OM GROUP INC
Form 10-K
March 09, 2006

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

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

OR

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

Commission file number 001-12515
OM GROUP, INC.
(Exact name of Registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	**52-1736882** (I.R.S. Employer Identification No.)
127 Public Square, **1500 Key Tower,** **Cleveland, Ohio** (Address of principal executive offices)	**44114-1221** (Zip Code)

216-781-0083
Registrant s telephone number, including area code
Securities registered pursuant to Section 12(b) of the Act:

Title of each class	**Name of each exchange on which registered**
Common Stock, par value $0.01 per share	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:
None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes o No x

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the Registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.
Large accelerated filer x Accelerated filer o Non-accelerated filer o

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

The aggregate market value of Common Stock, par value $.01 per share, held by nonaffiliates (based upon the closing sale price on the NYSE) on June 30, 2005 was approximately $704 million.

As of February 28, 2006 there were 29,313,951 shares of Common Stock, par value $.01 per share, outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Company s Proxy Statement for the 2006 Annual Meeting of Stockholders are incorporated by reference in Part III.

Table of Contents

PART I

Item 1.	Business	2
Item 1A.	Risk Factors	8
Item 1B.	Unresolved Staff Comments	14
Item 2.	Properties	14
Item 3.	Legal Proceedings	15
Item 4.	Submission of Matters to a Vote of Security Holders	16

PART II

Item 5.	Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities	18
Item 6.	Selected Financial Data	19
Item 7.	Management s Discussion and Analysis of Financial Condition and Results of Operations	20
Item 7A.	Quantitative and Qualitative Disclosures about Market Risk	34
Item 8.	Financial Statements and Supplementary Data	36
Item 9.	Changes in and Disagreements with Accountants on Accounting and Financial Disclosure	85
Item 9A.	Controls and Procedures	85
Item 9B.	Other Information	86

PART III

Item 10.	Directors and Executive Officers of the Registrant	87
Item 11.	Executive Compensation	87
Item 12.	Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	87
Item 13.	Certain Relationships and Related Transactions	88
Item 14.	Principal Accountant Fees and Services	88

PART IV

Item 15.	Exhibits, Financial Statement Schedules	89
	Signatures	95

PART I

Item 1. Business

General

OM Group, Inc. (OMG or the Company) is a leading, vertically integrated international producer and marketer of value-added, metal-based specialty chemicals and related materials, primarily from cobalt and nickel. The Company applies proprietary technology to unrefined cobalt and nickel raw materials to market more than 825 different product offerings to approximately 2,100 customers in over 30 industries. The Company believes that its focus on metal-based specialty chemicals and related materials as a core business and backward raw material integration is a critical component of the Company s current business model. The Company operates in two business segments Cobalt and Nickel.

The Cobalt segment produces products using unrefined cobalt and other metals including copper, zinc, manganese and calcium. The Nickel segment produces nickel-based products. The Company s products are essential components in numerous complex chemical and industrial processes, and are used in many end markets, such as rechargeable batteries, coatings, custom catalysts, liquid detergents, lubricants and fuel additives, plastic stabilizers, polyester promoters, adhesion promoters for rubber tires, colorants, petroleum additives, magnetic media, metal finishing agents, cemented carbides for mining and machine tools, diamond tools used in construction, stainless steel, alloy and plating applications. The Company s products are sold in various forms such as solutions, crystals, powders, cathodes and briquettes.

The Company s business is critically connected to both the price and availability of raw materials. The primary raw materials used by the Company are unrefined cobalt and nickel. Cobalt raw materials include ore, concentrate, slag and scrap. Nickel raw materials include concentrates, ore, intermediates, secondaries, scrap and matte. The cost of the Company s raw materials fluctuates due to actual or perceived changes in supply and demand of raw materials, changes in cobalt and nickel reference/market prices and changes in availability from suppliers. The Company attempts to mitigate changes in availability by maintaining adequate inventory levels and long-term supply relationships with a variety of suppliers. Fluctuations in the prices of cobalt and nickel have been significant in the past and the Company believes that cobalt and nickel price fluctuations are likely to continue in the future. The Company attempts to pass through to its customers increases in raw material prices by increasing the prices of its products. The Company s profitability is largely dependent on the Company s ability to maintain the differential between its product prices and product costs. Certain sales contracts and raw material purchase contracts contain variable pricing that adjusts based on changes in the price of cobalt and nickel. During periods of rapidly changing metal prices, however, there may be price lags that can impact the short-term profitability and cash flow from operations of the Company both positively and negatively. The Company attempts to minimize the effect on profitability of changes in the market price of nickel through hedging activities. Reductions in the price of raw materials or declines in the selling prices of the Company s finished goods could also result in the Company s inventory carrying value being written down to a lower market value.

In addition to the United States, the Company has manufacturing and other facilities in Africa, Canada, Europe and Asia-Pacific, and markets its products worldwide. Although most of the Company s raw material purchases and product sales are based on the U.S. dollar, prices of certain raw materials, non-U.S. operating expenses and income taxes are denominated in local currencies. As such, the results of operations are subject to the variability that arises from exchange rate movements (particularly the Euro and the Australian dollar). In addition, fluctuations in exchange rates may affect product demand and profitability in U.S. dollars of products provided by the Company in foreign markets in cases where payments for its products are made in local currency. Accordingly, fluctuations in currency prices affect the Company s operating results.

The Company has a 55% interest in a smelter joint venture (GTL) in the Democratic Republic of Congo (the DRC). GTL is consolidated in the Company s financial statements because the Company has controlling interest in the joint venture. The Company also has a 20% interest in an Australian nickel mining company.

Significant Events

New President and Chief Executive Officer On June 13, 2005, Joseph M. Scaminace became President and Chief Executive Officer of the Company. Mr. Scaminace came to the Company from The Sherwin-Williams Company, where he served for 22 years in a variety of positions of increasing responsibility, culminating in the role of president, chief operating officer, and board member. Mr. Scaminace replaced Frank E. Butler, the Company s interim chief executive officer, who filled that role from January 2005 when James P. Mooney ceased to be employed as the Company s Chief Executive Officer.

Transition of Board of Directors During 2005, the Company s board of directors adopted a new policy that requires all non-executive directors meet its standards of independence. In response to these standards, the Company added three additional directors during 2005: Leo J. Daley, Richard W. Blackburn and Steven J. Demetriou. Each of the Company s five non-executive directors meets the New York Stock Exchange independence standards as well as the additional requirements implemented by the Company s board of directors in the Corporate Governance Principles.

Changes and Additions to the Executive Leadership Team On September 26, 2005, Valerie Gentile Sachs became Vice President, General Counsel and Secretary of the Company. Ms. Sachs came to the Company from Jo-Ann Stores, Inc. where she served as executive vice president, general counsel and secretary since 2003.

On November 14, 2005, Kenneth Haber was named interim Chief Financial Officer. Prior to assuming the duties of Interim Chief Financial Officer, Mr. Haber worked as a consultant to the Company on a number of specific projects during 2005, including helping the company to develop its rigorous new planning/budgeting process, as well as establishing key performance metrics. On March 7, 2006 the Company named Mr. Haber its Chief Financial Officer. Mr. Haber replaced R. Louis Schneeberger, who ceased to be employed as the Company s Chief Financial Officer on November 11, 2005.

In addition to the changes listed above, since he became President and CEO in June 2005, Mr. Scaminace has made the following changes and additions to the executive leadership team:

In October 2005, Gregory J. Griffith was promoted to Vice President, Corporate Affairs & Investor Relations. Mr. Griffith had been Director, Investor Relations since 2002.

In October 2005, David S. Hakaim joined the Company as Vice President, Information Systems. From 2003 through October 2005, Mr. Hakaim was a senior consultant with Titan Technology Partners and in that capacity led the Company s outsourced IT function.

In February 2006, Daniel K. Lewis joined the Company as Vice President of Human Resources.

2006 Business Developments The Company reached a definitive agreement with Inco Limited to toll refine approximately 21,000 to 25,000 tonnes of contained nickel per year over a three-year period, starting July 1, 2006.

The Company has entered into an agreement to acquire Plaschem Specialty Products Pte Ltd. and its subsidiaries. Headquartered in Singapore, Plaschem develops and produces specialty chemicals for printed circuit board chemistries, semiconductor chemistries and general metal finishing. The company s operations include a plant in Singapore and an integrated manufacturing, research and technical support facility in the People s Republic of China near the Shanghai area. The company generated sales of approximately US$11 million in 2005.

Settlement of Class Action and Derivative Lawsuits The Company settled the shareholder class action lawsuits filed in November 2002 relating to the decline in the Company s stock price after the third quarter 2002 earnings announcement. During 2005, the Company paid $74.0 million in cash and the remaining $8.5 million was settled by the issuance of 407,478 shares of common stock.

The Company also settled the shareholder derivative lawsuits filed in November 2002 against the Company s then directors and certain of its then executives, which lawsuits also were related to the decline in the Company s stock price after the third quarter 2002 earnings announcement. During 2005, the Company issued

380,000 shares of common stock in payment of attorneys fees and costs incurred by plaintiffs counsel with respect to this litigation and undertook to implement various corporate governance changes as required under the settlement agreement. The market value of the 380,000 shares of common stock was $4.9 million at the date of issuance.

Completion of the Restatement of the 2003 Financial Results The Company completed the restatement of prior year financial statements included in the Company s 2003 Form 10-K, which was filed on March 31, 2005 and filed its Form 10-Q s for each of the first three quarters of 2004 on June 10, 2005. The Company filed its 2004 Form 10-K on August 22, 2005 and filed its Forms 10-Q for the first and second quarter of 2005 on September 23, 2005. Beginning with the third quarter 2005 Form 10-Q filing, the Company has remained current with all its SEC filings.

Products

The Company develops, processes, manufactures and markets specialty chemicals, powders, metals and related products from various base metals feeds, primarily cobalt and nickel. The Company s products leverage the Company s production capabilities and bring value to its customers through superior product performance. Typically, the Company s products represent a small portion of the customer s total cost of manufacturing or processing, but are critical to the customer s product performance. The products frequently are essential components in chemical and industrial processes where they facilitate a chemical or physical reaction and/or enhance the physical properties of end-products. The Company s products are sold in various forms such as solutions, crystals, powders, cathodes and briquettes.

The following table sets forth key applications for the Company s products:

Applications	**Metals Used**	**OMG s Product Attributes**
Stainless Steel	Nickel	Improves rust resistance in demanding applications; improves corrosion resistance in aggressive high temperatures or corrosive environments
Rechargeable Batteries	Cobalt, Nickel	Improves the electrical conduction of rechargeable batteries used in cellular phones, video cameras, portable computers, power tools and hybrid electric vehicles
Coatings and paints	Cobalt, Manganese, Calcium, Zirconium, Aluminum	Promotes faster drying in such products as house paints (exterior and interior) and industrial and marine coatings
Printing Inks	Cobalt, Manganese	Promotes faster drying in various printing inks
Tires	Cobalt	Promotes bonding of metal-to-rubber in radial tires
Construction Equipment and Cutting Tools	Cobalt	Strengthens and adds durability to diamond and machine cutting tools and drilling equipment used in construction, oil and gas drilling, and quarrying
Petrochemical Refining	Cobalt, Nickel	Catalyzes reduction of sulfur dioxide and nitrogen emissions
Ceramics and Glassware	Cobalt, Nickel	Provides color for pigments, earthenware and glass and facilitates adhesion of porcelain to metal
Polyester Resins	Cobalt, Copper, Zinc	Accelerates the curing of polyester resins found in reinforced fiberglass boats, storage tanks, bathrooms, sports equipment, automobile and truck components
Memory Disks	Nickel	Enhances information storage on disks for computers and consumer electronics

Financial information, including reportable segment and geographic data, is contained in Note 20 to the consolidated financial statements contained in Item 8 of this Annual Report.

4

Competition

The Company encounters a variety of competitors in each of its product lines, and no single company competes with the Company across all of its existing product lines. For 2005, the Company believes that it was the largest refiner of cobalt and producer of cobalt-based specialty products in the world and was the sixth largest refiner of primary nickel and the largest producer of electroless nickel plating chemistry for memory disk applications. Competition in these markets is based primarily on product quality, supply reliability, price, service and technical support capabilities. The markets in which the Company participates have historically been competitive and this environment is expected to continue.

Customers

The Company serves approximately 2,100 customers. During 2005, approximately 54% of the Company s net sales were in Europe, 19% in the Americas and 27% in Asia-Pacific. In 2005, sales to Outokumpu Oy represented approximately 16% of the Nickel segment s net sales, 5% of the Cobalt segment s net sales, and 12% of the Company s total net sales. In addition, sales to another customer were approximately 21% of the Cobalt segment s net sales in 2005. No one customer exceeded 10% of the Company s consolidated net sales in 2004. In 2003, sales to Glencore AG represented approximately 13% of the Company s net sales.

While customer demand for the Company s products is generally non-seasonal, supply/demand and price perception dynamics of key raw materials do periodically cause customers to either accelerate or delay purchases of the Company s products, generating short-term results that may not be indicative of longer-term trends. Historically, revenues during July and August have been lower than other months due to the summer holiday season in Europe. Furthermore, the Company uses the summer season as the appropriate time to perform its annual maintenance shut-down for both of its refineries in Finland.

Raw Materials

The primary raw materials used by the Company in manufacturing its products are unrefined cobalt and nickel. Cobalt raw materials include ore, concentrates, slag and scrap. Nickel raw materials include concentrates, ore, intermediates, secondaries, scrap and matte. The cost of the Company s raw materials fluctuates due to actual or perceived changes in supply and demand of raw materials, changes in cobalt and nickel reference/market prices and changes in availability from suppliers.

The Company attempts to mitigate changes in prices by passing through to its customers increases in raw material prices by increasing the prices of its products and by entering into sales contracts that contain variable pricing that adjusts based on changes in the price of nickel and cobalt. The Company also attempts to minimize the effect on profitability of changes in the market price of nickel through hedging activities.

Cobalt

A significant portion of the Company s supply of cobalt historically has been sourced from the DRC, Australia and Finland. Production problems and political and civil instability in certain supplier countries may in the future affect the supply and market price of raw material. During 2005, the reference price of 99.3% cobalt listed in the trade publication, Metal Bulletin, continued the decline from the unusually high prices experienced in early 2004, dropping from an average of $17.26 per pound in the first quarter of 2005 to an average of $12.51 per pound in the fourth quarter of 2005. During 2004, cobalt reference prices ranged from an average of $24.63 per pound in the first quarter, and trended downward to an average of $18.38 per pound in the fourth quarter. From November 1, 2003 to December 31, 2003, the reference price of cobalt increased 105%, from $10.00 to $20.50 per pound. Earlier in 2003 and in 2002, the market price of cobalt remained at unusually low levels of $6.00-$7.00 per pound.

GTL shut down its smelter as scheduled during January of 2005 for approximately four months for maintenance and production improvements. The smelter was re-opened in May of 2005. The Company expects the next extended maintenance shutdown will occur in 2008.

A graph of the end of the month reference price of 99.3% cobalt (as published in Metal Bulletin magazine) per pound for 2000 through 2005 is as follows:

Nickel

Nickel historically has been sourced from Australia, Finland and Brazil. In December 2001, the Company purchased an intermediate nickel refining facility and associated mine deposits in Australia (the Cawse mine), which provide the Company with direct access to feed to produce approximately 6,500 tons of nickel per year. In the first and second quarter of 2005, the average London Metal Exchange (LME) cash nickel price was $6.96 per pound and $7.44 per pound, respectively, falling to an average of $5.73 per pound in the fourth quarter of 2005. During 2004, nickel market prices ranged from approximately $6-$7 per pound, except for a brief drop to approximately $5 per pound in May 2004. From November 1, 2003 to December 31, 2003, the market price of nickel increased 40%, from $5.40 to $7.54 per pound.

A graph of the monthly LME price of nickel per pound for 2000 through 2005 is as follows:

Currently, the Company has arrangements in place for approximately 82% of its practical nickel refining capacity for 2006. This amount includes both supply contracts for raw material feed and tolling agreements to toll refine third party feedstocks. During 2006, the Company reached an agreement to toll refine approximately 21,000 to 25,000 tons of contained nickel per year over a three-year period, starting July 1, 2006 and ending July 31, 2009. As a result of the agreement, the Company s Harjavalta, Finland refinery will be operating near practical capacity in the second half of 2006. Currently, the Company has arrangements in place for approximately 100% of its practical nickel refining capacity for 2007 and 2008.

Research and Development

The Company s research and new product development program is an integral part of its business. Research and development focuses on adapting proprietary technologies to develop new products and working with customers to meet their specific requirements, including joint development arrangements with customers that involve innovative products. New products include new chemical formulations, metal-containing compounds, and concentrations of various components and product forms. Research and development also focuses on improving refining competency, processes, yield and throughput in each location. Research and development, applied technology and technical service expenses were approximately $14.9 million for 2005, $14.0 million for 2004 and $10.0 million for 2003.

The Company s research staff of approximately 85 people conducts research and development in laboratories located in Westlake, Ohio; Newark, New Jersey; Kuching, Malaysia; Manchester, England; Kokkola, Finland and Harjavalta, Finland.

Patents and Trademarks

The Company holds 120 patents comprising 36 patent families and has 32 pending patent applications relating to the manufacturing, processing and use of metal-organic and metal-based compounds. Specifically, the majority of these patents cover proprietary technology for base metal refining, metal and metal oxide powders, catalysts, metal-organic compounds and inorganic salts. The Company does not consider any single patent or group of patents to be material to its business as a whole.

Environmental Matters

The Company is subject to a wide variety of environmental laws and regulations in the United States and in foreign countries as a result of its operations and use of certain substances that are, or have been, used, produced or discharged by its plants. In addition, soil and/or groundwater contamination presently exists and may in the future be discovered at levels that require remediation under environmental laws at properties now or previously owned, operated or used by the Company. At December 31, 2005 and 2004, the Company has environmental reserves of $8.8 million and $9.5 million, respectively.

Ongoing environmental compliance costs, which are expensed as incurred, were approximately $7.4 million in 2005 and $7.0 million in 2004 and include costs relating to waste water analysis, treatment, and disposal; hazardous and non-hazardous solid waste analysis and disposal; air emissions control; groundwater monitoring and related staff costs. The Company anticipates that it will continue to incur compliance costs at moderately increasing levels for the foreseeable future as environmental laws and regulations are becoming increasingly stringent.

The Company also incurred capital expenditures of approximately $3.9 million in both 2005 and 2004 in connection with ongoing environmental compliance. The Company anticipates that capital expenditure levels for these purposes will increase to approximately $6.7 million in 2006, as it continues to modify certain processes that may have an environmental impact and undertakes new pollution prevention and waste reduction projects.

Due to the ongoing development and understanding of facts and remedial options and due to the possibility of unanticipated regulatory developments, the amount and timing of future environmental expenditures could vary significantly. Although it is difficult to quantify the potential impact of compliance with or liability under environmental protection laws, based on presently available information, the Company believes that its ultimate aggregate cost of environmental remediation as well as liability under environmental protection laws will not result in a material adverse effect upon its financial condition or results of operations.

Employees

At December 31, 2005, the Company had 1,451 full-time employees, of which 222 were located in North America, 667 in Europe, 351 in Africa and 211 in Asia-Pacific. Employees at the Company s production facilities in Franklin, Pennsylvania; Kuching, Malaysia; and Kalgoorlie, Australia are non-unionized. Employees at the Company s facilities in Harjavalta and Kokkola, Finland are members of several national workers unions under

various union agreements. Generally, these union agreements have two-year terms. Employees at the Company s facility in Manchester, England are members of various trade unions under a recognition agreement. This recognition agreement has an indefinite term. Employees at the Belleville, Canada facility are members of the Communications, Energy and Paperworkers Union of Canada. The current Belleville union agreement expired in December 2005 after a two-year term. Employees in Belleville are working under the terms of the previous agreement and the Company believes it will be able to successfully negotiate a new agreement. Employees in the DRC are members of various trade unions. The union agreements have a term of three years expiring in April 2008. The Company believes that relations with its employees are good.

SEC Reports

The Company makes available free of charge through its website (www.omgi.com) its reports on Forms 10-K, 10-Q and 8-K as soon as reasonably practicable after the reports are electronically filed with the Securities and Exchange Commission.

Item 1A. Risk Factors

Our business faces significant risks. These risks include those described below and may include additional risks and uncertainties not presently known to us or that we currently deem immaterial. Our business, financial condition and results of operations could be materially adversely affected by any of these risks. These risks should be read in conjunction with the other information in this report.

EXTENDED BUSINESS INTERRUPTION AT OUR FACILITIES COULD HAVE AN ADVERSE IMPACT ON OPERATING RESULTS.

Our results of operations are dependent in large part upon our ability to produce and deliver products promptly upon receipt of orders and to provide prompt and efficient service to our customers. Any disruption of our day-to-day operations could have a material adverse effect on our business, customer relations and profitability. Our Kokkola and Harjavalta, Finland facilities and the Cawse mine and processing facility in Australia are the primary refining and production facilities for our products. The GTL smelter in the DRC is a primary source for cobalt raw material feed. Our Cleveland, Ohio facility serves as our corporate headquarters. These facilities are critical to our business, and a fire, flood, earthquake or other disaster or condition that damaged or destroyed any of these facilities could disable them. Any such damage to, or other condition interfering with the operation of, these facilities would have a material adverse effect on our business, financial position and results of operations.

WE ARE AT RISK FROM FLUCTUATIONS IN THE PRICE OF OUR PRINCIPAL RAW MATERIALS.

The principal raw materials we use in manufacturing base metal chemistry products are cobalt and nickel, and the cost of these raw materials fluctuates due to actual or perceived changes in supply and demand, changes in cobalt and nickel reference/market prices and changes in availability from suppliers. Fluctuations in the prices of cobalt and nickel have been significant in the past and we believe price fluctuations are likely to occur in the future. Our ability to pass increases in raw material prices through to our customers by increasing the prices of our products is an important factor in our business. The extent of our profitability depends, in part, on our ability to maintain the differential between our product prices and raw material prices, and we cannot guarantee that we will be able to maintain an appropriate differential at all times.

We may be required under U.S. GAAP accounting rules to write down the carrying value of our inventory when cobalt and nickel prices decrease. In periods of raw material metal price declines or declines in the selling price of the Company s finished products, inventory carrying values could exceed the amount the Company could realize on sale, resulting in a charge against inventory that could adversely affect our operating results.

WE ARE AT RISK FROM UNCERTAINTIES IN THE SUPPLY OF SOME OF OUR PRINCIPAL RAW MATERIALS.

Historically, we have sourced our supply of cobalt primarily from the DRC, Australia and Finland. Production problems or political or civil instability in supplier countries may affect the supply and market price of cobalt. In particular, political and civil instability in the DRC may affect the availability of raw materials from that country. If a substantial interruption should occur in the supply of cobalt from the DRC or elsewhere, we may not be able to obtain as much cobalt from other sources as would be necessary to satisfy our requirements at prices comparable to our current arrangements and our operating results could be adversely impacted.

Historically, we have sourced our supply of nickel primarily from Australia, Finland and Brazil. If a substantial interruption should occur in the supply of nickel, we may not be able to obtain as much nickel as would be necessary to satisfy our requirements and our operating results could be adversely impacted.

WE ARE EXPOSED TO FLUCTUATIONS IN FOREIGN EXCHANGE RATES, WHICH MAY ADVERSELY AFFECT OUR OPERATING RESULTS.

We have manufacturing and other facilities in North America, Europe, Asia-Pacific and Africa, and we market our products worldwide. Although most of our raw material purchases and product sales are transacted in U.S. dollars, liabilities for non-U.S. operating expenses and income taxes are denominated in local currencies. In addition, fluctuations in exchange rates may affect product demand and may adversely affect the profitability in U.S. dollars of products provided by us in foreign markets where payment for our products is made in the local currency. Accordingly, fluctuations in currency rates may affect our operating results.

OUR SUBSTANTIAL INTERNATIONAL OPERATIONS SUBJECT US TO RISKS, WHICH MAY INCLUDE UNFAVORABLE POLITICAL, REGULATORY, LABOR AND TAX CONDITIONS IN OTHER COUNTRIES.

Our business is subject to risks related to the differing legal and regulatory requirements and the social, political and economic conditions of many jurisdictions. In addition to risks associated with fluctuations in foreign exchange rates, risks inherent in international operations include the following:

- potential supply disruptions as a result of political instability or civil unrest in countries in which we have operations, especially the DRC and surrounding countries;
- agreements may be difficult to enforce and receivables difficult to collect through a foreign country s legal system;
- foreign customers may have longer payment cycles;
- foreign countries may impose additional withholding taxes or otherwise tax our foreign income, impose tariffs or adopt other restrictions on foreign trade or investment, including currency exchange controls;
- general economic conditions in the countries in which we operate could have an adverse effect on our earnings from operations in those countries;
- unexpected adverse changes in foreign laws or regulatory requirements may occur, including with respect to export duties and quotas; and
- compliance with a variety of foreign laws and regulations may be difficult.

Our overall success as a global business depends, in part, upon our ability to succeed in differing legal, regulatory, economic, social and political conditions. We cannot assure you that we will implement policies and strategies that will be effective in each location where we do business. Furthermore, we cannot be sure that any of the foregoing factors will not have a material adverse effect on our business, financial condition or results of operations.

WE ARE SUBJECT TO STRINGENT ENVIRONMENTAL REGULATION AND MAY INCUR UNANTICIPATED COSTS OR LIABILITIES ARISING OUT OF ENVIRONMENTAL MATTERS.

We are subject to stringent laws and regulations relating to the storage, handling, disposal, emission and discharge of materials into the environment, and we have expended, and may be required to expend in the future, substantial funds for compliance with such laws and regulations. In addition, we may from time to time be subjected to claims for personal injury, property damages or natural resource damages made by third parties or regulators. Our annual environmental compliance costs were $7.4 million in 2005. In addition, we made capital expenditures of approximately $3.9 million in 2005 in connection with environmental compliance.

As of December 31, 2005, we had reserves of $8.8 million, which we believe to be sufficient to cover our estimated liabilities at that time. However, given the many uncertainties involved in assessing liability for environmental claims, our current reserves may prove to be insufficient. We continually evaluate the adequacy of our reserves and adjust reserves when determined to be appropriate. In addition, our current reserves are based only on known sites and the known contamination on those sites. It is possible that additional remediation sites will be identified in the future or that unknown contamination at previously identified sites will be discovered. This could require us to make additional expenditures for environmental remediation or could result in exposure to claims in the future.

THE COMPANY IS CURRENTLY IN A TRANSITIONAL PERIOD AS WE DEVELOP AND IMPLEMENT A NEW STRATEGIC PLAN.

As a result of changes to the Company s executive officers and members of the board of directors during 2005, the Company is currently in a transitional period and may make changes, which could be material, to the Company s business, operations, financial condition and results of operations. It is impossible to predict what these changes will be and the impact they will have on the Company s future results of operations.

SEC INVESTIGATION.

As previously disclosed, the SEC s Division of Enforcement is conducting an informal investigation resulting from the self reporting by the Company of an internal investigation. This internal investigation was conducted in 2004 by the audit committee of our board of directors in connection with the previous restatement of our financial results for the periods prior to December 31, 2003. We are cooperating fully with the SEC informal investigation, but we cannot assure you that the SEC s Division of Enforcement will not take any action that would adversely affect us.

ADVERSE RESOLUTION OF LITIGATION MAY HARM OUR OPERATING RESULTS OR FINANCIAL CONDITION.

We are party to lawsuits in the normal course of business. Litigation can be expensive, lengthy and disruptive to normal business operations. Moreover, the results of complex legal proceedings are difficult to predict. An unfavorable resolution of a particular lawsuit could have a material adverse effect on our business, operating results, or financial condition. For additional information regarding certain of the lawsuits in which we are involved, See Item 3, Legal Proceedings, contained in Part I of this report.

IMPLEMENTATION OF AN ENTERPRISE RESOURCE PLANNING (ERP) PROJECT HAS THE POTENTIAL FOR BUSINESS INTERRUPTION AND ASSOCIATED ADVERSE IMPACT ON OPERATING RESULTS.

During 2005, we initiated a multi-year ERP project that is expected to be implemented worldwide to achieve increased efficiency and effectiveness in supply chain and financial processes. The system will be implemented at one site in 2006. The implementation of the ERP system has the potential to disrupt our business by delaying the processing of key business transactions. In addition, the implementation of the ERP system may take longer than anticipated or be more costly than originally estimated.

WE HAVE A SIGNIFICANT AMOUNT OF DEBT, AND THE COST OF SERVICING THAT DEBT COULD ADVERSELY AFFECT OUR LIQUIDITY, FINANCIAL CONDITION OR OUR ABILITY TO TAKE ACTIONS.

Our level of debt and debt service requirements could have important consequences for our business. For example, it could:

- require us to dedicate a substantial portion of our cash flow from operations to payments on our indebtedness, thereby reducing the availability of our cash flow to fund working capital, capital expenditures, research and development efforts, and for other general corporate purposes;
- increase our vulnerability to interest rate increases to the extent our variable-rate debt is not effectively hedged;
- restrict our ability to dispose of assets or to pay cash dividends on or repurchase our stock;
- increase our vulnerability to adverse economic and industry conditions and competition;
- limit our flexibility in planning for, or reacting to changes in our business and our industry; and
- place us at a competitive disadvantage compared to our competitors that have less debt.

Any of the foregoing consequences could have a material adverse effect on us.

Our ability to make principal and interest payments, or to refinance our indebtedness, including our outstanding senior subordinated notes, depends on our future performance. Our future performance is, to a certain extent, subject to economic, financial, competitive and other factors beyond our control. We cannot guarantee that our business will generate sufficient cash flow from operations in the future to service our debt and fund necessary capital expenditures. If we are unable to generate sufficient cash flow, we may be required to refinance all or a portion of our existing debt, sell assets or obtain additional financing. We cannot guarantee that any refinancing or sale of assets or additional financing would be possible on terms reasonably favorable to us, or at all. Some of our competitors currently operate on a less leveraged basis and may have greater operating and financial flexibility.

WE MAY INCUR MORE DEBT, WHICH COULD EXACERBATE THE RISKS DESCRIBED ABOVE.

We and our subsidiaries may be able to incur additional indebtedness in the future. Our existing credit facilities and the indenture for our outstanding senior subordinated notes limit us from incurring additional indebtedness but do not fully prohibit us or our subsidiaries from doing so. If new debt is added to our and our subsidiaries current debt levels, the related risks that we and they now face could intensify.

THE OPERATING AND FINANCIAL RESTRICTIONS IMPOSED BY OUR DEBT AGREEMENTS, INCLUDING OUR CREDIT FACILITIES AND THE INDENTURE RELATING TO OUR SENIOR SUBORDINATED NOTES, LIMIT OUR ABILITY TO FINANCE OPERATIONS AND CAPITAL NEEDS OR ENGAGE IN OTHER BUSINESS ACTIVITIES.

Our debt agreements contain covenants that restrict our ability to:

- incur additional indebtedness (including guarantees);
- incur liens;
- dispose of assets;
- pay dividends and make other restricted payments;
- issue preferred stock containing redemption provisions requiring a payment before the maturity of the notes or, in the case of our subsidiaries, issue capital stock;

enter into sale and leaseback transactions;

- enter into some leases; and

- engage in some transactions with affiliates.

In addition, our credit facilities require us to comply with specified financial covenants including minimum cash flow coverage ratio and a maximum total leverage ratio.

Our ability to meet these covenants and requirements in the future may be affected by events beyond our control, including prevailing economic, financial and industry conditions. Our breach or failure to comply with any of these covenants could result in a default under our credit facilities or the indenture governing our outstanding senior subordinated notes. If we default under our credit facilities, the lenders could cease to make further extensions of credit, cause all of our outstanding debt obligations under these credit facilities to become due and payable, require us to apply all of our available cash to repay the indebtedness under these credit facilities, prevent us from making debt service payments on any other indebtedness we owe and/or proceed against the collateral granted to them to secure repayment of those amounts. If a default under the indenture occurs, the holders of the notes could elect to declare the notes immediately due and payable. If the indebtedness under our credit facilities or the notes is accelerated, we may not have sufficient assets to repay amounts due under these existing debt agreements or on other debt securities then outstanding.

WE MAY NOT BE ABLE TO RESPOND EFFECTIVELY TO TECHNOLOGICAL CHANGES IN OUR INDUSTRY OR IN OUR CUSTOMERS PRODUCTS.

Our future business success will depend in part upon our ability to maintain and enhance our technological capabilities, develop and market products and applications that meet changing customer needs and successfully anticipate or respond to technological changes on a cost-effective and timely basis. Our inability to anticipate, respond to or utilize changing technologies could have an adverse effect on our business, financial condition or results of operations. Moreover, technological and other changes in our customers products or processes may render some of our specialty chemicals unnecessary, which would reduce the demand for those chemicals.

WE OPERATE IN VERY COMPETITIVE INDUSTRIES.

We have many competitors. Some of our principal competitors have greater financial and other resources, less leverage and greater brand recognition than we have. Accordingly, these competitors may be better able to withstand changes in conditions within the industries in which we operate and may have significantly greater operating and financial flexibility than we do. As a result of the competitive environment in the markets in which we operate, we currently face and will continue to face pressure on the sales prices of our products from competitors and large customers. With these pricing pressures, we may experience future reductions in the profit margins on our sales, or may be unable to pass on future raw material price or operating cost increases to our customers, which also would reduce profit margins. In addition, we may encounter increased competition in the future, which could have a material adverse effect on our business. Since we conduct our business mainly on a purchase order basis, with few long-term commitments from our customers, this competitive environment could give rise to a sudden loss of business.

INDUSTRY CONSOLIDATION MAY LEAD TO INCREASED COMPETITION AND MAY HARM OUR OPERATING RESULTS.

There has been a trend toward industry consolidation in our markets. We believe that industry consolidation may result in stronger competitors with greater financial and other resources that are better able to compete for customers. This could lead to more variability in operating results and could have a material adverse effect on our business, operating results, and financial condition.

FAILURE TO RETAIN AND RECRUIT KEY PERSONNEL WOULD HARM OUR ABILITY TO MEET KEY OBJECTIVES.

Our key personnel are critical to the management and direction of our businesses. Our future success depends, in large part, on our ability to retain key personnel and other capable management personnel. Although we believe

that we will be able to attract and retain talented personnel and replace key personnel should the need arise, our inability to do so could make it difficult to meet key objectives and disrupt the operations of the segment affected or our overall operations.

WE MAY EXPAND OUR OPERATIONS THROUGH ACQUISITIONS, WHICH COULD DIVERT MANAGEMENT S ATTENTION AND EXPOSE US TO UNANTICIPATED COSTS AND LIABILITIES. WE MAY EXPERIENCE DIFFICULTIES INTEGRATING THE ACQUIRED OPERATIONS, AND WE MAY INCUR COSTS RELATING TO POTENTIAL ACQUISITIONS THAT ARE NEVER CONSUMMATED.

Our business plan could include growth through future acquisitions. However, our ability to consummate any future acquisitions on terms that are favorable to us may be limited by the number of attractive acquisition targets, internal demands on our resources and our ability to obtain financing. Our success in integrating newly acquired businesses will depend upon our ability to retain key personnel, avoid diversion of management s attention from operational matters, and integrate general and administrative services and key information processing systems. In addition, future acquisitions could result in the incurrence of additional debt, costs and contingent liabilities. Integration of acquired operations may take longer, or be more costly or disruptive to our business, than originally anticipated. It is also possible that expected synergies from future acquisitions may not materialize. We may also incur costs and divert management attention as regards potential acquisitions that are never consummated.

Although we undertake a due diligence investigation of each business that we acquire, there may be liabilities of the acquired companies that we fail to or are unable to discover during the due diligence investigation and for which we, as a successor owner, may be responsible. In connection with acquisitions, we generally seek to minimize the impact of these types of potential liabilities through indemnities and warranties from the seller, which may in some instances be supported by deferring payment of a portion of the purchase price. However, these indemnities and warranties, if obtained, may not fully cover the liabilities due to limitations in scope, amount or duration, financial limitations of the indemnitor or warrantor or other reasons.

OUR HEDGING ARRANGEMENTS INVOLVE RISK.

To manage our exposure to market risk, we periodically enter into forward and future contracts to hedge commodity price risk to nickel and swap agreements to hedge interest rate risk related to borrowings. These transactions may expose us to the risk of financial loss in certain circumstances, including instances in which the contractual counterparties fail to perform under the contracts or a sudden, unexpected event materially impacts nickel prices or interest rates.

CHANGES IN EFFECTIVE TAX RATES OR ADVERSE OUTCOMES RESULTING FROM EXAMINATION OF OUR INCOME TAX RETURNS COULD ADVERSELY AFFECT OUR RESULTS.

Our future effective tax rates could be adversely affected by earnings being lower than anticipated in countries where we have lower statutory rates, higher than anticipated in countries where we have higher statutory rates, or if we incur losses for which no corresponding tax benefit can be realized, by changes in the valuation of our deferred tax assets and liabilities, or by changes in tax laws, regulations, accounting principles or interpretations thereof. In addition, we are subject to examination of our income tax returns by the Internal Revenue Service and other tax authorities. We regularly assess the likelihood of adverse outcomes resulting from these examinations to determine the adequacy of our provision for income taxes. There can be no assurance that the outcomes from these examinations will not have an adverse effect on our operating results and financial condition.

In July 2005, the FASB issued an Exposure Draft of a proposed Interpretation Accounting for Uncertain Tax Positions an interpretation of FASB Statement No. 109. The proposed Interpretation proposes changes to the current accounting for uncertain tax positions. While we cannot predict with certainty the rules in the final Interpretation, there is risk that the final Interpretation could result in a cumulative effect charge to earnings

upon adoption, increases in future effective tax rates, and/or increases in future interperiod effective tax rate volatility.

OUR STOCK PRICE MAY CONTINUE TO BE VOLATILE.

Our common stock has experienced substantial price volatility, particularly as a result of variations between our actual financial results and the published expectations of analysts. Furthermore, speculation in the press or investment community about our strategic position, financial condition, results of operations, business, or significant transactions can cause changes in our stock price. These factors, as well as general economic and political conditions, may materially adversely affect the market price of our common stock in the future.

Item 1B. Unresolved Staff Comments

The Company has received no written comments regarding its periodic or current reports from the staff of the Securities and Exchange Commission that were issued 180 days or more preceding the end of its 2005 fiscal year and that remain unresolved.

Item 2. Properties

The Company believes that its plants and facilities, which are of varying ages and of different construction types, have been satisfactorily maintained, are suitable for the Company s operations and generally provide sufficient capacity to meet the Company s production requirements. The land on which the production facilities in Kalgoorlie, Australia are located; the land on which the Harjavalta, Finland (HNO) production facilities are located (except for the land on which the HNO chemical plant is located); and the land on which the Kokkola, Finland (KCO) production facilities are located are leased under agreements with varying expiration dates. The depreciation lives of fixed assets do not exceed the lives of the land leases. Otherwise, the land associated with the Company s remaining manufacturing facilities is owned by the Company.

The Company s KCO production facility is situated on property owned by Boliden Kokkola Oy. KCO and Boliden Kokkola Oy share certain physical facilities, services and utilities under agreements with varying expiration dates. The Company s HNO production facility is situated on land owned by Boliden Harjavalta Oy. The HNO facility also shares certain physical facilities and has contracts in place for toll smelting, waste disposal, utilities, laboratory services and raw material supply with Boliden Harjavalta Oy with varying expiration dates.

Information regarding the Company s primary offices, research and product development, and manufacturing and refining facilities, is set forth below:

Location	Segment	Facility Function*	Approximate Square Feet	Leased/Owned
Africa:				
Lubumbashi, DRC	Cobalt	M	116,000	joint venture (55% owned)
North America:				
Cleveland, Ohio	Corporate	A	24,500	leased
Westlake, Ohio	Cobalt	A, R	35,200	owned
Belleville, Ontario	Cobalt	M	38,000	owned
Franklin, Pennsylvania	Cobalt	M	331,500	owned
Newark, New Jersey	Nickel	A, R	32,000	owned
Asia-Pacific:				
Kalgoorlie, Australia	Nickel	M	294,400	owned
Kuching, Malaysia	Nickel	M, A, R	25,000	owned
Tokyo, Japan	Cobalt	A	2,300	leased
Taipei, Taiwan	Cobalt	A	4,000	leased
Singapore	Nickel	W, A	4,700	leased
Europe:				
Manchester, England	Cobalt	M, A, R	73,300	owned
Espoo, Finland	Nickel	A	3,000	leased
Harjavalta, Finland	Nickel	M, A, R	591,000	owned
Kokkola, Finland	Cobalt	M, A, R	470,000	owned

* M Manufacturing/refining; A Administrative; R Research and Development; W Warehouse

Item 3. Legal Proceedings

In November 2002, the Company received notice that shareholder class action lawsuits were filed in the U.S. District Court for the Northern District of Ohio related to the decline in the Company s stock price after the third quarter 2002 earnings announcement. The lawsuits alleged virtually identical claims under Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and SEC Rule 10b-5 against the Company, certain then executive officers and the then members of the board of directors. Plaintiffs sought damages in an unspecified amount to compensate persons who purchased the Company s stock between November 2001 and October 2002 at allegedly inflated market prices. In July 2004, these lawsuits were amended to include the entire restatement period back to and including 1999, and to add the Company s independent auditors, Ernst & Young LLP, as a defendant. The Company and the lead plaintiff of the shareholder class action lawsuits entered into a Stipulation and Agreement of Settlement (the Shareholder Class Action Agreement) dated June 6, 2005, which Shareholder Class Action Agreement, as amended, was approved on September 8, 2005 by the U.S. District Court hearing the cases. The Company recorded a charge to administrative expense of $82.5 million during the fourth quarter of 2003 related to these lawsuits. During 2005, the Company paid $74.0 million in cash and the remaining $8.5 million was settled by the issuance of 407,478 shares of common stock. The Company s insurance policies covered a portion of the settlement amounts. As of December 31, 2005, insurance proceeds of $44.0 million have been received, representing reimbursement of legal expenses ($16.5 million) as well as reimbursement of a portion of the settlement amount paid by the Company ($27.5 million). Amounts recorded in 2005, 2004 and 2003 were $32.4 million, $7.9 million and $3.7 million, respectively, and were recognized when received. The Company has no other insurance coverage available for the settlement.

In November 2002, the Company also received notice that shareholder derivative lawsuits had been filed in the U.S. District Court for the Northern District of Ohio against the then members of the Company s board of directors and certain of its then executives. Derivative plaintiffs allege the directors and executives breached their fiduciary duties to the Company in connection with a decline in the Company s stock price after its third quarter 2002 earnings announcement by failing to institute sufficient financial controls to ensure that the Company and its employees complied with generally accepted accounting principles by writing down the value of the Company s cobalt inventory on or before December 31, 2001. Derivative plaintiffs sought a number of changes to the Company s accounting, financial and management structures and unspecified damages from the directors and executives to compensate the Company for costs incurred in, among other things, defending the aforementioned securities lawsuits. In July 2004, the derivative plaintiffs amended these lawsuits to include conduct allegedly related to the Company s decision to restate its earnings back to and including 1999. The Company and the lead plaintiffs of the shareholder derivative lawsuits entered into a Stipulation and Agreement of Settlement dated September 23, 2005 (the Shareholder Derivative Agreement) which was preliminarily approved on September 29, 2005 by the U.S. District Court hearing the cases and finalized in November 2005. The Shareholder Derivative Agreement provided for the Company to issue 380,000 shares of its common stock in payment of attorneys fees and costs incurred by plaintiffs counsel with respect to this litigation, and also required the Company to implement various corporate governance changes. The Company recorded a charge to administrative expense of $2.0 million during the fourth quarter of 2003 and an additional charge to administrative expense of $7.5 million during the first quarter of 2004 related to these shareholder derivative lawsuits.

Prior to issuance, the 380,000 shares of common stock related to the settlement of the shareholder derivative litigation were marked-to-market through the Statement of Consolidated Income based on changes in the Company s stock price, as the liability was fixed in shares. The Company recognized income of $4.6 million during 2005 related to the mark-to-market of these shares. In November 2005, the 380,000 shares were issued to settle these lawsuits.

The Company is currently engaged in pending litigation with James P. Mooney in federal court in Florida. The Company brought suit against Mr. Mooney seeking disgorgement of certain bonuses and profits he received during his tenure as Chief Executive Officer. Mr. Mooney has asserted a counterclaim against the Company seeking damages based on additional bonuses he alleges he is owed and other additional payments he claims he is entitled to under his employment agreement. The Company is currently depositing Mr. Mooney s severance payments into an escrow account. Mr. Mooney has also filed suit against the Company in Delaware state court seeking advancement and reimbursement of his attorney s fees in connection with the pending Florida litigation and other related matters. The Company is defending these lawsuits.

The SEC s Division of Enforcement is conducting an informal investigation resulting from the self reporting by the Company of an internal investigation. This internal investigation was conducted in 2004 by the audit committee of the Company s board of directors in connection with the previously filed restatement of the Company s financial results for the periods prior to December 31, 2003. The Company is cooperating fully with the SEC informal investigation.

In addition, the Company is a party to various other legal and administrative proceedings incidental to its business. In the opinion of the Company, disposition of all suits and claims related to its ordinary course of business should not in the aggregate have a material adverse effect on the Company s financial position or results of operations.

Item 4. Submission of Matters to a Vote of Security Holders

No matters were submitted to a vote of security holders during the fourth quarter of the Company s 2005 fiscal year.

Executive Officers of the Registrant

The information under this item is being furnished pursuant to Instruction 3 of Item 401(b) of Regulation S-K.

There is set forth below the name, age, positions and offices held by each of the Company s executive officers, as well as their business experience during the past five years. Years indicate the year the individual was named to the indicated position.

Joseph M. Scaminace 52

Chairman and Chief Executive Officer, August 2005

Chief Executive Officer, June 2005

President, Chief Operating Officer and Board Member, The Sherwin-Williams Company 1999-2005

Kenneth Haber 55

Chief Financial Officer, March 2006

Interim Chief Financial Officer, November 2005 March 2006

Owner and President, G&H Group Company, dba, Partners in Success May 2000 March 2006

Valerie Gentile Sachs 50

Vice President, General Counsel and Secretary, September 2005

Executive Vice President, General Counsel and Secretary, 2003-2005, Jo-Ann Stores, Inc.

General Counsel, 2002-2003, Marconi plc.

Executive Vice President and General Counsel, April 2001 to March 2002, and Vice President and General Counsel, November 2000 to April 2001, Marconi Communications, Inc., the operating company for Marconi, plc in the Americas.

Marcus P. Bak 42

Vice President and General Manager, Nickel Group, January 2003

President, OMG Harjavalta Nickel Oy, October 2002 January 2003

Vice President and General Manager, OMG Powdered Metals, January 2000 October 2002

Stephen D. Dunmead 42

Vice President and General Manager, Cobalt Group, August 2003

Corporate Vice President of Technology, 2000 August 2003

Gregory J. Griffith 50

Vice President, Corporate Affairs and Investor Relations, October 2005

Director of Investor Relations, July 2002 October 2005

Director, Corporate Communications, Great Lakes Chemical Corporation 1999 2002

Daniel K. Lewis 51

Vice President, Human Resources, February 2006

Director of Human Resources, European Union, Goodyear Tire and Rubber Company June 2005 February 2006

Director of Human Resources, EPD and Chemicals, Goodyear Tire and Rubber Company March 2003 May 2005

Director of Human Resources, Corporate Staffing and Recruiting, Goodyear Tire and Rubber Company June 2001 March 2003

PART II

Item 5. Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

The Company s common stock is traded on the New York Stock Exchange under the symbol OMG . As of December 31, 2005, the approximate number of record holders of the Company s common stock was 1,556.

The high and low market prices for the Company s common stock for each quarter during the past two years are presented in the table below:

	2005		
	Sales Price		
	High	Low	Cash Dividend
First quarter	**$ 33.36**	**$ 27.47**	**$**
Second quarter	**$ 31.36**	**$ 19.35**	**$**
Third quarter	**$ 24.95**	**$ 18.62**	**$**
Fourth quarter	**$ 20.42**	**$ 12.35**	**$**

	2004		
	Sales Price		
	High	Low	Cash Dividend
First quarter	$ 35.20	$ 26.16	$
Second quarter	$ 33.04	$ 24.25	$
Third quarter	$ 36.56	$ 27.30	$
Fourth quarter	$ 37.38	$ 29.58	$

On November 17, 2005, the Company issued 380,000 shares of its common stock as part of the settlement of the shareholder derivative lawsuits that were filed in November 2002. These shares were not registered under the Securities Act of 1933 in reliance on the exemption contained in Section 3(a)(10) of such Act, as the share issuance was approved by the U.S. District Court hearing the cases. The Company did not receive any cash proceeds as a result of the issuance. The settlement of the derivative lawsuits is further described in Item 3 of this Annual Report.

Item 6. Selected Financial Data

	Year Ended December 31,				
	2005	**2004**	**2003**	**2002**	**2001**
(In millions, except per share data)					
Income Statement Data:					
Net sales	**$ 1,249.6**	$ 1,347.3	$ 912.1	$ 738.9	$ 681.6
Cost of products sold	**1,092.1**	1,016.9	732.1	690.8	578.0
Gross profit	**157.5**	330.4	180.0	48.1	103.6
Selling, general and administrative expenses	**90.0**	129.1	197.0	136.0	81.3
Income (loss) from operations	**$ 67.5**	$ 201.3	$ (17.0)	$ (87.9)	$ 22.3
Income (loss) from continuing operations before cumulative effect of change in accounting principle	**$ 27.2**	$ 125.7	$ (56.2)	$ (110.7)	$ (13.1)
Income (loss) of discontinued operations, net of tax	**9.4**	2.9	139.9	(98.1)	(22.1)
Cumulative effect of a change in accounting principle	**2.3**				
Net income (loss)	**$ 38.9**	$ 128.6	$ 83.7	$ (208.8)	$ (35.2)
Net income (loss) per common share basic:					
Continuing operations	**$ 0.95**	$ 4.42	$ (1.99)	$ (3.95)	$ (0.55)
Discontinued operations	**0.33**	0.10	4.94	(3.50)	(0.91)
Cumulative effect of change in accounting principle	**0.08**				
Net income (loss)	**$ 1.36**	$ 4.52	$ 2.95	$ (7.45)	$ (1.46)
Net income (loss) per common share assuming dilution:					
Continuing operations	**$ 0.95**	$ 4.39	$ (1.99)	$ (3.95)	$ (0.55)
Discontinued operations	**0.32**	0.10	4.94	(3.50)	(0.91)
Cumulative effect of a change in accounting principle	**0.08**				
Net income (loss)	**$ 1.35**	$ 4.49	$ 2.95	$ (7.45)	$ (1.46)
Dividends declared and paid per common share	**$**	$	$	$ 0.42	$ 0.52
Ratio of earnings to fixed charges(a)	**1.7x**	5.0x			
Balance Sheet Data:					

Total assets	**$ 1,220.3**	$ 1,334.7	$ 1,211.4	$ 2,105.3	$ 2,074.0
Long-term debt, excluding current portion(b)	**$ 416.1**	$ 24.7	$ 430.5	$ 1,195.6	$ 1,299.7

(a) Earnings were inadequate to cover fixed charges by $42.9 million, $134.5 million, and $18.5 million in 2003, 2002 and 2001, respectively.

(b) Amount in 2004 excludes $400 million of long-term debt in default which is classified as current.

Results for 2005 include $27.5 million of income related to the receipt of net insurance proceeds related to the shareholder class action and derivative lawsuits, and $4.6 million of income related to the mark-to-market of 380,000 shares of common stock issued in connection with the shareholder derivative litigation, both partially offset by an $8.9 million charge related to the former chief executive officer s termination.

Results for 2004 include a charge of $7.5 million for the shareholder derivative lawsuits.

Results for 2003 include the sale of the Company s Precious Metals Group (PMG) for cash proceeds of approximately $814 million, which resulted in a gain on sale of $145.9 million ($131.7 million after tax). Results for PMG are included in discontinued operations for all periods.

In 2003, cost of products sold includes restructuring charges of $5.8 million. Selling, general and administrative expenses include restructuring charges of $14.2 million and the shareholder class action and derivative lawsuit charge of $84.5 million. In addition, discontinued operations include $5.6 million of restructuring charges.
In 2002, cost of products sold includes restructuring charges of $37.8 million. Selling, general and administrative expenses include restructuring charges of $44.7 million. Also, in connection with its restructuring program, the Company recorded charges of $73.5 million in discontinued operations primarily associated with the planned disposal of such operations.
Net income for 2001 includes goodwill amortization expense of approximately $6.0 million in selling, general and administrative expenses. Goodwill amortization ceased in 2002 in connection with the adoption of Statement of Financial Accounting Standards (SFAS) No. 142, *Goodwill and Other Intangible Assets.*
In August, 2001 the Company acquired dmc2 Degussa Metals Catalysts Cerdec for a purchase price of approximately $1.1 billion. In September, 2001 the Company disposed of the electronic materials, performance pigments, glass systems and Cerdec ceramics divisions of dmc2 for $525.5 million. The remaining portion became the Company s PMG businesses.
On April 4, 2000 the Company acquired Outokumpu Nickel Oy (ONO) in Harjavalta, Finland for a cash purchase price of $206.0 million, which included contingent payments in 2004 and 2003 of $6.7 million and $11.2 million, respectively, to the seller under a contingent consideration arrangement (See Note 7 to the consolidated financial statements included in Item 8 of this Annual Report). There will be no further contingent consideration payments subsequent to 2004.

Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations

Management s discussion and analysis of financial condition and results of operations should be read in conjunction with the consolidated financial statements and the notes thereto appearing elsewhere in this Annual Report.

Overview

The Company is a leading, vertically integrated international producer and marketer of value-added, metal-based specialty chemicals and related materials, primarily from cobalt and nickel. The Company applies proprietary technology to unrefined cobalt and nickel raw materials to market more than 825 different product offerings to approximately 2,100 customers in over 30 industries. The Company operates in two business segments Cobalt and Nickel.
The Company s business is critically connected to both the price and availability of raw materials. The primary raw materials used by the Company are unrefined cobalt and nickel. Cobalt raw materials include ore, concentrates, slag and scrap. Nickel raw materials include concentrates, ore, intermediates, secondaries, scrap and matte. The cost of the Company s raw materials fluctuates due to actual or perceived changes in supply and demand, changes in cobalt and nickel reference/market prices and changes in availability from suppliers. The Company attempts to mitigate changes in availability by maintaining adequate inventory levels and long-term supply relationships with a variety of producers. Fluctuations in the prices of cobalt and nickel have been significant in the past and the Company believes that cobalt and nickel price fluctuations are likely to continue in the future. The Company attempts to pass through to its customers increases in raw material prices by increasing the prices of its products. The Company s profitability is largely dependent on the Company s ability to maintain the differential between its product prices and product costs. Certain sales contracts and raw material purchase contracts contain variable pricing that adjusts based on changes in the price of cobalt and nickel. During periods of rapidly changing metal prices, however, there may be price lags that can impact the short-term profitability and cash flow from operations of the Company both positively and negatively. The Company attempts to minimize the effect on profitability of changes in the market price of nickel through hedging activities.

Reductions in the price of raw materials or declines in the selling prices of the Company s finished goods could also result in the Company s inventory carrying value being written down to a lower market value.
The Company has manufacturing and other facilities in North America, Africa, Europe and Asia-Pacific, and markets its products worldwide. Although most of the Company s raw material purchases and product sales are based on the U.S. dollar, prices of certain raw materials, non-U.S. operating expenses and income taxes are denominated in local currencies. As such, the results of operations are subject to the variability that arises from exchange rate movements (particularly the Euro and the Australian dollar). In addition, fluctuations in exchange rates may affect product demand and profitability in U.S. dollars of products provided by the Company in foreign markets in cases where payments for its products are made in local currency. Accordingly, fluctuations in currency prices affect the Company s operating results.

Overall Operating Results for 2005, 2004 and 2003

Set forth below is a summary of the Statements of Consolidated Income for the years ended December 31,

(Millions of dollars & percent of net sales)	**2005**		2004		2003	
Net sales	**$ 1,249.6**		$ 1,347.3		$ 912.1	
Cost of products sold	**1,092.1**		1,016.9		732.1	
Gross profit	**157.5**	**12.6%**	330.4	24.5%	180.0	19.7%
Selling, general and administrative expenses	**90.0**	**7.2%**	129.1	9.6%	197.0	21.6%
Income (loss) from operations	**67.5**	**5.4%**	201.3	14.9%	(17.0)	(1.9)%
Other expense, net (including interest expense)	**(36.7)**		(39.1)		(25.6)	
Income tax expense	**(10.7)**		(35.1)		(14.5)	
Minority interest share of (income) loss	**7.1**		(1.4)		0.9	
Income (loss) from continuing operations before cumulative effect of change in accounting principle	**27.2**		125.7		(56.2)	
Income from discontinued operations, net of tax	**9.4**		2.9		139.9	
Income before cumulative effect of change in accounting principle	**36.6**		128.6		83.7	
Cumulative effect of change in accounting principle	**2.3**					
Net income	**$ 38.9**		$ 128.6		$ 83.7	

2005 Operating Results Compared to 2004

Net sales decreased $97.7 million, or 7.3%, to $1,249.6 million for the year ended December 31, 2005, compared with $1,347.3 million for the year ended December 31, 2004. The decrease in net sales was primarily due to lower cobalt metal prices and lower nickel sales volumes resulting from raw material feed shortages in 2005 compared with 2004, partially offset by higher nickel prices. During 2005, the reference price of 99.3% cobalt continued to decline from the unusually high prices experienced in early 2004, dropping from an average of $17.26 per pound in the first quarter of 2005 to an average of $12.51 per pound in the fourth quarter of 2005. During 2004, cobalt reference prices averaged $24.63 per pound in the first quarter, and trended downward to an average of $18.38 per pound in the fourth quarter.
Gross profit decreased $172.9 million to $157.5 million in 2005, compared with $330.4 million in 2004. Margins decreased to 12.6% from 24.5% primarily due to the sale of cobalt finished goods manufactured using higher cost raw

materials purchased before the overall decrease in cobalt metal prices discussed above and the effect of declining cobalt prices throughout 2005 compared to the opposite effect in 2004. Additional items negatively impacting gross profit in 2005 were lower nickel production caused by a lack of raw material feed resulting in

higher costs per unit produced, higher tolling costs due to a new tolling agreement at the Company s nickel refinery in Finland, lower of cost or market charges of $6.1 million in 2005 due to decreasing metal prices and the scheduled maintenance shut-down of the DRC smelter.

Selling, general and administrative expenses decreased by $39.1 million to $90.0 million in 2005 compared with $129.1 million in 2004. The decrease was primarily due to $27.5 million of income related to the receipt of net insurance proceeds related to the shareholder class action litigation and $4.6 million of income related to the mark-to-market of 380,000 shares of common stock issued in connection with the shareholder derivative litigation compared with a charge of $7.5 million related to the shareholder derivative lawsuits in 2004. Legal and professional fees decreased $5.4 million in 2005 compared with 2004 due to higher costs in 2004 associated with the restatement process, audit committee investigation and implementation of processes to comply with Sarbanes-Oxley requirements. In addition, 2005 also includes income of $2.5 million related to the collection of a note receivable that had been fully reserved in 2002. These positive factors were partially offset by an $8.9 million charge related to the former chief executive officer s departure and a $4.2 million charge to establish a reserve against the notes receivable from our joint venture partner in the DRC.

The decrease in other expense, net in 2005 compared with 2004 was primarily due to a gain of $2.4 million on the sale of investments in equity securities.

Income tax expense was $10.7 million on pre-tax income of $30.9 million in 2005. The effective income tax rate for 2005 was 34.8% compared with 21.6% for 2004. The higher rate in 2005 was primarily due to lower income in 2005 compared with 2004 in Finland which has a statutory rate of 26%. In 2004, higher income in Finland significantly lessened the impact on the overall effective income tax rate of losses in the United States with no income tax benefit. In both years, the rate was favorably impacted by the tax holiday from income taxes in Malaysia. Also in 2005, the weakening Euro compared with the U.S. dollar negatively impacted the tax rate, as the Company s statutory tax liability in Finland is payable in Euros but is remeasured to the U.S. dollar functional currency for preparation of consolidated financial statements. In 2004, when the Euro strengthened against the U.S. dollar, the opposite effect occurred reducing the overall effective income tax rate.

Minority interest share of losses in 2005 were due to the losses of GTL which were attributable to the scheduled extended maintenance shut-down of the GTL smelter and delayed shipments out of the DRC due primarily to distribution issues. The Company expects the next extended maintenance shutdown of the GTL smelter will occur in 2008. In 2004, GTL was profitable due to a full year of production and the benefit of higher cobalt prices.

Income from discontinued operations was $9.4 million in 2005. The income relates primarily to the reversal of a $5.5 million tax contingency accrual, a $1.6 million tax refund related to the Company s former Precious Metals Group (PMG) business and a reduction in Retained Liabilities of Businesses Sold attributable to foreign exchange gains of $1.6 million from remeasuring Euro-denominated liabilities to U.S. dollars. During 2005, the Company reversed a $5.5 million tax contingency accrual that was originally established in July 2003 upon the sale of PMG. Subsequent to that date, such amount had been included in Retained Liabilities of Businesses Sold in the Consolidated Balance Sheets. The contingency relates to a tax matter in Brazil for which the Company has indemnified the PMG buyer under terms of the PMG sale agreement. In mid-2005, a Brazilian mid-level federal court made a ruling that was unfavorable to the PMG buyer s case. However, in November 2005, the Brazilian Federal Supreme Court (the Court) ruled in favor of the taxpayer in a similar case, declaring the applicable law unconstitutional. Subsequent to that decision the Court has ruled in favor of the taxpayer in numerous other cases. The Court must hear all remaining individual cases that have been or will be appealed in this matter, including the PMG buyer s, and that process may take several years. Until the PMG buyer s case is adjudicated by the Court, the Company will remain liable for this matter based on the indemnification agreement. However, based upon the precedent set by the Court, the Company has concluded that this contingent liability is no longer probable at December 31, 2005, and has reversed the accrual. Although the contingency is no longer probable, the likelihood of an unfavorable outcome of this contingency is reasonably possible based on the length of time expected before the matter is closed and the inherent risk of changes in the political or legal situation in Brazil.

Income from discontinued operations of $2.9 million in 2004 relates to reductions in estimates of environmental and closure accruals established in connection with the sale of the SCM business and the exit of the Company s closed manufacturing facilities in St. George, Utah and Midland, Michigan.

Net income in 2005 includes $2.3 million of income related to the cumulative effect of a change in accounting principle for the adoption of FASB Interpretation (FIN) No. 47, Accounting for Conditional Asset Retirement Obligations. See further discussion of the adoption of FIN No. 47 in Note 2 to the Consolidated Financial Statements in this Form 10-K.

Net income was $38.9 million, or $1.35 per diluted share, in 2005 compared with $128.6 million, or $4.49 per diluted share, in 2004, due primarily to the aforementioned factors.

Cobalt Segment

The following table summarizes the average quarterly reference price of 99.3% cobalt:

	2005	2004	Change
First Quarter	**$ 17.26**	$ 24.63	$ (7.37)
Second Quarter	**$ 15.03**	$ 24.91	$ (9.88)
Third Quarter	**$ 13.41**	$ 23.17	$ (9.76)
Fourth Quarter	**$ 12.51**	$ 18.38	$ (5.87)
Full Year	**$ 14.55**	$ 22.76	$ (8.21)

The following table summarizes the percentage of sales dollars by end market:

	2005	2004	Change
Batteries	**28%**	38%	(10)%
Catalysts	**13%**	13%	
Tires	**11%**	11%	
Hard Metal	**11%**	11%	
Coatings and Inks	**9%**	9%	
Other	**28%**	18%	10%

Cobalt segment net sales decreased to $559.5 million in 2005 from $643.1 million in 2004, primarily due to lower product selling prices caused by the decrease in cobalt reference prices in 2005 compared with 2004 ($82.7 million). In addition, an overall decline in sales volumes was more than offset by a favorable shift in product mix ($13.1 million).

Operating profit for 2005 was $23.5 million compared to $146.9 million in 2004. The decrease was primarily due to the sale of finished goods manufactured using higher cost raw materials that were purchased before the decrease in metal prices which occurred throughout 2005 ($50.8 million) and the impact of lower cobalt metal prices ($23.5 million). In addition, operating profit was also adversely impacted by higher manufacturing costs ($18.5 million) primarily due to higher costs for petroleum-based products and process chemicals Operating profit was also impacted by decreased operating results at the smelter in the DRC ($17.1 million) primarily due to the scheduled maintenance shutdown and lower cobalt prices. During the fourth quarter of 2005, the Company identified irregularities in inventory valuation at a foreign subsidiary resulting in a write-down of approximately $2.0 million. In addition, the Company recorded a $4.2 million charge to establish a reserve against the note receivable from our joint venture partner in the DRC. Operating profit in 2004 included the benefit of increasing cobalt prices, resulting in the sale of finished goods manufactured using lower cost raw materials.

See Note 20 to the consolidated financial statements included in Item 8 of this Annual Report for a reconciliation of segment operating profit (loss) to consolidated income from continuing operations before income taxes and minority interests.

Nickel Segment

The following table summarizes the average quarterly LME market price of nickel:

	2005	2004	Change
First Quarter	**$ 6.96**	$ 6.68	$ 0.28
Second Quarter	**$ 7.44**	$ 5.67	$ 1.77
Third Quarter	**$ 6.61**	$ 6.35	$ 0.26
Fourth Quarter	**$ 5.73**	$ 6.39	$ (0.66)
Full Year	**$ 6.69**	$ 6.27	$ 0.42

Nickel segment net sales decreased to $743.5 million in 2005 compared with $781.8 million in 2004 primarily due to lower nickel volumes due to lack of raw material feed ($65.7 million), lower cobalt by-product sales ($23.5 million) primarily as a result of lower cobalt prices, partially offset by a higher average nickel price ($35.3 million) in 2005 compared with 2004, increased sales of memory disk products ($9.3 million), increased copper by-product revenues ($5.6 million) and increased revenue from tolling activities ($3.2 million).

Operating profit for 2005 was $58.1 million compared to $109.1 million in 2004 primarily due to higher manufacturing expenses at the Finland nickel refinery ($24.3 million) and the Cawse mine ($12.9 million). The increases at the Finland nickel refinery were primarily due to lower production caused by a lack of raw material feed resulting in higher costs per unit produced and higher smelting costs due to a new tolling agreement. The decrease was also due to lower by-product credits ($13.9 million) as a result of the lower cobalt prices, higher energy costs, lower feed grade from Cawse and a lower of cost or market charge of $6.1 million in the second and third quarters of 2005. These factors were partially offset by a higher average nickel price in 2005 ($13.9 million), the receipt of $2.5 million related to collection of a note receivable that had been fully reserved in 2002 and the July 2004 mechanical failure at Cawse that negatively impacted operating profit in 2004 ($7.0 million).

See Note 20 to the consolidated financial statements included in Item 8 of this Annual Report for a reconciliation of segment operating profit (loss) to consolidated income from continuing operations before income taxes and minority interests.

Corporate Expenses

Corporate expenses for 2005 were $14.0 million compared with $54.6 million in 2004. Selling general and administrative expenses for 2005 include $27.5 million of income related to the receipt of net insurance proceeds related to the shareholder class action and derivative lawsuits, and $4.6 million of income related to the mark-to-market of 380,000 shares of common stock issued in connection with the shareholder derivative litigation, both partially offset by an $8.9 million severance charge related to the former chief executive officer. Selling, general and administrative expense for 2004 included a $7.5 million charge related to the shareholder derivative lawsuits and $4.9 million for executive compensation awards, of which $3.4 million related to the departure in 2004 of the Company s former chief financial officer who was employed from 2002 to 2004. In addition, legal and professional fees decreased $5.4 million in 2005 compared with 2004 due to increased costs in 2004 associated with the restatement process, audit committee investigation and implementation of processes to comply with Sarbanes-Oxley requirements.

2004 operating results compared to 2003

The increase in net sales for 2004 as compared to 2003 was primarily due to higher selling prices for cobalt and nickel-based products, resulting from higher reference/market prices of these metals in 2004 compared to 2003. Cobalt prices continued to be positively affected by the growth in the battery sector related to demand for cell phones and other portable electronic devices. Nickel prices continued to be positively affected by significant growth in worldwide demand for stainless steel and other alloys, in addition to the limited availability of raw material feeds.

Gross profit was $330.4, or 24.5% of net sales, in 2004 compared to $180.0 million, or 19.7% of net sales, in 2003. The improvement was primarily due to the benefit of selling lower-cost inventory produced prior to the

24

sharp rise in cobalt prices that began in the fourth quarter of 2003 as well as the overall impact of higher average cobalt prices in 2004 versus 2003 ($100.0 million); the impact of higher average nickel prices in 2004 versus 2003 ($76.0 million); stronger results from the Fidelity business in 2004 versus 2003 ($5.0 million); and restructuring charges of $5.8 million in 2003. These benefits were partially offset by the weakening of the dollar versus the Euro and the Australian dollar ($33.0 million); the impact of a new tolling agreement which increased tolling charges at the Finland refinery ($14.0 million); and a mechanical failure at the Cawse facility in July 2004 ($7.0 million).

Selling, general and administrative expenses decreased to $129.1 million in 2004 compared to $197.0 million in 2003. The decrease was primarily due to charges for the shareholder derivative lawsuits in 2004 of $7.5 million compared to $84.5 million in 2003; and restructuring charges of $14.2 million in 2003. These factors were partially offset by increased professional fees of approximately $11.0 million primarily due to the audit committee investigation and the restatement process, and work associated with the requirements of Sarbanes-Oxley.

The increase in other expense, net in 2004 compared to 2003 was due primarily to foreign exchange loss in 2004 of $5.3 million compared to a foreign exchange gain of $3.0 million in 2003 and debt covenant waiver fees of $1.2 million in 2004 associated with the delay in filing periodic reports with the SEC. The 2003 amount included a gain on the sale of the Company s PVC business of $4.6 million and interest income of $6.9 million in 2003 on notes receivable from a DRC joint venture partner.

Income tax expense was $35.1 million on pre-tax income of $162.3 million in 2004 (21.6%). The effective rate in 2004 is lower than the statutory rate in the United States due primarily to a higher proportion of earnings in jurisdictions having lower statutory tax rates and a tax holiday from income taxes in Malaysia, both offset by losses in the United States with no corresponding tax benefit. The 2004 effective tax rate includes a change in the Finnish statutory rate from 29% to 26%, effective January 1, 2005, resulting from legislation that was enacted on July 30, 2004. As a result, a benefit of $1.7 million was recorded in the third quarter from the application of the newly enacted rate to existing deferred tax balances. The 2004 effective tax rate also includes a benefit of $1.7 million related to Malaysian income taxes to be refunded. In 2003, income tax expense was $14.5 million on a pre-tax loss of $42.7 million. The 2003 tax expense results from profitability of Finland operations and no tax benefit from losses in the U.S.

Income from discontinued operations was $2.9 million in 2004 compared to income of $140.0 million in 2003, due primarily to the gain on the PMG sale of $131.7 million after-tax in 2003. There were no discontinued operations in 2004. The 2004 amount represents changes in estimates of certain environmental and closure accruals established in 2002 in connection with the exit of the Company s closed manufacturing facilities in St. George, Utah and Midland, Michigan.

Net income was $128.6 million, or $4.49 per diluted share, in 2004 compared to $83.7 million, or $2.95 per diluted share, in 2003, due primarily to the aforementioned factors.

Cobalt Segment

The following table summarizes the average quarterly reference price of 99.3% cobalt:

	2004	2003	Change
First Quarter	$ 24.63	$ 7.73	$ 16.90
Second Quarter	$ 24.91	$ 9.04	$ 15.87
Third Quarter	$ 23.17	$ 9.75	$ 13.42
Fourth Quarter	$ 18.38	$ 12.61	$ 5.77
Full Year	$ 22.76	$ 9.69	$ 13.07

The following table summarizes the percentage of sales dollars by end market:

	2004	2003	Change
Batteries	38%	28%	10%
Catalysts	13%	15%	(2)%
Tires	11%	10%	1%
Hard Metal	11%	10%	1%
Coatings and Inks	9%	12%	(3)%
Other	18%	25%	(7)%

Cobalt segment net sales increased to $643.1 million in 2004 from $379.9 million in 2003 due to higher cobalt reference prices. Cobalt prices continued to be positively affected by the growth in the battery sector related to demand for cell phones and other portable electronic devices. Overall volume of products sold in the segment declined 12.6%. The decline in volume was the result of a shift away from the ceramics and catalysts markets to the battery and tire sectors.

Operating profit for 2004 was $146.9 million compared to $55.0 million in 2003. The improvement was due primarily to the benefit of higher cobalt reference prices in 2004 and low cost inventory at the beginning of 2004 ($80.0 million), and restructuring charges in 2003 of $9.6 million. Additionally, higher production through the company s joint venture in the DRC and a shift to higher margin value-added cobalt products added to the improvement. These improvements were offset by the weakening of the U.S. dollar against the Euro ($10.0 million). See Note 20 to the consolidated financial statements included in Item 8 of this Annual Report for a reconciliation of segment operating profit (loss) to consolidated income from continuing operations before income taxes and minority interests.

Nickel Segment

The following table summarizes the average quarterly LME market price of nickel:

	2004	2003	Change
First Quarter	$ 6.68	$ 3.79	$ 2.89
Second Quarter	$ 5.67	$ 3.80	$ 1.87
Third Quarter	$ 6.35	$ 4.25	$ 2.10
Fourth Quarter	$ 6.39	$ 5.64	$ 0.75
Full Year	$ 6.27	$ 4.37	$ 1.90

Nickel segment net sales increased to $781.8 million in 2004 from $567.9 million in 2003 due to higher nickel LME market prices. Overall volumes in the segment were down 2.7% due to feed limitations and a mechanical failure at the Company s Cawse facility in July 2004 that resulted in a production shutdown.

Operating profit for 2004 was $109.1 million compared to $58.3 million in 2003. The improvement was due primarily to the higher nickel market price ($76.0 million) and cobalt reference price ($20.0 million); stronger results from the Fidelity business ($5.0 million); and charges taken in 2003 for restructuring activities ($4.1 million) and environmental remediation ($2.5 million) that were not present in 2004. These improvements were offset by the weakening of the U.S. dollar against the Euro and the Australian dollar ($23.0 million); the impact of a new tolling agreement which increased tolling charges at the Finland refinery ($14.0 million); and the impact of the mechanical failure at the Cawse facility ($7.0 million).

See Note 18 to the consolidated financial statements included in Item 8 of this Annual Report for a reconciliation of segment operating profit (loss) to consolidated income from continuing operations before income taxes and minority interests.

26

Corporate Expenses

Corporate expenses for 2004 were $54.6 million compared to $130.3 million in 2003. The decrease was due primarily to charges for the shareholder derivative lawsuits in 2004 of $7.5 million compared to $84.5 million in 2003 and restructuring charges of $6.3 million in 2003 compared to a reversal of prior year charges in 2004 of $0.1 million. These improvements were partially offset by increased professional fees in 2004 of approximately $11.0 million primarily due to the audit committee investigation and the restatement process, and work associated with the requirements of Sarbanes-Oxley.

Dispositions and Restructuring

On July 31, 2003, the Company completed the sale of PMG for approximately $814 million in cash. After transaction costs and expenses, the Company recorded a gain of $145.9 million ($131.7 million after-tax). This business was comprised of the Company s Precious Metals Chemistry and Metal Management reportable segments, which were acquired in August 2001. PMG was classified as a discontinued operation for all periods. The net proceeds were used to repay all of the Company s indebtedness outstanding under its then-existing senior credit facilities.

On April 1, 2003, the Company completed the sale of its copper powders business, SCM Metal Products, Inc. (SCM), for $63.7 million. The net proceeds were used to repay a portion of the Company s indebtedness outstanding under its then existing Senior credit facilities. There was no gain or loss recorded on the sale of SCM as this business was written-down by $2.6 million to its fair value in 2002. This business is presented as a discontinued operation for all periods.

During 2003, the Company recorded restructuring charges of $20.0 million related to its continuing operations, and an additional $5.6 million related to its discontinued operations, to complete its restructuring program that commenced in the fourth quarter of 2002. The primary objectives of the restructuring plan were to de-leverage the balance sheet, focus on cash generation and restore profitability in certain of the Company s core businesses that were impacted by the weak economy as well as a sustained decline in the market price of cobalt through the third quarter of 2003. Specific actions taken in 2003 to accomplish these objectives included closure of the manufacturing facility in Thailand, closure of an administrative office in the United States, relocation of the corporate headquarters, disposal of a corporate aircraft, additional headcount reductions, and certain additional asset write-offs.

Liquidity and Capital Resources

The Company s cash flows from operating, investing and financing activities, as reflected in the Statements of Consolidated Cash Flows, are summarized in the following table (in millions):

Cash Flow Summary

	2005	**2004**	**change**
Net cash provided by (used for):			
Operating activities	**$ 121.8**	$ 19.6	$ 102.2
Investing activities	**(16.7)**	(25.1)	8.4
Financing activities	**(5.6)**	0.1	(5.7)
Effect of exchange rate changes on cash	**(5.3)**	1.1	(6.4)
Discontinued operations net cash used in operating activities	**(6.4)**	(23.6)	17.2
Net change in cash and cash equivalents	**$ 87.8**	$ (27.9)	$ 115.7

The $102.2 increase in net cash provided by operating activities was primarily due to the positive cash flow impact of a $111.0 million decrease in inventory at December 31, 2005 compared with December 31, 2004 versus an increase in inventory at December 31, 2004 of $146.3 million compared with December 31, 2003. The increase in inventory during 2004 was primarily due to higher metal prices and a build of inventory due to the planned shutdown of the cobalt smelter in the DRC in the first half of 2005. The shutdown of the smelter was

completed and the smelter was re-opened in May 2005. The decrease in inventory during 2005 was primarily due to working down the build up for the smelter shutdown, lower metal prices, lower availability of nickel raw material feedstocks and Company initiatives to reduce inventory levels. Advances to suppliers decreased $27.0 million at December 31, 2005 compared with December 31, 2004 due to a decrease in shipments of inventory that required prepayment to suppliers. The decrease in accounts receivable at December 31, 2005 compared with December 31, 2004 provided $35.2 million to cash flow provided by operating activities. Accounts receivable decreased as a result of decreased sales due to lower metal prices in the fourth quarter of 2005 compared with the fourth quarter of 2004. The favorable cash flow impact of the inventory reduction in 2005 was partially offset by the payment of $74.0 million related to the shareholder litigation settlement in 2005, a $89.8 million reduction in net income and a $28.9 million decrease in accounts payable in 2005 compared with a $3.9 million decrease in accounts payable in 2004, which corresponds to the changes in inventory levels.

Net cash used in investing activities decreased $8.4 million in 2005 compared with 2004 primarily due to the receipt of $4.5 million from the sale of an investment in equity securities and $5.5 million of proceeds from repayment of notes receivable.

Financing Activities

On December 20, 2005, the Company replaced its existing $150.0 million Senior Secured Revolving Credit Facility with a new Revolving Credit Agreement (the Revolver) with availability of up to $100.0 million, including up to the equivalent of $25.0 million in Euros or other foreign currencies. The Revolver includes an accordion feature under which the Company may increase the availability by $50.0 million to a maximum of $150.0 million subject to certain conditions. Obligations under the Revolver are guaranteed by each of the Company s U.S. subsidiaries and are secured by a lien on the assets of the Company and such subsidiaries. The Revolver provides for interest-only payments during its term, with principal due at maturity. The Company has the option to specify that interest be calculated based either on LIBOR, plus a calculated margin amount, or a base rate. The applicable margin for the LIBOR rate ranges from 0.50% to 1.00%. The Revolver also requires the payment of a fee of 0.125% to 0.25% per annum on the unused commitment. The margin and unused commitment fees are subject to quarterly adjustment based on a certain debt to adjusted earnings ratio. The Revolver matures on December 20, 2010 and contains various affirmative and negative covenants. At December 31, 2005, there were no borrowings outstanding under the Revolver and the Company was in compliance with all covenants.

The Company has outstanding $400.0 million of 9.25% Senior Subordinated Notes (the Notes) that mature on December 15, 2011. The Notes may be redeemed at the option of the Company beginning December 15, 2006 at prices specified in the indenture. The Company s domestic subsidiaries are the guarantors of the Notes (See Note 21 to the Consolidated Financial Statements in this Form 10-K). The delay by the Company in filing its Form 10-K for the year ended December 31, 2003 caused events of default under the indenture governing the Notes, and the Company reclassified the Notes from long-term to current as of March 31, 2004, which was the date the 2003 Form 10-K was due. The Company filed its 2003 Form 10-K on March 31, 2005 and filed its Form 10-Qs for each of the first three quarters of 2004 on June 10, 2005. The Company also was delayed in filing its Form 10-K for the year ended December 31, 2004 and its Form 10-Q for the first quarter of 2005, which resulted in new events of default on August 17, 2005 under the indenture governing the Notes. However, the Company filed its 2004 Form 10-K on August 22, 2005. The Company filed its Form 10-Qs for the first and second quarters of 2005 on September 23, 2005. The Company timely filed its Form 10-Q for the third quarter of 2005 on November 8, 2005. At December 31, 2005, the Notes are classified as long-term as the Company is no longer in default under the indenture and the holders of the Notes no longer have the right to accelerate payment of the Notes. At December 31, 2005, the fair value of the Notes, based upon the quoted market price, approximated $389.0 million.

During December 2003, the Company borrowed $22.9 million from a Belgium bank. This loan bore interest at a rate of LIBOR plus 2.75% and was scheduled to mature in December 2008. In November 2004, the Company refinanced this loan with a Finland bank, resulting in a new principal balance of $23.0 million. The refinanced loan has an interest rate of LIBOR plus 1.25% and is payable in 48 equal installments beginning in January 2005 and ending December 2008. The balance of this note was $17.3 million and $23.0 million at December 31, 2005 and 2004, respectively. Simultaneous to the initial borrowing, the proceeds were loaned by the Company to one of its DRC smelter joint venture partners. The note receivable is recorded in Note receivables from joint venture partner, bears interest at LIBOR plus 2.75% and matures in December 2008.

In August 2003, the Company entered into an interest rate swap agreement to convert the fixed rate on $50.0 million of the Notes to a variable rate of LIBOR plus 4.10% for the period ending December 15, 2011. In addition, in November 2003, the Company entered into another interest rate swap to convert the fixed rate on $50.0 million of the Notes to a variable rate of LIBOR plus 4.39% for the period ending December 15, 2011. These swap agreements are designated as fair value hedges.

In 2002, the Company completed the termination of, and settled for cash, interest rate swap agreements for an aggregate amount of $125.0 million expiring in 2011. These swap agreements converted fixed rate debt of 9.25% to a floating rate. In addition, the Company completed the termination of, and settled for cash, interest rate swap agreements for an aggregate amount of $55.0 million expiring in 2003. These swap agreements converted floating rate debt to a fixed rate. The combined pretax gain on the termination of the swaps of $8.0 million has been deferred and is being amortized to interest expense through the date on which the swaps were originally scheduled to mature.

At December 31, 2005, the combined effective rate of the Company s borrowings and related swap agreements was 8.91%. The net interest paid or received on interest rate swaps is included in interest expense. The counterparty to the interest rate swaps is an international commercial bank.

The Company has generated sufficient cash from operations during 2005 to provide for its working capital, debt service, litigation settlements and capital expenditure requirements. The Company believes that it will have sufficient cash provided by operations and available from its credit facility to provide for its working capital, debt service and capital expenditure requirements during the next year.

The Company did not pay cash dividends in 2005, 2004 or 2003. The Company intends to continue to retain earnings for use in the operation of the business and therefore does not anticipate paying cash dividends in 2006.

Capital Expenditures

Capital expenditures in 2005 were $25.2 million, related primarily to ongoing projects to maintain current operating levels and were funded through cash flows from operations. The Company expects to incur capital spending of approximately $46.0 million in 2006 primarily for a project at the Kokkola refinery to improve by-product yields, a project at the Cawse mine to increase capacity and other fixed asset replacements at existing facilities.

During 2005, the Company initiated a multi-year ERP project that is expected to be implemented worldwide to achieve increased efficiency and effectiveness in supply chain and financial processes and management reporting. The new ERP system will replace or complement existing legacy systems and business processes. The system will be implemented at one site in 2006 before worldwide implementation begins. The Company anticipates that the ERP system will be substantially complete by 2008.

Contractual Obligations

The Company has entered into contracts with various third parties in the normal course of business that will require future payments. The following table summarizes the Company s contractual cash obligations and their expected maturities at December 31, 2005 (in thousands).

	Payments due by period						
	Total	**2006**	**2007**	**2008**	**2009**	**2010**	**Thereafter**
Purchase and other obligations(1)	$ 1,396,998	$ 403,666	$ 367,741	$ 319,697	$ 230,581	$ 41,707	$ 33,606
Debt obligations	417,250	5,750	5,750	5,750			400,000
Fixed interest payments on Notes	222,000	37,000	37,000	37,000	37,000	37,000	37,000
Operating lease obligations	26,396	3,842	3,256	2,953	2,561	2,551	11,233
Total	$ 2,062,644	$ 450,258	$ 413,747	$ 365,400	$ 270,142	$ 81,258	$ 481,839

(1) For 2006 through 2011, purchase obligations include raw material contractual obligations reflecting estimated future payments based on committed tons of material per the applicable contract multiplied by the reference/market price of each metal. The price used in the computation is the average daily price for the last week of December 2005 for each respective metal. Commitments made under these contracts represent future purchases in line with expected usage.

Pension funding and postretirement benefit payments can vary significantly each year due to changes in legislation and the Company s significant assumptions. As a result, pension funding and post-retirement benefit payments have not been included in the table above. The Company expects to contribute approximately $1.0 million related to its SCM pension plan in 2006. Pension benefit payments are made from assets of the pension plan. The Company expects to make payments related to its other postretirement benefit plans of approximately $0.2 million annually over the next ten years. Benefit payments beyond that time cannot currently be estimated. The Company also has an unfunded supplemental executive retirement plan (SERP) for the former chief executive officer. The Company expects to make annual benefit payments of approximately $0.7 million related to the SERP from 2010 through 2015. Benefit payments beyond that time cannot currently be estimated.

Off Balance Sheet Arrangements

The Company has not entered into any off balance sheet financing arrangements, other than operating leases which are disclosed in the contractual obligations table and Note 18 to the consolidated financial statements included in Item 8 of this Annual Report.

Critical Accounting Policies

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires the Company s management to make estimates and assumptions in certain circumstances that affect amounts reported in the accompanying consolidated financial statements. In preparing these financial statements, management has made their best estimates and judgments of certain amounts included in the financial statements related to the critical accounting policies described below. The application of these critical accounting policies involves the exercise of judgment and use of assumptions as to future uncertainties and, as a result, actual results could differ from these estimates. In addition, other companies may utilize different estimates, which may impact the comparability of the Company s results of operations to similar businesses.

Revenue Recognition Revenues are recognized when the revenue is realized or realizable, and has been earned, in accordance with the U.S. Securities and Exchange Commission s Staff Accounting Bulletin No. 104, Revenue

Recognition in Financial Statements. The majority of the Company s sales are related to sales of product. Revenue for product sales is recognized when persuasive evidence of an arrangement exists, unaffiliated customers take title and assume risk of loss, the sales price is fixed or determinable and collection of the related receivable is reasonably assured. Revenue recognition generally occurs upon shipment of product or usage of consignment inventory. Freight costs and any directly related associated costs of transporting finished product to customers are recorded as Cost of products sold. During 2005, the Company began providing nickel tolling services. Revenue associated with nickel tolling is recognized when services are rendered.

Inventories The Company s inventories are stated at the lower of cost or market and valued using the first-in, first-out (FIFO) method. The cost of the Company s raw materials fluctuates due to actual or perceived changes in supply and demand of raw materials, changes in cobalt and nickel reference/market prices and changes in availability from suppliers. In periods of raw material metal price declines or declines in the selling prices of the Company s finished products, inventory carrying values may exceed the amount the Company could realize on sale, resulting in a lower of cost or market charge. Monthly, the Company evaluates the need for a lower of cost or market adjustment to inventories based on the end of the month market price.

Long-lived Assets Goodwill must be reviewed at least annually for impairment, in accordance with a specified methodology. Further, goodwill, intangible and other long-lived assets are assessed for impairment whenever events or changes in circumstances indicate that the carrying value may not be recoverable. The Company generally invests in long-lived assets to secure raw material feedstocks, produce new products, or increase production capacity or capability. Because market conditions may change, future cash flows may be difficult to forecast. Furthermore, the assets and related businesses may be in different stages of development. If the Company determined that the future undiscounted cash flows from these investments were not expected to exceed the carrying value of the investments, the Company would record an impairment charge. However, determining future cash flows is subject to estimates and different estimates could yield different results. Additionally, other changes in the estimates and assumptions, including the discount rate and expected long-term growth rate, which drive the valuation techniques employed to estimate the future cash flows of the these investments, could change and, therefore, impact the analysis of impairment in the future.

Asset Retirement Obligations The Company s estimate of asset retirement obligations under SFAS No. 143, as interpreted by FIN No. 47, which was initially adopted in the fourth quarter of 2005, includes key assumptions, including inflation rates, discount rates and the expected life of the Company s Cawse mining operations. The estimated obligations are particularly sensitive to the impact of changes in the expected lives and the difference between the inflation and discount rates. Changes in the estimates of closure costs due to changed legal or contractual requirements, available technology, inflation, overhead or profit rates would also have a significant impact on the recorded obligations.

Income Taxes Deferred income taxes are provided to recognize the effect of temporary differences between financial and tax reporting. Deferred income taxes are not provided for undistributed earnings of foreign consolidated subsidiaries, to the extent such earnings are determined to be reinvested for an indefinite period of time. The Company has significant operations outside the United States, where most of its pre-tax earnings are derived, and in jurisdictions where the statutory tax rate is lower than in the United States. The Company also has significant cash requirements in the United States to pay interest and principal on borrowings. As a result, significant tax and treasury planning and analysis of future operations are necessary to determine the proper amounts of tax assets, liabilities, and tax expense. The Company s tax assets, liabilities, and tax expense are supported by its best estimates and assumptions of its global cash requirements, planned dividend repatriations, and expectations of future earnings. Where the Company has determined that it is more likely than not that deferred tax assets will not be realized, a valuation allowance has been established. The existing valuation allowance pertains to the deferred tax assets resulting principally from net operating loss carryforwards in the United States.

Stock Awards Granted to Employees In December 2002, SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure, was issued. SFAS No. 148 amends SFAS No. 123, Accounting for Stock-Based Compensation, to provide alternative methods of transition when a company voluntarily changes to the fair value based method of recognizing expense in results of operations for stock-based employee compensation, including stock options granted to employees. Prior to 2003, the Company accounted for stock-based employee compensation under APB No. 25, Accounting for Stock Issued to Employees, and related interpretations. During the second quarter of 2003, the Company adopted, effective January 1, 2003, the fair value recognition provisions of SFAS No. 123, Accounting for Stock-Based Compensation. Under the prospective method of adoption selected by the Company under the provisions of SFAS No. 148, the fair value

recognition provisions have been applied to all employee awards granted, modified or settled after January 1, 2003. Under the fair value recognition provisions of SFAS No. 123, stock-based compensation cost is measured at the grant date based on the value of the award and is recognized as expense over the vesting period. Determining the fair value of stock-based awards at the grant date requires judgment, including estimating the expected term of stock options and the expected volatility of our stock. If actual results differ significantly from these estimates, stock-based compensation expense and results of operations could be materially impacted.

Derivative Instruments The Company enters into derivative instruments and hedging activities which are closely monitored and controlled in order to manage, where possible and economically efficient, commodity price risk for nickel and copper, interest rate risk related to borrowings, and, at times, foreign currency risk associated with manufacturing and sales locations where fluctuations in currency prices may affect the Company s operating results. The Company has certain derivative instruments that are designated as cash flow hedges. For these hedges, the effective portion of the gain or loss from the financial instrument is initially reported as a component of other comprehensive income (loss) in stockholders equity and subsequently reclassified to results of operations when the hedged item affects results of operations. Any ineffective portions of the cash flow hedges are recognized immediately in results of operations.

The gain or loss related to financial instruments that are not designated as hedges are recognized immediately in results of operations. These instruments are entered into to economically hedge certain movements in metal prices. During 2003, the Company entered into interest rate swap agreements that are designated as fair value hedges. For these hedges, changes in the fair value of both the hedging instruments and the underlying debt obligations are immediately recognized in earnings as equal and offsetting gains and losses in interest expense in the Statement of Consolidated Income. All fair value hedges are 100% effective and, therefore, there is no impact on earnings due to hedge ineffectiveness.

Recently Issued Accounting Standards

SFAS No. 155: In May 2005, the FASB issued SFAS No. 155, Accounting for Certain Hybrid Instruments, which is an amendment of SFAS No. 133 and 140 and allows financial instruments that have embedded derivatives to be accounted for as a whole (eliminating the need to bifurcate the derivative from its host) if the holder elects to account for the whole instrument on a fair value basis. SFAS No. 155 is effective for all financial instruments acquired or issued after the beginning of an entity s first fiscal year that begins after September 15, 2006. Companies must apply the standard prospectively. The Company is currently evaluating the effect the adoption of SFAS No. 155 will have on the Company s results of operations or financial position.

SFAS No. 154: In May 2005, the FASB issued SFAS No. 154, Accounting Changes and Error Corrections, which replaces APB Opinion No. 20, Accounting Changes, and SFAS No. 3, Reporting Accounting Changes in Interim Financial Statements, and provides guidance on the accounting for and reporting of accounting changes and error corrections. SFAS No. 154 applies to all voluntary changes in accounting principle and requires retrospective application (a term defined by the statement) to prior periods financial statements, unless it is impracticable to determine the effect of a change. It also applies to changes required by an accounting pronouncement that does not include specific transition provisions. In addition, SFAS No. 154 redefines restatement as the revising of previously issued financial statements to reflect the correction of an error. The statement is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The Company will adopt SFAS No. 154 beginning January 1, 2006.

SFAS No. 151: In November 2004, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 151, Inventory Costs An amendment of ARB No. 43. SFAS No. 151 clarifies that abnormal amounts of idle facility expense, freight, handling costs and spoilage should

be expensed as incurred and not included in overhead. Further, SFAS No. 151 requires that allocation of fixed production overheads to conversion costs should be based on normal capacity of the production facilities.
SFAS No. 151 is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. Companies must apply the standard prospectively. The adoption of SFAS No. 151 is not expected to have a material impact on the Company s results of operations or financial position.
SFAS No. 123R: In December 2004, the FASB issued SFAS No. 123 (revised), Share-Based Payments (SFAS No. 123R). SFAS No. 123R is a revision of SFAS No. 123, Accounting for Stock Issued to Employees (SFAS No. 123) and supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees. SFAS No. 123R requires that the cost of transactions involving share-based payments be recognized in the financial statements based on a fair-value-based measurement. SFAS No. 123R is effective for fiscal years beginning after June 15, 2005. The Company adopted the fair value recognition provisions of SFAS No. 123 in 2003 using the prospective method of adoption under SFAS No. 148. Under the prospective method of adoption, the fair value recognition provisions have been applied to all employee awards granted, modified or settled after January 1, 2003. As allowed under SFAS No. 123, the Company accounted for forfeitures as they occurred. Under SFAS No. 123R that method is no longer allowed and the Company must now estimate forfeitures at the grant date. When the Company adopts SFAS No. 123R on January 1, 2006, the Company will estimate forfeitures for stock options outstanding which have not yet vested. The adoption of SFAS No. 123R is not expected to have a material impact on the Company s results of operations or financial position.
EITF No. 04-6: In June 2005, the FASB ratified modifications to EITF No. 04-6, Accounting for Stripping Costs Incurred during Production in the Mining Industry. EITF No. 04-6 clarifies that stripping costs incurred during the production phase of a mine are variable production costs that should be included in the costs of the inventory produced during the period that the stripping costs are incurred. The Company currently capitalizes and defers stripping costs when developing a new pit or expanding an existing pit until that pit has reached full production. Upon adoption of EITF No. 04-6, the Company will be required to write-off the amount of deferred stripping costs that were incurred after production commenced at each pit. Such amounts capitalized total $1.8 million at December 31, 2005 and are included in Other non-current assets in the Consolidated Balance Sheet. EITF No. 04-6 is effective for fiscal years beginning after December 15, 2005. The transition provisions require that the consensus be accounted for in a manner similar to a cumulative effect adjustment with any adjustment recognized in the opening balance of retained earnings in the year of adoption. The Company will adopt EITF No. 04-06 on January 1, 2006 and the effect of adoption will be a $1.8 million reduction to Other non-current assets and beginning retained earnings.

Effects of Foreign Currency

In addition to the United States, the Company has manufacturing and other facilities in Africa, Canada, Europe and Asia-Pacific, and markets its products worldwide. Although most of the Company s raw material purchases and product sales are based on the U.S. dollar, prices of certain raw materials, non-U.S. operating expenses and income taxes are denominated in local currencies. As such, the results of operations are subject to the variability that arises from exchange rate movements (particularly the Euro and the Australian dollar). In addition, fluctuations in exchange rates may affect product demand and profitability in U.S. dollars of products provided by the Company in foreign markets in cases where payments for its products are made in local currency. Accordingly, fluctuations in currency prices affect the Company s operating results.

Environmental Matters

The Company is subject to a wide variety of environmental laws and regulations in the United States and in foreign countries as a result of its operations and use of certain substances that are, or have been, used, produced or discharged by its plants. In addition, soil and/or groundwater contamination presently exists and may in the future be discovered at levels that require remediation under environmental laws at properties now or previously owned, operated or used by the Company.

Due to the ongoing development and understanding of facts and remedial options and due to the possibility of unanticipated regulatory developments, the amount and timing of future environmental expenditures could vary significantly. Although it is difficult to quantify the potential impact of compliance with or liability under environmental protection laws, based on presently available information, the Company believes that its ultimate aggregate cost of environmental remediation as well as liability under environmental protection laws will not result in a material adverse effect upon its financial condition or results of operations. See Item I for further discussion of these matters.

Cautionary Statement for Safe Harbor Purposes Under the Private Securities Litigation Reform Act of 1995

The Private Securities Litigation Reform Act of 1995 provides a safe harbor for forward-looking statements made by or on behalf of the Company. This report contains statements that the Company believes may be forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934. These forward-looking statements are not historical facts and generally can be identified by use of statements that include phrases such as believe, expect, anticipate, intend, plan, foresee or other words or phrases of similar import. Similarly, statem describe the Company s objectives, plans or goals also are forward-looking statements. These forward-looking statements are subject to risks and uncertainties that are difficult to predict, may be beyond the Company s control and could cause actual results to differ materially from those currently anticipated. The Company undertakes no obligation to publicly revise these forward-looking statements to reflect events or circumstances that arise after the date hereof. Significant factors affecting these expectations are set forth under Item 1A Risk Factors in this Report on Form 10-K.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Quantitative and Qualitative Disclosures About Market Risk

The Company, as a result of its global operating and financing activities, is exposed to changes in metal prices, interest rates and foreign currency exchange rates which may adversely affect its results of operations and financial position. In seeking to minimize the risks and/or costs associated with such activities, the Company manages exposures to changes in metal prices, interest rates and, at times, foreign currency exchange rates through its regular operating and financing activities, which include the use of derivative instruments.

The primary raw materials used by the Company in manufacturing its products are cobalt and nickel. The Company s supply of cobalt has historically been sourced from the DRC, Australia and Finland. Although the Company has never experienced a significant shortage of cobalt raw material, production problems and political and civil instability in certain supplier countries may in the future affect the supply and market price of cobalt raw materials. Nickel historically has been sourced from Australia, Finland and Brazil. In December 2001, the Company purchased an intermediate nickel refining facility and associated mine deposits in Australia (the Cawse mine), which provide the Company with direct access to approximately 6,500 tons of nickel per year. Currently, the Company has arrangements in place for approximately 82% of its projected nickel refining capacity for 2006. This amount includes both supply contracts for raw material feed and tolling agreements to toll refine third party feedstocks. During 2006, the Company reached an agreement to toll refine approximately 21,000 to 25,000 tons of contained nickel per year over a three-year period, starting July 1, 2006 and ending July 31, 2009. As a result of the agreement, the Company s Harjavalta, Finland refinery will be operating near practical capacity in the second half of 2006. Currently, the Company has arrangements in place for approximately 100% of its practical nickel refining capacity for 2007 and 2008.

The cost of the Company s raw materials fluctuates due to actual or perceived changes in supply and demand, changes in cobalt and nickel reference/market prices and changes in availability from suppliers. The Company attempts to mitigate changes in availability by maintaining adequate inventory levels and long-term supply relationships with a variety of producers. Fluctuations in the prices of cobalt and nickel have been significant in the past and the Company believes that cobalt and nickel price fluctuations are likely to continue in the future. The Company attempts to pass through to its customers increases in raw material prices by increasing the prices

of its products. The Company s profitability is largely dependent on the Company s ability to maintain the differential between its product prices and product costs. Certain sales contracts and raw material purchase contracts contain variable pricing that adjusts based on changes in the price of cobalt and nickel. During periods of rapidly changing metal prices, however, there may be price lags that can impact the short-term profitability and cash flow from operations of the Company both positively and negatively. The Company attempts to minimize the effect on profitability of changes in the market price of nickel through hedging activities. Reductions in the price of raw materials or declines in the selling prices of the Company s finished goods could also result in the Company s inventory carrying value being written down to a lower market value.

The Company is exposed to interest rate risk primarily through its borrowing activities. The Company predominantly utilizes U.S. dollar denominated borrowings to fund its working capital and investment needs. The majority of the Company s borrowings are in fixed rate instruments. The Company entered into interest rate swap agreements to convert a portion of the fixed rate instruments to variable rate contracts. There is an inherent rollover risk for borrowings as they mature and are renewed at current market rates. The extent of this risk is not quantifiable or predictable because of the variability of future interest rates and business financing requirements (see Note 9 to the consolidated financial statements contained in Item 8 of this Annual Report). The following table presents principal cash flows and related weighted-average interest rates by expected maturity dates of the Company s debt.

	Fixed Rate Senior Subordinated Notes	Variable Rate Debt
2006	$	$ 5,750
2007		5,750
2008		5,750
2009		
2010		
2011	400,000	
Total book value	$ 400,000	$ 17,250
Interest rate at 12/31/2005	9.25%	5.38%
Fair value at 12/31/2005	$ 389,000	$ 17,250

The interest rate on the variable rate debt is based on the LIBOR rate (as of November 1, 2005) plus 1.1%. See Note 9 to the consolidated financial statements contained in Item 8 of this Annual Report for further discussion.

In addition to the United States, the Company has manufacturing and other facilities in Africa, Canada, Europe and Asia-Pacific, and markets its products worldwide. Although most of the Company s raw material purchases and product sales are based on the U.S. dollar, prices of certain raw materials, non-U.S. operating expenses and income taxes are denominated in local currencies. As such, the results of operations are subject to the variability that arises from exchange rate movements (particularly the Euro and the Australian dollar). In addition, fluctuations in exchange rates may affect product demand and profitability in U.S. dollars of products provided by the Company in foreign markets in cases where payments for its products are made in local currency. Accordingly, fluctuations in currency prices affect the Company s operating results.

Item 8. Financial Statements and Supplementary Data

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders of OM Group, Inc.

We have audited the accompanying consolidated balance sheets of OM Group, Inc. and subsidiaries as of December 31, 2005 and 2004, and the related consolidated statements of income, comprehensive income, stockholders equity, and cash flows for each of the three years in the period ended December 31, 2005. Our audits also included the financial statement schedule listed in the index at Item 15. These financial statements and schedule are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with auditing standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of OM Group, Inc. and subsidiaries at December 31, 2005 and 2004, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2005, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

As discussed in Note 1 to the consolidated financial statements, the Company adopted the provisions of Statement of Financial Accounting Standards Interpretation No. 47, Accounting for Conditional Asset Retirement Obligations, as of October 1, 2005.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Company s internal control over financial reporting as of December 31, 2005, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 27, 2006 expressed an unqualified opinion on management s assessment that it did not maintain effective internal control over financial reporting as of December 31, 2005 and an adverse opinion on the effectiveness of internal control over financial reporting as of December 31, 2005.

/s/ Ernst & Young LLP

Cleveland, Ohio

February 27, 2006

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders of OM Group, Inc.

We have audited management s assessment, included in the accompanying Management s Report on Internal Control Over Financial Reporting included elsewhere herein, that OM Group, Inc. did not maintain effective internal control over financial reporting as of December 31, 2005, because of the material weaknesses identified in management s assessment, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). OM Group, Inc. s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management s assessment and an opinion on the effectiveness of the company s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management s assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company s internal control over financial reporting is a process designed 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. A company s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

A material weakness is a control deficiency, or combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. The following material weaknesses have been identified and included in management s assessment:

Inadequate controls over the review of financial results of a foreign subsidiary which accounted for approximately 1% of the Company s consolidated assets and revenues as of and for the year ended December 31, 2005. During the 2005 year-end closing process, the Company identified irregularities in the subsidiary s inventory valuation that went undetected in prior periods, resulting in a material adjustment to correct the inventory valuation as of December 31, 2005. Management has performed a comprehensive review of all of the significant accounts at this subsidiary as of December 31, 2005 to ensure that reported amounts are reasonable.

Inadequate controls over the review of retained liabilities of businesses sold resulted in a material adjustment to reverse a tax contingency indemnification liability related to one of the Company s former subsidiaries in Brazil. As a result of a Brazilian Federal Supreme Court ruling in November 2005, as explained further in Note 5 to the consolidated financial statements, the Company s assessment of the likelihood of an unfavorable

outcome of the tax contingency changed from probable to reasonably possible. Accordingly, the indemnification liability was reversed through discontinued operations as a result of the year-end audit process.

Inadequate controls over the Company s joint venture smelter in the Democratic Republic of Congo (DRC) resulted in several control deficiencies that were individually not material weaknesses but, when aggregated, constitute a material weakness in internal control over financial reporting. The control deficiencies resulted from inherent control risks of doing business as a joint venture partner in the DRC, inadequate controls over reporting payroll and related taxes to the DRC tax authorities, inadequate general oversight of the finance function, use of Excel spreadsheets in lieu of an accounting system, and timing of reconciliation of certain general ledger accounts. These individual control deficiencies resulted in adjustments to the Company s results of operations in 2005 and, when considered in the aggregate, could result in material misstatement to annual or interim consolidated financial statements that would not be prevented or detected.

These material weaknesses were considered in determining the nature, timing, and extent of audit tests applied in our audit of the 2005 consolidated financial statements, and this report does not affect our report dated February 27, 2006 on those consolidated financial statements.

In our opinion, management s assessment that OM Group, Inc. did not maintain effective internal control over financial reporting as of December 31, 2005, is fairly stated, in all material respects, based on the COSO criteria. Also, in our opinion, because of the effect of the material weaknesses described above on the achievement of the objectives of the control criteria, OM Group, Inc. has not maintained effective internal control over financial reporting as of December 31, 2005, based on the COSO criteria.

/s/ Ernst & Young LLP

Cleveland, Ohio
February 27, 2006

Consolidated Balance Sheets

	December 31	
	2005	**2004**
(In thousands, except share data)		
Assets		
Current assets		
Cash and cash equivalents	**$ 114,618**	$ 26,779
Accounts receivable, less allowance of $1,348 in 2005 and $1,960 in 2004	**128,278**	161,346
Inventories	**304,557**	415,517
Advances to suppliers	**5,503**	32,498
Other current assets	**52,152**	52,719
Total current assets	**605,108**	688,859
Property, plant and equipment, net	**369,129**	389,812
Goodwill	**179,123**	181,871
Notes receivable from joint venture partner, less allowance of $4,200 in 2005 and $0 in 2004	**25,179**	29,379
Other non-current assets	**41,734**	44,780
Total assets	**$ 1,220,273**	$ 1,334,701
Liabilities and Stockholders Equity		
Current liabilities		
Current portion of long-term debt	**$ 5,750**	$ 5,750
Long-term debt in default		400,000
Accounts payable	**103,397**	132,312
Accrued employee costs	**21,100**	17,062
Retained liabilities of businesses sold	**6,020**	21,837
Shareholder litigation accrual		74,000
Other current liabilities	**31,772**	50,835
Total current liabilities	**168,039**	701,796
Long-term debt	**416,096**	24,683
Deferred income taxes	**21,461**	31,033
Shareholder litigation accrual		18,000
Minority interests	**36,994**	44,168
Other non-current liabilities	**41,150**	27,989
Stockholders equity:		
Preferred stock, $.01 par value:		
Authorized 2,000,000 shares, no shares issued or outstanding		
Common stock, $.01 par value:		
Authorized 60,000,000 shares; issued 29,368,519 in 2005 and 28,494,098 shares in 2004	**293**	285

Capital in excess of par value		**516,510**		498,250
Retained earnings (deficit)		**6,811**		(32,080)
Treasury stock (61,235 shares in 2005 and 14,025 shares in 2004, at cost)		**(2,226)**		(710)
Accumulated other comprehensive income		**15,145**		21,287
Total stockholders equity		**536,533**		487,032
Total liabilities and stockholders equity	**$**	**1,220,273**	$	1,334,701

See accompanying notes to consolidated financial statements.

Statements of Consolidated Income

	Year Ended December 31		
	2005	2004	2003
(In thousands, except per share data)			
Net sales	$ **1,249,609**	$ 1,347,338	$ 912,145
Cost of products sold	**1,092,088**	1,016,891	732,148
	157,521	330,447	179,997
Selling, general and administrative expenses	**89,975**	129,075	197,023
Income (loss) from operations	**67,546**	201,372	(17,026)
Other income (expense):			
Interest expense	**(41,282)**	(39,838)	(41,052)
Foreign exchange gain (loss)	**(3,874)**	(5,310)	3,023
Investment and other income, net	**8,498**	6,036	12,392
	(36,658)	(39,112)	(25,637)
Income (loss) from continuing operations before income taxes, minority interest and cumulative effect of change in accounting principle	**30,888**	162,260	(42,663)
Income tax expense	**(10,736)**	(35,068)	(14,534)
Minority interest share of (income) loss	**7,128**	(1,442)	914
Income (loss) from continuing operations before cumulative effect of change in accounting principle	**27,280**	125,750	(56,283)
Discontinued operations:			
Income from discontinued operations, net of tax	**9,359**	2,894	8,199
Gain on disposal of Precious Metals Group, net of tax			131,748
Income from discontinued operations, net of tax	**9,359**	2,894	139,947
Income before cumulative effect of change in accounting principle	**36,639**	128,644	83,664
Cumulative effect of change in accounting principle	**2,252**		
Net income	$ **38,891**	$ 128,644	$ 83,664
Net income (loss) per common share basic:			
Continuing operations	$ **0.95**	$ 4.42	$ (1.99)
Discontinued operations	**0.33**	0.10	4.94
Cumulative effect of change in accounting principle	**0.08**		
Net income	$ **1.36**	$ 4.52	$ 2.95
Net income (loss) per common share assuming dilution:			

Continuing operations	**$**	**0.95**	$ 4.39	$ (1.99)
Discontinued operations		**0.32**	0.10	4.94
Cumulative effect of change in accounting principle		**0.08**		
Net income	**$**	**1.35**	$ 4.49	$ 2.95
Weighted average shares outstanding				
Basic		**28,679**	28,470	28,354
Assuming dilution		**28,726**	28,622	28,368

See accompanying notes to consolidated financial statements.

Statements of Consolidated Comprehensive Income

	Year Ended December 31		
(In thousands)	**2005**	**2004**	**2003**
Net income	**$ 38,891**	$ 128,644	$ 83,664
Foreign currency translation adjustments	**(6,365)**	7,662	(26,928)
Reclassification of hedging activities into earnings	**(3,475)**	(6,689)	(841)
Unrealized gain on cash flow hedges, net of tax expense of $335 in 2005, $1,157 in 2004, and $3,602 in 2003	**954**	3,475	6,689
Realized gain on available-for-sale securities	**(930)**		
Unrealized gain on available-for-sale securities	**4,745**	930	
Additional minimum pension liability adjustment	**(1,071)**	(1,177)	4,108
Net change in accumulated other comprehensive income	**(6,142)**	4,201	(16,972)
Comprehensive income	**$ 32,749**	$ 132,845	$ 66,692

See accompanying notes to consolidated financial statements.

Statements of Consolidated Cash Flows

	Year Ended December 31		
(In thousands)	**2005**	**2004 Revised See Note 1**	**2003 Revised See Note 1**
Operating activities			
Net income	**$ 38,891**	$ 128,644	$ 83,664
Adjustments to reconcile net income to net cash provided by (used for) operating activities:			
Income from discontinued operations	**(9,359)**	(2,894)	(139,947)
Income from cumulative effect of change in accounting principle	**(2,252)**		
Depreciation and amortization	**49,107**	50,954	56,442
Foreign exchange loss (gain)	**3,874**	5,310	(3,023)
Gain on sale of investment in equity securities	**(2,359)**		
Gain on Weda Bay note receivable	**(2,500)**		
Restructuring charges, less cash spent			7,678
Provision for receivables from joint venture partner	**4,200**		
Deferred income taxes	**(7,511)**	6,023	25,923
Minority interest income (losses)	**(7,128)**	1,442	(914)
Equity income from investment	**(3,207)**	(4,479)	(1,066)
Other non-cash items	**836**	1,381	1,161
Changes in operating assets and liabilities			
Accounts receivable	**35,230**	(26,027)	(38,842)
Advances to suppliers	**26,996**	(13,098)	(12,272)
Notes receivable from joint venture partners		21,808	(19,117)
Inventories	**110,960**	(146,316)	(58,128)
Accounts payable	**(28,916)**	(3,878)	36,235
Shareholder litigation accrual	**(74,000)**	7,500	84,500
Other, net	**(11,025)**	(6,759)	(35,683)
Net cash provided by (used for) operating activities	**121,837**	19,611	(13,389)
Investing activities			
Expenditures for property, plant and equipment, net	**(25,189)**	(18,417)	(10,910)
Proceeds from MPI note receivable	**3,035**		
Proceeds from Weda Bay note receivable	**2,500**		
Proceeds from sale of investments in equity securities	**4,534**		
Investments in non-consolidated joint ventures	**(1,534)**		
Acquisition of business		(6,715)	(11,151)
Proceeds from sales of businesses net of cash sold			871,281
Net cash (used for) provided by investing activities	**(16,654)**	(25,132)	849,220
Financing activities			

Long-term borrowings		23,000	22,919
Payments of long-term debt and revolving line of credit	**(55,622)**	(22,919)	(794,400)
Proceeds from the revolving line of credit	**49,872**		
Proceeds from exercise of stock options	**117**		406
Net cash (used for) provided by financing activities	**(5,633)**	81	(771,075)
Effect of exchange rate changes on cash	**(5,293)**	1,068	6,238
Cash and cash equivalents			
Increase (decrease) from continuing operations	**94,257**	(4,372)	70,994
Discontinued operations net cash used for operating activities	**(6,418)**	(23,568)	(10,012)
Discontinued operations net cash used for investing activities			(18,733)
Balance at the beginning of the year	**26,779**	54,719	12,470
Balance at the end of the year	**$ 114,618**	$ 26,779	$ 54,719

See accompanying notes to consolidated financial statements.

Statements of Consolidated Stockholders Equity

	Year Ended December 31		
	2005	**2004**	**2003**
(In thousands)			
Common Stock Shares			
Beginning balance	**28,480**	28,480	28,452
Shares issued under stock compensation plans	**40**		28
Shares issued for settlement of shareholder litigation	**787**		
	29,307	28,480	28,480
Common Stock Dollars			
Beginning balance	**$ 285**	$ 285	$ 284
Shares issued under stock compensation plans			1
Shares issued for settlement of shareholder litigation	**8**		
	293	285	285
Capital in Excess of Par Value			
Beginning balance	**498,250**	495,107	494,546
Shares issued under stock compensation plans	**845**		536
Settlement of shareholder litigation	**13,375**		
Non-employee directors compensation		190	25
Stock option compensation	**3,184**	2,366	
Restricted stock compensation	**856**	587	
	516,510	498,250	495,107
Retained Earnings (Deficit)			
Beginning balance	**(32,080)**	(160,724)	(244,388)
Net income	**38,891**	128,644	83,664
	6,811	(32,080)	(160,724)
Treasury Stock			
Beginning balance	**(710)**	(710)	(710)
Reacquired shares	**(1,516)**		
	(2,226)	(710)	(710)
Accumulated Other Comprehensive Income			
Beginning balance	**21,287**	17,086	34,058
Foreign currency translation adjustments	**(6,365)**	7,662	(26,928)
Reclassification of hedging activities into earnings	**(3,475)**	(6,689)	(841)
Unrealized gain on cash flow hedges, net of tax expense of $335 in 2005, $1,157 in 2004, and $3,602 in 2003	**954**	3,475	6,689
	(930)		

Reclassification of realized gain on available-for-sale securities into earnings			
Unrealized gain on available-for-sale securities	**4,745**	930	
Additional minimum pension liability adjustment	**(1,071)**	(1,177)	4,108
	15,145	21,287	17,086
Unearned Compensation			
Beginning balance		(592)	(2,950)
Restricted stock compensation		592	2,358
			(592)
Total Stockholders Equity	**$ 536,533**	$ 487,032	$ 350,452

See accompanying notes to consolidated financial statements.

Notes to Consolidated Financial Statements
OM Group, Inc. and Subsidiaries
(In thousands, except as noted and per share amounts)
Note 1 Significant Accounting Policies
Principles of Consolidation The consolidated financial statements include the accounts of OM Group, Inc. (the Company) and its subsidiaries. Intercompany accounts and transactions have been eliminated in consolidation. The Company has a 55% interest in a smelter joint venture in the Democratic Republic of Congo (the DRC). The joint venture is consolidated because the Company has controlling interest in the joint venture. Minority interest is recorded for the remaining 45% interest. The Company has a 20% interest in an Australian nickel company (Lionore Australia Pty Ltd) that is accounted for by the equity method. The investment is included in other non-current assets in the Consolidated Balance Sheets, and equity income (loss) is included in investment and other income, net in the Statements of Consolidated Income. The Company does not have off-balance sheet arrangements, financings or other relationships with unconsolidated entities or other persons known as special purpose entities (SPE s), as defined by Financial Accounting Standards Board (FASB) Interpretation (FIN) No. 46, Consolidation of Variable Interest Entities .
Unless otherwise indicated, all disclosures and amounts in the Notes to Consolidated Financial Statements relate to the Company s continuing operations.
Use of Estimates The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions in certain circumstances that affect the amounts reported in the accompanying consolidated financial statements and notes. Actual results could differ from these estimates.
Cash Equivalents All highly liquid investments with a maturity of three months or less when purchased are considered to be cash equivalents.
Revenue Recognition The Company recognizes revenue when persuasive evidence of an arrangement exists, unaffiliated customers take title and assume risk of loss, the sales price is fixed or determinable and collection of the related receivable is reasonably assured. Revenue recognition generally occurs upon shipment of product or usage of consignment inventory. During 2005, the Company began providing nickel tolling services. Revenue associated with nickel tolling is recognized when services are rendered.
Cost of Products Sold Shipping and handling costs are included in cost of products sold.
Concentrations of Credit Risk Concentration of credit risk in accounts receivable is limited due to the Company s large number of customers. The Company does not require collateral from its customers.
Allowance for Doubtful Accounts The Company has recorded an allowance for doubtful accounts to reduce accounts receivable to their estimated net realizable value. The allowance is based upon an analysis of historical bad debts, a review of the aging of accounts receivable and the current creditworthiness of customers. Accounts are written off against the allowance when it becomes evident that collections will not occur. Bad debt expense is included in selling, general and administrative expenses and amounted to $0.6 million, $1.4 million and $1.2 million in 2005, 2004 and 2003, respectively.
Marketable Securities Prior to 2005, the Company had an interest in Weda Bay Minerals, Inc. (Weda Bay) that was accounted for under the equity method. As a result of an other-than-temporary decline in value, the investment was written down to $0 in 2002. In December 2005, Weda Bay completed a private placement of 17,600,000 shares of common stock. Subsequent to that transaction, the Company owns approximately 7% of the outstanding shares of Weda Bay at December 31, 2005. In May of 2005, the Company signed a standstill agreement in which it agreed not to sell or otherwise dispose of it shares of Weda Bay for a period of 18 months. In December 2005, as consideration for consenting to the private placement, the Company was released from the standstill agreement, and is therefore free to sell the Weda Bay shares without restriction. Accordingly, the

Notes to Consolidated Financial Statements
OM Group, Inc. and Subsidiaries *Continued*

Company concluded that this investment should be accounted for under Statement of Financial Accounting Standards (SFAS) No. 115, Accounting for Certain Investments in Debt and Equity Securities beginning in December of 2005. These available-for-sale securities are recorded at fair value (based on the quoted market price of related shares) with the unrealized gains and losses included in Accumulated other comprehensive income in the Consolidated Balance Sheets. At December 31, 2005, the unrealized gain of $4.7 million represents the fair value of the investment.

At December 31, 2004, the Company had an available-for-sale-security with an unrealized gain of $0.9 million included in Accumulated other comprehensive income in the Consolidated Balance Sheets. During 2005, this investment was sold resulting in a realized gain of $2.4 million which is included in Investment and other income, net in the Statements of Consolidated Income.

Inventories Inventories are stated at the lower of cost or market and valued using the first-in, first-out (FIFO) method. The cost of the Company s raw materials fluctuates due to actual or perceived changes in supply and demand of raw materials, changes in cobalt and nickel market prices and changes in availability from suppliers. Monthly, the Company evaluates the need for a lower of cost or market adjustment to inventories based on the end of the month market price.

Receivables from Joint Venture Partners and Minority Interests The Company has a 55% interest in a smelter joint venture in the DRC. The remaining 45% interest is owned by two partners at 25% and 20%.

In 2001 and prior years, the Company financed the capital contribution for the 20% minority shareholder in its joint venture in the DRC. During 2004, the receivable from this partner ($21.8 million) was repaid.

In years prior to 2004, the Company refinanced the capital contribution for the 25% minority shareholder in its joint venture in the DRC. At December 31, 2005 the receivables from this partner were $25.2 million, net of a $4.2 million valuation allowance. At December 31, 2004, the receivables from this partner were $29.4 million. The receivables are due in full on December 31, 2008 ($22.9 million) and December 31, 2010 ($6.5 million). The interest rate on the $22.9 million is LIBOR plus 2.75%, or 7.01%, at December 31, 2005 and resets annually on January 2. The interest rate on the $6.5 million is LIBOR plus 1.25%, or 4.35%, at December 31, 2005 and resets quarterly. The Company has recorded a full allowance ($3.4 million and $1.6 million at December 31, 2005 and 2004, respectively) against the interest due on the receivables. Interest income will be recorded when received. No interest payments have been received to date.

Under the terms of the receivables, the partner s share of any dividends from the joint venture and any other cash flow distributions (secondary considerations) paid by the joint venture, if any, first serve to reduce the Company s receivables before any amounts are remitted to the joint venture partner. The receivables are secured by 80% of the partner s interest in the joint venture (book value of $16.5 million at December 31, 2005 and $19.6 million at December 31, 2004), and by a loan payable from the joint venture to the partner (principal balance of $3.9 million at December 31, 2005 and 2004, plus accrued interest), as repayment of the loan would qualify as a secondary consideration.

The Company currently anticipates that repayment of the receivables will be made from the partner s share of any dividends from the joint venture and any other secondary considerations paid by the joint venture.

Advances to Suppliers Advances to suppliers represent payments under certain raw material purchase agreements that require the Company to make payment prior to title and risk of loss transferring to the Company. When title and risk of loss transfer to the Company, which generally occurs upon receipt of the material at the Company s manufacturing location, the amount is reclassified to inventories.

Depreciation and Amortization Property, plant and equipment is recorded at historical cost less accumulated depreciation. Depreciation of plant and equipment is provided by the straight-line method over the useful lives of

Notes to Consolidated Financial Statements
OM Group, Inc. and Subsidiaries *Continued*
approximately 30 years for buildings, 3 to 15 years for equipment and 5 years for leasehold improvements. Finite lived intangible assets, which are included in Other non-current assets on the Consolidated Balance Sheets, consist principally of patents and capitalized software and are amortized using the straight-line method over 3 to 17 years. Long-lived assets, including finite lived intangible assets, are reviewed for impairment whenever events or changes in circumstances indicate the carrying amount may not be recoverable. Events or circumstances that would result in an impairment review primarily include operating losses, a significant change in the use of an asset, or the planned disposal or sale of the asset. The asset would be considered impaired when the future net undiscounted cash flows generated by the asset are less than its carrying value. An impairment loss would be recognized based on the amount by which the carrying value of the asset exceeds its fair value.
Goodwill In accordance with SFAS No. 142 Goodwill and Other Intangible Assets, the Company evaluates the carrying value of goodwill for impairment annually as of October 1 and between annual evaluations if changes in circumstances or the occurrence of certain events indicate potential impairment. The results of the testing as of October 1, 2005 confirmed that the fair value of goodwill exceeded its carrying value and therefore no impairment loss was required to be recognized.
Retained Liabilities of Businesses Sold Retained liabilities of businesses sold include obligations of the Company related to its former Precious Metals Group (PMG), which was sold on July 31, 2003 (see Note 5). Under terms of the sale agreement, the Company will reimburse the buyer of this business for certain items that become due and payable by the buyer subsequent to the sale date. At December 31, 2005, such items are comprised of income taxes payable related to periods during which the Company owned PMG. The total liability at December 31, 2005 is $10.0 million, of which $6.0 million is included in current liabilities and $4.0 million is included in Other non-current liabilities in the Consolidated Balance Sheet.
Research and Development Research and development costs are charged to operations when incurred, are included in selling, general and administrative expenses and amounted to $14.9 million, $14.0 million and $10.0 million in 2005, 2004 and 2003, respectively.
Repairs and Maintenance The Company expenses repairs and maintenance costs, including periodic maintenance shutdowns at its manufacturing facilities, when incurred.
Accounting for Leases Lease expense is recorded on a straight-line basis. The noncancellable lease term used to calculate the amount of the straight-line expense is generally determined to be the initial lease term, including any optional renewal terms that are reasonably assured. Leasehold improvements related to these operating leases are amortized over the shorter of their estimated useful lives or the noncancellable lease.
Income Taxes Deferred income taxes are provided to recognize the effect of temporary differences between financial and tax reporting. Deferred income taxes are not provided for undistributed earnings of foreign consolidated subsidiaries, to the extent such earnings are reinvested for an indefinite period of time.
Foreign Currency Translation The functional currency for the Company s Finnish subsidiaries and related DRC operations is the U.S. dollar since a majority of their purchases and sales are denominated in U.S. dollars. Accordingly, foreign currency exchange gains and losses related to assets, liabilities and transactions denominated in other currencies (principally the Euro and Australian dollar) are included in the Statements of Consolidated Income. The functional currency for the Company s other subsidiaries outside of the United States is the applicable local currency. For those operations, financial statements are translated into U.S. dollars at year-end exchange rates as to assets and liabilities and weighted average exchange rates as to revenues and expenses. The resulting translation adjustments are recorded as a component of Accumulated other comprehensive income in stockholders equity.

Notes to Consolidated Financial Statements
OM Group, Inc. and Subsidiaries *Continued*

Derivative Instruments The Company enters into derivative instruments and hedging activities to manage, where possible and economically efficient, commodity price risk for nickel and interest rate risk related to borrowings. The use of forward and future contracts to hedge nickel price risk is discussed in Note 10. The use of interest rate swaps to hedge interest rate risk on the Company s debt is discussed in Note 9.

During 2003, the Company entered into interest rate swap agreements that are designated as fair value hedges. For these hedges, changes in the fair value of both the hedging instruments and the underlying debt obligations are immediately recognized in earnings as equal and offsetting gains and losses in interest expense. All fair value hedges are 100% effective and therefore, there is no impact on earnings.

The Company has certain derivative instruments that are designated as cash flow hedges. For these hedges, the effective portion of the gain or loss from the financial instrument is initially reported as a component of Accumulated other comprehensive income in stockholders equity and subsequently reclassified to the Statements of Consolidated Income when the hedged item affects the Statements of Consolidated Income. Any ineffective portions of such cash flow hedges are recognized immediately in the Statements of Consolidated Income.

The gain or loss related to financial instruments that are not designated as hedges are recognized immediately in results of operations. These instruments are entered into to economically hedge certain movements in the price of nickel.

Stock Options and Compensation Plans In December 2002, SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure, was issued. SFAS No. 148 amends SFAS No. No. 123 Accounting for Stock-Based Compensation, to provide alternative methods of transition when a company voluntarily changes to the fair value based method. Effective January 1, 2003, the Company adopted the fair value recognition provisions of SFAS No. 123 using the prospective method of adoption under SFAS No. 148. Under the prospective method of adoption, the fair value recognition provisions have been applied to all employee awards granted, modified or settled after January 1, 2003. Accordingly, the Statements of Consolidated Income include compensation expense for stock options granted to employees in 2005, 2004 and 2003 of $3.2 million, $2.6 million and $0.1 million, respectively.

Notes to Consolidated Financial Statements
OM Group, Inc. and Subsidiaries *Continued*

If the Company had elected to adopt the retroactive restatement provisions of SFAS No. 148 and thereby record compensation expense related to employee stock compensation awards prior to January 1, 2003, pro forma results of operations would have been as follows:

	December 31		
	2005	2004	2003
Income (loss) from continuing operations before cumulative effect of change in accounting principle	**$ 27,280**	$ 125,750	$ (56,283)
Add: Stock-based employee compensation expense included in income from continuing operations before cumulative effect of change in accounting principle	**4,040**	3,734	2,476
Deduct: Total stock-based employee compensation expense using the fair value method for all awards	**(4,040)**	(4,001)	(2,662)
Pro forma income (loss) from continuing operations before cumulative effect of change in accounting principle	**$ 27,280**	$ 125,483	$ (56,469)
Income (loss) per common share from continuing operations before cumulative effect of change in accounting principle basic:			
As reported	**$ 0.95**	$ 4.42	$ (1.99)
Pro forma	**$ 0.95**	$ 4.41	$ (1.99)
Income (loss) per common share from continuing operations before cumulative effect of change in accounting principle assuming dilution:			
As reported	**$ 0.95**	$ 4.39	$ (1.99)
Pro forma	**$ 0.95**	$ 4.38	$ (1.99)

The fair value of options was estimated at the date of grant using a Black-Scholes options pricing model with the following weighted-average assumptions:

	December 31		
	2005	2004	2003
Risk-free interest rate	**4.0%**	3.5%	3.2%
Dividend yield			
Volatility factor of Company common stock	**0.44**	0.45	0.42
Weighted-average expected option life (years)	**5**	5	5

In June 2005, the Company granted 166,194 shares of restricted stock to its new Chief Executive Officer (the CEO). The restricted shares vest on May 31, 2008 subject to the CEO remaining employed by the Company on that date. The market value of the restricted stock award based upon the market value of an unrestricted share of the Company s common stock was $4.1 million and the expense is being recognized ratably over the vesting period.
In April 2002, the Company granted 28,000 shares of restricted stock to its former Chief Financial Officer who was employed from 2002 to 2004. The restricted shares were scheduled to vest in increments of 4,000 shares from April 30, 2003 to April 30, 2009. The market value of the restricted stock award was $1.9 million and was recorded in unearned compensation in stockholders equity. On July 31, 2003, in connection with the sale of PMG, the compensation committee of the board of directors approved accelerated vesting of these restricted shares resulting in compensation expense of $1.6 million in 2003.

Notes to Consolidated Financial Statements
OM Group, Inc. and Subsidiaries *Continued*

The Statements of Consolidated Income include compensation expense related to restricted stock grants of $0.8 million, $1.2 million and $2.4 million in 2005, 2004 and 2003, respectively.

Reclassifications Certain amounts in the prior years consolidated financial statements have been reclassified to conform to the current year s presentation. The Company has separately disclosed the 2003 operating and investing portions of the cash flows attributable to its discontinued operations, which in prior periods were reported on a combined basis as a single amount. In addition, cash flows associated with liabilities of business sold for 2004 and 2003, which had previously been included in the operating section of the cash flow statement, have been reclassified and are now included with cash flows attributable to discontinued operations.

Note 2 Recently Issued Accounting Standards

Accounting Standards Adopted in 2005

FIN No. 47: In March 2005, the FASB issued FIN No. 47, Accounting for Conditional Asset Retirement Obligations, which clarifies the term conditional asset retirement obligation as used in SFAS No. 143, Accounting for Asset Retirement Obligations, as a legal obligation to perform an asset retirement activity in which the timing and/or method of settlement are conditional on a future event that may or may not be within the control of the Company. FIN No. 47 is effective no later than the end of fiscal years ending after December 15, 2005. The Company adopted FIN No. 47 in the fourth quarter of 2005.

SFAS No. 143 provides accounting requirements for retirement obligations associated with tangible long-lived assets, including: (i) the timing of liability recognition; (ii) initial measurement of the liability; (iii) allocation of asset retirement cost to expense; (iv) subsequent measurement of the liability; and (v) financial statement disclosures. SFAS No. 143 requires that an asset s retirement cost should be capitalized as part of the cost of the related long-lived asset and subsequently allocated to expense using a systematic and rational method.

As a result of the adoption of FIN No. 47, the Company recorded asset retirement obligations for costs to dismantle the plant, close its surface mines and reclaim the land disturbed as a result of its normal mining activities in Australia. The Company determined these obligations based on estimates adjusted for inflation, projected to the estimated closure dates, and then discounted using a credit-adjusted risk-free interest rate. Because these asset retirement obligations have a remaining expected life of 24 years, an appropriate market risk premium could not be estimated or considered when escalating the estimated obligations.

The estimated future asset retirement obligations have been discounted to their present value and are being accreted to their projected future obligations via charges to operating expenses. Additionally, the fixed assets recorded concurrently with the liabilities are being depreciated over the period until retirement activities are expected to occur. The associated asset established in connection with the implementation of FIN No. 47 is recorded in Property, Plant and Equipment, net in the Consolidated Balance Sheet at December 31, 2005. Total accretion and depreciation expense for 2005 was $0.1 million and is included in cost of products sold in the Statement of Consolidated Income.

As of December 31, 2004, a $2.9 million accrual was recorded for future costs associated with land reclamation. As a result of the adoption of FIN No. 47, this liability was remeasured in accordance with SFAS No. 143. At December 31, 2005, the Company has a $3.4 million asset retirement obligation included in Other non-current liabilities in the Consolidated Balance Sheet.

The adoption of FIN No. 47 resulted in a $2.3 million cumulative effect of a change in accounting principle in the Statements of Consolidated Income for the year ended December 31, 2005. The Nickel group s Australian operation currently has net operating loss carryforwards and a full valuation allowance and accordingly there was no related tax impact.

Notes to Consolidated Financial Statements
OM Group, Inc. and Subsidiaries *Continued*

The Company is required by the Australian government to maintain bonds to be used for land reclamation. At December 31, 2005 and 2004, the Company recorded $3.2 million and $3.4 million, respectively, for the bonds. The bonds are included in Other non-current assets in the Consolidated Balance Sheets. There are no other assets legally restricted for purposes of settling the asset retirement obligations. The remaining asset retirement obligations will be funded out of general corporate funds.

Assuming the adoption of FIN No. 47 in prior years, the liabilities recorded on the Consolidated Balance Sheets for asset retirement obligations related to mining activities in Australia would have been as follows:

Balance at January 1, 2003	$ 0.6
Balance at December 31, 2003	$ 0.8
Balance at December 31, 2004	$ 1.0

Additional pro forma information, assuming the adoption of FIN No. 47 on January 1, 2003, is as follows for the year ended December 31:

	2004	**2003**
Reported net income	$ 128.6	$ 83.7
Less: Additional expense assuming adoption of FIN No. 47 on January 1, 2003	(0.1)	(0.1)
Add: Cumulative effect of a change in accounting principle		0.9
Add: Reversal of expense actually recorded related to land reclamation	0.5	0.6
Pro-forma net income	$ 129.0	$ 85.1
Reported earnings per share basic	$ 4.52	$ 2.95
Less: Additional expense assuming adoption of FIN No. 47 on January 1, 2003		
Add: Cumulative effect of a change in accounting principle		0.03
Add: Reversal of expense actually recorded related to land reclamation	0.02	0.02
Pro-forma earnings per share basic	$ 4.54	$ 3.00
Reported earnings per share assuming dilution	$ 4.49	$ 2.95
Less: Additional expense assuming adoption of FIN No. 47 on January 1, 2003		
Add: Cumulative effect of a change in accounting principle		0.03
Add: Reversal of expense actually recorded related to land reclamation	0.02	0.02
Pro-forma earnings per share assuming dilution	$ 4.51	$ 3.00

The American Jobs Creation Act of 2004 (the AJCA): The AJCA was enacted on October 22, 2004. The AJCA repeals an export incentive, creates a new deduction for qualified domestic manufacturing activities, and includes a special one-time deduction of 85 percent of certain foreign earnings repatriated to the U.S. In December 2004, the FASB issued FSP No. FAS 109-1, Application of SFAS No. 109, Accounting for Income Taxes, to the Tax Deduction on Qualified Production Activities Provided by the American Jobs Creation Act of 2004 (FSP 109-1). In accordance with FSP 109-1, the Company will treat the deduction for qualified domestic manufacturing as a special deduction in future years as realized. The deduction for qualified domestic manufacturing activities did not impact the Company s consolidated financial statements in 2004 or 2005. The phase-out of the export incentive is not expected to have a

material impact on the Company s effective tax rate in the future. In December 2004, the FASB issued FSP No. FAS 109-2, Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision with the American Jobs Creation Act of 2004, allowing companies additional time to evaluate the effect of the AJCA on plans for reinvestment or repatriation of foreign earnings. The Company has not repatriated any foreign earnings under the repatriation provision of the AJCA.

Notes to Consolidated Financial Statements
OM Group, Inc. and Subsidiaries *Continued*

EITF No. 05-6: In June 2005, the Emerging Issues Task Force (EITF) reached a consensus on EITF No. 05-6, Determining the Amortization Period for Leasehold Improvements. EITF No. 05-6 requires that leasehold improvements acquired in a business combination or purchased subsequent to the inception of a lease be amortized over the lesser of the useful life of the assets or a term that includes renewals that are reasonably assured at the date of the business combination or purchase. The guidance is effective for periods beginning after June 29, 2005. The adoption of EITF No. 05-6 did not and is not expected to have a material impact on the Company s results of operations or financial position.

Accounting Standards Not Yet Adopted

SFAS No. 155: In May 2005, the FASB issued SFAS No. 155, Accounting for Certain Hybrid Instruments, which is an amendment of SFAS No. 133 and 140 and allows financial instruments that have embedded derivatives to be accounted for as a whole (eliminating the need to bifurcate the derivative from its host) if the holder elects to account for the whole instrument on a fair value basis. SFAS No. 155 is effective for all financial instruments acquired or issued after the beginning of an entity s first fiscal year that begins after September 15, 2006. Companies must apply the standard prospectively. The Company is currently evaluating the effect the adoption of SFAS No. 155 will have on the Company s results of operations and financial position.

SFAS No. 154: In May 2005, the FASB issued SFAS No. 154, Accounting Changes and Error Corrections, which replaces APB Opinion No. 20, Accounting Changes, and SFAS No. 3, Reporting Accounting Changes in Interim Financial Statements, and provides guidance on the accounting for and reporting of accounting changes and error corrections. SFAS No. 154 applies to all voluntary changes in accounting principle and requires retrospective application (a term defined by the statement) to prior periods financial statements, unless it is impracticable to determine the effect of a change. It also applies to changes required by an accounting pronouncement that does not include specific transition provisions. In addition, SFAS No. 154 redefines restatement as the revising of previously issued financial statements to reflect the correction of an error. The statement is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The Company will adopt SFAS No. 154 beginning January 1, 2006.

SFAS No. 151: In November 2004, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 151, Inventory Costs An amendment of ARB No. 43. SFAS No. 151 clarifies that abnormal amounts of idle facility expense, freight, handling costs and spoilage should be expensed as incurred and not included in overhead. Further, SFAS No. 151 requires that allocation of fixed production overheads to conversion costs should be based on normal capacity of the production facilities. SFAS No. 151 is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. Companies must apply the standard prospectively. The adoption of SFAS No. 151 is not expected to have a material impact on the Company s results of operations or financial position.

SFAS No. 123R: In December 2004, the FASB issued SFAS No. 123 (revised), Share-Based Payments (SFAS No. 123R). SFAS No. 123R is a revision of SFAS No. 123, Accounting for Stock Issued to Employees (SFAS No. 123) and supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees. SFAS No. 123R requires that the cost of transactions involving share-based payments be recognized in the financial statements based on a fair-value-based measurement. SFAS No. 123R is effective for fiscal years beginning after June 15, 2005. The Company adopted the fair value recognition provisions of SFAS No. 123 using the prospective method of adoption under SFAS No. 148. Under the prospective method of adoption, the fair value recognition provisions have been applied to all employee awards granted, modified or settled after January 1, 2003. As allowed under SFAS No. 123, the Company accounted for forfeitures as they occurred. Under SFAS No. 123R that method is no longer allowed and the Company must instead estimate forfeitures at the grant date. When the Company adopts SFAS No. 123R on January 1, 2006, the Company will estimate

Notes to Consolidated Financial Statements
OM Group, Inc. and Subsidiaries *Continued*

forfeitures for outstanding stock options which have not yet vested. The adoption of SFAS No. 123R is not expected to have a material impact on the Company s results of operations or financial position.

EITF No. 04-6: In June 2005, the FASB ratified modifications to EITF No. 04-6, Accounting for Stripping Costs Incurred during Production in the Mining Industry. EITF No. 04-6 clarifies that stripping costs incurred during the production phase of a mine are variable production costs that should be included in the costs of the inventory produced during the period that the stripping costs are incurred. The Company currently capitalizes and defers stripping costs when developing a new pit or expanding an existing pit until that pit has reached full production. Upon adoption of EITF No. 04-6, the Company will be required to write-off the amount of deferred stripping costs that were incurred after production commenced at each pit. Such amounts capitalized total $1.8 million at December 31, 2005 and are included in Other non-current assets in the Consolidated Balance Sheet. EITF No. 04-6 is effective for fiscal years beginning after December 15, 2005. The transition provisions require that the consensus be accounted for in a manner similar to a cumulative effect adjustment with any adjustment recognized in the opening balance of retained earnings in the year of adoption. The Company will adopt EITF No. 04-06 on January 1, 2006 and the effect of adoption will be a $1.8 million reduction to Other non-current assets and beginning retained earnings.

Note 3 Inventories

Inventories consist of the following as of December 31,

	2005	2004
Raw materials and supplies	**$ 192,739**	$ 248,536
Work-in-process	**21,781**	37,711
Finished goods	**90,037**	129,270
	$ 304,557	$ 415,517

The Company recorded a lower of cost or market charge of $6.1 million in 2005 due to decreasing metal prices. No lower of cost or market charge was recorded in 2004 or 2003.

Note 4 Property, Plant and Equipment

Property, plant and equipment consists of the following as of December 31,

	2005	2004
Land	**$ 6,508**	$ 4,982
Buildings and improvements	**166,787**	161,566
Machinery and equipment	**507,794**	493,930
Furniture and fixtures	**16,344**	17,130
Property, plant and equipment, at cost	**697,433**	677,608
Less accumulated depreciation	**328,304**	287,796
	$ 369,129	$ 389,812

Total depreciation expense on property, plant and equipment was $47.4 million, $45.2 million, and $49.7 million in 2005, 2004, and 2003, respectively.

Note 5 Divestiture of Precious Metals Group and Other Discontinued Operations

On April 1, 2003, the Company completed the sale of its copper powders business, SCM Metal Products, Inc. (SCM) for $63.7 million. The net proceeds were used to repay a portion of the Company s indebtedness

Notes to Consolidated Financial Statements
OM Group, Inc. and Subsidiaries *Continued*

outstanding under its then-existing Senior credit facilities. There was no gain or loss recorded on the sale of SCM, as this business was written-down by $2.6 million to its fair value in 2002. This business was classified as a discontinued operation in 2003.

On July 31, 2003, the Company completed the sale of its Precious Metals Group (PMG) to Umicore N.A. for approximately $814 million. After transaction costs and expenses, the Company recorded a gain on the sale of this business of $145.9 million ($131.7 million after-tax). This business was comprised of the Company s Precious Metals Chemistry and Metal Management reportable segments, which were acquired by the Company in August 2001. PMG was classified as a discontinued operation in 2003. The net proceeds were used to repay all of the Company s indebtedness outstanding under its then-existing Senior credit facilities.

The 2003 operating results for discontinued operations are summarized as follows (in millions):

Net sales	$	2,415.6
Operating income	$	48.0
Interest expense	$	38.8
Income tax benefit	$	(15.3)
Income	$	8.2

The 2003 operating results summarized above include restructuring and other charges of $5.6 million, primarily to adjust these asset groups to their estimated net realizable value. The results also include an allocation of consolidated interest expense, based on the estimated proceeds from the sales of the PMG business and SCM that were required to be used to re-pay indebtedness outstanding under the Company s then-existing Senior credit facilities.

In 2004, the Company recorded income from discontinued operations of $2.9 million. The income primarily relates to reductions in estimates of environmental and closure accruals established in connection with the sale of the SCM business and the exit of the Company s closed manufacturing facilities in St. George, Utah and Midland, Michigan.

In 2005, the Company recorded income from discontinued operations of $9.4 million. The income relates to the reversal of a $5.5 million tax contingency accrual included in Retained Liabilities of Businesses Sold, a $1.6 million tax refund related to PMG, and a reduction in Retained Liabilities of Businesses Sold attributable to foreign exchange gains of $1.6 million from remeasuring Euro-denominated liabilities to U.S. dollars.

During 2005, the Company reversed a $5.5 million tax contingency accrual that was originally established in July 2003 upon the sale of PMG. Subsequent to that date, such amount had been included in Retained Liabilities of Businesses Sold in the Consolidated Balance Sheets. The contingency relates to a tax matter in Brazil for which the Company has indemnified the buyer under terms of the PMG sale agreement. In mid-2005, a Brazilian mid-level federal court made a ruling that was unfavorable to the PMG buyer s case. However, in November 2005, the Brazilian Federal Supreme Court (the Court) ruled in favor of the taxpayer in a similar case, declaring the applicable law unconstitutional. Subsequent to that decision the Court has ruled in favor of the taxpayer in numerous other cases. The Court must hear all remaining individual cases that have been or will be appealed in this matter, including the PMG buyer s, and that process may take several years. Until the PMG buyer s case is adjudicated by the Court, the Company will remain liable for this matter based on the indemnification agreement. However, based upon the precedent set by the Court, the Company has concluded that this contingent liability is no longer probable at December 31, 2005, and has reversed the accrual. Although the contingency is no longer probable, the likelihood of an unfavorable outcome of this contingency is reasonably possible based on the length of time expected before the matter is closed and the inherent risk of changes in the political or legal situation in Brazil.

Notes to Consolidated Financial Statements
OM Group, Inc. and Subsidiaries *Continued*
Note 6 Restructuring and Other Charges

During 2003, the Company recorded restructuring charges of $20.0 million, completing the program that began in the fourth quarter of 2002. These charges include $5.8 million classified in cost of products sold and $14.2 million classified in selling, general and administrative expenses. A summary of the 2003 charges, which had a cash component of approximately $9.5 million (primarily workforce reductions of $3.7 million, aircraft lease termination of $2.5 million and cash expenses related to the Thailand shut-down of $0.8 million), is as follows (in millions):

Exit of facilities	$ 10.7
Workforce reductions	3.7
Inventory and other asset write-downs	1.2
Other	4.4
	$ 20.0

Charges for the exit of facilities include amounts related to the shut-down of the U.S. manufacturing operations of the electroless nickel business in Newark, New Jersey ($4.1 million); the shut-down of the manufacturing facility in Thailand ($2.8 million); relocation of the corporate headquarters and shut-down of an administrative facility in Cleveland, Ohio ($3.7 million). With respect to the electroless nickel business, the Company continues to serve customers in that market through manufacturing at its facility in Malaysia, and through tolling agreements in the United States. Other includes $2.5 million related to contract termination payments on the disposal of one of the Company s corporate aircraft.

The charge for the Newark shut-down ($4.1 million) and the Thailand charges for inventory and fixed asset write-downs ($1.7 million) are included in cost of products sold.

In addition to these charges, the Company also incurred charges of $2.2 million in 2003 related to executive compensation awards that vested upon successful completion of the sale of PMG. These awards were comprised of a cash bonus of $0.6 million to the Company s former Chief Executive Officer, and accelerated vesting of previously issued restricted stock awards to the Company s former Chief Financial Officer who was employed from 2002 to 2004 totaling $1.6 million.

An analysis of restructuring activity for the Company s continuing operations is summarized below (dollars in millions):

	Number of Employees	Workforce Reductions	Inventory and Other Asset Write-downs	Exit of Facilities and Other	Total
Balance at January 1, 2003	68	$ 5.2	$	$ 2.6	$ 7.8
2003 charges	19	3.7	1.2	15.1	20.0
Utilized in 2003	(87)	(5.8)	(1.2)	(16.3)	(23.3)
Balance at December 31, 2003		3.1		1.4	4.5
Reversal of prior year charges		(0.5)		(0.1)	(0.6)
Utilized in 2004		(2.0)		(1.1)	(3.1)
Balance at December 31, 2004		0.6		0.2	0.8

Reversal of prior year charges			(0.1)	(0.1)
Utilized in 2005	(0.4)		(0.1)	(0.5)
Balance at December 31, 2005	**$ 0.2**	**$**	**$**	**$ 0.2**

The amounts utilized in 2005, 2004 and 2003 include cash paid of $0.5 million, $3.1 million and $12.3 million, respectively.

Notes to Consolidated Financial Statements
OM Group, Inc. and Subsidiaries *Continued*

During 2005 and 2004, the Company reversed certain restructuring reserves totaling $0.1 and $0.6 million, respectively, when estimates to complete the activities changed.

Note 7 Acquisitions

In April 2000, the Company acquired Outokumpu Nickel Oy (ONO) for a cash purchase price on the acquisition date of $188.1 million. During 2004 and 2003, the Company made additional payments to the seller in the amount of $6.7 million and $11.2 million, respectively, under a contingent price participation clause of the original purchase agreement, whereby the seller was entitled to receive such payment based on a formula when the LME nickel price was above $3.50 per pound. Such price participation clause was in place through May 2004, at which time this original contract provision expired. The ultimate aggregate purchase price for the ONO acquisition was $206.0 million, including the price participation payments. These price participation payments reduce negative goodwill as calculated in the initial purchase price allocation. In accordance with the provisions of APB 16, Business Combinations, such negative goodwill was recorded in the opening balance sheet as a reduction of acquired long-lived assets (primarily property, plant and equipment). The price participation payments were accounted for as a reduction of negative goodwill as initially calculated, resulting in an increase to long-lived assets. Depreciation expense on the increase in long-lived assets has been calculated and recorded on a prospective basis over the estimated remaining useful life of the acquired assets.

Note 8 Goodwill and Other Intangible Assets

Goodwill is tested for impairment on an annual basis and more often if indicators of impairment exist. Estimates of future cash flows, discount rates and terminal value amounts are used to determine the estimated fair value of the Company s reporting units. The reporting units are the operating segments: Cobalt and Nickel. Goodwill was originally allocated to the reporting units based on their estimated fair values. The results of the Company s testing in 2005 and 2004 indicated that no impairment charge for goodwill was required.

Changes in the carrying amount of goodwill by operating segment are as follows:

	Carrying Amount of Goodwill		
	Cobalt	**Nickel**	**Consolidated**
Balance at January 1, 2004	$ 113,965	$ 64,713	$ 178,678
Foreign currency translation adjustments	3,193		3,193
Balance at December 31, 2004	117,158	64,713	181,871
Foreign currency translation adjustments	(2,748)		(2,748)
Balance at December 31, 2005	**$ 114,410**	**$ 64,713**	**$ 179,123**

A summary of intangible assets follows:

	Gross Carrying Amount	**Accumulated Amortization**	**Net Balance**
Customer list	$ 4,584	$ (3,285)	$ 1,299
Other intangibles	4,780	(2,332)	2,448

Balance at December 31, 2005	**$**	**9,364**	**$**	**(5,617)**	**$**	**3,747**
Customer list	$	4,584	$	(2,979)	$	1,605
Other intangibles		3,684		(1,148)		2,536
Balance at December 31, 2004	$	8,268	$	(4,127)	$	4,141

Notes to Consolidated Financial Statements
OM Group, Inc. and Subsidiaries *Continued*

All of the Company s intangible assets have finite lives and are amortized over their useful lives. Other intangible assets included in the table above are primarily capitalized software costs and patents. The weighted average amortization period for the customer list is 4 years and the weighted average amortization period for the other intangibles is 7 years at December 31, 2005. Amortization expense related to intangible assets for the years ended December 31, 2005, 2004 and 2003 was approximately $1.5 million, $1.5 million and $1.3 million, respectively. Estimated annual pretax amortization expense for intangible assets for each of the next five years is approximately $1.0 million for 2006, $0.9 million for 2007 and 2008, $0.5 million for 2009 and $0.2 million for 2010.

Note 9 Debt and Other Financial Instruments

Debt consists of the following as of December 31:

	2005	2004
Senior Subordinated Notes	**$ 400,000**	$ 400,000
Note payable bank	**17,250**	23,000
Deferred gain on termination of fair value hedges	**5,984**	6,711
Fair value of interest rate swaps (fair value hedges)	**(1,388)**	722
	421,846	430,433
Less: Current portion of long-term debt	**5,750**	5,750
Long-term debt in default		400,000
Total long-term debt	**$ 416,096**	$ 24,683

The Senior Subordinated Notes (the Notes) bear interest at 9.25%, mature on December 15, 2011 and may be redeemed at the option of the Company beginning December 15, 2006 at prices specified in the indenture. The Company s domestic subsidiaries are the guarantors of the Notes (See Note 21). The delay by the Company in filing its Form 10-K for the year ended December 31, 2003 caused events of default under the indenture governing the Notes, and the Company reclassified the Notes from long-term to current as of March 31, 2004, which was the date the 2003 Form 10-K was due. The Company filed its 2003 Form 10-K on March 31, 2005 and filed its Form 10-Qs for each of the first three quarters of 2004 on June 10, 2005. The Company also was delayed in filing its Form 10-K for the year ended December 31, 2004 and its Form 10-Q for the first quarter of 2005, which resulted in new events of default on August 17, 2005 under the indenture governing the Notes. However, the Company filed its 2004 Form 10-K on August 22, 2005. The Company filed its Form 10-Qs for the first and second quarters of 2005 on September 23, 2005. The Company timely filed its Form 10-Q for the third quarter of 2005 on November 8, 2005. At December 31, 2005, the Notes are classified as long-term as the Company is no longer in default under the indenture and the holders of the Notes no longer have the right to accelerate payment of the Notes. At December 31, 2005, the fair value of the Notes, based upon the quoted market price, approximated $389.0 million.

On December 20, 2005, the Company replaced its existing $150.0 million Senior Secured Revolving Credit Facility with a new Revolving Credit Agreement (the Revolver) with availability of up to $100.0 million, including up to the equivalent of $25.0 million in Euros or other foreign currencies. The Revolver includes an accordion feature under which the Company may increase the availability by $50.0 million to a maximum of $150.0 million subject to certain conditions. Obligations under the Revolver are guaranteed by each of the Company s U.S. subsidiaries and are secured by a lien on the assets of the Company and such subsidiaries. The Revolver provides for interest-only payments during its term, with principal due at maturity. The Company has the option to specify that interest be calculated based either on a London interbank market rate (LIBOR), plus a calculated margin amount, or a base rate. The applicable margin for the LIBOR rate ranges from 0.50% to

56

Notes to Consolidated Financial Statements
OM Group, Inc. and Subsidiaries *Continued*
1.00%. The Revolver also requires the payment of a fee of 0.125% to 0.25% per annum on the unused commitment. The margin and unused commitment fees are subject to quarterly adjustment based on a certain debt to adjusted earnings ratio. The Revolver matures on December 20, 2010. There were no borrowings outstanding under the Revolver at December 31, 2005.
The Revolver contains certain covenants, including financial covenants, that require the Company to (i) maintain a minimum cash flow coverage ratio and (ii) not exceed a certain debt to adjusted earnings ratio. As of December 31, 2005, the Company was in compliance with all of the covenants in the Revolver.
The Company incurred fees and expenses of approximately $0.4 million in 2005 related to the Revolver. These fees and expenses were deferred and are being amortized to interest expense. Unamortized fees of $0.7 million related to the previous revolver were expensed in 2005 and are included in interest expense in the Statements of Consolidated Income.
During December 2003, the Company borrowed $22.9 million from a Belgium bank. This loan bore interest at a rate of LIBOR plus 2.75% and was scheduled to mature in December 2008. In November 2004, the Company refinanced this loan with a Finland bank, resulting in a new principal balance of $23.0 million. The refinanced loan has an interest rate of LIBOR plus 1.25% and is payable in 48 equal installments beginning in January 2005 and ending December 2008. The balance of this note was $17.3 million and $23.0 million at December 31, 2005 and 2004, respectively. Simultaneous to the initial borrowing, the proceeds were loaned by the Company to one of its DRC smelter joint venture partners. The note receivable is recorded in Receivables from joint venture partners (see further discussion in Note 1).
Aggregate annual maturities of total debt are as follows:

2006	$	5,750
2007		5,750
2008		5,750
2009		
2010		
thereafter		400,000
	$	417,250

Interest paid on long-term debt, net of capitalized amounts, was $38.2 million, $37.7 million, and $37.0 million related to continuing operations for 2005, 2004 and 2003, respectively, and $41.1 million related to discontinued operations for 2003. Interest capitalized as part of the acquisition or construction of major fixed assets at the Company s continuing operations was $0.4 million in 2003. No interest was capitalized in 2005 or 2004.
In August 2003, the Company entered into an interest rate swap agreement to convert the fixed rate on $50 million of the Notes to a variable rate of LIBOR plus 4.10% for the period ending December 15, 2011. In addition, in November 2003, the Company entered into another interest rate swap to convert the fixed rate on $50 million of the Notes to a variable rate of LIBOR plus 4.39% for the period ending December 15, 2011. These swap agreements are designated as fair value hedges.
In 2002, the Company completed the termination of, and settled for cash, interest rate swap agreements for an aggregate amount of $125 million expiring in 2011. These swap agreements converted fixed rate debt of 9.25% to a floating rate. In addition, the Company completed the termination of, and settled for cash, interest rate swap agreements for an aggregate amount of $55 million expiring in 2003. These swap agreements converted floating rate debt to a fixed rate. The combined pretax gain on the termination of the swaps of $8.0 million has been

Notes to Consolidated Financial Statements
OM Group, Inc. and Subsidiaries *Continued*
deferred and is being amortized to interest expense through the date on which the swaps were originally scheduled to mature.
At December 31, 2005, the combined effective rate of the Company s borrowings and related swap agreements was 8.91%. The net interest paid or received on interest rate swaps is included in interest expense. The counterparty to the interest rate swaps is an international commercial bank.
The Company used various assumptions and methods in estimating fair value disclosures for financial instruments. The carrying amounts of cash and cash equivalents, accounts receivable and accounts payable approximated their fair value due to the short maturity of these instruments. The fair value of the Notes was estimated based on quoted market prices. The carrying value of the remaining debt approximates fair value as the interest rate is variable. The fair values of interest rate swaps and commodity forward contracts were estimated based on current settlement prices.
The carrying amounts and fair values of the Company s financial instruments consisted of the following:

	December 31, 2005		December 31, 2004	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Marketable securities	$ 4,745	$ 4,745	$ 3,106	$ 3,106
Senior Subordinated Notes	$ 400,000	$ 389,000	$ 400,000	$ 426,000
Other debt	$ 17,250	$ 17,250	$ 23,000	$ 23,000
Interest rate swaps	$ (1,388)	$ (1,388)	$ 722	$ 722
Commodity forward contracts	$ 1,319	$ 1,319	$ 4,633	$ 4,633

Note 10 Metals Financial Instruments
The Company attempts to minimize the effect on profitability of changes in the market price of nickel through hedging activities. The Company enters into forward contracts to hedge the sale and purchase price of nickel transactions. These contracts are designated as cash flow hedges. Therefore, realized gains and losses on these forward contracts are included as a component of net sales or cost of products sold, and are recognized when the related product is sold. Unrealized gains and losses are recorded in Accumulated other comprehensive income. In 2005, 2004 and 2003, there was no impact on earnings resulting from hedge ineffectiveness. At December 31, 2005 and 2004, the notional value of the open contracts approximated $40.7 million and $21.3 million, respectively, and the fair value of open contracts, based on settlement prices at December 31, 2005 and 2004, generated unrealized gains of approximately $1.3 million and $4.6 million, respectively, which are included in Accumulated other comprehensive income. The related receivables are recorded in Other current assets in the Consolidated Balance Sheets. All open contracts at December 31, 2005 mature no later than March 2007 and all open contracts at December 31, 2004 mature no later than June 2006.
In addition, the Company enters into hedging positions on a daily basis to protect its net sale/purchase nickel position. The underlying contracts for these financial instruments do not qualify as accounting hedges under SFAS No.
No. 133, and therefore they are marked-to-market with the related gains or losses recognized immediately in the Statements of Consolidated Income. The amounts recorded in the Statements of Consolidated Income are gains of $0.8 million in 2005 and losses of $3.2 million and $4.9 million in 2004 and 2003, respectively, which are included as a component of cost of products sold.

Notes to Consolidated Financial Statements
OM Group, Inc. and Subsidiaries *Continued*
Note 11 Income Taxes
Income (loss) from continuing operations before income taxes, minority interest and cumulative effect of change in accounting principle consists of the following:

	Year Ended December 31		
	2005	**2004**	**2003**
United States	**$ (47,897)**	$ (71,900)	$ (192,915)
Outside the United States	**78,785**	234,160	150,252
	$ 30,888	$ 162,260	$ (42,663)

Income tax expense (benefit) is summarized as follows:

	Year Ended December 31		
	2005	**2004**	**2003**
Current tax provision (benefit):			
United States:			
Federal	**$ 365**	$ 769	$ 1,385
State and local	**(105)**		3
Outside the United States	**17,987**	28,276	(12,777)
Total current	**18,247**	29,045	(11,389)
Deferred tax provision (benefit):			
United States			
Outside the United States	**(7,511)**	6,023	25,923
Total deferred	**(7,511)**	6,023	25,923
	$ 10,736	$ 35,068	$ 14,534

A reconciliation of income taxes computed using the United States statutory rate to income taxes computed using the Company s effective income tax rate is as follows:

	Year Ended December 31		
	2005	**2004**	**2003**
Income (loss) from continuing operations before income taxes, minority interest and cumulative effect of change in accounting principle	**$ 30,888**	$ 162,260	$ (42,663)

Income taxes at the United States statutory rate (35%)	**$ 10,811**	$ 56,791	$ (14,932)
Effective tax rate differential on earnings/losses outside of the United States	**(7,740)**	(36,764)	(32,460)
Repatriation of foreign earnings	**46,900**	52,690	31,148
Malaysia tax holiday	**(5,986)**	(6,697)	(4,560)
Change in Finland tax rate		(2,518)	
Adjustment of worldwide tax liabilities	**(1,587)**	(2,983)	(2,614)
Income (loss) with no related tax (expense) benefit	**(30,814)**	(24,689)	37,528
Other, net	**(848)**	(762)	424
Income tax expense	**$ 10,736**	$ 35,068	$ 14,534
Effective income tax rate	**34.8%**	21.6%	(34.1%)

Notes to Consolidated Financial Statements
OM Group, Inc. and Subsidiaries *Continued*
Significant components of the Company s deferred income taxes are as follows:

	December 31	
	2005	**2004**
Current asset operating and litigation accruals	**$ 13,543**	$ 55,732
Current liability earnings repatriation	**(42,000)**	(36,750)
Current liability prepaid expenses	**(3,827)**	(2,241)
Non-current asset employee benefit and other accruals	**29,346**	27,949
Non-current asset operating loss carryforwards	**91,120**	92,309
Non-current liability accelerated depreciation	**(21,543)**	(33,198)
Valuation allowance	**(91,102)**	(134,649)
Net deferred tax liability	**$ (24,463)**	$ (30,848)

Deferred income taxes are recorded in the Consolidated Balance Sheets in the following accounts:

	December 31	
	2005	**2004**
Other current assets	**$ 13**	$
Other non-current assets		185
Other current liabilities	**(3,015)**	
Deferred income taxes Other non-current liabilities	**(21,461)**	(31,033)
	$ (24,463)	$ (30,848)

At December 31, 2005, the Company had net operating loss carryforwards of approximately $280.8 million of which $227.2 million are U.S. federal and state net operating losses and $53.6 million are foreign net operating losses. These carryforwards expire at various dates from 2019 through 2025 (approximately $27.0 million of foreign net operating loss carryforwards have an indefinite carryforward period). The U.S. federal net operating losses utilized in 2005 and 2004 were $0 million and $42.3 million, respectively.
Where the Company has determined that it is more likely than not that deferred tax assets will not be realized, a valuation allowance has been established. The valuation allowance pertains to the deferred tax assets resulting principally from the net operating loss carryforwards in the United States. The Company intends to maintain a valuation allowance until sufficient positive evidence exists to support realization of the related deferred tax assets.
The Company has not provided additional United States income taxes on approximately $292.4 million of undistributed earnings of consolidated foreign subsidiaries. Such earnings could become taxable upon the sale or liquidation of these foreign subsidiaries or upon dividend repatriation. The Company s intent is for such earnings to be reinvested by the subsidiaries. It is not practicable to estimate the amount of unrecognized withholding taxes and tax liability on such earnings.
In connection with an investment incentive arrangement, the Company has a tax holiday from income taxes in Malaysia. This arrangement, which expires on December 31, 2006, reduced income tax expense by $6.0 million,

$6.7 million and $4.6 million for 2005, 2004, and 2003 respectively. The benefit of the tax holiday on net income per diluted share was approximately $0.21, $0.23 and $0.16 in 2005, 2004 and 2003, respectively.

Tax returns of certain of the Company s subsidiaries are being examined by various taxing authorities. The Company has not been informed of any material assessments resulting from such examinations for which an accrual has not been previously provided, and the Company would vigorously contest any material assessment.

Notes to Consolidated Financial Statements
OM Group, Inc. and Subsidiaries *Continued*

While the examinations are ongoing, the Company believes that any potential assessment would not materially affect the Company s financial condition or results of operations.

Income tax payments were $37.0 million, $22.4 million and $4.6 million in 2005, 2004 and 2003, respectively.

Note 12 Pension and Other Postretirement Benefit Plans

The Company sponsors a defined contribution plan covering all eligible U.S. employees. To be eligible for the plan, an employee must be a full-time associate for at least six months and at least 21 years of age. Company contributions are determined by the board of directors annually and are computed based upon participant compensation. The Company also sponsors a non-contributory, nonqualified supplemental executive retirement plan for certain employees, providing benefits beyond those covered in the defined contribution plan. Aggregate defined contribution plan expenses were $2.2 million, $2.3 million and $2.6 million in 2005, 2004 and 2003, respectively. Company contributions are directed by the employee into various investment options. At December 31, 2005 and 2004, the plan had invested in 77,893 shares, or $1.5 million, and 121,050 shares, or $3.9 million, of the Company s common stock, respectively, based on the market price of the common stock at those dates.

The Company has a funded non-contributory defined benefit pension plan for certain retired employees in the United States related to the Company s divested SCM business. The Company also has an unfunded supplemental executive retirement plan (SERP) for the former Chief Executive Officer that was executed as of January 1, 2004 and other unfunded postretirement benefit plans (OPEB), primarily health care and life insurance for certain employees and non-employees in the United States. The Company uses an October 31 measurement date for both its pension and postretirement benefit plans.

Actuarial assumptions used in the calculation of the recorded amounts are as follows:

	2005	**2004**
Discount rate	**5.50%**	6.00%
Return on pension plan assets	**8.75%**	8.75%
Projected health care cost trend rate	**11.00%**	13.00%
Ultimate health care cost trend rate	**6.00%**	6.00%
Year ultimate health care trend rate is achieved	**2011**	2011

Set forth below is a detail of the net periodic pension expense for the defined benefit plans for the years ended December 31:

	Pension Benefits		
	2005	**2004**	**2003**
Service cost	**$**	$	$
Interest cost	**1,246**	1,200	867
Amortization of unrecognized net loss	**214**	31	176
Expected return on plan assets	**(575)**	(854)	(1,033)
Amortization of unrecognized prior service cost	**172**	857	
Amortization of unrecognized net transition asset	**(369)**	(117)	
FAS 88 curtailment loss	**4,854**		
	$ 5,542	$ 1,117	$ 10

Notes to Consolidated Financial Statements
OM Group, Inc. and Subsidiaries *Continued*

	Other Postretirement Benefits		
	2005	**2004**	**2003**
Service cost	**$ 69**	$ 61	$ 169
Interest cost	**252**	251	324
Net amortization	**40**	40	(18)
FAS 88 curtailment gain			(3,085)
	$ 361	$ 352	$ (2,610)

In 2005, the Company recorded a $4.9 million curtailment loss related to the SERP for the former Chief Executive Officer. In 2003, the Company recorded a $3.1 million curtailment gain from freezing retiree health care benefits. The following table sets forth the changes in the benefit obligation and the plan assets during the year and reconciles the funded status of the defined benefit plans with the amounts recognized in the Consolidated Balance Sheets at December 31:

	Pension Benefits		Other Postretirement Benefits	
	2005	**2004**	**2005**	**2004**
Change in benefit obligation				
Projected benefit obligation at beginning of year	**$ (21,917)**	$ (14,056)	**$ (4,341)**	$ (4,133)
Service cost			**(69)**	(61)
Interest cost	**(1,246)**	(1,200)	**(252)**	(251)
Participant contributions			**(131)**	(128)
Actuarial loss	**(464)**	(1,393)	**(128)**	(131)
Benefits paid	**890**	903	**407**	363
SERP obligation		(6,171)		
Projected benefit obligation at end of year	**$ (22,737)**	$ (21,917)	**$ (4,514)**	$ (4,341)
Change in plan assets				
Fair value of plan assets at beginning of year	**$ 10,093**	$ 9,428	**$**	$
Actual return on plan assets	**575**	854		
Employer contributions	**173**	714	**276**	235
Participant contributions			**131**	128
Benefits paid	**(890)**	(903)	**(407)**	(363)
Fair value of plan assets at end of year	**$ 9,951**	$ 10,093	**$**	$
Net amount recognized				
Obligation in excess of plan assets	**$ (12,786)**	$ (11,824)	**$ (4,514)**	$ (4,341)

Unrecognized actuarial (gain) loss	**9,254**	8,472	**(120)**	(248)
Unrecognized prior service cost		5,314	**341**	381
Net amount recognized	**$ (3,532)**	$ 1,962	**$ (4,293)**	$ (4,208)
Amounts recorded in the balance sheet consist of:				
Accrued benefit liability	**$ (12,786)**	$ (6,221)	**$ (4,293)**	$ (4,208)
Accumulated other comprehensive income	**9,254**	8,183		
Net amount recognized	**$ (3,532)**	$ 1,962	**$ (4,293)**	$ (4,208)

Notes to Consolidated Financial Statements
OM Group, Inc. and Subsidiaries *Continued*

The accumulated benefit obligation at December 31, 2005 and 2004 equals the projected benefit obligation at December 31, 2005 and 2004 as the Company s defined benefit plans are frozen and no additional benefits are being accrued.

During 2005, 2004 and 2003, Other Comprehensive Income (Loss) includes $1.1 million loss, $1.2 million loss and $4.1 million income, respectively, resulting from changes in the minimum pension liability adjustments, which were determined in accordance with SFAS No. 87, Employers Accounting for Pensions. The minimum pension liability adjustment, which is a component of Accumulated other comprehensive income (loss) in the Stockholders Equity section of the Consolidated Balance Sheets, represents the income (loss) not yet recognized as net periodic pension cost determined by an actuarial calculation of the funded status of the pension plan at the end of each measurement period.

The Company s policy is to make contributions to fund these plans within the range allowed by applicable regulations. Expected contributions are dependent on many variables, including the variability of the market value of the assets as compared to the obligation and other market or regulatory conditions. Accordingly, actual funding may differ significantly from current estimates. The Company expects to contribute $1.0 million to its pension plans in 2006. Benefits are paid to plan participants directly from pension plan assets.

Future pension and other postretirement benefit payments expected to be paid are as follows:

Expected Benefit Payments	**Pension**	**Other Postretirement Benefits**
2006	$ 886	$ 169
2007	$ 874	$ 178
2008	$ 950	$ 166
2009	$ 997	$ 183
2010	$ 1,737	$ 184
2011-2015	$ 9,059	$ 793

The Company employs a total return investment approach for the defined benefit pension plan assets. A mix of equities and fixed income investments are used to maximize the long-term return of assets for a prudent level of risk. In determining the expected long-term rate of return on defined benefit pension plan assets, management considers the historical rates of return over a period of time that is consistent with the long-term nature of the underlying obligations of these plans, the nature of investments and an expectation of future investment strategies.

The Company s pension plan weighted-average asset allocations and target allocation by asset category are as follows:

	Target Allocation	**December 31,**	
	2006	**2005**	**2004**
Equity securities	**65%**	63%	72%
Debt securities	**35%**	37%	25%
Other			3%
Total assets	**100%**	100%	100%

The Company s investment objective for defined benefit plan assets is to meet the plan s benefit obligations, without undue exposure to risk. The investment strategy focuses on asset class diversification, liquidity to meet

Notes to Consolidated Financial Statements
OM Group, Inc. and Subsidiaries *Continued*

benefit payments and an appropriate balance of long-term investment return and risk. The Investment Committee oversees the investment allocation process, which includes the selection and evaluation of the investment manager, the determination of investment objectives and risk guidelines, and the monitoring of actual investment performance.

Assumed health care cost trend rates may have a significant effect on the amounts reported for other postretirement benefits. A one percentage point change in the assumed health care cost trend rate would have the following effect:

	1% Increase	1% Decrease
2005 benefit cost	$ 78	$ (61)
Recorded liability at December 31, 2005	$ 936	$ (753)

The Medicare Prescription Drug, Improvement and Modernization Act (Act) was enacted on December 8, 2003. The Act introduces a prescription drug benefit under Medicare Part D, in addition to a federal subsidy to sponsors of postretirement benefit plans that provide a prescription drug benefit that is at least actuarially equivalent to Medicare Part D. In May 2004, FASB Staff Position 106-2, Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003, was issued which provides guidance on accounting for the federal subsidy. The provisions of FASB 106-2 have been applied prospectively resulting in a $1.2 million reduction of the accumulated postretirement benefit obligation for 2005 and will result in decreased expense beginning in 2006.

Note 13 Stockholders Equity

In 1996, the Company s board of directors adopted a Stockholder Rights Agreement. Under this plan, rights were distributed as a dividend at the rate of one right for each share of common stock outstanding. The rights become exercisable if a person or group (acquiring person) acquires or attempts to acquire 15% or more of the shares of common stock outstanding. In the event that the rights become exercisable, each right (except for rights beneficially owned by the acquiring person, which become null and void) would initially entitle the holder to purchase a unit consisting of one one-hundredth (a unit) of a share of Series A Participating Preferred Stock at an initial purchase price of $160 per unit, subject to adjustment.

If a person or group acquires the threshold percentage of common stock, each right will then entitle the holder (except for rights beneficially owned by the acquiring person, which become null and void) to buy shares of common stock having a market value of twice the exercise price of the rights (e.g. $160). If the Company is acquired in a merger or other business combination, each right will entitle the holder, other than the acquiring person, to purchase securities of the surviving company having a market value equal to twice the exercise price of the rights (e.g. $160).

The rights may be redeemed by the board of directors in whole, but not in part, at a price of $0.01 per right through November 14, 2006. The rights have no voting or dividend privileges and are attached to, and do not trade separately from, the common stock of the Company. The rights expire on November 14, 2006.

Notes to Consolidated Financial Statements
OM Group, Inc. and Subsidiaries *Continued*
Note 14 Accumulated Other Comprehensive Income (Loss)

	Foreign Currency Translation	Unrealized Gains and Losses, Net on Cash Flow Hedging Derivatives	Unrealized Gain on Available For-Sale Securities	Additional Minimum Pension Liability	Accumulated Other Comprehensive Income (Loss)
Balance at January 1, 2003	$ 44,331	$ 841	$	$ (11,114)	$ 34,058
Reclassification adjustments	(74,297)	(841)		2,484	(72,654)
Current period credit	47,369	10,291		1,624	59,284
Deferred taxes		(3,602)			(3,602)
Balance December 31, 2003	17,403	6,689		(7,006)	17,086
Reclassification adjustments		(6,689)			(6,689)
Current period credit (charge)	7,662	4,632	930	(1,177)	12,047
Deferred taxes		(1,157)			(1,157)
Balance December 31, 2004	25,065	3,475	930	(8,183)	21,287
Reclassification adjustments	(723)	(3,475)	(930)		(5,128)
Current period credit (charge)	(5,642)	1,289	4,745		