remediation and related matters that we believe are at the present time and/or in their current phase reasonably estimable. The upper end of the range of reasonably possible costs to us for remediation and related matters for which we believe it is possible to estimate costs is approximately \$161 million, including the amount currently accrued. These accruals have not been discounted to present value.

We believe that it is not reasonably possible to estimate the range of costs for certain sites. At June 30, 2017, there were approximately 5 sites for which we are not currently able to reasonably estimate a range of costs. For these sites, generally the investigation is in the early stages, and we are unable to determine whether or not we actually had any association with the site, the nature of our responsibility for the contamination at the site, if any, and the extent of contamination at and cost to remediate the site. The timing and availability of information on these sites is dependent on events outside of our control, such as when the party alleging liability provides information to us. At certain of these previously inactive sites, we have received general and special notices of liability from the EPA and/or state agencies alleging that we, sometimes with other PRPs, are liable for past and future costs of remediating environmental contamination allegedly caused by former operations. These notifications may assert that we, along with any other alleged PRPs, are liable for past and/or future clean-up costs. As further information becomes available to us for any of these sites, which would allow us to estimate a range of costs, we would at that time adjust

our accruals. Any such adjustment could result in the recognition of an accrual that would have a material effect on our consolidated financial statements, results of operations and liquidity.

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#### Insurance coverage claims

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

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

For a complete discussion of certain litigation involving us and certain of our former insurance carriers, refer to our 2016 Annual Report.

#### Other litigation

We have been named as a defendant in various lawsuits in several jurisdictions, alleging personal injuries as a result of occupational exposure primarily to products manufactured by our former operations containing asbestos, silica and/or mixed dust. In addition, some plaintiffs allege exposure to asbestos from working in various facilities previously owned and/or operated by us. There are 101 of these types of cases pending, involving a total of approximately 586 plaintiffs. In addition, the claims of approximately 8,687 plaintiffs have been administratively dismissed or placed on the inactive docket in Ohio state court. We do not expect these claims will be re-opened unless the plaintiffs meet the courts' medical criteria for asbestos-related claims. We have not accrued any amounts for this litigation because of the uncertainty of liability and inability to reasonably estimate the liability, if any. To date, we have not been adjudicated liable in any of these matters.

Based on information available to us, including:

- facts concerning historical operations,
- the rate of new claims,
- the number of claims from which we have been dismissed, and
- our prior experience in the defense of these matters,

we believe that the range of reasonably possible outcomes of these matters will be consistent with our historical costs (which are not material). Furthermore, we do not expect any reasonably possible outcome would involve amounts material to our consolidated financial position, results of operations or liquidity. We have sought and will continue to vigorously seek dismissal and/or a finding of no liability from each claim. In addition, from time to time, we have received notices regarding asbestos or silica claims purporting to be brought against former subsidiaries, including notices provided to insurers with which we have entered into settlements extinguishing certain insurance policies. These insurers may seek indemnification from us. For a discussion of other legal proceedings to which we are a party, refer to our 2016 Annual Report.

In addition to the litigation described above, we and our affiliates are also involved in various other environmental, contractual, product liability, patent (or intellectual property), employment and other claims and disputes incidental to

present and former businesses. In certain cases, we have insurance coverage for these items, although we do not expect additional material insurance coverage for environmental matters.

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

Note 14 – Financial instruments and fair value measurements:

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

The following table presents the financial instruments that are not carried at fair value but which require fair value disclosure:

|   | December 31,<br>2016 |               | June 30, 2017      |               |
|---|----------------------|---------------|--------------------|---------------|
|   | Carrying<br>amount   | Fair<br>value | Carrying<br>amount | Fair<br>value |
|   | (In thousands)       |               |                    |               |
| Cash, cash equivalents and restricted cash    | \$98,242             | \$98,242      | \$94,550           | \$94,550      |
| Noncontrolling interest in CompX common stock | 16,350               | 26,790        | 17,040             | 25,399        |

The fair value of our noncontrolling interest in CompX stockholders' equity is based upon its quoted market price at each balance sheet date, which represents a Level 1 input. Due to their near-term maturities, the carrying amounts of accounts receivable and accounts payable are considered equivalent to fair value.

Note 15 – Recent accounting pronouncements not yet adopted:

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-09, Revenue from Contracts with Customers (Topic 606). This standard replaces existing revenue recognition guidance, which in many cases was tailored for specific industries, with a uniform accounting standard applicable to all industries and transactions. The new standard, as amended, is currently effective for us beginning with the first quarter of 2018. Entities may elect to adopt ASU No. 2014-09 retrospectively for all periods for all contracts and transactions which occurred during the period (with a few exceptions for practical expediency) or retrospectively with a cumulative effect recognized as of the date of adoption. ASU No. 2014-09 is a fundamental rewriting of existing GAAP with respect to revenue recognition, and we are still evaluating the effect the Standard will have on our Consolidated Financial Statements. We currently expect to adopt the standard in the first quarter of 2018 using the modified retrospective approach to adoption. Our sales generally involve single performance obligations to ship goods pursuant to customer purchase orders without further underlying contracts, and as such, we expect adoption of this standard will have a minimal effect on our revenues. We are in the process of evaluating the additional disclosure requirements.

In January 2016, the FASB issued ASU 2016-01, Financial Instruments-Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities, which addresses certain aspects related to the recognition, measurement, presentation and disclosure of financial instruments. The ASU requires equity investments (except for those accounted for under the equity method of accounting or those that result in the consolidation of the investee) to generally be measured at fair value with changes in fair value recognized in net income. The amendment also requires a number of other changes, including among others: simplifying the impairment assessment for equity instruments without readily determinable fair values; eliminating the requirement for public business entities to disclose method

and assumptions used to determine fair value for financial instruments measured at amortized cost; requiring an exit price notion when measuring the fair value of financial instruments for disclosure purposes; and requiring separate presentation of financial assets and liabilities by measurement category and form of asset. The changes indicated above will be effective for us beginning in the first quarter of 2018, with prospective application required, and early adoption is not permitted. The most significant aspect of adopting this ASU will be the requirement to recognize changes in fair value of our available-for-sale marketable equity securities in net income (currently changes in fair value of such securities are recognized in other comprehensive income).

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842), which is a comprehensive rewriting of the lease accounting guidance which aims to increase comparability and transparency with regard to lease

transactions. The primary change will be the recognition of lease assets for the right-of-use of the underlying asset and lease liabilities for the obligation to make payments by lessees on the balance sheet for leases currently classified as operating leases. The ASU also requires increased qualitative disclosure about leases in addition to quantitative disclosures currently required. Companies are required to use a modified retrospective approach to adoption with a practical expedient which will allow companies to continue to account for existing leases under the prior guidance unless a lease is modified, other than the requirement to recognize the right-of-use asset and lease liability for all operating leases. The changes indicated above will be effective for us beginning in the first quarter of 2019, with early adoption permitted. We are in the process of assessing all of our current leases. We have not yet evaluated the effect this ASU will have on our Consolidated Financial Statements, but given the insignificant amount of our future minimum payments under non-cancellable operating leases at December 31, 2016 discussed in Note 17 to our 2016 Annual Report, we do not expect the adoption of this standard to have a material effect on our Consolidated Balance Sheets.

In January 2017, the FASB issued ASU 2017-04, Intangibles— Goodwill and Other (Topic 350) Simplifying the Test for Goodwill Impairment, which aims to simplify the subsequent measurement of goodwill by eliminating Step 2 from the goodwill impairment test. Previously, Step 2 measured a goodwill impairment loss by comparing the implied fair value of a reporting unit's goodwill with the carrying amount of that goodwill. Instead, under the new ASU, an entity should perform its annual, or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount, and a goodwill impairment charge would be recognized for the amount by which the carrying amount exceeds the reporting unit's fair value. In no circumstances would the loss recognized exceed the total amount of goodwill allocated to that reporting unit. The changes indicated above will be effective for us beginning in 2020 (our annual impairment tests are completed in the third quarter), with prospective application required, and early adoption is permitted. We do not believe the application of ASU 2017-04 will have a material effect on our Condensed Consolidated Financial Statements, and we plan to early adopt this ASU beginning with our current year goodwill impairment tests.

In March 2017, the FASB issued ASU 2017-07, Compensation— Retirement Benefits (Topic 715) Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost, which requires that the service cost component of net periodic defined benefit pension and OPEB cost be reported in the same line item as other compensation costs for applicable employees incurred during the period. Other components of such net benefit cost are required to be presented in the income statement separately from the service cost component, and below income from operations (if such a subtotal is presented). These other net benefit cost components must be disclosed either on the face of the financial statements or in the notes to the financial statements. In addition only the service cost component is eligible for capitalization in assets where applicable (inventory or internally constructed fixed assets for example). The amendments in ASU 2017-06 are effective for us beginning with in the first quarter of 2018, early adoption as of the beginning of an annual period is permitted, retrospective presentation is required for the income statement presentation of the service cost component and other components of net benefit cost, and prospective application is required for the capitalization in assets of the service cost component of net benefit cost. We expect to adopt this ASU in the first quarter of 2018. Our net benefit cost for both defined benefit pension plans and OPEB plans does not include any service cost component, none of such net benefit costs are capitalized in assets, we present a subtotal for income from operations and our net benefit cost is currently included in the determination of income from operations. Accordingly, adoption of this standard will change the determination of the amount we report as income from operations. As disclosed in Note 11 to our 2016 Annual Report, our total net periodic defined benefit pension costs were \$865,000 in 2016, and our net periodic OPEB cost was a credit of \$597,000 during 2016.





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

Business overview

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

CompX is a leading manufacturer of engineered components utilized in a variety of applications and industries. Through its Security Products operations, CompX manufactures mechanical and electronic cabinet locks and other locking mechanisms used in recreational transportation, postal, office and institutional furniture, cabinetry, tool storage and healthcare applications. CompX also manufactures stainless steel exhaust systems, gauges, throttle controls and trim tabs for the recreational marine and other non-marine industries through its Marine Components operations.

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

Forward-looking information

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

- Future supply and demand for our products
- The extent of the dependence of certain of our businesses on certain market sectors
- The cyclicity of our businesses (such as Kronos' TiO<sub>2</sub> operations)
- Customer and producer inventory levels
- Unexpected or earlier-than-expected industry capacity expansion (such as the TiO<sub>2</sub> industry)
- Changes in raw material and other operating costs (such as ore, zinc, brass, aluminum, steel and energy costs) and our ability to pass those costs on to our customers or offset them with reductions in other operating costs
- Changes in the availability of raw material (such as ore)
- General global economic and political conditions (such as changes in the level of gross domestic product in various regions of the world and the impact of such changes on demand for, among other things, TiO<sub>2</sub> and component products)

Competitive products and substitute products

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- Price and product competition from low-cost manufacturing sources (such as China)
- Customer and competitor strategies
- Potential consolidation of Kronos' competitors
- Potential consolidation of Kronos' customers
- The impact of pricing and production decisions
- Competitive technology positions
- Potential difficulties in integrating future acquisitions
- Potential difficulties in upgrading or implementing new accounting and manufacturing software systems (such as Kronos' new enterprise resource planning system)
- The introduction of trade barriers
- Possible disruption of Kronos' or CompX's business, or increases in our cost of doing business resulting from terrorist activities or global conflicts
- The impact of current or future government regulations (including employee healthcare benefit related regulations)
- Fluctuations in currency exchange rates (such as changes in the exchange rate between the U.S. dollar and each of the euro, the Norwegian krone and the Canadian dollar), or possible disruptions to our business resulting from potential instability resulting from uncertainties associated with the euro or other currencies
- Operating interruptions (including, but not limited to, labor disputes, leaks, natural disasters, fires, explosions, unscheduled or unplanned downtime, transportation interruptions and cyber attacks)
- Decisions to sell operating assets other than in the ordinary course of business
- Kronos' ability to renew or refinance credit facilities
- Our ability to maintain sufficient liquidity
- The timing and amounts of insurance recoveries
  - The extent to which our subsidiaries or affiliates were to become unable to pay us dividends
- The ultimate outcome of income tax audits, tax settlement initiatives or other tax matters
- Uncertainties associated with CompX's development of new product features
- Our ability to utilize income tax attributes or changes in income tax rates related to such attributes, the benefits of which may or may not have been recognized under the more-likely-than-not recognition criteria
- Environmental matters (such as those requiring compliance with emission and discharge standards for existing and new facilities or new developments regarding environmental remediation at sites related to our former operations)
- Government laws and regulations and possible changes therein (such as changes in government regulations which might impose various obligations on former manufacturers of lead pigment and lead-based paint, including us, with respect to asserted health concerns associated with the use of such products)
- The ultimate resolution of pending litigation (such as our lead pigment and environmental matters)
- Possible future litigation.

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

## Results of operations

### Net income (loss) overview

#### Quarter ended June 30, 2017 compared to the quarter ended June 30, 2016

Our net income attributable to NL stockholders was \$41.2 million, or \$.85 per share, in the second quarter of 2017 compared to \$.9 million, or \$.02 per share, in the second quarter of 2016. As more fully described below, the increase in our earnings per share from 2016 to 2017 is primarily due to the net effects of:

- equity in earnings of Kronos in 2017 of \$59.7 million compared to \$.5 million in 2016;
- higher income from operations attributable to CompX of \$.9 million in 2017; and
- higher litigation fees and related costs of \$.5 million in 2017.

Our 2017 net income attributable to NL stockholders includes income of \$.64 per share, net of income taxes, included in our equity in earnings of Kronos related to Kronos' non-cash deferred income tax benefit recognized as a result of a net decrease in Kronos' deferred income tax asset valuation allowance related to its German and Belgian operations.

Our 2016 net income attributable to NL stockholders includes a loss of \$.01 per share, net of income taxes, included in our equity in earnings of Kronos related to Kronos' recognition of a deferred income tax asset valuation allowance related to its German and Belgian operations.

#### Six months ended June 30, 2017 compared to six months ended June 30, 2016

Our net income attributable to NL stockholders was \$49.5 million, or \$1.02 per share, in the first six months of 2017 compared to a net loss attributable to NL stockholders of \$1.6 million, or \$.03 per share, in the first six months of 2016. As more fully described below, the increase in our earnings per share from 2016 to 2017 is primarily due to the net effects of:

- equity in earnings of Kronos in 2017 of \$70.9 million compared to equity in losses of \$.7 million in 2016;
- higher income from operations attributable to CompX of \$2.0 million in 2017; and
- higher litigation fees and related costs of \$.2 million in 2017, and
- higher environmental remediation and related costs of \$.1 million in 2017.

Our 2017 net income attributable to NL stockholders includes income of \$.66 per share, net of income taxes, included in our equity in losses of Kronos related to Kronos' non-cash deferred income tax benefit recognized as a result of a net decrease in Kronos' deferred income tax asset valuation allowance related to its German and Belgian operations.

Our 2016 net loss attributable to NL stockholders includes:

- income of \$.01 per share, net of income taxes, included in our equity in losses of Kronos related to Kronos' insurance settlement gain related to a 2014 business interruption claim, and
- loss of \$.01 per share, net of income taxes, included in our equity in losses of Kronos related to Kronos' recognition of a deferred income tax asset valuation allowance related to its German and Belgian operations.

Income (loss) from operations

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

|                               | Three months ended             |        |          | Six months ended               |       |          |
|-------------------------------|--------------------------------|--------|----------|--------------------------------|-------|----------|
|                               | June 30, 2016<br>(In millions) | 2017   | % Change | June 30, 2016<br>(In millions) | 2017  | % Change |
| CompX                         | \$3.7                          | \$4.6  | 24 %     | \$7.1                          | \$9.1 | 28 %     |
| Insurance recoveries          | .2                             | -      | (72 )    | .3                             | .1    | (67 )    |
| Corporate expense             | (3.3)                          | (3.4)  | (3 )     | (9.0)                          | (8.9) | 1        |
| Income (loss) from operations | \$ .6                          | \$ 1.2 | 102      | \$ (1.6)                       | \$ .3 | 119      |

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

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

|                                       | Three months ended             |         |          | Six months ended               |         |          |
|---------------------------------------|--------------------------------|---------|----------|--------------------------------|---------|----------|
|                                       | June 30, 2016<br>(In millions) | 2017    | % Change | June 30, 2016<br>(In millions) | 2017    | % Change |
| Equity in earnings (losses) of Kronos | \$ .5                          | \$ 59.7 | 11,840 % | \$ (.7)                        | \$ 70.9 | 10,229 % |
| Interest and dividend income          | .4                             | .9      | 125      | .8                             | 1.6     | 100      |

CompX International Inc.

|                              | Three months ended             |        |          | Six months ended               |        |          |
|------------------------------|--------------------------------|--------|----------|--------------------------------|--------|----------|
|                              | June 30, 2016<br>(In millions) | 2017   | % Change | June 30, 2016<br>(In millions) | 2017   | % Change |
| Net sales                    | \$27.1                         | \$30.0 | 11 %     | \$54.2                         | \$60.0 | 11 %     |
| Cost of sales                | 18.6                           | 20.5   | 10       | 37.5                           | 40.8   | 9        |
| Gross margin                 | 8.5                            | 9.5    | 12       | 16.7                           | 19.2   | 15       |
| Operating costs and expenses | 4.8                            | 4.9    | 3        | 9.6                            | 10.1   | 5        |

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|                          |       |       |    |       |       |    |
|--------------------------|-------|-------|----|-------|-------|----|
| Income from operations   | \$3.7 | \$4.6 | 24 | \$7.1 | \$9.1 | 29 |
| Percentage of net sales: |       |       |    |       |       |    |
| Cost of sales            | 69    | % 68  | %  | 69    | % 68  |    |
| Gross margin             | 31    | 32    |    | 31    | 32    |    |
| Operating costs          |       |       |    |       |       |    |
| and expenses             | 18    | 16    |    | 18    | 17    |    |
| Income from operations   | 14    | 15    |    | 13    | 15    |    |

Net sales – Net sales increased \$2.9 million in the second quarter of 2017 and \$5.8 million in the first six months of 2017 compared to the respective periods of 2016, primarily due to higher Security Products sales volumes to existing government security customers, partially offset by a decrease in sales of security products to an original equipment manufacturer of recreational transportation products. Relative changes in selling prices did not have a material impact on net sales comparisons.

Cost of sales and gross margin – Cost of goods sold and resulting gross profit as a percentage of sales in the second quarter of 2017 was comparable to the same period in 2016. Cost of goods sold as a percentage of sales for the first six months of 2017 was approximately 1% less than 2016. As a result, gross profit increased over the same period. The higher gross profit percentage for the most recent six month period is primarily due to manufacturing efficiencies facilitated by the higher production volumes at CompX’s Security Products reporting unit.

Operating costs and expenses – Operating costs and expenses consist primarily of sales and administrative-related personnel costs, sales commissions and advertising expenses, as well as gains and losses on plant, property and equipment. Operating costs and expenses for the second quarter and first six months of 2017 were comparable to the same periods in 2016.

Income from operations – As a percentage of net sales, income from operations for the second quarter and first six months of 2017 increased compared to the same period of 2016 and was primarily impacted by the factors impacting cost of goods sold, gross margin and operating costs discussed above.

#### Results by reporting unit

The key performance indicator for CompX’s reporting units is the level of their income from operations (see discussion below).

|                                     | Three months ended             |               |           | Six months ended               |               |           |   |
|-------------------------------------|--------------------------------|---------------|-----------|--------------------------------|---------------|-----------|---|
|                                     | June 30, 2016<br>(In millions) | 2017          | % Change  | June 30, 2016<br>(In millions) | 2017          | % Change  |   |
| <b>Net sales:</b>                   |                                |               |           |                                |               |           |   |
| Security Products                   | \$23.2                         | \$26.0        | 12        | \$46.6                         | \$52.1        | 12        | % |
| Marine Components                   | 3.9                            | 4.0           | 1         | 7.6                            | 7.9           | 4         |   |
| <b>Total net sales</b>              | <b>\$27.1</b>                  | <b>\$30.0</b> | <b>11</b> | <b>\$54.2</b>                  | <b>\$60.0</b> | <b>11</b> |   |
| <b>Gross margin:</b>                |                                |               |           |                                |               |           |   |
| Security Products                   | \$7.4                          | \$8.4         | 14        | \$14.7                         | \$17.2        | 17        |   |
| Marine Components                   | 1.1                            | 1.1           | (3 )      | 2.0                            | 2.0           | -         |   |
| <b>Total gross margin</b>           | <b>\$8.5</b>                   | <b>\$9.5</b>  | <b>12</b> | <b>\$16.7</b>                  | <b>\$19.2</b> | <b>15</b> |   |
| <b>Income from operations:</b>      |                                |               |           |                                |               |           |   |
| Security Products                   | \$4.8                          | \$5.4         | 12        | \$9.3                          | \$11.0        | 19        |   |
| Marine Components                   | .6                             | .5            | (11 )     | .9                             | .9            | (3 )      |   |
| Corporate operating expenses        | (1.7 )                         | (1.3 )        | (23 )     | (3.1 )                         | (2.8 )        | 9         |   |
| <b>Total income from operations</b> | <b>\$3.7</b>                   | <b>\$4.6</b>  | <b>24</b> | <b>\$7.1</b>                   | <b>\$9.1</b>  | <b>29</b> |   |
| <b>Gross margin:</b>                |                                |               |           |                                |               |           |   |
| Security Products                   | 32                             | % 32          | %         | 32                             | % 33          |           |   |
| Marine Components                   | 28                             | 27            |           | 27                             | 26            |           |   |



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|                                |    |      |      |    |
|--------------------------------|----|------|------|----|
| Total gross margin             | 31 | 32   | 31   | 32 |
| Income from operations margin: |    |      |      |    |
| Security Products              | 21 | % 21 | % 20 | 21 |
| Marine Components              | 14 | 13   | 12   | 11 |
| Total income from              |    |      |      |    |
| operations margin              | 14 | 15   | 13   | 15 |

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Security Products — Security Products net sales increased 12% in each of the second quarter and first six months of 2017 compared to the same periods last year. The increase in sales is primarily due to approximately \$3.2 million and \$6.3 million for the second quarter and six month periods, respectively, in higher sales volumes to existing government security customers, partially offset by decreases of approximately \$0.9 million and \$1.7 million for the second quarter and six month periods, respectively, in sales to a customer serving the recreational transportation market.

Gross profit margin and operating income as a percentage of sales for the second quarter of 2017 were comparable to the same period in the prior year. Gross profit margin and operating income as a percentage of sales for the first six months of 2017 increased compared to the same period in 2016 as a result of manufacturing efficiencies, principally in the first quarter of 2017, facilitated by higher production volumes.

Marine Components – Marine Components net sales increased 1% and 4% in the second quarter and first six months of 2017, respectively, as compared to the same periods last year. The increase in sales for the first six months of 2017 reflects generally improved demand for products sold to various markets. Gross profit margin and operating income as a percentage of net sales decreased in the second quarter and first six months of 2017 compared to the same periods last year due to a combination of factors, including customer and product mix as well as manufacturing inefficiencies resulting from temporary personnel turnover in key departments.

Outlook – Sales for the first half of 2017 reflect continued strong demand for our products, particularly high-security applications for our existing government customers, partially offset by lower security product sales to the transportation market, where a significant customer of the segment continues to experience weakened sales volumes. While we expect government security sales to moderate in the second half of 2017 and anticipate continued softness in transportation sales, full year sales of security products for 2017 should meet or exceed 2016 levels. Similarly, we expect 2017 sales of marine products to meet or exceed 2016, as our growing Marine Components segment continues to benefit from innovation and diversification in our product offerings to the recreational boat market. As in prior periods, we will continue to monitor general economic conditions and sales order rates and respond to fluctuations in customer demand through continuous evaluation of staffing levels and consistent execution of our lean manufacturing and cost improvement initiatives. Additionally, we continue to seek opportunities to gain market share in markets we currently serve, to expand into new markets and to develop new product features in order to mitigate the impact of changes in demand as well as broaden our sales base.

#### General corporate and other items

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

The agreements with certain of our insurance carriers also include reimbursement for a portion of our future litigation defense costs. We are not able to determine how much we will ultimately recover from these carriers for defense costs incurred by us because of certain issues that arise regarding which defense costs qualify for reimbursement. Accordingly, these insurance recoveries are recognized when the receipt is probable and the amount is determinable. See Note 13 to our Condensed Consolidated Financial Statements.

Corporate expense – Corporate expenses were \$3.4 million in the second quarter of 2017, \$1 million higher than in the second quarter of 2016 primarily due to higher litigation and related costs in 2017 mostly offset by lower administrative costs in 2017. Included in corporate expense in the second quarter of 2016 and 2017 are:

litigation fees and related costs of \$1.3 million in 2017 compared to \$.8 million in 2016, and  
environmental remediation and related costs of \$.1 million in 2017 compared to \$.2 million in 2016.

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Corporate expenses were \$8.9 million in the first six months of 2017, \$.1 million lower than in the first six months of 2016 primarily due to lower administrative expenses in 2017 mostly offset by higher litigation and related costs and environmental remediation and related costs in 2017. Included in corporate expense in the first six months of 2016 and 2017 are:

litigation fees and related costs of \$1.8 million in 2017 compared to \$1.6 million in 2016, and environmental remediation and related costs of \$3.2 million in 2017 compared to \$3.1 million in 2016.

The level of our litigation fees and related costs varies from period to period depending upon, among other things, the number of cases in which we are currently involved, the nature of such cases and the current stage of such cases (e.g. discovery, pre-trial motions, trial or appeal, if applicable). See Note 13 to our Condensed Consolidated Financial Statements. If our current expectations regarding the number of cases in which we expect to be involved during 2017 or the nature of such cases were to change, our corporate expenses could be higher than we currently estimate.

Obligations for environmental remediation costs are difficult to assess and estimate and it is possible that actual costs for environmental remediation will exceed accrued amounts or that costs will be incurred in the future for sites in which we cannot currently estimate our liability. If these events were to occur in 2017, our corporate expenses would be higher than we currently estimate. In addition, we adjust our environmental accruals as further information becomes available to us or as circumstances change. Such further information or changed circumstances could result in an increase in our accrued environmental costs. See Note 13 to our Condensed Consolidated Financial Statements.

Overall, we expect that our general corporate expenses for all of 2017 will be comparable to 2016. If our current expectations regarding the number of cases or sites in which we expect to be involved during 2017, or if the nature of such cases or sites were to change, our corporate expenses could be higher than we currently estimate and involve amounts that are material.

Interest and dividend income – Interest and dividend income increased \$.5 million in the second quarter and \$.8 million in the first half of 2017 compared to prior year periods primarily due to interest income earned on CompX's revolving promissory note receivable from Valhi, which CompX entered into in August 2016. Interest income on such note receivable from Valhi was \$.4 million in the second quarter of 2017 and \$.8 million in the first six months of 2017.

Income tax expense – We recognized income tax expense of \$20.3 million in the second quarter of 2017 compared to \$.3 million in the second quarter of 2016 and income tax expense of \$22.5 million in the first half of 2017 compared to an income tax benefit of \$.5 million in the first half of 2016. In accordance with GAAP, we recognize deferred income taxes on our undistributed equity in earnings (losses) of Kronos. Because we and Kronos are part of the same U.S. federal income tax group, any dividends we receive from Kronos are nontaxable to us. Accordingly, we do not recognize and we are not required to pay income taxes on dividends from Kronos. Therefore, our full-year effective income tax rate will generally be lower than the U.S. federal statutory income tax rate in years during which we receive dividends from Kronos and recognize equity in earnings of Kronos. Conversely, our effective income tax rate will generally be higher than the U.S. federal statutory income tax rate in years during which we receive dividends from Kronos and recognize equity in losses of Kronos. During interim periods, our effective income tax rate may not necessarily correspond to the foregoing due to the application of accounting for income taxes in interim periods which requires us to base our effective rate on full year projections. We received dividends from Kronos of \$10.6 million in the first half of each of 2016 and 2017.

Our effective tax rate attributable to our equity in earnings of Kronos, including the effect of the non-taxable dividends we received from Kronos was 30.9% in the first six months of 2017 and 9.7% in the first six months of 2016. See Note 11 to our Condensed Consolidated Financial Statements for more information about our 2017 income tax items, including a tabular reconciliation of our statutory tax expense (benefit) to our actual expense (benefit).



Noncontrolling interest – Noncontrolling interest in net income of CompX is consistent in the second quarter and year-to-date periods of 2016 and 2017. The noncontrolling interest we recognize in each period is directly related to the level of earnings at CompX for the period.

Equity in earnings (losses) of Kronos Worldwide, Inc.

|  | Three months ended             |         |          | Six months ended               |         |          |  |
|--|--------------------------------|---------|----------|--------------------------------|---------|----------|--|
|  | June 30, 2016<br>(In millions) | 2017    | % Change | June 30, 2016<br>(In millions) | 2017    | % Change |  |
| Net sales                              | \$356.1                        | \$441.4 | 24 %     | \$674.5                        | \$811.2 | 20 %     |  |
| Cost of sales                          | 300.6                          | 311.6   | 4 %      | 578.6                          | 578.0   | - %      |  |
| Gross margin                           | \$55.5                         | \$129.8 |          | \$95.9                         | \$233.2 |          |  |
| Income from operations                 | \$10.5                         | \$70.1  | 568 %    | \$10.2                         | \$122.4 | 1,100 %  |  |
| Other, net                             | .2                             | .1      |          | .4                             | .3      |          |  |
| Interest expense                       | (5.1 )                         | (4.8 )  |          | (10.2 )                        | (9.5 )  |          |  |
| Income before income taxes             | 5.6                            | 65.4    |          | 0.4                            | 113.2   |          |  |
| Income tax expense (benefit)           | 3.9                            | (131.1) |          | 2.5                            | (120.1) |          |  |
| Net income (loss)                      | \$1.7                          | \$196.5 |          | \$(2.1 )                       | \$233.3 |          |  |
| Percentage of net sales:               |                                |         |          |                                |         |          |  |
| Cost of sales                          | 84                             | % 71    | %        | 86                             | % 71    | %        |  |
| Income (loss) from operations          | 3                              | % 16    | %        | 2                              | % 15    | %        |  |
| Equity in earnings (losses)            |                                |         |          |                                |         |          |  |
| of Kronos Worldwide, Inc.              | \$0.5                          | \$59.7  |          | \$(0.7 )                       | \$70.9  |          |  |
| TiO <sub>2</sub> operating statistics: |                                |         |          |                                |         |          |  |
| Sales volumes*                         | 149                            | 157     | 6 %      | 287                            | 300     | 5 %      |  |
| Production volumes*                    | 131                            | 141     | 8 %      | 262                            | 286     | 9 %      |  |
| Change in TiO <sub>2</sub> net sales:  |                                |         |          |                                |         |          |  |
| TiO <sub>2</sub> product pricing       |                                |         | 20 %     |                                |         | 19 %     |  |
| TiO <sub>2</sub> sales volumes         |                                |         | 6        |                                |         | 5        |  |
| TiO <sub>2</sub> product mix/other     |                                |         | -        |                                |         | (2 )     |  |
| Changes in currency exchange           |                                |         |          |                                |         |          |  |
| rates                                  |                                |         | (2 )     |                                |         | (2 )     |  |
| Total                                  |                                |         | 24 %     |                                |         | 20 %     |  |

\* Thousands of metric tons

The key performance indicators for Kronos are TiO<sub>2</sub> average selling prices, its level of TiO<sub>2</sub> sales and production volumes and the cost of third-party feedstock ore. TiO<sub>2</sub> selling prices generally follow industry trends and prices will

increase or decrease generally as a result of market pressures.

Current industry conditions – Due to the successful implementation of previously-announced price increases, average selling prices began to rise in the second quarter of 2016 and have continued to rise through the first half of 2017. Kronos' average TiQ selling prices in the second quarter of 2017 were 20% higher as compared to the second quarter of 2016, and Kronos' average selling prices at the end of the second quarter of 2017 were 8% higher than at the end of the first quarter of 2017, and were 12% higher than at the end of 2016, with higher prices in all major markets. Kronos experienced higher sales volumes in the North American and export markets in the first half of 2017 as compared to the same period of 2016, partially offset by lower volumes in the Latin American market.

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Kronos operated its production facilities at overall average capacity utilization rates of 100% in the first six months of 2017 compared to approximately 96% in the first six months of 2016. The table below lists Kronos' comparative quarterly capacity utilization rates.

|                | Production<br>Capacity<br>Utilization<br>Rates |      |
|----------------|--|------|
|                | 2016   | 2017 |
| First quarter  | 97%  | 100% |
| Second quarter | 95%  | 100% |

Throughout 2016, Kronos experienced moderation in the cost of TiO<sub>2</sub> feedstock ore procured from third parties. Kronos' cost of sales per metric ton of TiO<sub>2</sub> sold declined throughout 2016 and into the first six months of 2017 primarily due to the moderation in the cost of TiO<sub>2</sub> feedstock ore in 2016. Consequently, Kronos' cost of sales per metric ton of TiO<sub>2</sub> sold in the first six months of 2017 was lower than its cost of sales per metric ton of TiO<sub>2</sub> sold in the first six months of 2016 (excluding the effect of changes in currency exchange rates).

Net sales - Net sales in the second quarter of 2017 increased 24%, or \$85.3 million, compared to the second quarter of 2016 primarily due to the favorable effects of a 20% increase in average TiO<sub>2</sub> selling prices (which increased net sales by approximately \$71 million) and a 6% increase in sales volumes (which increased net sales by approximately \$21 million). TiO<sub>2</sub> selling prices will increase or decrease generally as a result of competitive market pressures, changes in the relative level of supply and demand as well as changes in raw material and other manufacturing costs.

Kronos' sales volumes increased 6% in the second quarter of 2017 as compared to the second quarter of 2016 primarily due to higher sales in the North American and European markets, partially offset by lower sales in the Latin American market. Kronos' sales volumes in the second quarter of 2017 set a new overall record for a second quarter. In addition to the impact of changes in average TiO<sub>2</sub> selling prices and sales volumes, Kronos estimates that changes in currency exchange rates (primarily the euro) decreased its net sales by approximately \$8 million as compared to the second quarter of 2016.

Net sales in the first six months of 2017 increased 20%, or \$136.7 million, compared to the first six months of 2016 primarily due to the favorable effects of a 19% increase in average TiO<sub>2</sub> selling prices (which increased net sales by approximately \$128 million) and a 5% increase in sales volumes (which increased net sales by approximately \$34 million). TiO<sub>2</sub> selling prices will increase or decrease generally as a result of competitive market pressures, changes in the relative level of supply and demand as well as changes in raw material and other manufacturing costs.

Kronos' sales volumes increased 5% in the first six months of 2017 as compared to the first six months of 2016 primarily due to higher sales in the North American and export markets, partially offset by lower sales in the Latin American market. Kronos' sales volumes in the first half of 2017 set a new overall record for a first-six-month period. In addition to the impact of changes in average TiO<sub>2</sub> selling prices and sales volumes, Kronos estimates that changes in currency exchange rates decreased its net sales by approximately \$15 million as compared to the first six months of 2016.

Cost of sales – Kronos' cost of sales increased \$11.0 million or 4% in the second quarter of 2017 compared to the second quarter of 2016 due to the net impact of a 6% increase in sales volumes, efficiencies related to an 8% increase in TiO<sub>2</sub> production volumes, lower raw materials and production costs of approximately \$1 million and currency fluctuations (primarily the euro). Kronos' cost of sales as a percentage of net sales decreased to 71% in the second quarter of 2017 compared to 84% in the same period of 2016 primarily due to the favorable impact of higher average selling prices, and to a lesser extent lower raw materials and other production costs and efficiencies related to higher



production volumes.

Kronos' cost of sales decreased \$.6 million in the first six months of 2017 compared to the same period in 2016 primarily due to the net impact of a 5% increase in sales volumes, efficiencies related to a 9% increase in TiO<sub>2</sub> production volumes, lower raw materials and other production costs of approximately \$14 million and currency fluctuations (primarily the euro). Kronos' cost of sales as a percentage of net sales decreased to 71% in the first six

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months of 2017 compared to 86% in the same period of 2016 due to the favorable impact of higher average selling prices, lower raw materials and other production costs and efficiencies related to higher production volumes.

Other operating income and expense, net – Kronos' other operating income and expense, net in the second quarter of and first six months of 2016 includes an insurance settlement gain of \$1.4 million and \$3.4 million in the second quarter and first six months of 2016, respectively, related to a 2014 business interruption claim.

Gross margin and income from operations – Kronos' income from operations increased by \$59.6 million compared to the second quarter of 2016. Income from operations as a percentage of net sales increased to 16% in the second quarter of 2017 from 3% in the same period of 2016. This increase was driven by the increase in gross margin percentage, which increased to 29% for the second quarter of 2017 compared to 16% for the second quarter of 2016. As discussed and quantified above, Kronos' gross margin percentage increased primarily due to the effects of higher average selling prices, higher sales and production volumes and lower raw materials and other production costs. Kronos estimates that changes in currency exchange rates decreased income from operations by approximately \$5 million in the second quarter of 2017 as compared to the same period in 2016, as discussed below.

Income from operations increased by \$112.2 million in the first six months of 2017 compared to the first six months of 2016. Income from operations as a percentage of net sales increased to 15% in the first six months of 2017 from 2% in the same period of 2016. This increase was driven by the increase in gross margin, which increased to 29% for the first six months of 2017 compared to 14% for the first six months of 2016. As discussed and quantified above, Kronos' gross margin increased primarily due to the effects of higher average selling prices, higher sales and production volumes and lower raw materials and other production costs. Kronos estimates that changes in currency exchange rates decreased income from operations by approximately \$13 million in the first six months of 2017 as compared to the same period in 2016.

Other non-operating income (expense) – Kronos' interest expense decreased \$.3 million, or 6%, in the second quarter of 2017 compared to the second quarter of 2016. Interest expense decreased \$.7 million, or 7%, in the first six months of 2017 compared to 2016. Kronos currently expect its interest expense for all of 2017 will be comparable to 2016.

Income tax expense (benefit) - Kronos recognized income tax benefit of \$131.1 million in the second quarter of 2017 compared to an income tax expense of \$3.9 million in the second quarter of 2016. Kronos recognized income tax benefit of \$120.1 million in the first six months of 2017 compared to an income tax expense of \$2.5 million in the first six months of 2016. The difference is primarily due to the effect of the reversal of Kronos' deferred income tax asset valuation allowance associated with Kronos' German and Belgian operations in 2017, as discussed below. Kronos' earnings are subject to income tax in various U.S. and non-U.S. jurisdictions, and the income tax rates applicable to its pre-tax earnings (losses) of its non-U.S. operations is generally lower than the income tax rates applicable to its U.S. operations. Excluding the effect of any increase or decrease in its deferred income tax asset valuation allowance, Kronos would generally expect its overall effective tax rate to be lower than the U.S. federal statutory tax rate of 35% primarily because of its non-U.S. operations.

Kronos has substantial net operating loss (NOL) carryforwards in Germany (the equivalent of \$638 million for German corporate purposes and \$71 million for German trade tax purposes at December 31, 2016) and in Belgium (the equivalent of \$93 million for Belgian corporate tax purposes at December 31, 2016), all of which have an indefinite carryforward period. As a result, Kronos has net deferred income tax assets with respect to these two jurisdictions, primarily related to these NOL carryforwards. The German corporate tax is similar to the U.S. federal income tax, and the German trade tax is similar to the U.S. state income tax. Prior to June 30, 2015, and using all available evidence, Kronos had concluded no deferred income tax asset valuation allowance was required to be recognized with respect to these net deferred income tax assets under the more-likely-than-not recognition criteria, primarily because (i) the carryforwards have an indefinite carryforward period, (ii) Kronos utilized a portion of such

carryforwards during the most recent three-year period, and (iii) Kronos expected to utilize the remainder of the carryforwards over the long term. Kronos had also previously indicated that facts and circumstances could change, which might in the future result in the recognition of a valuation allowance against some or all of such deferred income tax assets. However, as of June 30, 2015, and given Kronos' operating results during the second quarter of 2015 and its expectations at that time for its operating results for the remainder of 2015, which had been driven in large part by the trend in Kronos' average TiQ selling prices over such periods as well as the \$21.1 million pre-tax

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charge recognized in the second quarter of 2015 in connection with the implementation of certain workforce reductions, Kronos did not have sufficient positive evidence to overcome the significant negative evidence of having cumulative losses in the most recent twelve consecutive quarters in both its German and Belgian jurisdictions at June 30, 2015 (even considering that the carryforward period of its German and Belgian NOL carryforwards is indefinite, one piece of positive evidence). Accordingly, at June 30, 2015, Kronos concluded that it was required to recognize a non-cash deferred income tax asset valuation allowance under the more-likely-than-not recognition criteria with respect to its German and Belgian net deferred income tax assets at such date. Kronos recognized an additional non-cash deferred income tax asset valuation allowance during the second half of 2015 due to losses recognized by its German and Belgian operations during such period. During 2016, Kronos recognized an aggregate \$2.2 million non-cash tax benefit as the result of a net decrease in such deferred income tax valuation allowance, as the impact of utilizing a portion of its German NOLs during such period more than offset the impact of additional losses recognized by its Belgian operations during such period. Such valuation allowance aggregated approximately \$173 million at December 31, 2016 (\$153 million with respect to Germany and \$20 million with respect to Belgium). During the first six months of 2017, Kronos recognized an aggregate non-cash income tax benefit of \$12.7 million as a result of a net decrease in such deferred income tax asset valuation allowance, due to utilizing a portion of both the German and Belgian NOLs during such period, including \$7.7 million in the second quarter of 2017. Kronos continues to believe it will ultimately realize the full benefit of these German and Belgian NOL carryforwards, in part because of their indefinite carryforward period. As previously disclosed, Kronos' ability to reverse all or a portion of either the German or Belgian valuation allowance is dependent on the presence of sufficient positive evidence, such as the existence of cumulative profits in the most recent twelve consecutive quarters or profitability in recent quarters during which such profitability was trending upward throughout such period, and the ability to demonstrate future profitability for a sustainable period. As noted below, Kronos determined such conditions were satisfied at June 30, 2017.

Although Kronos' Belgian operations were profitable in the first quarter of 2017 and it utilized a portion of the Belgian NOLs during such period, Kronos' Belgian operations continued to have cumulative losses in the most recent twelve quarters at March 31, 2017. Although the results of Kronos' German operations had improved during 2016 and the first quarter of 2017, indicating a change in the negative trend in earnings that existed at December 31, 2015, and Kronos utilized a portion of its German NOLs during 2016 and the first quarter of 2017, and Kronos had cumulative income with respect to its German operations for the most recent twelve consecutive quarters at March 31, 2017, the sustainability of such positive trend in earnings had not yet been demonstrated at such date. As previously disclosed, while neither Kronos' business as a whole nor any of its principal product groups is seasonal to any significant extent, TiO<sub>2</sub> sales are generally higher in the second and third quarters of the year, due in part to the increase in paint production in the spring to meet demand during the spring and summer painting seasons. While Kronos has some insight into the overall demand expected to be generated by a particular year's paint season and TiO<sub>2</sub> pricing at the end of the first quarter (the start of the paint season), it has much greater insight and certainty regarding overall demand and TiO<sub>2</sub> pricing for a particular year's paint season by the end of the second quarter of the year, in part because some factors, such as weather, can have an impact on both overall demand and pricing each year. Accordingly, at March 31, 2017 Kronos did not have sufficient positive evidence to support a sustainable profit trend and consequently, it did not have sufficient positive evidence under the more-likely-than-not recognition criteria to support reversal of the entire valuation allowance related to Kronos' German or Belgian operations at such date. During the second quarter of 2017, Kronos' German and Belgian operations continued to be profitable, and both reported levels of profitability higher as compared to the first quarter of 2017. As discussed above, Kronos' consolidated results of operations in general, and its German and Belgian operations in particular, were favorably impacted during the quarter by, among other things, continued higher average TiO<sub>2</sub> selling prices and higher sales volumes. Kronos' German operations had cumulative income for the most recent twelve consecutive quarters at June 30, 2017. While Kronos' Belgian operations had cumulative losses in the most recent twelve consecutive quarters at June 30, 2017, such operations generated income in both the first and second quarters of 2017, with higher income in the second quarter as compared to the first quarter, the amount of cumulative losses of Kronos' Belgian operations for the most recent twelve

consecutive quarters was lower as of June 30, 2017 as compared to both March 31, 2017 and December 31, 2016 and Kronos expects to have cumulative profits in the third and fourth quarters. Kronos' production facilities have been operating at near practical capacity utilization rates in the first six months of 2017. In addition, consistent with Kronos' expectation regarding its consolidated results of operations for the remainder of 2017 (as discussed below under the "Outlook" subsection), Kronos currently believes it is likely its German and Belgian operations will continue to report improved operating results in 2017 as compared to 2016. Accordingly, at June 30, 2017 Kronos concluded it now has sufficient positive evidence under the more-likely-than-

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not recognition criteria to support reversal of the entire valuation allowance related to its German and Belgian operations. As discussed below, a large portion of the remaining valuation allowance is reversed as of June 30, 2017, but a portion of the remaining valuation allowance will be reversed in the second half of 2017. Such sufficient positive evidence includes, among other things, the existence of cumulative profits in the most recent twelve consecutive quarters (Germany) or profitability in recent quarters during which such profitability was trending upward throughout such period (Belgium), the ability to demonstrate future profitability in Germany and Belgium for a sustainable period (as supported by, among other things, recent trends in profitability, driven in large part by increases in TiO<sub>2</sub> selling prices, and continued strong demand indicating that such profitability trends will continue in the future), and the indefinite carryforward period for the German and Belgian NOLs. Kronos' income tax benefit in the second quarter of 2017 includes an aggregate non-cash income tax benefit of \$149.9 million related to such reversal at June 30, 2017 (\$141.9 million related to Germany, and \$8.0 million related to Belgium). Such second quarter 2017 income tax benefit associated with reversal of the entire German and Belgian valuation allowance excludes the non-cash income tax benefit of \$7.7 million discussed above. In addition to the above amounts, Kronos' deferred income tax asset valuation allowance increased by \$9.5 million during the first six months of 2017 as a result of changes in currency exchange rates, which was recognized as part of other comprehensive income (loss).

In accordance with the ASC 740-270 guidance regarding accounting for income taxes at interim dates, the amount of the valuation allowance reversed at June 30, 2017 (\$149.9 million) relates to Kronos' change in judgment regarding the realizability of the related deferred income tax asset as it relates to future years (i.e. 2018 and after). A change in judgment regarding the realizability of deferred tax assets as it relates to the current year is considered in determining the estimated annual effective tax rate for the year. Accordingly, of the aggregate \$173 million deferred income tax asset valuation allowance recognized at December 31, 2016, approximately \$163 million has been reversed through June 30, 2017, and the remaining \$20 million will be reversed during the third and fourth quarters of 2017 (such aggregate reversal amount includes the \$9.5 million increase to our deferred income tax asset valuation allowance as a result of changes in currency exchange rates recognized as part of other comprehensive income (loss)).

#### Effects of Currency Exchange Rates

Kronos has substantial operations and assets located outside the United States (primarily in Germany, Belgium, Norway and Canada). The majority of its sales from non-U.S. operations are denominated in currencies other than the U.S. dollar, principally the euro, other major European currencies and the Canadian dollar. A portion of Kronos' sales generated from its non-U.S. operations is denominated in the U.S. dollar (and consequently its non-U.S. operations will generally hold U.S. dollars from time to time). Certain raw materials used in all Kronos' production facilities, primarily titanium-containing feedstocks, are purchased in U.S. dollars, while labor and other production and administrative costs are incurred primarily in local currencies. Consequently, the translated U.S. dollar value of Kronos' non-U.S. sales and operating results are subject to currency exchange rate fluctuations which may favorably or unfavorably impact reported earnings and may affect the comparability of period-to-period operating results. In addition to the impact of the translation of sales and expenses over time, Kronos' non-U.S. operations also generate currency transaction gains and losses which primarily relate to (i) the difference between the currency exchange rates in effect when non-local currency sales or operating costs (primarily U.S. dollar denominated) are initially accrued and when such amounts are settled with the non-local currency, (ii) changes in currency exchange rates during time periods when its non-U.S. operations are holding non-local currency (primarily U.S. dollars), and (iii) relative changes in the aggregate fair value of currency forward contracts held from time to time. Kronos periodically uses currency forward contracts to manage a portion of its currency exchange risk, and relative changes in the aggregate fair value of any currency forward contracts Kronos holds from time to time serves in part to mitigate the currency transaction gains or losses it would otherwise recognize from the first two items described above. Overall, Kronos estimates that fluctuations in currency exchange rates had the following effects on its sales and income from operations for the periods indicated.



## Impact of changes in currency exchange rates

three months ended June 30, 2017 vs June 30, 2016

|                        | Transaction gains/losses |             |           | Translation  | Total currency |
|------------------------|--------------------------|-------------|-----------|--------------|----------------|
|                        | recognized               | gain/loss – | impact of |              |                |
|                        | 2016                     | 2017        | Change    | rate changes | 2017 vs 2016   |
|                        | (In millions)            |             |           |              |                |
| <b>Impact on:</b>      |                          |             |           |              |                |
| Net sales              | \$-                      | \$ -        | \$ -      | \$ (8 )      | \$ (8 )        |
| Income from operations | 2                        | (4 )        | (6 )      | 1            | (5 )           |

The \$8 million reduction in Kronos' net sales (translation loss) was caused primarily by a strengthening of the U.S. dollar relative to the euro, as our euro-denominated sales were translated into fewer U.S. dollars in 2017 as compared to 2016. The strengthening of the U.S. dollar relative to the Canadian dollar and the Norwegian krone in 2017 did not have a significant effect on the reported amount of Kronos' net sales, as a substantial portion of the sales generated by Kronos' Canadian and Norwegian operations are denominated in the U.S. dollar.

The \$5 million decrease in Kronos' income from operations was comprised of the following:

- Approximately \$6 million from net currency transaction losses primarily caused by relative changes in currency exchange rates at each applicable balance sheet date between the U.S. dollar and the euro, Canadian dollar and the Norwegian krone, which causes increases or decreases, as applicable, in U.S. dollar-denominated receivables and payables and U.S. dollar currency held by Kronos' non-U.S. operations, and
- Approximately \$1 million from net currency translation gains primarily caused by a strengthening of the U.S. dollar relative to the Canadian dollar, as its local currency-denominated operating costs were translated into fewer U.S. dollars in 2017 as compared to 2016, and such translation, as it related to the U.S. dollar relative to the euro, had a negative effect on income from operations in 2017 as compared to 2016, as the negative impact of the stronger U.S. dollar on euro-denominated sales more than offset the favorable effect of euro-denominated operating costs being translated into fewer U.S. dollars in 2017 compared to 2016.

## Impact of changes in currency exchange rates

six months ended June 30, 2017 vs June 30 2016

|                        | Transaction gains/losses |             |           | Translation  | Total currency |
|------------------------|--------------------------|-------------|-----------|--------------|----------------|
|                        | recognized               | gain/loss – | impact of |              |                |
|                        | 2016                     | 2017        | Change    | rate changes | 2017 vs 2016   |
|                        | (In millions)            |             |           |              |                |
| <b>Impact on:</b>      |                          |             |           |              |                |
| Net sales              | \$-                      | \$ -        | \$ -      | \$ (15 )     | \$ (15 )       |
| Income from operations | 4                        | (4 )        | (8 )      | (5 )         | (13 )          |



The \$15 million reduction in Kronos' net sales (translation loss) was caused primarily by a strengthening of the U.S. dollar relative to the euro, as our euro-denominated sales were translated into fewer U.S. dollars in 2017 as compared to 2016. The strengthening of the U.S. dollar relative to the Canadian dollar and the Norwegian krone in 2017 did not have a significant effect on the reported amount of Kronos' net sales, as a substantial portion of the sales generated by Kronos' Canadian and Norwegian operations are denominated in the U.S. dollar.

The \$13 million net decrease in Kronos' income from operations comprised the following:

- Approximately \$8 million from net currency transaction losses caused primarily by relative changes in currency exchange rates at each applicable balance sheet date between the U.S. dollar and the euro, Canadian dollar and the Norwegian krone, which causes increases or decreases, as applicable, in U.S. dollar-denominated receivables and payables and U.S. dollar currency held by Kronos' non-U.S. operations, and
- Approximately \$5 million of net currency translation losses caused primarily by a strengthening of the U.S. dollar relative to the euro, as such translation had a negative effect on income from operations in 2017 as compared to 2016, as the negative impact of the stronger U.S. dollar on euro-denominated sales more than offset the favorable effect of euro-denominated operating costs being translated into fewer U.S. dollars in 2017 as compared to 2016, along with the effects of a slight strengthening of the U.S. dollar relative to the Canadian dollar and the Norwegian krone in 2017 as compared to 2016.

#### Outlook

During the first half of 2017 Kronos operated its production facilities at 100% of practical capacity. Kronos expects its production volumes to be slightly higher in 2017 as compared to 2016, as its production rates in 2017 will be positively impacted by the implementation of certain productivity-enhancing improvement projects at certain facilities. Assuming global economic conditions do not deteriorate, Kronos expects its 2017 sales volumes to be comparable to 2016 sales volumes. Kronos will continue to monitor current and anticipated near-term customer demand levels and align its production and inventories accordingly. Kronos believes it is reasonably likely we will set a new record for production volumes in 2017 (its prior record was 550,000 metric tons in 2011).

Kronos experienced moderation in the cost of TiO<sub>2</sub> feedstock ore procured from third parties in 2016. However, the cost of third-party feedstock ore Kronos procured in the first half of 2017 was comparable to slightly higher as compared to the first half of 2016, and such higher cost feedstock ore is expected to be reflected in Kronos' results of operations beginning in the third quarter of 2017. Kronos expects its cost of sales per metric ton of TiO<sub>2</sub> sold for the full year of 2017 will be slightly higher than its per-metric ton cost in 2016.

Kronos started 2017 with average selling prices 11% higher than the beginning of 2016, and average selling prices increased by an additional 12% in the first six months of 2017. Industry data indicates that overall TiO<sub>2</sub> inventory held by producers declined significantly during 2016. In addition, Kronos believe most customers hold very low inventories of TiO<sub>2</sub> with many operating on a just-in-time basis. With the strong sales volumes experienced in the first half of 2017, Kronos continue to see evidence of strengthening demand for its TiO<sub>2</sub> products in certain of its primary markets. Kronos and its major competitors have announced price increases, which Kronos began implementing in the second quarter of 2016, as contracts have allowed. The extent to which Kronos will be able to achieve any additional price increases in the near term will depend on market conditions.

Overall, Kronos expect income from operations in 2017 will be higher as compared to 2016, principally as a result of expected higher average selling prices in 2017 as compared to 2016 and to a lesser extent from the favorable effects of anticipated higher production volumes in 2017. In addition, and as discussed above, Kronos recognized a non-cash tax benefit of \$162.6 million in the first six months of 2017 (including \$157.6 million in the second quarter of 2017) related to Kronos' deferred income tax asset valuation allowance associated with Kronos' German and Belgian operations, and Kronos expect the remaining valuation allowance of \$20 million will be reversed during the third and fourth quarters of 2017.

Due to the constraints of high capital costs and extended lead time associated with adding significant new TiO<sub>2</sub> production capacity, especially for premium grades of TiO<sub>2</sub> products produced from the chloride process, Kronos

believes increased and sustained profit margins will be necessary to financially justify major expansions of TiO<sub>2</sub> production capacity required to meet expected future growth in demand. As a result of relative customer inventory levels during the recent past and the resulting adverse effect on global TiO<sub>2</sub> pricing, some industry projects to increase TiO<sub>2</sub> production capacity have been cancelled or deferred indefinitely, and announcements have been made regarding the closure of certain facilities. Given the lead time required for production capacity

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expansions, a shortage of TiO<sub>2</sub> could occur if economic conditions improve and global demand levels for TiO<sub>2</sub> increase sufficiently.

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

## LIQUIDITY AND CAPITAL RESOURCES

### Consolidated cash flows

#### Operating activities

Trends in cash flows from operating activities, excluding the impact of deferred taxes and relative changes in assets and liabilities, are generally similar to trends in our income from operations.

Net cash provided by operating activities was \$10.1 million in the first six months of 2017 compared to \$7.6 million in the first six months of 2016. The \$2.5 million net increase in cash provided by operating activities includes the net effects of:

- higher income from operations of CompX in 2017 of \$2.0 million;
- higher cash paid for income taxes primarily as a result of increased operating income at CompX of \$2.1 million in 2017;
- lower cash used for environmental remediation and related costs in 2017 of \$.4 million; and
- higher interest and dividend income in 2017 of \$.8 million.

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

|  | Six months<br>ended |         |
|--|---------------------|---------|
|  | June 30,<br>2016    | 2017    |
|  | (In millions)       |         |
| Net cash provided by operating activities: |                     |         |
| CompX                                      | \$ 1.9              | \$ 4.3  |
| NL Parent and wholly-owned subsidiaries    | 6.8                 | 6.9     |
| Eliminations                               | (1.1)               | (1.0)   |
| Total                                      | \$ 7.6              | \$ 10.2 |

Changes in working capital can have a significant effect on cash flows from operating activities. Generally, we expect our average days sales outstanding to increase from December to June as the result of a seasonal increase in sales during the second quarter as compared to the fourth quarter. Overall, our June 30, 2017 days sales outstanding compared to December 31, 2016 is in line with our expectations. As expected, our total average number of days in inventory decreased from December 31, 2016 to June 30, 2017 primarily as a result of the seasonal increase in sales

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during the second quarter 2017 as compared to the fourth quarter of 2016. For comparative purposes, we have provided information for December 31, 2015 and June 30, 2016 below.

|                        | December 31,<br>2015 | June 30,<br>2016 | December 31,<br>2016 | June 30,<br>2017 |
|------------------------|----------------------|------------------|----------------------|------------------|
| Days sales outstanding | 31 days              | 42 days          | 36 days              | 37 days          |
| Days in inventory      | 76 days              | 69 days          | 79 days              | 68 days          |

### Investing activities

Net cash used in investing activities totaled \$13.7 million in the first six months of 2017 and \$1.7 million in the first six months of 2016. During the third quarter of 2016, CompX entered into an unsecured revolving demand promissory note with Valhi whereby CompX agreed to loan Valhi up to \$40 million. During the first half of 2017, CompX loaned to Valhi a net \$12.1 million under the promissory note receivable (\$39.3 million of gross borrowings and \$27.2 million of gross repayments).

We spent \$1.6 million in capital expenditures during the first half of 2017 and \$1.7 million in the first half of 2016, substantially all of which related to CompX.

### Financing activities

Cash flows from financing activities in the first half of each of 2016 and 2017 consist of CompX dividends paid to its stockholders other than us.

### Outstanding debt obligations

At June 30, 2017, NLKW had outstanding debt obligations of \$.5 million under its secured revolving credit facility with Valhi, and CompX did not have any outstanding debt obligations. We are in compliance with all of the covenants contained in our secured revolving credit facility with Valhi at June 30, 2017. See Note 8 to our Condensed Consolidated Financial Statements.

Kronos' North American and European revolvers and its term loan contain a number of covenants and restrictions which, among other things, restrict its ability to incur additional debt, incur liens, pay dividends or merge or consolidate with, or sell or transfer substantially all of our assets to, another entity, and contains other provisions and restrictive covenants customary in lending transactions of this type. Certain of Kronos' credit agreements contain provisions which could result in the acceleration of indebtedness prior to their stated maturity for reasons other than defaults for failure to comply with typical financial or payment covenants. For example, certain credit agreements allow the lender to accelerate the maturity of the indebtedness upon a change of control (as defined in the agreement) of the borrower. In addition, certain credit agreements could result in the acceleration of all or a portion of the indebtedness following a sale of assets outside the ordinary course of business. Kronos' European revolving credit facility also requires the maintenance of certain financial ratios, and one of such requirements is based on the ratio of net debt to the last twelve months EBITDA of the borrowers. Kronos is in compliance with all of its debt covenants at June 30, 2017. Kronos believes that it will be able to continue to comply with the financial covenants contained in its credit facilities through their maturity.

### Future cash requirements

### Liquidity

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

At June 30, 2017, we had aggregate cash, cash equivalents and restricted cash of \$94.5 million, substantially all of which was held in the U.S. A detail by entity is presented in the table below.

|   | Amount<br>(In<br>millions) |
|---|----------------------------|
| CompX                                   | \$ 22.5                    |
| NL Parent and wholly-owned subsidiaries | 72.0                       |
| Total                                   | \$ 94.5                    |

In addition, at June 30, 2017 we owned 14.4 million shares of Valhi common stock with an aggregate market value of \$18.5 million. See Note 4 to our Condensed Consolidated Financial Statements. We also owned 35.2

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million shares of Kronos common stock at June 30, 2017 with an aggregate market value of \$641.7 million. See Note 5 to our Condensed Consolidated Financial Statements.

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

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

Based upon our expectations of our operating performance, and the anticipated demands on our cash resources we expect to have sufficient liquidity to meet our short-term obligations (defined as the twelve-month period ending June 30, 2018) including any amounts CompX might loan from time to time under the terms of its new revolving loan to Valhi (which loans would be solely at CompX's discretion). If actual developments differ materially from our expectations, our liquidity could be adversely affected. In this regard, Valhi has agreed to loan us up to \$50 million on a revolving basis. At June 30, 2017, we had \$.5 million in outstanding borrowings under this facility, and we had \$49.5 million available for future borrowing. See Note 8 to our Condensed Consolidated Financial Statements.

#### Capital Expenditures

Firm purchase commitments for capital projects in process at June 30, 2017 approximated \$.6 million. CompX's 2017 capital investments are limited to those expenditures required to meet expected customer demand and those required to properly maintain our facilities and technology infrastructure.

#### Dividends

Because our operations are conducted primarily through subsidiaries and affiliates, our long-term ability to meet parent company-level corporate obligations is largely dependent on the receipt of dividends or other distributions from our subsidiaries and affiliates. A detail of annual dividends we expect to receive from our subsidiaries and affiliates in 2017, based on the number of shares of common stock of these affiliates we own as of June 30, 2017 and their current regular quarterly dividend rate, is presented in the table below.

|        | Shares held<br>(In<br>millions) | Current<br>Quarterly<br>Dividend Rate | Annual Expected<br>Dividend<br><br>(In millions) |
|--------|---------------------------------|---------------------------------------|--|
| Kronos | 35.2                            | \$ .15                                | \$ 21.1  |
| CompX  | 10.8                            | .05                                   | 2.2  |
| Valhi  | 14.4                            | .02                                   | 1.1  |



Total expected annual dividends \$ 24.4

Investments in our subsidiaries and affiliates and other acquisitions

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

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#### Off-balance sheet financing arrangements

Other than operating lease commitments discussed in our 2016 Annual Report, we are not party to any material off-balance sheet financing arrangements.

#### Commitments and contingencies

There have been no material changes in our contractual obligations since we filed our 2016 Annual Report and we refer you to that report for a complete description of these commitments.

We are subject to certain commitments and contingencies, as more fully described in our 2016 Annual Report, or in Note 13 to our Condensed Consolidated Financial Statements or in Part II, Item 1 of this report, including certain legal proceedings. In addition to such legal proceedings, various legislation and administrative regulations have, from time to time, been proposed that seek to (i) impose various obligations on present and former manufacturers of lead pigment and lead-based paint (including us) with respect to asserted health concerns associated with the use of such products and (ii) effectively overturn court decisions in which we and other pigment manufacturers have been successful. Examples of such proposed legislation include bills which would permit civil liability for damages on the basis of market share, rather than requiring plaintiffs to prove that the defendant's product caused the alleged damage and bills which would revive actions barred by the statute of limitations. While no legislation or regulations have been enacted to date that are expected to have a material adverse effect on our consolidated financial position, results of operations or liquidity, enactment of such legislation could have such an effect.

#### Recent accounting pronouncements

See Note 15 to our Condensed Consolidated Financial Statements.

#### Critical accounting policies and estimates

For a discussion of our critical accounting policies, refer to Part I, — “Management’s Discussion and Analysis of Financial Condition and Results of Operations” in our 2016 Annual Report. There have been no changes in our critical accounting policies during the first six months of 2017.

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

We are exposed to market risk, including currency exchange rates, interest rates and security prices. There have been no material changes in these market risks since we filed our 2016 Annual Report, and we refer you to Part I, Item 7A. —“Quantitative and Qualitative Disclosure about Market Risk” in our 2016 Annual Report. See also Note 14 to our Condensed Consolidated Financial Statements.

### ITEM 4. CONTROLS AND PROCEDURES

Evaluation of disclosure controls and procedures – We maintain disclosure controls and procedures which, as defined in Exchange Act Rule 13a-15(e), means controls and other procedures that are designed to ensure that information

required to be disclosed in the reports that we file or submit to the SEC under the Securities Exchange Act of 1934, as amended (the Act), is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information we are required to disclose in the reports we file or submit to the SEC under the Act is accumulated and communicated to our management, including our principal executive officer and our principal financial officer, or persons performing similar functions, as appropriate to allow timely decisions to be made regarding required disclosure. Each of Robert D. Graham, our Vice Chairman of the Board and Chief Executive Officer and Gregory M. Swalwell, our Executive Vice President and Chief Financial Officer, have evaluated the design and effectiveness of our disclosure controls and procedures as of June 30, 2017. Based upon their evaluation, these executive officers have concluded that our disclosure controls and procedures are effective as of the date of this evaluation.

Internal control over financial reporting – Our management is responsible for establishing and maintaining adequate internal control over financial reporting which, as defined by Exchange Act Rule 13a-15(f) means a process designed by, or under the supervision of, our principal executive and principal financial officers, or persons performing similar functions, and effected by the 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 generally accepted accounting principles, and includes those policies and procedures that:

- Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect transactions and dispositions of our assets,

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

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

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

Changes in internal control over financial reporting – There have been no changes to our internal control over financial reporting during the quarter ended June 30, 2017 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## PART II. OTHER INFORMATION

### Item 1. Legal Proceedings

In addition to the matters discussed below, refer to Note 13 to our Condensed Consolidated Financial Statements and our 2016 Annual Report for descriptions of certain legal proceedings.

United States v. NL Industries, Inc. (United States District Court, Western District of New York, Case No. 17-cv-124). In July 2017, the District Court entered the Consent Decree and NL paid the settlement amount to the United States.

In August 2017, we were served in Refined Metals Corporation v. NL Industries, Inc., (United States District Court for the Southern District of Indiana, Case 1:17-cv-2565). This is a CERCLA and state law contribution action brought by the current owner of a former secondary lead smelting facility located in Beech Grove, Indiana. We intend to deny liability and will defend vigorously against all claims.

### Item 1A. Risk Factors

For a discussion of the risk factors related to our businesses, refer to Part I, Item 1A., "Risk Factors," in our 2016 Annual Report.

### Item 6. Exhibits

31.1 [Certification](#)

31.2 [Certification](#)

32.1 [Certification](#)

101.INS XBRL Instance Document

101.SCHXBRL Taxonomy Extension Schema

101.CALXBRL Taxonomy Extension Calculation Linkbase

101.DEF XBRL Taxonomy Extension Definition Linkbase

101.LAB XBRL Taxonomy Extension Label Linkbase

101.PRE XBRL Taxonomy Extension Presentation Linkbase

SIGNATURES

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

NL INDUSTRIES, INC.  
(Registrant)

Date: August 7, 2017 /s/ Gregory M. Swalwell  
Gregory M. Swalwell  
(Executive Vice President and  
Chief Financial Officer,  
Principal Financial Officer)

Date: August 7, 2017 /s/ Amy Allbach Samford  
Amy Allbach Samford  
(Vice President and Controller,  
Principal Accounting Officer)