TITANIUM METALS CORP
Form 10-K
February 28, 2007

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 2006

Commission file number 1-14368

Titanium Metals Corporation
(Exact name of registrant as specified in its charter)

Delaware	13-5630895
(State or other jurisdiction of incorporation or organization)	(IRS employer identification no.)

5430 LBJ Freeway, Suite 1700, Dallas, Texas 75240
(Address of principal executive offices, including zip code)

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

Securities registered pursuant to Section 12(b) of the Act:

Common Stock ($.01 par value)	New York Stock Exchange
(Title of each class)	(Name of each exchange on which registered)

Securities registered pursuant to Section 12(g) of the Act:

6¾% Series A Convertible Preferred Stock ($.01 par value)
(Title of class)

Indicate by check mark:

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

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

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

If disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by

reference in Part III of this Form 10-K or any amendment to this Form 10-K __

Whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer (as defined in Rule 12b-2 of the Act). Large accelerated filer X Accelerated filer __ Non-accelerated filer __.

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

The aggregate market value of the 84.2 million shares of voting stock held by nonaffiliates of Titanium Metals Corporation as of June 30, 2006 approximated $2,894.6 million. There are no shares of non-voting stock outstanding. As of February 23, 2007, 161,588,623 shares of common stock were outstanding.

Documents incorporated by reference:

The information required by Part III is incorporated by reference from the Registrant's definitive proxy statement to be filed with the Commission pursuant to Regulation 14A not later than 120 days after the end of the fiscal year covered by this report.

Forward-Looking Information

The statements contained in this Annual Report on Form 10-K ("Annual Report") that are not historical facts, including, but not limited to, statements found in the Notes to Consolidated Financial Statements and in Item 1 - Business, Item 1A - Risk Factors, Item 2 - Properties, Item 3 - Legal Proceedings and Item 7 - Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A"), are forward-looking statements that represent our beliefs and assumptions based on currently available information. Forward-looking statements can generally be identified by the use of words such as "believes," "intends," "may," "will," "looks," "should," "could," "anticipates," "expects" or c terminology or by discussions of strategies or trends. Although we believe that the expectations reflected in such forward-looking statements are reasonable, we cannot give any assurance that these expectations will prove to be correct. Such statements by their nature involve substantial risks and uncertainties that could significantly affect expected results. Actual future results could differ materially from those described in such forward-looking statements, and we disclaim any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. Among the factors that could cause actual results to differ materially are the risks and uncertainties discussed in this Annual Report, including risks and uncertainties in those portions referenced above and those described from time to time in our other filings with the Securities and Exchange Commission ("SEC") which include, but are not limited to:

- the cyclicality of the commercial aerospace industry;
- the performance of aerospace manufacturers and us under their long-term agreements;
- the existence or renewal of certain long-term agreements;
- the difficulty in forecasting demand for titanium products;
- global economic and political conditions;
- global productive capacity for titanium;
- changes in product pricing and costs;
- the impact of long-term contracts with vendors on our ability to reduce or increase supply;
- the possibility of labor disruptions;
- fluctuations in currency exchange rates;
- fluctuations in the market price of marketable securities;
- uncertainties associated with new product or new market development;
- the availability of raw materials and services;
- changes in raw material prices and other operating costs (including energy costs);
- possible disruption of business or increases in the cost of doing business resulting from terrorist activities or global conflicts;
- competitive products and strategies; and
- other risks and uncertainties.

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

PART I

ITEM 1: BUSINESS

General. Titanium Metals Corporation was formed in 1950 and was incorporated in Delaware in 1955. Unless otherwise indicated, references in this report to "we", "us" or "our" refer to TIMET and its subsidiaries, taken as a whole. We are one of the world's leading producers of titanium melted and mill products. We are the only producer with major titanium production facilities in both the United States and Europe, the world's principal markets for titanium consumption. We are currently the largest producer of titanium sponge, a key raw material, in the United States.

Titanium was first manufactured for commercial use in the 1950s. Titanium's unique combination of corrosion resistance, elevated-temperature performance and high strength-to-weight ratio makes it particularly desirable for use in commercial and military aerospace applications where these qualities are essential design requirements for certain critical parts such as wing supports and jet engine components. While aerospace applications have historically accounted for a substantial portion of the worldwide demand for titanium, other end-use applications for titanium in military and industrial markets have continued to develop, including the use of titanium-based alloys in armor plating, structural components, chemical plants, power plants, desalination plants and pollution control equipment. Demand for titanium is also increasing in emerging markets with such diverse uses as offshore oil and gas production installations, automotive, geothermal facilities and architectural applications.

Our products include titanium sponge, melted products, mill products and industrial fabrications. The titanium industry is comprised of several manufacturers that, like us, produce a relatively complete range of titanium products and a significant number of producers worldwide that manufacture a limited range of titanium mill products.

Our long-term strategy is to maximize the value of our core aerospace business while expanding our presence in non-aerospace markets and also developing new applications and products. In the near-term, we intend to continue to utilize our improved operating cash flow and capital availability to support increased levels of investment in the expansion of our productive capacity in response to the industry's long-term positive demand outlook. Opportunities to expand our existing production and conversion capacities may be accomplished through internal expansion and long-term third-party arrangements, as well as potential joint ventures and acquisitions.

Titanium industry. We develop certain industry estimates based on our extensive experience within the titanium industry as well as information obtained from publicly available external resources (e.g., United States Geological Survey, International Titanium Association and Japan Titanium Society). We estimate that we accounted for approximately 20% during 2005 and 2006 of worldwide industry shipments of titanium mill products, and approximately 8% of 2005 and 7% of 2006 worldwide titanium sponge production. The following chart illustrates our estimates of aggregate industry mill product shipments over the past ten years:

Mill Product Shipments by Industry Sector

The cyclical nature of the commercial aerospace sector has been the principal driver of the historical fluctuations in the performance of most titanium product producers. Over the past 20 years, the titanium industry has had a variety of cyclical peaks and troughs in mill product shipments. Prior to 2004, demand for titanium reached its highest level in 1997 when industry mill product shipments reached approximately 60,700 metric tons. However, since 1997, titanium mill product demand in the military, industrial and emerging market sectors has fluctuated significantly, primarily due to the continued development of innovative uses for titanium products in these other industries. We estimate that industry shipments approximated 69,000 metric tons in 2005 and 75,000 metric tons in 2006, and we currently expect 2007 total industry mill product shipments to increase by approximately 7% to 15% as compared to an estimated 9% growth in 2006.

Demand for titanium products within the commercial aerospace sector is derived from both jet engine components (e.g., blades, discs, rings and engine cases) and airframe components (e.g., bulkheads, tail sections, landing gear, wing supports and fasteners). The commercial aerospace sector has a significant influence on titanium companies, particularly mill product producers. Deliveries of titanium generally precede aircraft deliveries by about one year, and our business cycle generally correlates to this timeline, although the actual timeline can vary considerably depending on the titanium product. We estimate that 2007 industry mill product shipments into the commercial aerospace sector will increase 10% to 15% from 2006.

Our business is more dependent on commercial aerospace demand than is the overall titanium industry. We shipped approximately 59% of our mill products to the commercial aerospace sector in 2006, whereas we estimate approximately 41% of the overall titanium industry's mill products were shipped to the commercial aerospace sector in 2006.

The Airline Monitor, a leading aerospace publication, traditionally issues forecasts for commercial aircraft deliveries each January and July. *The Airline Monitor's* most recently issued forecast (January 2007) estimates deliveries of large commercial aircraft (aircraft with over 100 seats) totaled 820 (including 103 twin aisle aircraft) in 2006, and the following table summarizes its forecast of deliveries of large commercial aircraft over the next five years:

	Forecasted deliveries		% increase (decrease) over previous year	
Year	Total	Twin aisle	Total	Twin aisle
2007	925	117	12.8%	13.6%
2008	1,037	170	12.1%	45.3%
2009	1,086	200	4.71%	17.6%
2010	1,205	250	11.0%	25.0%
2011	980	250	(18.7)%	-

The latest forecast from *The Airline Monitor* reflects a 5% increase in forecasted deliveries over the next five years compared to the July 2006 forecast over the next five years, in large part due to the record level of new orders placed for Boeing and Airbus models during 2005 and a stronger than expected order rate in 2006. Total order bookings for Boeing and Airbus in 2006 were 1,857 planes, and current expectations are that new orders in 2007 will be lower than 2006. However, the strong bookings in 2006 have increased the order backlog for both Boeing and Airbus, and these backlogs reflect orders for aircraft to be delivered over the next several years.

Changes in the economic environment and the financial condition of airlines can result in rescheduling or cancellation of contractual orders. Accordingly, aircraft manufacturer backlogs are not necessarily a reliable indicator of near-term

business activity, but may be indicative of potential business levels over a longer-term horizon. The latest forecast from *The Airline Monitor* estimates Airbus' firm order backlog at 329 twin aisle planes and 2,204 single aisle planes and Boeing's firm order backlog at 895 twin aisle planes and 1,541 single aisle planes

Twin aisle planes (e.g., Boeing 747, 777 and 787 and Airbus A330, A340, A350 and A380) tend to use a higher percentage of titanium in their airframes, engines and parts than single aisle planes (e.g., Boeing 737 and 757 and Airbus A318, A319 and A320), and newer models tend to use a higher percentage of titanium than older models. Additionally, Boeing generally uses a higher percentage of titanium in its airframes than Airbus. For example, based on information we receive from airframe and engine manufacturers and other industry sources, we estimate that approximately 59 metric tons, 45 metric tons and 18 metric tons of titanium are purchased for the manufacture of each Boeing 777, 747 and 737, respectively, including both the airframes and engines. Based on these sources, we estimate that approximately 25 metric tons, 18 metric tons and 12 metric tons of titanium are purchased for the manufacture of each Airbus A340, A330 and A320, respectively, including both the airframes and engines.

At year-end 2006, a total of 166 firm orders had been placed for the Airbus A380, a program officially launched in 2000 with anticipated first deliveries in 2007. Based on information we receive from airframe and engine manufacturers and other industry sources, we estimate that approximately 146 metric tons of titanium (120 metric tons for the airframe and 26 metric tons for the engines) will be purchased for each A380 manufactured. Additionally, at year-end 2006, a total of 448 firm orders have been placed for the Boeing 787, a program officially launched in April 2004 with anticipated first deliveries in 2008. Although the 787 will contain more composite materials than a typical Boeing aircraft, based on these sources, we estimate that approximately 136 metric tons of titanium (125 metric tons for the airframe and 11 metric tons for the engines) will be purchased for each 787 manufactured. We believe significant additional titanium will be required in the early years of 787 manufacturing until the program reaches maturity. Additionally, during 2006, Airbus officially launched the A350 XWB program, which is a major derivative of the Airbus A330, with first deliveries scheduled for 2012. As of December 31, 2006, a total of 102 firm orders had been placed for the A350 XWB. These A350 XWBs will use composite materials and new engines similar to those used on the Boeing 787 and are expected to require significantly more titanium as compared with earlier Airbus models. Based on these sources, our preliminary estimates are that at least 51 metric tons (40 metric tons for the airframe and 11 metric tons for the engines) will be purchased for each A350 XWB manufactured. However, the final titanium buy weight may change as the A350 XWB is still in the design phase.

Titanium shipments into the military sector are largely driven by government defense spending in North America and Europe. Military aerospace programs were the first to utilize titanium's unique properties on a large scale, beginning in the 1950s. Titanium shipments to military aerospace markets reached a peak in the 1980s before falling to historical lows in the early 1990s after the end of the Cold War. In recent years, titanium has become an accepted use in ground combat vehicles as well as in naval vessels. The importance of military markets to the titanium industry is expected to continue to rise in coming years as defense spending budgets increase in reaction to terrorist activities and global conflicts and to replace aging conventional armaments. Defense spending for all systems is expected to remain strong until at least 2010. Current and future military strategy leading to light armament and mobility favor the use of titanium due to light weight and strong ballistic performance.

As the strategic environment demands a greater need for global lift and mobility, the U.S. military needs more airlift capacity and capability. Airframe programs are expected to drive the military market demand for titanium through 2015. The U.S. is the world's largest market for single aisle airframes, and overall is expected to require approximately 33% of both single aisle and twin aisle deliveries over the next 20 years. Several of today's active U.S. military programs, including the C-17 and F-15, are currently expected to continue in production through the end of the current decade, while other programs, such as the F/A 18 and F-16, are expected to continue into the middle of the next decade. European military programs also have active aerospace programs offering the possibility for increased titanium consumption. Production levels for the Saab Gripen, Eurofighter Typhoon, Dassault Rafale and Dassault Mirage 2000 are all forecasted to remain steady through the end of the decade.

In addition to the established programs, newer U.S. programs offer growth opportunities for increased titanium consumption. The F/A-22 Raptor was given full-rate production approval in April 2005. Additionally, the F-35 Joint Strike Fighter, now known as the Lightning II, is expected to enter low-rate initial production in late 2008, with delivery of the first production aircraft in 2010. Although no specific delivery patterns have been established, according to *The Teal Group*, a leading aerospace publication, procurement is expected to extend over the next 30 to 40 years and may include as many as approximately 3,500 planes, including sales to foreign nations.

Utilization of titanium on military ground combat vehicles for armor appliqué and integrated armor or structural components continues to gain acceptance within the military market segment. Titanium armor components provide the necessary ballistic performance while achieving a mission critical vehicle performance objective of reduced weight in new generation vehicles. In order to counteract increased threat levels, titanium is being utilized on vehicle upgrade programs in addition to new builds. Based on active programs, as well as programs currently under evaluation, we believe there will be additional usage of titanium on ground combat vehicles that will provide continued growth in the military market sector. In armor and armament, we sell plate and sheet products for fabrication into appliqué plate and reactive armor for protection of the entire ground combat vehicle as well as the vehicle's primary structure.

Since titanium's initial commercial uses, the number of end-use markets for titanium has expanded significantly. Established industrial uses for titanium include chemical plants, power plants, desalination plants and pollution control equipment. Rapid growth of the Chinese and other Southeast Asian economies has brought unprecedented demand for titanium-intensive industrial equipment. In November 2005, we entered into a joint venture with XI'AN BAOTIMET VALINOX TUBES CO. LTD. ("BAOTIMET") to produce welded titanium tubing in the Peoples Republic of China. BAOTIMET's production facilities are located in Xi'an, China, and production began in January 2007.

Titanium continues to gain acceptance in many emerging market applications, including automotive, energy (including oil and gas) and architecture. Although titanium is generally more expensive than other competing metals, over the entire life cycle of the application, customers find that titanium is a less expensive alternative due to its durability and longevity. In many cases customers also find the physical properties of titanium to be attractive from the standpoint of weight, performance, design alternatives and other factors. We continue to explore opportunities in these emerging markets through marketing initiatives, and we actively pursue the research and development of proprietary alloys designed to provide more cost effective alternatives for these markets.

Although we estimate that emerging market demand presently represents only about 4% of the 2006 total industry demand for titanium mill products, we believe emerging market demand, in the aggregate, could grow at double-digit rates over the next several years. We have ongoing initiatives to actively pursue and expand these markets, and these initiatives have resulted in net sales growth from our mill product shipments into emerging markets by more than 50% from 2004 to 2005 and again from 2005 to 2006.

The automotive market continues to be an attractive emerging market due to its potential for sustainable long-term growth. We are focused on developing and marketing proprietary alloys and processes specifically suited for automotive applications. Titanium is now used in several consumer car and truck applications as well as in numerous motorcycles. The decision to select titanium components for consumer car, truck and motorcycle components remains highly cost sensitive; however, we believe titanium's acceptance in consumer vehicles will expand as the automotive industry continues to better understand the benefits titanium offers.

The oil and gas market utilizes titanium for down-hole logging tools, critical riser components, fire water systems and saltwater-cooling systems. Additionally, as offshore development of new oil and gas fields moves into the ultra deep-water depths, market demand for titanium's light-weight, high-strength and corrosion-resistance properties is creating new opportunities for the material. We have focused additional resources on development of alloys and production processes to promote the expansion of titanium use in this market and in other non-aerospace applications.

Products and operations. We are a vertically integrated titanium manufacturer whose products include:

(i) titanium sponge, the basic form of titanium metal used in titanium products;

(ii) melted products (ingot, electrodes and slab), the result of melting sponge and titanium scrap, either alone or with various alloys;

(iii) mill products that are forged and rolled from ingot or slab, including long products (billet and bar), flat products (plate, sheet and strip) and pipe; and

(iv) fabrications (spools, pipe fittings, manifolds, vessels, etc.) that are cut, formed, welded and assembled from titanium mill products

During the past three years, all of our net sales were generated by our integrated titanium operations (our "Titanium melted and mill products" segment), which is our only business segment. Business and geographic financial information is included in Note 19 to the Consolidated Financial Statements.

Titanium sponge is the commercially pure, elemental form of titanium metal with a porous and sponge-like appearance. The first step in our sponge production involves the combination of titanium-containing rutile ores (derived from beach sand) with chlorine and petroleum coke to produce titanium tetrachloride. Titanium tetrachloride is purified and then reacted with magnesium in a closed system, producing titanium sponge and magnesium chloride as co-products. Our titanium sponge production facility in Henderson, Nevada uses vacuum distillation process ("VDP") technology, which removes the magnesium and magnesium chloride residues by applying heat to the sponge mass while maintaining a vacuum in a chamber. The combination of heat and vacuum boils the residues from the sponge mass, and then the sponge mass is mechanically pushed out of the distillation vessel, sheared and crushed. The residual magnesium chloride, a by-product of the VDP process, is electrolytically separated and recycled.

Melted products (ingot, electrodes and slab) are produced by melting sponge and titanium scrap, either alone or with alloys to produce various grades of titanium products suited to the ultimate application of the product. By introducing other alloys such as vanadium, aluminum, molybdenum, tin and zirconium, the melted titanium product is engineered to produce quality grades with varying combinations of certain physical attributes such as strength-to-weight ratio, corrosion-resistance and milling compatibility. Titanium ingot is a cylindrical solid shape that, in our case, weighs up to 8 metric tons. Titanium slab is a rectangular solid shape that, in our case, weighs up to 16 metric tons. The melting process for ingot and slab is closely controlled and monitored utilizing computer control systems to maintain product quality and consistency and to meet customer specifications. In most cases, we use our ingot and slab as the intermediate material for further processing into mill products. However, we also sell ingot, electrodes and slab to third parties.

Mill products are forged or rolled from our melted products (ingot or slab). Mill products include long products (billet and bar), flat products (plate, sheet and strip) and pipe. Our mill products can be milled or forged to meet customer specifications with respect to size and finish using specified grades of material.

We send certain products to outside vendors for further processing (e.g., certain rolling, finishing and other processing steps in the U.S., and certain melting and forging steps in France) before being shipped to customers. In France, our processor is also a partner in our 70%-owned subsidiary, TIMET Savoie, S.A. ("TIMET Savoie"). During 2006, we entered into a 20-year conversion services agreement with Haynes International, Inc. ("Haynes"), whereby Haynes will provide an annual output capacity of 4,500 metric tons of titanium mill rolling services at their facility in Kokomo, Indiana. We also have the option of increasing this output capacity to 9,000 metric tons. This agreement provides us with a long-term secure source for processing flat products, resulting in a significant increase in our existing mill product conversion capabilities, which allows us to assure our customers of our long-term ability to meet their needs.

During the production process and following the completion of manufacturing, we perform extensive testing on our products. The inspection process is critical to ensuring that our products meet our customer's high quality requirements, particularly in aerospace component production. We certify that our products meet customer specification at the time of shipment for substantially all customer orders.

Titanium scrap is a by-product of the forging, rolling, milling and machining operations, and significant quantities of scrap are generated in the production process for finished titanium products and components. Scrap by-product from our mill production processes is typically recycled and introduced into the melting process once the scrap is sorted and cleaned.

Distribution. We sell our products through our own sales force based in the U.S. and Europe and through independent agents and distributors worldwide. Our distribution system also includes eight Company-owned service centers (five in the U.S. and three in Europe), which sell our products on a just-in-time basis. The service centers primarily sell value-added and customized mill products, including bar, sheet, plate, tubing and strip. We believe our service centers provide a competitive advantage because of their ability to foster customer relationships, customize products to suit specific customer requirements and respond quickly to customer needs.

Raw materials. The principal raw materials used in the production of titanium ingot, slab and mill products are titanium sponge, titanium scrap and alloys. The following table summarizes our 2006 raw material usage requirements in the production of our melted and mill products:

	Percentage of total raw material requirements
Internally produced sponge	24%
Purchased sponge	29%
Titanium scrap	40%
Alloys	7%
	100%

The primary raw materials used in the production of titanium sponge are titanium-containing rutile ore, chlorine, magnesium and petroleum coke. Rutile ore is currently available from a limited number of suppliers around the world, principally located in Australia, South Africa and Sri Lanka. We purchase the majority of our supply of rutile ore from Australia. We believe the availability of rutile ore will be adequate for the foreseeable future and do not anticipate any interruptions of our rutile supplies.

Chlorine is currently obtained from a single supplier near our sponge plant in Henderson, Nevada. While we do not presently anticipate any chlorine supply problems, we have taken steps to mitigate this risk in the event of supply disruption, including establishing the feasibility of certain equipment modifications to enable us to utilize material from alternative chlorine suppliers or to purchase and utilize an intermediate product which will allow us to eliminate the purchase of chlorine if needed. Magnesium and petroleum coke are generally available from a number of suppliers.

We are currently the largest U.S. producer of titanium sponge. Beginning in 2005, we commenced a 47% expansion of our sponge production capacity at our Henderson, Nevada plant, which is nearing completion, and commercial production from this additional capacity is expected to commence during the second quarter of 2007. During 2006, other producers also increased capacity and announced plans to begin construction on additional capacity expansion projects during 2007. However, the degree to which quality and cost of the sponge produced by our competitors will be comparable to the high-grade sponge that we produce in our Henderson, Nevada facility is unknown. Because we

cannot supply all of our needs for all grades of titanium sponge internally, we will continue to be dependent on third parties for a portion of our raw material requirements. Titanium melted and mill products require varying grades of sponge and/or scrap depending on the customers' specifications and expected end use. We will continue to purchase sponge from a variety of sources in 2007, including those sources under existing supply agreements that end on December 31, 2007. We continue to evaluate sources of sponge supply, including new long-term supply agreements or renewals of existing long-term sponge supply agreements.

We utilize titanium scrap for melted products that is internally generated from our mill product production process or externally purchased from certain of our customers under various contractual agreements or on the open market. Such scrap consists of alloyed and commercially pure solids and turnings. Internally produced scrap is generated in our factories during both melting and mill product processing. Scrap obtained through customer arrangements provides a "closed-loop" arrangement resulting in certainty of supply and cost stability. Externally purchased scrap comes from a wide range of sources, including customers, collectors, processors and brokers. We anticipate that 20% to 25% of the scrap we will utilize during 2007 will be purchased from external suppliers, as compared to 25% to 30% for 2006, due to our successful efforts to increase our closed-loop arrangements. We also occasionally sell scrap, usually in a form or grade we cannot economically recycle.

All of our major competitors also utilize scrap as a raw material in their melt operations. In addition to use by titanium manufacturers, titanium scrap is used in steel-making operations during production of interstitial-free steels, stainless steels and high-strength-low-alloy steels. Although the demand for scrap remained strong in 2006 from steel-making and titanium melting sectors, as evidenced by high market prices for scrap compared to historical levels, the steel-making sector did not have as much influence on the availability and pricing for titanium scrap in 2006 as compared to 2005.

Overall market forces can significantly impact the supply or cost of externally produced scrap, as the amount of scrap generated in the supply chain varies during the titanium business cycles. Early in the titanium cycle, the demand for titanium melted and mill products begins to increase the scrap requirements for titanium manufacturers which precedes the increase in scrap generation by downstream customers and the supply chain. The pressure on scrap generation and the supply chain places upward pressure on the market price of scrap. The opposite situation occurs when demand for titanium melted and mill products begins to decline, resulting in greater availability of supply and downward pressure on the market price of scrap. During the middle of the cycle, scrap generation and consumption are in relative equilibrium, minimizing disruptions in supply or significant changes in the available supply and market prices for scrap. Increasing or decreasing cycles tend to cause significant changes in both the supply and market price of scrap. These supply chain dynamics result in selling prices for melted and mill products which tend to correspond with the changes in raw material costs. We expect that titanium industry-wide demand increases will continue and that average market prices will remain high in 2007. Because we are a net purchaser of scrap, this high level of demand and continued high pricing will continue to influence our raw material costs which will likely also influence our average selling prices.

In 2006 we were somewhat limited in our ability to raise prices for the portion of our business that is subject to long-term pricing agreements. However, our ability to offset increased material costs with higher selling prices improved in 2006 compared to 2005, as many of our long-term agreements ("LTAs") have either expired or have been renegotiated with selling price adjustments that take into account our raw material cost fluctuations. Further, previously announced sponge expansions, including our VDP sponge expansion, and the increased generation of scrap as the commercial aerospace cycle advances, should help to further reduce the recent imbalance of global supply and demand for raw materials. However, we do not believe the raw material shortage will be fully relieved at any time in the near future, and therefore, we expect relatively high prices for raw materials to continue for at least the near term.

Various alloys used in the production of titanium products are also available from a number of suppliers. The recent high level of global demand for steel products has also resulted in a significant increase in the costs for several alloys, such as vanadium and molybdenum. In 2006, the cost of these alloys remained above historical levels of the past 10

years but were well below the cost peaks we experienced in the spring of 2005. Although availability is not expected to be a concern and we have negotiated certain price and cost protection with suppliers and customers, alloy costs may continue to fluctuate in the future.

Customer agreements. We have LTAs with certain major customers, including, among others, The Boeing Company ("Boeing"), Rolls-Royce plc and its German and U.S. affiliates ("Rolls-Royce"), United Technologies Corporation ("UTC," Pratt & Whitney and related companies), Société Nationale d´Etude et de Construction de Moteurs d´Aviation ("Snecma"), Wyman-Gordon Company ("Wyman-Gordon," a unit of Precision Castparts Corporation ("PCC")) and VALTIMET SAS ("VALTIMET"). These agreements expire at various times through 2017, are subject to certain conditions and generally provide for (i) minimum market shares of the customers' titanium requirements or firm annual volume commitments, (ii) formula-determined prices (including some elements based on market pricing) and (iii) price adjustments for certain raw material and energy cost fluctuations. Generally, the LTAs require our service and product performance to meet specified criteria and contain a number of other terms and conditions customary in transactions of these types. Certain provisions of these LTAs have been amended in the past and may be amended in the future to meet changing business conditions. Our 2006 sales revenues to customers under LTAs were 39% of our total sales revenues, an eight percentage point decrease from 2005. This decrease primarily reflects LTAs with customers that expired in 2005, for which our sales to these customers were on an annual or spot purchase basis in 2006.

In certain events of nonperformance by us or the customer, the LTAs may be terminated early. Although it is possible that some portion of the business would continue on a non-LTA basis, the termination of one or more of the LTAs could result in a material effect on our business, results of operations, financial position or liquidity. The LTAs were designed to limit selling price volatility to the customer, while providing us with a committed volume base throughout the titanium industry business cycles and certain mechanisms to adjust pricing for changes in certain cost elements.

Effective July 1, 2005, we entered into a new LTA with Boeing (which replaced a prior LTA). The new LTA expires on December 31, 2010 and provides for, among other things, (i) mutual annual purchase and supply commitments by both parties, (ii) continuation of the buffer inventory program currently in place for Boeing and (iii) certain improved product pricing, including certain adjustments for raw material cost fluctuations. Beginning in 2006, the new LTA also replaced the take-or-pay provisions of the previous LTA with an annual makeup payment early in the following year in the event Boeing purchases less than its annual volume commitment in any year. In 2006, Boeing met its minimum volume commitment, so no makeup payment was required. See Item 7 - MD&A for additional information regarding the Boeing LTA.

Markets and customer base. The following table summarizes our sales revenue by geographical location: