

KRONOS INTERNATIONAL INC
Form 10-K
March 10, 2010

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 and Exchange Act of 1934:
For the fiscal year ended December 31, 2009
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
Dallas, Texas 75240-2697
(Address of principal executive offices)

Registrant's telephone number, including area code: (972) 233-1700
No securities are registered pursuant to Section 12(b) of the Act.

No securities are registered pursuant to Section 12(g) of the Act.

Indicate by check mark:

If the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No X

If the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No X

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

Whether the registrant has submitted electronically and posted on its corporate Website, 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

* The registrant has not yet been phased into the interactive data requirements.

Whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting

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company (as defined in Rule 12b-2 of the Act). Large accelerated filer Accelerated filer Non-accelerated filer X
Smaller reporting company

Whether the Registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes No X

No common stock was held by nonaffiliates of the Registrant as of June 30, 2009 (the last business day of the Registrant's most recently-completed second fiscal quarter).

As of February 26, 2010, 2,968 shares of the Registrant's common stock were outstanding.

The Registrant is a wholly-owned subsidiary of Kronos Worldwide, Inc. (File No. 1-31763) and meets the conditions set forth in General Instructions I(1) (a) and (b) and is therefore filing this Form 10-K with the reduced disclosure format.

Documents incorporated by reference

None.

Forward-Looking Information

This Annual Report on Form 10-K contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, as amended. Statements in this Annual Report that are not historical facts are forward-looking in nature and represent management's beliefs and assumptions based on currently available information. In some cases, you can identify forward-looking statements by the use of words such as "believes," "intends," "may," "should," "could," "anticipates," "expects" or comparable terminology, or by discussions of strategies or trends. Although we believe that the expectations reflected in such 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 actual future results to differ materially from those described herein are the risks and uncertainties discussed in this Annual Report and those described from time to time in our other filings with the SEC include, but are not limited to, the following:

- Future supply and demand for our products
 - The extent of the dependence of certain of our businesses on certain market sectors
 - The cyclicity of our businesses
- Customer inventory levels (such as the extent to which our customers may, from time to time, accelerate purchases of titanium dioxide pigments ("TiO₂") in advance of anticipated price increases or defer purchases of TiO₂ in advance of anticipated price decreases)
 - Changes in raw material and other operating costs (such as energy costs)
- 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 TiO₂)
 - Competitive products and substitute products
 - Customer and competitor strategies
 - Potential consolidation or solvency of our competitors
 - The impact of pricing and production decisions
 - Competitive technology positions
- Possible disruption of our business or increases in the cost of doing business resulting from terrorist activities or global conflicts
 - The introduction of trade barriers
- Fluctuations in currency exchange rates (such as changes in the exchange rate between the U.S. dollar and each of the euro and the Norwegian krone)
- Operating interruptions (including, but not limited to, labor disputes, leaks, natural disasters, fires, explosions, unscheduled or unplanned downtime and transportation interruptions)
 - The timing and amounts of insurance recoveries
 - 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
 - The ultimate resolution of pending litigation
 - Possible future litigation

Should one or more of these risks materialize (or the consequences of such a development worsen), or should the underlying assumptions prove incorrect, actual results could differ materially from those forecasted or expected. We

disclaim any intention or obligation to update or revise any forward-looking statements whether as a result of changes in information, future events or otherwise.

PART I

ITEM 1. BUSINESS

General

Kronos International, Inc., a Delaware corporation, is registered in the Commercial Register of the Federal Republic of Germany. We are a wholly-owned subsidiary of Kronos Worldwide, Inc. (NYSE: KRO; "Kronos"). At December 31, 2009, (i) Valhi, Inc. (NYSE: VHI) held approximately 59% of Kronos' common stock and NL Industries, Inc. (NYSE: NL) held approximately 36% of Kronos' common stock, (ii) Valhi held approximately 83% of NL's outstanding common stock and (iii) Subsidiaries of Contran Corporation held approximately 93% of Valhi's outstanding common stock. Substantially all of Contran's outstanding voting stock is held by trusts established for the benefit of certain descendants of Harold C. Simmons (of which Mr. Simmons is trustee), or is held by persons or other entities related to Mr. Simmons. Consequently, Mr. Simmons may be deemed to control all of these companies.

Our principal place of business is in Leverkusen, Germany. We conduct Kronos' European value-added TiO₂ pigment operations. We, along with our distributors and agents sell our products to over 3,000 customers in approximately 100 countries with the majority of our sales in Europe. Our chemical businesses have operated in the European markets before the 1920's. We have considerable expertise and efficiency in the manufacture, sale, shipment and service of our products.

TiO₂ is an inorganic pigment used to impart whiteness, brightness and opacity for products such as coatings, plastics, paper, fibers, food, ceramics and cosmetics. TiO₂ is considered a "quality-of-life" product with demand and growth affected by gross domestic product and overall economic conditions in our markets in various parts of the world. TiO₂ derives its value from its whitening properties and hiding power (opacity), which is the ability to cover or mask other materials effectively and efficiently. TiO₂ is the largest commercially used whitening pigment because it has a high refractive rating giving it more hiding power than any other commercially produced white pigment. In addition, TiO₂ has excellent resistance to interaction with other chemicals, good thermal stability and resistance to ultraviolet degradation. We ship TiO₂ to our customers in either a powder form or a slurry form via rail, truck and ocean carrier. We, including our predecessors, have produced and marketed TiO₂ in Europe, North America and other parts of the world for over 80 years.

Per capita utilization of TiO₂ in the United States and Western Europe far exceeds that of other areas of the world. We expect these markets to continue to be the largest consumers of TiO₂ for the foreseeable future. It is probable that significant markets for TiO₂ could emerge in other areas of the world. China continues to develop into a significant market and as its economy continues to mature it is probable that quality-of-life products, including TiO₂, will experience greater demand in that country. In addition, growth in recent years in Eastern Europe and the Far East has been significant as the economies in these regions continue developing to the point that quality-of-life products, including TiO₂, experience greater demand. Industry demand declined in Eastern Europe significantly in 2009 due to the global economic crisis.

Sales of TiO₂ were about 86% of our net sales in 2009. The remaining 14% of net sales is made up of other product lines that are complementary to TiO₂. These other products are described as follows:

- We own and operate two ilmenite mines in Norway pursuant to a governmental concession with an unlimited term. We commenced production from our second mine in 2009. Ilmenite is a raw material used directly as a feedstock by some sulfate-process TiO₂ plants, including all of our sulfate-process plants. We also sell ilmenite ore to third-parties, some of whom are our competitors. The mines have estimated aggregate reserves which are

expected to last for at least another 60 years.

- We manufacture and sell iron-based chemicals, which are co-products and processed co-products of sulfate and chloride process TiO₂ pigment production. These co-product chemicals are marketed through our Ecochem division and are primarily used as treatment and conditioning agents for industrial effluents and municipal wastewater as well as in the manufacture of iron pigments, cement and agricultural products.
- We manufacture and sell titanium oxychloride and titanyl sulfate, which are side-stream specialty products from the production of TiO₂. Titanium oxychloride is used in specialty applications in the formulation of pearlescent pigments, production of electroceramic capacitors for cell phones and other electronic devices. Titanyl sulfate products are used in pearlescent pigments, natural gas pipe and other specialty applications.

Manufacturing and operation

We currently produce over 40 different TiO₂ grades under the Kronos™ trademark which provide a variety of performance properties to meet customers' specific requirements. Our major customers include domestic and international paint, plastics and paper manufacturers.

Extenders, such as kaolin clays, calcium carbonate and polymeric opacifiers, are used in a number of the same end-use markets as white pigments. However, the opacity in these products is not able to duplicate the performance characteristics of TiO₂, therefore we believe these products are not effective substitutes for TiO₂.

We produce TiO₂ in two crystalline forms: rutile and anatase. Rutile TiO₂ is manufactured using both a chloride production process and a sulfate production process, whereas anatase TiO₂ is only produced using a sulfate production process. Chloride process rutile is preferred for the majority of customer applications. From a technical standpoint, chloride process rutile has a bluer undertone and higher durability than sulfate process rutile. Although many end-use applications can use either form, chloride process rutile is the preferred form for use in coatings and plastics, the two largest end-use markets. Sulfate process anatase represents a much smaller percentage of annual global TiO₂ production and is preferred for use in selected paper products, ceramics, rubber tires, man-made fibers, food and cosmetics.

- Chloride production process. Approximately two-thirds of our current production capacity is based on the chloride process. The chloride process is a continuous process in which chlorine is used to extract rutile TiO₂. The chloride process typically has lower manufacturing costs than the sulfate process due to newer technology, higher yield, less waste, lower energy requirements and lower labor costs. The chloride process produces less waste than the sulfate process because much of the chlorine is recycled and feedstock bearing a higher titanium content is used.
- Sulfate production process. The sulfate process is a batch chemical process that uses sulfuric acid to extract both rutile and anatase TiO₂. In addition to the factors indicated above, the higher production costs associated with the sulfate process result in part from the need to process the spent sulfuric acid remaining at the end of the production process.

Once an intermediate TiO₂ pigment has been produced by either the chloride or sulfate process, it is "finished" into products with specific performance characteristics for particular end-use applications through proprietary processes involving various chemical surface treatments and intensive micronizing (milling). Due to environmental factors and customer considerations, the proportion of TiO₂ industry sales represented by chloride process pigments has increased relative to sulfate process pigments and, in 2009 chloride process production facilities represented approximately 60% of industry capacity.

We produced slightly over 257,000 metric tons of TiO₂ in 2009, down from the 350,000 metric tons we produced in 2008. Our average production capacity utilization rates were near or at full capacity in 2007 and 2008 and

approximately 71% in 2009. In late 2008, and as a result of the sharp decline in global demand, we experienced a build up in our inventory levels. In order to decrease our inventory levels and improve our liquidity, we implemented production curtailments during the first half of 2009. Consequently, our average production capacity utilization rates were approximately 51% during the first half of 2009 as compared to 92% during the second half of 2009.

Our production capacity has increased by approximately 30% over the past ten years due to debottlenecking programs, with only moderate capital expenditures. We believe that our annual attainable production capacity for 2010 is approximately 362,000 metric tons and we currently expect we will operate at approximately 90% to 95% of our attainable capacity. See Outlook in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Raw materials

The primary raw materials used in chloride process TiO₂ are titanium-containing feedstock (natural rutile ore or purchased slag), chlorine and coke. Chlorine and coke are available from a number of suppliers. Titanium-containing feedstock suitable for use in the chloride process is available from a limited but increasing number of suppliers principally in Australia, South Africa, Canada, India and the United States. Through Kronos (US), Inc., a wholly-owned subsidiary of Kronos, we purchase chloride process grade slag from Rio Tinto Iron and Titanium under a long-term supply contract that expires at the end of 2011. We purchase natural rutile ore primarily from Iluka Resources, Limited under a long-term supply contract that expires at the end of 2014. We have in the past been, and expect in the future will continue to be, successful in obtaining long-term extensions to these and other existing supply contracts prior to their expiration. We expect the raw materials purchased under these contracts to meet our chloride process feedstock requirements over the next several years.

The primary raw materials used in sulfate process TiO₂ are titanium-containing feedstock, primarily ilmenite or purchased sulfate grade slag and sulfuric acid. Sulfuric acid is available from a number of suppliers. Titanium-containing feedstock suitable for use in the sulfate process is available from a limited number of suppliers principally in Norway, Canada, Australia, India and South Africa. As one of the few vertically-integrated producers of sulfate process TiO₂ we own and operate rock ilmenite mines in Norway, which provided all of the feedstock for our European sulfate process TiO₂ plants in 2009. We expect ilmenite production from our mines to meet our sulfate process feedstock requirements for the foreseeable future and any remaining will be sold to third parties.

Many of our raw material contracts contain fixed quantities we are required to purchase, although these contracts allow for an upward or downward adjustment in the quantity purchased. The pricing under these agreements is generally negotiated annually.

The following table summarizes our raw materials procured or mined in 2009.

Production Process/Raw Material	Quantities of Raw Materials Procured or Mined (In thousands of metric tons)
Chloride process plants - purchased slag or natural rutile ore	199
Sulfate process plants - raw ilmenite ore mined & used internally	226

Competition

The TiO₂ industry is highly competitive. Our principal competitors are E.I. du Pont de Nemours & Co.; Millennium Inorganic Chemicals, Inc. (a subsidiary of National Titanium Dioxide Company Ltd. (Cristal)); Huntsman Corporation (Huntsman); Tronox Incorporated and Sachtleben Chemie. These competitors have estimated individual shares of TiO₂ production capacity ranging from 4% (for Sachtleben) to 22% (for DuPont) and an estimated aggregate share of worldwide TiO₂ production volume of approximately 60%. Tronox filed for Chapter 11 bankruptcy protection in January 2009, and has continued to operate as a debtor-in-possession since that date. In December 2009, Tronox announced its intention to restructure and emerge from Chapter 11. It remains unclear how and to what extent Tronox or a successor will compete in the TiO₂ industry at the conclusion of Tronox's bankruptcy proceedings.

We compete primarily on the basis of price, product quality, technical service and the availability of high-performance pigment grades. Although certain TiO₂ grades are considered specialty pigments, the majority of our grades and substantially all of our production are considered commodity pigments with price being one of the most significant competitive factors along with quality and customer service. We believe we are the leading seller of TiO₂ in Germany and are among the leading marketers in the Benelux and Scandinavian markets. We had an estimated 8% share of worldwide TiO₂ sales volume in 2009. Overall, we are Europe's second largest producer of TiO₂.

Over the past ten years, we and our competitors have increased industry capacity through debottlenecking projects. Although overall industry pigment demand is expected to be higher in 2010 as compared to 2009 as a result of improving worldwide economic conditions, we do not expect any significant efforts will be undertaken by us or our competitors to further increase capacity through such projects for the foreseeable future. If actual developments differ from our expectations, ours and the TiO₂ industry's performance could be unfavorably affected.

Worldwide capacity additions in the TiO₂ market resulting from construction of new plants require significant capital expenditures and substantial lead time (typically three to five years in our experience). We are not aware of any TiO₂ plants currently under construction and we believe it is not likely that any new plants will be constructed in Europe or North America in the foreseeable future.

Research and development

Our research and development activities are directed primarily at improving the chloride and sulfate production processes, improving product quality and strengthening our competitive position by developing new pigment applications. Our research and development activities are conducted at our Leverkusen, Germany facility. Our expenditures for research and development and certain technical support programs were approximately \$12 million in each of 2007, 2008 and 2009.

We continually seek to improve the quality of our grades and have been successful at developing new grades for existing and new applications to meet the needs of customers and increase product life cycle. Since 2004, we have added five new grades for plastics and coatings applications.

Patents and trademarks

We believe our patents held for products and production processes are important to us and our continuing business activities. We seek patent protection for our technical developments, principally in the United States, Canada and Europe, and from time to time we enter into licensing arrangements with third parties. Our existing patents generally have terms of 20 years from the date of filing and have remaining terms ranging from less than 1 year to 19 years. We seek to protect our intellectual property rights, including our patent rights, and from time to time are engaged in disputes relating to the protection and use of intellectual property relating to our products.

Our trademarks, including Kronos, are protected by registration in the United States and elsewhere with respect to those products we manufacture and sell. We also rely on unpatented proprietary knowledge and continuing technological innovation and other trade secrets to develop and maintain our competitive position. Our proprietary

chloride production process is an important part of our technology and our business could be harmed if we fail to maintain confidentiality of our trade secrets used in this technology.

Major customers

We sell to a diverse customer base and no single customer made up more than 10% of our sales for 2009. Our largest ten customers, excluding sales to Kronos and affiliates accounted for approximately 20% of sales in 2009.

Seasonality

Neither our business as a whole nor that of any of our principal product groups is seasonal to any significant extent. However, TiO₂ sales are generally higher in the second and third quarter of the year. This is due in part to the increase in paint production in the spring to meet demand during the spring and summer painting season.

Employees

As of December 31, 2009, we employed approximately 2,000 persons. Hourly employees in our production facilities are represented by a variety of labor unions, with labor agreements having various expiration dates. Our union employees are covered by master collective bargaining agreements in the chemicals industry that are generally renewed annually. We believe our labor relations are good.

Regulatory and environmental matters

Our operations are governed by various environmental laws and regulations. Certain of our operations are, or have been, engaged in the handling, manufacture or use of substances or compounds that may be considered toxic or hazardous within the meaning of applicable environmental laws and regulations. As with other companies engaged in similar businesses, certain of our past and current operations and products have the potential to cause environmental or other damage. We have implemented and continue to implement various policies and programs in an effort to minimize these risks. Our policy is to maintain compliance with applicable environmental laws and regulations at all of our facilities and to strive to improve our environmental performance. It is possible that future developments, such as stricter requirements in environmental laws and enforcement policies, could adversely affect our production, handling, use, storage, transportation, sale or disposal of such substances and could adversely affect our consolidated financial position and results of operations or liquidity.

While the laws regulating operations of industrial facilities in Europe vary from country to country, a common regulatory framework is provided by the European Union ("EU"). Germany and Belgium are members of the EU and follow its initiatives. Norway is not a member but generally patterns its environmental regulatory actions after the EU. We believe we have obtained all required permits and are in substantial compliance with applicable environmental requirements for our facilities.

At our sulfate plant facilities in Germany, we recycle weak sulfuric acid either through contracts with third parties or at our own facilities. In addition, at our German locations we have a contract with a third party to treat certain sulfate-process effluents. At our Norwegian plant, we ship spent acid to a third party location where it is used as a neutralization agent. These contracts may be terminated by either party after giving three or four years advance notice, depending on the contract.

From time to time, our facilities may be subject to environmental regulatory enforcement under U.S. and non-U.S. statutes. Typically we establish compliance programs to resolve these matters. Occasionally, we may pay penalties. To date such penalties have not involved amounts having a material adverse effect on our consolidated financial position, results of operations or liquidity. We believe that all of our facilities are in substantial compliance with applicable environmental laws.

In December 2006, the EU approved Registration, Evaluation and Authorization of Chemicals (“REACH”), which took effect on June 1, 2007 and will be phased-in over 11 years. Under REACH, companies that manufacture or import more than one ton of a chemical substance per year will be required to register such chemical substances in a central data base. REACH affects our European operations by imposing a testing, evaluation and registration program for many of the chemicals we use or produce in Europe. We have established a REACH team that is working to identify and list all substances purchased, manufactured or imported by or for us in the EU. We spent \$.4 million in 2007, \$.5 million in 2008 and \$.7 million in 2009 on REACH compliance and we do not anticipate that future compliance costs will be material to us.

Capital expenditures in 2009 related to ongoing environmental compliance, protection and improvement programs were \$3.1 million and are currently expected to be approximately \$12 million in 2010, including approximately \$9.7 million for a desulfurization unit at our Belgian facility.

Website and other available information

Our fiscal year ends December 31. Our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and any amendments to those reports are available on Kronos’ website at www.kronosww.com, as we do not maintain our own website. These reports are available on the website, without charge, as soon as is reasonably practicable after we file or furnish them electronically with the Securities and Exchange Commission (“SEC”). Information contained on this website is not part of this report. We will also provide free copies of such documents upon written request. Such requests should be directed to the Corporate Secretary at our address on the cover page of this Form 10-K.

The public may read and copy any materials we file with the SEC at the SEC’s Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. The public may obtain information about the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. We are an electronic filer and the SEC maintains an internet website that contains reports, proxy and information statements and other information regarding issuers that file electronically with the SEC at www.sec.gov.

ITEM 1A. RISK FACTORS

Below are certain risk factors associated with our business. In addition to the potential effect of these risk factors discussed below, any risk factor which could result in reduced earnings or operating losses, or reduced liquidity, could in turn adversely affect our ability to service our liabilities or pay dividends on our common stock or adversely affect the quoted market prices for our securities.

Demand for, and prices of, certain of our products are influenced by changing market conditions and we are currently operating in a depressed worldwide market for our products, which may result in reduced earnings or operating losses.

Approximately 86% of our revenues are attributable to sales of TiO₂. Pricing within the global TiO₂ industry over the long term is cyclical and changes in economic conditions, especially in Western industrialized nations, can significantly impact our earnings and operating cash flows. The current world-wide economic downturn depressed sales volumes in 2009, principally in the first half of the year, and we are unable to predict with a high degree of certainty when demand will return to the levels experienced prior to the commencement of the downturn. This may result in reduced earnings or operating losses.

Historically, the markets for many of our products have experienced alternating periods of increasing and decreasing demand. Relative changes in the selling prices for our products are one of the main factors that affect the level of our

profitability. In periods of increasing demand, our selling prices and profit margins generally will tend to increase, while in periods of decreasing demand our selling prices and profit margins generally tend to decrease. Huntsman closed one of its European facilities and Tronox closed its Savannah, Georgia facility in 2009. We believe further shutdowns or closures in the industry are possible. The closures may not be sufficient to alleviate the current excess industry capacity and such conditions may be further aggravated by anticipated or unanticipated capacity additions or other events.

The demand for TiO₂ during a given year is also subject to annual seasonal fluctuations. TiO₂ sales are generally higher in the second and third quarters of the year. This is due in part to the increase in paint production in the spring to meet demand during the spring and summer painting season. See Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations" for further discussion on production and price changes.

We sell several of our products in mature and highly-competitive industries and face price pressures in the markets in which we operate, which may result in reduced earnings or operating losses.

The global markets in which we operate our business are highly competitive. Competition is based on a number of factors, such as price, product quality and service. Some of our competitors may be able to drive down prices for our products because their costs are lower than our costs. In addition, some of our competitors' financial, technological and other resources may be greater than our resources and such competitors may be better able to withstand changes in market conditions. Our competitors may be able to respond more quickly than we can to new or emerging technologies and changes in customer requirements. Further, consolidation of our competitors or customers may result in reduced demand for our products or make it more difficult for us to compete with our competitors. New competitors could emerge by modifying their existing production facilities so they could manufacture products that compete with our products. The occurrence of any of these events could result in reduced earnings or operating losses.

Higher costs or limited availability of our raw materials may reduce our earnings and decrease our liquidity.

The number of sources for and availability of, certain raw materials is specific to the particular geographical region in which a facility is located. For example, titanium-containing feedstocks suitable for use in our TiO₂ facilities are available from a limited number of suppliers around the world. Political and economic instability in the countries from which we purchase our raw material supplies could adversely affect their availability. If our worldwide vendors were unable to meet their contractual obligations and we were unable to obtain necessary raw materials, we could incur higher costs for raw materials or may be required to reduce production levels. We may not always be able to increase our selling prices to offset the impact of any higher costs or reduced production levels, which could reduce our earnings and decrease our liquidity.

Negative global economic conditions increase the risk that we could suffer unrecoverable losses on our customers' accounts receivable which would adversely affect our financial results.

We extend credit and payment terms to our customers. Although we have an ongoing process of evaluating customers' financial condition, we could suffer significant losses if a customer fails and/or is unable to pay. A significant loss of an accounts receivable would have a negative impact on our results of operations, financial condition and liquidity.

Our leverage may impair our financial condition or limit our ability to operate our businesses.

We currently have a significant amount of debt. As of December 31, 2009, our total consolidated debt was approximately \$596.5 million, which relates to our 6.5% Senior Secured Notes and a revolving credit facility of certain wholly-owned subsidiaries. Our level of debt could have important consequences to our stockholders and creditors, including:

- making it more difficult for us to satisfy our obligations with respect to our liabilities;
 - increasing our vulnerability to adverse general economic and industry conditions;
- requiring that a portion of our cash flows from operations be used for the payment of interest on our debt, which reduces our ability to use our cash flow to fund working capital, capital expenditures, dividends on our common stock, acquisitions or general corporate requirements;
- limiting our ability to obtain additional financing to fund future working capital, capital expenditures, acquisitions or general corporate requirements;
- limiting our flexibility in planning for, or reacting to, changes in our business and the industry in which we operate; and
 - placing us at a competitive disadvantage relative to other less leveraged competitors.

In addition to our indebtedness, we are party to various lease and other agreements pursuant to which, along with our indebtedness, we are committed to pay approximately \$146.3 million in 2010. Our ability to make payments on and refinance our debt and to fund planned capital expenditures, depends on our future ability to generate cash flow. To some extent, this is subject to general economic, financial, competitive, legislative, regulatory and other factors that are beyond our control. In addition, our ability to borrow funds under our subsidiaries' credit facilities in the future will, in some instances, depend in part on these subsidiaries' ability to maintain specified financial ratios and satisfy certain financial covenants contained in the applicable credit agreement.

Our business may not generate cash flows from operating activities sufficient to enable us to pay our debts when they become due and to fund our other liquidity needs. As a result, we may need to refinance all or a portion of our debt before maturity. We may not be able to refinance any of our debt in a timely manner on favorable terms, if at all, in the current credit markets. Any inability to generate sufficient cash flows or to refinance our debt on favorable terms could have a material adverse effect on our financial condition.

Global climate change legislation could negatively impact our financial results or limit our ability to operate our businesses.

We operate production facilities in several countries. We believe all of our worldwide production facilities are in substantial compliance with applicable environmental laws. In many of the countries in which we operate, legislation has been passed, or proposed legislation is being considered, to limit greenhouse gases through various means, including emissions permits and/or energy taxes. In several of our production facilities, we consume large amounts of energy, including electricity and natural gas. To date, the permit system in effect in the various countries in which we operate has not had a material adverse effect on our financial results. However, if greenhouse gas legislation were to be enacted in one or more countries, it could negatively impact our future results from operations through increased costs of production, particularly as it relates to our energy requirements. If such increased costs of production were to materialize, we may be unable to pass price increases onto our customers to compensate for increased production costs, which may decrease our liquidity, operating income and results of operations.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

We currently operate four TiO₂ facilities and two ilmenite mines at the following locations. We own all such facilities, unless otherwise indicated.

Location	Description
Leverkusen, Germany (1)	TiO ₂ production, chloride and sulfate process, co-products

Nordenham, Germany	TiO ₂ production, sulfate process, co-products
Langerbrugge, Belgium	TiO ₂ production, chloride process, co-products, titanium chemicals products
Fredrikstad, Norway (2)	TiO ₂ production, sulfate process, co-products
Hauge i Dalane, Norway	Ilmenite mines

(1) The Leverkusen facility is located within an extensive manufacturing complex owned by Bayer AG. We own the Leverkusen facility, which represents about one-half of our current TiO₂ production capacity, but we lease the land under the facility from Bayer AG under a long term agreement which expires in 2050. Lease payments are periodically negotiated with Bayer for periods of at least two years at a time. Bayer provides some raw materials, including chlorine, auxiliary and operating materials, utilities and services necessary to operate the Leverkusen facility under separate supplies and services agreements.

(2) The Fredrikstad plant is located on public land and is leased until 2013, with an option to extend the lease for an additional 50 years.

Our corporate headquarters is located in Dallas, Texas. We have under lease various corporate and administrative offices located in the U.S. and various sales offices located in France, the Netherlands and the U.K. The roads leading to our facilities are generally maintained by the applicable local government and are adequate for our purposes.

Information on our properties is incorporated by reference to Item 1: Business, Manufacturing and Operations above. See Note 12 to our Consolidated Financial Statements for information on our leases.

ITEM 3. LEGAL PROCEEDINGS

We are involved in various environmental, contractual, intellectual property, product liability and other claims and disputes incidental to our business. Information called for by this Item is incorporated by reference to Note 12 to our Consolidated Financial Statements.

ITEM 4. RESERVED

PART II

ITEM 5. MARKET FOR OUR COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

All of our common stock is held by Kronos. There is no established public trading market for our common stock. The indenture governing our 6.5% Senior Secured Notes Due 2013 limits our ability to pay dividends or make other restricted payments, as defined. The aggregate amount of dividends and other restricted payments since June 2002 may not exceed 75% of the aggregate consolidated net income, as defined in the indenture, plus \$25 million. At December 31, 2009, there was no availability for dividends or other restricted payments, as defined, therefore we currently do not expect to pay dividends or make other restricted payments as permitted by the indenture. Declaration and payment of future dividends is discretionary and the amount thereof is dependent upon our results of operations, financial condition, contractual limitations, cash requirements for our businesses and other factors deemed relevant by our Board of Directors. See Note 6 to our Consolidated Financial Statements.

We paid \$34.2 million of dividends to Kronos in 2007 and \$34.9 million in 2008. We paid no dividends to Kronos in 2009.

ITEM 6. SELECTED FINANCIAL DATA

The following selected financial data should be read in conjunction with our Consolidated Financial Statements and Item 7 - "Management's Discussion and Analysis of Financial Condition and Results of Operations."

	Years ended December 31,				
	2005	2006(2)	2007	2008	2009
	(In millions, except ratios)				
STATEMENTS OF OPERATIONS DATA:					
Net sales	\$850.9	\$914.2	\$946.1	\$952.9	\$819.9
Gross margin	238.4	223.0	196.4	170.4	67.2
Income (loss) from operations	138.2	107.4	78.7	45.1	(33.8)
Net income (loss)	60.3	73.7	(58.8)	21.3	(46.5)
BALANCE SHEET DATA (at year end):					
Total assets	\$955.3	\$1,080.6	\$1,103.1	\$1,053.5	\$1,013.9
Long-term debt including current maturities	453.8	529.8	590.8	605.6	596.5
Stockholder's equity	183.3	211.5	181.4	137.3	103.4
STATEMENTS OF CASH FLOW DATA:					
Net cash provided by (used in):					
Operating activities	\$92.7	\$62.5	\$84.9	\$1.0	\$67.5
Investing activities	(35.8)	(47.1)	(42.5)	(61.7)	(19.5)
Financing activities	(8.5)	(31.1)	(34.0)	7.2	(33.6)
TiO2 OPERATING STATISTICS:					
Sales volume*	326	353	348	317	304
Production volume*	335	348	350	350	257
Production rate as a percentage of capacity	Full	Full	98 %	97 %	71 %
OTHER FINANCIAL DATA:					
Ratio of earnings to combined	3.6	2.0	2.6	1.5	-

fixed charges (unaudited) (1)

* Metric tons in thousands

- (1) Fixed charges represents, as applicable, the sum of (i) total interest expense and (ii) the interest component of rent expense (calculated as one-third of rent expense). Earnings represents, as applicable, the sum of (i) fixed charges, (ii) income before income taxes and (iii) amortization of capitalized interest. Total earnings available for fixed charges were insufficient to cover fixed charges for the year ended December 31, 2009 by \$73.4 million. As a result, the ratio of earnings to combined fixed charges is not meaningful for 2009.
- (2) We adopted the asset and liability recognition provisions of Accounting Standard Codification Topic 715 Compensation – Retirement Benefits effective December 31, 2006.

ITEM 7. 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 TiO₂. TiO₂ is used for a variety of manufacturing applications, including plastics, paints, paper and other industrial products. For 2009, approximately 77% of our sales volumes were sold into European markets. We believe we are the second largest producer of TiO₂ in Europe with an estimated 19% share of European TiO₂ sales volumes in 2009. Our production facilities are located throughout Europe.

We consider TiO₂ 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 TiO₂ to grow by 2% to 3% per year. This is 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 TiO₂ 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 TiO₂ inventory levels of our customers. We believe our customers’ inventory levels are partly influenced by their expectation for future changes in the market TiO₂ selling prices. The majority of our TiO₂ grades and substantially all of our production are considered commodity pigment products; we compete for sales primarily on the basis of price.

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

- TiO₂ selling prices,
- currency exchange rates (particularly the exchange rate for the U.S. dollar relative to the euro) and the Norwegian krone to the euro,
 - our TiO₂ sales and production volumes, and
 - manufacturing costs, particularly raw materials, maintenance and energy-related expenses.

Our key performance indicators are our TiO₂ average selling prices and our level of TiO₂ sales and production volumes. TiO₂ selling prices generally follow industry trends and prices will increase or decrease generally as a result of competitive market pressures.

In addition, our effective income tax rate in each of 2007, 2008 and 2009 has been impacted by certain favorable and unfavorable developments.

Executive summary

We reported a net loss of \$46.5 million in 2009 compared to net income of \$21.3 million in 2008. The \$67.8 million decrease in net income from 2008 to 2009 is due primarily to the net effects of (i) lower income (loss) from operations in 2009 resulting principally from lower sales and production volumes and (ii) an income tax benefit we recognized in 2008. In late 2008, as a result of the sharp decline in global demand, we experienced a build up in our inventory levels. In order to decrease our inventory levels and improve our liquidity, we implemented production curtailments during the first half of 2009. In addition, throughout all of 2009 we implemented cost controls and reduced our capital spending. Through these actions we successfully reduced our inventory and increased our liquidity, although the resulting curtailments led to a net loss in 2009 due to the large amount of unabsorbed fixed production costs we charged to expense as incurred.

We reported net income of \$21.3 million in 2008 compared to a net loss of \$58.8 million in 2007. The \$80.1 million increase in net income from 2007 to 2008 is due primarily to the net effects of (i) an income tax benefit we recognized in 2008, (ii) lower income from operations in 2008 resulting principally from lower sales volumes and higher raw material and energy costs and (iii) an income tax charge we recognized in 2007 associated with the adjustment of certain German income tax attributes.

Net income for 2009 includes a \$4.7 million non-cash deferred income tax benefit related to a net decrease in our reserve for uncertain tax positions.

Net income for 2008 includes a \$7.2 million income tax benefit related to a European Court ruling that resulted in the favorable resolution of certain income tax issues in Germany and an increase in the amount of our German corporate and trade tax net operating loss carryforwards.

Net income for 2007 includes (i) a non-cash charge of \$90.8 million relating to a decrease in our net deferred income tax asset in Germany resulting from the reduction of the German income tax rates, (ii) a non-cash charge of \$8.7 million related to the adjustment of certain German income tax attributes and (iii) a \$.7 million income tax benefit resulting from a net reduction in our reserve for uncertain tax positions.

Each of these items is more fully discussed below and/or in the Notes to our Consolidated Financial Statements.

We currently expect improved results from operations in 2010 compared to 2009 primarily as a result of higher sales volumes, higher average selling prices and lower production costs as compared to 2009. We currently expect to report net income in 2010 as compared to the net loss in 2009 due to higher expected income from operations in 2010. In addition, and as a consequence of a European Court ruling that resulted in a favorable resolution of certain income tax issues in Germany, during the first quarter of 2010 the German tax authorities agreed to an increase in our German net operating loss carryforwards. Accordingly, we expect to report a non-cash income tax benefit of approximately \$35.2 million in the first quarter of 2010.

Critical accounting policies and estimates

The accompanying "Management's Discussion and Analysis of Financial Condition and Results of Operations" is based upon our Consolidated Financial Statements, which we have prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP"). The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of revenues and expenses during the reported period. On an on-going basis, we evaluate our estimates, including those related to the recoverability of long-lived assets, pension benefit obligations and the underlying actuarial assumptions related thereto, the realization of deferred income tax assets and accruals for, litigation, income tax and other contingencies. We base our estimates on historical experience and on various other assumptions which we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the reported amounts of assets, liabilities, revenues and expenses. Actual results may differ significantly from

previously-estimated amounts under different assumptions or conditions.

The following critical accounting policies affect our more significant judgments and estimates used in the preparation of our Consolidated Financial Statements:

- **Long-lived assets.** We recognize an impairment charge associated with our long-lived assets, including property and equipment, whenever we determine that recovery of such long-lived asset is not probable. Such determination is made in accordance with the applicable GAAP requirements of Accounting Standard Codification (“ASC”) Topic 360-10-35, Property, Plant and Equipment and is based upon, among other things, estimates of the amount of future net cash flows to be generated by the long-lived asset and estimates of the current fair value of the asset. Significant judgment is required in estimating such cash flows. Adverse changes in such estimates of future net cash flows or estimates of fair value could result in an inability to recover the carrying value of the long-lived asset, thereby possibly requiring an impairment charge to be recognized in the future. We do not assess our property and equipment for impairment unless certain impairment indicators specified in ASC Topic 360-10-35 are present. We did not evaluate any long-lived assets for impairment during 2009 because no such impairment indicators were present.
- **Pension plans.** We maintain various defined benefit pension plans. The amounts recognized as defined benefit pension expenses, and the reported amounts of pension asset and accrued pension costs, are actuarially determined based on several assumptions, including discount rates, expected rates of returns on plan assets and expected health care trend rates. Variances from these actuarially assumed rates will result in increases or decreases, as applicable, in the recognized pension obligations, pension expenses and funding requirements. These assumptions are more fully described below under “Defined Benefit Pension Plans.”
- **Income taxes.** We recognize deferred taxes for future tax effects of temporary differences between financial and income tax reporting in accordance with the recognition criteria of ASC Topic 740 Income Taxes. We record a valuation allowance to reduce our deferred income tax assets to the amount that is believed to be realized under the more-likely-than-not recognition criteria. While we have considered future taxable income and ongoing prudent and feasible tax planning strategies in assessing the need for a valuation allowance, it is possible that in the future we may change our estimate of the amount of the deferred income tax assets that would more-likely-than-not be realized in the future, resulting in an adjustment to the deferred income tax asset valuation allowance that would either increase or decrease, as applicable, reported net income in the period such change in estimate was made. For example, we have substantial net operating loss carryforwards in Germany (the equivalent of \$941 million for German corporate purposes and \$288 million for German trade tax purposes at December 31, 2009). At December 31, 2009, 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 operating 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.

We record a reserve for uncertain tax positions in accordance with ASC Topic 740 Income Taxes for tax positions where we believe it is more-likely-than-not our position will not prevail with the applicable tax authorities. It is possible that in the future we may change our assessment regarding the probability that our tax positions will prevail that would require an adjustment to the amount of our reserve for uncertain tax positions that could either increase or decrease, as applicable, reported net income in the period the change in assessment was made.

In addition, we evaluate at the end of each reporting period as to whether or not some or all of the undistributed earnings of our non-U.S. subsidiaries are permanently reinvested (as that term is defined in GAAP). While we may have concluded in the past that some of such undistributed earnings are permanently reinvested, facts and circumstances can change in the future and it is possible that a change in facts and circumstances, such as a change in the expectation regarding the capital needs of our non-U.S. subsidiaries, could result in a conclusion that some or all of such undistributed earnings are no longer permanently reinvested. In such an event, we would be required to recognize a deferred income tax liability in an amount equal to the estimated incremental U.S. income tax and withholding tax liability that would be generated if all of such previously-considered permanently reinvested undistributed earnings were distributed to the U.S.

- **Contingencies.** We record accruals for legal and other contingencies when estimated future expenditures associated with such contingencies and commitments become probable and the amounts can be reasonably estimated. However, new information may become available, or circumstances (such as applicable laws and regulations) may change, thereby resulting in an increase or decrease in the amount required to be accrued for such matters (and therefore a decrease or increase in reported net income in the period of such change).

Income from operations is impacted by certain of these significant judgments and estimates, such as allowance for doubtful accounts, reserves for obsolete or unmarketable inventories, impairment of long-lived assets, defined benefit pension plans and loss accruals. In addition, net income (loss) is impacted by the significant judgments and estimates for deferred income tax asset valuation allowances and loss accruals.

Comparison of 2009 to 2008 Results of Operations

	Year ended December 31,					
	2008		2009			
	(Dollars in millions)					
Net sales	\$952.9	100	%	\$819.9	100	%
Cost of sales	782.5	82		752.7	92	
Gross margin	170.4	18		67.2	8	
Other operating income and expenses, net	125.3	13		101.0	12	
Income (loss) from operations	\$45.1	5	%	\$(33.8)	(4))%
					%	
					Change	
TiO2 operating statistics:						
Sales volumes*	317			304	(4))%
Production volumes*	350			257	(27))%
Percent change in net sales:						
TiO2 product pricing					(2))%
TiO2 sales volumes					(4))
TiO2 product mix					(4))
Changes in currency exchange rates					(4))
Total					(14))%

* Thousands of metric tons

Net sales – Net sales decreased 14% or \$133.0 million for 2009 compared to 2008, primarily due to a 4% decrease in sales volumes and a 2% decrease in average selling prices. Variations in grades of products sold unfavorably impacted net sales by 4%. In addition, we estimate the unfavorable effect of changes in currency exchange rates decreased our net sales by approximately \$40 million, or 4%, as compared to the same period in 2008. TiO₂ selling prices generally follow industry trends and prices will increase or decrease generally as a result of competitive market pressures. As a result of these market pressures our average TiO₂ prices in 2009 were 2% lower than the prior year. During the first half of 2009, our average selling prices were generally declining, as we faced weak demand and excessive inventory levels. Beginning in mid-2009, we and our competitors announced various price increases. A portion of these price increase announcements were implemented during the third and fourth quarters of 2009, and as a result our average selling price at the end of the second half of 2009 was 2% higher than at the end of the first half of 2009.

Our 4% decrease in sales volumes in 2009 is primarily due to lower sales volumes in the European market as a result of a global weakening of demand due to poor overall economic conditions, principally in the first half of 2009.

Cost of sales - Cost of sales decreased 4% or \$29.8 million for 2009, compared to 2008, primarily due to the net impact of a 4% decrease in sales volumes, lower raw material costs of \$14.3 million, a decrease in maintenance costs of \$24.1 million as part of our efforts to reduce operating costs where possible and currency fluctuations (primarily the euro). The cost of sales as a percentage of net sales increased to 92% in the year ended December 31, 2009 compared to 82% in the same period of 2008 primarily due to the unfavorable effects of the significant amount of unabsorbed fixed production costs resulting from reduced production volumes during the first six months of 2009. TiO₂ production volumes decreased due to temporary plant curtailments during the first six months of 2009 that resulted in approximately \$70 million of unabsorbed fixed production costs which were charged directly to cost of sales in the first six months of 2009.

Income (loss) from operations – Income (loss) from operations declined by \$78.9 million from income from operations of \$45.1 million in 2008 to a loss from operations of \$33.8 million in 2009. Income (loss) from operations as a percentage of net sales declined to (4%) in 2009 from 5% in 2008. This decrease is driven by the decline in gross margin, which fell to 8% for 2009 compared to 18% for 2008. Our gross margin has decreased primarily because of the significant amount of unabsorbed fixed production costs resulting from the production curtailments we implemented during the first six months of 2009 as well as the effect of lower sales volumes. However, changes in currency rates have positively affected our gross margin and income (loss) from operations. We estimate that changes in currency exchange rates increased income (loss) from operations by approximately \$24 million in 2009 as compared to 2008.

As a percentage of net sales, selling, general and administrative expenses were relatively consistent at approximately 14% for both 2008 and 2009.

Other non-operating income and expense, net – Interest expense decreased \$0.5 million from \$40.7 million in 2008 to \$40.2 million in 2009 due to changes in currency exchange rates which offset the effect of increased average borrowings under our revolving credit facility and higher interest rates on our revolving credit facility. The interest expense we recognize will vary with fluctuations in the euro exchange rate.

Income tax provision (benefit) – Our income tax benefit was \$27.3 million in 2009 compared to an income tax provision of \$1.4 million in 2008. See Note 7 to our Consolidated Financial Statements for a tabular reconciliation of our statutory income tax benefit to our actual tax benefit. Some of the more significant items impacting this reconciliation are summarized below.

- Our income tax benefit for 2009 includes a non-cash benefit of \$4.7 million related to a net decrease in our reserve for uncertain tax positions, primarily as a result of the resolution of tax audits in Belgium and Germany in the third and fourth quarters.

- Our income tax benefit for 2008 includes a non-cash benefit of \$7.2 million relating to a European Court ruling that resulted in the favorable resolution of certain income tax issues in Germany and an increase in the amount of our German corporate and trade tax net operating loss carryforwards.

Comparison of 2008 to 2007 Results of Operations

	Year ended December 31,					
	2007		2008			
	(Dollars in millions)					
Net sales	\$946.1	100	%	\$952.9	100	%
Cost of sales	749.7	79		782.5	82	
Gross margin	196.4	21		170.4	18	
Other operating income and expenses, net	117.7	13		125.3	13	
Income from operations	\$78.7	8	%	\$45.1	5	%
					%	Change
TiO2 operating statistics:						
Sales volumes*	348			317	(9)%
Production volumes*	350			350	-	
Percent change in net sales:						
TiO2 product pricing					1	%
TiO2 sales volumes					(9)
TiO2 product mix					2	
Changes in currency exchange rates					7	
Total					1	%

* Thousands of metric tons

Net sales – Net sales increased 1% or \$6.8 million for 2008 compared to 2007, primarily due to favorable currency exchange rates, which we estimate increased our net sales for 2008 by approximately \$62 million, or 7%, compared to the same period in 2007. Variations in grades of products sold favorably impacted net sales by 2%, along with a 1% increase in average TiO2 selling prices. TiO2 selling prices generally follow industry trends and prices will increase or decrease generally as a result of competitive market pressures. During the early part of 2008, our average selling prices were generally flat. During the second and third quarters of 2008, we and our competitors announced various price increases and surcharges in response to higher operating costs. A portion of these increase announcements were implemented during the second, third and fourth quarters of 2008. The positive impact of currency, product mix and pricing in 2008 were substantially offset by a 9% decrease in sales volumes.

Our 9% decrease in sales volumes in 2008 is primarily due to lower sales volumes in all markets as a result of a global weakening of demand due to poor overall economic conditions.

Cost of sales - Cost of sales increased 4% or \$32.8 million for 2008, compared to 2007, due to the impact of a 20% or approximately \$22 million increase in utility costs (primarily energy costs), an 11% or approximately \$32 million increase in raw material costs and currency fluctuations (primarily the euro). The cost of sales as a percentage of net

sales increased to 82% in the year ended December 31, 2008 compared to 79% in the same period of 2007 primarily due to the net effects of higher operating costs and slightly higher average selling prices.

Income from operations – Income from operations in 2008 declined by 43% to \$45.1 million compared to 2007; income from operations as a percentage of net sales decreased to 5% in 2008 from 8% for 2007. The decline in income from operations is driven by the decline in gross margin, which decreased to 18% in 2008 compared to 21% in 2007. While our average TiO₂ selling prices were higher in 2008, our gross margin decreased primarily because of lower sales volumes and higher manufacturing costs, which more than offset the impact of higher sales prices and the positive effect of changes in currency rates. Changes in currency rates have also positively affected our gross margin. We estimate the positive effect of changes in currency exchange rates increased income from operations by approximately \$8 million when comparing 2008 to 2007.

As a percentage of net sales, selling, general and administrative expenses were relatively consistent at approximately 13% for both 2007 and 2008.

Other non-operating income and expense, net – Interest expense increased \$2.9 million from \$37.8 million for 2007 to \$40.7 million for 2008 due to unfavorable changes in currency exchange rates in 2008 compared to 2007 and increased borrowings in 2008 (primarily under our revolving credit facility). The interest expense we recognize will vary with fluctuations in the euro exchange rate.

Provision (benefit) for income taxes – Our income tax provision was \$1.4 million for 2008 compared to \$122.4 million for 2007. See Note 7 to our Consolidated Financial Statements for a tabular reconciliation of our statutory income tax expense to our actual tax expense. Some of the more significant items impacting this reconciliation are summarized below.

- Our income tax expense for 2008 includes a non-cash benefit of \$7.2 million relating to a European Court ruling that resulted in the favorable resolution of certain income tax issues in Germany and an increase in the amount of our German corporate and trade tax net operating loss carryforwards.
 - Our income tax expense in 2007 includes:
 - a non-cash charge of \$90.8 million relating to a decrease in our net deferred income tax asset in Germany resulting from the reduction in its income tax rates;
 - a non-cash charge of \$8.7 million relating to the adjustment of certain German income tax attributes; and
 - a non-cash income tax benefit of \$.7 million resulting from a net reduction in our reserve for uncertain tax positions.

Effects of currency exchange rates

All of our operations and assets are located outside the United States (primarily in Germany, Belgium and Norway). The majority of our sales are denominated in currencie