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VALHI INC /DE/
Form 10-Q
May 08, 2006

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarter ended March 31, 2006 Commission file number 1-5467

VALHI, INC.

(Exact name of Registrant as specified in its charter)

Delaware

87-0110150

(State or other jurisdiction of
incorporation or organization)

(IRS Employer
Identification No.)

5430 LBJ Freeway, Suite 1700, Dallas, Texas 75240-2697

(Address of principal executive offices) (Zip Code)

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

Indicate by check mark:

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

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 Accelerated filer X non-accelerated filer .

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

Number of shares of the Registrant's common stock outstanding on April 28, 2006:
115,703,678.

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VALHI, INC. AND SUBSIDIARIES

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Items 3, 4 and 5 of Part II are omitted because there is no information to report.

VALHI, INC. AND SUBSIDIARIES CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands)

| ASSETS | December 31, 2005 ----- |
|--------------------------------------|-------------------------------|
| Current assets: | |
| Cash and cash equivalents | \$ 274,963 |
| Restricted cash equivalents | 6,007 |
| Marketable securities | 11,755 |
| Accounts and other receivables, net | 218,766 |
| Refundable income taxes | 1,489 |
| Receivable from affiliates | 34 |
| Inventories, net | 283,157 |
| Prepaid expenses | 9,981 |
| Deferred income taxes | 10,502 |
| | ----- |
| Total current assets | 816,654 ----- |
| Other assets: | |
| Marketable securities | 258,705 |
| Investment in affiliates | 270,632 |
| Unrecognized net pension obligations | 11,916 |
| Prepaid pension cost | 3,529 |
| Goodwill | 361,783 |
| Other intangible assets | 3,432 |
| Deferred income taxes | 213,726 |
| Other | 61,639 |
| | ----- |
| Total other assets | 1,185,362 ----- |
| Property and equipment: | |
| Land | 37,876 |
| Buildings | 220,110 |
| Equipment | 827,690 |
| Mining properties | 19,969 |
| Construction in progress | 15,771 |
| | ----- |
| | 1,121,416 |
| Less accumulated depreciation | 545,055 ----- |

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| | |
|----------------------------|-------------|
| Net property and equipment | 576,361 |
| | ----- |
| Total assets | \$2,578,377 |
| | ===== |

VALHI, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS (CONTINUED)

(In thousands)

| LIABILITIES AND STOCKHOLDERS' EQUITY | December 31, 2005 |
|---|----------------------|
| | ----- |
| Current liabilities: | |
| Current maturities of long-term debt | \$ 1,615 |
| Accounts payable | 105,650 |
| Accrued liabilities | 129,429 |
| Payable to affiliates | 13,754 |
| Income taxes | 24,680 |
| Deferred income taxes | 4,313 |
| | ----- |
| Total current liabilities | 279,441 |
| | ----- |
| Noncurrent liabilities: | |
| Long-term debt | 715,820 |
| Accrued pension costs | 140,742 |
| Accrued OPEB costs | 32,279 |
| Accrued environmental costs | 49,161 |
| Deferred income taxes | 400,964 |
| Other | 39,328 |
| | ----- |
| Total noncurrent liabilities | 1,378,294 |
| | ----- |
| Minority interest | 125,049 |
| | ----- |
| Stockholders' equity: | |
| Common stock | 1,207 |
| Additional paid-in capital | 108,810 |
| Retained earnings | 786,268 |
| Accumulated other comprehensive income: | |
| Marketable securities | 4,194 |
| Currency translation | 11,157 |
| Pension liabilities | (78,101) |
| Treasury stock | (37,942) |
| | ----- |

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| | |
|--|----------------------|
| Total stockholders' equity | 795,593 ----- |
| Total liabilities, minority interest and stockholders' equity | \$2,578,377 ===== |

Commitments and contingencies (Notes 11 and 13)

See accompanying Notes to Condensed Consolidated Financial Statements.

VALHI, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
Three months ended March 31, 2005 and 2006
(In thousands, except per share data)
(Unaudited)

| | 2005 ----- |
|---------------------------------------|------------------|
| Revenues and other income: | |
| Net sales | \$341,247 |
| Other income, net | 26,637 |
| Equity in earnings of: | |
| Titanium Metals Corporation ("TIMET") | 16,801 |
| Other | 112 |
| | ----- |
| Total revenues and other income | 384,797 ----- |
| Costs and expenses: | |
| Cost of sales | 251,982 |
| Selling, general and administrative | 54,431 |
| Interest | 17,879 |
| | ----- |
| Total costs and expenses | 324,292 ----- |
| Income before income taxes | 60,505 |
| Provision for income taxes | 29,946 |

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| | |
|--|-----------|
| Minority interest in after-tax earnings | 5,497 |
| | ----- |
| Income from continuing operations | 25,062 |
| Discontinued operations, net of tax | (272) |
| | ----- |
| Net income | \$ 24,790 |
| | ===== |
| Basic and diluted earnings per share: | |
| Income from continuing operations | \$.21 |
| Discontinued operations | - |
| | ----- |
| Net income | \$.21 |
| | ===== |
| Cash dividends per share | \$.10 |
| | ===== |
| Shares used in the calculation of per share amounts: | |
| Basic earnings per common share | 120,223 |
| Dilutive impact of outstanding stock options | 349 |
| | ----- |
| Diluted earnings per share | 120,572 |
| | ===== |

See accompanying Notes to Condensed Consolidated Financial Statements.

VALHI, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

Three months ended March 31, 2005 and 2006

(In thousands)

(Unaudited)

| | |
|--|----------|
| | 2005 |
| | ---- |
| Net income | \$24,790 |
| | ----- |
| Other comprehensive income (loss), net of tax: | |
| Marketable securities adjustment | (168) |
| Currency translation adjustment | (11) |

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| | |
|--|----------|
| Total other comprehensive income (loss), net | (179) |
| Comprehensive income | \$24,611 |

See accompanying Notes to Condensed Consolidated Financial Statements.

VALHI, INC. AND SUBSIDIARIES
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

Three months ended March 31, 2005 and 2006

(In thousands)

(Unaudited)

| | |
|--|-------|
| Cash flows from operating activities: | |
| Net income | \$ 24 |
| Depreciation and amortization | 19 |
| Goodwill impairment | |
| Securities transactions, net | (14) |
| Benefit plan expense less then cash funding: | |
| Defined benefit pension expense | (1) |
| Other postretirement benefit expense | |
| Deferred income taxes: | |
| Continuing operations | 20 |
| Discontinued operations | |
| Minority interest: | |
| Continuing operations | 5 |
| Discontinued operations | |
| Other, net | |
| Equity in: | |
| TIMET | (16) |
| Other | |
| Net distributions from (contributions to): | |
| Manufacturing joint venture | |
| Other | |
| Change in assets and liabilities: | |
| Accounts and other receivables | (44) |
| Inventories | (14) |
| Accounts payable and accrued liabilities | 12 |
| Accounts with affiliates | |
| Income taxes | 7 |
| Other, net | (8) |
| Net cash used in operating activities | (10) |

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| | |
|---|-------|
| Cash flows from investing activities: | |
| Capital expenditures | (12) |
| Purchases of: | |
| Kronos common stock | |
| CompX common stock | |
| TIMET common stock | (11) |
| Marketable securities | (12) |
| Proceeds from disposal of: | |
| Business unit | 18 |
| Kronos common stock | 19 |
| Marketable securities | 2 |
| Loans to affiliate: | |
| Loans | (11) |
| Collections | 10 |
| Cash of disposed business unit | (4) |
| Change in restricted cash equivalents, net | 2 |
| Other, net | |
| | ----- |
| Net cash provided by (used in) investing activities | 1 |
| | ----- |

VALHI, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)

Three months ended March 31, 2005 and 2006

(In thousands)

(Unaudited)

| | |
|---|----------|
| | 2005 |
| | ---- |
| Cash flows from financing activities: | |
| Indebtedness: | |
| Borrowings | \$ - |
| Principal payments | (82) |
| Deferred financing costs paid | (28) |
| Valhi dividends paid | (12,424) |
| Distributions to minority interest | (1,477) |
| Treasury stock acquired | - |
| NL common stock issued | 2,413 |
| Issuance of Valhi common stock and other, net | 742 |
| | ----- |
| Net cash provided by (used in) financing activities | (10,856) |
| | ----- |
| Cash and cash equivalents - net change from: | |
| Operating, investing and financing activities | (19,948) |

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| | |
|--|-----------|
| Currency translation | (280) |
| Cash and equivalents at beginning of period | 267,829 |
| | ----- |
| Cash and equivalents at end of period | \$247,601 |
| | ===== |
| Supplemental disclosures: | |
| Cash paid (received) for: | |
| Interest, net of amounts capitalized | \$ 6,224 |
| Income taxes, net | 6,117 |
| Noncash investing activity - note receivable | |
| received upon disposal of business unit | \$ 4,179 |

See accompanying Notes to Condensed Consolidated Financial Statements.

VALHI, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

Three months ended March 31, 2006

(In thousands)

(Unaudited)

| | Common stock | Additional paid-in capital | Retained earnings | Accumulated other comprehensive i Marketable securities | Currency translation | Pens liabil |
|---|-----------------|----------------------------------|----------------------|---|-------------------------|----------------|
| | ----- | ----- | ----- | ----- | ----- | ----- |
| Balance at December 31, 2005 | \$1,207 | \$108,810 | \$786,268 | \$4,194 | \$11,157 | \$(78, |
| Net income | - | - | 22,864 | - | - | - |
| Dividends | - | - | (12,060) | - | - | - |
| Other comprehensive income (loss), net | - | - | - | (113) | 3,314 | - |
| Treasury stock: | | | | | | |
| Acquired | - | - | - | - | - | - |
| Retired | (3) | (248) | (4,651) | - | - | - |
| Other, net | 1 | 17 | - | - | - | - |
| | ----- | ----- | ----- | ----- | ----- | ----- |
| Balance at March 31, 2006 | \$1,205 | \$108,579 | \$792,421 | \$ 4,081 | \$14,471 | \$(78, |
| | ===== | ===== | ===== | ===== | ===== | ===== |

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See accompanying Notes to Condensed Consolidated Financial Statements.

VALHI, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2006

(Unaudited)

Note 1 - Organization and basis of presentation:

The Condensed Consolidated Balance Sheet of Valhi, Inc. and Subsidiaries (collectively, the "Company") at December 31, 2005 has been derived from the Company's audited Condensed Consolidated Financial Statements at that date. The Consolidated Balance Sheet at March 31, 2006, and the Condensed Consolidated Statements of Income, Comprehensive Income, Stockholders' Equity and Cash Flows for the interim periods ended March 31, 2005 and 2006, have been prepared by the Company, without audit, in accordance with accounting principles generally accepted in the United States of America ("GAAP"). In the opinion of management, all adjustments, consisting only of normal recurring adjustments, necessary to state fairly the consolidated financial position, results of operations and cash flows have been made. As permitted by regulations of the SEC, the Condensed Consolidated Balance Sheet data as of December 31, 2005 does not include all disclosures required by GAAP.

The results of operations for the interim periods are not necessarily indicative of the operating results for a full year or of future operations. Certain information normally included in financial statements prepared in accordance with GAAP has been condensed or omitted. The accompanying Condensed Consolidated Financial Statements should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended December 31, 2005, as filed with the Securities and Exchange Commission on March 24, 2006 (the "2005 Annual Report").

Contran Corporation holds, directly or through subsidiaries, approximately 92% of Valhi's outstanding common stock at March 31, 2006. Substantially all of Contran's outstanding voting stock is held by trusts established for the benefit of certain children and grandchildren of Harold C. Simmons, of which Mr. Simmons is sole trustee, or is held by Mr. Simmons or persons or other entities related to Mr. Simmons. Consequently, Mr. Simmons, may be deemed to control such companies.

Note 2 - Business segment information:

| Business segment | % owned by Valhi at Entity | March 31, 2006 |
|--------------------|-------------------------------|----------------|
| Chemicals | Kronos Worldwide, Inc. | 95% |
| Component products | CompX International Inc. | 70% |
| Waste management | Waste Control Specialists LLC | 100% |
| Titanium metals | TIMET | 37% |

The Company's ownership of Kronos includes 59% held directly by Valhi and 36% held directly by NL Industries, Inc., an 83%-owned subsidiary of Valhi. During the first quarter of 2006, Valhi purchased approximately 829,000 shares of Kronos common stock in market transactions for an aggregate of \$22.4 million.

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The acquisition of these shares of common stock were accounted for by the purchase method (step acquisition).

The Company's ownership of CompX is principally held directly by CompX Group, Inc, a majority-owned subsidiary of NL. NL owns 82.4% of CompX Group, and TIMET owns the remaining 17.6% of CompX Group. CompX Group's sole asset consists of shares of CompX common stock representing approximately 83% of the total number of CompX shares outstanding, and the percentage ownership of CompX shown above includes NL's ownership interest in CompX Group multiplied by CompX Group's ownership interest in CompX, or 68%. NL also owns an additional 2% of CompX directly. During the first quarter of 2006, NL purchased approximately 26,500 shares of CompX common stock in market transactions for an aggregate of \$404,000. The acquisition of these shares of common stock were accounted for by the purchase method (step acquisition).

The company's ownership of TIMET includes 33% owned directly by Tremont LLC, a wholly-owned subsidiary of the Company, and 4% owned directly by Valhi. In addition, TIMET owns directly an additional 3% of CompX, .5% of NL and less than .1% of Kronos, and TIMET accounts for such CompX, NL and Kronos shares, as well as its shares of CompX Group, as available-for-sale marketable securities carried at fair value. The Combined Master Retirement Trust ("CMRT"), a collective investment trust sponsored by Contran to permit the collective investment by certain master trusts which fund certain employee benefits plans sponsored by Contran and certain of its affiliates, owned an additional 10% of TIMET's outstanding common stock at March 31, 2006. Because the Company does not consolidate either TIMET or the CMRT, the shares of CompX Group, CompX, NL and Kronos owned by TIMET, and the shares of TIMET held by the CMRT, are not considered as part of the Company's investments in such companies.

Kronos (NYSE: KRO), NL (NYSE: NL), CompX (NYSE: CIX) and TIMET (NYSE: TIE) each file periodic reports with the Securities and Exchange Commission ("SEC") pursuant to the Securities Exchange Act of 1934, as amended.

| | Three mo Ma 2005 ----- (In m |
|------------------------|--|
| Net sales: | |
| Chemicals | \$291.9 |
| Component products | 46.8 |
| Waste management | 2.5 |
| | ----- |
| Total net sales | \$341.2 ===== |
| Operating income: | |
| Chemicals | \$ 43.6 |
| Component products | 4.1 |
| Waste management | (2.8) |
| | ----- |
| Total operating income | 44.9 |
| Equity in: | |
| TIMET | 16.8 |
| Other | .1 |

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General corporate items:

| | |
|-----------------------------------|---------|
| Interest and dividend income | 10.2 |
| Securities transaction gains, net | 14.6 |
| Insurance recoveries | - |
| General expenses, net | (8.2) |
| Interest expense | (17.9) |
| | ----- |
| Income before income taxes | \$ 60.5 |
| | ===== |

Segment results reported herein may differ from amounts separately reported by the Company's various subsidiaries and affiliates due to purchase accounting adjustments and related amortization or differences in the way the Company defines operating income.

Note 3 - Marketable securities:

| | |
|---|----------------------|
| | December 31, 2005 |
| | ----- |
| | (In thousands) |
| Current assets (available for sale): | |
| Restricted debt securities | \$ 9,265 |
| Other debt securities | 2,490 |
| | ----- |
| Total | \$ 11,755 |
| | ===== |
| Noncurrent assets (available-for-sale): | |
| The Amalgamated Sugar Company LLC | \$250,000 |
| Restricted debt securities | 2,572 |
| Other debt securities and common stocks | 6,133 |
| | ----- |
| Total | \$258,705 |
| | ===== |

Note 4 - Accounts and other receivables, net:

December 31,
2005

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(In thousand)

| | |
|---|-----------|
| Accounts receivable | \$211,156 |
| Notes receivable | 4,267 |
| Accrued interest and dividends receivable | 6,158 |
| Allowance for doubtful accounts | (2,815) |
| | ----- |
| Total | \$218,766 |
| | ===== |

Note 5 - Inventories, net:

December 31,
2005

(In thousand)

| | |
|--------------------------------|-----------|
| Raw materials: | |
| Chemicals | \$ 52,343 |
| Component products | 7,022 |
| | ----- |
| Total raw materials | 59,365 |
| | ----- |
| In-process products: | |
| Chemicals | 17,959 |
| Component products | 9,898 |
| | ----- |
| Total in-process products | 27,857 |
| | ----- |
| Finished products: | |
| Chemicals | 150,675 |
| Component products | 5,542 |
| | ----- |
| Total finished products | 156,217 |
| | ----- |
| Supplies (primarily chemicals) | 39,718 |
| | ----- |
| Total inventories, net | \$283,157 |
| | ===== |

Note 6 - Accrued liabilities:

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December 31,
2005

(In thousand)

Current:

| | |
|---------------------|-----------|
| Employee benefits | \$ 48,341 |
| Environmental costs | 16,565 |
| Deferred income | 5,101 |
| Interest | 1,067 |
| Other | 58,355 |
| | ----- |

| | |
|-------|-----------|
| Total | \$129,429 |
| | ===== |

Noncurrent:

| | |
|-------------------------------|-----------|
| Insurance claims and expenses | \$ 24,257 |
| Employee benefits | 4,998 |
| Asset retirement obligations | 1,381 |
| Deferred income | 573 |
| Other | 8,119 |
| | ----- |

| | |
|-------|-----------|
| Total | \$ 39,328 |
| | ===== |

Note 7 - Other assets:

December 31,
2005

(In thousand)

Investment in affiliates:

TIMET:

| | |
|-----------------|-----------|
| Common stock | \$138,677 |
| Preferred stock | 183 |
| | ----- |
| | 138,860 |

| | |
|----------------------------------|---------|
| TiO2 manufacturing joint venture | 115,308 |
| Other | 16,464 |
| | ----- |

| | |
|-------|-----------|
| Total | \$270,632 |
| | ===== |

Other noncurrent assets:

| | |
|--|-----------|
| IBNR receivables | \$ 16,735 |
| Deferred financing costs | 8,278 |
| Waste disposal site operating permits, net | 14,133 |
| Loans and other receivables | 2,502 |

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| | |
|-----------------------------|-----------|
| Restricted cash equivalents | 382 |
| Other | 19,609 |
| | ----- |
| Total | \$ 61,639 |
| | ===== |

At March 31, 2006, the Company held 28.0 million shares of TIMET with a quoted market price of \$48.55 per share, or an aggregate market value of \$1.4 billion. In February 2006, TIMET effected a 2:1 split of its common stock. Such stock split had no financial statement impact to the Company, and the Company's ownership interest in TIMET did not change as a result of such split.

At March 31, 2006, TIMET reported total assets of \$989.9 million and stockholders' equity of \$639.2 million. TIMET's total assets at March 31, 2006 include current assets of \$619.7 million, property and equipment of \$262.9 million, marketable securities of \$46.1 million and investment in joint ventures of \$28.6 million. TIMET's total liabilities at March 31, 2006 include current liabilities of \$180.2 million, accrued OPEB and pension costs aggregating \$74.9 million and long-term debt of \$48.8 million. During the first quarter of 2006, TIMET reported net sales of \$286.9 million, operating income of \$95.1 million and net income attributable to common stockholders of \$56.8 million (2005 - net sales of \$155.2 million, operating income of \$19.4 million and net income attributable to common stockholders of \$38.1 million).

Note 8 - Other income, net:

| | |
|------------------------------|----------|
| | Three m |
| | M |
| | 2005 |
| | ---- |
| | (In tho |
| Securities earnings: | |
| Dividends and interest | \$10,175 |
| Securities transactions, net | 14,607 |
| | ----- |
| Total securities earnings | 24,782 |
| Currency transactions, net | 874 |
| Insurance recoveries | - |
| Other, net | 981 |
| | ----- |
| Total other income, net | \$26,637 |
| | ===== |

Note 9 - Long-term debt:

December 31,
2005

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(In thousand)

| | |
|--|-----------|
| Valhi - Snake River Sugar Company | \$250,000 |
| | ----- |
| Subsidiaries: | |
| Kronos International 8.875% Senior Secured Notes | 449,298 |
| Kronos U.S. bank credit facility | 11,500 |
| Kronos Canadian bank credit facility | - |
| Other | 6,637 |
| | ----- |
| Total debt of subsidiaries | 467,435 |
| | ----- |
| Total debt | 717,435 |
| | ----- |
| Less current maturities | 1,615 |
| | ----- |
| Total long-term debt | \$715,820 |
| | ===== |

During the first quarter of 2006, Kronos borrowed an aggregate of Cdn. \$5.0 million (\$4.3 million) under its Canadian revolving credit facility, and also borrowed an additional net \$18.3 million under its U.S. bank credit facility.

In April 2006, Kronos' wholly owned subsidiary, Kronos International, called all of its 8.875% Senior Secured Notes for redemption on May 11, 2006 at 104.437% of their aggregate principal amount of euro 375 million (including such call premium, an aggregate of \$470.2 million at March 31, 2006 exchange rates). Funds for such redemption were provided by Kronos International's issuance of an aggregate of euro 400 million principal amount of 6.5% Senior Secured Notes due April 2013, issued on April 11, 2006 at 99.306% of their principal amount. The new Senior Secured Notes were issued pursuant to an indenture that contains covenants, restrictions and collateral substantially identical to the covenants, restrictions and collateral of the 8.875% Senior Secured Notes. The Company expects to recognize a \$21 million pre-tax charge in the second quarter of 2006 related to the early extinguishment of KII's 8.875% Senior Secured Notes, consisting of the call premium on such Notes and the net write-off of deferred financing costs and existing unamortized premium related to such Notes.

Note 10 - Accounts with affiliates:

| | |
|--------------------------------------|---------------|
| | December 31, |
| | 2005 |
| | ----- |
| | (In thousand) |
| Current receivables from affiliates: | |
| Contran - income taxes, net | \$ 33 |
| Other | 1 |
| | ----- |
| Total | \$ 34 |

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| | |
|---------------------------|----------|
| | ===== |
| Payables to affiliates: | |
| Louisiana Pigment Company | \$ 9,803 |
| Contran - trade items | 3,940 |
| Other, net | 11 |
| | ----- |
| Total | \$13,754 |
| | ===== |

Note 11 - Provision for income taxes:

| | |
|---|-----------|
| | Three mon |
| | March |
| | 2005 |
| | ----- |
| | (In mil) |
| Expected tax expense | \$21.2 |
| Incremental U.S. tax and rate differences on equity in earnings | 4.8 |
| Non-U.S. tax rates | - |
| Nondeductible expenses | 1.2 |
| Adjustment of prior year income taxes, net | - |
| Income tax on distribution of shares of Kronos common stock | .7 |
| Excess of book basis over tax basis of shares of Kronos common stock sold | 1.6 |
| U.S. state income taxes, net | .3 |
| Other, net | .1 |
| | ----- |
| | \$29.9 |
| | ===== |
| Comprehensive provision for income taxes (benefit) allocated to: | |
| Income from continuing operations | \$29.9 |
| Discontinued operations | (.4) |
| Other comprehensive income: | |
| Marketable securities | .9 |
| Currency translation | (.2) |
| | ----- |
| | \$30.2 |
| | ===== |

Certain of the Company's U.S. and non-U.S. tax returns are being examined and tax authorities have or may propose tax deficiencies, including penalties and interest. For example:

- o Kronos received a preliminary tax assessment related to 1993 from the

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Belgian tax authorities proposing tax deficiencies, including related interest, of approximately euro 6 million (\$7 million at March 31, 2006). Kronos filed a protest to this assessment, and believes that a significant portion of the assessment is without merit. The Belgian tax authorities have filed a lien on the fixed assets of Kronos' Belgian TiO2 operations in connection with this assessment.

- o The Norwegian tax authorities have notified Kronos of their intent to assess tax deficiencies of approximately kroner 12 million (\$2 million) relating to the years 1998 through 2000. Kronos has objected to this proposed assessment.

No assurance can be given that these tax matters will be resolved in the Company's favor in view of the inherent uncertainties involved in settlement initiatives and court and tax proceedings. The Company believes that it has provided adequate accruals for additional taxes and related interest expense which may ultimately result from all such examinations and believes that the ultimate disposition of such examinations should not have a material adverse effect on its consolidated financial position, results of operations or liquidity.

Note 12 - Minority interest:

| | December 31, 2005 |
|----------------------------------|----------------------|
| (In thousand) | |
| Minority interest in net assets: | |
| NL Industries | \$ 51,177 |
| Kronos Worldwide | 28,167 |
| CompX International | 45,630 |
| Subsidiary of Kronos | 75 |
| | ----- |
| Total | \$125,049 |
| | ===== |

| | Three months March 2005 |
|--|-------------------------------|
| (In thousand) | |
| Minority interest in net earnings - Continuing operations: | |
| NL Industries | \$3,228 |
| Kronos Worldwide | 1,534 |
| CompX International | 701 |
| Subsidiary of Kronos | 4 |
| Subsidiary of NL | 30 |
| | ----- |
| Total | \$5,497 |
| | ===== |

Note 13 - Commitments and contingencies:

Lead pigment litigation - NL.

NL's former operations included the manufacture of lead pigments for use in paint and lead-based paint. NL, other former manufacturers of lead pigments for use in paint and lead-based paint, and the Lead Industries Association (which discontinued business operations prior to 2005) 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, large U.S. 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. 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 in favor of either the defendants or the plaintiffs. In addition, various other cases are pending (in which NL is not a defendant) seeking recovery for injuries allegedly caused by lead pigment and lead-based paint. Although NL is not a defendant in these cases, the outcome of these cases may have an impact on additional cases being filed against NL in the future.

NL believes these actions are without merit, intends to continue to deny all allegations of wrongdoing and liability and to defend against all actions vigorously. NL has never settled any of these cases, nor have any final adverse judgments against NL been entered. NL has not accrued any amounts for pending lead pigment and lead-based paint litigation. Liability that may result, if any, cannot currently be reasonably estimated. There can be no assurance that NL will not incur liability in the future in respect of this pending litigation in view of the inherent uncertainties involved in court and jury rulings in pending and possible future cases. If any such future liability were to be incurred, it could have a material adverse effect on the Company's consolidated financial statements, results of operations and liquidity.

In one of these lead pigment cases (State of Rhode Island v. Lead Industries Association), a trial before a Rhode Island state court jury began in September 2002 on the question of whether lead pigment in paint on Rhode Island buildings is a public nuisance. In October 2002, the trial judge declared a mistrial in the case when the jury was unable to reach a verdict on the question, with the jury reportedly deadlocked 4-2 in the defendants' favor. In November 2005, the State of Rhode Island began a retrial of the case on the State's claims of public nuisance, indemnity and unjust enrichment against NL and three other defendants. Following the State's presentation of its case, the trial court dismissed the State's claims of indemnity and unjust enrichment. The

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public nuisance claim was sent to the jury in February 2006, and the jury found that NL and two other defendants substantially contributed to the creation of a public nuisance as a result of the collective presence of lead pigments in paints and coatings on buildings in Rhode Island. The jury also found that NL and the two other defendants should be ordered to abate the public nuisance. Following the jury verdict, the trial court dismissed the State's claim for punitive damages. A hearing on the abatement remedy will be held before the judge. The extent, nature and cost of such remedy is not currently known, and will be determined only following additional proceedings. Various matters remain pending before the trial court, including NL's motion to dismiss. NL intends to appeal any adverse judgment which the trial court may enter against NL.

The Rhode Island case is unique in that this is the first time that an adverse verdict has been entered against NL. Given the number of meritorious issues which NL believes can be appealed in this case, NL currently believes that it is not probable that NL will ultimately be found liable in this matter. In addition, liability that might result to NL, if any, with respect to this and the other lead pigment litigation can not currently be reasonably estimated. However, legal proceedings are subject to inherent uncertainties, and there is no assurance that any appeal would be successful. Therefore, it is reasonably possible that NL would in the near term conclude that it was probable NL had incurred some liability in this Rhode Island matter that would result in the recognition of a loss contingency accrual. Such potential liability could have a material adverse impact on net income for the interim or annual period during which such liability is recognized, and a material adverse impact on the Company's financial condition and liquidity. Various other cases in which NL is a defendant are also pending in other jurisdictions, and new cases could be filed against NL, the resolution of which could also result in recognition of a loss contingency accrual that could have a material adverse impact on net income for the interim or annual period during which such liability is recognized, and a material adverse impact on the Company's financial condition and liquidity. An estimate of the potential impact on the Company's results of operations, financial condition or liquidity related to these matters can not currently be reasonably estimated.

Environmental matters and litigation.

General. The Company's operations are governed by various environmental laws and regulations. Certain of the Company's 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 past and current operations and products of the Company have the potential to cause environmental or other damage. The Company has implemented and continues to implement various policies and programs in an effort to minimize these risks. The Company's policy is to maintain compliance with applicable environmental laws and regulations at all of its plants and to strive to improve its environmental performance. From time to time, the Company may be subject to environmental regulatory enforcement under U.S. and foreign statutes, 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 thereunder, could adversely affect the Company's production, handling, use, storage, transportation, sale or disposal of such substances. The Company believes all of its plants are in substantial compliance with applicable environmental laws.

Certain properties and facilities used in the Company's former businesses, including divested primary and secondary lead smelters and former mining locations of NL, are the subject of civil litigation, administrative proceedings or investigations arising under federal and state environmental laws. Additionally, in connection with past disposal practices, the Company has been named as a defendant, potentially responsible party ("PRP") or both, pursuant to

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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 currently or previously owned, operated or used by the Company or its subsidiaries, or their predecessors, certain of which are on the U.S. EPA's Superfund National Priorities List or similar state lists. 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 the Company may be jointly and severally liable for such costs, in most cases it is only one of a number of PRPs who may also be jointly and severally liable.

Environmental obligations are difficult to assess and estimate for numerous reasons including the complexity and differing interpretations of governmental regulations, the number of PRPs and the PRPs' ability or willingness to fund such allocation of costs, their financial capabilities and the allocation of costs among PRPs, the solvency of other PRPs, the multiplicity of possible solutions, and the years of investigatory, remedial and monitoring activity required. In addition, the imposition of more stringent standards or requirements under environmental laws or regulations, new developments or changes respecting site cleanup costs or allocation of such costs among PRPs, solvency of other PRPs, the results of future testing and analysis undertaken with respect to certain sites or a determination that the Company is potentially responsible for the release of hazardous substances at other sites, could result in expenditures in excess of amounts currently estimated by the Company to be required for such matters. In addition, with respect to other PRPs and the fact that the Company may be jointly and severally liable for the total remediation cost at certain sites, the Company could ultimately be liable for amounts in excess of its accruals due to, among other things, reallocation of costs among PRPs or the insolvency of one or more PRPs. No assurance can be given that actual costs will not exceed accrued amounts or the upper end of the range for sites for which estimates have been made, and no assurance can be given that costs will not be incurred with respect to sites as to which no estimate presently can be made. Further, there can be no assurance that additional environmental matters will not arise in the future. If any such future liability were to be incurred, it could have a material adverse effect on the Company's consolidated financial statements, results of operations and liquidity.

The Company records liabilities related to environmental remediation obligations when estimated future expenditures are probable and reasonably estimable. Such accruals are adjusted as further information becomes available or circumstances change. Estimated future expenditures are generally not discounted to their present value. Recoveries of remediation costs from other parties, if any, are recognized as assets when their receipt is deemed probable. At March 31, 2006, no receivables for such recoveries had been recognized.

The exact time frame over which the Company makes payments with respect to its accrued environmental costs is unknown and is dependent upon, among other things, the timing of the actual remediation process that in part depends on factors outside the control of the Company. At each balance sheet date, the Company makes an estimate of the amount of its accrued environmental costs that will be paid out over the subsequent 12 months, and the Company classifies such amount as a current liability. The remainder of the accrued environmental costs is classified as a noncurrent liability.

A summary of the activity in the Company's accrued environmental costs during the first quarter of 2006 is presented in the table below.

Balance at the beginning of the period
Additions charged to expense, net
Payments, net

Balance at the end of the period

Amounts recognized in the balance sheet at the end of the period:

Current liability
Noncurrent liability

Total

NL. On a quarterly basis, NL evaluates the potential range of its liability at sites where it has been named as a PRP or defendant. At March 31, 2006, NL had accrued \$52.9 million for those environmental matters which NL believes are reasonably estimable. NL believes it is not possible to estimate the range of costs for certain sites. The upper end of the range of reasonably possible costs to NL for sites for which NL believes it is possible to estimate costs is approximately \$79 million. NL's estimates of such liabilities have not been discounted to present value.

At March 31, 2006, there are approximately 20 sites for which NL is unable to estimate a range of costs. For these sites, generally the investigation is in the early stages, and it is either unknown as to whether or not NL actually had any association with the site, or if NL had association with the site, the nature of its responsibility, if any, for the contamination at the site and the extent of contamination. The timing on when information would become available to NL to allow NL to estimate a range of loss is unknown and dependent on events outside the control of NL, such as when the party alleging liability provides information to NL. On certain of these sites that had previously been inactive, NL has received general and special notices of liability from the EPA alleging that NL, along with other PRPs, is liable for past and future costs of remediating environmental contamination allegedly caused by former operations conducted at such sites. These notifications may assert that NL, along with other PRPs, is liable for past clean-up costs that could be material to NL if liability for such amounts ultimately were determined against NL.

Tremont. Prior to 2005, Tremont, entered into a voluntary settlement agreement with the Arkansas Department of Environmental Quality and certain other PRPs pursuant to which Tremont and the other PRPs will undertake certain investigatory and interim remedial activities at a former mining site located in Hot Springs County, Arkansas. Tremont had entered into an agreement with another PRP for this site, Halliburton Energy Services, Inc., that provides for, among other things, the interim sharing of remediation costs associated with the site pending a final allocation of costs and an agreed-upon procedure through arbitration to determine such final allocation of costs. On December 9, 2005, Halliburton and DII Industries, LLC, another PRP of this site, filed suit in the United States District Court for the Southern District of Texas, Houston Division, Case No. H-05-4160, against NL, Tremont and certain of its subsidiaries, M-I, L.L.C., Milwhite, Inc. and Georgia-Pacific Corporation seeking (i) to recover response and remediation costs incurred at the site, (ii) a declaration of the parties' liability for response and remediation costs incurred at the site, (iii) a declaration of the parties' liability for response

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and remediation costs to be incurred in the future at the site and (iv) a declaration regarding the obligation of Tremont to indemnify Halliburton and DII for costs and expenses attributable to the site. On December 27, 2005, a subsidiary of Tremont filed suit in the United States District Court for the Western District of Arkansas, Hot Springs Division, Case No. 05-6089, against Georgia-Pacific, seeking to recover response costs it has incurred and will incur at the site. Subsequently, plaintiffs in the Houston litigation agreed to stay that litigation by entering into with NL, Tremont and its affiliates an amendment to the arbitration agreement previously agreed upon for resolving the allocation of costs at the site. Tremont has also agreed with Georgia Pacific to stay the Arkansas litigation pending further developments in the Houston litigation. Tremont has based its accrual for this site based upon the agreed-upon interim cost sharing allocation. Tremont currently expects that the nature and extent of any final remediation measures that might be imposed with respect to this site will not be known until 2008. Currently, no reasonable estimate can be made of the cost of any such final remediation measures, and accordingly Tremont has accrued no amounts at March 31, 2006 for any such cost. The amount accrued at March 31, 2006 (\$3.6 million) represents Tremont's estimate of the probable and reasonably estimable costs to be incurred through 2008 with respect to the interim remediation measures.

TIMET. At March 31, 2006, TIMET had accrued approximately \$3.0 million for environmental cleanup matters, principally related to TIMET's facility in Nevada. The upper end of the range of reasonably possible costs related to these matters is approximately \$5.2 million.

Other. The Company has also accrued approximately \$7.5 million at March 31, 2006 in respect of other environmental cleanup matters. Such accrual is near the upper end of the range of the Company's estimate of reasonably possible costs for such matters.

Other litigation.

Reference is made to the 2005 Annual Report for a discussion of certain other legal proceedings to which the Company is a party.

NL has been named as a defendant in various lawsuits in a variety of jurisdictions, alleging personal injuries as a result of occupational exposure primarily to products manufactured by formerly-owned operations of NL containing asbestos, silica and/or mixed dust. Approximately 500 of these types of cases remain pending, involving a total of approximately 10,600 plaintiffs and their spouses following the administrative dismissal by a trial court in Ohio of approximately 1,500 plaintiffs in March 2006. NL has not accrued any amounts for this litigation because liability that NL might incur, if any, cannot currently be reasonably estimated. To date, NL has not been adjudicated liable in any of these matters. Based on information available to NL, including facts concerning its historical operations, the rate of new claims, the number of claims from which NL has been dismissed and NL's prior experience in the defense of these matters, NL believes that the range of reasonably possible outcomes of these matters will be consistent with NL's historical costs with respect to these matters (which are not material), and no reasonably possible outcome is expected to involve amounts that are material to NL. NL has and will continue to vigorously seek dismissal from each claim and/or a finding of no liability by NL in each case. In addition, from time to time, NL has received notices regarding asbestos or silica claims purporting to be brought against former subsidiaries of NL, including notices provided to insurers with which NL has entered into settlements extinguishing certain insurance policies. These insurers may seek indemnification from NL.

In April 2006, NL was served with a complaint in Murphy, et al. v. NL Industries, Inc., et al. (United States District Court, District of New Jersey, Case No. 2:06-cv-01535-WHW-SDW). The plaintiffs, three former minority

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shareholders of NL Environmental Management Services, Inc. ("EMS"), seek damages related to their equity investment in EMS. The defendants named in the complaint are Contran, Valhi, NL, EMS and certain current or former officers or directors of NL or EMS. EMS was formed in 1988 as a majority-owned environmental management subsidiary that contractually assumed certain of NL's environmental liabilities. In June 2005, EMS received notices from the three minority shareholders indicating that they were exercising their right, which became exercisable on June 1, 2005, to require EMS to purchase their preferred shares in EMS as of June 30, 2005 for a formula-determined amount as provided in EMS' certificate of incorporation. In accordance with the certificate of incorporation, EMS made a determination in good faith of the amount payable to the three former minority shareholders to purchase their shares of EMS stock. In June 2005 EMS set aside funds as payment for the shares of EMS. As of March 2006, however, the shareholders had not tendered their shares or received any of such funds. The plaintiffs claim that, in preparing the valuation of the plaintiffs' preferred shares for purchase by EMS, the defendants engaged in a pattern of racketeering activity and conspired to conduct a pattern of racketeering in violation of United States and New Jersey laws. In addition, the plaintiffs allege that the defendants have committed minority shareholder oppression, fraud, breach of fiduciary duty, civil conspiracy, aiding and abetting fraud, aiding and abetting breach of fiduciary duty, breach of contract and tortious interference with economic relations under New Jersey laws. The defendants believe that these claims are without merit and intend to deny all allegations of wrongdoing and liability and to defend against all such claims vigorously.

In addition to the litigation described above, the Company and its affiliates are also involved in various other environmental, contractual, product liability, patent (or intellectual property), employment and other claims and disputes incidental to its present and former businesses. In certain cases, the Company has insurance coverage for such items, although the Company does not currently expect any additional material insurance coverage for its environmental claims.

The Company currently believes that the disposition of all claims and disputes, individually or in the aggregate, should not have a material adverse effect on its consolidated financial position, results of operations and liquidity beyond the accruals already provided for.

Insurance coverage claims.

Reference is made to the 2005 Annual Report for a discussion of certain litigation involving NL and certain of its former insurance carriers. Additional information regarding such litigation, or new litigation, is below.

OneBeacon American Insurance Company v. NL Industries, Inc., et. al. (Supreme Court of the State of New York, County of New York, Index No. 603429-05). In March 2006, NL's motion to dismiss was denied by the trial court. In April 2006, NL filed a notice of appeal of the trial court's ruling.

NL Industries, Inc. v. OneBeacon America Insurance Company, et. al. (District Court for Dallas County, Texas, Case No. 05-11347). In December 2005, NL filed a motion to remand the case to state court.

In February 2006, NL was served with a complaint in Certain Underwriters at Lloyds, London v. Millennium Holdings LLC et. al. (Supreme Court of the State of New York, County of New York, Index No. 06/60026). The plaintiff, a former insurance carrier of NL, seeks a declaratory judgment of its obligations to NL under insurance policies issued to NL by plaintiff with respect to certain lead pigment lawsuits. In April 2006, NL filed a motion to dismiss.

In April 2006, NL filed an action against American Re Insurance Company and

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certain other former insurance companies, captioned NL Industries, Inc. v. American Re Insurance Company, et. al. (Dallas County Court at Law, Texas, Case No. CC-06-04523-E) asserting that American Re Insurance and the other named defendants have breached their obligations to NL under such insurance policies and seeking a declaratory judgment of each defendant's obligations to NL under such policies.

The issue of whether insurance coverage for defense costs or indemnity or both will be found to exist for NL's lead pigment litigation depends upon a variety of factors, and there can be no assurance that such insurance coverage will be available. NL has not considered any potential insurance revoceries for lead pigment or environmental litigation matters in determining related accruals.

Note 14 - Employee benefit plans:

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

| | Three months March 31 2005 ----- (In thousa |
|--|---|
| Service cost | \$ 1,987 |
| Interest cost | 5,803 |
| Expected return on plan assets | (5,744) |
| Amortization of prior service cost | 154 |
| Amortization of net transition obligations | 140 |
| Recognized actuarial losses | 1,150 ----- |
| Total | \$ 3,490 ===== |

Postretirement benefits other than pensions. The components of net periodic OPEB cost are presented in the table below.

| | Three months March 31 2005 ----- (In thousa |
|--------------------------------------|---|
| Service cost | \$ 55 |
| Interest cost | 483 |
| Amortization of prior service credit | (232) |
| Recognized actuarial losses (gains) | (142) ----- |
| Total | \$ 164 ===== |

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Contributions. Contributions the Company expects to contribute to its various defined benefit pension and OPEB plans in 2006 are disclosed in the 2005 Annual Report.

Note 15 - Discontinued operations, net of tax:

Discontinued operations relates to CompX's former Thomas Regout operations in The Netherlands. In January 2005, CompX completed the sale of such operations for net proceeds that were approximately \$860,000 less than previously estimated (primarily due to higher expenses associated with the disposal of the Thomas Regout operations). Discontinued operations in the first quarter of 2005 includes a charge related to such higher expenses (\$272,000, net of income tax benefit and minority interest).

Note 16 - Accounting principles newly adopted in 2006:

Inventory costs. The Company adopted Statement of Financial Accounting Standards ("SFAS") No. 151, Inventory Costs, an amendment of ARB No. 43, Chapter 4, on January 1, 2006 for inventory costs incurred on or after such date. SFAS No. 151 requires that the allocation of fixed production overhead costs to inventory shall be based on normal capacity. Normal capacity is not defined as a fixed amount; rather, normal capacity refers to a range of production levels expected to be achieved over a number of periods under normal circumstances, taking into account the loss of capacity resulting from planned maintenance shutdowns. The amount of fixed overhead allocated to each unit of production is not increased as a consequence of idle plant or production levels below the low end of normal capacity, but instead a portion of fixed overhead costs is charged to expense as incurred. Alternatively, in periods of production above the high end of normal capacity, the amount of fixed overhead costs allocated to each unit of production is decreased so that inventories are not measured above cost. SFAS No. 151 also clarifies existing GAAP to require that abnormal freight and wasted materials (spoilage) are to be expensed as incurred. The Company's production cost accounting had already complied with the requirements of SFAS No. 151, and therefore adoption of SFAS No. 151 did not have an effect on its consolidated financial statements.

Stock options. As permitted by regulations of the SEC, the Company adopted SFAS No. 123R, Share-Based Payment, as of January 1, 2006. SFAS No. 123R, among other things, eliminates the alternative in existing GAAP to use the intrinsic value method of accounting for stock-based employee compensation under Accounting Principles Board Opinion ("APBO") No. 25, Accounting for Stock Issued to Employees. The Company is now generally required to recognize the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award, with the cost recognized over the period during which an employee is required to provide services in exchange for the award (generally, the vesting period of the award). No compensation cost will be recognized in the aggregate for equity instruments for which the employee does not render the requisite service (generally, if the instrument is forfeited before it has vested). The grant-date fair value will be estimated using option-pricing models (e.g. Black-Sholes or a lattice model). Under the transition alternatives permitted under SFAS No. 123R, the Company will apply the new standard to all new awards granted on or after January 1, 2006, and to all awards existing as of December 31, 2005 which are subsequently modified, repurchased or cancelled (referred to as the modified prospective method in SFAS No. 123R). Additionally, as of January 1, 2006, the Company recognizes compensation cost previously measured under SFAS No. 123 for the portion of any non-vested award existing as of December 31, 2005 over the remaining vesting period. The number of non-vested awards as of December 31, 2005 with respect to

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options granted by Valhi and its subsidiaries and affiliates is not material, and therefore the effect of adopting SFAS No. 123R, in so far as it relates to the recognition of compensation cost for existing stock options in the Company's consolidated statements of income, did not have a material effect on the Company's Consolidated Financial Statements. Should Valhi or its subsidiaries and affiliates, however, either grant a significant number of options or modify, repurchase or cancel existing options in the future, the Company could in the future recognize material amounts of compensation cost related to such options in its consolidated financial statements.

Also upon adoption of SFAS No. 123R, the cash income tax benefit resulting from the exercise of stock options in excess of the cumulative income tax benefit related to such options previously recognized for GAAP financial reporting purposes in the Company's consolidated statements of income, if any, will be reflected as a cash inflow from financing activities in the Company's consolidated statements of cash flows, and the Company's cash flows from operating activities will reflect the effect of cash paid for income taxes exclusive of such cash income tax benefit. The aggregate amount of such income tax benefits recognized as a component of cash flows from financing activities was not significant in the first quarter of 2006.

SFAS No. 123R also requires certain expanded disclosures regarding the Company's stock options, and such expanded disclosures were provided in the 2005 Annual Report.

Prior to January 1, 2006, the Company accounted for stock-based employee compensation in accordance with APBO No. 25 and its various interpretations. Under APBO No. 25, no compensation cost was generally recognized for fixed stock options in which the exercise price was greater than or equal to the market price on the grant date. Prior to 2005, and following the cash settlement of certain stock options held by employees of NL, NL and the Company commenced accounting for NL's remaining stock options using the variable accounting method because NL could not overcome the presumption that it would not similarly cash settle its remaining stock options. Under the variable accounting method, the intrinsic value of all unexercised stock options (including those with an exercise price at least equal to the market price on the date of grant) are accrued as an expense over their vesting period, with subsequent increases (decreases) in the market price of the underlying common stock resulting in additional compensation expense (income). Following adoption of SFAS No. 123R effective January 1, 2006, the Company will continue to account for NL's remaining stock options in a manner similar to the variable accounting method of APBO No. 25, as required by the guidance of SFAS No. 123R.

Net compensation expense related to stock-based employee compensation recognized by the Company was approximately \$120,000 in the first quarter of 2005, and net compensation income was approximately \$600,000 in the first quarter of 2006. Had Valhi and its subsidiaries and affiliates accounted for their respective stock-based employee compensation related to stock options in accordance with the fair value-based recognition provisions of SFAS No. 123R for all awards granted subsequent to January 1, 1995, the effect on the Company's results of operations in the first quarter of 2005 there would not have been a material effect on the Company's results of operations in the first quarter of 2005.

Note 17 - Stockholders' equity:

In March 2005, the Company's board of directors authorized the repurchase of up to 5.0 million shares of Valhi's common stock in open market transactions, including block purchases, or in privately negotiated transactions, which may include transactions with affiliates of Valhi. The stock may be purchased from time to time as market conditions permit. The stock repurchase program does not include specific price targets or timetables and may be suspended at any time.

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Depending on market conditions, the program could be terminated prior to completion. The Company will use its cash on hand to acquire the shares. Repurchased shares will be retired and cancelled or may be added to Valhi's treasury and used for employee benefit plans, future acquisitions or other corporate purposes.

During the first quarter of 2006, the Company purchased an aggregate of 275,000 shares of its common stock in market transactions for an aggregate of \$4.9 million. At March 31, 2006, these treasury shares had been cancelled, and the aggregate \$4.9 million cost of such treasury shares cancelled was allocated to common stock at par value, additional paid-in capital and retained earnings in accordance with GAAP. As of March 31, 2006, 1.2 million shares were available for purchases under such authorization.

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

RESULTS OF OPERATIONS

General

The Company reported income from continuing operations of \$22.9 million, or \$.20 per diluted share, in the first quarter of 2006 compared to income of \$25.1 million, or \$.21 per diluted share, in the first quarter of 2005.

The decrease in the Company's diluted earnings per share from the first quarter of 2005 to the first quarter of 2006 is due primarily to the net effects of (i) lower chemicals operating income at Kronos in 2006, (ii) higher component products operating income at CompX in 2006, (iii) certain securities transaction gains realized in the first quarter of 2005, (iv) certain income tax benefits recognized by TIMET in 2005 and (v) higher operating income for TIMET in 2006. The Company currently believes its net income in calendar 2006 will be lower than 2005 due primarily to lower expected chemicals operating income.

Income from continuing operations in the first quarter of 2006 includes income of \$.01 per diluted share related to certain insurance recoveries of NL. Income from continuing operations in the first quarter of 2005 include (i) certain securities transaction gains of NL of \$.05 per diluted share and (ii) income related to certain income benefits recognized by TIMET of \$.07 per diluted share. Such amounts are more fully described below or in the 2005 Annual Report.

As provided by the safe harbor provisions of the Private Securities Litigation Reform Act of 1995, the Company cautions that the statements in this Quarterly Report on Form 10-Q relating to matters that are not historical facts, 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 management's beliefs and assumptions based on currently available information. Forward-looking statements can be identified by the use of words such as "believes," "intends," "may," "should," "could," "anticipates," "expected" or comparable terminology, or by discussions of strategies or trends. Although the Company believes that the expectations reflected in such forward-looking statements are reasonable, it cannot give any assurances that these expectations will prove to be correct. Such statements by their nature involve substantial risks and uncertainties that could

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significantly impact expected results, and actual future results could differ materially from those described in such forward-looking statements. While it is not possible to identify all factors, the Company continues to face many risks and uncertainties. Among the factors that could cause 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 the Company's other filings with the SEC including, but not limited to, the following:

- o Future supply and demand for the Company's products,
- o The extent of the dependence of certain of the Company's businesses on certain market sectors (such as the dependence of TIMET's titanium metals business on the commercial aerospace industry),
- o The cyclical nature of certain of the Company's businesses (such as Kronos' TiO₂ operations and TIMET's titanium metals operations),
- o The impact of certain long-term contracts on certain of the Company's businesses (such as the impact of TIMET's long-term contracts with certain of its customers and such customers' performance thereunder and the impact of TIMET's long-term contracts with certain of its vendors on its ability to reduce or increase supply or achieve lower costs),
- o Customer inventory levels (such as the extent to which Kronos' customers may, from time to time, accelerate purchases of TiO₂ in advance of anticipated price increases or defer purchases of TiO₂ in advance of anticipated price decreases, or the relationship between inventory levels of TIMET's customers and such customers' current inventory requirements and the impact of such relationship on their purchases from TIMET),
- o Changes in raw material and other operating costs (such as energy costs),
- o The possibility of labor disruptions,
- o 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),
- o Competitive products and substitute products,
- o Possible disruption of business or increases in the cost of doing business resulting from terrorist activities or global conflicts,
- o Customer and competitor strategies,
- o The impact of pricing and production decisions,
- o Competitive technology positions,
- o The introduction of trade barriers,
- o Fluctuations in currency exchange rates (such as changes in the exchange rate between the U.S. dollar and each of the euro, the Norwegian kroner and the Canadian dollar),
- o Operating interruptions (including, but not limited to, labor disputes, leaks, natural disasters, fires, explosions, unscheduled or unplanned downtime and transportation interruptions),
- o The timing and amounts of insurance recoveries,
- o The ability of the Company to renew or refinance credit facilities,
- o Uncertainties associated with new product development (such as TIMET's ability to develop new end-uses for its titanium products),
- o The ultimate outcome of income tax audits, tax settlement initiatives or other tax matters,
- o The ultimate ability to utilize income tax attributes, the benefit of which has been recognized under the "more-likely-than-not" recognition criteria (such as Kronos' ability to utilize its German net operating loss carryforwards),
- o 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 former operation of the Company),

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- o Government laws and regulations and possible changes therein (such as changes in government regulations which might impose various obligations on present and former manufacturers of lead pigment and lead-based paint, including NL, with respect to asserted health concerns associated with the use of such products),
- o The ultimate resolution of pending litigation (such as NL's lead pigment litigation and litigation surrounding environmental matters of NL and Tremont), and
- o Possible future litigation.

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

Chemicals

Relative changes in Kronos' TiO2 sales and operating income during the 2005 and 2006 periods presented are primarily due to (i) relative changes in TiO2 sales and production volumes, (ii) relative changes in TiO2 average selling prices and (iii) relative changes in foreign currency exchange rates. Selling prices (in billing currencies) for TiO2, Kronos' principal product, were generally: increasing in the first six months of 2005, decreasing during the second half of 2005 and increasing during the first quarter of 2006.

| | Three months ended March 31, | |
|--|---------------------------------|--------|
| | 2005 | 2006 |
| | (In \$ millions) | |
| Net sales | \$291.9 | \$304. |
| Operating income | 43.6 | 32. |
| TiO2 operating statistics: | | |
| Sales volumes* | 114 | 12 |
| Production volumes* | 122 | 12 |
| Percent change in TiO2 average selling prices: | | |
| Using actual foreign currency exchange rates -3% | | |
| Impact of changes in foreign currency exchange rates | | |

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In billing currencies

* Thousands of metric tons

Kronos' sales increased \$12.4 million (4%) in the first quarter of 2006 as compared to the first quarter of 2005 due to the net effects of higher average TiO2 selling prices, higher TiO2 sales volumes and the unfavorable net effect of fluctuations in foreign currency exchange rates, which decreased chemicals sales by approximately \$16 million, as further discussed below. Excluding the effect of fluctuations in the value of the U.S. dollar relative to other currencies, Kronos' average TiO2 selling prices in billing currencies in the first quarter of 2006 were 2% higher as compared to the first quarter of 2005. When translated from billing currencies to U.S. dollars using actual foreign currency exchange rates prevailing during the respective periods, Kronos' average TiO2 selling prices in the first quarter of 2006 were 3% lower compared to the first quarter of 2005.

Kronos' sales are denominated in various currencies, including the U.S. dollar, the euro, other major European currencies and the Canadian dollar. The disclosure of the percentage change in Kronos' average TiO2 selling prices in billing currencies (which excludes the effects of fluctuations in the value of the U.S. dollar relative to other currencies) is considered a "non-GAAP" financial measure under regulations of the SEC. The disclosure of the percentage change in Kronos' average TiO2 selling prices using actual foreign currency exchange rates prevailing during the respective periods is considered the most directly comparable financial measure presented in accordance with GAAP ("GAAP measure"). Kronos discloses percentage changes in its average TiO2 prices in billing currencies because Kronos believes such disclosure provides useful information to investors to allow them to analyze such changes without the impact of changes in foreign currency exchange rates, thereby facilitating period-to-period comparisons of the relative changes in average selling prices in the actual various billing currencies. Generally, when the U.S. dollar either strengthens or weakens against other currencies, the percentage change in average selling prices in billing currencies will be higher or lower, respectively, than such percentage changes would be using actual exchange rates prevailing during the respective periods. The difference between the 3% decrease in Kronos' average TiO2 selling prices during the first quarter of 2006 as compared to the first quarter of 2005 using actual foreign currency exchange rates prevailing during the respective periods (the GAAP measure), and the 2% increase in Kronos' average TiO2 selling prices in billing currencies (the non-GAAP measure) during such periods is due to the effect of changes in foreign currency exchange rates. The above table presents in a tabular format (i) the percentage change in Kronos' average TiO2 selling prices using actual foreign currency exchange rates prevailing during the respective periods (the GAAP measure), (ii) the percentage change in Kronos' average TiO2 selling prices in billing currencies (the non-GAAP measure) and (iii) the percentage change due to changes in foreign currency exchange rates (or the reconciling item between the non-GAAP measure and the GAAP measure).

Kronos' TiO2 sales volumes in the first quarter of 2005 increased 9% compared to the first quarter of 2004, due primarily to higher sales volumes in the United States and slightly higher sales volumes in Europe and in export markets offsetting the effect of lower sales volumes in Canada. Demand for TiO2 has remained strong in the first quarter of 2006, and while Kronos believes that the strong demand is largely attributable to the end-use demand of its customers, it is possible that some portion of the strong demand resulted from customers increasing their inventory levels in advance of implementation of announced or anticipated price increases. Kronos' operating income comparisons were favorably impacted by higher production levels, which increased 4% in the first quarter of 2006 as compared to the same period in 2005. Kronos' operating

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rates were near full capacity in both periods, and Kronos' sales and production volumes in the first quarter of 2006 were new records for Kronos for a first quarter. Kronos' operating income comparisons were negatively impacted by higher raw material and other operating costs (including energy).

Kronos has substantial operations and assets located outside the United States (primarily in Germany, Belgium, Norway and Canada). A significant amount of Kronos' sales generated from its 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 are denominated in the U.S. dollar. Certain raw materials, primarily titanium-containing feedstocks, are purchased in U.S. dollars, while labor and other production costs are denominated primarily in local currencies. Consequently, the translated U.S. dollar value of Kronos' foreign sales and operating results are subject to currency exchange rate fluctuations which may favorably or adversely impact reported earnings and may affect the comparability of period-to-period operating results. Overall, fluctuations in the value of the U.S. dollar relative to other currencies, primarily the euro, decreased TiO₂ sales by a net \$16 million in the first quarter of 2006 as compared to the first quarter of 2005. Fluctuations in the value of the U.S. dollar relative to other currencies similarly impacted Kronos' foreign currency-denominated operating expenses. Kronos' operating costs that are not denominated in the U.S. dollar, when translated into U.S. dollars, were lower in the first quarter of 2006 as compared to the same period in 2005. Overall, currency exchange rate fluctuations resulted in a net \$5 million decrease in Kronos' operating income in the first quarter of 2006 as compared to the first quarter of 2005.

On September 22, 2005, the chloride-process TiO₂ facility operated by Kronos' 50%-owned joint venture, Louisiana Pigment Company ("LPC"), temporarily halted production due to Hurricane Rita. Although storm damage to core processing facilities was not extensive, a variety of factors, including loss of utilities, limited access and availability of employees and raw materials, prevented the resumption of partial operations until October 9, 2005 and full operations until late 2005. The joint venture expects the majority of its property damage and unabsorbed fixed costs for periods in which normal production levels were not achieved will be covered by insurance, and Kronos believes insurance will cover its lost profits (subject to applicable deductibles) resulting from its share of the lost production from LPC. Insurance proceeds from the lost profit for product that Kronos was not able to sell as a result of the loss of production from LPC are expected to be recognized by Kronos during the remainder of 2006, although the amount and timing of such insurance recoveries is not presently determinable. The effect on Kronos' financial results will depend on the timing and amount of insurance recoveries.

Kronos' efforts to debottleneck its production facilities to meet long-term demand continue to prove successful. Such debottlenecking efforts included, among other things, the addition of finishing capacity in the German chloride-process facility and equipment upgrades and enhancements in several locations to allow for reduced downtime for maintenance activities. Kronos' production capacity has increased by approximately 30% over the past ten years due to debottlenecking programs, with only moderate capital expenditures. Kronos believes its annual attainable production capacity for 2006 is approximately 510,000 metric tons, with some additional capacity expected to be available in 2007 through its continued debottlenecking efforts.

Kronos expects its operating income in 2006 will continue to be somewhat lower than 2005. Kronos' expectations as to the future prospects of Kronos and the TiO₂ industry are based upon a number of factors beyond Kronos' control, including worldwide growth of gross domestic product, competition in the marketplace, unexpected or earlier-than-expected capacity additions and technological advances. If actual developments differ from Kronos' expectations,

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Kronos' results of operations could be unfavorably affected.

Chemicals operating income, as presented above, is stated net of amortization of Valhi's purchase accounting adjustments made in conjunction with its acquisitions of its interest in NL and Kronos. Such adjustments result in additional depreciation and amortization expense beyond amounts separately reported by Kronos. Such additional non-cash expenses reduced chemicals operating income, as reported by Valhi, by \$4.4 million in the first quarter of 2005 and \$4.0 million in the first quarter of 2006.

Component products

| | Three months ended March 31, | |
|------------------|---------------------------------|--------|
| | 2005 | 2006 |
| | (In millions) | |
| Net sales | \$46.8 | \$47.1 |
| Operating income | 4.1 | 5.1 |

Component product sales increased slightly in the first quarter of 2006 as compared to the same quarter of 2005 as higher volumes of security product sales were offset by decreases in sales for certain other products resulting from increased competition. Sales comparisons were also positively impacted by volumes associated with an acquisition of a small components products business in August 2005. Component products operating income increased due to the favorable impact of CompX's continued focus on reducing costs across all segments and a favorable change in product mix resulting from increases in sales of certain higher margin security products.

CompX has substantial operations and assets located outside the United States in Canada and Taiwan. A portion of CompX's sales generated from its non-U.S. operations are denominated in currencies other than the U.S. dollar, principally the Canadian dollar and the New Taiwan dollar. In addition, a portion of CompX's sales generated from its non-U.S. operations (principally in Canada) are denominated in the U.S. dollar. Most raw materials, labor and other production costs for such non-U.S. operations are denominated primarily in local currencies. Consequently, the translated U.S. dollar values of CompX's foreign sales and operating results are subject to currency exchange rate fluctuations which may favorably or unfavorably impact reported earnings and may affect comparability of period-to-period operating results. During the first quarter of 2006, currency exchange rate fluctuations did not have a significant effect on component products sales or operating income as compared to the first quarter of 2005.

The component product areas where CompX operates are highly competitive in terms of product pricing and features. CompX's strategy is to focus on areas where it can provide products that have value-added, user-oriented-features which enable its customers to compete more effectively in their markets. One of the focal points of this strategy is to replace low margin, commodity type products with higher margin user-oriented feature products. Additionally, CompX believes that its focus on collaborating with customers to identify solutions and its ability to provide a high level of customer service enable it to compete effectively. In response to competitive pricing pressure, CompX continuously focuses on reducing production cost through product reengineering, improvement in manufacturing processes or moving production to lower-cost facilities.

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Raw material prices, especially steel, zinc and copper, continue to be volatile putting pressure on CompX's margins. CompX actively seeks to mitigate the margin impact by entering into raw material supply agreements in order to stabilize the cost for a period of time, execute larger volume tactical spot purchases at prices that are expected to be favorable compared to future prices and, if necessary, pass on the cost increases to customers through surcharges and price increases.

Waste management

Net sales
Operating loss

Three

2005

(In

\$ 2.5
(2.8)

Waste management sales increased, and its operating loss declined, in the first quarter of 2006 as compared to the first quarter of 2005 due to higher utilization of waste management services. Waste Control Specialists also continues to explore opportunities to obtain certain types of new business (including disposal and storage of certain types of waste) that, if obtained, could help to further increase its sales, and decrease its operating loss, in the remainder of 2006.

Waste Control Specialists currently has permits which allow it to treat, store and dispose of a broad range of hazardous and toxic wastes, and to treat and store a broad range of low-level and mixed low-level radioactive wastes. Certain sectors of the waste management industry are experiencing a relative improvement in the number of environmental remediation projects generating wastes. However, efforts on the part of generators to reduce the volume of waste and/or manage waste onsite at their facilities may result in weaker demand for Waste Control Specialists' waste management services. Although Waste Control Specialists believes demand appears to be improving, there is continuing price pressure for waste management services. While Waste Control Specialists believes its broad range of authorizations for the treatment and storage of low-level and mixed low-level radioactive waste streams provides certain competitive advantages, a key element of Waste Control Specialists' long-term strategy to provide "one-stop shopping" for hazardous, low-level and mixed low-level radioactive wastes includes obtaining additional regulatory authorizations for the disposal of low-level and mixed low-level radioactive wastes.

Prior to June 2003, the state law in Texas (where Waste Control Specialists' disposal facility is located) prohibited the applicable Texas regulatory agency from issuing a license for the disposal of a broad range of low-level and mixed low-level radioactive waste to a private enterprise operating a disposal facility in Texas. In June 2003, a new Texas state law was enacted that allows the Texas Commission on Environmental Quality ("TCEQ") to issue a low-level radioactive waste disposal license to a private entity, such as Waste Control Specialists. Waste Control Specialists has applied for such a disposal license with the TCEQ, and Waste Control Specialists was the only entity to submit an application for such a disposal license. The application was declared administratively complete by the TCEQ in February 2005. The regulatorially required merit review has been completed, and the TCEQ began its

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technical review of the application in May 2005. The length of time that it will take to complete the review and act upon the license application is uncertain, although Waste Control Specialists does not currently expect the agency will issue any final decision on the license application before late 2007. There can be no assurance that Waste Control Specialists will be successful in obtaining any such license.

Waste Control Specialists applied to the Texas Department of State Health Services ("TDSHS") for a license to dispose of byproduct 11.e(2) waste material in June 2004. Waste Control Specialists can currently treat and store byproduct material, but may not dispose of it. The length of time that TDSHS will take to review and act upon the license application is uncertain, but Waste Control Specialists currently expects the TDSHS will issue a final decision on the license application sometime during 2006. There can be no assurance that Waste Control Specialists will be successful in obtaining any such license.

Waste Control Specialists is continuing its efforts to increase its sales volumes from waste streams that conform to authorizations it currently has in place. Waste Control Specialists is also continuing to identify certain waste streams, and attempting to obtain modifications to its current permits, that would allow for treatment, storage and disposal of additional types of wastes. The ability of Waste Control Specialists to achieve increased sales volumes of these waste streams, together with improved operating efficiencies through further cost reductions and increased capacity utilization, are important factors in Waste Control Specialists' ability to achieve improved cash flows. The Company currently believes Waste Control Specialists can become a viable, profitable operation, even if Waste Control Specialists is unsuccessful in obtaining a license for the disposal of a broad range of low-level and mixed low-level radioactive wastes. However, there can be no assurance that Waste Control Specialists' efforts will prove successful in improving its cash flows. Valhi has in the past, and may in the future, consider strategic alternatives with respect to Waste Control Specialists. There can be no assurance that the Company would not report a loss with respect to any such strategic transaction.

Equity in earnings of TIMET

| | Three mo Ma ----- 2005 ---- (In mi |
|------------------------------|---|
| TIMET historical: | |
| Net sales | \$155.2 ===== |
| Operating income | \$ 19.4 |
| Other general corporate, net | .7 |
| Interest expense | (.7) ----- |
| | 19.4 |
| Income tax benefit (expense) | 22.9 |

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| | |
|------------------------------|-------|
| Minority interest | (.9) |
| Dividends on preferred stock | (3.3) |
| | ----- |

| | |
|------------|---------|
| Net income | \$ 38.1 |
| | ===== |

| | |
|-----------------------------|---------|
| Equity in earnings of TIMET | \$ 16.8 |
| | ===== |

TIMET reported higher sales and operating income in the first quarter of 2006 as compared to the first quarter of 2005, due in part to a 3% increase in sales volumes of melted products (ingot and slab), a 19% increase in sales volumes of mill products and 107% and 52% increases in average selling prices for melted and mill products, respectively. The increased sales volumes were driven by increased demand across all of TIMET's market sectors. TIMET's melted products are generally sold in U.S. dollars. Average selling prices for TIMET's melted and mill products were both positively affected by current market conditions and changes in customer and product mix. TIMET's mill products average selling prices were negatively affected by the strengthening of the U.S. dollar as compared to both the British pound sterling and the euro.

TIMET's operating results comparisons were negatively impacted by higher costs for raw materials and energy. TIMET's operating results comparisons were favorably impacted by improved plant operating rates, which increased from 80% in the first quarter of 2005 to 88% in the first quarter of 2006. TIMET's operating results in 2006 include an additional \$7.1 million resulting primarily from the sale of other non-mill products as compared to the 2005 period.

TIMET currently expects its full-year 2006 sales revenue will increase to between \$1.1 billion and \$1.2 billion. TIMET's cost of sales is affected by a number of factors including customer and product mix, material yields, plant operating rates, raw material costs, labor costs and energy costs. Raw material costs, which include sponge, scrap and alloys, represent the largest portion of its manufacturing cost structure, and TIMET currently expects it will continue to experience increases in raw material costs during 2006. TIMET currently expects its operating income for 2006 will increase to between \$297 million and \$322 million, primarily related to the effects of the higher average selling prices, offset in part by higher raw material costs.

The Company accounts for its interest in TIMET by the equity method. The Company's equity in earnings of TIMET differs from the amounts that would be expected by applying the Company's ownership percentage to TIMET's separately-reported earnings because of the effect of amortization of purchase accounting adjustments made by the Company in conjunction with the Company's acquisitions of its interests in TIMET. Amortization of such basis differences generally increases earnings (or reduces losses) attributable to TIMET as reported by the Company, and aggregated \$1.3 million in the first quarter of 2005 and \$1.1 million in the first quarter of 2006.

General corporate and other items

General corporate interest and dividend income. General corporate interest and dividend income in the first quarter of 2006 was comparable to the first quarter of 2005. A significant portion of the Company's general corporate interest and dividend income in both the first quarter of 2005 and 2006 relates to distributions received from The Amalgamated Sugar Company LLC and, in the first quarter of 2005, from interest income on the Company's \$80 million loan to Snake River Sugar Company that was prepaid in October 2005.

In October 2005, the Company and Snake River Sugar Company amended the

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Company Agreement of the LLC pursuant to which, among other things, the LLC is required to make higher minimum levels of distributions to its members (including the Company) as compared to levels required under the prior Company Agreement, which would result in the Company receiving annual distributions from the LLC in aggregate amounts of approximately \$25.4 million. In addition, assuming certain specified conditions are met (which conditions the Company were met during the fourth quarter of 2005 and which are currently expected to be met during 2006), the LLC would be required to distribute, in addition to the distributions noted in the preceding sentence, additional amounts that would result in the Company receiving at least an additional \$25 million during the 15-month period ending December 31, 2006 (with approximately \$19 received in the fourth quarter of 2005 and the remaining \$6 million expected to be paid during 2006). Consequently, general corporate dividend and interest income for all of 2006 is expected to be lower than 2005, principally due to a significantly lower amount expected in the fourth quarter of 2006 as compared to the same quarter of 2005.

Insurance recoveries. NL has reached an agreement with a former insurance carrier in which such carrier would reimburse NL for a portion of its past and future lead pigment litigation defense costs. NL received approximately \$750,000 during the first quarter of 2006 under such agreement. The aggregate amount that NL will ultimately recover from such carrier with respect to such defense costs incurred by NL is not yet determinable.

Insurance recoveries in the first quarter of 2006 also include approximately \$1.5 million in settlements NL received from certain of its former insurance carriers. These settlements, as well as similar prior settlements NL reached in the past few years, resolved court proceedings in which NL had sought reimbursement from carriers for legal defense costs and indemnity coverage for certain of NL's environmental remediation expenditures. No further material settlements relating to litigation concerning environmental remediation coverages are expected.

While NL continues to seek additional insurance recoveries, there can be no assurance that NL will be successful in obtaining reimbursement for either defense costs or indemnity. NL has not considered any potential insurance recoveries in determining related accruals for lead pigment litigation matters. Any such additional insurance recoveries would be recognized when their receipt is deemed probable and the amount is determinable.

General corporate expenses. Net general corporate expenses in the first quarter of 2006 were \$1.8 million lower than the first quarter of 2005 due primarily to lower environmental remediation and legal expenses of NL. Net general corporate expenses in calendar 2006 are currently expected to be higher as compared to calendar 2005, in part due to higher expected litigation and related expenses of NL. However, obligations for environmental remediation obligations are difficult to assess and estimate, and no assurance can be given that actual costs for environmental remediation will not exceed accrued amounts or that costs will not be incurred in the future with respect to sites for which no estimate of liability can presently be made. See Note 13 to the Condensed Consolidated Financial Statements.

Interest expense. The Company has a significant amount of indebtedness denominated in the euro, primarily Kronos International's ("KII") euro-denominated 8.875% Senior Secured Notes (euro 375 million outstanding at March 31, 2009). Accordingly, the reported amount of interest expense will vary depending on relative changes in foreign currency exchange rates. Interest expense in the first quarter of 2006 was lower than the same period of 2005 due primarily to relative changes in foreign currency exchange rates, which decreased the U.S. dollar equivalent of interest expense on the euro 375 million principal amount of KII's Senior Secured Notes outstanding by approximately \$1.1 million in the first quarter of 2006 as compared to the first quarter of 2005.

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As a result of the April 2006 issuance of a euro 400 million principal amount of KII's 6.5% Senior Secured Notes due 2013, the proceeds of which will be used to redeem KII's existing 8.875% Senior Secured Notes due 2009 (euro 375 million outstanding at March 31, 2006), annual interest expense associated with the new Senior Secured Notes due 2013 will be less than annual interest expense associated with the existing Senior Secured Notes due 2009, as the impact of a higher principal amount outstanding will be more than offset by the lower coupon rate on the new Senior Secured Notes. As a result of KII's redemption of its 8.875% Senior Secured Notes, the Company expects to recognize a \$21 million pre-tax charge in the second quarter of 2006 related to the early extinguishment of such indebtedness, consisting of the call premium on such Notes and the net write-off of deferred financing costs and existing unamortized premium related to such Notes. Such charge will be classified as part of interest expense. See Note 9 to the Condensed Consolidated Financial Statements. Assuming interest rates and foreign currency exchange rates do not change significantly from current levels, and ignoring the impact of the \$21 million charge related to the redemption of KII's 8.875% Senior Secured Notes, interest expense in the remainder of 2006 is currently expected to be less than the same periods of 2005 due primarily to the effect of the redemption of the existing Senior Secured Notes due 2009 with the new issue of KII Senior Secured Notes due 2013.

Provision for income taxes. The principal reasons for the difference between the Company's effective income tax rates and the U.S. federal statutory income tax rates are explained in Note 11 to the Condensed Consolidated Financial Statements.

At March 31, 2006, Kronos has the equivalent of \$597 million and \$93 million of income tax loss carryforwards for German corporate and trade tax purposes, respectively, all of which have no expiration date. Kronos has currently concluded that the benefit of such net carryforwards meet the more-likely-than-not recognition criteria of GAAP, and accordingly Kronos has no deferred income tax asset valuation allowance related to such German carryforwards and other net deductible temporary differences related to Germany. Prior to the complete utilization of such carryforwards, it is possible that Kronos might conclude in the future that the benefit of such carryforwards would no longer meet the more-likely-than-not recognition criteria, at which point Kronos would be required to recognize a valuation allowance against the then-remaining tax benefit associated with the carryforwards.

Minority interest. See Note 12 to the Condensed Consolidated Financial Statements.

Discontinued operations. See Note 15 to the Condensed Consolidated Financial Statements.

Accounting principles newly adopted in 2006. See Note 16 to the Condensed Consolidated Financial Statements.

LIQUIDITY AND CAPITAL RESOURCES

Summary

The Company's primary source of liquidity on an ongoing basis is its cash flows from operating activities, which is generally used to (i) fund capital expenditures, (ii) repay short-term indebtedness incurred primarily for working capital purposes and (iii) provide for the payment of dividends (including dividends paid to Valhi by its subsidiaries). In addition, from time-to-time the Company will incur indebtedness, generally to (i) fund short-term working capital needs, (ii) refinance existing indebtedness, (iii) make investments in marketable and other securities (including the acquisition of securities issued by subsidiaries and affiliates of the Company) or (iv) fund major capital

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expenditures or the acquisition of other assets outside the ordinary course of business. Also, the Company will from time-to-time sell assets outside the ordinary course of business, the proceeds of which are generally used to (i) repay existing indebtedness (including indebtedness which may have been collateralized by the assets sold), (ii) make investments in marketable and other securities, (iii) fund major capital expenditures or the acquisition of other assets outside the ordinary course of business or (iv) pay dividends.

At March 31, 2006, the Company's third-party indebtedness was substantially comprised of (i) Valhi's \$250 million of loans from Snake River Sugar Company due in 2027, (ii) KII's euro-denominated 8.875% Senior Secured Notes (equivalent of \$455.6 million principal amount outstanding) due in 2009 (which, as noted above, have been called for redemption, with the redemption price being funded by KII's new issue of Senior Secured Notes due 2013), (iii) Kronos' U.S. revolving bank credit facility (\$29.8 million outstanding) due in 2008 and (iv) Kronos' Canadian bank credit facility (\$4.3 million outstanding) due in 2009. Accordingly, since none of such indebtedness comes due in 2006, the Company does not currently expect that a significant amount of its cash flows from operating activities generated during 2006 will be required to be used to repay indebtedness during 2006.

Based upon the Company's expectations for the industries in which its subsidiaries and affiliates operate, and the anticipated demands on the Company's cash resources as discussed herein (including debt refinancing expectations), the Company expects to have sufficient liquidity to meet its short-term obligations (defined as the twelve-month period ending March 31, 2007) and its long-term obligations (defined as the five-year period ending December 31, 2010, the time period for which the Company generally does long-term budgeting), including operations, capital expenditures, debt service current dividend policy and repurchases of its common stock. To the extent that actual developments differ from the Company's expectations, the Company's liquidity could be adversely affected.

Consolidated cash flows

Operating activities. Trends in cash flows from operating activities (excluding the impact of significant asset dispositions and relative changes in assets and liabilities) are generally similar to trends in the Company's earnings. However, certain items included in the determination of net income are non-cash, and therefore such items have no impact on cash flows from operating activities. Non-cash items included in the determination of net income include depreciation and amortization expense, non-cash interest expense, deferred income taxes, asset impairment charges and unrealized securities transactions gains and losses. Non-cash interest expense relates principally to Kronos and consists of amortization of original issue discount or premium on certain indebtedness and amortization of deferred financing costs.

Certain other items included in the determination of net income may have an impact on cash flows from operating activities, but the impact of such items on cash flows from operating activities will differ from their impact on net income. For example, equity in earnings of affiliates will generally differ from the amount of distributions received from such affiliates, and equity in losses of affiliates does not necessarily result in current cash outlays paid to such affiliates. The amount of periodic defined benefit pension plan expense and periodic OPEB expense depends upon a number of factors, including certain actuarial assumptions, and changes in such actuarial assumptions will result in a change in the reported expense. In addition, the amount of such periodic

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expense generally differs from the outflows of cash required to currently pay for such benefits. Also, proceeds from the disposal of marketable securities classified as trading securities are reported as a component of cash flows from operating activities, and such proceeds will generally differ from the amount of the related gain or loss on disposal.

Certain other items included in the determination of net income have no impact on cash flows from operating activities, but such items do impact cash flows from investing activities (although their impact on such cash flows differs from their impact on net income). For example, realized gains and losses from the disposal of available-for-sale marketable securities and long-lived assets are included in the determination of net income, although the proceeds from any such disposal are shown as part of cash flows from investing activities.

Changes in product pricing, production volumes and customer demand, among other things, can significantly affect the liquidity of the Company. Relative changes in assets and liabilities generally result from the timing of production, sales, purchases and income tax payments. Such relative changes can significantly impact the comparability of cash flows from operations from period to period, as the income statement impact of such items may occur in a different period from when the underlying cash transaction occurs. Relative changes in accounts receivable are affected by, among other things, the timing of sales and the collection of the resulting receivable. Relative changes in inventories, accounts payable and accrued liabilities are affected by, among other things, the timing of raw material purchases and the payment for such purchases and the relative difference between production volumes and sales volumes. Relative changes in accrued environmental costs are affected by, among other things, the period in which the environmental accrual is recognized and the period in which the remediation expenditure is actually made.

Cash flows from operating activities changed from a use of cash of \$10.5 million in the first quarter of 2005 to a use of cash of \$14.4 million in the first quarter of 2006. This \$3.9 million net decrease is due primarily to the net effects of (i) lower net income of \$1.9 million, (ii) lower net securities transaction gains of \$14.4 million, (iii) a lower provision for deferred income taxes of \$8.1 million, (iv) lower minority interest of \$2.7 million, (v) higher equity in earnings of TIMET of \$5.3 million, (vi) higher net cash contributions to the TiO₂ manufacturing joint venture of \$1.9 million and (vii) \$9.9 million higher net cash provided related to relative changes in asset and liabilities (principally accounts receivable, inventories, payables and accruals and accounts with affiliates).

Kronos' average days sales outstanding ("DSO") increased from 55 days at December 31, 2005 to 68 days at March 31, 2006 due to the timing of collection on the higher accounts receivable balance at the end of March. CompX's average DSO increased from 40 days to 44 days, also due to the timing of collection on the higher accounts receivable balance at the end of March. Kronos' average days sales in inventory ("DSI") decreased from 102 days at December 31, 2005 to 100 days at March 31, 2006 due to the effects of higher sales volumes. CompX's DSI decreased from 59 days to 57 days due primarily to lower raw material inventories.

Valhi does not have complete access to the cash flows of certain of its subsidiaries and affiliates, in part due to limitations contained in certain credit agreements as well as the fact that such subsidiaries and affiliates are not 100% owned by Valhi. A detail of Valhi's consolidated cash flows from operating activities is presented in the table below. Eliminations consist of intercompany dividends (most of which are paid to Valhi Parent and NL Parent).

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Cash provided by (used in) operating activities:

| | |
|---------------------------|-----------|
| Kronos | \$ (5.0) |
| CompX | 1.9 |
| Waste Control Specialists | (2.5) |
| NL Parent | (4.5) |
| Tremont | (.7) |
| Valhi Parent | 13.4 |
| Other | - |
| Eliminations | (13.1) |
| | ----- |
| | \$ (10.5) |
| | ===== |

Investing and financing activities. Approximately 60% of the Company's consolidated capital expenditures in the first quarter of 2006 relate to Kronos, 38% relate to CompX and substantially all of the remainder relate to Waste Control Specialists. During the first quarter of 2006, (i) Valhi purchased shares of Kronos common stock in market transactions for \$22.4 million, (ii) NL purchased shares of CompX common stock in market transactions for \$404,000, and (iii) the Company made net purchases of marketable securities of \$483,000. See Note 2 to the Condensed Consolidated Financial Statements.

During the first quarter of 2006, (i) Kronos borrowed an aggregate of \$18.3 million under its U.S. bank credit facility and an aggregate of Cdn. \$5.0 million (\$4.3 million when borrowed) under its Canadian bank credit facility and (ii) CompX prepaid certain industrial revenue bond indebtedness of \$1.5 million. Valhi paid aggregate cash dividends of \$12.1 million (\$.10 per share) in the first quarter of 2006. Distributions to minority interest in the first quarter of 2006 are primarily comprised of Kronos cash dividends paid to shareholders other than Valhi and NL, and CompX dividends paid to shareholders other than NL. In addition, Valhi purchased approximately 275,000 shares of its common stock in market transactions for an aggregate of \$4.9 million, and other cash flows from financing activities relate primarily to proceeds from the issuance of NL and Valhi common stock issued upon exercise of stock options.

At March 31, 2006, unused credit available under existing credit facilities approximated \$272.7 million, which was comprised of: CompX - \$50.0 million under its revolving credit facility; Kronos - \$94.0 million under its European credit facility, \$15.0 million under its U.S. credit facility, \$11.0 million under its Canadian credit facility and \$4.0 million under other non-U.S. facilities; and Valhi - \$98.7 million under its revolving bank credit facility.

Provisions contained in certain of the Company's credit agreements could result in the acceleration of the applicable indebtedness prior to its stated maturity for reasons other than defaults from failing to comply with typical financial covenants. For example, certain credit agreements allow the lender to accelerate the maturity of the indebtedness upon a change of control (as defined) of the borrower. The terms of Valhi's revolving bank credit facility could require Valhi to either reduce outstanding borrowings or pledge additional collateral in the event the fair value of the existing pledged collateral falls below specified levels. In addition, certain credit agreements could result in

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the acceleration of all or a portion of the indebtedness following a sale of assets outside the ordinary course of business. See Note 9 to the Condensed Consolidated Financial Statements.

Off-balance sheet financing arrangements. Other than the operating leases discussed in the 2005 Annual Report, neither Valhi nor any of its subsidiaries or affiliates are parties to any off-balance sheet financing arrangements.

Chemicals - Kronos

At March 31, 2006, Kronos had cash, cash equivalents and marketable debt securities of \$65.2 million, including restricted balances of \$3.6 million, and Kronos had approximately \$124 million available for borrowing under its U.S., Canadian and European credit facilities. Based upon Kronos' expectations for the TiO2 industry, Kronos expects to have sufficient liquidity to meet its future obligations including operations, capital expenditures, debt service and current dividend policy. To the extent that actual developments differ from Kronos' expectations, Kronos' liquidity could be adversely affected.

At March 31, 2006, Kronos' outstanding debt was comprised primarily of \$455.6 million related to KII's 8.875% Senior Secured Notes, \$29.8 million outstanding under Kronos' U.S. revolving credit facility and approximately \$4.3 million related to its Canadian bank credit facility. In April 2006, KII called all of its 8.875% Senior Secured Notes due 2009 for redemption, which redemption was funded by KII's issue of 6.5% Senior Secured Notes due 2013 issued in April 2006. See Note 9 to the Condensed Consolidated Financial Statements.

See Note 11 to the Condensed Consolidated Financial Statements for certain income tax examinations currently underway with respect to certain of Kronos' income tax returns in various U.S. and non-U.S. jurisdictions, and see Note 13 to the Condensed Consolidated Financial Statements with respect to certain legal proceedings with respect to Kronos.

KII's assets consist primarily of investments in its operating subsidiaries, and its ability to service its parent level obligations, including the Senior Secured Notes, depends in large part upon the distribution of earnings of its subsidiaries, whether in the form of dividends, advances or payments on account of intercompany obligation, or otherwise. None of its subsidiaries have guaranteed the Senior Secured Notes due 2009 (or the new issue of Senior Secured Notes due 2013 issued in April 2006), although KII has pledged 65% of the common stock or other ownership interest of certain of its first-tier operating subsidiaries as collateral of such Senior Secured Notes.

Kronos periodically evaluates its liquidity requirements, alternative uses of capital, capital needs and availability of resources in view of, among other things, its dividend policy, its debt service and capital expenditure requirements and estimated future operating cash flows. As a result of this process, Kronos in the past has sought and may in the future seek to reduce, refinance, repurchase or restructure indebtedness, raise additional capital, repurchase shares of its common stock, modify its dividend policy, restructure ownership interests, sell interests in subsidiaries or other assets, or take a combination of such steps or other steps to manage its liquidity and capital resources. In the normal course of its business, Kronos may review opportunities for the acquisition, divestiture, joint venture or other business combinations in the chemicals or other industries, as well as the acquisition of interests in related entities. In the event of any such transaction, Kronos may consider using available cash, issuing equity securities or increasing its indebtedness to the extent permitted by the agreements governing Kronos' existing debt.

Kronos has substantial operations located outside the United States for which the functional currency is not the U.S. dollar. As a result, the reported amounts of Kronos' assets and liabilities related to its non-U.S. operations,

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and therefore Kronos' consolidated net assets, will fluctuate based upon changes in currency exchange rates.

NL Industries

At March 31, 2006, NL (exclusive of CompX) had cash, cash equivalents and marketable debt securities of \$52.8 million, including restricted balances of \$13.2 million.

See Note 11 to the Condensed Consolidated Financial Statements for certain income tax examinations currently underway with respect to certain of NL's income tax returns, and see Note 13 to the Condensed Consolidated Financial Statements and Part II, Item 1, "Legal Proceedings" with respect to certain legal proceedings and environmental matters with respect to NL.

In addition to those legal proceedings described in Note 13 to the Condensed Consolidated Financial Statements, 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 with respect to asserted health concerns associated with the use of such products and (ii) effectively overturn court decisions in which NL 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 NL's consolidated financial position, results of operations or liquidity, enactment of such legislation could have such an effect.

NL periodically evaluates its liquidity requirements, alternative uses of capital, capital needs and availability of resources in view of, among other things, its dividend policy, its debt service and capital expenditure requirements and estimated future operating cash flows. As a result of this process, NL has in the past and may in the future seek to reduce, refinance, repurchase or restructure indebtedness, raise additional capital, repurchase shares of its common stock, modify its dividend policy, restructure ownership interests, sell interests in subsidiaries or other assets, or take a combination of such steps or other steps to manage its liquidity and capital resources. In the normal course of its business, NL may review opportunities for the acquisition, divestiture, joint venture or other business combinations in the component products or other industries, as well as the acquisition of interests in, and loans to, related entities.

Component products - CompX International

CompX periodically evaluates its liquidity requirements, alternative uses of capital, capital needs and available resources in view of, among other things, its capital expenditure requirements, dividend policy and estimated future operating cash flows. As a result of this process, CompX has in the past and may in the future seek to raise additional capital, refinance or restructure indebtedness, issue additional securities, modify its dividend policy, repurchase shares of its common stock or take a combination of such steps or other steps to manage its liquidity and capital resources. In the normal course of business, CompX may review opportunities for acquisitions, divestitures, joint ventures or other business combinations in the component products industry. In the event of any such transaction, CompX may consider using cash, issuing additional equity securities or increasing the indebtedness of CompX or its subsidiaries.

Waste management - Waste Control Specialists

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At March 31, 2006, Waste Control Specialists' indebtedness consisted principally of \$6.9 million of borrowings owed to a wholly-owned subsidiary of Valhi (December 31, 2005 intercompany indebtedness - \$4.6 million). During the first quarter of 2006, this subsidiary of Valhi loaned an additional net \$2.3 million to Waste Control Specialists, which were used by Waste Control Specialists primarily to fund its operating loss and its capital expenditures. Such indebtedness is eliminated in the Company's Condensed Consolidated Financial Statements. Waste Control Specialists will likely borrow additional amounts during the remainder of 2006 from such Valhi subsidiary under the terms of its revolving credit facility that has a maturity date of March 2007 and provides for an aggregate line of credit of up to \$19.0 million as of March 31, 2006.

TIMET

At March 31, 2006, TIMET had \$176 million of borrowing availability under its various U.S. and European credit agreements.

In May 2005, TIMET announced it plans to expand its existing titanium sponge facility in Nevada. This expansion, which TIMET currently expects to complete by the first quarter of 2007 and cost an aggregate of \$38 million, will provide the capacity to produce an additional 4,000 metric tons of sponge annually, an increase of approximately 42% over the current sponge production capacity levels at its Nevada facility.

See Note 13 to the Condensed Consolidated Financial Statements for certain legal proceedings, environmental matters and other contingencies associated with TIMET. While TIMET currently believes that the outcome of these matters, individually and in the aggregate, will not have a material adverse effect on TIMET's consolidated financial position, liquidity or overall trends in results of operations, all such matters are subject to inherent uncertainties. Were an unfavorable outcome to occur in any given period, it is possible that it could have a material adverse impact on TIMET's consolidated results of operations or cash flows in a particular period.

TIMET periodically evaluates its liquidity requirements, capital needs and availability of resources in view of, among other things, its alternative uses of capital, debt service requirements, the cost of debt and equity capital, and estimated future operating cash flows. As a result of this process, TIMET has in the past, or in light of its current outlook, may in the future seek to raise additional capital, modify its common and preferred dividend policies, restructure ownership interests, incur, refinance or restructure indebtedness, repurchase or redeem of shares of capital stock or debt securities, sell assets, or take a combination of such steps or other steps to increase or manage its liquidity and capital resources. In the normal course of business, TIMET investigates, evaluates, discusses and engages in acquisition, joint venture, strategic relationship and other business combination opportunities in the titanium, specialty metal and other industries. In the event of any future acquisition or joint venture opportunities, TIMET may consider using then-available liquidity, issuing equity securities or incurring additional indebtedness.

Tremont LLC

See Note 13 to the Condensed Consolidated Financial Statements for certain legal proceedings and environmental matters with respect to Tremont.

General corporate - Valhi

Because Valhi's operations are conducted primarily through its subsidiaries and affiliates, Valhi's long-term ability to meet its parent company level

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corporate obligations is dependent in large measure on the receipt of dividends or other distributions from its subsidiaries and affiliates. Based on the 28.9 million shares of Kronos held by Valhi at March 31, 2006 and Kronos' current quarterly dividend rate of \$.25 per share, Valhi would receive aggregate annual dividends from Kronos of \$28.9 million. NL, which paid its 2004 regular quarterly dividends of \$.20 per share in the form of shares of Kronos common stock, increased its regular quarterly dividend in the first quarter of 2005 to \$.25 per share, which also was in the form of shares of Kronos common stock. In the second, third and fourth quarters of 2005, NL paid its regular quarterly dividend in the form of cash. NL's dividend for the first quarter of 2006 was \$.125 per share, also paid in cash. Assuming NL paid its regular quarterly dividends in the form of cash, and based on the 40.4 million shares of NL common stock held by Valhi at March 31, 2006, Valhi would receive aggregate annual dividends from NL of \$20.2 million at such \$.125 per share quarterly dividend rate. The Company does not currently expect to receive any distributions from Waste Control Specialists or TIMET during 2006. CompX dividends are paid to NL.

Various credit agreements to which certain subsidiaries or affiliates are parties contain customary limitations on the payment of dividends, typically a percentage of net income or cash flow; however, such restrictions in the past have not significantly impacted Valhi's ability to service its parent company level obligations. Valhi generally does not guarantee any indebtedness or other obligations of its subsidiaries or affiliates. To the extent that one or more of Valhi's subsidiaries were to become unable to maintain its current level of dividends, either due to restrictions contained in the applicable subsidiary's credit agreements, to satisfy their liabilities or otherwise, Valhi parent company's ability to service its liabilities or to pay dividends on its common stock could be adversely impacted. In such an event, Valhi might consider reducing or eliminating its dividends or selling interests in subsidiaries or other assets. If we were required to liquidate any of such assets in order to generate funds to satisfy our liabilities, we may be required to sell such assets at a time or times at which we would not be able to realize what we believe to be the actual value of such assets.

Waste Control Specialists is required to provide certain financial assurances to Texas government agencies with respect to certain decommissioning obligations related to its facility in West Texas. Such financial assurances may be provided by various means, including a parent company guarantee assuming the parent meets specified financial tests. In March 2005, Valhi agreed to guarantee certain specified decommissioning obligations of Waste Control Specialists, currently estimated by Waste Control Specialists at approximately \$3.5 million. Such obligations would arise only upon a closure of the facility and Waste Control Specialists' failure to perform such activities. The Company does not currently expect that it will have to perform under such guarantee for the foreseeable future.

In March 2005, the Company's board of directors authorized the repurchase of up to 5.0 million shares of Valhi's common stock in open market transactions, including block purchases, or in privately negotiated transactions, which may include transactions with affiliates of Valhi. The stock may be purchased from time to time as market conditions permit. The stock repurchase program does not include specific price targets or timetables and may be suspended at any time. Depending on market conditions, the program could be terminated prior to completion. The Company will use its cash on hand to acquire the shares. Repurchased shares will be retired and cancelled or may be added to Valhi's treasury and used for employee benefit plans, future acquisitions or other corporate purposes. During the first quarter of 2006, the Company purchased 275,000 shares of its common stock under the repurchase program in market transactions for an aggregate of \$4.9 million. See Note 17 to the Condensed Consolidated Financial Statements.

At March 31, 2006, Valhi had \$96.2 million of parent level cash and cash

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equivalents and had no amounts outstanding under its revolving bank credit agreement. In addition, Valhi had \$98.7 million of borrowing availability under its revolving bank credit facility.

The terms of The Amalgamated Sugar Company LLC Company Agreement provide for annual "base level" of cash dividend distributions (sometimes referred to as distributable cash) by the LLC of \$26.7 million, from which the Company is entitled to a 95% preferential share. Distributions from the LLC are dependent, in part, upon the operations of the LLC. The Company records dividend distributions from the LLC as income when they are declared by the LLC, which is generally the same month in which such distributions are received by the Company, although such distributions may in certain cases be paid on the first business day of the following month. To the extent the LLC's distributable cash is below this base level in any given year, the Company is entitled to an additional 95% preferential share of any future annual LLC distributable cash in excess of the base level until such shortfall is recovered. Based on the LLC's current projections for 2006, Valhi currently expects that distributions received from the LLC in 2006 will exceed its debt service requirements under its \$250 million loans from Snake River Sugar Company.

The Company may, at its option, require the LLC to redeem the Company's interest in the LLC beginning in 2012, and the LLC has the right to redeem the Company's interest in the LLC beginning in 2027. The redemption price is generally \$250 million plus the amount of certain undistributed income allocable to the Company, if any. In the event the Company requires the LLC to redeem the Company's interest in the LLC, Snake River has the right to accelerate the maturity of and call Valhi's \$250 million loans from Snake River. Redemption of the Company's interest in the LLC would result in the Company reporting income related to the disposition of its LLC interest for income tax purposes, although the Company would not be expected to report a gain in earnings for financial reporting purposes at the time its LLC interest was redeemed. However, because of Snake River's ability to call its \$250 million loans to Valhi upon redemption of the Company's interest in the LLC, the net cash proceeds (after repayment of the debt) generated by the redemption of the Company's interest in the LLC could be less than the income taxes that would become payable as a result of the disposition.

The Company routinely compares its liquidity requirements and alternative uses of capital against the estimated future cash flows to be received from its subsidiaries, and the estimated sales value of those units. As a result of this process, the Company has in the past and may in the future seek to raise additional capital, refinance or restructure indebtedness, repurchase indebtedness in the market or otherwise, modify its dividend policies, consider the sale of interests in subsidiaries, affiliates, business units, marketable securities or other assets, or take a combination of such steps or 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.

The Company and related entities routinely 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 the Company's current businesses. The Company intends to consider such acquisition activities in the future and, in connection with this activity, may consider issuing additional equity securities and increasing the indebtedness of the Company, its subsidiaries and related companies. From time to time, the Company and related entities also evaluate the restructuring of ownership interests among their respective subsidiaries and related companies.

Non-GAAP financial measures

In an effort to provide investors with additional information regarding the

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Company's results of operations as determined by GAAP, the Company has disclosed certain non-GAAP information which the Company believes provides useful information to investors:

- o The Company discloses percentage changes in Kronos' average TiO2 selling prices in billing currencies, which excludes the effects of foreign currency translation. The Company believes disclosure of such percentage changes allows investors to analyze such changes without the impact of changes in foreign currency exchange rates, thereby facilitating period-to-period comparisons of the relative changes in average TiO2 selling prices in the actual various billing currencies. Generally, when the U.S. dollar either strengthens or weakens against other currencies, the percentage change in average TiO2 selling prices in billing currencies will be higher or lower, respectively, than such percentage changes would be using actual exchange rates prevailing during the respective periods.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

Reference is made to the 2005 Annual Report for a discussion of the market risks associated with changes in foreign currency exchange rates, interest rates and security prices that affect the Company. There have been no material changes in such market risks since the Company filed the 2005 Annual Report.

Certain of the Kronos' sales generated by its non-U.S. operations are denominated in U.S. dollars. Kronos periodically uses currency forward contracts to manage a very nominal portion of foreign exchange rate risk associated with receivables denominated in a currency other than the holder's functional currency or similar exchange rate risk associated with future sales. Kronos has not entered into these contracts for trading or speculative purposes in the past, nor does Kronos currently anticipate entering into such contracts for trading or speculative purposes in the future. Derivatives used to hedge forecasted transactions and specific cash flows associated with foreign currency denominated financial assets and liabilities which meet the criteria for hedge accounting are designated as cash flow hedges. Consequently, the effective portion of gains and losses is deferred as a component of accumulated other comprehensive income and is recognized in earnings at the time the hedged item affects earnings. Contracts that do not meet the criteria for hedge accounting are marked-to-market at each balance sheet date with any resulting gain or loss recognized in income currently as part of net currency transactions. To manage such exchange rate risk, at March 31, 2006, Kronos held a series of contracts, with expiration dates ranging from April to September 2006, to exchange an aggregate of U.S. \$25.5 million for an equivalent amount of Canadian dollars at exchange rates ranging from Cdn. \$1.16 to Cdn. \$1.17 per U.S. dollar. At March 31, 2006, the actual exchange rate was Cdn. \$1.17 per U.S. dollar. The estimated fair value of such foreign currency forward contracts at March 31, 2006 is insignificant.

Certain of the CompX's sales generated by its non-U.S. operations are denominated in U.S. dollars. CompX periodically uses currency forward contracts to manage a portion of foreign exchange rate market risk associated with receivables, or similar exchange rate risk associated with future sales, denominated in a currency other than the holder's functional currency or similar exchange rate risk associated with future sales. CompX has not entered into these contracts for trading or speculative purposes in the past, nor does CompX currently anticipate entering into such contracts for trading or speculative

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purposes in the future. Derivatives used to hedge forecasted transactions and specific cash flows associated with foreign currency denominated financial assets and liabilities which meet the criteria for hedge accounting are designated as cash flow hedges. Consequently, the effective portion of gains and losses is deferred as a component of accumulated other comprehensive income and is recognized in earnings at the time the hedged item affects earnings. Contracts that do not meet the criteria for hedge accounting are marked-to-market at each balance sheet date with any resulting gain or loss recognized in income currently as part of net currency transactions. To manage such exchange rate risk, at March 31, 2006, CompX held a series of contracts maturing through June 2006 to exchange an aggregate of U.S. \$5.2 million for an equivalent amount of Canadian dollars at an exchange rate of Cdn. \$1.16 per U.S. dollar. At March 31, 2006, the actual exchange rate was Cdn. \$1.17 per U.S. dollar. The estimated fair value of such foreign currency forward contracts at March 31, 2006 is insignificant.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures. The Company maintains a system of disclosure controls and procedures. The term "disclosure controls and procedures," as defined by regulations of the SEC, means controls and other procedures that are designed to ensure that information required to be disclosed in the reports that the Company files or submits 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 required to be disclosed by the Company in the reports that it files or submits to the SEC under the Act is accumulated and communicated to the Company's management, including its principal executive officer and its principal financial officer, or persons performing similar functions, as appropriate to allow timely decisions to be made regarding required disclosure. Each of Steven L. Watson, the Company's President and Chief Executive Officer, and Bobby D. O'Brien, the Company's Vice President and Chief Financial Officer, have evaluated the design and operations effectiveness of the Company's disclosure controls and procedures as of March 31, 2006. Based upon their evaluation, these executive officers have concluded that the Company's disclosure controls and procedures were effective as of March 31, 2006.

Internal Control Over Financial Reporting. The Company also maintains internal control over financial reporting. The term "internal control over financial reporting," as defined by regulations of the SEC, means a process designed by, or under the supervision of, the Company's principal executive and principal financial officers, or persons performing similar functions, and effected by the Company's board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP, and includes those policies and procedures that:

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

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As permitted by the SEC, the Company's assessment of internal control over financial reporting excludes (i) internal control over financial reporting of its equity method investees and (ii) internal control over the preparation of the Company's financial statement schedules required by Article 12 of Regulation S-X. However, our assessment of internal control over financial reporting with respect to the Company's equity method investees did include our controls over the recording of amounts related to our investment that are recorded in our Condensed 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 has been no change to the Company's internal control over financial reporting during the quarter ended March 31, 2006 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

Part II. OTHER INFORMATION

Item 1. Legal Proceedings.

Reference is made to Note 13 to the Condensed Consolidated Financial Statements and to the 2005 Annual Report for descriptions of certain legal proceedings.

State of Rhode Island v. Lead Industries Association, et al. (Superior Court of Rhode Island, No. 99-5226). In April 2006, NL filed a post-trial motion to dismiss, motion for new trial and motion for judgment notwithstanding the verdict.

Smith, et al. v. Lead Industries Association, et al. (Circuit Court for Baltimore City, Maryland, Case No. 24-C-99-004490). In March 2006, defendants filed a conditional cross-appeal, asserting that there is no final judgment to be reviewed because the trial court's severance was improper.

County of Santa Clara v. Atlantic Richfield Company, et al. (Superior Court of the State of California, County of Santa Clara, Case No. CV788657). In March 2006, defendants filed a petition for rehearing with the appellate court. In April 2006, the defendants filed a petition for review with the California Supreme Court.

City of Milwaukee v. NL Industries, Inc. and Mautz Paint (Circuit Court, Civil Division, Milwaukee County, Wisconsin, Case No. 01CV003066). In March 2006, the court denied the defendants' motion to dismiss and set a trial date of January 2007.

Hess, et. al. v. NL Industries, Inc., et al. (Missouri Circuit Court 22nd Judicial Circuit, St. Louis City, Cause No. 052-11799). NL has denied all allegations of liability.

In April 2006, NL and the U.S. EPA entered into an administrative order on consent to perform an additional removal action with respect to ponds located within a residential area at the site of a formerly owned lead smelting facility located in Collinsville, Illinois.

Brown et. al. v. NL Industries, Inc. et. al. (Circuit Court Wayne County, Michigan, Case No. 06-602096 CZ). In February 2006, NL removed the case to

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federal court.

Item 1A. Risk Factors.

Reference is made to the 2005 Annual Report for a discussion of risk factors related to the Company's businesses. There have been no material changes in such risk factors since the Company filed the 2005 Annual Report.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds; Share Repurchases.

In March 2005, the Company's board of directors authorized the repurchase of up to 5.0 million shares of Valhi's common stock in open market transactions, including block purchases, or in privately negotiated transactions, which may include transactions with affiliates of Valhi. The stock may be purchased from time to time as market conditions permit. The stock repurchase program does not include specific price targets or timetables and may be suspended at any time. Depending on market conditions, the program could be terminated prior to completion. The Company will use its cash on hand to acquire the shares. Repurchased shares will be retired and cancelled or may be added to Valhi's treasury and used for employee benefit plans, future acquisitions or other corporate purposes. See Note 17 to the Condensed Consolidated Financial Statements.

The following table discloses certain information regarding shares of Valhi common stock purchased by Valhi during the first quarter of 2006. All of such purchases were made under the repurchase program discussed above, and all of such purchases were made in open market transactions.

| Period ----- | Total number of shares purchased ----- | Average price paid per share including commissions ----- | Total number of shares purchased as part of a publicly-announced plan ----- |
|---|--|---|--|
| January 1, 2006 to January 31, 2006 | 40,500 | \$18.33 | 40,500 |
| February 1, 2006 to February 28, 2006 | 80,500 | 18.18 | 80,500 |
| March 1, 2006 to March 31, 2006 | 153,700 ----- | 17.54 | 153,700 ----- |
| | 274,700 ===== | | 274,700 ===== |

Item 6. Exhibits.

31.1 - Certification

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- 31.2 - Certification
- 32.1 - Certification.

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.

VALHI, INC.
(Registrant)

Date May 8, 2006

By /s/ Bobby D. O'Brien

Bobby D. O'Brien
Vice President and Chief Financial
Officer
(Principal Financial Officer)

Date May 8, 2006

By /s/ Gregory M. Swalwell

Gregory M. Swalwell
Vice President and Controller
(Principal Accounting Officer)