

KRONOS INTERNATIONAL INC

Form 10-Q

May 09, 2012

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# SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

## FORM 10-Q

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

For the quarter ended March 31, 2012

Commission file number 333-100047

## KRONOS INTERNATIONAL, INC.

(Exact name of Registrant as specified in its charter)

DELAWARE  
(State or other jurisdiction of

incorporation or organization)

22-2949593  
(IRS Employer

Identification No.)

5430 LBJ Freeway, Suite 1700

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Dallas, Texas 75240-2697

(Address of principal executive offices)

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

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

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

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

Large accelerated filer ☐

Accelerated filer ☐

Non-accelerated filer ☒

Smaller reporting company ☐

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

Number of shares of the Registrant's common stock outstanding on April 30, 2012: 2,968.

The Registrant is a wholly-owned subsidiary of Kronos Worldwide, Inc. (File No. 1-31763) and meets the conditions set forth in General Instructions H(1)(a) and H(1)(b) of Form 10-Q for reduced disclosure format.

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**KRONOS INTERNATIONAL, INC. AND SUBSIDIARIES**

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**Table of Contents****KRONOS INTERNATIONAL, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED BALANCE SHEETS****(In millions)**

	<b>December 31, 2011</b>	<b>March 31, 2012 (unaudited)</b>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 19.9	\$ 23.0
Restricted cash	1.9	1.8
Accounts and other receivables	180.6	293.3
Inventories	339.9	449.1
Prepaid expenses and other	3.7	4.5
Total current assets	546.0	771.7
Other assets:		
Deferred financing costs, net	2.0	1.7
Deferred income taxes	130.6	117.6
Other	9.5	9.0
Total other assets	142.1	128.3
Property and equipment:		
Land	41.4	42.8
Buildings	171.1	176.7
Equipment	841.3	872.9
Mining properties	114.9	120.6
Construction in progress	19.1	19.7
	1,187.8	1,232.7
Less accumulated depreciation and amortization	773.7	808.3
Net property and equipment	414.1	424.4
Total assets	\$ 1,102.2	\$ 1,324.4

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**KRONOS INTERNATIONAL, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED BALANCE SHEETS (CONTINUED)**

(In millions)

	December 31, 2011	March 31, 2012 (unaudited)
<b>LIABILITIES AND STOCKHOLDER S EQUITY</b>		
Current liabilities:		
Current maturities of long-term debt	\$ 2.2	\$ 2.0
Accounts payable and accrued liabilities	212.1	195.3
Income taxes	13.4	30.0
Deferred income taxes	6.2	6.3
<b>Total current liabilities</b>	<b>233.9</b>	<b>233.6</b>
Noncurrent liabilities:		
Long-term debt	362.9	479.5
Deferred income taxes	11.1	11.5
Accrued pension cost	90.0	91.3
Other	26.0	27.1
<b>Total noncurrent liabilities</b>	<b>490.0</b>	<b>609.4</b>
Stockholder s equity:		
Common stock	.3	.3
Additional paid-in capital	1,983.1	1,986.5
Retained deficit	(1,155.0)	(1,065.2)
Notes receivable from affiliates	(276.7)	(281.6)
Accumulated other comprehensive loss	(173.4)	(158.6)
<b>Total stockholder s equity</b>	<b>378.3</b>	<b>481.4</b>
<b>Total liabilities and stockholder s equity</b>	<b>\$ 1,102.2</b>	<b>\$ 1,324.4</b>

Commitments and contingencies (Notes 6 and 9)

See accompanying Notes to Condensed Consolidated Financial Statements.

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**KRONOS INTERNATIONAL, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF INCOME**

(In millions)

	Three months ended March 31, 2011      2012 (unaudited)	
Net sales	\$ 298.7	\$ 383.9
Cost of sales	194.4	216.2
Gross margin	104.3	167.7
Selling, general and administrative expense	33.4	37.3
Currency transaction gains, net		.5
Other operating income, net	2.4	6.0
Income from operations	73.3	136.9
Other income (expense):		
Interest income	.1	.2
Loss on prepayment of debt	(3.3)	
Interest expense	(9.3)	(6.3)
Income before income taxes	60.8	130.8
Income tax expense	19.7	41.0
Net income	\$ 41.1	\$ 89.8

See accompanying Notes to Condensed Consolidated Financial Statements.

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**KRONOS INTERNATIONAL, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

(In millions)

	Three months ended March 31, 2011      2012 (unaudited)	
Net income	\$ 41.1	\$ 89.8
Other comprehensive income (loss), net of tax:		
Marketable securities adjustment		(.7)
Currency translation adjustment	10.2	14.5
Pension plans	1.1	1.0
Total other comprehensive income	11.3	14.8
Comprehensive income	\$ 52.4	\$ 104.6

See accompanying Notes to Condensed Consolidated Financial Statements.

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**KRONOS INTERNATIONAL, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY**

**Three months ended March 31, 2012**

**(In millions)**

	<b>Common stock</b>	<b>Additional paid-in capital</b>	<b>Retained deficit</b>	<b>Notes receivable from affiliates (unaudited)</b>	<b>Accumulated other comprehensive loss</b>	<b>Total stockholders equity</b>
Balance at December 31, 2011	\$ .3	\$ 1,983.1	\$ (1,155.0)	\$ (276.7)	\$ (173.4)	\$ 378.3
Net income			89.8			89.8
Other comprehensive income, net					14.8	14.8
Intercompany interest - Kronos Worldwide, Inc.		3.4		(4.9)		(1.5)
Balance at March 31, 2012	\$ .3	\$ 1,986.5	\$ (1,065.2)	\$ (281.6)	\$ (158.6)	\$ 481.4

See accompanying Notes to Condensed Consolidated Financial Statements.



**Table of Contents****KRONOS INTERNATIONAL, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(In millions)**

	<b>Three months ended March 31, 2011                      2012 (unaudited)</b>	
Cash flows from operating activities:		
Net income	\$ 41.1	\$ 89.8
Depreciation and amortization	9.9	10.2
Deferred income taxes	7.7	15.3
Loss on prepayment of debt	3.3	
Call premium paid	(2.5)	
Defined benefit pension plan expense less than cash funding	(1.9)	(.1)
Other, net	.2	.4
Change in assets and liabilities:		
Accounts and other receivables	(37.6)	(109.9)
Inventories	(35.7)	(96.2)
Prepaid expenses	(.7)	(.5)
Accounts payable and accrued liabilities	8.8	25.2
Income taxes	5.7	15.1
Accounts with affiliates	12.9	(34.6)
Other, net	(1.1)	1.4
<b>Net cash provided by (used in) operating activities</b>	<b>10.1</b>	<b>(83.9)</b>
Cash flows from investing activities:		
Capital expenditures	(13.0)	(20.8)
Change in restricted cash, net	.6	.5
<b>Net cash used in investing activities</b>	<b>(12.4)</b>	<b>(20.3)</b>
Cash flows from financing activities:		
Indebtedness:		
Borrowings	113.3	107.4
Principal payments	(113.8)	(.4)
<b>Net cash provided by (used in) financing activities</b>	<b>(.5)</b>	<b>107.0</b>
Cash and cash equivalents net change from:		
Operating, investing and financing activities	(2.8)	2.8
Currency translation	2.6	.3
Balance at beginning of period	49.8	19.9
<b>Balance at end of period</b>	<b>\$ 49.6</b>	<b>\$ 23.0</b>
Supplemental disclosures:		
Cash paid for:		

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Interest (including call premium paid)	\$	5.8	\$	
Income taxes		6.0		17.2
Accrual for capital expenditures		2.6		1.3

See accompanying Notes to Condensed Consolidated Financial Statements.

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**KRONOS INTERNATIONAL, INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**March 31, 2012**

**(unaudited)**

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

*Organization* We are a wholly-owned subsidiary of Kronos Worldwide, Inc. ( "Kronos" ) (NYSE: KRO). We are incorporated in the state of Delaware, U.S.A., with our seat of management in Leverkusen, Germany. At March 31, 2012, Valhi, Inc. (NYSE: VHI) held approximately 50% of Kronos' outstanding common stock and NL Industries, Inc. (NYSE: NL) held an additional 30% of Kronos' common stock. Valhi owns approximately 83% of NL's outstanding common stock. Approximately 95% of Valhi's outstanding common stock is held by Contran Corporation and its subsidiaries. Substantially all of Contran's outstanding voting stock is held by trusts established for the benefit of certain children and grandchildren of Harold C. Simmons (for which Mr. Simmons is sole trustee), or is held directly by Mr. Simmons or other persons or entities related to Mr. Simmons. Consequently, Mr. Simmons may be deemed to control each of Contran, Valhi and us.

*Basis of presentation* The unaudited Condensed Consolidated Financial Statements contained in this Quarterly Report have been prepared on the same basis as the audited Consolidated Financial Statements in our Annual Report on Form 10-K for the year ended December 31, 2011 that we filed with the Securities and Exchange Commission (SEC) on March 5, 2012 (the 2011 Annual Report). In our opinion, we have made all necessary adjustments (which include only normal recurring adjustments) in order to state fairly, in all material respects, our consolidated financial position, results of operations and cash flows as of the dates and for the periods presented. We have condensed the Consolidated Balance Sheet and Statement of Stockholders' Equity at December 31, 2011 contained in this Quarterly Report as compared to our audited Consolidated Financial Statements at that date, and we have omitted certain information and footnote disclosures (including those related to the Consolidated Balance Sheet at December 31, 2011) normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). Our results of operations for the interim period ended March 31, 2012 may not be indicative of our operating results for the full year. The Condensed Consolidated Financial Statements contained in this Quarterly Report should be read in conjunction with our 2011 Consolidated Financial Statements contained in our 2011 Annual Report.

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

**Table of Contents****Note 2 Accounts and other receivables:**

	December 31, 2011	March 31, 2012
	(In millions)	
Trade receivables	\$ 159.9	\$ 261.6
Recoverable VAT and other receivables	17.1	24.1
Refundable income taxes	2.0	2.2
Receivable from affiliates:		
Kronos Canada, Inc.	2.7	5.3
Kronos (US), Inc.	.1	1.3
Allowance for doubtful accounts	(1.2)	(1.2)
Total	\$ 180.6	\$ 293.3

**Note 3 Inventories:**

	December 31, 2011	March 31, 2012
	(In millions)	
Raw materials	\$ 80.6	\$ 127.7
Work in process	14.1	17.1
Finished products	199.0	254.2
Supplies	46.2	50.1
Total	\$ 339.9	\$ 449.1

**Note 4 Accounts payable and accrued liabilities:**

	December 31, 2011	March 31, 2012
	(In millions)	
Accounts payable	\$ 93.6	\$ 95.6
Employee benefits	25.3	26.0
Accrued sales discounts and rebates	9.0	7.8
Payable to affiliates:		
Kronos (US), Inc.	52.8	33.0
Kronos Canada, Inc.	.1	
Kronos income taxes	7.1	
Accrued interest	5.0	11.2
Other	19.2	21.7
Total	\$ 212.1	\$ 195.3

**Note 5 Long-term debt:**

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	December 31, 2011	March 31, 2012
	(In millions)	
Long-term debt:		
6.5% Senior Secured Notes	\$ 360.6	\$ 371.0
Revolving credit facility		106.4
Other	4.5	4.1
Total debt	365.1	481.5
Less current maturities	2.2	2.0
Total long-term debt	\$ 362.9	\$ 479.5

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**Senior Secured Notes** In March, 2011, we redeemed 80 million of our 400 million 6.5% Senior Secured Notes at 102.17% of the principal amount for an aggregate of \$115.7 million, including a \$2.5 million call premium. During the third and fourth quarters of 2011, we repurchased in open market transactions an aggregate of 40.8 million principal amount of the Senior Notes for an aggregate of 40.6 million (an aggregate of \$57.6 million when repurchased). Following such partial redemption and repurchases, 279.2 million principal amount of Senior Notes remain outstanding. We recognized a \$3.3 million pre-tax interest charge related to the prepayment of the Senior Notes in the first quarter of 2011, consisting of the call premium and the write-off of unamortized deferred financing costs and original issue discount associated with the redeemed Senior Notes.

**Revolving credit facility** During the first three months of 2012, we borrowed 80 million (\$107.4 million when borrowed) under our bank credit facility. The average interest rate on these borrowings at March 31, 2012 was 1.94%.

**Restrictions and other** Our credit facility described above requires the borrower to maintain minimum levels of equity, requires the maintenance of certain financial ratios, limits dividends and additional indebtedness and contains other provisions and restrictive covenants customary in lending transactions of this type. We are in compliance with all of our debt covenants at March 31, 2012. We believe that we will be able to comply with the financial covenants contained in our credit facility through its maturity; however if future operating results differ materially from our expectations we may be unable to maintain compliance.

The terms of the indenture governing the 6.5% Senior Secured Notes limit our ability to pay dividends and make other restricted payments. At March 31, 2012, the maximum amount of dividends and other restricted payments that we could make (the Restricted Payment Basket) was \$348.0 million.

**Note 6 Income taxes:**

	Three months ended March 31,	
	2011	2012
	(In millions)	
Expected tax expense, at U.S. federal statutory income tax rate of 35%	\$ 21.3	\$ 45.8
Non-U.S. tax rates	(2.1)	(5.3)
Other, net	.5	.5
Total	\$ 19.7	\$ 41.0

Tax authorities are examining certain of our tax returns and have or may propose tax deficiencies, including penalties and interest. Because of the inherent uncertainties involved in the settlement initiatives and court and tax proceedings, we cannot guarantee that these tax matters will be resolved in our favor, and therefore our potential exposure, if any, is also uncertain. We believe we have adequate accruals for additional taxes and related interest expense which could ultimately result from tax examinations. We believe the ultimate disposition of tax examinations should not have a material adverse effect on our consolidated financial position, results of operations or liquidity. We currently estimate that our unrecognized tax benefits will not change materially during the next twelve months.

**Table of Contents****Note 7 Employee benefit plans:**

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

	Three months ended March 31, 2011      2012 (In millions)	
Service cost	\$ 2.0	\$ 1.7
Interest cost	4.5	4.4
Expected return on plan assets	(3.0)	(3.0)
Amortization of prior service cost	.1	.1
Recognized actuarial losses	1.2	1.3
Total	\$ 4.8	\$ 4.5

*Contributions* We expect our 2012 contributions for our pension plans to be approximately \$19 million.

**Note 8 Other noncurrent liabilities:**

	December 31, 2011	March 31, 2012 (In millions)
Reserve for uncertain tax positions	\$ 11.9	\$ 12.5
Employee benefits	10.2	10.5
Other	3.9	4.1
Total	\$ 26.0	\$ 27.1

**Note 9 Commitments and contingencies:**

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

Please refer to our 2011 Annual Report for a discussion of certain other legal proceedings to which we are a party.

**Note 10 Financial instruments:**

The following table presents the financial instruments that are not carried at fair value but which require fair value disclosure as of December 31, 2011 and March 31, 2012.

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	December 31, 2011		March 31, 2012	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
	(In millions)			
Cash, cash equivalents and restricted cash	\$ 21.8	\$ 21.8	\$ 24.8	\$ 24.8
Notes payable and long-term debt:				
Fixed rate with market quotes - 6.5% Senior Secured Notes	\$ 360.6	\$ 362.6	\$ 371.0	\$ 375.6
European credit facility			106.4	106.4

At December 31, 2011 and March 31, 2012, the estimated market price of the 6.5% Notes was approximately 1,004 and 1,011 per 1,000 principal amount, respectively. The fair value of our 6.5% Notes is based upon quoted market prices at each balance sheet date; these quoted market prices represent Level 2 inputs because the markets in which the Notes trade are not active. The fair value of variable interest rate debt is deemed to approximate book value. Due to their near-term maturities, the carrying amounts of accounts receivable and accounts payable are considered equivalent to fair value.

**Note 11 Recent accounting standards:**

In June 2011 the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2011-05, *Presentation of Comprehensive Income*. ASU 2011-05 eliminates the option of presenting comprehensive income as a component of the Consolidated Statement of Stockholders' Equity and instead requires comprehensive income to be presented as a component of the Consolidated Statement of Income or in a separate Consolidated Statement of Comprehensive Income immediately following the Consolidated Statement of Income. In accordance with ASU 2011-05, we now present our comprehensive income in a separate Condensed Consolidated Statement of Comprehensive Income. Additionally, ASU 2011-05 would have required us to present on the face of our financial statements the effect of reclassifications out of accumulative other comprehensive income on the components of net income and other comprehensive income. However, in December 2011 the FASB issued ASU 2011-12, *Comprehensive Income (Topic 220): Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05*. ASU 2011-12 defers the effective date for the requirement to present on the face of our financial statements the effects of reclassifications out of accumulated other comprehensive income on the components of net income and other comprehensive income. Adoption of ASU 2011-05, as amended by ASU 2011-12, did not have a material effect on our Condensed Consolidated Financial Statements.

In December 2011 the FASB issued ASU 2011-11 *Disclosures about Offsetting Assets and Liabilities*. ASU 2011-11 requires entities to disclose both gross information and net information about both instruments and transactions eligible for offset in the balance sheet and instruments and transactions subject to an agreement similar to a master netting arrangement. This standard will be effective for annual and interim periods beginning with our first quarter 2013 report. We do not believe the adoption of this standard will have a material effect on our Condensed Consolidated Financial Statements.



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

#### **Business overview**

We are a leading global producer and marketer of value-added titanium dioxide pigments, or TiO<sub>2</sub>. TiO<sub>2</sub> is used for a variety of manufacturing applications, including plastics, paints, paper and other industrial products. For the three months ended March 31, 2012, approximately three-fourths of our sales volumes were into European markets. Our production facilities are located in Europe.

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

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

Our TiO<sub>2</sub> sales and production volumes,

TiO<sub>2</sub> selling prices,

Currency exchange rates (particularly the exchange rate for the U.S. dollar relative to the euro and the Norwegian krone) and

Manufacturing costs, particularly raw materials, maintenance and energy-related expenses.

Our key performance indicators are our TiO<sub>2</sub> average selling prices and our TiO<sub>2</sub> sales and production volumes. TiO<sub>2</sub> selling prices generally follow industry trends and prices will increase or decrease generally as a result of competitive market pressures.

#### **Executive summary**

We reported net income of \$89.8 million in the first quarter of 2012 as compared to net income of \$41.1 million in the first quarter of 2011. Our net income in the first quarter 2012 is higher principally due to higher income from operations resulting from higher average selling prices and higher production volumes in 2012.

#### **Forward-looking information**

This report contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, as amended. Statements in this Quarterly Report on Form 10-Q that are not historical facts are forward-looking in nature and represent management's beliefs and assumptions based on currently available information. Statements in this report

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

Future supply and demand for our products

The extent of the dependence of certain of our businesses on certain market sectors

The cyclical nature of our business

Customer inventory levels

Changes in raw material and other operating costs (such as energy and ore costs)

Changes in the availability of raw material (such as ore)

General global economic and political conditions (such as changes in the level of gross domestic product in various regions of the world and the impact of such changes on demand for TiO<sub>2</sub>)

Competitive products and substitute products

Customer and competitor strategies

Potential consolidation of our competitors

The impact of pricing and production decisions

Competitive technology positions

The introduction of trade barriers

Possible disruption of our business, or increases in our cost of doing business resulting from terrorist activities or global conflicts

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Fluctuations in currency exchange rates (such as changes in the exchange rate between the U.S. dollar and each of the euro and the Norwegian krone), or possible disruptions to our business resulting from potential instability resulting from uncertainties associated with the euro

Operating interruptions (including, but not limited to, labor disputes, leaks, natural disasters, fires, explosions, unscheduled or unplanned downtime and transportation interruptions)

Our ability to renew or refinance credit facilities

Our ability to maintain sufficient liquidity

The ultimate outcome of income tax audits, tax settlement initiatives or other tax matters

Our ability to utilize income tax attributes, the benefits of which have been recognized under the more-likely-than-not recognition criteria

Environmental matters (such as those requiring compliance with emission and discharge standards for existing and new facilities)

Government laws and regulations and possible changes therein

Possible future litigation

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

## Results of operations

*Quarter ended March 31, 2012 compared to the quarter ended March 31, 2011 -*

	2011	Three months ended March 31, 2012	
		(Dollars in millions)	
Net sales	\$ 298.7	100 %	\$ 383.9 100 %
Cost of sales	194.4	65	216.2 56
Gross margin	104.3	35	167.7 44
Other operating income and expense, net	31.0	10	30.8 8
Income from operations	\$ 73.3	25%	\$ 136.9 36%
			% Change
TiO <sub>2</sub> operating statistics:			
Sales volumes*	84	85	1 %
Production volumes*	90	94	4 %
Percent change in net sales:			
TiO <sub>2</sub> product pricing			31 %
TiO <sub>2</sub> sales volumes			1
TiO <sub>2</sub> product mix			
Changes in currency exchange rates			(3)
Total			29 %

\* Thousands of metric tons

**Current industry conditions** Throughout 2011 and continuing into 2012, our production facilities operated at full practical capacity rates. We also increased TiO<sub>2</sub> selling prices throughout 2011, resulting in increased profitability and cash flows. Selling prices in the first quarter 2012 were 31% higher as compared to the first quarter of 2011 and our average selling prices at the end of the first quarter of 2012 were comparable to selling prices at the end of 2011. Global customer demand for our TiO<sub>2</sub> products also remained strong throughout much of 2011. Although we did experience a softening of demand in the fourth quarter of 2011 as a result of customer destocking, customer demand in the first quarter of 2012 rebounded from the softness experienced in the fourth quarter of 2011. We expect demand will continue to strengthen during the remainder of 2012 and we anticipate we will be able to implement further TiO<sub>2</sub> selling price increases.

We experienced increased costs for our raw materials such as ore and petroleum coke in 2011 and in the first quarter 2012. We expect further increases in raw material costs throughout 2012, as discussed below.

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Overall, based on positive market dynamics in the TiO<sub>2</sub> industry, we expect our profitability and cash flows to increase in 2012 and the foreseeable future.

*Net sales* Net sales in the first quarter of 2012 increased 29%, or \$85.2 million, compared to the first quarter of 2011 primarily due to a 31% increase in average TiO<sub>2</sub> selling prices. TiO<sub>2</sub> selling prices will increase or decrease generally as a result of competitive market pressures, changes in the relative level of supply and demand as well as changes in raw material and other manufacturing costs. Based on current conditions in the TiO<sub>2</sub> industry, as well as the expectation for increases in our manufacturing costs discussed below, we currently expect average selling prices in the remainder of 2012 to continue to be higher than the comparable periods in 2011.

Our sales volumes increased 1% in the first quarter of 2012 as compared to the first quarter of 2011 as higher sales volumes in the export markets were offset by lower sales volumes in Europe. Our sales volumes in the first quarter of 2012 set a new record for a first quarter. In addition, we estimate the unfavorable effect of changes in currency exchange rates decreased our net sales by approximately \$9 million, or 3%, as compared to the first quarter of 2011.

*Cost of sales* Cost of sales increased \$21.8 million or 11% in the first quarter of 2012 compared to 2011 primarily due to the net impact of a 1% increase in sales volumes, a 4% increase in TiO<sub>2</sub> production volumes, higher raw material costs of approximately \$18 million (primarily feedstock ore and petroleum coke) and currency fluctuations (primarily the euro). Cost of sales as a percentage of net sales decreased to 56% in the first quarter of 2012 compared to 65% in the first quarter of 2011 primarily due to the higher selling prices and higher production volumes in the first quarter of 2012. Our production volumes in the first quarter of 2012 set a new record for a first quarter. We expect further increases in our manufacturing costs during the remainder of 2012, as discussed below.

*Income from operations* Income from operations increased by \$63.6 million from \$73.3 million in the first quarter of 2011 to \$136.9 million in the first quarter of 2012. Income from operations as a percentage of net sales increased to 36% in the first quarter of 2012 from 25% in the same period of 2011. This increase was driven by the improvement in gross margin, which increased to 44% for the first quarter of 2012 compared to 35% for the first quarter of 2011. Our gross margin has increased primarily because of higher selling prices, higher sales volumes and higher production volumes all of which more than offset the impact of higher manufacturing costs (primarily raw materials). Additionally, changes in currency exchange rates have negatively affected our gross margin and income from operations. We estimate that changes in currency exchange rates decreased income from operations by approximately \$1 million in the first quarter of 2012 as compared to the same period in 2011.

*Other non-operating income (expense)* On March 24, 2011, we redeemed 80 million of our 400 million 6.5% Senior Secured Notes and borrowed under our revolving credit facility. As a result, we recognized a \$3.3 million pre-tax interest charge related to the prepayment of the 6.5% Senior Secured Notes in the first quarter of 2011, consisting of the call premium and the write-off of unamortized deferred financing costs and original issue discount associated with the redeemed Senior Notes. See Note 5 to our Condensed Consolidated Financial Statements.

Interest expense decreased \$3.0 million from \$9.3 million in the first quarter of 2011 to \$6.3 million in the first quarter of 2012 due to the net effects of the prepayment and open market purchases of a portion of the 6.5% Senior Secured Notes made in the third and fourth quarters of 2011. The interest expense we recognize will vary with fluctuations in the euro exchange rate.

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**Income tax expense** Our income tax provision was \$41.0 million in the first quarter of 2012 compared to \$19.7 million in the same period last year. This increase is primarily due to our increased earnings. See Note 6 to our Condensed Consolidated Financial Statements for a tabular reconciliation of our statutory income tax provision to our actual tax provision.

We have substantial net operating loss carryforwards in Germany (the equivalent of \$799 million and \$188 million for German corporate and trade tax purposes, respectively, at December 31, 2011). At March 31, 2012, we have concluded that no deferred income tax asset valuation allowance is required to be recognized with respect to such carryforwards, principally because (i) such carryforwards have an indefinite carryforward period, (ii) we have utilized a portion of such carryforwards during the most recent three-year period and (iii) we currently expect to utilize the remainder of such carryforwards over the long term. However, prior to the complete utilization of such carryforwards, particularly if the economic recovery were to be short-lived or we were to generate losses in our German operations for an extended period of time, it is possible that we might conclude the benefit of such carryforwards would no longer meet the more-likely-than-not recognition criteria, at which point we would be required to recognize a valuation allowance against some or all of the then-remaining tax benefit associated with the carryforwards.

**Effects of Currency Exchange Rates**

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

Overall, we estimate that fluctuations in currency exchange rates had the following effects on our sales and income from operations for the first quarter of 2012 as compared to the first quarter of 2011.

Impact of changes in currency exchange rates					
Three months ended March 31, 2012 vs. March 31, 2011					
	Transaction gains recognized		Translation loss- impact of rate changes (In millions)	Total currency impact 2012 vs. 2011	
	2011	2012		Change	
<b>Impact on:</b>					
Net sales	\$	\$	\$	\$ (9)	\$ (9)
Income from operations		1	1	(2)	(1)

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### ***Outlook***

During the first quarter of 2012 we operated our production facilities at full practical capacity levels, consistent with our operating rates throughout 2011. While we will continue to work on debottlenecking projects in 2012 to increase our production capacity, we believe such debottlenecking projects will produce relatively nominal increases in our capacity. We currently expect to operate our facilities in 2012 at production levels consistent with or slightly lower than 2011.

The overall strengthening global demand for TiO<sub>2</sub> we experienced in the first quarter of 2012 is expected to continue through the remainder of the year. We currently expect our sales volumes to increase in 2012 as compared to 2011, and our 2012 sales volumes to exceed our 2012 production volumes.

We implemented significant increases in TiO<sub>2</sub> selling prices throughout 2011 and raised prices in certain markets in the first quarter of 2012. Our average TiO<sub>2</sub> selling prices were 31% higher in the first quarter of 2012 as compared to the first quarter of 2011, and our average selling prices at the end of the first quarter of 2012 were 2% lower than prices at the end of 2011. Based on product demand levels and increases in our manufacturing costs discussed below, we anticipate our average selling prices will increase during the remainder of 2012, including increases to offset the impact of our expected higher manufacturing costs.

During 2012, we expect to see significantly higher feedstock ore costs driven by tight ore supplies and higher-than-historical increases in petroleum coke and energy costs. Overall, we currently expect our per metric ton cost of TiO<sub>2</sub> we produce in 2012 will increase approximately 50% to 60% as compared to 2011, primarily due to higher feedstock ore costs. Our cost of sales per metric ton of TiO<sub>2</sub> sold in calendar 2012 is consequently expected to be significantly higher as compared to calendar 2011. However, our cost of sales per metric ton of TiO<sub>2</sub> sold in the first quarter of 2012 is significantly lower as compared to our expected cost of sales per metric ton of TiO<sub>2</sub> sold in the remainder of 2012, as a substantial portion of the TiO<sub>2</sub> products we sold in the first quarter of 2012 was produced with lower-cost feedstock ore. Given the current conditions in the TiO<sub>2</sub> industry, if our costs of production exceed our current expectations in 2012 and demand for TiO<sub>2</sub> remains strong, we believe we could recoup such higher costs through additional selling price increases.

Overall, we expect income from operations will be higher in 2012 as compared to 2011, as the favorable effects of higher selling prices and sales volumes will more than offset the impact of higher production costs.

Our expectations as to the future of the TiO<sub>2</sub> industry are based upon a number of factors beyond our control, including worldwide growth of gross domestic product, competition in the marketplace, continued operation of competitors, unexpected or earlier-than-expected capacity additions or reductions and technological advances. If actual developments differ from our expectations, our results of operations could be unfavorably affected.

## **LIQUIDITY AND CAPITAL RESOURCES**

### **Consolidated cash flows**

#### ***Operating activities***

Trends in cash flows as a result of our operating activities (excluding the impact of significant asset dispositions and relative changes in assets and liabilities) are generally similar to trends in our earnings.

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Our cash used by operating activities was \$83.9 million in the first three months of 2012 compared to cash provided by operating activities of \$10.1 million in the first three months of 2011. This \$94.0 million decrease in the amount of cash provided was primarily due to the net effects of the following:

Higher income from operations in 2012 of \$63.6 million;

Higher net cash used from relative changes in our inventories, receivables, payables and accruals in 2012 of \$163.7 million, primarily due to the relative increases in our inventories and receivables, as discussed below;

Higher cash paid for income taxes in 2012 of \$11.2 million due to our improved earnings; and

Lower cash paid for interest in 2012 of \$5.8 million, principally due to the \$2.5 million call premium associated with the redemption of 80 million of our 6.5% Senior Secured Notes in 2011, as well as the interest on the Senior Notes paid at redemption.

Changes in working capital were affected by accounts receivable and inventory changes. As shown below:

Our average days sales outstanding, or DSO, increased from December 31, 2011 to March 31, 2012 due to higher sales volumes and selling prices we achieved in the first quarter of 2012; and

Our average days sales in inventory, or DSI, increased from December 31, 2011 to March 31, 2012 principally due to the higher cost of our inventories resulting primarily from higher feedstock ore costs. Strong production from 2011 continued into the first quarter of 2012 resulting in higher inventory levels in advance of spring painting season.

For comparative purposes, we have also provided comparable prior years numbers below:

	December 31, 2010	March 31, 2011	December 31, 2011	March 31, 2012
DSO	54 days	62 days	52 days	67 days
DSI	50 days	62 days	101 days	106 days

### ***Investing activities***

Our capital expenditures of \$13.0 million and \$20.8 million in the three months ended March 31, 2011 and 2012, respectively, were primarily to maintain and improve the cost-effectiveness of our existing manufacturing facilities.

### ***Financing activities***

During the three months ended March 31, 2012, we borrowed 80 million (\$107.4 million when borrowed) on our European credit facility.

### **Outstanding debt obligations**

At March 31, 2012, our consolidated debt comprised:

279.2 million principal amount of our 6.5% Senior Secured Notes (\$371.0 million) due in April 2013; and



80 million (\$106.4 million) under our revolving credit facility which matures in October 2013; and

approximately \$4.1 million of other indebtedness.

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With respect to the 279.2 million principal amount outstanding at March 31, 2012 of our Senior Secured Notes due in April 2013, we have commenced efforts to refinance the Senior Notes, and have engaged a financial advisor to assist us in these efforts. The definitive terms of any such refinancing have not yet been determined, and while there can be no assurance that we would be able to complete a refinancing on terms acceptable to us, we believe we will be able to refinance the remaining Senior Notes before their maturity date.

Our revolving credit facility described above contains provisions which could result in the acceleration of indebtedness prior to their stated maturity for reasons other than defaults for failure to comply with applicable covenants. For example, certain credit agreements allow the lender to accelerate the maturity of the indebtedness upon a change of control (as defined in the agreement) of the borrower. In addition, certain credit agreements could result in the acceleration of all or a portion of the indebtedness following a sale of assets outside the ordinary course of business. We are in compliance with all of our debt covenants at March 31, 2012. See Note 5 to our Condensed Consolidated Financial Statements.

Our assets consist primarily of investments in operating subsidiaries, and our ability to service parent level obligations, including the Senior Secured Notes, depends in large part upon the distribution of earnings of our subsidiaries, whether in the form of dividends, advances or payments on account of intercompany obligations or otherwise. None of our subsidiaries have guaranteed the Senior Secured Notes, we have pledged 65% of the common stock or other ownership interests of certain of our first-tier operating subsidiaries as collateral for the Senior Secured Notes. The terms of the indenture governing the Senior Secured Notes limits our ability to pay dividends and make other restricted payments. At March 31, 2012, the maximum amount of dividends and other restricted payments that we could make (the Restricted Payment Basket ) was approximately \$348.0 million.

## **Future cash requirements**

### ***Liquidity***

Our primary source of liquidity on an ongoing basis is cash flows from operating activities which is generally used to (i) fund working capital expenditures, (ii) repay any short-term indebtedness incurred for working capital purposes and (iii) provide for the payment of dividends. From time-to-time we will incur indebtedness, generally to (i) fund short-term working capital needs, (ii) refinance existing indebtedness or (iii) fund major capital expenditures or the acquisition of other assets outside the ordinary course of business. We will also from time-to-time sell assets outside the ordinary course of business and use the proceeds to (i) repay existing indebtedness, (ii) make investments in marketable and other securities, (iii) fund major capital expenditures or the acquisition of other assets outside the ordinary course of business or (iv) pay dividends.

Pricing within the TiO<sub>2</sub> industry is cyclical, and changes in industry economic conditions significantly impact earnings and operating cash flows. Changes in TiO<sub>2</sub> pricing, production volumes and customer demand, among other things, could significantly affect our liquidity.

We routinely evaluate our liquidity requirements, alternative uses of capital, capital needs and availability of resources in view of, among other things, our dividend policy, our debt service and capital expenditure requirements and estimated future operating cash flows. As a result of this process, we have in the past and may in the future seek to reduce, refinance, repurchase or restructure indebtedness, raise additional capital, repurchase shares of our common stock, modify our dividend policy, restructure ownership

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interests, sell interests in our subsidiaries or other assets, or take a combination of these steps or other steps to manage our liquidity and capital resources. Such activities have in the past and may in the future involve related companies. In the normal course of our business, we may investigate, evaluate, discuss and engage in acquisition, joint venture, strategic relationship and other business combination opportunities in the TiO<sub>2</sub> industry. In the event of any future acquisition or joint venture opportunity, we may consider using then-available liquidity, issuing our equity securities or incurring additional indebtedness.

At March 31, 2012, we had aggregate cash, cash equivalents and restricted cash on hand of \$24.8 million. At March 31, 2012, we had borrowed the full 80 million under our European credit facility. Based upon our expectation for the TiO<sub>2</sub> industry and anticipated demands on cash resources, we expect to have sufficient liquidity to meet our short-term obligations (defined as the twelve-month period ending March 31, 2013) and our long-term obligations (defined as the five-year period ending March 31, 2017, our time period for long-term budgeting). If actual developments differ from our expectations, our liquidity could be adversely affected.

### ***Capital expenditures***

We currently estimate that we will invest approximately \$64 million in capital expenditures to maintain and improve our existing facilities during 2012, including the \$20.8 million we have spent through March 31, 2012.

### **Off-balance sheet financing**

We do not have any off-balance sheet financing agreements other than the operating leases discussed in our 2011 Annual Report.

### **Commitments and contingencies**

See Notes 6 and 9 to the Condensed Consolidated Financial Statements for a description of certain income tax examinations currently underway and legal proceedings.

### **Recent accounting pronouncements**

See Note 11 to our Condensed Consolidated Financial Statements.

### **Critical accounting policies**

For a discussion of our critical accounting policies, refer to Part I, Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations in our 2011 Annual Report. There have been no changes in our critical accounting policies during the first three months of 2012.

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

We are exposed to market risk, including currency exchange rates, interest rates and raw material prices. For a discussion of such market risk items, refer to Part I, Item 7A. Quantitative and Qualitative Disclosure About Market Risk in our 2011 Annual Report. There have been no material changes in these market risks during the first three months of 2012.

Our operations are located outside the United States and our functional currency is not the U.S. dollar. As a result, the reported amounts of our assets and liabilities related to our operations, and therefore our consolidated net assets, will fluctuate based upon changes in currency exchange rates.

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### **ITEM 4. CONTROLS AND PROCEDURES**

#### **Evaluation of Disclosure Controls and Procedures**

We maintain a system of disclosure controls and procedures. The term disclosure controls and procedures, as defined by Exchange Act Rule 13a-15(e), means controls and other procedures that are designed to ensure that information required to be disclosed in the reports that we file or submit to the SEC under the Securities Exchange Act of 1934, as amended (the Exchange Act), is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information we are required to disclose in the reports we file or submit to the SEC under the Exchange Act is accumulated and communicated to our management, including our principal executive officer and our principal financial officer, or persons performing similar functions, as appropriate to allow timely decisions to be made regarding required disclosure. Each of Steven L. Watson, our Chief Executive Officer, and Gregory M. Swalwell, our Vice President, Finance and Chief Financial Officer, have evaluated the design and operating effectiveness of our disclosure controls and procedures as of March 31, 2012. Based upon their evaluation, these executive officers have concluded that our disclosure controls and procedures are effective as of March 31, 2012.

#### **Internal Control over Financial Reporting**

We also maintain internal control over financial reporting. The term internal control over financial reporting, as defined by Exchange Act Rule 13a-15(f), means a process designed by, or under the supervision of, our principal executive and principal financial officers, or persons performing similar functions, and effected by our board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP, and includes those policies and procedures that:

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

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

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

As permitted by the SEC, our assessment of internal control over financial reporting excludes (i) internal control over financial reporting of our equity method investees and (ii) internal control over the preparation of our financial statement schedules required by Article 12 of Regulation S-X.

#### **Changes in Internal Control over Financial Reporting**

There has been no change to our internal control over financial reporting during the quarter ended March 31, 2012 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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**Part II. OTHER INFORMATION**

**Item 1. Legal Proceedings**

Refer to Note 9 of the Condensed Consolidated Financial Statements and to our 2011 Annual Report for descriptions of certain legal proceedings.

**Item 1A. Risk Factors**

For a discussion of the risk factors related to our businesses, refer to Part I, Item 1A., Risk Factors, in our 2011 Annual report. There have been no material changes to such risk factors during the three months ended March 31, 2012.

**Item 6. Exhibits**

31.1	Certification
31.2	Certification
32.1	Certification
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema
101.CAL	XBRL Taxonomy Extension Calculation Linkbase
101.DEF	XBRL Taxonomy Extension Definition Linkbase
101.LAB	XBRL Taxonomy Extension Label Linkbase
101.PRE	XBRL Taxonomy Extension Presentation Linkbase

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**SIGNATURES**

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

KRONOS INTERNATIONAL, INC.

(Registrant)

Date: May 8, 2012

/s/ Gregory M. Swalwell  
Gregory M. Swalwell  
Vice President, Finance and

Chief Financial Officer

(Principal Financial Officer)

Date: May 8, 2012

/s/ Tim C. Hafer  
Tim C. Hafer  
Vice President and Controller

(Principal Accounting Officer)

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