

NL INDUSTRIES INC
Form 10-Q
August 05, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarter ended June 30, 2016

Commission file number 1-640

NL INDUSTRIES, INC.

(Exact name of Registrant as specified in its charter)

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

incorporation or organization)

5430 LBJ Freeway, Suite 1700

Dallas, Texas 75240-2697

(Address of principal executive offices)

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

Edgar Filing: NL INDUSTRIES INC - Form 10-Q

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 July 29, 2016: 48,705,884.

NL INDUSTRIES, INC. AND SUBSIDIARIES

INDEX

	Page number
Part I. FINANCIAL INFORMATION	
Item 1. Financial Statements	
<u>Condensed Consolidated Balance Sheets - December 31, 2015; June 30, 2016 (unaudited)</u>	3
<u>Condensed Consolidated Statements of Operations (unaudited) – Three and six months ended June 30, 2015 and 2016</u>	5
<u>Condensed Consolidated Statements of Comprehensive Income (Loss) (unaudited) – Three and six months ended June 30, 2015 and 2016</u>	6
<u>Condensed Consolidated Statement of Equity (unaudited) – Six months ended June 30, 2016</u>	7
<u>Condensed Consolidated Statements of Cash Flows (unaudited) - Six months ended June 30, 2015 and 2016</u>	8
<u>Notes to Condensed Consolidated Financial Statements (unaudited)</u>	9
Item 2. <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	22
Item 3. <u>Quantitative and Qualitative Disclosure About Market Risk</u>	40
Item 4. <u>Controls and Procedures</u>	40
Part II. <u>OTHER INFORMATION</u>	
Item 1. <u>Legal Proceedings</u>	42
Item 1A. <u>Risk Factors</u>	42
Item 6. <u>Exhibits</u>	42
Items 2, 3, 4 and 5 of Part II are omitted because there is no information to report.	

NL INDUSTRIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands)

	December 31, 2015	June 30, 2016 (unaudited)
ASSETS		
Current assets:		
Cash and cash equivalents	\$96,462	\$ 102,056
Restricted cash and cash equivalents	3,246	3,399
Accounts and other receivables, net	8,977	12,682
Inventories, net	15,098	14,124
Prepaid expenses and other	981	1,586
Total current assets	124,764	133,847
Other assets:		
Marketable securities	19,260	22,566
Investment in Kronos Worldwide, Inc.	140,695	133,000
Goodwill	27,156	27,156
Other assets, net	3,331	3,578
Deferred income taxes	11	11
Total other assets	190,453	186,311
Property and equipment:		
Land	5,138	5,138
Buildings	21,502	22,788
Equipment	64,051	65,445
Construction in progress	1,567	455
	92,258	93,826
Less accumulated depreciation	58,152	60,003
Net property and equipment	34,106	33,823
Total assets	\$349,323	\$ 353,981

NL INDUSTRIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS (CONTINUED)

(In thousands)

	December 31, 2015	June 30, 2016 (unaudited)
LIABILITIES AND EQUITY		
Current liabilities:		
Accounts payable	\$4,557	\$4,378
Accrued and other current liabilities	10,783	8,469
Accrued environmental remediation and related costs	8,668	11,385
Total current liabilities	24,008	24,232
Noncurrent liabilities:		
Accrued pension costs	14,155	13,875
Accrued postretirement benefits (OPEB) costs	2,773	2,617
Accrued environmental remediation and related costs	104,465	103,728
Deferred income taxes	25,035	27,031
Other	13,636	13,596
Total noncurrent liabilities	160,064	160,847
Equity:		
NL stockholders' equity:		
Common stock	6,086	6,088
Additional paid-in capital	300,543	300,674
Retained earnings	88,679	87,055
Accumulated other comprehensive loss	(245,358)	(240,670)
Total NL stockholders' equity	149,950	153,147
Noncontrolling interest in subsidiary	15,301	15,755
Total equity	165,251	168,902
Total liabilities and equity	\$349,323	\$353,981
Commitments and contingencies (Notes 11 and 13)		

See accompanying notes to Condensed Consolidated Financial Statements.

4

NL INDUSTRIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)

	Three months ended June 30, 2015 2016 (unaudited)		Six months ended June 30, 2015 2016	
Net sales	\$28,918	\$27,107	\$56,808	\$54,182
Cost of sales	19,758	18,621	39,082	37,491
Gross margin	9,160	8,486	17,726	16,691
Selling, general and administrative expense	4,854	4,769	9,719	9,621
Other operating income (expense):				
Insurance recoveries	233	233	3,367	323
Other income	17	5	17	5
Corporate expense	(5,656)	(3,334)	(9,487)	(8,983)
Income (loss) from operations	(1,100)	621	1,904	(1,585)
Equity in earnings (losses) of Kronos Worldwide, Inc.	(48,589)	497	(42,984)	(653)
Other income - interest and dividend income	282	377	584	730
Income (loss) before income taxes	(49,407)	1,495	(40,496)	(1,508)
Income tax provision (benefit)	(20,507)	330	(21,953)	(492)
Net income (loss)	(28,900)	1,165	(18,543)	(1,016)
Noncontrolling interest in net income of subsidiary	367	320	682	608
Net income (loss) attributable to NL stockholders	\$(29,267)	\$845	\$(19,225)	\$(1,624)
Amounts attributable to NL stockholders:				
Basic and diluted net income (loss) per share	\$(.60)	\$.02	\$(.39)	\$(.03)
Weighted average shares used in the calculation				
of net income (loss) per share	48,687	48,699	48,685	48,695

See accompanying notes to Condensed Consolidated Financial Statements.

5

NL INDUSTRIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(In thousands)

	Three months ended June 30, 2015		Six months ended June 30, 2015	
	2016	2015	2016	2015
	(unaudited)			
Net income (loss)	\$ (28,900)	\$ 1,165	\$ (18,543)	\$ (1,016)
Other comprehensive income (loss), net of tax:				
Marketable securities	(5,358)	3,730	(7,144)	2,199
Currency translation	1,188	(980)	(11,771)	1,851
Interest rate swap	-	(157)	-	(728)
Defined benefit pension plans	1,087	823	1,821	1,630
Other postretirement benefit plans	(137)	(132)	(273)	(264)
Total other comprehensive income (loss), net	(3,220)	3,284	(17,367)	4,688
Comprehensive income (loss)	(32,120)	4,449	(35,910)	3,672
Comprehensive income attributable to				
noncontrolling interest	367	320	682	608
Comprehensive income (loss) attributable to				
NL stockholders	\$ (32,487)	\$ 4,129	\$ (36,592)	\$ 3,064

See accompanying notes to Condensed Consolidated Financial Statements.

NL INDUSTRIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENT OF EQUITY

Six months ended June 30, 2016

(In thousands)

	Common stock (unaudited)	Additional paid-in capital	Retained earnings	Accumulated other comprehensive income (loss)	Noncontrolling interest in subsidiary	Total equity
Balance at December 31, 2015	\$6,086	\$ 300,543	\$ 88,679	\$ (245,358)	\$ 15,301	\$165,251
Net income (loss)	-	-	(1,624)	-	608	(1,016)
Other comprehensive income, net of tax	-	-	-	4,688	-	4,688
Issuance of NL common stock	2	35	-	-	-	37
Dividends	-	-	-	-	(166)	(166)
Other, net	-	96	-	-	12	108
Balance at June 30, 2016	\$6,088	\$ 300,674	\$ 87,055	\$ (240,670)	\$ 15,755	\$168,902

See accompanying notes to Condensed Consolidated Financial Statements.

NL INDUSTRIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

	Six months ended June 30,	
	2015	2016
	(unaudited)	
Cash flows from operating activities:		
Net income (loss)	\$(18,543)	\$(1,016)
Depreciation and amortization	1,802	1,889
Deferred income taxes	(17,372)	(534)
Equity in losses of Kronos Worldwide, Inc.	42,984	653
Dividends received from Kronos Worldwide, Inc.	10,566	10,566
Cash funding of benefit plans in excess of net benefit plan expense	(757)	(146)
Other, net	280	328
Change in assets and liabilities:		
Accounts and other receivables, net	(4,220)	(3,710)
Inventories, net	632	851
Prepaid expenses and other	(41)	(605)
Accounts payable and accrued liabilities	1,618	(2,599)
Income taxes	(5)	(4)
Accounts with affiliates	(1,516)	8
Accrued environmental remediation and related costs	1,993	1,980
Other noncurrent assets and liabilities, net	(4,672)	(166)
Net cash provided by operating activities	12,749	7,495
Cash flows from investing activities:		
Capital expenditures	(1,994)	(1,684)
Change in restricted cash equivalents, net	-	(51)
Proceeds from the sale of marketable securities	255	-
Purchase of marketable securities	(251)	-
Net cash used in investing activities	(1,990)	(1,735)
Cash flows from financing activities -		
Distributions to noncontrolling interests in subsidiary	(164)	(166)
Cash and cash equivalents - net change from:		
Operating, investing and financing activities	10,595	5,594
Cash and cash equivalents at beginning of period	72,560	96,462

Edgar Filing: NL INDUSTRIES INC - Form 10-Q

Cash and cash equivalents at end of period	\$83,155	\$102,056
Supplemental disclosure - cash paid for:		
Income taxes, net	\$1,585	\$55

See accompanying notes to Condensed Consolidated Financial Statements.

8

NL INDUSTRIES, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2016

(unaudited)

Note 1 – Organization and basis of presentation:

Organization – At June 30, 2016, Valhi, Inc. (NYSE: VHI) held approximately 83% of our outstanding common stock and a wholly-owned subsidiary of Contran Corporation held approximately 93% of Valhi’s outstanding common stock. All of Contran’s outstanding voting stock is held by a family trust established for the benefit of Lisa K. Simmons and Serena Simmons Connelly and their children for which Ms. Simmons and Ms. Connelly are co-trustees, or is held directly by Ms. Simmons and Ms. Connelly or entities related to them. Consequently, Ms. Simmons and Ms. Connelly may be deemed to control Contran, Valhi and us.

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

The unaudited Condensed Consolidated Financial Statements contained in this Quarterly Report have been prepared on the same basis as the audited Consolidated Financial Statements in our Annual Report on Form 10-K for the year ended December 31, 2015 that we filed with the SEC on March 10, 2016 (the 2015 Annual Report). In our opinion, we have made all necessary adjustments (which include only normal recurring adjustments) in order to state fairly, in all material respects, our consolidated financial position, results of operations and cash flows as of the dates and for the periods presented. We have condensed the Consolidated Balance Sheet at December 31, 2015 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, 2015) normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). Our results of operations for the interim periods ended June 30, 2016 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 2015 Consolidated Financial Statements contained in our 2015 Annual Report.

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

Note 2 – Accounts and other receivables, net:

	December	
	31,	June 30,
	2015	2016
	(In thousands)	
Trade receivables - CompX	\$8,847	\$12,457
Accrued insurance recoveries	138	226
Other receivables	79	70

Edgar Filing: NL INDUSTRIES INC - Form 10-Q

Allowance for doubtful accounts (87) (71)

Total \$8,977 \$12,682

Accrued insurance recoveries are discussed in Note 13.

9

Note 3 – Inventories, net:

	December	
	31, 2015	June 30, 2016
	(In thousands)	
Raw materials	\$2,807	\$2,813
Work in process	9,346	8,832
Finished products	2,945	2,479
Total	\$15,098	\$14,124

Note 4 – Marketable securities:

	Fair value measurement level	Market value	Cost basis	Unrealized loss
		(In thousands)		
December 31, 2015				
Valhi common stock 1		\$19,260	\$24,347	\$ (5,087)
June 30, 2016				
Valhi common stock 1		\$22,566	\$24,347	\$ (1,781)

At December 31, 2015 and June 30, 2016, we held approximately 14.4 million shares of common stock of our immediate parent company, Valhi. See Note 1. We account for our investment in Valhi common stock as available-for-sale marketable equity securities and any unrealized gains or losses on the securities are recognized through other comprehensive income, net of deferred income taxes. Our shares of Valhi common stock are carried at fair value based on quoted market prices, representing a Level 1 input within the fair value hierarchy. At December 31, 2015 and June 30, 2016, the quoted per share market price of Valhi common stock was \$1.34 and \$1.57, respectively.

With respect to our investment in Valhi stock, our cost basis had exceeded its market value at December 2015, but we considered such decline in market price to be temporary, as the aggregate market value of our investment in Valhi common stock exceeded our cost basis as of April 19, 2016. At June 30, 2016, our cost basis had exceeded its market value continuously since June 24, 2016, but we also consider such decline in market price to be temporary, as the aggregate market value of our investment in Valhi stock exceeded our cost basis as of July 13, 2016.

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

Note 5 – Investment in Kronos Worldwide, Inc.:

Edgar Filing: NL INDUSTRIES INC - Form 10-Q

At December 31, 2015 and June 30, 2016, we owned approximately 35.2 million shares of Kronos common stock. At June 30, 2016, the quoted market price of Kronos' common stock was \$5.25 per share, or an aggregate market value of \$184.9 million. At December 31, 2015, the quoted market price was \$5.64 per share, or an aggregate market value of \$198.6 million.

10

Edgar Filing: NL INDUSTRIES INC - Form 10-Q

The change in the carrying value of our investment in Kronos during the first six months of 2016 is summarized below.

	Amount (In millions)
Balance at the beginning of the period	\$ 140.7
Equity in losses of Kronos	(.7)
Dividends received from Kronos	(10.6)
Equity in Kronos' other comprehensive income (loss):	
Marketable securities	.1
Currency translation	2.8
Interest rate swap	(1.1)
Defined benefit pension plans	1.8
Balance at the end of the period	\$ 133.0

Selected financial information of Kronos is summarized below:

	December	
	31, 2015	June 30, 2016
	(In millions)	
Current assets	\$710.8	\$697.4
Property and equipment, net	429.5	439.6
Investment in TiO ₂ joint venture	82.9	76.3
Other noncurrent assets	19.5	21.1
Total assets	\$1,242.7	\$1,234.4
Current liabilities	\$201.7	\$218.6
Long-term debt	337.2	336.5
Accrued pension and postretirement benefits	209.4	208.6
Other noncurrent liabilities	32.5	34.1
Stockholders' equity	461.9	436.6
Total liabilities and stockholders' equity	\$1,242.7	\$1,234.4

	Three months ended June 30, 2015		Six months ended June 30, 2016	
	2015	2016	2015	2016
	(In millions)			
Net sales	\$360.2	\$356.1	\$725.3	\$674.5
Cost of sales	313.7	300.6	601.4	578.6
Income (loss) from operations	(10.4)	10.5	21.8	10.2
Income tax expense	145.1	3.9	154.5	2.5
Net income (loss)	(159.8)	1.7	(141.4)	(2.1)

Note 6 – Other noncurrent assets, net:

	December 31, 2015	June 30, 2016
	(In thousands)	
Pension asset	\$ 1,303	\$ 1,420
Restricted cash	1,273	1,279
Other	755	879
Total	\$3,331	\$3,578

Note 7 – Accrued and other current liabilities:

	December 31, 2015	June 30, 2016
	(In thousands)	
Employee benefits	\$8,438	\$5,940
Professional fees	698	416
Payables to affiliates:		
Income taxes - Valhi	40	32
Other	180	196
Income taxes	5	5
Other	1,422	1,880
Total	\$10,783	\$8,469

Note 8 – Other noncurrent liabilities:

	December 31, 2015	June 30, 2016
	(In thousands)	
Reserve for uncertain tax positions	\$12,186	\$12,186
Insurance claims and expenses	663	627
Other	787	783
Total	\$13,636	\$13,596

Our reserve for uncertain tax positions is discussed in Note 11.

Note 9 – Long-term debt:

During the first six months of 2016, we had no borrowings under our promissory note with Valhi, and at June 30, 2016, the full \$40 million was available for borrowing under this facility. The amount of any such loan Valhi would

make to us is at Valhi's discretion.

12

Edgar Filing: NL INDUSTRIES INC - Form 10-Q

Note 10 – Accumulated other comprehensive income (loss):

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

	Three months ended June 30,		Six months ended June 30,	
	2015	2016	2015	2016
	(In thousands)			
Accumulated other comprehensive loss, net of tax:				
Marketable securities:				
Balance at beginning of period	\$45,326	\$(1,336)	\$47,112	\$195
Other comprehensive income -				
unrealized gains (losses) arising during the year	(5,358)	3,730	(7,144)	2,199
Balance at end of period	\$39,968	\$2,394	\$39,968	\$2,394
Currency translation:				
Balance at beginning of period	\$(167,132)	\$(169,553)	\$(154,173)	\$(172,384)
Other comprehensive income (loss)	1,188	(980)	(11,771)	1,851
Balance at end of period	\$(165,944)	\$(170,533)	\$(165,944)	\$(170,533)
Interest rate swap:				
Balance at beginning of period	\$-	\$(1,016)	\$-	\$(445)
Other comprehensive loss:				
Unrealized losses arising during the year	-	(269)	-	(952)
Less reclassification adjustment for				
amounts included in interest expense	-	112	-	224
Balance at end of period	\$-	\$(1,173)	\$-	\$(1,173)
Defined benefit pension plans:				
Balance at beginning of period	\$(74,526)	\$(71,905)	\$(75,260)	\$(72,712)
Other comprehensive income -				
amortization of net losses included				
in net periodic pension cost	1,087	823	1,821	1,630
Balance at end of period	\$(73,439)	\$(71,082)	\$(73,439)	\$(71,082)
OPEB plans:				
Balance at beginning of period	\$146	\$(144)	\$282	\$(12)
Other comprehensive loss -				
amortization of prior service credit and				
net gains included in net periodic OPEB cost	(137)	(132)	(273)	(264)

Edgar Filing: NL INDUSTRIES INC - Form 10-Q

Balance at end of period	\$9	\$(276)	\$9	\$(276)
Total accumulated other comprehensive loss:				
Balance at beginning of period	\$(196,186)	\$(243,954)	\$(182,039)	\$(245,358)
Other comprehensive income (loss)	(3,220)	3,284	(17,367)	4,688
Balance at end of period	\$(199,406)	\$(240,670)	\$(199,406)	\$(240,670)

See Note 12 for amounts related to our defined benefit pension plans and OPEB plans.

Note 11 – Income taxes:

	Three months ended June 30, 2015		Six months ended June 30, 2016	
	2015	2016	2015	2016
(In millions)				
Expected tax expense (benefit), at U.S. federal statutory				
income tax rate of 35%	\$(17.3)	\$.6	\$(14.2)	\$(.5)
Rate differences on equity in earnings (losses) of Kronos	(3.2)	(.1)	(4.7)	.2
Adjustment to the reserve for uncertain tax positions, net	-	-	(3.0)	-
Nontaxable income	(.1)	-	(.2)	(.2)
U.S. state income taxes and other, net	-	(.2)	.1	-
Income tax expense (benefit)	\$(20.6)	\$.3	\$(22.0)	\$(.5)
Comprehensive provision for income taxes (benefit) allocable to:				
Net income (loss)	\$(20.6)	\$.3	\$(22.0)	\$(.5)
Other comprehensive income (loss):				
Marketable securities	(2.8)	2.0	(3.8)	1.2
Currency translation	.7	(.5)	(6.3)	1.0
Interest rate swap	-	(.1)	-	(.4)
Pension plans	.6	.5	1.0	.9
OPEB plans	(.1)	-	(.2)	(.1)
Total	\$(22.2)	\$2.2	\$(31.3)	\$2.1

In accordance with GAAP, we recognize deferred income taxes on our undistributed equity in earnings (losses) of Kronos. Because we and Kronos are part of the same U.S. federal income tax group, any dividends we receive from Kronos are nontaxable to us. Accordingly, we do not recognize and we are not required to pay income taxes on dividends from Kronos. We received aggregate dividends from Kronos of \$10.6 million in the first six months of 2015 and 2016. The amounts shown in the above table of our income tax rate reconciliation for rate differences on equity in earnings (losses) of Kronos represents the net tax (benefit) associated with such non-taxability of the dividends we receive from Kronos, as it relates to the amount of deferred income taxes we recognize on our undistributed equity in earnings (losses) of Kronos.

Kronos has substantial net operating losses in Germany and Belgium, the benefit of which Kronos had previously recognized under the more-likely-than-not recognition criteria. In the second quarter of 2015, Kronos determined that such losses did not meet the more-likely-than-not recognition criteria, and as a result Kronos recognized a non-cash deferred income tax expense of \$150.3 million in the second quarter of 2015 as a valuation allowance against Kronos' net deferred income tax assets in such jurisdictions. Kronos recognized \$2.9 million of deferred tax expense in the second quarter and first six months of 2016 as additional valuation allowance against additional losses in such jurisdictions. The rate difference related to our equity in losses of Kronos in the second quarter and first six months of 2015 and 2016 includes our equity in such non-cash deferred income tax expense recognized by Kronos.

Tax authorities are examining certain of our U.S. and non-U.S. tax returns, including those of Kronos, and tax authorities have or may propose tax deficiencies, including penalties and interest. We cannot guarantee these tax

matters will be resolved in our favor due to the inherent uncertainties involved in settlement initiatives and court and tax proceedings. 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.

14

Edgar Filing: NL INDUSTRIES INC - Form 10-Q

In the first six months of 2015, we recognized a first quarter non-cash income tax benefit of \$3.0 million related to the release of a portion of our reserve for uncertain tax positions due to the expiration of the applicable statute of limitations. We currently estimate that our unrecognized tax benefits will not change materially during the next twelve months.

Note 12 – Employee benefit plans:

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

	Three months ended		Six months ended	
	June 30, 2015	2016	June 30, 2015	2016
	(In thousands)			
Interest cost	\$635	\$601	\$1,204	\$1,193
Expected return on plan assets	(875)	(736)	(1,676)	(1,471)
Recognized actuarial losses	350	477	676	908
Total	\$110	\$342	\$204	\$630

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

	Three months ended		Six months ended	
	June 30, 2015	2016	June 30, 2015	2016
	(In thousands)			
Interest cost	\$27	\$24	\$54	\$48
Amortization of prior service credit	(156)	(136)	(311)	(271)
Recognized actuarial gains	(26)	(38)	(51)	(76)
Total	\$(155)	\$(150)	\$(308)	\$(299)

Contributions – We currently expect our 2016 contributions to our defined benefit pension plans and other postretirement plans to be approximately \$1 million.

Note 13 – Commitments and contingencies:

General

We are involved in various environmental, contractual, product liability, patent (or intellectual property), employment and other claims and disputes incidental to our current and former businesses. At least quarterly our management discusses and evaluates the status of any pending litigation or claim to which we are a party or which has been asserted against us. The factors considered in such evaluation include, among other things, the nature of such pending cases and claims, the status of such pending cases and claims, the advice of legal counsel and our experience in

similar cases and claims (if any). Based on such evaluation, we make a determination as to whether we believe (i) it is probable a loss has been incurred, and if so if the amount of such loss (or a range of loss) is reasonably estimable, or (ii) it is reasonably possible but not probable a loss has been incurred, and if so if the amount of such loss (or a range of loss) is reasonably estimable, or (iii) the probability a loss has been incurred is remote.

15

Lead pigment litigation

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

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

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

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

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

In one of these lead pigment cases, in April 2000 we were served with a complaint in County of Santa Clara v. Atlantic Richfield Company, et al. (Superior Court of the State of California, County of Santa Clara, Case No. 1-00-CV-788657) brought by a number of California government entities against the former pigment manufacturers, the LIA and certain paint manufacturers. The County of Santa Clara sought to recover compensatory damages for funds the plaintiffs have expended or would in the future expend for medical treatment, educational expenses, abatement or other costs due to exposure to, or potential exposure to, lead paint, disgorgement of profit, and punitive damages. In July 2003, the trial judge granted defendants’ motion to dismiss all remaining claims. Plaintiffs appealed and the intermediate appellate court reinstated public nuisance, negligence, strict liability, and fraud claims in March 2006. A fourth amended complaint was filed in March 2011 on behalf of The People of California by the County

Attorneys of Alameda, Ventura, Solano, San Mateo, Los Angeles and Santa Clara, and the City Attorneys of San Francisco, San Diego and Oakland. That complaint alleged that the presence of lead paint created a public nuisance in each of the prosecuting jurisdictions and sought its abatement. In July and August 2013, the case was tried. In January 2014, the Judge issued a judgment finding us, The Sherwin Williams Company and ConAgra Grocery Products Company jointly and severally liable for the abatement of lead paint in pre-1980 homes, and ordered the

defendants to pay an aggregate \$1.15 billion to the people of the State of California to fund such abatement. In February 2014, we filed a motion for a new trial, and in March 2014 the court denied the motion. Subsequently in March 2014, we filed a notice of appeal with the Sixth District Court of Appeal for the State of California and the appeal is proceeding with the appellate court. NL believes that this judgment is inconsistent with California law and is unsupported by the evidence, and we will defend vigorously against all claims.

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

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

Environmental matters and litigation

Our operations are governed by various environmental laws and regulations. Certain of our businesses are and have been engaged in the handling, manufacture or use of substances or compounds that may be considered toxic or hazardous within the meaning of applicable environmental laws and regulations. As with other companies engaged in similar businesses, certain of our past and current operations and products have the potential to cause environmental or other damage. We have implemented and continue to implement various policies and programs in an effort to minimize these risks. Our policy is to maintain compliance with applicable environmental laws and regulations at all of our plants and to strive to improve environmental performance. From time to time, we may be subject to environmental regulatory enforcement under U.S. and non-U.S. statutes, the resolution of which typically involves the establishment of compliance programs. It is possible that future developments, such as stricter requirements of environmental laws and enforcement policies, could adversely affect our production, handling, use, storage, transportation, sale or disposal of such substances. We believe that all of our facilities are in substantial compliance with applicable environmental laws.

Certain properties and facilities used in our former operations, including divested primary and secondary lead smelters and former mining locations, are the subject of civil litigation, administrative proceedings or investigations arising under federal and state environmental laws and common law. Additionally, in connection with past operating practices, we are currently involved as a defendant, potentially responsible party (PRP) or both, pursuant to the

Comprehensive Environmental Response, Compensation and Liability Act, as amended by the Superfund Amendments and Reauthorization Act (CERCLA), and similar state laws in various governmental and private actions associated with waste disposal sites, mining locations, and facilities that we or our predecessors, our subsidiaries or their predecessors currently or previously owned, operated or used, certain of which are on the United States Environmental Protection Agency's (EPA) Superfund National Priorities List or similar state lists.

17

These proceedings seek cleanup costs, damages for personal injury or property damage and/or damages for injury to natural resources. Certain of these proceedings involve claims for substantial amounts. Although we may be jointly and severally liable for these costs, in most cases we are only one of a number of PRPs who may also be jointly and severally liable, and among whom costs may be shared or allocated. In addition, we are occasionally named as a party in a number of personal injury lawsuits filed in various jurisdictions alleging claims related to environmental conditions alleged to have resulted from our operations.

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

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

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

We record liabilities related to environmental remediation and related matters (including costs associated with damages for personal injury or property damage and/or damages for injury to natural resources) when estimated future expenditures are probable and reasonably estimable. We adjust such accruals as further information becomes available to us or as circumstances change. Unless the amounts and timing of such estimated future expenditures are fixed and reasonably determinable, we generally do not discount estimated future expenditures to their present value due to the uncertainty of the timing of the payout. We recognize recoveries of costs from other parties, if any, as assets when their receipt is deemed probable. At December 31, 2015 and June 30, 2016, we have not recognized any receivables for recoveries.

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

Edgar Filing: NL INDUSTRIES INC - Form 10-Q

Changes in the accrued environmental remediation and related costs during the first six months of 2016 are as follows:

	Amount (In thousands)
Balance at the beginning of the period	\$ 113,133
Additions charged to expense, net	3,024
Payments, net	(1,044)
Balance at the end of the period	\$ 115,113
Amounts recognized in the Condensed Consolidated Balance Sheet at the end of the period:	
Current liability	\$ 11,385
Noncurrent liability	103,728
Balance at the end of the period	\$ 115,113

On a quarterly basis, we evaluate the potential range of our liability for environmental remediation and related costs at sites where we have been named as a PRP or defendant, including sites for which our wholly-owned environmental management subsidiary, NL Environmental Management Services, Inc. (EMS), has contractually assumed our obligations. At June 30, 2016, we had accrued approximately \$115 million related to approximately 40 sites associated with remediation and related matters that we believe are at the present time and/or in their current phase reasonably estimable. The upper end of the range of reasonably possible costs to us for remediation and related matters for which we believe it is possible to estimate costs is approximately \$173 million, including the amount currently accrued.

We believe that it is not reasonably possible to estimate the range of costs for certain sites. At June 30, 2016, there were approximately 5 sites for which we are not currently able to reasonably estimate a range of costs. For these sites, generally the investigation is in the early stages, and we are unable to determine whether or not we actually had any association with the site, the nature of our responsibility for the contamination at the site, if any, and the extent of contamination at and cost to remediate the site. The timing and availability of information on these sites is dependent on events outside of our control, such as when the party alleging liability provides information to us. At certain of these previously inactive sites, we have received general and special notices of liability from the EPA and/or state agencies alleging that we, sometimes with other PRPs, are liable for past and future costs of remediating environmental contamination allegedly caused by former operations. These notifications may assert that we, along with any other alleged PRPs, are liable for past and/or future clean-up costs. As further information becomes available to us for any of these sites, which would allow us to estimate a range of costs, we would at that time adjust our accruals. Any such adjustment could result in the recognition of an accrual that would have a material effect on our consolidated financial statements, results of operations and liquidity.

Insurance coverage claims

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

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

For a complete discussion of certain litigation involving us and certain of our former insurance carriers, refer to our 2015 Annual Report.

Other litigation

We have been named as a defendant in various lawsuits in several jurisdictions, alleging personal injuries as a result of occupational exposure primarily to products manufactured by our former operations containing asbestos, silica and/or mixed dust. In addition, some plaintiffs allege exposure to asbestos from working in various facilities previously owned and/or operated by us. There are 103 of these types of cases pending, involving a total of approximately 588 plaintiffs. In addition, the claims of approximately 8,692 plaintiffs have been administratively dismissed or placed on the inactive docket in Ohio state court. We do not expect these claims will be re-opened unless the plaintiffs meet the courts' medical criteria for asbestos-related claims. We have not accrued any amounts for this litigation because of the uncertainty of liability and inability to reasonably estimate the liability, if any. To date, we have not been adjudicated liable in any of these matters.

Based on information available to us, including:

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

we believe that the range of reasonably possible outcomes of these matters will be consistent with our historical costs (which are not material). Furthermore, we do not expect any reasonably possible outcome would involve amounts material to our consolidated financial position, results of operations or liquidity. We have sought and will continue to vigorously seek, dismissal and/or a finding of no liability from each claim. In addition, from time to time, we have received notices regarding asbestos or silica claims purporting to be brought against former subsidiaries, including notices provided to insurers with which we have entered into settlements extinguishing certain insurance policies. These insurers may seek indemnification from us. For a discussion of other legal proceedings to which we are a party, refer to our 2015 Annual Report.

In addition to the litigation described above, we and our affiliates are also involved in various other environmental, contractual, product liability, patent (or intellectual property), employment and other claims and disputes incidental to present and former businesses. In certain cases, we have insurance coverage for these items, although we do not expect additional material insurance coverage for environmental matters.

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

Note 14 – Related party transactions:

From time to time, we may have loans and advances outstanding between us and various related parties pursuant to term and demand notes. We generally enter into these loans and advances for cash management purposes. When we loan funds to related parties, we are generally able to earn a higher rate of return on the loan than we would earn if we invested the funds in other instruments, and when we borrow from related parties, we are generally able to pay a lower rate of interest than we would pay if we had incurred third-party indebtedness. While certain of these loans to affiliates may be of a lesser credit quality than cash equivalent instruments otherwise available to us, we believe we have considered the credit risks in the terms of the applicable loans. In this regard, on

20

Edgar Filing: NL INDUSTRIES INC - Form 10-Q

August 3, 2016 CompX entered into an unsecured revolving demand promissory note with Valhi whereby CompX has agreed to loan Valhi up to \$40 million. CompX's loan to Valhi bears interest at prime plus 1.00%, payable quarterly, with all principal due on demand, but in any event no earlier than December 31, 2017. The amount of CompX's outstanding loans to Valhi at any time is at its discretion.

Note 15 – Financial instruments and fair value measurements:

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

The following table presents the financial instruments that are not carried at fair value but which require fair value disclosure at December 31, 2015 and June 30, 2016:

	December 31, 2015		June 30, 2016	
	Carrying amount	Fair value	Carrying amount	Fair value
	(In thousands)			
Cash, cash equivalents and restricted cash	\$100,981	\$100,981	\$106,734	\$106,734
Noncontrolling interest in CompX common stock	15,301	18,878	15,755	19,136

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

Note 16 – Recent accounting pronouncements not yet adopted:

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-09, Revenue from Contracts with Customers (Topic 606). This standard replaces existing revenue recognition guidance, which in many cases was tailored for specific industries, with a uniform accounting standard applicable to all industries and transactions. The new standard, as amended, is currently effective for us beginning with the first quarter of 2018. Entities may elect to adopt ASU No. 2014-09 retrospectively for all periods for all contracts and transactions which occurred during the period (with a few exceptions for practical expediency) or retrospectively with a cumulative effect recognized as of the date of adoption. ASU No. 2014-09 is a fundamental rewriting of existing GAAP with respect to revenue recognition, and we are still evaluating the effect the Standard will have on our Consolidated Financial Statements. We currently expect to adopt the standard in the first quarter of 2018. In addition, we have not yet determined the method we will use to adopt the Standard.

In January 2016, the FASB issued ASU 2016-01, Financial Instruments-Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities, which addresses certain aspects related to the recognition, measurement, presentation and disclosure of financial instruments. The ASU requires equity investments (except for those accounted for under the equity method of accounting or those that result in the consolidation of the investee) to generally be measured at fair value with changes in fair value recognized in net income. The amendment also requires a number of other changes, including among others: simplifying the impairment assessment for equity instruments without readily determinable fair values; eliminating the requirement for public business entities to disclose method and assumptions used to determine fair value for financial instruments measured at amortized cost; requiring an exit price notion when measuring the fair value of financial instruments for disclosure purposes; and requiring separate presentation of financial assets and liabilities by measurement category and form of asset. The changes indicated above will be effective for us beginning in the first quarter of 2018, with prospective application required, and early adoption is not permitted. The most significant aspect of adopting this ASU will be the requirement to recognize changes in fair value of our available-for-sale marketable equity securities in net income (currently changes in fair value of such securities are recognized in other comprehensive income).

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

Business overview

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

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

We account for our 30% non-controlling interest in Kronos by the equity method. Kronos is a leading global producer and marketer of value-added titanium dioxide pigments (TiO₂). TiO₂ is used for a variety of manufacturing applications including paints, plastics, paper and other industrial and specialty products.

Forward-looking information

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

- Future supply and demand for our products
- The extent of the dependence of certain of our businesses on certain market sectors
- The cyclical nature of our businesses (such as Kronos' TiO₂ operations)
- Customer and producer inventory levels
- Unexpected or earlier-than-expected industry capacity expansion (such as the TiO₂ industry)
 - Changes in raw material and other operating costs (such as energy, ore, zinc and brass costs) and our ability to pass those costs on to our customers or offset them with reductions in other operating costs
- Changes in the availability of raw material (such as ore)
- General global economic and political conditions (such as changes in the level of gross domestic product in various regions of the world and the impact of such changes on demand for, among other things, TiO₂ and component products)
- Competitive products and substitute products
- Price and product competition from low-cost manufacturing sources (such as China)

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

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

Results of operations

Net income (loss) overview

Quarter ended June 30, 2016 compared to the quarter ended June 30, 2015

Our net income attributable to NL stockholders was \$.9 million, or \$.02 per share, in the second quarter of 2016 compared to net loss attributable to NL stockholders of \$29.2 million, or \$.60 per share, in the second quarter of 2015. As more fully described below, the increase in our earnings per share from 2015 to 2016 is primarily due to the net effects of:

- equity in earnings from Kronos in 2016 of \$.5 million compared to equity in losses from Kronos in 2015 of \$48.6 million,
- lower income from operations attributable to CompX of \$.6 million, and
- lower environmental remediation and related costs in 2016 of \$2.2 million.

Our 2016 net income attributable to NL stockholders includes:

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

Our 2015 net loss attributable to NL stockholders includes:

- loss of \$.61 per share, net of income taxes, included in our equity in losses of Kronos related to Kronos' recognition of a deferred income tax asset valuation allowance related to its German and Belgian operations, and
- loss of \$.07 per share, net of income taxes, included in our equity in losses of Kronos related to certain workforce reduction charges recognized by Kronos.

Six months ended June 30, 2016 compared to six months ended June 30, 2015

Our net loss attributable to NL stockholders was \$1.6 million, or \$.03 per share, in the first six months of 2016 compared to net loss attributable to NL stockholders of \$19.2 million, or \$.39 per share, in the first six months of 2015. As more fully described below, the increase in our earnings per share from 2015 to 2016 is primarily due to the net effects of:

- equity in losses from Kronos in 2016 of \$.7 million compared to equity in losses from Kronos in 2015 of \$43.0 million,
- lower income from operations attributable to CompX of \$.9 million,
- lower insurance recoveries in 2016 of \$3.1 million primarily related to an insurance recovery settlement for certain past lead pigment litigation defense costs in the first quarter of 2015,
- a first quarter non-cash income tax benefit in 2015 related to a net reduction in our reserve for uncertain tax positions of \$3.0 million, and
- lower litigation fees and related costs in 2016 of \$1.1 million.

Our 2016 net loss attributable to NL stockholders includes:

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

Our 2015 net loss attributable to NL stockholders includes:

- loss of \$.61 per share, net of income taxes, included in our equity in losses of Kronos related to Kronos' recognition of a deferred income tax asset valuation allowance related to its German and Belgian operations,
- loss of \$.07 per share, net of income taxes, included in our equity in losses of Kronos related to certain workforce reduction charges recognized by Kronos,
- income of \$.06 per share related to a net reduction of our reserve for uncertain tax positions, and
- income of \$.04 per share, net of income taxes, related to insurance recoveries we recognized.

Income (loss) from operations

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

	Three months ended			Six months ended		
	June 30, 2015 (In millions)	2016	% Change	June 30, 2015 (In millions)	2016	% Change
CompX	\$4.3	\$3.7	(14)%	\$8.0	\$7.1	(12)%
Insurance recoveries	.3	.2	-	3.4	.3	(90)
Corporate expense	(5.7)	(3.3)	(41)	(9.5)	(9.0)	(5)
Income (loss) from operations	\$(1.1)	\$.6	156	\$1.9	\$(1.6)	(183)

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

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

	Three months ended			Six months ended		
	June 30, 2015 (In millions)	2016	% Change	June 30, 2015 (In millions)	2016	% Change
Equity in earnings (losses)						
of Kronos	\$(48.6)	\$.5	101	\$(43.0)	\$(.7)	98
Interest and dividend income	.3	.4	34	.6	.8	25

CompX International Inc.

	Three months ended			Six months ended		
	June 30, 2015 (In millions)	2016	% Change	June 30, 2015 (In millions)	2016	% Change
Net sales	\$28.9	\$27.1	(6)%	\$56.8	\$54.2	(5)%
Cost of sales	19.8	18.6	(6)	39.1	37.5	(4)
Gross margin	9.1	8.5	(7)	17.7	16.7	(6)
Operating costs and expenses	4.8	4.8	(2)	9.7	9.6	(1)
Income from operations	\$4.3	\$3.7	(14)	\$8.0	\$7.1	(12)
Percentage of net sales:						
Cost of sales	68	% 69	%	69	% 69	%
Gross margin	32	31		31	31	
Operating costs						
and expenses	17	18		17	18	
Income from operations	15	14		14	13	

Net sales – Net sales decreased \$1.8 million in the second quarter of 2016 and \$2.6 million in the first six months of 2016 compared to the respective periods in 2015, primarily due to CompX’s Security Products business sales in 2015 for a government security end-user that, as expected, did not recur in 2016. For the six months ended June 2016, the decrease in CompX’s Security Products business sales was partially offset by increased CompX Marine Components business sales to the waterski/wakeboard boat market. Relative changes in selling prices did not have a material impact on net sales comparisons.

Cost of sales and gross margin – Cost of sales as a percentage of sales increased less than 1% in the second quarter and first six months of 2016 compared to the same periods in 2015. As a result, gross margin as a percentage of net sales decreased slightly over the same periods. Gross margin dollars decreased due to lower sales in CompX’s Security Products business. The decrease in gross margin percentage is primarily due to decreased leverage of fixed manufacturing costs as a result of decreased production volumes during the second quarter and first six months of 2016 partially offset by improved variable contribution margins attributable to relative changes in customer and product mix, primarily in CompX’s Security Products business.

Operating costs and expenses – Operating costs and expenses consist primarily of sales and administrative related personnel costs, sales commissions and advertising expenses, as well as gains and losses on property, plant and equipment. Operating costs and expenses for the second quarter and first six months of 2016 were comparable to the same periods in 2015.

Income from operations – As a percentage of net sales, income from operations for the second quarter and first six months of 2016 decreased compared to the same periods in 2015 and was primarily impacted by the factors impacting gross margin and operating costs discussed above.

Results by reporting unit

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

26

Edgar Filing: NL INDUSTRIES INC - Form 10-Q

	Three months ended			Six months ended		
	June 30, 2015 (In millions)	2016	% Change	June 30, 2015 (In millions)	2016	% Change
Net sales:						
Security Products	\$25.0	\$23.2	(7)%	\$49.7	\$46.6	(6)%
Marine Components	3.9	3.9	1	7.1	7.6	7
Total net sales	\$28.9	\$27.1	(6)	\$56.8	\$54.2	(5)
Gross margin:						
Security Products	\$8.0	\$7.4	(8)	\$15.8	\$14.7	(7)
Marine Components	1.1	1.1	-	1.9	2.0	6
Total gross margin	\$9.1	\$8.5	(7)	\$17.7	\$16.7	(6)
Income from operations:						
Security Products	\$5.3	\$4.8	(9)	\$10.2	\$9.3	(9)
Marine Components	.6	.6	(8)	.9	.9	3
Corporate operating expenses	(1.6)	(1.7)	4	(3.1)	(3.1)	1
Total income from operations	\$4.3	\$3.7	(14)	\$8.0	\$7.1	(12)
Gross margin:						
Security Products	32	% 32	%	32	% 32	%
Marine Components	29	28		27	27	
Total gross margin	32	31		31	31	
Income from operations margin:						
Security Products	21	% 21	%	21	% 20	%
Marine Components	16	14		12	12	
Total income from operations margin	15	14		14	13	

Security Products – Security Products net sales decreased 7% in the second quarter of 2016 and 6% in the first six months of 2016 compared to the same periods last year. The decrease in sales is primarily due to a decrease of approximately \$1.6 million and \$3.2 million in sales for a government security end-user that did not recur in the second quarter or first six months of 2016, respectively. Gross margin and income from operations as a percentage of sales for the second quarter and first six months of 2016 decreased compared to the same periods in 2015 primarily due to decreased leverage of fixed costs and operating costs and expenses as a result of decreased production volumes, partially offset by improved variable contribution margins attributable to changes in customer and product mix.

Marine Components – Marine Components net sales increased 1% and 7% in the second quarter and first six months of 2016, respectively, as compared to the same periods last year. The increase in sales for the first six months of 2016 is primarily due to improved demand for products sold to the waterski/wakeboard boat market. Gross margin and income from operations as a percentage of net sales for the second quarter of 2016 decreased from the same period in 2015. Due to recent shifts in customer and product mix that temporarily reduced required stocking levels, Marine

Components' production volumes for the second quarter of 2016 were lower than the same period in 2015, resulting in decreased leverage of fixed costs and operating costs and expenses in the current period. Gross margin and income from operations as a percentage of net sales for the first six months of 2016 were comparable to the same period in 2015.

Outlook – Security Products sales for the first half of 2016 were comparable to the first half of 2015 except for approximately \$3.2 million in 2015 sales for a government security end-user project which did not recur in 2016. We continue to benefit from innovation and diversification in our product offerings, particularly with respect to the

27

recreational boat markets served by our Marine Components business. With the exception of the nonrecurring sales of over \$5 million in all of 2015 for the single government security end-user (including the \$3.2 million in the first half of the year), and in the absence of any improvement in general economic conditions, current year sales are expected to remain relatively comparable to prior year. We will continue to monitor general economic conditions and sales order rates and respond to fluctuations in customer demand through continuous evaluation of staffing levels and consistent execution of our lean manufacturing and cost improvement initiatives. Additionally, we continue to seek opportunities to gain market share in existing markets, to expand into new markets and to further develop new and current customers, products and features in order to mitigate the impact of changes in demand and broaden our sales base. Any success in these efforts could lead to sales and profitability levels in the second half of 2016 greater than otherwise anticipated.

General corporate and other items

Insurance recoveries – We have agreements with certain insurance carriers pursuant to which the carriers reimburse us for a portion of our past lead pigment and asbestos litigation defense costs. Insurance recoveries include amounts we received from these insurance carriers. Substantially all of the \$3.4 million insurance recoveries we recognized in the first six months of 2015 relate to a first quarter settlement we reached with one of our insurance carriers in which they agreed to reimburse us for a portion of our past litigation defense costs.

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

Corporate expense – Corporate expenses were \$3.3 million in the second quarter of 2016, \$2.4 million lower than in the second quarter of 2015 primarily due to lower environmental remediation and related costs in 2016. Included in corporate expense in the second quarter of 2015 and 2016 are:

- environmental remediation and related costs of \$.3 million in 2016 compared to \$2.5 million in 2015, and
- litigation fees and related costs of \$.8 million in 2016 compared to \$1.0 million in 2015.

Corporate expenses were \$9.0 million in the first six months of 2016, \$.5 million lower than in the first six months of 2015 primarily due to lower litigation fees and related costs in 2016. Included in corporate expense in the first six months of 2015 and 2016 are:

- environmental remediation and related costs of \$3.1 million in 2016 compared to \$2.6 million in 2015, and
- litigation and related costs of \$1.7 million in 2016 compared to \$2.8 million in 2015.

The level of our litigation fees and related costs varies from period to period depending upon, among other things, the number of cases in which we are currently involved, the nature of such cases and the current stage of such cases (e.g. discovery, pre-trial motions, trial or appeal, if applicable). See Note 13 to our Condensed Consolidated Financial Statements. If our current expectations regarding the number of cases in which we expect to be involved during 2016 or the nature of such cases were to change, our corporate expenses could be higher than we currently estimate.

Obligations for environmental remediation costs are difficult to assess and estimate and it is possible that actual costs for environmental remediation will exceed accrued amounts or that costs will be incurred in the future for sites in which we cannot currently estimate our liability. If these events were to occur in 2016, our corporate expenses would be higher than we currently estimate. In addition, we adjust our environmental accruals as further information becomes available to us or as circumstances change. Such further information or changed circumstances could result in an increase in our accrued environmental costs. See Note 13 to our Condensed Consolidated Financial Statements.

Overall, we expect that our general corporate expenses for all of 2016 will be comparable to 2015. If our current expectations regarding the number of cases or sites in which we expect to be involved during 2016, or if the nature of such cases or sites were to change, our corporate expenses could be higher than we currently estimate and involve amounts that are material.

Income tax expense – We recognized an income tax expense of \$.3 million in the second quarter of 2016 compared to income tax benefit of \$20.6 million in the second quarter of 2015 and an income tax benefit of \$.5 million in the first six months of 2016 compared to an income tax benefit of \$22.0 million in the first six months of 2015. Our income tax benefit in the first six months of 2015 includes a first quarter non-cash income tax benefit of \$3.0 million related to the release of a portion of our reserve for uncertain tax positions due to the expiration of the applicable statute of limitations. In accordance with GAAP, we recognize deferred income taxes on our undistributed equity in earnings (losses) of Kronos. Because we and Kronos are part of the same U.S. federal income tax group, any dividends we receive from Kronos are nontaxable to us. Accordingly, we do not recognize and we are not required to pay income taxes on dividends from Kronos. Therefore, our full-year effective income tax rate will generally be lower than the U.S. federal statutory income tax rate in years during which we receive dividends from Kronos and recognize equity in earnings of Kronos. Conversely, our effective income tax rate will generally be higher than the U.S. federal statutory income tax rate in years during which we receive dividends from Kronos and recognize equity in losses of Kronos. During interim periods, our effective income tax rate may not necessarily correspond to the foregoing due to the application of accounting for income taxes in interim periods which requires us to base our effective rate on full year projections. We received dividends from Kronos of \$10.6 million in each of the first six months of 2015 and 2016.

Our effective tax rate attributable to our equity in earnings of Kronos, including the effect of the non-taxable dividends we received from Kronos was 9.7% in the first six months of 2016 and 45.9% in the first six months of 2015. Kronos has substantial net operating losses in Germany and Belgium, the benefit of which Kronos had previously recognized under the more-likely-than-not recognition criteria. In the second quarter of 2015, Kronos determined that such losses did not meet the more-likely-than-not recognition criteria, and as a result Kronos recognized a non-cash deferred income tax expense of \$150.3 million in the second quarter of 2015 as a valuation allowance against Kronos' net deferred income tax assets in such jurisdictions. Kronos recognized \$2.9 million of deferred tax expense in the second quarter of 2016 as additional valuation allowance against additional losses in such jurisdictions. Our equity in losses of Kronos in the second quarter and first six months of 2015 and 2016 includes our equity in such non-cash deferred income tax expense recognized by Kronos. See Note 11 to our Condensed Consolidated Financial Statements for more information about our 2016 income tax items, including a tabular reconciliation of our statutory tax expense (benefit) to our actual expense (benefit).

Noncontrolling interest – Noncontrolling interest in net income of CompX is consistent in the second quarter and year-to-date periods of 2015 and 2016. The noncontrolling interest we recognize in each period is directly related to the level of earnings at CompX for the period.

Edgar Filing: NL INDUSTRIES INC - Form 10-Q

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

	Three months ended			Six months ended		
	June 30, 2015 (In millions)	2016	% Change	June 30, 2015 (In millions)	2016	% Change
Net sales	\$360.2	\$356.1	(1)%	\$725.3	\$674.5	(7)%
Cost of sales	313.7	300.6	(4)%	601.4	578.6	(4)%
Gross margin	\$46.5	\$55.5		\$123.9	\$95.9	
Income (loss) from operations	\$(10.4)	\$10.5	201 %	\$21.8	\$10.2	(53)%
Other, net	.1	.2		.3	.4	
Interest expense	(4.4)	(5.1)		(9.0)	(10.2)	
Income (loss) before income taxes	(14.7)	5.6		13.1	.4	
Income tax expense	145.1	3.9		154.5	2.5	
Net income (loss)	\$(159.8)	\$1.7		\$(141.4)	\$(2.1)	
Percentage of net sales:						
Cost of sales	87 %	84 %		83 %	86 %	
Income (loss) from operations	(3)%	3 %		3 %	2 %	
Equity in earnings (losses)						
of Kronos Worldwide, Inc.	\$(48.6)	\$.5		\$(43.0)	\$(.7)	
TiO ₂ operating statistics:						
Sales volumes*	139	149	7 %	270	287	6 %
Production volumes*	140	131	(7)%	265	262	(1)%
Change in TiO ₂ net sales:						
TiO ₂ product pricing			(7)%			(11)%
TiO ₂ sales volumes			7			6
TiO ₂ product mix/other			(2)			(1)
Changes in currency exchange rates			1			(1)
Total			(1)%			(7)%

* Thousands of metric tons

The key performance indicators for Kronos are TiO₂ average selling prices, its level of TiO₂ sales and production volumes and the cost of third-party feedstock ore.

Current industry conditions – Due to competitive pressures, Kronos’ average selling prices decreased throughout 2015 and, to a much lesser extent, into the first quarter of 2016. Kronos’ average selling prices at the beginning of 2016 were 17% lower as compared to the beginning of 2015. In the second quarter of 2016, Kronos’ average selling prices began to rise due to the implementation of previously-announced price increases. Kronos’ average selling prices at the end of the second quarter of 2016 were 4% higher than at the end of the first quarter of 2016 and 2% higher than at the end of 2015, with higher prices in most major markets except Latin America. Kronos experienced higher sales volumes in European, North American and export markets in the second quarter and first half of 2016 as compared to the second quarter and first half of 2015, partially offset by slightly lower volumes in the Latin American market in 2016 as compared to the same periods of 2015.

Kronos operated its production facilities at overall average capacity utilization rates of 96% in the first six months of 2016 (approximately 97% and 95% of practical capacity in the first and second quarters, respectively) compared to approximately 97% in the first six months of 2015 (93% and 100% in the first and second quarters of

30

2015, respectively). Kronos' production rates in the first quarter of 2015 were impacted by the implementation of certain productivity-enhancing improvement projects at certain facilities, as well as necessary improvements to ensure continued compliance with its permit regulations, which resulted in longer-than-normal maintenance shutdowns in some instances.

Kronos experienced moderation in the cost of TiO₂ feedstock ore procured from third parties in 2015 which continued into the first half of 2016. Given the time lag between when third-party feedstock ore is purchased and when the TiO₂ product produced with such ore is reflected in its cost of sales, Kronos' cost of sales per metric ton of TiO₂ sold declined throughout 2015 and into the first half of 2016. Consequently, Kronos' cost of sales per metric ton of TiO₂ sold in the first six months of 2016 was lower than its cost of sales per metric ton of TiO₂ sold in the first six months of 2015 (excluding the effect of changes in currency exchange rates).

Net sales – Kronos' net sales in the second quarter of 2016 decreased 1%, or \$4.1 million, compared to the second quarter of 2015 primarily due to the net effect of a 7% decrease in average TiO₂ selling prices (which decreased net sales by approximately \$25 million) and a 7% increase in sales volumes (which increased net sales by approximately \$25 million). TiO₂ selling prices will increase or decrease generally as a result of competitive market pressures, changes in the relative level of supply and demand as well as changes in raw material and other manufacturing costs.

Kronos' sales volumes increased 7% in the second quarter of 2016 compared to the second quarter of 2015 primarily due to higher sales in European, North American and export markets, partially offset by lower sales in Latin America. Kronos' sales volumes in the second quarter of 2016 set a new overall record for a second quarter. In addition to the impact of changes in average TiO₂ selling prices and sales volumes, Kronos estimates that changes in currency exchange rates (primarily the euro) increased its net sales by approximately \$5 million as compared to the second quarter of 2015.

Kronos' net sales in the first six months of 2016 decreased 7%, or \$50.8 million, compared to the first six months of 2015 primarily due to the net effect of an 11% decrease in average TiO₂ selling prices (which decreased net sales by approximately \$80 million) and a 6% increase in sales volumes (which increased net sales by approximately \$44 million). TiO₂ selling prices will increase or decrease generally as a result of competitive market pressures, changes in the relative level of supply and demand as well as changes in raw material and other manufacturing costs.

Kronos' sales volumes increased 6% in the first six months of 2016 as compared to the first six months of 2015 primarily due to higher sales in European, North American and export markets, partially offset by lower sales in Latin America. Kronos' sales volumes in the first half of 2016 set a new overall record for a first-six-months period. In addition to the impact of changes in average TiO₂ selling prices and sales volumes, Kronos estimates that changes in currency exchange rates decreased its net sales by approximately \$6 million as compared to the first six months of 2015.

Cost of sales – Kronos' cost of sales decreased \$13.1 million or 4% in the second quarter of 2016 compared to the second quarter of 2015 due to the net impact of lower raw materials and other production costs of approximately \$17 million (primarily lower third-party feedstock ore costs), approximately \$2.0 million in savings resulting from workforce reductions implemented in 2015 as part of a restructuring plan designed to improve Kronos' long-term cost structure, a 7% increase in sales volumes, a 7% decrease in TiO₂ production volumes and currency fluctuations (primarily the euro). Kronos' cost of sales in 2015 includes approximately \$10.7 million of severance costs related to workforce reductions. Kronos' cost of sales as a percentage of net sales decreased to 84% in the second quarter of 2016 compared to 87% in the same period of 2015, as the favorable effects of lower raw materials and other production costs and the impact of the \$10.7 million second quarter 2015 workforce reduction charge classified in cost of sales, and associated cost savings from such workforce reduction realized in the second quarter of 2016, more than offset the unfavorable impact of lower average selling prices and lower production volumes, as discussed above.

Kronos' cost of sales decreased \$22.8 million or 4% in the first six months of 2016 compared to the same period in 2015 primarily due to the net impact of lower raw materials and other production costs of approximately \$23 million (primarily lower third-party feedstock ore costs), approximately \$4.0 million in savings resulting from

31

workforce reductions implemented in 2015, a 6% increase in sales volumes, and currency fluctuations (primarily the euro). Kronos' cost of sales in 2015 includes approximately \$10.7 million of severance costs related to workforce reductions.

Kronos' cost of sales as a percentage of net sales increased to 86% in the first six months of 2016 compared to 83% in the same period of 2015, as the unfavorable impact of lower average selling prices more than offset the favorable effects of lower raw materials and other production costs and the impact of the \$10.7 million second quarter 2015 workforce reduction charge classified in cost of sales and associated cost savings from such workforce reduction realized in the first six months of 2016, as discussed above.

Other operating income and expense, net – Kronos' other operating income and expense, net in the second quarter of 2016 was \$45.0 million, a decrease of \$11.9 million compared to the second quarter of 2015. Kronos' other operating expense in the second quarter of 2015 includes \$10.4 million of severance costs related to workforce reductions classified in selling, general and administrative expense. In addition, Kronos' other operating expense decreased in the second quarter of 2016 due to approximately \$3.0 million in cost savings realized in 2016 from workforce reductions implemented in 2015, and other operating income and expense in the second quarter of 2016 includes an insurance settlement gain of \$1.4 million related to a 2014 business interruption claim.

Kronos' other operating income and expense, net in the first six months of 2016 was \$85.7 million, a decrease of \$16.4 million compared to the first six months of 2015. Kronos' other operating expense in the second quarter of 2015 includes \$10.4 million of severance costs related to workforce reductions classified in selling, general and administrative expense. In addition, Kronos' other operating expense decreased in the first six months of 2016 due to approximately \$5.5 million in cost savings realized in 2016 from workforce reductions implemented in 2015, and other operating income and expense in the first six months of 2016 also includes an insurance settlement gain of \$3.4 million related to a 2014 business interruption claim.

Gross margin and income (loss) from operations – Kronos' income from operations increased by \$20.9 million compared to the second quarter of 2015. Income (loss) from operations as a percentage of net sales increased to 3% in the second quarter of 2016 from (3)% in the same period of 2015. This increase was driven by the increase in gross margin percentage, which increased to 16% for the second quarter of 2016 compared to 13% for the second quarter of 2015, and the impact of the \$10.4 million second quarter 2015 workforce reduction charge classified in selling, general and administrative expense and the associated cost savings from such workforce reduction realized in the second quarter of 2016 of \$3.0 million. As discussed and quantified above, Kronos' gross margin percentage increased primarily due to the net effect of lower raw material and other production costs (including 2015 workforce reduction charges of \$10.7 million classified as cost of sales and the associated \$2.0 million of cost savings from such workforce reduction realized in 2016), higher sales volumes, lower selling prices and lower production volumes. Kronos estimates that changes in currency exchange rates increased income from operations by approximately \$4 million in the second quarter of 2016 as compared to the same period in 2015, as discussed below.

Kronos' income from operations decreased by \$11.6 million compared to the first six months of 2015. Income from operations as a percentage of net sales decreased to 2% in the first six months of 2016 from 3% in the same period of 2015. This decrease was driven by the decline in gross margin, which decreased to 14% for the first six months of 2016 compared to 17% for the first six months of 2015, partially offset by the impact of the \$10.4 million second quarter 2015 workforce reduction charge classified in selling, general and administrative expense and the associated cost savings from such workforce reductions realized in the first six months of 2016 of \$5.5 million. As discussed and quantified above, Kronos' gross margin decreased primarily due to the net effect of lower selling prices, lower raw material and other production costs (including 2015 workforce reduction charges of \$10.7 million classified as cost of sales and the associated \$4.0 million of cost savings from such workforce reduction realized in 2016), and higher sales volumes. Kronos estimates that changes in currency exchange rates increased income from operations by approximately \$11 million in the first six months of 2016 as compared to the same period in 2015.

Other non-operating income (expense) – Kronos’ interest expense increased \$.7 million, or 16%, in the second quarter of 2016 compared to the second quarter of 2015. Kronos’ interest expense increased \$1.2 million, or 13%, in the first six months of 2016 compared to 2015 primarily due to higher average debt levels in 2016. Kronos currently expects its interest expense for all of 2016 will be comparable to 2015.

32

Income tax expense – Kronos recognized income tax expense of \$3.9 million in the second quarter of 2016 compared to income tax expense of \$145.1 million in the second quarter of 2015. As discussed below, Kronos' income tax expense in the second quarter of 2016 and 2015 includes a non-cash deferred income tax expense of \$2.9 million and \$150.3 million, respectively, related to the recognition of a deferred income tax asset valuation allowance for its German and Belgian operations. Kronos' earnings are subject to income tax in various U.S. and non-U.S. jurisdictions, and the income tax rates applicable to its pre-tax earnings (losses) of its non-U.S. operations is generally lower than the income tax rates applicable to Kronos' U.S. operations.

Kronos has substantial net operating loss (NOL) carryforwards in Germany (the equivalent of \$683 million for German corporate purposes and \$96 million for German trade tax purposes, respectively, at December 31, 2015) and in Belgium (the equivalent of \$86 million for Belgian corporate tax purposes at December 31, 2015), all of which have an indefinite carryforward period. As a result, Kronos has net deferred income tax assets with respect to these two jurisdictions, primarily related to these NOL carryforwards. The German corporate tax is similar to the U.S. federal income tax, and the German trade tax is similar to the U.S. state income tax. Prior to June 30, 2015, and using all available evidence, Kronos had concluded no deferred income tax asset valuation allowance was required to be recognized with respect to these net deferred income tax assets under the more-likely-than-not recognition criteria, primarily because (i) the carryforwards have an indefinite carryforward period, (ii) Kronos utilized a portion of such carryforwards during the most recent three-year period, and (iii) Kronos expected to utilize the remainder of the carryforwards over the long term. Kronos had also previously indicated that facts and circumstances could change, which might in the future result in the recognition of a valuation allowance against some or all of such deferred income tax assets. However, as of June 30, 2015, and given Kronos' operating results during the second quarter of 2015 and Kronos' expectations at that time for its operating results for the remainder of 2015, which had been driven in large part by the trend in Kronos' average TiQ selling prices over such periods as well as the \$21.1 million pre-tax charge recognized in the second quarter of 2015 in connection with the implementation of certain workforce reductions, Kronos did not have sufficient positive evidence to overcome the significant negative evidence of having cumulative losses in the most recent twelve consecutive quarters in both its German and Belgian jurisdictions at June 30, 2015 (even considering that the carryforward period of its German and Belgian NOL carryforwards is indefinite, one piece of positive evidence). Accordingly, at June 30, 2015, Kronos concluded that it was required to recognize a non-cash deferred income tax asset valuation allowance under the more-likely-than-not recognition criteria with respect to its German and Belgian net deferred income tax assets at such date. Kronos recognized an additional non-cash deferred income tax asset valuation allowance during the second half of 2015 due to losses recognized by its German and Belgian operations during such period. Such valuation allowance aggregated \$168.9 million at December 31, 2015. Kronos recognized an additional non-cash deferred income tax asset valuation allowance during the first half of 2016 of \$2.9 million, all of which was recognized in the second quarter. Kronos continues to believe it will ultimately realize the full benefit of these German and Belgian NOL carryforwards, in part because of their indefinite carryforward period. However, Kronos' ability to reverse all or a portion of such valuation allowance in the future is dependent on the presence of sufficient positive evidence, such as the existence of cumulative profits in the most recent twelve consecutive quarters, and the ability to demonstrate future profitability for a sustainable period. Until such time as Kronos is able to reverse the valuation allowance in full, to the extent Kronos generates additional losses in Germany or Belgium in the intervening periods, Kronos' effective income tax rate would be impacted by the existence of such valuation allowance, because such losses would effectively be recognized without any associated net income tax benefit, as such losses would result in a further increase in the deferred income tax asset valuation allowance. Alternatively, until such time as Kronos is able to reverse the valuation allowance in full, to the extent Kronos generates income in Germany or Belgium in the intervening periods, its effective income tax rate would also be impacted by the existence of such valuation allowance, because such income may be recognized without any associated net income tax expense, subject to certain NOL usage limitations, as Kronos would reverse a portion of the valuation allowance to offset the income tax expense attributable to such income. In addition, any change in tax law related to the indefinite carryforward period of these NOLs could adversely impact Kronos' ability to reverse the valuation allowance in full. Consistent with Kronos' expectation regarding its consolidated results of operations in the remainder of 2016 (as discussed below under the "Outlook" subsection), Kronos currently believes it is likely its German and Belgian operations will report improved operating results in 2016 as compared to 2015. However

Kronos currently does not expect that its German and Belgian operating results would improve to such an extent in 2016 that reversal of the valuation allowance in full would be supported by the presence of sufficient positive evidence.

33

Kronos recognized income tax expense of \$2.5 million in the first six months of 2016 compared to income tax expense of \$154.5 million in the same period last year. As discussed above, Kronos' income tax expense in the first six months of 2016 and 2015 includes a second quarter non-cash deferred income tax expense of \$2.9 million and \$150.3 million, respectively, related to the recognition of a deferred income tax asset valuation allowance for its German and Belgian operations. Kronos' earnings are subject to income tax in various U.S. and non-U.S. jurisdictions, and the income tax rates applicable to its pre-tax earnings (losses) of its non-U.S. operations are generally lower than the income tax rates applicable to Kronos' U.S. operations. Excluding the effect of any increase or decrease in Kronos' deferred income tax asset valuation allowance, Kronos would generally expect its overall effective tax rate to be lower than the U.S. federal statutory rate of 35% primarily because of its non-U.S. operations. Kronos' effective income tax rate in the first six months of 2015, excluding the impact of the deferred income tax asset valuation allowances Kronos recognized, was lower than the U.S. federal statutory tax rate of 35%. However, as a result of Kronos' estimated annual effective tax rate at June 30, 2015, Kronos' non-U.S. rate reconciling items increased its effective tax rate but this increase was more than offset by tax benefits related to nondeductible expenses and its reserve for uncertain tax positions. Kronos' effective income tax rate in the first six months of 2016, excluding the impact of the deferred income tax asset valuation allowances Kronos recognized, was higher than the U.S. federal statutory rate of 35%. Although Kronos reported positive pre-tax earnings in the first six months of 2016, Kronos recognized a net income tax benefit in the first six months of 2016, excluding the impact of the deferred income tax asset valuation allowance it recognized, primarily because Kronos is required under ASC 740-270 to compute the interim tax provision by calculating an estimated annual effective tax rate. Because the estimate is based on full year income, the tax rate differences may not have a meaningful relationship to quarterly or year-to-date interim pre-tax income and may produce unusual and unexpected relationships to other tax rate reconciling items. Excluding the impact of the deferred income tax asset valuation allowance Kronos recognized, its effective income tax rate and the net income tax benefit recognized in the first six months of 2016 is not indicative of the effective income tax rate or income tax expense (benefit) Kronos would expect for the full year of 2016, in part given the near break-even pre-tax results Kronos recognized in the first six months of 2016.

Effects of Currency Exchange Rates

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

Impact of changes in currency exchange rates

three months ended June 30, 2016 vs. June 30, 2015

	Transaction gains/(losses) recognized			Translation gain/loss- impact of rate changes	Total currency impact 2016 vs. 2015
	2015	2016	Change		
	(In millions)				
Impact on:					
Net sales	\$-	\$ -	\$ -	\$ 5	\$ 5
Income from operations	-	2	2	2	4

The \$5 million increase in Kronos' net sales (translation gain) was caused primarily by a weakening of the U.S. dollar relative to the euro, as its euro-denominated sales were translated into more U.S. dollars in 2016 as compared to 2015. The strengthening of the U.S. dollar relative to the Canadian dollar and the Norwegian krone in 2016 did not have a significant effect on the reported amount of Kronos' net sales, as a substantial portion of the sales generated by its Canadian and Norwegian operations are denominated in the U.S. dollar.

The \$4 million net increase in income from operations comprised the following:

- approximately \$2 million from net currency transaction gains caused primarily by a strengthening of the U.S. dollar relative to the Norwegian krone and the Canadian dollar, as U.S. dollar-denominated receivables and U.S. dollar currency held by Kronos' non-U.S. operations became equivalent to a greater amount of local currency in the 2016 period as compared to the 2015 period, and
- approximately \$2 million from net currency translation gains caused primarily by a strengthening of the U.S. dollar relative to the Canadian dollar and the Norwegian krone, as their local currency denominated operating costs were translated into fewer U.S. dollars in 2016 as compared to 2015, (and such translation, as it related to the U.S. dollar relative to the euro, had a negative effect on Kronos' income from operations in 2016 as compared to 2015, as the positive impact of the weaker U.S. dollar on euro-denominated sales was more than offset by the unfavorable effect of euro-denominated operating costs being translated into more U.S. dollars in 2016 as compared to 2015).

Impact of changes in currency exchange rates

six months ended June 30, 2016 vs. June 30, 2015

	Transaction gains/(losses) recognized			Translation gain/loss- impact of rate changes	Total currency impact 2016 vs. 2015
	2015	2016	Change		
	(In millions)				
Impact on:					
Net sales	\$-	\$ -	\$ -	\$ (6)	\$ (6)
Income from operations	1	4	3	8	11

The \$6 million reduction in net sales (translation loss) was caused primarily by a strengthening of the U.S. dollar relative to the euro, as Kronos' euro-denominated sales were translated into fewer U.S. dollars in 2016 as compared to 2015. The strengthening of the U.S. dollar relative to the Canadian dollar and the Norwegian krone in 2016 did not have a significant effect on the reported amount of Kronos' net sales, as a substantial portion of the sales generated by its Canadian and Norwegian operations are denominated in the U.S. Dollar.

The \$11 million net increase in income from operations comprised the following:

· approximately \$3 million from net currency transaction gains caused primarily by a strengthening of the U.S. dollar relative to the euro, the Norwegian krone and the Canadian dollar, as U.S. dollar-denominated receivables and U.S. dollar currency held by Kronos' non-U.S. operations became equivalent to a greater amount of local currency in the 2016 period as compared to the 2015 period, and

35

·approximately \$8 million of net currency translation gains caused primarily by a strengthening of the U.S. dollar relative to the Canadian dollar and the Norwegian krone, as their local currency denominated operating costs were translated into fewer U.S. dollars in 2016 as compared to 2015, (and such translation, as it related to the U.S. dollar relative to the euro, had a negative effect on Kronos' income from operations in 2016 as compared to 2015, as the negative impact of the stronger U.S. dollar on euro-denominated sales more than offset the favorable effect of euro-denominated operating costs being translated into fewer U.S. dollars in 2016 as compared to 2015).

Outlook

During the first half of 2016 Kronos operated its production facilities at 96% of practical capacity. Kronos expects its production volumes to be higher in 2016 as compared to 2015, as its production rates in 2015 were impacted by the implementation of certain productivity-enhancing improvement projects at certain facilities, as well as necessary improvements to ensure continued compliance with its permit regulations, which resulted in longer-than-normal maintenance shutdowns in some instances. Assuming global economic conditions do not deteriorate, Kronos expects its sales volumes to be higher in 2016 as compared to 2015. Kronos will continue to monitor current and anticipated near-term customer demand levels and align its production and inventories accordingly.

Kronos experienced moderation in the cost of TiO₂ feedstock ore procured from third parties in 2015 which continued into the first half of 2016. Given the time lag between when third-party feedstock ore is purchased and when the TiO₂ product produced with such ore is reflected in its cost of sales, Kronos' cost of sales per metric ton of TiO₂ sold in the first half of 2016 was lower than its cost of sales per metric ton of TiO₂ sold in the first half of 2015 (excluding the effect of changes in currency exchange rates). Kronos expects its cost of sales per metric ton of TiO₂ sold for the remainder of 2016 will be lower than its per-metric ton cost in the comparable periods of 2015, due in part to the favorable effect of the workforce reductions and other cost reduction initiatives Kronos implemented beginning in the second quarter of 2015 as well as some expected additional modest improvement in the cost of feedstock ore.

Kronos started 2016 with selling prices 17% lower than the beginning of 2015, and prices declined by an additional 1% in the first quarter of 2016. In the second quarter of 2016, Kronos' average selling prices began to rise due to the implementation of previously-announced price increases. Kronos' average selling prices at the end of the second quarter of 2016 were 4% higher than at the end of the first quarter of 2016, and 2% higher than at the end of 2015. Industry data indicates that overall TiO₂ inventory held by producers declined significantly during 2015. In addition, Kronos believes most customers hold very low inventories of TiO₂ with many operating on a just-in-time basis. With the strong sales volumes experienced in the first half of 2016, Kronos continues to see evidence of strengthening demand for its TiO₂ products in certain of its primary markets. Kronos and its major competitors have announced price increases, which Kronos began implementing in the second quarter of 2016, as contracts have allowed. The extent to which Kronos will be able to achieve any additional price increases in the near term will depend on market conditions.

Kronos initiated a restructuring plan in 2015 designed to improve its long-term cost structure. As part of such plan, Kronos implemented certain voluntary and involuntary workforce reductions during 2015 at certain of its facilities impacting approximately 160 individuals. Such workforce reductions are expected to result in approximately \$19 million of annual cost savings, including \$9.4 million realized during the first six months of 2016. These workforce reductions are not expected to negatively impact Kronos' ability to operate its production facilities at their practical capacity rates. In addition to the workforce reductions implemented in 2015, Kronos is also in the process of implementing other cost reduction initiatives throughout the organization, including the implementation of continued process productivity improvements.

Overall, Kronos expects income from operations in 2016 will be higher as compared to 2015 as a result of:

- the favorable effects of anticipated higher sales and production volumes in 2016,
- the favorable effect of lower-cost third party feedstock ore,

- the expected cost savings from workforce reductions and other cost reduction initiatives throughout the organization, and
- the expected implementation of price increases.

Due to the constraints of high capital costs and extended lead time associated with adding significant new TiO₂ production capacity, especially for premium grades of TiO₂ products produced from the chloride process, Kronos believes increased and sustained profit margins will be necessary to financially justify major expansions of TiO₂ production capacity required to meet expected future growth in demand. As a result of relative customer inventory levels during the recent past and the resulting adverse effect on global TiO₂ pricing, some industry projects to increase TiO₂ production capacity have been cancelled or deferred indefinitely, and announcements have been made regarding the closure of certain facilities. Given the lead time required for production capacity expansions, a shortage of TiO₂ could occur if economic conditions improve and global demand levels for TiO₂ increase sufficiently.

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

LIQUIDITY AND CAPITAL RESOURCES

Consolidated cash flows

Operating activities

Trends in cash flows from operating activities, excluding the impact of deferred taxes and relative changes in assets and liabilities, are generally similar to trends in our income from operations. Changes in working capital are primarily related to changes in receivables and inventories (as discussed below) and payables and accrued liabilities.

Net cash provided by operating activities was \$7.5 million in the first six months of 2016 compared to \$12.7 million in the first six months of 2015. The \$5.2 million net decrease in cash provided by operating activities includes the net effects of:

- higher amount of net cash used for relative changes in receivables (excluding insurance recoveries), inventories, payables and accrued liabilities in 2016 of \$2.7 million,
- lower cash received for insurance recoveries in 2016 of \$3.2 million,
- lower cash paid for income taxes in 2016 of \$1.5 million, due to lower taxable earnings, and
- lower income from operations of CompX in 2016 of \$.9 million.

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

	Six months ended	
	June 30, 2015	2016
	(In millions)	
Net cash provided by operating activities:		
CompX	\$.6	\$ 1.9

Edgar Filing: NL INDUSTRIES INC - Form 10-Q

NL Parent and wholly-owned subsidiaries	13.2	6.7
Eliminations	(1.1)	(1.1)
Total	\$12.7	\$7.5

37

Edgar Filing: NL INDUSTRIES INC - Form 10-Q

Changes in working capital can have a significant effect on cash flows from operating activities. Generally, we expect our average days sales outstanding to increase from December to June as the result of a seasonal increase in sales during the second quarter as compared to the fourth quarter. Overall, our June 30, 2016 days sales outstanding compared to December 31, 2015 is in line with our expectations. As shown below, our total average number of days in inventory decreased from December 31, 2015 to June 30, 2016 as a result of the seasonal increase in sales during the second quarter of 2016 as compared to the fourth quarter 2015 and the temporary reduction in stocking levels at CompX's Marine Components business. For comparative purposes, we have provided information for December 31, 2014 and June 30, 2015 below.

	December 31, 2014	June 30, 2015	December 31, 2015	June 30, 2016
Days sales outstanding	32 days	41 days	31 days	42 days
Days in inventory	90 days	74 days	76 days	69 days

Investing and financing activities

In the first six months of 2016, we spent \$1.7 million in capital expenditures, substantially all of which related to CompX. Cash flows from financing activities in the first six months of 2016 consist of CompX dividends paid to its stockholders other than us.

Outstanding debt obligations

At June 30, 2016, NL and CompX did not have any outstanding debt obligations.

Kronos' North American and European revolvers and its term loan contain a number of covenants and restrictions which, among other things, restrict its ability to incur additional debt, incur liens, pay dividends or merge or consolidate with, or sell or transfer substantially all of its assets to, another entity, and contains other provisions and restrictive covenants customary in lending transactions of this type. Certain of Kronos' credit agreements contain provisions which could result in the acceleration of indebtedness prior to their stated maturity for reasons other than defaults for failure to comply with typical financial or payment covenants. For example, certain credit agreements allow the lender to accelerate the maturity of the indebtedness upon a change of control (as defined in the agreement) of the borrower. In addition, certain credit agreements could result in the acceleration of all or a portion of the indebtedness following a sale of assets outside the ordinary course of business. Kronos' European revolving credit facility also requires the maintenance of certain financial ratios, and one of such requirements is based on the ratio of net debt to the last twelve months EBITDA of the borrowers. Kronos is in compliance with all of its debt covenants at June 30, 2016. Kronos believes that it will be able to continue to comply with the financial covenants contained in its credit facilities through their maturity.

Future cash requirements

Liquidity

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

At June 30, 2016, we had aggregate cash, cash equivalents and restricted cash of \$106.7 million, substantially all of which was held in the U.S. A detail by entity is presented in the table below.

Edgar Filing: NL INDUSTRIES INC - Form 10-Q

	Amount (In millions)
CompX	\$ 51.3
NL Parent and wholly-owned subsidiaries	55.4
Total	\$ 106.7

38

In addition, at June 30, 2016 we owned 14.4 million shares of Valhi common stock with an aggregate market value of \$22.6 million. See Note 4 to our Condensed Consolidated Financial Statements. We also owned 35.2 million shares of Kronos common stock at June 30, 2016 with an aggregate market value of \$184.9 million. See Note 5 to our Condensed Consolidated Financial Statements.

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

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

Based upon our expectations of our operating performance, and the anticipated demands on our cash resources we expect to have sufficient liquidity to meet our short-term obligations (defined as the twelve-month period ending June 30, 2017) including any amounts CompX might loan from time to time under the terms of its new revolving loan to Valhi discussed in Note 14 to our Condensed Consolidated Financial Statements (which loans would be solely at CompX's discretion). If actual developments differ materially from our expectations, our liquidity could be adversely affected. In this regard, Valhi has agreed to loan us up to \$40 million on a revolving basis. At June 30, 2016, we had no outstanding borrowings under this facility, and the full \$40 million was available for future borrowing. The amount of any such outstanding loan Valhi would make to us is at Valhi's discretion. We currently do not expect to be required to borrow any amounts from Valhi during the remainder of 2016 under this facility.

Capital Expenditures

Firm purchase commitments for capital projects in process at June 30, 2016 approximated \$.4 million. CompX's 2016 capital investments are limited to those expenditures required to meet expected customer demand and those required to properly maintain our facilities and technology infrastructure.

Dividends

Because our operations are conducted primarily through subsidiaries and affiliates, our long-term ability to meet parent company-level corporate obligations is largely dependent on the receipt of dividends or other distributions from our subsidiaries and affiliates. A detail of annual dividends we expect to receive from our subsidiaries and affiliates in 2016, based on the number of shares of common stock of these affiliates we own as of June 30, 2016 and their current regular quarterly dividend rate, is presented in the table below.

	Shares held at June 30, 2016 (In millions)	Current Quarterly Dividend Rate	Annual Expected Dividend (In millions)
Kronos	35.2	\$.15	\$ 21.1
CompX	10.8	.05	2.2
Valhi	14.4	.02	1.1
Total expected annual dividends			\$ 24.4

Investments in our subsidiaries and affiliates and other acquisitions

We have in the past and may in the future, purchase the securities of our subsidiaries and affiliates or third-parties in market or privately-negotiated transactions. We base our purchase decisions on a variety of factors, including an analysis of the optimal use of our capital, taking into account the market value of the securities and the

39

relative value of expected returns on alternative investments. In connection with these activities, we may consider issuing additional equity securities or increasing our indebtedness. We may also evaluate the restructuring of ownership interests of our businesses among our subsidiaries and related companies.

Off-balance sheet financing arrangements

Other than operating lease commitments discussed in our 2015 Annual Report, we are not party to any material off-balance sheet financing arrangements.

Commitments and contingencies

There have been no material changes in our contractual obligations since we filed our 2015 Annual Report and we refer you to that report for a complete description of these commitments.

We are subject to certain commitments and contingencies, as more fully described in our 2015 Annual Report, or in Note 13 to our Condensed Consolidated Financial Statements or in Part II, Item 1 of this report, including certain legal proceedings. In addition to such legal proceedings, various legislation and administrative regulations have, from time to time, been proposed that seek to (i) impose various obligations on present and former manufacturers of lead pigment and lead-based paint (including us) with respect to asserted health concerns associated with the use of such products and (ii) effectively overturn court decisions in which we and other pigment manufacturers have been successful. Examples of such proposed legislation include bills which would permit civil liability for damages on the basis of market share, rather than requiring plaintiffs to prove that the defendant's product caused the alleged damage and bills which would revive actions barred by the statute of limitations. While no legislation or regulations have been enacted to date that are expected to have a material adverse effect on our consolidated financial position, results of operations or liquidity, enactment of such legislation could have such an effect.

Recent accounting pronouncements

See Note 16 to our Condensed Consolidated Financial Statements.

Critical accounting policies and estimates

For a discussion of our critical accounting policies, refer to Part I, - "Management's Discussion and Analysis of Financial Condition and Results of Operations" in our 2015 Annual Report. There have been no changes in our critical accounting policies during the first six months of 2016.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

We are exposed to market risk, including currency exchange rates, interest rates and security prices. There have been no material changes in these market risks since we filed our 2015 Annual Report, and we refer you to Part I, Item 7A. - "Quantitative and Qualitative Disclosure about Market Risk" in our 2015 Annual Report. See also Note 15 to our Condensed Consolidated Financial Statements.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of disclosure controls and procedures – We maintain disclosure controls and procedures which, as defined in Exchange Act Rule 13a-15(e), means controls and other procedures that are designed to ensure that information required to be disclosed in the reports that we file or submit to the SEC under the Securities Exchange Act of 1934, as amended (the Act), is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information we are required to disclose in the reports we file or submit to the SEC under the Act is accumulated and communicated to our management, including our principal executive officer and our principal financial officer, or persons performing similar functions, as appropriate to allow timely decisions to be made

regarding required disclosure. Each of Robert D. Graham, our Chairman of the Board, President and Chief Executive Officer and Gregory M. Swalwell, our Executive Vice President and Chief Financial Officer, have evaluated the design and effectiveness of our disclosure controls and procedures as of June 30, 2016. Based upon

40

their evaluation, these executive officers have concluded that our disclosure controls and procedures are effective as of the date of this evaluation.

Internal control over financial reporting – Our management is responsible for establishing and maintaining adequate internal control over financial reporting which, as defined by Exchange Act Rule 13a-15(f) means a process designed by, or under the supervision of, our principal executive and principal financial officers, or persons performing similar functions, and effected by the board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles, and includes those policies and procedures that:

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

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

Changes in internal control over financial reporting – There have been no changes to our internal control over financial reporting during the quarter ended June 30, 2016 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

In addition to the matters discussed below, refer to Note 13 to our Condensed Consolidated Financial Statements, our 2015 Annual Report and our Quarterly Report on Form 10-Q for the quarter ended March 31, 2016 for descriptions of certain legal proceedings.

EPEC Polymers, Inc., v. NL Industries, Inc., (United States District Court for the District of New Jersey, Case 3:12-cv-03842-PGS-TJB). In April 2016, the case was stayed and administratively terminated pending court-ordered mediation. If the mediation is unsuccessful, the case will become active and we will continue to defend vigorously against all of the claims.

In June 2016, NL and one other party received special notice from EPA for Operable Unit 2 of the Madison County Mines Superfund Site near Fredericktown, Missouri. The Site includes several mining properties in Madison County, Missouri. Operable Unit 2 is a former cobalt mine and refinery that is now owned by another mining company. In the special notice, EPA requested that NL and the other mining company agree to perform a Remedial Investigation/Feasibility Study for Operable Unit 2. NL initiated a dialog with EPA regarding the special notice.

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 2015 Annual Report.

Item 6. Exhibits

- 10.1 Unsecured Revolving Demand Promissory Note dated August 3, 2016 in the original principal amount of \$40.0 million executed by Valhi, Inc. and payable to the order of CompX International Inc. – incorporated by reference to Exhibit 10.1 to the Quarterly Report of CompX International Inc. (File No. I-13905) for the quarter ended June 30, 2016.
- 10.2 Ninth Amended and Restated Unsecured Revolving Demand Promissory Note dated August 3, 2016 in the original principal amount of \$60.0 million executed by Valhi, Inc. and payable to the order of Kronos Worldwide, Inc. – incorporated by reference to Exhibit 10.1 to the Quarterly Report of Kronos Worldwide, Inc. (File No. 001-31763) for the quarter ended June 30, 2016.
- 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.LABXBRL Taxonomy Extension Label Linkbase

101.PRE XBRL Taxonomy Extension Presentation Linkbase

42

SIGNATURES

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

NL INDUSTRIES, INC.
(Registrant)

Date: August 5, 2016 /s/ Gregory M. Swalwell
Gregory M. Swalwell
(Executive Vice President and
Chief Financial Officer,
Principal Financial Officer)

Date: August 5, 2016 /s/ Tim C. Hafer
Tim C. Hafer
(Vice President and Controller,
Principal Accounting Officer)