

BANK OF AMERICA CORP /DE/  
Form 424B2  
April 27, 2018  
**April 2018**

Filed Pursuant to Rule 424(b)(2)

Registration Statement No. 333-202354

Pricing Supplement

Dated April 25, 2018

\$5,000,000 Step Up Callable Notes, due April 27, 2028

The Step Up Callable Notes (the “notes”) are senior unsecured obligations of Bank of America Corporation. **All payments due on the notes, including the payment of principal and interest, will be subject to our credit risk.** The notes will be issued in minimum denominations of \$1,000, and whole multiples of \$1,000. The notes are senior debt securities issued by Bank of America Corporation, and are not guaranteed or insured by the FDIC or secured by collateral. The notes will not be listed on any securities exchange.

#### SUMMARY TERMS

|                             |   |
|-----------------------------|---|
| Issuer:                     | Bank of America Corporation (“BAC”)   |
| Stated principal amount:    | \$1,000 per note  |
| Pricing date:               | April 25, 2018  |
| Original issue date:        | April 27, 2018  |
| Maturity date:              | April 27, 2028  |
| <b>Payment at maturity:</b> | The payment at maturity per note will be the stated principal amount plus accrued and unpaid interest.<br>The notes will accrue interest at the following rates per annum during the indicated periods of their term: |
|                             | · Years 1-3 (April 27, 2018 to but excluding April 27, 2021):<br>3.50%;   |
|                             | · Years 4-6 (April 27, 2021 to but excluding April 27, 2024):<br>4.00%;   |
| Interest rate:              | · Years 7-9 (April 27, 2024 to but excluding April 27, 2027):<br>4.50%; and   |
|                             | · Year 10 (April 27, 2027 to but excluding April 27, 2028):<br>6.00%.   |

Each semi-annual interest period (other than the first interest period, which will begin on the issue date) will begin on, and will include, an interest payment date, and will extend to, but will exclude, the next succeeding interest payment date (or the maturity date, as applicable).

Interest day count fraction: 30/360

Coupon interest rule: Following business day convention, subject to no adjustment for coupon period end dates.

Interest payment dates: April 27 and October 27 of each year, beginning on October 27, 2018, subject to adjustment as described in the prospectus if any such date is not a business day, with the final interest payment date occurring on the maturity date.

Record Dates for Interest Payments: For book-entry only notes, one business day in New York, New York prior to the payment date. If notes are not held in book-entry only form, the record dates will be the fifteenth calendar day preceding such interest payment date, whether or not such record date is a business day.

Optional Early Redemption: We have the right to redeem all, but not less than all, of the notes on April 27, 2019, and on each subsequent interest payment date (other than the maturity date). The redemption price will be 100% of the principal amount of the notes, plus any accrued and unpaid interest. In order to call the notes, we will give notice to the senior trustee at least five business days but not more than 60 calendar days before the specified early redemption date.

Repayment at Option of Holder: None.

Selling agent: Merrill Lynch, Pierce, Fenner & Smith Incorporated (“MLPF&S”). See “Additional Information About the Notes—Supplemental information regarding plan of distribution; conflicts of interest.”

CUSIP: 06048WWC0

|                              |                              |   |                    |
|------------------------------|------------------------------|---|--------------------|
| Commissions and issue price: | <b>Public offering price</b> | Selling agent’s commission <sup>(1)</sup> | Proceeds to issuer |
| Per note                     | \$1,000.00                   | \$10.00                                   | \$990.00           |
| Total                        | \$5,000,000                  | \$50,000                                  | \$4,950,000        |

*Selected dealers and their financial advisors will collectively receive from the selling agent, MLPF&S, a fixed (1) sales commission of \$10.00 for each note that they sell. See “Additional Information About the Notes—Supplemental information regarding plan of distribution; conflicts of interest.”*

**The notes are unsecured and are not savings accounts, deposits, or other obligations of a bank. The notes are not guaranteed by Bank of America, N.A. or any other bank, are not insured by the Federal Deposit Insurance Corporation (the “FDIC”) or any other governmental agency and involve investment risks. Potential purchasers of the notes should consider the information in “Risk Factors” beginning on page PS-3 of this pricing supplement, page S-5 of the attached prospectus supplement, and page 9 of the attached prospectus.**

**None of the Securities and Exchange Commission (the “SEC”), any state securities commission, or any other regulatory body has approved or disapproved of these notes or passed upon the adequacy or accuracy of this pricing supplement or the accompanying prospectus supplement or prospectus. Any representation to the contrary is a criminal offense.**

We will deliver the notes in book-entry form only through The Depository Trust Company on April 27, 2018 against payment in immediately available funds.

Series M MTN prospectus supplement dated September 11, 2017 and prospectus dated May 1, 2015

Step Up Callable Notes, due April 27, 2028

About the Notes

## General

You should read carefully this entire pricing supplement, prospectus supplement, and prospectus to understand fully the terms of the notes, as well as the tax and other considerations important to you in making a decision about whether to invest in the notes. In particular, you should review carefully the section in this pricing supplement entitled “Risk Factors,” which highlights a number of risks, to determine whether an investment in the notes is appropriate for you.

Certain capitalized terms used and not defined in this pricing supplement have the meanings ascribed to them in the prospectus supplement and prospectus.

You are urged to consult with your own attorneys and business and tax advisors before making a decision to purchase any of the notes.

The information in this section is qualified in its entirety by the more detailed explanation set forth elsewhere in this pricing supplement and the accompanying prospectus supplement and prospectus. You should rely only on the information contained in this pricing supplement and the accompanying prospectus supplement and prospectus. We have not authorized any other person to provide you with different information. If anyone provides you with different or inconsistent information, you should not rely on it. Neither of us nor MLPF&S is making an offer to sell these notes in any jurisdiction where the offer or sale is not permitted. You should assume that the information in this pricing supplement, the accompanying prospectus supplement, and prospectus is accurate only as of the date on their respective front covers.

Unless otherwise indicated or unless the context requires otherwise, all references in this pricing supplement to “we,” “us,” “our,” or similar references are to Bank of America Corporation.

## Interest Payments

The notes will accrue interest during the following periods at the following rates per annum:

| Dates:   | Annual Rate: |
|--|--------------|
| April 27, 2018 to but excluding April 27, 2021 | 3.50%        |
| April 27, 2021 to but excluding April 27, 2024 | 4.00%        |
| April 27, 2024 to but excluding April 27, 2027 | 4.50%        |
| April 27, 2027 to but excluding April 27, 2028 | 6.00%        |

Each semi-annual interest period (other than the first interest period, which will begin on the issue date) will begin on, and will include, an interest payment date, and will extend to, but will exclude, the next succeeding interest payment date (or the maturity date, as applicable). The interest payment dates will be April 27 and October 27 of each year, beginning on October 27, 2018, with the final interest payment date occurring on the maturity date.

April 2018 Page PS-2

Step Up Callable Notes, due April 27, 2028

## Risk Factors

*Your investment in the notes entails significant risks, many of which differ from those of a conventional debt security. Your decision to purchase the notes should be made only after carefully considering the risks of an investment in the notes, including those discussed below, with your advisors in light of your particular circumstances. The notes are not an appropriate investment for you if you are not knowledgeable about significant elements of the notes or financial matters in general.*

**The notes are subject to our early redemption.** We may redeem all, but not less than all, of the notes on any interest payment date on or after April 27, 2019 (other than the maturity date). If you intend to purchase the notes, you must be willing to have your notes redeemed as early as that date. We are generally more likely to elect to § redeem the notes during periods when the remaining interest to be accrued on the notes is to accrue at a rate that is greater than that which we would pay on our other interest bearing debt securities having a maturity comparable to the remaining term of the notes.

If we redeem the notes prior to the maturity date, you may not be able to reinvest your proceeds from the redemption in an investment with a return that is as high as the return on the notes would have been if they had not been redeemed, or that have a similar level of risk. No further payments will be made on the notes after they have been redeemed.

**Step-up notes present different investment considerations than fixed-rate notes.** The rate of interest paid by us on the notes will increase upward from the initial stated rate of interest on the notes. The notes are callable by us, in whole but not in part, prior to maturity and, therefore, contain the redemption risk described above. If we do not call the notes, the interest rate will step up as described on the cover of this pricing supplement. Unless general interest rates rise significantly, you should not expect to earn the highest scheduled interest rate set forth on the cover of this § pricing supplement because the notes are likely to be called prior to maturity if interest rates remain the same or fall during their term. When determining whether to invest in a step-up fixed rate note, you should not focus on the highest stated interest rate, which usually is the final step-up rate of interest. You should instead consider, among other things, the overall annual percentage rate of interest to maturity or the various potential redemption dates as compared to other investment alternatives.

**An investment in the notes may be more risky than an investment in notes with a shorter term.** The notes have a term of 10 years, subject to our right to call the notes as set forth in this pricing supplement. By purchasing notes with a relatively longer term, you are more exposed to fluctuations in interest rates than if you purchased a note with § a shorter term. In particular, you may be negatively affected if interest rates begin to rise, because the likelihood that we will redeem your notes will decrease and the interest rate on the notes may be less than the amount of interest you could earn on other investments with a similar level of risk available at that time. In addition, if you tried to sell your notes at such time, their value in any secondary market transaction would also be adversely affected.

**Payments on the notes are subject to our credit risk, and actual or perceived changes in our creditworthiness are expected to affect the value of the notes.** The notes are our senior unsecured debt securities. As a result, your receipt of all payments of interest and principal on the notes is dependent upon our ability to repay our obligations on § the applicable payment date. No assurance can be given as to what our financial condition will be at any time during the term of the notes or on the maturity date. If we become unable to meet our financial obligations as they become due, you may not receive the amounts payable under the terms of the notes.

Our credit ratings are an assessment by ratings agencies of our ability to pay our obligations. Consequently, our perceived creditworthiness and actual or anticipated decreases in our credit ratings or increases in our credit spreads prior to the maturity date of the notes may adversely affect the market value of the notes. However, because your return on the notes depends upon factors in addition to our ability to pay our obligations, such as the difference between the interest rates accruing on the notes and current market interest rates, an improvement in our credit ratings will not reduce the other investment risks related to the notes.

**We have included in the terms of the notes the costs of developing, hedging, and distributing them, and the price, if any, at which you may sell the notes in any secondary market transaction will likely be lower than the § public offering price due to, among other things, the inclusion of these costs.** In determining the economic terms of the notes, and consequently the potential return on the notes to you, a number of factors are taken into account.

Among these factors are certain costs associated with developing, hedging, and offering the notes.

Assuming there is no change in market conditions or any other relevant factors, the price, if any, at which the selling agent or another purchaser might be willing to purchase the notes in a secondary market transaction is expected to be lower than the price

April 2018 Page PS-3

Step Up Callable Notes, due April 27, 2028

that you paid for them. This is due to, among other things, the inclusion of these costs, and the costs of unwinding any relating hedging.

The quoted price of any of our affiliates for the notes could be higher or lower than the price that you paid for them.

**We cannot assure you that a trading market for your notes will ever develop or be maintained.** We will not list § the notes on any securities exchange. We cannot predict how the notes will trade in any secondary market, or whether that market will be liquid or illiquid.

The development of a trading market for the notes will depend on our financial performance and other factors. The number of potential buyers of the notes in any secondary market may be limited. We anticipate that our affiliate, MLPF&S, will act as a market-maker for the notes, but neither MLPF&S nor any of our other affiliates is required to do so. MLPF&S may discontinue its market-making activities as to the notes at any time. To the extent that MLPF&S engages in any market-making activities, it may bid for or offer the notes. Any price at which MLPF&S may bid for, offer, purchase, or sell any notes may differ from the values determined by pricing models that it may use, whether as a result of dealer discounts, mark-ups, or other transaction costs. These bids, offers, or completed transactions may affect the prices, if any, at which the notes might otherwise trade in the market.

In addition, if at any time MLPF&S were to cease acting as a market-maker for the notes, it is likely that there would be significantly less liquidity in the secondary market and there may be no secondary market at all for the notes. In such a case, the price at which the notes could be sold likely would be lower than if an active market existed, and you should be prepared to hold the notes until maturity.

**Many economic and other factors will impact the market value of the notes.** The market for, and the market § value of, the notes may be affected by a number of factors that may either offset or magnify each other, including:

- o the time remaining to maturity of the notes;
- o the aggregate amount outstanding of the notes;
- o our right to redeem the notes on the dates set forth above;
- o the level, direction, and volatility of market interest rates generally (in particular, increases in U.S. interest rates, which may cause the market value of the notes to decrease);
- o general economic conditions of the capital markets in the United States;
- o geopolitical conditions and other financial, political, regulatory, and judicial events that affect the capital markets generally;
- o our financial condition and creditworthiness; and
- o any market-making activities with respect to the notes.

**Our trading and hedging activities may create conflicts of interest with you.** We or one or more of our affiliates, including MLPF&S, may engage in trading activities related to the notes that are not for your account or on your behalf. We expect to enter into arrangements to hedge the market risks associated with our obligation to pay the amounts due under the notes. We may seek competitive terms in entering into the hedging arrangements for the notes, but are not required to do so, and we may enter into such hedging arrangements with one of our subsidiaries or § affiliates. This hedging activity is expected to result in a profit to those engaging in the hedging activity, which could be more or less than initially expected, but which could also result in a loss for the hedging counterparty. These trading and hedging activities may present a conflict of interest between your interest in the notes and the interests we and our affiliates may have in our proprietary accounts, in facilitating transactions for our other customers, and in accounts under our management.

April 2018 Page PS-4

Step Up Callable Notes, due April 27, 2028

Additional Information About the Notes

Please read this information in conjunction with the summary terms on the front cover of this document.

**Additional provisions:**

The notes are part of a series of medium-term notes entitled “Medium-Term Notes, Series M” issued under the Senior Indenture, as amended and supplemented from time to time. The Senior Indenture is described more fully in the accompanying prospectus supplement and prospectus. The following description of the notes supplements the description of the general terms and provisions of the notes and debt securities set forth under the headings “Description of the Notes” in the prospectus supplement and “Description of Debt Securities” in the prospectus. These documents should be read in connection with this pricing supplement.

**The notes:**

Prior to maturity, the notes are not repayable at your option. The notes are not subject to any sinking fund.

The notes will be issued in book-entry form only.

**Record dates for interest payments:**

For book-entry only notes, one business day in New York, New York prior to the payment date. If notes are not held in book-entry only form, the record dates will be the fifteenth calendar day preceding such interest payment date, whether or not such record date is a business day.

**Redemption at our option:**

We have the right to redeem all, but not less than all, of the notes on April 27, 2019, and on each subsequent interest payment date (other than the maturity date). The redemption price will be 100% of the principal amount of the notes, plus any accrued and unpaid interest. In order to call the notes, we will give notice to the senior trustee at least five business days but not more than 60 calendar days before the specified early redemption date.

**Redemption at option of holder:**

None

**Minimum ticketing size:**

\$1,000

The notes will accrue interest at the following rates per annum during the indicated year of their term:

§ Years 1-3 (April 27, 2018 to but excluding April 27, 2021): 3.50%;

§ Years 4-6 (April 27, 2021 to but excluding April 27, 2024): 4.00%;

**Interest:**

§ Years 7-9 (April 27, 2024 to but excluding April 27, 2027): 4.50%; and

§ Year 10 (April 27, 2027 to but excluding April 27, 2028): 6.00%.

Each semi-annual interest period (other than the first interest period, which will begin on the issue date) will begin on, and will include, an interest payment date, and will extend to, but will exclude, the next succeeding interest payment date (or the maturity date, as applicable).

**Calculation agent:**

Merrill Lynch Capital Services, Inc. (“MLCS”)

**Role of the calculation agent:** The calculation agent has the sole discretion to make all determinations regarding the notes, including determinations regarding each interest payment and business days. Absent manifest error, all determinations of the calculation agent will be final and binding on you and us, without any liability on the part of the calculation agent.

We have initially appointed our subsidiary, MLCS, as the calculation agent, but we may change the calculation agent at any time without notifying you.

**Same-day settlement and payment:** The notes will be delivered in book-entry form only through The Depository Trust Company against payment by purchasers of the notes in immediately available funds. We will make payments of the principal amount and each interest payment in immediately available funds so long as the notes are maintained in book-entry form.

April 2018 Page PS-5



Step Up Callable Notes, due April 27, 2028

**Supplemental information regarding plan of distribution; conflicts of interest:** Our broker-dealer subsidiary, MLPF&S, will act as our selling agent in connection with the offering of the notes. The selling agent is a party to the Distribution Agreement described in the “Supplemental Plan of Distribution (Conflicts of Interest)” on page S-24 of the accompanying prospectus supplement.

MLPF&S will sell the notes to other broker-dealers that will participate in the offering and that are not affiliated with us, at an agreed discount to the principal amount. Each of those broker-dealers may sell the notes to one or more additional broker-dealers. MLPF&S has informed us that these discounts may vary from dealer to dealer and that not all dealers will purchase or repurchase the notes at the same discount.

The selling agent is a member of the Financial Industry Regulatory Authority, Inc. (“FINRA”). Accordingly, the offering of the notes will conform to the requirements of FINRA Rule 5121.

The selling agent is not your fiduciary or advisor solely as a result of the offering of the notes, and you should not rely upon this pricing supplement, or the accompanying prospectus or prospectus supplement as investment advice or a recommendation to purchase notes. You should make your own investment decision regarding the notes after consulting with your legal, tax, and other advisors.

The settlement of the notes will occur on April 27, 2018.

The selling agent and any of our other broker-dealer affiliates, may use this pricing supplement and the accompanying prospectus supplement and prospectus for offers and sales in secondary market transactions and market-making transactions in the notes. However, they are not obligated to engage in such secondary market transactions and/or market-making transactions. The selling agent may act as principal or agent in these transactions, and any such sales will be made at prices related to prevailing market conditions at the time of the sale.

Any price that MLPF&S may pay to repurchase the notes will depend upon then prevailing market conditions and other considerations, as mentioned above, and will include transaction costs.

No Prospectus (as defined in Directive 2003/71/EC (as amended, the (“Prospectus Directive”))) will be prepared in connection with these notes. Accordingly, these notes may not be offered to the public in any member state of the EEA, and any purchaser of these notes who subsequently sells any of these notes in any EEA member state must do so only in accordance with the requirements of the Prospectus Directive, as implemented in that member state.

The notes are not intended to be offered, sold or otherwise made available to, and should not be offered, sold or otherwise made available to, any retail investor in the EEA. For these purposes, the expression “offer” includes the communication in any form and by any means of sufficient information on the terms of the offer and the notes to be offered so as to enable an investor to decide to purchase or subscribe the notes, and a “retail investor” means a person who is one (or more) of: (a) a retail client, as defined in point (11) of Article 4(1) of Directive 2014/65/EU (as amended, “MiFID II”); or (b) a customer, within the meaning of Insurance Distribution Directive 2016/97/EU, as amended, where that customer would not qualify as a professional client as defined in point (10) of Article 4(1) of MiFID II; or (c) not a qualified investor as defined in the Prospectus

Directive. Consequently, no key information document required by Regulation (EU) No 1286/2014 (as amended, the "PRIIPs Regulation") for offering or selling the notes or otherwise making them available to retail investors in the EEA has been prepared, and therefore, offering or selling the notes or otherwise making them available to any retail investor in the EEA may be unlawful under the PRIIPs Regulation.

April 2018 Page PS-6

Step Up Callable Notes, due April 27, 2028

**Validity of the notes:**

In the opinion of McGuireWoods LLP, as counsel to BAC, when the trustee has made an appropriate entry on Schedule 1 to the Master Registered Global Senior Note, dated February 7, 2017 (the “Master Note”) identifying the notes offered hereby as supplemental obligations thereunder in accordance with the instructions of BAC and the notes have been delivered against payment therefor as contemplated in this pricing supplement and the related prospectus supplement and prospectus, all in accordance with the provisions of the indenture governing the notes, such notes will be legal, valid and binding obligations of BAC, subject to the effect of applicable bankruptcy, insolvency (including laws relating to preferences, fraudulent transfers and equitable subordination), reorganization, moratorium and other similar laws affecting creditors’ rights generally, and to general principles of equity. This opinion is given as of the date hereof and is limited to the laws of the State of New York and the Delaware General Corporation Law (including the statutory provisions, all applicable provisions of the Delaware Constitution and reported judicial decisions interpreting the foregoing) as in effect on the date hereof. In addition, this opinion is subject to the assumption that the trustee’s certificate of authentication of the Master Note has been manually signed by one of the trustee’s authorized officers and to customary assumptions about the trustee’s authorization, execution and delivery of the indenture governing the notes, the validity, binding nature and enforceability of the indenture governing the notes with respect to the trustee, the legal capacity of natural persons, the genuineness of signatures, the authenticity of all documents submitted to McGuireWoods LLP as originals, the conformity to original documents of all documents submitted to McGuireWoods LLP as copies thereof, the authenticity of the originals of such copies and certain factual matters, all as stated in the letter of McGuireWoods LLP dated January 13, 2017, which has been filed as an exhibit to BAC’s Current Report on Form 8-K dated January 13, 2017. Morgan Stanley Wealth Management clients may contact their local Morgan Stanley branch office or Morgan Stanley’s principal executive offices at 1585 Broadway, New York, New York 10036 (telephone number (866) 477-4776). All other clients may contact their local brokerage representative. Third-party distributors may contact Morgan Stanley Structured Investment Sales at (800) 233-1087. We have filed a registration statement (including a prospectus supplement and a prospectus) with the SEC for the offering to which this pricing supplement relates. Before you invest, you should read these documents, this document, and the other documents that we have filed with the SEC, for more complete information about us and this offering. You may get these documents without cost by visiting EDGAR on the SEC website at [www.sec.gov](http://www.sec.gov). Alternatively, we, any agent, or any dealer participating in this offering will arrange to send you these documents if you so request by calling MLPF&S toll-free at 1-800-294-1322.

**Contact:**

**Where you can find more information:**

The terms and risks of the notes are contained in this document and in the following:

i Series M MTN prospectus supplement dated September 11, 2017 and prospectus dated May 1, 2015:

<https://www.sec.gov/Archives/edgar/data/70858/000119312517281476/d283568d424b3.htm>



Step Up Callable Notes, due April 27, 2028

### U.S. Federal Income Tax Summary

The following summary of the material U.S. federal income tax considerations of the acquisition, ownership, and disposition of the notes is based upon the advice of Morrison & Foerster LLP, our tax counsel. The following discussion is not exhaustive of all possible tax considerations. This summary is based upon the Internal Revenue Code of 1986, as amended (the “Code”), regulations promulgated under the Code by the U.S. Treasury Department (including proposed and temporary regulations), rulings, current administrative interpretations and official pronouncements of the Internal Revenue Service (the “IRS”), and judicial decisions, all as currently in effect and all of which are subject to differing interpretations or to change, possibly with retroactive effect. No assurance can be given that the IRS would not assert, or that a court would not sustain, a position contrary to any of the tax consequences described below.

The following discussion supplements, is subject to the same qualifications and limitations as, and should be read in conjunction with the discussion in the prospectus supplement under the caption “U.S. Federal Income Tax Considerations,” and in the prospectus under the caption “U.S. Federal Income Tax Considerations.” To the extent inconsistent, the following discussion supersedes the discussion in the prospectus supplement and the prospectus.

This discussion only applies to U.S. holders (as defined in the accompanying prospectus) that are not excluded from the discussion of U.S. federal income taxation in the accompanying prospectus. In particular, this summary is directed solely to U.S. holders that will purchase the notes upon original issuance and will hold the notes as capital assets within the meaning of Section 1221 of the Code, which generally means as property held for investment. This summary assumes that the issue price of the notes, as determined for U.S. federal income tax purposes, equals the principal amount thereof.

The notes will be treated as debt instruments for U.S. federal income tax purposes. The notes provide for an initial fixed rate of interest that increases in subsequent periods. In addition, the notes provide us with the right to redeem the notes on April 27, 2019 and on each subsequent interest payment date at a redemption price equal to 100% of the principal amount of the notes, plus any accrued and unpaid interest. Solely for purposes of computing the yield and maturity of a debt instrument, applicable Treasury regulations generally deem an issuer to exercise a call option in a manner that minimizes the yield on the debt instrument. This assumption is made solely for U.S. federal income tax purposes of determining whether the notes are issued with original issue discount (“OID”) and is not an indication of our intention to call or not to call the notes at any time. The yield on the notes would be minimized if we call the notes on April 27, 2021. Accordingly, solely for purposes of determining the yield and maturity of the notes we are deemed to exercise our right to redeem the notes on such date and the notes should be treated as maturing on that date. Therefore, the notes should not be treated as having been issued with OID. If we do not call the notes on such date, solely for purposes of determining the yield and maturity of the notes, the notes should be deemed to be retired and reissued for an amount equal to their adjusted issue price on that date. This deemed retirement and reissuance should not result in any taxable gain or loss to you. Solely for purposes of determining yield and maturity, the deemed reissued notes should be subject to the rules discussed above. By application of those rules, the deemed reissued notes should be treated as fixed rate debt instruments not bearing OID. The same analysis would apply to each subsequent interest rate step up date.

You should consult the discussion under “U.S. Federal Income Tax Considerations—Taxation of Debt Securities—Consequences to U.S. Holders” as it relates to fixed rate debt instruments not bearing OID in the accompanying prospectus for a description of the consequences to you of the ownership and disposition of the notes.

Upon the sale, exchange, retirement, or other disposition of a note, a U.S. holder will recognize gain or loss equal to the difference between the amount realized upon the sale, exchange, retirement, or other disposition (less an amount

equal to any accrued interest not previously included in income if the note is disposed of between interest payment dates, which will be included in income as interest income for U.S. federal income tax purposes) and the U.S. holder's adjusted tax basis in the note. A U.S. holder's adjusted tax basis in a note generally will be the cost of the note to such U.S. holder, increased by any OID, market discount, de minimis OID, or de minimis market discount previously included in income with respect to the note, and decreased by the amount of any premium previously amortized to reduce interest on the note and the amount of any payment (other than a payment of qualified stated interest) received in respect of the note.

Except as discussed in the prospectus with respect to market discount, gain or loss realized on the sale, exchange, retirement, or other disposition of a note generally will be capital gain or loss and will be long-term capital gain or loss if the note has been held for more than one year. The ability of U.S. holders to deduct capital losses is subject to limitations under the Code.

*You should consult your own tax advisor concerning the U.S. federal income tax consequences to you of acquiring, owning, and disposing of the notes, as well as any tax consequences arising under the laws of any state, local, foreign, or other tax jurisdiction and the possible effects of changes in U.S. federal or other tax laws.*

April 2018 Page PS-8

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#### Legal Proceedings

Item 1A.

Risk Factors

56

Item 6.

Exhibits

57

Items 2, 3, 4 and 5 of Part II are omitted because there is no information to report.

- 2 -

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## VALHI, INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED BALANCE SHEETS

(In millions)

|  | December 31,<br>2017 | June 30,<br>2018<br>(unaudited) |
|--|----------------------|---------------------------------|
| <b>ASSETS</b>  |                      |                                 |
| Current assets:  |                      |                                 |
| Cash and cash equivalents                                  | \$ 435.7             | \$ 554.5                        |
| Restricted cash equivalents                                | 16.1                 | 14.4                            |
| Marketable securities                                      | 3.0                  | 1.6                             |
| Accounts and other receivables, net                        | 365.8                | 411.6                           |
| Land held for development                                  | 16.5                 | 15.1                            |
| Inventories, net   | 398.4                | 429.4                           |
| Other current assets                                       | 15.5                 | 16.6                            |
| Current assets of discontinued operations                  | 11.2                 | —                               |
| Total current assets                                       | 1,262.2              | 1,443.2                         |
| Other assets:  |                      |                                 |
| Marketable securities                                      | 255.7                | 256.8                           |
| Investment in TiO <sub>2</sub> manufacturing joint venture | 86.5                 | 80.3                            |
| Goodwill   | 379.7                | 379.7                           |
| Deferred income taxes                                      | 119.8                | 98.6                            |
| Other assets   | 174.1                | 175.5                           |
| Noncurrent assets of discontinued operations               | 40.8                 | —                               |
| Total other assets   | 1,056.6              | 990.9                           |
| Property and equipment:                                    |                      |                                 |
| Land   | 47.0                 | 46.6                            |
| Buildings  | 261.6                | 253.7                           |
| Equipment  | 1,150.8              | 1,155.7                         |
| Mining properties  | 35.0                 | 31.8                            |
| Construction in progress                                   | 58.3                 | 37.9                            |
|  | 1,552.7              | 1,525.7                         |
| Less accumulated depreciation                              | 964.0                | 958.9                           |
| Net property and equipment                                 | 588.7                | 566.8                           |
| Total assets   | \$ 2,907.5           | \$ 3,000.9                      |

## VALHI, INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED BALANCE SHEETS (CONTINUED)

(In millions)

|   | December 31,<br>2017 | June 30,<br>2018<br>(unaudited) |
|---|----------------------|---------------------------------|
| <b>LIABILITIES AND EQUITY</b>                       |                      |                                 |
| <b>Current liabilities:</b>                         |                      |                                 |
| Current maturities of long-term debt                | \$ 1.6               | \$ 1.6                          |
| Accounts payable and accrual liabilities            | 257.1                | 337.1                           |
| Income taxes  | 25.1                 | 44.9                            |
| Current liabilities of discontinued operations      | 47.3                 | —                               |
| Total current liabilities                           | 331.1                | 383.6                           |
| <b>Noncurrent liabilities:</b>                      |                      |                                 |
| Long-term debt                                      | 1,041.5              | 1,061.7                         |
| Deferred income taxes                               | 183.2                | 157.6                           |
| Payable to affiliates                               | 70.1                 | 64.0                            |
| Accrued pension costs                               | 266.4                | 257.5                           |
| Accrued environmental remediation and related costs | 110.7                | 101.3                           |
| Accrued postretirement benefits costs               | 11.3                 | 10.7                            |
| Other liabilities                                   | 73.6                 | 94.1                            |
| Noncurrent liabilities of discontinued operations   | 52.9                 | —                               |
| Total noncurrent liabilities                        | 1,809.7              | 1,746.9                         |
| <b>Equity:</b>                                      |                      |                                 |
| <b>Valhi stockholders' equity:</b>                  |                      |                                 |
| Preferred stock                                     | 667.3                | 667.3                           |
| Common stock  | 3.6                  | 3.6                             |
| Additional paid-in capital                          | —                    | —                               |
| Retained earnings (deficit)                         | (17.9 )              | 72.6                            |
| Accumulated other comprehensive loss                | (179.0 )             | (185.2 )                        |
| Treasury stock, at cost                             | (49.6 )              | (49.6 )                         |
| Total Valhi stockholders' equity                    | 424.4                | 508.7                           |
| Noncontrolling interest in subsidiaries             | 342.3                | 361.7                           |
| Total equity  | 766.7                | 870.4                           |
| Total liabilities and equity                        | \$ 2,907.5           | \$ 3,000.9                      |

Commitments and contingencies (Notes 14 and 17)

See accompanying Notes to Condensed Consolidated Financial Statements.



## VALHI, INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(In millions, except per share data)

|  | Three months<br>ended<br>June 30,<br>2017 |         | Six months ended<br>June 30,<br>2018 |          |
|--|---|---------|--------------------------------------|----------|
|  | (unaudited)                               |         |                                      |          |
| <b>Revenues and other income:</b>                            |   |         |                                      |          |
| Net sales  | \$481.8                                   | \$510.2 | \$87.1                               | \$ 976.2 |
| Other income, net  | 3.8                                       | 19.3    | 11.4                                 | 39.7     |
| Total revenues and other income                              | 485.6                                     | 529.5   | 898.5                                | 1,015.9  |
| <b>Costs and expenses:</b>                                   |   |         |                                      |          |
| Cost of sales  | 338.0                                     | 326.2   | 626.7                                | 606.9    |
| Selling, general and administrative                          | 66.1                                      | 79.5    | 129.6                                | 159.7    |
| Litigation settlement expense, net                           | —   | 62.0    | —                                    | 62.0     |
| Other components of net periodic pension and OPEB expense    | 4.3                                       | 3.8     | 8.4                                  | 7.5      |
| Interest   | 14.7                                      | 16.0    | 29.2                                 | 31.4     |
| Total costs and expenses                                     | 423.1                                     | 487.5   | 793.9                                | 867.5    |
| <b>Income from continuing operations before income taxes</b> |   |         |                                      |          |
|  | 62.5                                      | 42.0    | 104.6                                | 148.4    |
| Income tax expense (benefit)                                 | (100.8)                                   | 22.0    | (82.2 )                              | 58.2     |
| Net income from continuing operations                        | 163.3                                     | 20.0    | 186.8                                | 90.2     |
| Income (loss) from discontinued operations                   | (108.2)                                   | .4      | (109.9 )                             | 38.0     |
| Net income   | 55.1                                      | 20.4    | 76.9                                 | 128.2    |
| Noncontrolling interest in net income of subsidiaries        | 46.3                                      | 8.7     | 55.4                                 | 27.2     |
| Net income attributable to Valhi stockholders                | \$8.8                                     | \$11.7  | \$1.5                                | \$ 101.0 |
| <b>Amount attributable to Valhi stockholders:</b>            |   |         |                                      |          |
| Income from continuing operations                            | \$117.0                                   | \$11.3  | \$31.4                               | 63.0     |
| Income (loss) from discontinued operations                   | (108.2)                                   | .4      | (109.9 )                             | 38.0     |
| Net income attributable to Valhi stockholders                | \$8.8                                     | 11.7    | \$1.5                                | \$ 101.0 |
| <b>Basic and diluted net income per share:</b>               |   |         |                                      |          |
| Income from continuing operations                            | \$.35                                     | \$.03   | \$.38                                | \$ .18   |
| Income (loss) from discontinued operations                   | (.32 )                                    | —       | (.32 )                               | .11      |
| Net income attributable to Valhi stockholders                | \$.03                                     | \$.03   | \$.06                                | \$ .29   |
| Cash dividends per share                                     | \$.02                                     | \$.02   | \$.04                                | \$ .04   |
| Basic and diluted weighted average shares outstanding        | 342.0                                     | 342.0   | 342.0                                | 342.0    |

See accompanying Notes to Condensed Consolidated Financial Statements.

- 5 -

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## VALHI, INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(In millions)

|  | Three months<br>ended June<br>30,<br>2017 2018<br>(unaudited) |          | Six months<br>ended June 30,<br>2017 2018 |         |
|--|---|----------|---|---------|
| Net income   | \$55.1  | \$20.4   | \$76.9                                    | \$128.2 |
| Other comprehensive income (loss), net of tax:               |   |          |   |         |
| Currency translation   | 12.6  | (22.9)   | 20.1                                      | (13.1)  |
| Marketable securities  | (.5 )   | —        | (.8 )                                     | (.1 )   |
| Interest rate swap   | (.4 )   | —        | .1  | —       |
| Defined benefit pension plans                                | .8  | 2.5      | 3.6                                       | 5.1     |
| Other postretirement benefit plans                           | (.2 )   | (.2 )    | (.4 )                                     | (.5 )   |
| Total other comprehensive income (loss), net                 | 12.3  | (20.6)   | 22.6                                      | (8.6 )  |
| Comprehensive income (loss)                                  | 67.4  | (.2 )    | 99.5                                      | 119.6   |
| Comprehensive income attributable to noncontrolling interest | 49.2  | 3.2      | 61.0                                      | 24.9    |
| Comprehensive income (loss) attributable to                  |   |          |   |         |
| Valhi stockholders   | \$18.2  | \$(3.4 ) | \$38.5                                    | \$94.7  |

See accompanying Notes to Condensed Consolidated Financial Statements.

## VALHI, INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In millions)

|  | Six months<br>ended<br>June 30,<br>2017      2018<br>(unaudited) |         |
|--|--|---------|
| <b>Cash flows from operating activities:</b>   |  |         |
| Net income   | \$76.9   | \$128.2 |
| Depreciation and amortization  | 33.2   | 28.9    |
| Benefit plan expense greater than cash funding   | 4.6  | 3.4     |
| Deferred income taxes  | (183.9)  | 37.2    |
| Gain on sale of WCS  | —  | (58.4)  |
| Gain on land sales   | —  | (12.5)  |
| Distributions from TiO <sub>2</sub> manufacturing joint venture, net                       | 8.4  | 4.8     |
| Long-lived asset impairment  | 170.6  | —       |
| Other, net   | 1.5  | 6.6     |
| <b>Change in assets and liabilities:</b>   |  |         |
| Accounts and other receivables, net  | (77.8 )  | (64.5 ) |
| Inventories, net   | 22.6   | (41.7 ) |
| Land held for development, net   | 3.1  | (1.2 )  |
| Accounts payable and accrued liabilities   | 8.8  | 62.7    |
| Accounts with affiliates   | .3   | 25.4    |
| Income taxes   | 5.8  | 20.1    |
| Other, net   | 14.6   | 20.7    |
| Net cash provided by operating activities  | 88.7   | 159.7   |
| <b>Cash flows from investing activities:</b>   |  |         |
| Capital expenditures   | (30.5 )  | (27.6 ) |
| Cash, cash equivalents and restricted cash and cash equivalents of discontinued operations |  |         |
| at time of sale  | —  | (28.9 ) |
| Capitalized permit costs   | (2.2 )   | —       |
| Proceeds from sale of land   | —  | 19.5    |
| Purchases of marketable securities   | (5.6 )   | (3.7 )  |
| Disposals of marketable securities   | 5.5  | 3.9     |
| Other, net   | —  | .1      |
| Net cash used in investing activities  | (32.8 )  | (36.7 ) |
| <b>Cash flows from financing activities:</b>   |  |         |
| <b>Indebtedness:</b>   |  |         |
| Borrowings   | 175.7  | —       |
| Principal payments   | (148.9)  | (3.7 )  |
| Deferred financing costs paid  | (.2 )  | —       |
| Valhi cash dividends paid  | (13.6 )  | (13.6 ) |
| Distributions to noncontrolling interest in subsidiaries                                   | (7.0 )   | (7.9 )  |
| Net cash provided by (used in) financing activities  | 6.0  | (25.2 ) |

|  |         |         |
|--|---------|---------|
| Cash, cash equivalents and restricted cash and cash equivalents - net change from: |         |         |
| Operating, investing and financing activities                                      | 61.9    | 97.8    |
| Effect of exchange rates on cash   | 8.6     | (9.3 )  |
| Balance at beginning of period   | 196.5   | 489.4   |
| Balance at end of period   | \$267.0 | \$577.9 |
| Supplemental disclosures:  |         |         |
| Cash paid for:   |         |         |
| Interest, net of capitalized interest  | \$30.0  | \$31.0  |
| Income taxes, net  | 26.3    | 5.9     |
| Noncash investing activities:  |         |         |
| Change in accruals for capital expenditures  | 4.0     | 1.0     |
| Noncash financing activities:  |         |         |
| Trade payable to affiliate converted to indebtedness                               | —       | 36.3    |
| Indebtedness borrowings paid directly to lender to settle refinanced indebtedness  | 9.3     | —       |
| Indebtedness principal payments paid directly by lender                            | (8.4 )  | —       |
| Indebtedness borrowings paid directly to lender for debt issuance costs            | (.9 )   | —       |
| See accompanying Notes to Condensed Consolidated Financial Statements.             |         |         |



## VALHI, INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENT OF EQUITY

Six months ended June 30, 2018

(In millions)

(unaudited)

|   | Valhi Stockholders' Equity |                 |                                  |                                   | Accumulated                   |                   | Non-<br>controlling<br>interest | Total<br>equity |
|---|----------------------------|-----------------|----------------------------------|-----------------------------------|-------------------------------|-------------------|---------------------------------|-----------------|
|   | Preferred<br>stock         | Common<br>stock | Additional<br>paid-in<br>capital | Retained<br>earnings<br>(deficit) | other<br>comprehensiv<br>loss | Treasury<br>stock |                                 |                 |
| Balance at December 31, 2017                    | \$667.3                    | \$ 3.6          | \$ --                            | \$ (17.9 )                        | \$ (179.0 )                   | \$ (49.6 )        | \$ 342.3                        | \$766.7         |
| Change in accounting principle –<br>ASU 2014-09 | --                         | --              | --                               | 2.7                               | --                            | --                | 2.3                             | 5.0             |
| Balance at January 1, 2018, as<br>adjusted      | 667.3                      | 3.6             | --                               | (15.2 )                           | (179.0 )                      | (49.6 )           | 344.6                           | 771.7           |
| Net income                                      | --                         | --              | --                               | 101.0                             | --                            | --                | 27.2                            | 128.2           |
| Other comprehensive loss, net                   | --                         | --              | --                               | --                                | (6.2 )                        | --                | (2.4 )                          | (8.6 )          |
| Cash dividends                                  | --                         | --              | (.4 )                            | (13.2 )                           | --                            | --                | (7.9 )                          | (21.5 )         |
| Other, net                                      | --                         | --              | .4                               | --                                | --                            | --                | .2                              | .6              |
| Balance at June 30, 2018                        | \$667.3                    | \$ 3.6          | \$ --                            | \$ 72.6                           | \$ (185.2 )                   | \$ (49.6 )        | \$ 361.7                        | \$870.4         |

See accompanying Notes to Condensed Consolidated Financial Statements.



VALHI, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2018

(unaudited)

Note 1—Organization and basis of presentation:

Organization— We are majority owned by a wholly-owned subsidiary of Contran Corporation (“Contran”), which owns approximately 92% of our outstanding common stock at June 30, 2018. All of Contran's outstanding voting stock is held by a family trust established for the benefit of Lisa K. Simmons and Serena Simmons Connelly and their children, for which Ms. Simmons and Ms. Connelly are co-trustees, or is held directly by Ms. Simmons and Ms. Connelly or entities related to them. Consequently, Ms. Simmons and Ms. Connelly may be deemed to control Contran and us.

Basis of Presentation—Consolidated in this Quarterly Report are the results of our majority-owned and wholly-owned subsidiaries, including NL Industries, Inc., Kronos Worldwide, Inc., CompX International Inc., Tremont LLC, Basic Management, Inc. (“BMI”) and The LandWell Company (“LandWell”). Kronos (NYSE: KRO), NL (NYSE: NL), and CompX (NYSE American: CIX) each file periodic reports with the Securities and Exchange Commission (“SEC”). In January 2018, we sold Waste Control Specialists LLC (“WCS”). See Note 3.

The unaudited Condensed Consolidated Financial Statements contained in this Quarterly Report have been prepared on the same basis as the audited Consolidated Financial Statements included in our Annual Report on Form 10-K for the year ended December 31, 2017 that we filed with the SEC on March 15, 2018 (the “2017 Annual Report”). In our opinion, we have made all necessary adjustments (which include only normal recurring adjustments, other than the gain on the sale of WCS recognized in the first quarter of 2018 as discussed in Note 3), in order to state fairly, in all material respects, our consolidated financial position, results of operations and cash flows as of the dates and for the periods presented. We have condensed the Consolidated Balance Sheet at December 31, 2017 contained in this Quarterly Report as compared to our audited Consolidated Financial Statements at that date, and we have omitted certain information and footnote disclosures (including those related to the Consolidated Balance Sheet at December 31, 2017) normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”). Our results of operations for the interim periods ended June 30, 2018 may not be indicative of our operating results for the full year. The Condensed Consolidated Financial Statements contained in this Quarterly Report should be read in conjunction with our 2017 Consolidated Financial Statements contained in our 2017 Annual Report.

Unless otherwise indicated, references in this report to “we,” “us” or “our” refer to Valhi, Inc. and its subsidiaries (NYSE: VHI), taken as a whole.

Note 2—Business segment information:

| Business segment                       | Entity           | % controlled at<br>June 30, 2018 |   |
|--|------------------|----------------------------------|---|
| Chemicals                              | Kronos           | 80                               | % |
| Component products                     | CompX            | 87                               | % |
| Real estate management and development | BMI and LandWell | 63% - 77                         | % |

- 9 -

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Our control of Kronos includes 50% we hold directly and 30% held directly by NL. We own 83% of NL. Our control of CompX is through NL. We own 63% of BMI. Our control of LandWell includes the 27% we hold directly and 50% held by BMI.

|   | Three months ended |          | Six months ended |          |
|---|--------------------|----------|------------------|----------|
|   | June 30,           | June 30, | June 30,         | June 30, |
|   | 2017               | 2018     | 2017             | 2018     |
|   | (unaudited)        |          |                  |          |
|   | (In millions)      |          |                  |          |
| Net sales:  |                    |          |                  |          |
| Chemicals   | \$441.4            | \$471.8  | \$ 811.2         | \$ 902.2 |
| Component products  | 30.1               | 32.4     | 60.0             | 60.8     |
| Real estate management and development                    | 10.3               | 6.0      | 15.9             | 13.2     |
| Total net sales   | \$481.8            | \$510.2  | \$ 887.1         | \$ 976.2 |
| Cost of sales:  |                    |          |                  |          |
| Chemicals   | \$309.6            | \$300.5  | \$ 573.8         | \$ 556.6 |
| Component products  | 20.5               | 21.2     | 40.8             | 40.1     |
| Real estate management and development                    | 7.9                | 4.5      | 12.1             | 10.2     |
| Total cost of sales                                       | \$338.0            | \$326.2  | \$ 626.7         | \$ 606.9 |
| Gross margin:   |                    |          |                  |          |
| Chemicals   | \$131.8            | \$171.3  | \$ 237.4         | \$ 345.6 |
| Component products  | 9.6                | 11.2     | 19.2             | 20.7     |
| Real estate management and development                    | 2.4                | 1.5      | 3.8              | 3.0      |
| Total gross margin  | \$143.8            | \$184.0  | \$ 260.4         | \$ 369.3 |
| Operating income:   |                    |          |                  |          |
| Chemicals   | \$77.2             | \$123.6  | \$ 136.3         | \$ 234.2 |
| Component products  | 4.6                | 6.0      | 9.1              | 10.4     |
| Real estate management and development                    | 1.3                | .4       | 1.8              | 4.2      |
| Total operating income                                    | 83.1               | 130.0    | 147.2            | 248.8    |
| General corporate items:                                  |                    |          |                  |          |
| Securities earnings                                       | 7.1                | 8.5      | 14.1             | 16.8     |
| Insurance recoveries                                      | —                  | .2       | .1               | .4       |
| Gain on land sales  | —                  | —        | —                | 12.5     |
| Other components of net periodic pension and OPEB expense | (4.3 )             | (3.8 )   | (8.4 )           | (7.5 )   |
| Litigation settlement expense                             | —                  | (62.0 )  | —                | (62.0 )  |
| General expenses, net                                     | (8.7 )             | (14.9 )  | (19.2 )          | (29.2 )  |
| Interest expense  | (14.7 )            | (16.0 )  | (29.2 )          | (31.4 )  |
| Income from continuing operations before income taxes     | \$62.5             | \$42.0   | \$ 104.6         | \$ 148.4 |

Segment results we report may differ from amounts separately reported by our various subsidiaries due to purchase accounting adjustments and related amortization or differences in the way we define operating income. Intersegment

sales are not material.

- 10 -

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## Note 3—Business disposition — Waste Control Specialists LLC:

Pursuant to an agreement we entered into in December 2017, on January 26, 2018 we completed the sale of our Waste Management Segment to JFL-WCS Partners, LLC ("JFL Partners"), an entity sponsored by certain investment affiliates of J.F. Lehman & Company, for consideration consisting of the assumption of all of WCS' third-party indebtedness and other liabilities. Our Waste Management Segment, which operated in the low-level radioactive, hazardous, toxic and other waste disposal industry historically struggled to generate sufficient recurring disposal volumes to generate positive operating results or cash flows. We believe the sale will enable us to focus more effort on continuing to develop our remaining segments which we believe have greater opportunity for higher returns than our Waste Management segment.

In accordance with GAAP, the Waste Management Segment has been classified as discontinued operations in our Condensed Consolidated Balance Sheets and Condensed Consolidated Statements of Income for all periods presented. Also in accordance with GAAP, we have not reclassified our Condensed Consolidated Statement of Cash Flows to reflect the Waste Management Segment as discontinued operations. We recognized a pre-tax gain of approximately \$58 million primarily in the first quarter of 2018 on the transaction (\$38.6 million, or \$.11 per diluted share, net of tax) because the carrying value of the liabilities of the business assumed by the purchaser exceeded the carrying value of the assets sold at the time of the sale in large part due to the previously-reported long-lived asset impairment of \$170.6 million recognized in the second quarter of 2017, as discussed in the 2017 Annual Report. The net assets of the disposed Waste Management Segment at the time we completed the sale on January 26, 2018 were not materially different as compared to December 31, 2017. The income tax benefit associated with discontinued operations recognized in the second quarter of 2018 relates principally to a change in the amount of the deferred income tax asset valuation allowance recognized during 2018 allocated to discontinued operations under the intra-period guidance of ASC 740 associated with the business interest expense deduction limitation discussed in Note 13. Selected financial data for the operations of the disposed Waste Management Segment for periods prior to completing the sale is presented below. Current assets at December 31, 2017 consist principally of trade accounts receivable.

|                                   | December<br>31,<br><br>2017<br>(In<br>millions) |
|-----------------------------------|---|
| <b>ASSETS</b>                     |   |
| Current assets                    | \$ 11.2   |
| Restricted cash                   | 27.2  |
| Property and equipment, net       | 6.0   |
| Other noncurrent assets           | 7.6   |
| Total noncurrent assets           | 40.8  |
| Total assets                      | \$ 52.0   |
| <b>LIABILITIES</b>                |   |
| Current portion of long-term debt | \$ 3.0  |
| Payable to Contran                | 36.1  |
| Other current liabilities         | 8.2   |
| Total current liabilities         | 47.3  |

|   |          |
|---|----------|
| Long-term debt                                    | 65.0     |
| Deferred income taxes                             | (43.8 )  |
| Accrued noncurrent closure and post closure costs | 31.7     |
| Total noncurrent liabilities                      | 52.9     |
| Total liabilities                                 | \$ 100.2 |

- 11 -

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|   | Three months ended |      | Six months ended |                     |
|---|--------------------|------|------------------|---------------------|
|   | June 30,<br>2017   | 2018 | June 30,<br>2017 | 2018 <sup>(1)</sup> |
|   | (In millions)      |      |                  |                     |
| Net sales                                 | \$20.5             | \$—  | \$42.0           | \$4.6               |
| Operating loss <sup>(2)</sup>             | \$(171.6)          | \$—  | (171.0)          | (.4)                |
| Termination fee                           | 4.0                | —    | 4.0              | —                   |
| Other expense, net                        | (5.8)              | —    | (7.7)            | —                   |
| Interest expense, net                     | (1.2)              | —    | (2.4)            | (.3)                |
| Loss before taxes                         | (174.6)            | —    | (177.1)          | (.7)                |
| Income tax benefit                        | (66.4)             | —    | (67.2)           | (.1)                |
| Net loss                                  | (108.2)            | —    | (109.9)          | (.6)                |
| Pre-tax gain on disposal                  | —                  | —    | —                | 58.4                |
| Income tax expense (benefit)              | —                  | (.4) | —                | 19.8                |
| After-tax gain on disposal                | —                  | .4   | —                | 38.6                |
| Total                                     | \$(108.2)          | \$.4 | \$(109.9)        | \$38.0              |
| Net cash provided by operating activities |                    |      | \$8.8            | \$2.3               |
| Net cash used in investing activities     |                    |      | \$(2.6)          | \$(.1)              |

(1) Includes results of the Waste Management Segment through January 26, 2018, the date of the sale.

(2) Operating results in the second quarter and first six months of 2017 includes a \$170.6 million long-lived asset impairment.

In connection with the January 2018 sale, JFL Partners did not assume WCS' trade payable owed to Contran, which consisted primarily of intercorporate service fees charged to WCS by Contran which WCS did not pay to Contran for several years. Immediately prior to the closing of the sale of WCS, Contran transferred its associated receivable of \$36.3 million from WCS to Valhi, in return for a deemed \$36.3 million borrowing by Valhi under its revolving credit facility with Contran, see Note 8. Valhi subsequently contributed such receivable from WCS to WCS's equity, and the trade payable obligation of WCS was deemed paid in full.

Note 4—Accounts and other receivables, net:

|                            | December 31,<br>2017 | June 30,<br>2018 |
|----------------------------|----------------------|------------------|
|                            | (In millions)        |                  |
| Trade accounts receivable: |                      |                  |
| Kronos                     | \$301.4              | \$350.8          |
| CompX                      | 10.5                 | 13.8             |

|                                    |         |         |
|------------------------------------|---------|---------|
| BMI and LandWell                   | 1.6     | 1.9     |
| VAT and other receivables          | 20.7    | 26.6    |
| Insurance recovery receivable – NL | —       | 15.0    |
| Refundable income taxes            | .5      | .7      |
| Receivable from affiliates:        |         |         |
| Contran – trade items              | 1.0     | .9      |
| Contran – income taxes             | 19.4    | —       |
| LPC – trade items                  | 8.9     | —       |
| Other – trade items                | 3.3     | 3.3     |
| Allowance for doubtful accounts    | (1.5 )  | (1.4 )  |
| Total                              | \$365.8 | \$411.6 |

The insurance recovery receivable due to NL is discussed in Note 17.

- 12 -

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## Note 5—Inventories, net:

|                           | June<br>December 31,<br>2017 2018<br>(In millions) |         |
|---------------------------|--|---------|
| <b>Raw materials:</b>     |  |         |
| Chemicals                 | \$106.9  | \$89.3  |
| Component products        | 2.7  | 2.7     |
| Total raw materials       | 109.6  | 92.0    |
| <b>Work in process:</b>   |  |         |
| Chemicals                 | 20.8   | 33.1    |
| Component products        | 9.8  | 10.6    |
| Total in-process products | 30.6   | 43.7    |
| <b>Finished products:</b> |  |         |
| Chemicals                 | 192.2  | 226.4   |
| Component products        | 2.8  | 3.3     |
| Total finished products   | 195.0  | 229.7   |
| Supplies (chemicals)      | 63.2   | 64.0    |
| Total                     | \$398.4  | \$429.4 |

## Note 6—Marketable securities:

Our marketable securities consist of marketable equity and debt securities. Prior to 2018, any unrealized gains or losses on equity securities were recognized through other comprehensive income, net of deferred income taxes. Beginning on January 1, 2018 with the adoption of Accounting Standards Update (“ASU”) 2016-01, our marketable equity securities will continue to be carried at fair value as noted above, but any unrealized gains or losses on the securities are now recognized as a component of other income included in the securities transactions, net on our Condensed Consolidated Statements of Income. See Note 19.

|                                   | Market<br>value | Cost<br>basis | Unrealized<br>losses, net |
|-----------------------------------|-----------------|---------------|---------------------------|
| (In millions)                     |                 |               |                           |
| <b>December 31, 2017:</b>         |                 |               |                           |
| Current assets                    | \$3.0           | 3.0           | —                         |
| <b>Noncurrent assets:</b>         |                 |               |                           |
| The Amalgamated Sugar Company LLC | \$250.0         | 250.0         | —                         |
| Other                             | 5.7             | 5.9           | (.2 )                     |
| Total                             | \$255.7         | 255.9         | (.2 )                     |
| <b>June 30, 2018:</b>             |                 |               |                           |
| Current assets                    | \$1.6           | 1.6           | —                         |
| <b>Noncurrent assets:</b>         |                 |               |                           |

|                                   |         |         |     |       |
|-----------------------------------|---------|---------|-----|-------|
| The Amalgamated Sugar Company LLC | \$250.0 | \$250.0 | \$  | —     |
| Other                             | 6.8     | 7.1     | (.3 | )     |
| Total                             | \$256.8 | \$257.1 | \$  | (.3 ) |

All of our marketable securities are accounted for as available-for-sale, which are carried at fair value using quoted market prices, primarily Level 1 inputs as defined by ASC Topic 820, Fair Value Measurements and Disclosures, except for our investment in The Amalgamated Sugar Company LLC (“Amalgamated”). Our investment in Amalgamated is measured using significant unobservable inputs, which are Level 3 inputs. Please refer to Note 6 in our 2017 Annual Report for a complete description of the valuation methodology for our investment in Amalgamated. There have been no changes to the carrying value of this investment during the periods presented. See Note 18. Our other marketable securities, which consist of marketable equity and debt securities, are not material.

On May 30, 2018, we entered into an agreement with Snake River Sugar Company, an Oregon agricultural cooperative corporation that controls Amalgamated ("Snake River"), in which we agreed to sell our interest in Amalgamated for consideration consisting of \$12.5 million in cash and the deemed payment in full of our \$250 million in loans we owe Snake River (see Note 8). Closing of the sale is scheduled for August 31, 2018, or such other date as shall be agreed to by us and Snake River. Snake River's obligation to complete the closing of the sale is contingent on Snake River obtaining all required consents of the secured lenders of Snake River and Amalgamated and Snake River has agreed to work diligently and use commercially reasonable efforts to obtain such

consents. Such consents have not yet been received, and accordingly there is no assurance that such sale will be completed and as such we have continued to classify our investment in Amalgamated as a noncurrent asset (and our \$250 million in loans we owe Snake River as a noncurrent liability) at June 30, 2018.

Note 7—Other noncurrent assets:

|                                 | June           |                |
|---------------------------------|----------------|----------------|
|                                 | December 31,   | 2018           |
|                                 | 2017           | 2018           |
|                                 | (In millions)  |                |
| <b>Other noncurrent assets:</b> |                |                |
| Land held for development       | \$126.6        | \$123.1        |
| Restricted cash                 | 9.9            | 9.0            |
| Land contract receivables       | —              | 7.3            |
| IBNR receivables                | 6.8            | 6.9            |
| Pension asset                   | 4.2            | 6.0            |
| Notes receivable - OPA          | —              | 2.6            |
| Other                           | 26.6           | 20.6           |
| <b>Total</b>                    | <b>\$174.1</b> | <b>\$175.5</b> |

Land contract receivables classified as a noncurrent asset relate to our Real Estate Management and Development Segment. Such receivables relate to certain fees we collect from builders when the builder sells a home to a customer, as discussed in Note 19.

As disclosed in Note 18 to our 2017 Annual Report under an Owner Participation Agreement (“OPA”) entered into by LandWell with the Redevelopment Agency of the City of Henderson, Nevada, if LandWell develops certain real property for commercial and residential purposes in a master planned community in Henderson, Nevada, the cost of certain public infrastructure may be reimbursed to us through tax increment. The maximum reimbursement under the OPA is \$209 million, and is subject to, among other things, completing construction of approved qualifying public infrastructure, transferring title of such infrastructure to the City of Henderson, receiving approval from the Redevelopment Agency of the funds expended to be eligible for tax increment reimbursement and the existence of a sufficient property tax valuation base and property tax rates in order to generate tax increment reimbursement funds. We are entitled to receive 75% of the tax increment generated by the master planned community through 2036, subject to the qualifications and limitations indicated above. Public infrastructure costs previously incurred for which the Redevelopment Agency had provided its approval for tax increment reimbursement but we had not yet received such reimbursement through tax increment receipts aggregated \$3.1 million at December 31, 2017. Such amount is evidenced by a promissory note issued to LandWell by the City of Henderson.

Prior to 2018, due to the significant uncertainty of the timing and amount of any of such potential tax increment reimbursements, we recognized any such tax increment reimbursements only when received. However, due to growth in the master planned community and the increase in tax increment funds to which we are entitled, we determined in the first quarter of 2018 we expected the tax increment reimbursements to be collected in the future would at least be sufficient to support recognizing the \$3.1 million note payable issued by the City of Henderson to us. The note payable bears interest at 6% annually and the note expires in 2036. Any unpaid balances in 2036 are forfeited. See Note 13.

- 14 -

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## Note 8—Long-term debt:

|                                       | December 31,  | June 30,  |
|---------------------------------------|---------------|-----------|
|                                       | 2017          | 2018      |
|                                       | (In millions) |           |
| <b>Valhi:</b>                         |               |           |
| Snake River Sugar Company             | \$250.0       | \$250.0   |
| Contran credit facility               | 284.3         | 320.6     |
| Total Valhi debt                      | 534.3         | 570.6     |
| <b>Subsidiary debt:</b>               |               |           |
| <b>Kronos:</b>                        |               |           |
| Senior Secured Notes                  | 471.1         | 458.6     |
| <b>Tremont:</b>                       |               |           |
| Promissory note payable               | 13.1          | 10.9      |
| <b>BMI:</b>                           |               |           |
| Bank loan – Western Alliance Bank     | 18.8          | 18.0      |
| <b>LandWell:</b>                      |               |           |
| Note payable to the City of Henderson | 2.5           | 2.3       |
| Other                                 | 3.3           | 2.9       |
| Total subsidiary debt                 | 508.8         | 492.7     |
| Total debt                            | 1,043.1       | 1,063.3   |
| Less current maturities               | 1.6           | 1.6       |
| Total long-term debt                  | \$1,041.5     | \$1,061.7 |

Valhi – Snake River Sugar Company – In connection with the proposed sale of our ownership interest in Amalgamated, our outstanding debt obligations to Snake River Sugar Company due in 2027 would be deemed to be paid in full upon completion of such sale. See Note 6. As discussed above, completion of such sale is contingent on Snake River obtaining all required consents of the secured lenders of Snake River and Amalgamated to the closing of the sale and such consents have not yet been received, and accordingly there is no assurance that such sale will be completed. We have continued to classify our \$250 million in loans we owe Snake River as a noncurrent liability at June 30, 2018.

Contran credit facility – In connection with the sale of WCS discussed in Note 3, immediately prior to the closing of the sale, Contran transferred its associated receivable of \$36.3 million from WCS to Valhi, in return for a deemed \$36.3 million borrowing by Valhi under its revolving credit facility with Contran. The average interest rate on the existing balance as of and for the six months ended June 30, 2018 was 6.0% and 5.62%, respectively. At June 30, 2018, the equivalent of \$39.4 million was available for borrowing under this facility.

Kronos – Senior Secured Notes - At June 30, 2018, the carrying value of Kronos' 3.75% Senior Secured Notes due September 15, 2025 (€400 million aggregate principal amount outstanding) is stated net of unamortized debt issuance costs of \$6.8 million.

North American and European revolving credit facilities– During the first six months of 2018, Kronos had no borrowings or repayments under its North American revolving credit facility and its European revolving credit facility. At June 30, 2018, approximately \$118.1 million was available for additional borrowing under the North American Revolving credit facility. Kronos' European revolving credit facility requires the maintenance of certain financial ratios, and one of such requirements is based on the ratio of net debt to last twelve months earnings before income tax, interest, depreciation and amortization expense (EBITDA) of the borrowers. Based upon the borrowers' last twelve months EBITDA as of June 30, 2018 and the net debt to EBITDA financial test, the full €90.0 million of the

credit facility (\$104.7 million) is available for borrowing availability at such date.

Tremont – Promissory note payable – In January 2018, and following Tremont’s sale of certain land held for investment, discussed in Note 13, Tremont prepaid (without penalty) \$2.2 million principal amount on the note as required under the terms of the note agreement.

Restrictions and other – Certain of the credit facilities with unrelated, third-party lenders described above require the respective borrowers to maintain minimum levels of equity, require the maintenance of certain financial ratios, limit dividends and additional indebtedness and contain other provisions and restrictive covenants customary in lending transactions of this type. We are in compliance with all of our debt covenants at June 30, 2018.

- 15 -

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## Note 9—Accounts payable and accrued liabilities:

|   | December 31,<br>2017 2018 |         |
|---|---------------------------|---------|
|   | (In millions)             |         |
| Accounts payable:                           |                           |         |
| Kronos                                      | \$107.9                   | \$120.6 |
| CompX                                       | 2.3                       | 3.0     |
| BMI and LandWell                            | 3.7                       | 2.8     |
| NL  | 1.8                       | .7      |
| Other                                       | .4                        | .4      |
| Payable to affiliates:                      |                           |         |
| Contran – taxes                             | —                         | 2.7     |
| LPC – trade items                           | 16.2                      | 12.5    |
| Litigation settlement                       | —                         | 60.0    |
| Employee benefits                           | 36.3                      | 28.0    |
| Deferred income                             | 28.3                      | 22.8    |
| Accrued sales discounts and rebates         | 14.3                      | 19.2    |
| Environmental remediation and related costs | 6.8                       | 19.6    |
| Interest                                    | 5.5                       | 5.4     |
| Other                                       | 33.6                      | 39.4    |
| Total                                       | \$257.1                   | \$337.1 |

The litigation settlement accrual is discussed in Note 17.

## Note 10—Other noncurrent liabilities:

|                                     | December 31,<br>2017 2018 |        |
|-------------------------------------|---------------------------|--------|
|                                     | (In millions)             |        |
| Reserve for uncertain tax positions | \$16.5                    | \$17.2 |
| Litigation settlement               | —                         | 17.0   |
| Deferred income                     | 15.7                      | 15.9   |
| Employee benefits                   | 8.4                       | 8.2    |
| Insurance claims and expenses       | 9.1                       | 9.6    |
| Deferred payment obligation         | 9.3                       | 9.4    |
| Accrued development costs           | 6.1                       | 7.9    |
| Other                               | 8.5                       | 8.9    |
| Total                               | \$73.6                    | \$94.1 |

The litigation settlement accrual is discussed in Note 17.

#### Note 11 – Revenue Recognition

Chemicals and Component Products Segments - Our sales involve single performance obligations to ship our products pursuant to customer purchase orders. In some cases, the purchase order is supported by an underlying master sales agreement, but our purchase order acceptance generally evidences the contract with our customer by specifying the key terms of product and quantity ordered, price and delivery and payment terms. Effective January 1, 2018 with the adoption of ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606), see Note 19, we record revenue when we satisfy our performance obligations to our customers by transferring control of our products to them, which generally occurs at point of shipment or upon delivery. Such transfer of control is also evidenced by transfer of legal title and other risks and rewards of ownership (giving the customer the ability to direct the use of, and obtain substantially all of the benefits of, the product), and our customers becoming obligated to pay us and such payment being probable of occurring. In certain arrangements we provide shipping and handling activities after the transfer of control to our customer (e.g. when control transfers prior to delivery). In such arrangements shipping and handling are considered fulfillment activities, and accordingly, such costs are accrued when the related revenue is recognized.

Revenue is recorded in an amount that reflects the net consideration we expect to receive in exchange for our products. Prices for our products are based on terms specified in published list prices and purchase orders, which generally do not include financing components, noncash consideration or consideration paid to our customers. As our standard payment terms are less than one year, we have elected the practical expedient under ASC 606 and we have not assessed whether a contract has a significant financing

- 16 -

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component. We state sales net of price, early payment and distributor discounts as well as volume rebates (collectively, variable consideration). Variable consideration, to the extent present, is recognized as the amount to which we are most-likely to be entitled, using all information (historical, current and forecasted) that is reasonably available to us, and only to the extent that a significant reversal in the amount of the cumulative revenue recognized is not probable of occurring in a future period. Differences, if any, between estimates of the amount of variable consideration to which we will be entitled and the actual amount of such variable consideration have not been material in the past. We report any tax assessed by a governmental authority that we collect from our customers that is both imposed on and concurrent with our revenue-producing activities (such as sales, use, value added and excise taxes) on a net basis (meaning we do not recognize these taxes either in our revenues or in our costs and expenses).

Frequently, we receive orders for products to be delivered over dates that may extend across reporting periods. We invoice for each delivery upon shipment and recognize revenue for each distinct shipment when all sales recognition criteria for that shipment have been satisfied. As scheduled delivery dates for these orders are within a one year period, under the optional exemption provided by ASC 606, we do not disclose sales allocated to future shipments of partially completed contracts.

Real Estate Management and Development Segment – Our sales involve providing utility services, among other things, to an industrial park located in Henderson, Nevada and we are responsible for the delivery of water to the city of Henderson and various other users through a water distribution system we own. These sales involve single performance obligations and we record revenue when we satisfy our performance obligations to our customers generally after the service is performed and our customers become obligated to pay us and such payment being probable of occurring. Revenue is recorded in an amount that reflects the net consideration we expect to receive in exchange for our services. Prices for our products are based on contracted rates and do not include financing components, noncash consideration or consideration paid to our customers. As our standard payment terms are less than one year, we have elected the practical expedient under ASC 606 and we have not assessed whether a contract has a significant financing component.

Our revenues also are related to efforts to develop certain real estate in Henderson, Nevada, including approximately 2,100 acres zoned for residential/planned community purposes and approximately 400 acres zoned for commercial and light industrial use. Contracts for land sales are negotiated on an individual basis, involve single performance obligations, and generally require us to complete property development and improvements after title passes to the buyer and we have received all or a substantial portion of the selling price. We recognize land sales revenue associated with the residential/planned community over time using cost based input methods. Land sales associated with the residential/planned community have variable consideration components which are based on a percentage of the builder's ultimate selling price of residential housing unit to their customer (generally 3.5% of such sales price). The amount we recognize when a parcel is sold to a home builder is the amount to which we are most-likely to be entitled, using all information (historical, current and forecasted) that is reasonably available to us, and only to the extent that a significant reversal in the amount of the cumulative revenue recognized is not probable of occurring in a future period. By recognizing revenue over time using cost based input methods, revenues (including variable consideration) and profits are recognized in the same proportion of our progress towards completion of our contractual obligations, with our progress measured by costs incurred as a percentage of total costs estimated to be incurred relative to the parcels sold. Estimates of total costs expected to be incurred require significant management judgment, and the amount of revenue and profits that have been recognized to date are subject to revisions throughout the

development period. The impact on the amount of revenue recognized resulting from any future change in the estimate of total costs estimated to be incurred would be accounted for prospectively in accordance with GAAP. We also receive variable consideration of 1% tied to the builders ultimate selling price to their customers which is intended to recover our expenses for marketing the entire residential/planned community. Because we control and direct the marketing campaign we recognize both the revenues and expenses on a gross basis. We record estimated deferred revenue on the amount to which we are most-likely to be entitled and deferred revenue is recognized into revenue as the housing units are sold.

Disaggregation of sales—The following table disaggregates the net sales of our Chemicals Segment by place of manufacture (point of origin) and the location of the customer (point of destination), which are the categories that depict how the nature, amount timing and uncertainty of revenue and cash flows are affected by economic factors (as required by ASC 606).

- 17 -

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|  | Three months ended |                | Six months ended |                |
|--|--------------------|----------------|------------------|----------------|
|  | June 30,           |                | June 30,         |                |
|  | 2017               | 2018           | 2017             | 2018           |
|  | (In millions)      |                |                  |                |
| <b>Net sales – point of origin::</b>     |                    |                |                  |                |
| Germany                                  | \$231.9            | \$257.7        | \$415.5          | \$492.2        |
| United States                            | 208.6              | 208.9          | 414.3            | 405.7          |
| Canada                                   | 79.9               | 82.2           | 157.8            | 153.8          |
| Belgium                                  | 72.0               | 68.9           | 130.1            | 138.6          |
| Norway                                   | 51.3               | 56.5           | 98.6             | 109.6          |
| Eliminations                             | (202.3)            | (202.4)        | (405.1)          | (397.7)        |
| <b>Total</b>                             | <b>\$441.4</b>     | <b>\$471.8</b> | <b>\$811.2</b>   | <b>\$902.2</b> |
| <b>Net sales – point of destination:</b> |                    |                |                  |                |
| Europe                                   | \$226.6            | \$238.5        | \$406.3          | \$472.4        |
| North America                            | 138.1              | 143.6          | 262.1            | 270.6          |
| Other                                    | 76.7               | 89.7           | 142.8            | 159.2          |
| <b>Total</b>                             | <b>\$441.4</b>     | <b>\$471.8</b> | <b>\$811.2</b>   | <b>\$902.2</b> |

The following table disaggregates the net sales of our Component Products and Real Estate Management and Development Segments by major product line.

|  | Three months ended |               | Six months ended |               |
|--|--------------------|---------------|------------------|---------------|
|  | June 30,           |               | June 30,         |               |
|  | 2017               | 2018          | 2017             | 2018          |
|  | (In millions)      |               |                  |               |
| <b>Component Products:</b>                     |                    |               |                  |               |
| Net sales:                                     |                    |               |                  |               |
| Security products                              | \$26.1             | \$27.2        | \$52.1           | \$51.3        |
| Marine components                              | 4.0                | 5.2           | 7.9              | 9.5           |
| <b>Total</b>                                   | <b>\$30.1</b>      | <b>\$32.4</b> | <b>60.0</b>      | <b>60.8</b>   |
| <b>Real Estate Management and Development:</b> |                    |               |                  |               |
| Net sales:                                     |                    |               |                  |               |
| Land sales                                     | \$8.4              | \$3.8         | 12.1             | 9.6           |
| Water delivery                                 | 1.4                | 1.9           | 2.7              | 2.8           |
| Utility and other                              | .5                 | .3            | 1.1              | .8            |
| <b>Total</b>                                   | <b>\$10.3</b>      | <b>\$6.0</b>  | <b>\$15.9</b>    | <b>\$13.2</b> |

Note 12—Employee benefit plans:

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

|   | Three months ended |          | Six months ended |          |
|---|--------------------|----------|------------------|----------|
|   | June 30,           | June 30, | June 30,         | June 30, |
|   | 2017               | 2018     | 2017             | 2018     |
|   | (In millions)      |          |                  |          |
| Service cost                                    | \$2.8              | \$2.9    | \$ 5.5           | \$ 5.9   |
| Interest cost                                   | 3.9                | 4.0      | 7.7              | 8.0      |
| Expected return on plan assets                  | (3.2)              | (3.8)    | (6.4 )           | (7.8 )   |
| Amortization of unrecognized prior service cost | .1                 | —        | .2               | .1       |
| Recognized actuarial losses                     | 3.7                | 3.9      | 7.3              | 7.7      |
| Total   | \$7.3              | \$7.0    | \$ 14.3          | \$ 13.9  |

The components of our net periodic other postretirement benefit cost are presented in the table below.

|                                      | Three months ended |                  | Six months ended |                  |
|--------------------------------------|--------------------|------------------|------------------|------------------|
|                                      | June 30,<br>2017   | June 30,<br>2018 | June 30,<br>2017 | June 30,<br>2018 |
|                                      | (In millions)      |                  |                  |                  |
| Service cost                         | \$ .1              | \$ .1            | \$ .1            | \$ .1            |
| Interest cost                        | .1                 | —                | .2               | .1               |
| Amortization of prior service credit | (.3)               | (.2)             | (.5 )            | (.5 )            |
| Recognized actuarial gains           | —                  | (.1)             | (.1 )            | (.1 )            |
| Total                                | \$(.1)             | \$(.2)           | \$(.3 )          | \$(.4 )          |

Upon the adoption of ASU 2017-07, Compensation— Retirement Benefits (Topic 715) Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost, our net periodic defined benefit pension cost and other postretirement benefit cost, other than the service cost component, is presented as a separate line item (“Other components of net periodic pension and OPEB expense”) in our Condensed Consolidated Statements of Income for all periods presented. See Note 19. We expect to contribute the equivalent of approximately \$19.8 million and \$1.0 million, respectively, to all of our defined benefit pension plans and other postretirement benefit plans during 2018.

Note 13—Other income, net:

|                              | Six<br>months ended<br>June 30,<br>2017 2018<br>(In millions) |         |
|------------------------------|---|---------|
|                              | Securities earnings:  |         |
| Dividends and interest       | \$ 14.1   | \$ 16.8 |
| Currency transactions, net   | (3.7 )  | 4.8     |
| Insurance recoveries         | .1  | .4      |
| Infrastructure reimbursement | .2  | 4.0     |
| Gain on land sales           | —   | 12.5    |
| Other, net                   | .7  | 1.2     |
| Total                        | \$ 11.4   | \$ 39.7 |

Insurance recoveries reflect, in part, amounts NL received from certain of its former insurance carriers and relate to the recovery of prior lead pigment and asbestos litigation defense costs incurred by NL. See Note 17.

Infrastructure reimbursement costs relate principally to tax increment reimbursements of our Real Estate Management and Development Segment discussed in Note 7.

In the first quarter of 2018 we sold two parcels of land not used in our operating activities. We sold the first parcel for net proceeds of \$18.9 million, and recognized a pre-tax gain on the sale of \$11.9 million. We were required under our debt agreement with NERT to use a portion of the net proceeds received for the property to pay down our note balance and accordingly we made \$2.2 million in principal payments on our debt, see Note 8. In addition NL sold excess property with a nominal book value for proceeds of \$.6 million.



## Note 14—Income taxes:

|  | Three months ended |        | Six months ended |        |
|--|--------------------|--------|------------------|--------|
|  | June 30,<br>2017   | 2018   | June 30,<br>2017 | 2018   |
|  | (In millions)      |        |                  |        |
| Expected tax expense, at U.S. federal statutory income tax rate of 35% in 2017 and 21% in 2018 | \$21.9             | \$8.8  | \$36.6           | \$31.2 |
| Incremental net tax on earnings and losses of non-U.S., U.S. and non-tax group companies       | 37.1               | 4.9    | 48.3             | 9.0    |
| Non-U.S. tax rates   | (2.3 )             | 7.9    | (4.7 )           | 14.9   |
| Valuation allowance  | (157.6)            | 1.7    | (162.6 )         | 2.0    |
| Adjustment to the reserve for uncertain tax positions, net                                     | .6                 | .3     | 1.1              | 1.9    |
| Canada – Germany APA   | —                  | —      | —                | (1.4 ) |
| Nondeductible expenses   | .3                 | .3     | .7               | .7     |
| Domestic production activities deduction   | (1.5 )             | —      | (2.1 )           | —      |
| U.S. state income taxes and other, net   | .7                 | (1.9 ) | .6               | (.1 )  |
| Income tax expense (benefit)   | \$(100.8)          | \$22.0 | \$(82.2 )        | \$58.2 |
| Comprehensive provision for income taxes (benefit) allocable to:                               |                    |        |                  |        |
| Income from continuing operations  | \$(100.8)          | \$22.0 | \$(82.2 )        | \$58.2 |
| Discontinued operations  | (66.4 )            | (.4 )  | (67.2 )          | 19.8   |
| Retained earnings – change in accounting principle   | —                  | —      | —                | 1.1    |
| Other comprehensive income (loss):   |                    |        |                  |        |
| Currency translation   | 16.3               | (3.3 ) | 18.1             | (1.9 ) |
| Pension plans  | 2.2                | 1.5    | 3.1              | 3.0    |
| OPEB plans   | (.1 )              | (.1 )  | (.2 )            | (.2 )  |
| Marketable securities  | (.4 )              | —      | (.5 )            | —      |
| Interest rate swap   | (.3 )              | —      | .1               | —      |
| Total  | \$(149.5)          | \$19.7 | \$(128.8 )       | \$80.0 |

The amount shown in the above table of our income tax rate reconciliation for non-U.S. tax rates represents the result determined by multiplying the pre-tax earnings or losses of each of our non-U.S. subsidiaries by the difference between the applicable statutory income tax rate for each non-U.S. jurisdiction and the U.S. federal statutory tax rate of 35% in 2017 and 21% in 2018. The amount shown on such table for incremental net tax (benefit) on earnings and losses on non-U.S. and non-tax group companies includes, as applicable, (i) deferred income taxes (or deferred income tax benefits) associated with the current-year change in the aggregate amount of undistributed earnings of our Chemicals Segment's Canadian subsidiary and, beginning in 2018, the post-1986 undistributed earnings of our Chemicals Segment's European subsidiaries (such post-1986 undistributed earnings were subject to a permanent reinvestment plan until December 31, 2017), (ii) current U.S. income taxes (or current income tax benefit), including U.S. personal holding company tax, as applicable, attributable to current-year income (losses) of one of Kronos' non-U.S. subsidiaries, which subsidiary is treated as a dual resident for U.S. income tax purposes, to the extent the current-year income (losses) of such subsidiary is subject to U.S. income tax under the U.S. dual-resident provisions of the Internal Revenue Code, (iv) deferred income taxes associated with our direct investment in Kronos and (v) current and deferred income taxes associated with distributions and earnings from our investment in LandWell and BMI.

Our Chemicals Segment has substantial net operating loss (NOL) carryforwards in Germany (the equivalent of \$652 million for German corporate purposes and \$.5 million for German trade tax purposes at December 31, 2017) and in Belgium (the equivalent of \$50 million for Belgian corporate tax purposes at December 31, 2017), all of which have an indefinite carryforward period. As a result, we have net deferred income tax assets with respect to these two jurisdictions, primarily related to these NOL carryforwards. The German corporate tax is similar to the U.S. federal income tax, and the German trade tax is similar to the U.S. state income tax. As discussed in the 2017 Annual Report, commencing June 30, 2015, we concluded that we were required to recognize a non-cash deferred income tax asset valuation allowance under the more-likely-than-not recognition criteria with respect to our Chemicals Segment's German and Belgian net deferred income tax assets at such date. During the first six months of 2017, Kronos recognized an aggregate non-cash deferred income tax benefit of \$12.7 million as a result of a net decrease in such deferred income tax asset valuation allowance, due to utilizing a portion of both the German and Belgian NOL during the period, including \$7.7 million in the second quarter of 2017. As also discussed in the 2017 Annual Report, at June 30, 2017, we concluded we had sufficient positive evidence under the more-likely-than-not recognition criteria to support reversal of the entire valuation allowance related to our Chemicals Segment's German and Belgian operations. In accordance with the ASC 740-270 guidance regarding accounting for income taxes at interim dates, the amount of the valuation allowance reversed at June 30, 2017 (\$149.9 million, of which \$141.9

- 20 -

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million related to Germany and \$8.0 million related to Belgium) relates to our change in judgment at that date regarding the realizability of the related deferred income tax asset as it relates to future years (i.e., 2018 and after). A change in judgment regarding the realizability of deferred tax assets as it relates to the current year is considered in determining the estimated annual effective tax rate for the year and is recognized throughout the year, including interim periods subsequent to the date of the change in judgment. Accordingly, our income tax benefit in calendar 2017 includes an aggregate non-cash deferred income tax benefit of \$186.7 million related to the reversal of the German and Belgian valuation allowance, comprised of \$12.7 million recognized in the first half of 2017 (noted above) related to the utilization of a portion of both the German and Belgian NOLs during such period, \$149.9 million related to the portion of the valuation allowance reversed as of June 30, 2017 and \$24.1 million recognized in the second half of 2017 related to the utilization of a portion of both the German and Belgian NOLs during such period. Our deferred income tax asset valuation allowance increased \$13.7 million in 2017 as a result of changes in currency exchange rates, which increase was recognized as part of other comprehensive income (loss).

As discussed in the 2017 Annual Report, on December 22, 2017, the 2017 Tax Act was enacted into law. This new tax legislation, among other changes, (i) reduced the U.S. Federal corporate income tax rate from 35% to 21% effective January 1, 2018; (ii) implemented a territorial tax system and imposed a one-time repatriation tax (“Transition Tax”) on the deemed repatriation of the post-1986 undistributed earnings of non-U.S. subsidiaries accumulated up through December 31, 2017, regardless of whether such earnings are repatriated; (iii) eliminated U.S. tax on future non-U.S. earnings (subject to certain exceptions); (iv) eliminated the domestic production activities deduction beginning in 2018; (v) eliminated the net operating loss carryback and provides for an indefinite carryforward period subject to an 80% annual usage limitation; (vi) allows for the expensing of certain capital expenditures; (vii) imposed a tax on global intangible low-tax income (“GILTI”) beginning in 2018; (viii) imposed a base erosion anti-abuse tax (“BEAT”) beginning in 2018; and (ix) amended the rules limiting the deduction for business interest expense beginning in 2018. Following the enactment of the 2017 Tax Act, the Securities and Exchange Commission issued Staff Accounting Bulletin (“SAB”) 118 to provide guidance on the accounting and reporting impacts of the 2017 Tax Act. SAB 118 states that companies should account for changes related to the 2017 Tax Act in the period of enactment if all information is available and the accounting can be completed. In situations where companies do not have enough information to complete the accounting in the period of enactment, a company must either 1) record an estimated provisional amount if the impact of the change can be reasonably estimated; or 2) continue to apply the accounting guidance that was in effect immediately prior to the 2017 Tax Act if the impact of the change cannot be reasonably estimated. If estimated provisional amounts are recorded, SAB 118 provides a measurement period of no longer than one year during which companies should adjust those amounts as additional information becomes available in the reporting period within the measurement period in which such adjustment is determined.

Under GAAP, we are required to revalue our net deferred tax liability associated with our U.S. net deductible temporary differences in the period in which the new tax legislation is enacted based on deferred tax balances as of the enactment date, to reflect the effect of such reduction in the corporate income tax rate. Our temporary differences as of December 31, 2017 were not materially different from our temporary differences as of the enactment date, accordingly revaluation of our net taxable temporary differences was based on our net deferred tax as of December 31, 2017. Such revaluation resulted in a provisional non-cash deferred income tax benefit of \$77.1 million recognized as of December 31, 2017 in continuing operations, reducing our net deferred income tax liability. The amounts recorded as of December 31, 2017 as a result of the 2017 Tax Act represent estimates based on information currently available. We have not made any additional measurement-period adjustments to the provisional amounts recorded for this item during the first six months of 2018 because we are still waiting on additional guidance that may impact the income tax effects of the new legislation recognized at December 31, 2017. We will complete our accounting for this item within the prescribed measurement period ending December 22, 2018, pursuant to the guidance under SAB 118, and if we determine an adjustment to the provisional amount recognized at December 31, 2017 is required, we will recognize such adjustment in the reporting period within the SAB 118 measurement period in which such adjustment is determined.

Prior to the enactment of the 2017 Tax Act, the undistributed earnings of our European subsidiaries were deemed to be permanently reinvested (we had not made a similar determination with respect to the undistributed earnings of our Canadian subsidiary). Pursuant to the Transition Tax provisions imposing a one-time repatriation tax on post-1986 undistributed earnings, we recognized a provisional current income tax expense of \$76.2 million in the fourth quarter of 2017. The amounts recorded as of December 31, 2017 as a result of the 2017 Tax Act represent estimates based on information currently available. We elected to pay such tax over an eight year period beginning in 2018, including approximately \$6.1 million which was paid in April 2018 (for the 2017 tax year) and \$3.1 million which was paid in June 2018 (for the 2018 tax year). Of the remaining \$67.0 million, \$64.0 million is recorded as a noncurrent payable to affiliate (income taxes payable to Contran) classified as a noncurrent liability in our Condensed Consolidated Balance Sheet, and \$3.0 million is included with our current payable to affiliate (income taxes payable to Contran) classified as a current liability. Such remaining amounts will be paid in quarterly increments over the remainder of the eight year period. We have not made any measurement-period adjustments to the provisional amounts recorded for this item during the first six months of 2018 because no new information became available during the period that required an adjustment. We are continuing to gather information and await further guidance, primarily from the state jurisdictions in which we operate, and given the complexities of these new rules and the long time period over which information about our subsidiaries is needed, further guidance is necessary in order to determine the amount of the Transition Tax, which may impact the amount of the Transition Tax recognized in the fourth

- 21 -

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quarter of 2017. We will complete our accounting for this item within the prescribed measurement period ending December 22, 2018, pursuant to the guidance under SAB 118, and if we determine an adjustment to the provisional amount recognized at December 31, 2017 is required, we will recognize such adjustment in the reporting period within the SAB 118 measurement period in which such adjustment is determined.

Prior to the enactment of the 2017 Tax Act the undistributed earnings of our European subsidiaries were deemed to be permanently reinvested (we had not made a similar determination with respect to the undistributed earnings of our Canadian subsidiary). As a result of the implementation of a territorial tax system under the 2017 Tax Act, effective January 1, 2018, and the Transition Tax which in effect taxes the post-1986 undistributed earnings of our non-U.S. subsidiaries accumulated up through December 31, 2017, we determined effective December 31, 2017 that all of the post-1986 undistributed earnings of our European subsidiaries are not permanently reinvested. Accordingly, in the fourth quarter of 2017 we recognized an aggregate provisional non-cash deferred income tax expense of \$5.3 million based on our reasonable estimates of the U.S. state and non-U.S. income tax and withholding tax liability attributable to all of such previously-considered permanently reinvested undistributed earnings through December 31, 2017. The amounts recorded as of December 31, 2017 as a result of the 2017 Tax Act represent estimates based on information currently available. We have not made any measurement-period adjustments to the provisional amounts recorded at December 31, 2017 for this item during the first six months of 2018. However, we recorded a provisional non-cash deferred income tax expense of \$2.3 million for the estimated U.S. state and non-U.S. income tax and withholding tax liability attributable to the 2018 undistributed earnings of our non-U.S. subsidiaries in the first six months of 2018, including withholding taxes related to the undistributed earnings of our Canadian subsidiary. We are continuing our review of certain other provisions under the 2017 Tax Act and waiting on further guidance primarily from the state jurisdictions in which we operate that may impact our determination of the aggregate temporary differences attributable to our investments in our non-U.S. subsidiaries. We will complete our accounting for this item within the prescribed measurement period ending December 22, 2018, pursuant to the guidance under SAB 118, and if we determine an adjustment to the provisional amount recognized at December 31, 2017 and June 30, 2018 are required, we will recognize such adjustment in the reporting period within the SAB 118 measurement period in which such adjustment is determined.

Under U.S. GAAP, as it relates to the new GILTI tax rules, we are allowed to make an accounting policy choice of either (1) treating taxes due on future U.S. inclusions in taxable income related to GILTI as a current-period expense when incurred (the "period cost method") or (2) factoring such amounts into the measurement of our deferred taxes (the "deferred method"). Our selection of an accounting policy related to the GILTI tax provisions will depend, in part, on analyzing our global income to determine whether we expect to have future U.S. inclusions in taxable income related to GILTI and, if so, what the impact is expected to be. While our future global operations depend on a number of different factors, we do expect to have future U.S. inclusions in taxable income related to GILTI. As such, we performed an analysis of GILTI's impact on our provision and determined the impact is not material. Because the impact is not material to our tax provision, we have not recorded any adjustments related to potential GILTI tax in our financial statements in the first six months of 2018. Further, we have not made a policy decision regarding whether to record deferred taxes on GILTI or record GILTI tax as a current-period expense when incurred. We will complete our policy election for this item within the prescribed measurement period ending December 22, 2018, pursuant to the guidance under SAB 118 and if we determine such policy election impacts our provision, we will recognize an adjustment in the reporting period within the SAB 118 measurement period in which such adjustment is determined. Similarly, we have evaluated the tax impact of BEAT on our tax provision in the first six months of 2018 and determined that the tax law has no material impact on our tax provision as we have historically not entered into international payments between related parties that are unrelated to cost of goods sold.

The 2017 Tax Act amended the rules limiting the deduction for business interest expense beginning in 2018. The limitation applies to all taxpayers and our annual deduction for business interest expense is limited to the sum of our business interest income and 30% of our adjusted taxable income as defined under the 2017 Tax Act. Any business interest expense not allowed as a deduction as a result of the limitation may be carryforward indefinitely and is treated as interest paid in the carryforward year subject to the respective year's limitation. We have determined that our interest expense for 2018 is limited under these provisions, in part because of the loss we recognized on the sale of WCS for income tax purposes. We have concluded that we are required to recognize a non-cash deferred income tax asset valuation allowance under the more-likely-than-not recognition criteria with respect to a portion of our deferred tax asset attributable to the nondeductible amount of business interest expense carryforward. Consequently, our provision for income taxes in the first six months of 2018 includes a non-cash deferred income tax expense of \$7.1 million for the amount of such deferred income tax asset that we have determined does not meet the more-likely-than-not recognition criteria. In accordance with the ASC 740 guidance regarding intra-period allocation of income taxes, \$5.1 million of such non-cash deferred income tax expense is classified as part of the income taxes associated with the pre-tax gain we recognized for financial reporting purposes on the sale of WCS which is classified as part of discontinued operations as discussed in Note 3, and the remaining \$2.0 million is classified as part of our provision for income taxes attributable to continuing operations. Our estimate of the amount of such non-cash deferred income tax asset valuation allowance we are required to recognize, and the allocation of such valuation allowance between continuing and discontinued operations under the intra-period guidance of ASC 740, can change during the year due to, among other things, changes in our estimate of the amount of business interest expense, business interest income and adjusted taxable income for the current year.

- 22 -

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We recognize deferred income taxes with respect to the excess of the financial reporting carrying amount over the income tax basis of our direct investment in Kronos common stock because the exemption under GAAP to avoid such recognition of deferred income taxes is not available to us. At December 31, 2017, we had recognized a deferred income tax liability with respect to our direct investment in Kronos of \$157.6 million. There is a maximum amount (or cap) of such deferred income taxes we are required to recognize with respect to our direct investment in Kronos. The maximum amount of such deferred income tax liability we would be required to have recognized (the cap) is \$173.0 million. During the first six months of 2018, we recognized a non-cash deferred income tax expense with respect to our direct investment in Kronos of \$7.5 million for the increase in the deferred income taxes required to be recognized with respect to the excess of the financial reporting carrying amount over the income tax basis of our direct investment in Kronos common stock, to the extent such increase related to our equity in Kronos' net income during such period. We recognized a similar non-cash deferred income tax expense of \$39.5 million in the first six months of 2017. A portion of the net change with respect to the excess of the financial reporting carrying amount over the income tax basis of our direct investment in Kronos common stock during such periods related to our equity in Kronos' other comprehensive income (loss) items, and the amounts shown in the table above for income tax expense (benefit) allocated to other comprehensive income (loss) items includes amounts related to our equity in Kronos' other comprehensive income (loss) items. Due to uncertainties and complexities of the new legislation, we are still evaluating the impact of the one-time deemed repatriation of the post-1986 undistributed earnings of our non-U.S. subsidiaries up through December 31, 2017 as it relates to the income tax basis of our direct investment in Kronos. Our deferred income tax liability with respect to our direct investment in Kronos and the deferred income taxes recognized at December 31, 2017 and June 30, 2018 represents our reasonable estimate and, in accordance with the guidance in SAB 118, such amounts are provisional and subject to adjustment as we obtain additional information and complete our analysis of the impact of the new legislation as it relates to the income tax basis of our direct investment in Kronos. We made no adjustments to the provisional amounts recorded at December 31, 2017 as it relates to the income tax basis of our direct investment in Kronos at such date in the first six months of 2018. We will complete our accounting for these items within the prescribed measurement period ending December 22, 2018, pursuant to the guidance under SAB 118 and if such estimates change, we will recognize an adjustment in the reporting period within the measurement period in which such adjustment is determined.

None of our U.S. and non-U.S. tax returns are currently under examination. As a result of prior audits in certain jurisdictions, which are now settled, in 2008 Kronos filed Advance Pricing Agreement Requests with the tax authorities in the U.S., Canada and Germany. These requests have been under review with the respective tax authorities since 2008 and prior to 2016, it was uncertain whether an agreement would be reached between the tax authorities and whether Kronos would agree to execute and finalize such agreements. During the third quarter of 2017, Kronos' Canadian subsidiary executed and finalized an Advance Pricing Agreement with the Competent Authority for Canada (the "Canada-Germany APA") effective for tax years 2005 - 2017. During the first quarter of 2018, Kronos' German subsidiary executed and finalized the related Advance Pricing Agreement with the Competent Authority for Germany (the "Germany-Canada APA") effective for tax years 2005 - 2017. In the first quarter of 2018, we recognized a net \$1.4 million non-cash income tax benefit related to an APA tax settlement payment between Kronos' German and Canadian subsidiaries.

We believe we have adequate accruals for additional taxes and related interest expense which could ultimately result from tax examinations. We believe the ultimate disposition of tax examinations should not have a material adverse effect on our consolidated financial position, results of operations or liquidity. We currently estimate that our unrecognized tax benefits will decrease by approximately \$1.8 million during the next twelve months primarily due to certain adjustments to our prior year returns and the expiration of certain statutes of limitations.

## Note 15—Noncontrolling interest in subsidiaries:

|  | December 31,<br>2017 | June<br>30,<br>2018 |
|--|----------------------|---------------------|
| (In millions)                          |                      |                     |
| Noncontrolling interest in net assets: |                      |                     |
| Kronos Worldwide                       | \$204.9              | \$224.2             |
| NL Industries                          | 71.1                 | 66.0                |
| CompX International                    | 17.8                 | 18.7                |
| BMI                                    | 26.0                 | 27.6                |
| LandWell                               | 22.5                 | 25.2                |
| Total                                  | \$342.3              | \$361.7             |

- 23 -

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|   | Six months<br>ended June<br>30,<br>2017 2018<br>(In millions) |        |
|---|---|--------|
| Noncontrolling interest in net income (loss) of subsidiaries: |   |        |
| Kronos Worldwide  | \$45.6  | \$29.0 |
| NL Industries   | 8.4   | (4.8 ) |
| CompX International   | .9  | 1.1    |
| BMI   | .2  | .7     |
| LandWell  | .3  | 1.2    |
| Total   | \$55.4  | \$27.2 |

## Note 16—Accumulated other comprehensive loss:

Changes in accumulated other comprehensive income (loss) attributable to Valhi stockholders for the three and six months ended June 30, 2017 and 2018 are presented in the table below.

|   | Three months ended<br>June 30,<br>2017 2018<br>(In millions) |           | Six months ended<br>June 30,<br>2017 2018<br>(In millions) |           |
|---|--|-----------|--|-----------|
| Accumulated other comprehensive income (loss), net of tax                 |  |           |  |           |
| and noncontrolling interest:  |  |           |  |           |
| Marketable securities:  |  |           |  |           |
| Balance at beginning of period  | \$1.7  | \$1.6     | \$1.7  | \$1.7     |
| Other comprehensive loss – unrealized losses arising during the period    | —  | —         | —  | (.1 )     |
| Balance at end of period  | \$1.7  | \$1.6     | \$1.7  | \$1.6     |
| Interest rate swap:   |  |           |  |           |
| Balance at beginning of period  | \$(.8 )  | \$—       | \$(1.2 )   | \$—       |
| Other comprehensive income (loss):  |  |           |  |           |
| Unrealized losses arising during the year                                 | (.5 )  | —         | (.5 )  | —         |
| Less reclassification adjustment for amounts included in interest expense | .2   | —         | .6   | —         |
| Balance at end of period  | \$(1.1 )   | \$—       | \$(1.1 )   | \$—       |
| Currency translation adjustment:  |  |           |  |           |
| Balance at beginning of period  | \$(83.1 )  | \$(46.9 ) | \$(88.5 )  | \$(54.1 ) |
| Other comprehensive income (loss)   | 9.3  | (16.7 )   | 14.7   | (9.5 )    |
| Balance at end of period  | \$(73.8 )  | \$(63.6 ) | \$(73.8 )  | \$(63.6 ) |
| Defined benefit pension plans:  |  |           |  |           |

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|   |           |           |           |           |
|---|-----------|-----------|-----------|-----------|
| Balance at beginning of period  | \$(135.0) | \$(127.1) | \$(137.0) | \$(129.0) |
| Other comprehensive income— amortization of prior service cost and net losses included in net periodic pension cost | .6        | 1.9       | 2.6       | 3.8       |
| Balance at end of period  | \$(134.4) | \$(125.2) | \$(134.4) | \$(125.2) |
| OPEB plans:   |           |           |           |           |
| Balance at beginning of period  | \$2.9     | \$2.2     | \$3.1     | \$2.4     |
| Other comprehensive loss – amortization of prior service credit   | (.2 )     | (.2 )     | (.4 )     | (.4 )     |
| Balance at end of period  | \$2.7     | \$2.0     | \$2.7     | \$2.0     |
| Total accumulated other comprehensive income (loss):  |           |           |           |           |
| Balance at beginning of period  | \$(214.3) | \$(170.2) | \$(221.9) | \$(179.0) |
| Other comprehensive income (loss)   | 9.4       | (15.0)    | 17.0      | (6.2)     |
| Balance at end of period  | \$(204.9) | \$(185.2) | \$(204.9) | \$(185.2) |

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

Note 17 – 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 (together, the "former pigment manufacturers"), and the Lead Industries Association (LIA), which discontinued business operations in 2002, have been named as defendants in various legal proceedings seeking damages for personal injury, property damage and governmental expenditures allegedly caused by the use of lead-based paints. Certain of these actions have been filed by or on behalf of states, counties, cities or their public housing authorities and school districts, and certain others have been asserted as class actions. These lawsuits seek recovery under a variety of theories, including public and private nuisance, negligent product design, negligent failure to warn, strict liability, breach of warranty, conspiracy/concert of action, aiding and abetting, enterprise liability, market share or risk contribution liability, intentional tort, fraud and misrepresentation, violations of state consumer protection statutes, supplier negligence and similar claims.

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

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

• NL has never settled any of the market share, intentional tort, fraud, nuisance, supplier negligence, breach of warranty, conspiracy, misrepresentation, aiding and abetting, enterprise liability, or statutory cases (subject to the final outcome of the Santa Clara case discussed below),

• no final, non-appealable adverse verdicts have ever been entered against NL (subject to the final outcome of the Santa Clara case discussed below), and

• NL has never ultimately been found liable with respect to any such litigation matters, including over 100 cases over a twenty-year period for which we were previously a party and for which we have been dismissed without any finding of liability.

Accordingly, other than with respect to the Santa Clara case discussed below, we have not accrued any amounts for any of the pending lead pigment and lead-based paint litigation cases filed by or on behalf of states, counties, cities or their public housing authorities and school districts, or those asserted as class actions and we have determined that

liability to us which may result, if any, cannot be reasonably estimated at this time because there is no prior history of a loss of this nature on which an estimate could be made and there is no substantive information available upon which an estimate could be based.

In one of these lead pigment cases, in April 2000 NL was served with a complaint in County of Santa Clara v. Atlantic Richfield Company, et al, (Superior Court of the State of California, County of Santa Clara, Case No. 1-00-CV-788657) brought by a number of California government entities against former lead pigment manufacturers, the LIA and certain paint manufacturers. The County of Santa Clara sought to recover compensatory damages for funds the plaintiffs had expended or would in the future expend for medical treatment, educational expenses, abatement or other costs due to exposure to, or potential exposure to, lead paint, disgorgement of profit, and punitive damages. In July 2003, the trial judge granted defendants' motion to dismiss all remaining claims. Plaintiffs appealed and the intermediate appellate court reinstated public nuisance, negligence, strict liability, and fraud claims in March 2006. A fourth amended complaint was filed in March 2011 on behalf of The People of California by the County Attorneys of Alameda, Ventura, Solano, San Mateo, Los Angeles and Santa Clara, and the City Attorneys of San Francisco, San Diego and Oakland. That complaint alleged that the presence of lead paint created a public nuisance in each of the prosecuting jurisdictions and sought its abatement. In July and August 2013, the case was tried. In January 2014, the judge issued a judgment finding NL, The Sherwin Williams Company and ConAgra Grocery Products Company jointly and severally liable for the abatement of lead paint in pre-1980 homes, and ordered the defendants to pay an aggregate \$1.15 billion to the people of the State of California to fund such abatement. The trial court's judgment also found that to the extent any abatement funds remained unspent after four years, such funds were to be returned to the defendants. In February 2014, NL filed a motion for a new trial, and in March 2014 the trial court denied

the motion. Subsequently in March 2014, NL filed a notice of appeal with the Sixth District Court of Appeal for the State of California. On November 14, 2017, the Sixth District Court of Appeal issued its opinion, upholding the trial court's judgment, except that it reversed the portion of the judgment requiring abatement of homes built between 1951 and 1980 which significantly reduced the number of homes subject to the abatement order. In addition, the appellate court ordered the case be remanded to the trial court to recalculate the amount of the abatement fund, to limit it to the amount necessary to cover the cost of investigating and remediating pre-1951 homes, and to hold an evidentiary hearing to appoint a suitable receiver. In addition, the appellate court found that NL and the other defendants had the right to seek recovery from liable parties that contributed to a hazardous condition at a particular property. Subsequently, we and the other defendants filed a Petition with the California Supreme Court seeking its review of a number of issues. On February 14, 2018, the California Supreme Court denied such petition. In July 2018, NL and the other defendants filed appeals with the U.S. Supreme Court, seeking its review of two federal issues in the trial court's original judgment. Review by the U.S. Supreme Court is discretionary, and there can be no assurance that the U.S. Supreme Court would agree to hear any such appeal, or if they would agree to hear any such appeal, that the U.S. Supreme Court would rule in favor of us and the other defendants.

Under such remand ordered by the appellate court, the trial court would among other things, (i) recalculate the amount of the abatement fund, excluding remediation of homes built between 1951 and 1980, (ii) hold an evidentiary hearing to appoint a suitable receiver for the abatement fund and (iii) enter an order setting forth its rulings on these issues. NL believes any party will have a right to appeal any of these new decisions to be made by the trial court from the remand of the case. Several uncertainties exist with respect to the new decisions to be made by the trial court from the remand of the case, including the following:

- The appellate court has remanded the case back to the trial court to recalculate the total amount of the abatement, limiting the abatement to pre-1951 homes. In this regard, NL and the other defendants have filed a brief with the trial court proposing a recalculated maximum abatement fund amount of no more than \$409 million and plaintiffs have filed a brief proposing an abatement fund amount of \$730 million, and the trial court has scheduled a case-management hearing regarding the recalculated abatement fund amount for August 17, 2018;
- The appellate court upheld NL's and the other defendants' right to seek contribution from other liable parties (e.g. property owners who have violated the applicable housing code) on a house-by-house basis. The method by which the trial court would undertake to determine such house-by-house responsibility, and the outcome of such a house-by-house determination, is not presently known;
- Participation in any abatement program by each homeowner is voluntary, and each homeowner would need to consent to allowing someone to come into the home to undertake any inspection and abatement, as well as consent to the nature, timing and extent of any abatement. The original trial court's judgment unrealistically assumed 100% participation by the affected homeowners. Actual participation rates are likely to be less than 100% (the ultimate extent of participation is not presently known);
- The remedy ordered by the trial court is an abatement fund. The trial court ordered that any funds unspent after four years are to be returned to the defendants (this provision of the trial court's original judgment was not overturned by the appellate court). As noted above, the actual number of homes which would participate in any abatement, and the nature, timing and extent of any such abatement, is not presently known; and
- NL and the other two defendants are jointly and severally liable for the abatement, and we do not believe any individual defendant would be 100% responsible for the cost of any abatement.

In May 2018, NL and the plaintiffs entered into a settlement agreement pursuant to which, as supplemented, the plaintiffs would be paid an aggregate of \$80 million, in return for which we would be dismissed from the case with prejudice and all pending and future claims, causes of action, cross-complaints, actions or proceedings against us and

our affiliates for indemnity, contribution, reimbursement or declaratory relief in respect to the case would be barred, discharged and enjoined as a matter of applicable law. Of such \$80 million, \$65 million would be paid by NL and \$15 million would be provided by one of NL's former insurance carriers that has previously placed such amount on deposit with the trial court in satisfaction of potential liability such former carrier might have with respect to the case under certain insurance policies we had with such former carrier. Of such \$65 million which would be paid by us, \$45 million would be paid upon the trial court's approval of the terms of the settlement, and the remaining \$20 million would be paid in five annual installments beginning four years from such approval (\$6 million for the first installment, \$5 million for the second installment and \$3 million for each of the third, fourth and fifth installments). The settlement agreement is subject to a number of conditions including the trial court's approval of the terms of the settlement (which trial court approval includes a determination that such settlement agreement meets the standards for a "good faith" settlement under applicable California law). The other defendants have filed motions with the trial court objecting to the terms of the settlement. NL believes the settlement agreement satisfies the standards for a "good faith" settlement under applicable California law.

The Santa Clara case is unusual in that this is the second time that an adverse verdict in the lead pigment litigation has been entered against NL (the first adverse verdict against us was ultimately overturned on appeal). Given the appellate court's November 2017 ruling, and the denial of an appeal by the California Supreme Court, we have concluded that the likelihood of a loss in this case has reached a standard of "probable" as contemplated by ASC 450. With all of the uncertainties that exist with respect to the new decisions to be made by the trial court from the remand of the case, as noted above, we had previously concluded that the amount of

such loss could not be reasonably estimated (nor could a range of loss be reasonably estimated). However, the terms of the settlement agreement entered into by NL and the plaintiffs in May 2018, as supplemented, provides evidence that the amount of the loss to us can now be reasonably estimated. For financial reporting purposes, we discounted the five payments aggregating \$20 million to be paid in installments to their estimated net present value, using a discount rate of 3.0% per annum. Such net present value is \$17 million. Accordingly, in the second quarter of 2018 we recognized a net \$62 million pre-tax charge with respect to this matter (\$45 million for the amount to be paid by us upon the trial court's approval of the terms of the settlement and \$17 million for the net present value of the five payments aggregating \$20 million to be paid by us in installments beginning four years from such approval), representing the net amount we would pay in full settlement of our liability under the terms of the proposed settlement agreement. For purposes of our condensed consolidated balance sheet, we have presented the aggregate \$45 million that would be paid to the plaintiffs upon the trial court's approval of the terms of the settlement and the \$15 million that would be paid to the plaintiffs from the amount placed on deposit with the trial court by one of NL's former insurance carriers as a current liability, \$17 million for the net present value of the five payments aggregating \$20 million to be paid by us in installments beginning four years from such approval as a noncurrent liability and the \$15 million portion of such aggregate \$80 million undiscounted amount which would be funded from the amount placed on deposit with the trial court by one of our former insurance carriers as a current insurance recovery receivable. See Notes 4, 9 and 10.

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

#### Environmental matters and litigation

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

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

Amendments and Reauthorization Act (“CERCLA”), and similar state laws in various governmental and private actions associated with waste disposal sites, mining locations, and facilities that we or our predecessors, our subsidiaries or their predecessors currently or previously owned, operated or used, certain of which are on the United States Environmental Protection Agency’s (“EPA”) Superfund National Priorities List or similar state lists. These proceedings seek cleanup costs, damages for personal injury or property damage and/or damages for injury to natural resources. Certain of these proceedings involve claims for substantial amounts. Although we may be jointly and severally liable for these costs, in most cases we are only one of a number of PRPs who may also be jointly and severally liable, and among whom costs may be shared or allocated. In addition, we are occasionally named as a party in a number of personal injury lawsuits filed in various jurisdictions alleging claims related to environmental conditions alleged to have resulted from our operations.

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

- complexity and differing interpretations of governmental regulations,
- number of PRPs and their ability or willingness to fund such allocation of costs,
- financial capabilities of the PRPs and the allocation of costs among them,

- 27 -

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- solvency of other PRPs,
- multiplicity of possible solutions,
  - number of years of investigatory, remedial and monitoring activity required,
- uncertainty over the extent, if any, to which our former operations might have contributed to the conditions allegedly giving rise to such personal injury, property damage, natural resource and related claims, and
- number of years between former operations and notice of claims and lack of information and documents about the former operations.

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

We record liabilities related to environmental remediation and related matters (including costs associated with damages for personal injury or property damage and/or damages for injury to natural resources) when estimated future expenditures are probable and reasonably estimable. We adjust such accruals as further information becomes available to us or as circumstances change. Unless the amounts and timing of such estimated future expenditures are fixed and reasonably determinable, we generally do not discount estimated future expenditures to their present value due to the uncertainty of the timing of the payout. We recognize recoveries of costs from other parties, if any, as assets when their receipt is deemed probable. At December 31, 2017 we had not recognized any material receivables and at June 30, 2018, we have recognized \$15.0 million of receivables for recoveries related to the California case discussed above.

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

The table below presents a summary of the activity in our accrued environmental costs during the first six months of 2018.

|   | Amount<br>(In<br>millions) |
|---|----------------------------|
| Balance at the beginning of the year                                  | \$ 117.5                   |
| Additions charged to expense, net                                     | 4.5                        |
| Payments, net   | (1.1 )                     |
| Balance at the end of period  | \$ 120.9                   |
| Amounts recognized in our Condensed Consolidated Balance Sheet at the |                            |

|                        |          |
|------------------------|----------|
| end of the period:     |          |
| Current liabilities    | \$ 19.6  |
| Noncurrent liabilities | 101.3    |
| Total                  | \$ 120.9 |

NL – On a quarterly basis, NL evaluates the potential range of its liability for environmental remediation and related costs at sites where it has been named as a PRP or defendant. At June 30, 2018, NL had accrued approximately \$115 million related to approximately 38 sites associated with remediation and related matters that it believes are at the present time and/or in their current phase reasonably estimable. The upper end of the range of reasonably possible costs to NL for remediation and related matters for which we believe it is possible to estimate costs is approximately \$145 million, including the amount currently accrued.

NL believes that it is not reasonably possible to estimate the range of costs for certain sites. At June 30, 2018, there were approximately 5 sites for which NL is not currently able to estimate a range of costs. For these sites, generally the investigation is in the early stages, and NL is unable to determine whether or not NL actually had any association with the site, the nature of its responsibility, if any, for the contamination at the site and the extent of contamination at and cost to remediate the site. The timing and

availability of information on these sites is dependent on events outside of our control, such as when the party alleging liability provides information to us. At certain of these previously inactive sites, NL has received general and special notices of liability from the EPA and/or state agencies alleging that NL, sometimes with other PRPs, are liable for past and future costs of remediating environmental contamination allegedly caused by former operations. These notifications may assert that NL, along with any other alleged PRPs, are liable for past and/or future clean-up costs. As further information becomes available to us for any of these sites which would allow us to estimate a range of costs, we would at that time adjust our accruals. Any such adjustment could result in the recognition of an accrual that would have a material effect on our consolidated financial statements, results of operations and liquidity.

Other – We have also accrued approximately \$5.9 million at June 30, 2018 for other environmental cleanup matters.

#### Insurance coverage claims

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

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

For additional discussion of certain litigation involving NL and certain of its former insurance carriers, please refer to our 2017 Annual Report.

#### Other litigation

NL— NL has been named as a defendant in various lawsuits in several jurisdictions, alleging personal injuries as a result of occupational exposure primarily to products manufactured by our former operations containing asbestos, silica and/or mixed dust. In addition, some plaintiffs allege exposure to asbestos from working in various facilities previously owned and/or operated by NL. There are 110 of these types of cases pending, involving a total of approximately 583 plaintiffs. In addition, the claims of approximately 8,676 plaintiffs have been administratively dismissed or placed on the inactive docket in Ohio courts. We do not expect these claims will be re-opened unless the plaintiffs meet the courts' medical criteria for asbestos-related claims. We have not accrued any amounts for this litigation because of the uncertainty of liability and inability to reasonably estimate the liability, if any. To date, we have not been adjudicated liable in any of these matters. Based on information available to us, including:

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

We believe that the range of reasonably possible outcomes of these matters will be consistent with our historical costs (which are not material). Furthermore, we do not expect any reasonably possible outcome would involve amounts

material to our consolidated financial position, results of operations or liquidity. We have sought and will continue to vigorously seek, dismissal and/or a finding of no liability from each claim. In addition, from time to time, we have received notices regarding asbestos or silica claims purporting to be brought against former subsidiaries, including notices provided to insurers with which we have entered into settlements extinguishing certain insurance policies. These insurers may seek indemnification from us.

Kronos— In March 2013, Kronos was served with the complaint, Los Gatos Mercantile, Inc. d/b/a Los Gatos Ace Hardware, et al v. E.I. Du Pont de Nemours and Company, et al. (United States District Court, for the Northern District of California, Case No. 3:13-cv-01180-SI). The defendants include us, E.I. Du Pont de Nemours & Company, Huntsman International LLC and Millennium Inorganic Chemicals, Inc. As amended by plaintiffs' third amended complaint (Harrison, Jan, et al v. E.I. Du Pont de Nemours and Company, et al), plaintiffs seek to represent a class consisting of indirect purchasers of titanium dioxide in the states of Arizona, Arkansas, California, the District of Columbia, Florida, Iowa, Kansas, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, Nebraska, New Hampshire, New Mexico, New York, North Carolina, Oregon and Tennessee that indirectly purchased titanium dioxide from one or more of the defendants on or after March 1, 2002. The complaint alleges that the defendants conspired

and combined to fix, raise, maintain, and stabilize the price at which titanium dioxide was sold in the United States and engaged in other anticompetitive conduct. In December 2017, the Court preliminarily approved a settlement agreement with the class plaintiffs. In January 2018, without admitting any fault or wrongdoing, Kronos paid an immaterial amount in full settlement of this matter. We expect final approval of the settlement in the second half of 2018.

In September 2016, Kronos was served with the complaint, Home Depot U.S.A., Inc. v. E.I. DuPont Nemours and Company, et al. (United States District Court, for the Northern District of California, Case No. 3:16-cv-04865). The defendants include us, E.I. Du Pont de Nemours & Company, Huntsman International LLC and Millennium Inorganic Chemicals, Inc. The plaintiff alleges that it indirectly purchased titanium dioxide from one or more of the defendants on or after March 1, 2002. The complaint alleges that the defendants conspired and combined to fix, raise, maintain, and stabilize the price at which titanium dioxide was sold in the United States and engaged in other anticompetitive conduct. In June 2018, without admitting any fault or wrongdoing Kronos entered into a settlement agreement with the plaintiff and paid an immaterial amount in full settlement of this matter.

Other—In addition to the litigation described above, we and our affiliates are involved in various other environmental, contractual, product liability, patent (or intellectual property), employment and other claims and disputes incidental to our present and former businesses. In certain cases, we have insurance coverage for these items, although we do not expect any additional material insurance coverage for our environmental claims. We currently believe that the disposition of all of these various other claims and disputes (including asbestos-related claims), individually or in the aggregate, should not have a material adverse effect on our consolidated financial position, results of operations or liquidity beyond the accruals already provided.

Note 18—Fair value measurements and financial instruments:

The following table summarizes the valuation of our marketable securities, financial instruments and other items recorded on a fair value basis as of:

|                           | Fair Value Measurements |  |   |  |
|---------------------------|-------------------------|--|---|--|
|                           |                         | Quoted<br>Prices in<br>Active<br>Markets<br>(Level<br>1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
| Total                     |                         |  |   |  |
| (In millions)             |                         |  |   |  |
| Asset                     |                         |  |   |  |
| December<br>31, 2017:     |                         |  |   |  |
| Marketable<br>securities: |                         |  |   |  |
| Current                   | \$3.0                   | \$ —   | \$ 3.0  | \$ —   |
| Noncurrent                | 255.7                   | 1.3  | 4.4   | 250.0  |

June 30,  
2018:

Marketable  
securities:

|            |        |      |        |       |
|------------|--------|------|--------|-------|
| Current    | \$ 1.6 | \$ — | \$ 1.6 | \$ —  |
| Noncurrent | 256.8  | 3.8  | 3.0    | 250.0 |

See Note 6 for information on how we determine fair value of our noncurrent marketable securities.

- 30 -

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Certain of our sales generated by Chemicals Segment's non-U.S. operations are denominated in U.S. dollars. Our Chemicals Segment periodically uses currency forward contracts to manage a very nominal portion of currency exchange rate risk associated with trade receivables denominated in a currency other than the holder's functional currency or similar exchange rate risk associated with future sales. Derivatives that we use are primarily currency forward contracts and interest rate swaps. We have not entered into these contracts for trading or speculative purposes in the past, nor do we 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 financial assets and liabilities denominated in currencies other than the U.S. dollar and 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 (loss) 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. The fair value of the currency forward contracts is determined using Level 1 inputs based on the currency spot forward rates quoted by banks or currency dealers. During 2017 and the first six months of 2018, Kronos had no currency forward contracts outstanding.

Interest rate swap contract - See the 2017 Annual Report for a discussion of the interest rate swap Kronos had entered into in August 2015, and which was voluntarily terminated in September 2017.

The following table presents the financial instruments that are not carried at fair value but which require fair value disclosure:

|  | December 31,<br>2017 |               | June 30, 2018      |               |
|--|----------------------|---------------|--------------------|---------------|
|  | Carrying<br>amount   | Fair<br>value | Carrying<br>amount | Fair<br>value |
|  | (In millions)        |               |                    |               |
| Cash, cash equivalents and restricted cash equivalents | \$461.7              | \$461.7       | \$577.9            | \$577.9       |
| Deferred payment obligation                            | 9.3                  | 9.3           | 9.4                | 9.4           |
| Long-term debt (excluding capitalized leases):         |                      |               |                    |               |
| Kronos Senior Notes                                    | 471.1                | 495.1         | 458.6              | 449.3         |
| Snake River Sugar Company fixed rate loans             | 250.0                | 250.0         | 250.0              | 250.0         |
| Valhi credit facility with Contran                     | 284.3                | 284.3         | 320.6              | 320.6         |
| Tremont promissory note payable                        | 13.1                 | 13.1          | 10.9               | 10.9          |
| BMI bank note payable                                  | 18.8                 | 19.7          | 18.0               | 18.9          |
| LandWell note payable to the City of Henderson         | 2.5                  | 2.5           | 2.3                | 2.3           |

At June 30, 2018, the estimated market price of Kronos' Senior Notes was €965 per €1,000 principal amount. The fair value of Kronos' Senior Notes was based on quoted market prices; however, these quoted market prices represent Level 2 inputs because the markets in which the term loan trades were not active. The fair value of our fixed-rate nonrecourse loans from Snake River Sugar Company is based upon the \$250 million redemption price of our investment in Amalgamated, which collateralizes the nonrecourse loans (this is a Level 3 input). The fair value of variable interest rate debt and other fixed-rate debt, which represents Level 2 inputs, is deemed to approximate

carrying values. See Note 8. Due to their near-term maturities, the carrying amounts of accounts receivable and accounts payable are considered equivalent to fair value. See Notes 4 and 9.

Note 19—Recent accounting pronouncements:

Adopted

On January 1, 2018, we adopted ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606) for all contracts which were not completed as of January 1, 2018 using the modified retrospective method. Prior to adoption of this standard, we recorded sales of our Chemicals and Component Products Segments when our products were shipped and title and other risks and rewards of ownership had passed to our customer, which was generally at the time of shipment (although in some instances shipping terms were FOB destination point, for which we did not recognize revenue until the product was received by our customer). Following adoption of this standard, we will record sales of our Chemicals and Component Products Segments when we satisfy our performance obligation to our customers by transferring control of our products to them, which we have determined is at the same point in time as when we would have recognized revenue prior to adoption of this new standard. Accordingly, the adoption of Topic 606 as of January 1, 2018 did not have a material impact on our consolidated financial statements as it relates to sales of our Chemicals and Component Products Segments, and we believe adoption of this standard will have a minimal effect on our revenues of our Chemicals and Component Products Segments on an ongoing basis. See Note 11.

Revenues from our Real Estate Management and Development Segment are generally under long-term contracts. We collect certain fees from builders when the builder sells a home to a customer which we previously recognized when received and now

- 31 -

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beginning on January 1, 2018 we recognize these fees as revenue at the time we sell the parcels to the builder versus our previous practice which did not recognize revenue until the homes were sold. Accordingly, upon adoption of ASU 2014-09, such fees we collect from builders when the builder sells a home to a customer are now estimated at the time we sell a parcel to a builder, and such fees are part of the revenue we recognize over time using cost based input methods for our retail land sales in the case of the home participation fee or over the time the homes in the parcel are sold in the case of the marketing fee. Under the transition requirements for adopting this ASU, we recognized the cumulative amount of such revenue that we would have recognized through December 31, 2017, had we recognized such builder fees under this new accounting method (\$6.1 million, or \$2.7 million, net of applicable income taxes and noncontrolling interest), as a direct increase in our retained earnings as of January 1, 2018. A portion of such builder fees are expected to be collected more than twelve months from the balance sheet date, and such amounts are classified as a noncurrent asset (Land contract receivables), see Note 7. In addition to recognizing such \$6.1 million receivable, we recognized a contract asset of \$8.8 million and an offsetting liability for deferred revenue of \$8.8 million upon the adoption of this ASU for the estimated amount of such builder fees which we expect to receive from future home sales by the builders, which builder fees are not yet recognizable as revenue (and a portion of such contract asset is also classified as a noncurrent receivable along with an equal amount of noncurrent deferred revenue). Had we recognized revenue in 2018 on the same basis we did in 2017, our land sales revenue would have been lower by \$.1 million and higher by \$.2 million in the second quarter and first six months of 2018, respectively.

On January 1, 2018, we adopted ASU 2016-01, Financial Instruments-Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities, which addresses certain aspects related to the recognition, measurement, presentation and disclosure of financial instruments. The ASU requires equity investments (except for those accounted for under the equity method of accounting or those that result in the consolidation of the investee) to generally be measured at fair value with changes in fair value recognized in net income (previously, changes in fair value of such securities were recognized in other comprehensive income). The amendment also requires a number of other changes, including among others: simplifying the impairment assessment for equity instruments without readily determinable fair values; eliminating the requirement for public business entities to disclose methods and assumptions used to determine fair value for financial instruments measured at amortized cost; requiring an exit price notion when measuring the fair value of financial instruments for disclosure purposes; and requiring separate presentation of financial assets and liabilities by measurement category and form of asset. We adopted the new standard prospectively. The most significant aspect of adopting this ASU is the requirement to recognize changes in fair value of our available-for-sale marketable equity securities in net income. At December 31, 2017, our portfolio of marketable equity securities was not material.

In March 2017, the FASB issued ASU 2017-07, Compensation— Retirement Benefits (Topic 715) Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost, which requires that the service cost component of net periodic defined benefit pension and OPEB cost be reported in the same line item as other compensation costs for applicable employees incurred during the period. Other components of such net benefit cost are required to be presented in the income statement separately from the service cost component, and below income from operations (if such a subtotal is presented). These other net benefit cost components must be disclosed either on the face of the financial statements or in the notes to the financial statements. In addition only the service cost component is eligible for capitalization in assets where applicable (inventory or internally constructed fixed assets for example). We adopted the amendments in ASU 2017-06 beginning in the first quarter of 2018, with retrospective presentation in our Condensed Consolidated Statements of Income. We began applying ASU 2017-07 prospectively beginning on January 1, 2018 as it relates to the capitalization of the service cost component of net benefit cost into assets (primarily inventory). We are availing ourselves of the practical expedient that permits us to use amounts we previously disclosed as components of our net periodic defined benefit pension and OPEB cost for periods prior to the adoption of this ASU as the estimation basis for applying the retrospective presentation requirements. As a result we have reclassified \$2.6 million and \$1.7 million previously classified as part of cost of sales and selling, general and administrative expenses, respectively, for the second quarter 2017 and \$5.2 million and \$3.2 million for the first six

months of 2017, to “Other components of net periodic pension and OPEB cost” in our Condensed Consolidated Statement of Income. See Note 12.

#### Pending Adoption

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842), which is a comprehensive rewriting of the lease accounting guidance which aims to increase comparability and transparency with regard to lease transactions. The primary change will be the recognition of lease assets for the right-of-use of the underlying asset and lease liabilities for the obligation to make payments by lessees on the balance sheet for leases currently classified as operating leases. The ASU also requires increased qualitative disclosure about leases in addition to quantitative disclosures currently required. Companies are currently required to use a modified retrospective approach to adoption with a practical expedient which will allow companies to continue to account for existing leases under the prior guidance unless a lease is modified, other than the requirement to recognize the right-of-use asset and lease liability for all operating leases. The changes indicated above will be effective for us beginning in the first quarter of 2019, with early adoption permitted. We expect to adopt ASU 2016-02 beginning in the first quarter of 2019. We are in the process of assessing all of our current leases. We have not yet evaluated the effect this ASU will have on our Consolidated Financial Statements, but given the

material amount of our future minimum payments under non-cancellable operating leases at December 31, 2017 discussed in Note 18 to our 2017 Annual Report, we expect to recognize a material right-of-use lease asset and lease liability upon adoption of the ASU. This ASU permits companies to elect certain practical expedients upon adoption, and at adoption we expect to elect such practical expedients related to, among other things, lease classification (in which existing leases classified as operating leases under current GAAP would be classified as an operating lease under the new ASU, and existing leases classified as a capital lease under current GAAP would be classified as a finance lease under the new ASU), nonlease components (in which nonlease components associated with a lease and paid by us to the lessor, such as property taxes, insurance and maintenance, would be treated as a lease component and considered part of minimum lease rent payments), and short-term leases (in which leases with an original term of 12 months or less would be excluded from the recognition requirements of the new ASU). In addition, in July 2018 FASB issued ASU 2018-11, Leases (Topic 842), which amends the transition guidance in ASU 2016-02 to provide for an additional transition method, under which a company would recognize a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption, and prior period financial statements would not be restated. We expect to elect this new transition method upon adoption.

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

### RESULTS OF OPERATIONS

#### Business Overview

We are primarily a holding company. We operate through our wholly-owned and majority-owned subsidiaries, including NL Industries, Inc., Kronos Worldwide, Inc., CompX International Inc., Tremont LLC, Basic Management, Inc. ("BMI") and the LandWell Company ("LandWell"). Kronos (NYSE: KRO), NL (NYSE: NL) and CompX (NYSE American: CIX) each file periodic reports with the SEC.

On January 26, 2018 we completed the sale of our Waste Management Segment to JFL-WCS Partners, LLC ("JFL Partners"), an entity sponsored by certain investment affiliates of J.F. Lehman & Company, for consideration consisting of the assumption of all of WCS' third-party indebtedness and other liabilities, accordingly the results of operations of our Waste Management Segment is reflected as discontinued operations in our Consolidated Statements of Operations for all periods presented. We recognized a pre-tax gain of approximately \$58 million on the transaction in the first quarter of 2018 because the carrying value of the liabilities of the business assumed by the purchaser exceeded the carrying value of the assets sold at the time of sale in large part due to a long-lived asset impairment of \$170.6 million recognized with respect to the Waste Management Segment in the second quarter of 2017. Such pre-tax gain is classified as part of discontinued operations. Our Waste Management Segment, which operated in the low-level radioactive, hazardous, toxic and other waste disposal industry historically struggled to generate sufficient recurring disposal volumes to generate positive operating results or cash flows. We believe the sale will enable us to focus more effort on continuing to develop our remaining segments which we believe have greater opportunity for higher returns. See Note 3 to our Condensed Consolidated Financial Statements.

We have three consolidated reportable operating segments:

☛ **Chemicals**—Our chemicals segment is operated through our majority control of Kronos. Kronos is a leading global producer and marketer of value-added titanium dioxide pigments ("TiQ"). TiQ is used to impart whiteness, brightness, opacity and durability to a wide variety of products, including paints, plastics, paper, fibers and ceramics. Additionally, TiO<sub>2</sub> is a critical component of everyday applications, such as coatings, plastics and paper, as well as many specialty products such as inks, foods and cosmetics.

☛ **Component Products**—We operate in the component products industry through our majority control of CompX. CompX is a leading manufacturer of security products used in the recreational transportation, postal, office and institutional furniture, cabinetry, tool storage, healthcare and a variety of other industries. CompX is also a leading manufacturer of stainless steel exhaust systems, gauges, throttle controls and trim tabs for the recreational marine industry.

☛ **Real Estate Management and Development**—We operate in real estate management and development through our majority control of BMI and LandWell. BMI provides utility services to certain industrial and municipal customers and owns real property in Henderson, Nevada. LandWell is engaged in efforts to develop certain land holdings for commercial, industrial and residential purposes in Henderson, Nevada.

#### General

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, as amended. Statements in this Quarterly Report that are not historical facts are forward-looking in nature and represent management's beliefs and assumptions based on currently available information. In some cases, you can identify forward-looking statements by the use of words such as "believes," "intends," "may," "should," "could," "anticipates," "expects" or comparable terminology, or by discussions of strategies or trends.

Although we believe that the expectations reflected in such forward-looking statements are reasonable, we do not know if these expectations will be correct. Such statements by their nature involve substantial risks and uncertainties that could significantly impact expected results. Actual future results could differ materially from those predicted. The factors that could cause actual future results to differ materially from those described herein are the risks and uncertainties discussed in this Quarterly Report and those described from time to time in our other filings with the SEC include, but are not limited to, the following:

- Future supply and demand for our products;
- The extent of the dependence of certain of our businesses on certain market sectors;
- The cyclicity of certain of our businesses (such as Kronos' TiQ operations);
- Customer and producer inventory levels;

- 34 -

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- Unexpected or earlier-than-expected industry capacity expansion (such as the TiO<sub>2</sub> industry);
- Changes in raw material and other operating costs (such as ore, zinc, brass, aluminum, steel and energy costs) and our ability to pass those costs on to our customers or offset them with reductions in other operating costs;
- Changes in the availability of raw materials (such as ore);
- General global economic and political conditions (such as changes in the level of gross domestic product in various regions of the world and the impact of such changes on demand for, among other things, TiO<sub>2</sub> and component products);
- Competitive products and prices and substitute products, including increased competition from low-cost manufacturing sources (such as China);
- Possible disruption of our business or increases in the cost of doing business resulting from terrorist activities or global conflicts;
- Customer and competitor strategies;
- Potential difficulties in integrating future acquisitions;
- Potential difficulties in upgrading or implementing new accounting and manufacturing software systems (such as the Chemicals Segment's new enterprise resource planning system);
- Potential consolidation of our competitors;
- Potential consolidation of our customers;
- The impact of pricing and production decisions;
- Competitive technology positions;
- The introduction of trade barriers;
- The ability of our subsidiaries to pay us dividends;
- The impact of current or future government regulations (including employee healthcare benefit related regulations);
- Uncertainties associated with new product development and the development of new product features;
- Fluctuations in currency exchange rates (such as changes in the exchange rate between the U.S. dollar and each of the euro, the Norwegian krone and the Canadian dollar) or possible disruptions to our business resulting from potential instability resulting from uncertainties associated with the euro or other currencies;
- Operating interruptions (including, but not limited to, labor disputes, leaks, natural disasters, fires, explosions, unscheduled or unplanned downtime, transportation interruptions and cyber-attacks);
- Decisions to sell operating assets other than in the ordinary course of business;
- The timing and amounts of insurance recoveries;
- Our ability to renew, amend, refinance or establish credit facilities;
- Our ability to maintain sufficient liquidity;
- The ultimate outcome of income tax audits, tax settlement initiatives or other tax matters, including future tax reform;
- Our ultimate ability to utilize income tax attributes, the benefits of which may or may not presently have been recognized under the more-likely-than-not recognition criteria;
- Environmental matters (such as those requiring compliance with emission and discharge standards for existing and new facilities, or new developments regarding environmental remediation at sites related to our former operations);
- Government laws and regulations and possible changes therein (such as changes in government regulations which might impose various obligations on former manufacturers of lead pigment and lead-based paint, including NL, with respect to asserted health concerns associated with the use of such products);
- The ultimate resolution of pending litigation (such as NL's lead pigment litigation, environmental and other litigation and Kronos' class action litigation);
- Our ability to comply with covenants contained in our revolving bank credit facilities;
- Our ability to complete and comply with the conditions of our licenses and permits;

- Changes in real estate values and construction costs in Henderson, Nevada;
- Water levels in Lake Mead; and
- Possible future litigation.

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

## Operations Overview

### Quarter Ended June 30, 2018 Compared to the Quarter Ended June 30, 2017 —

We reported net income from continuing operations attributable to Valhi stockholders of \$11.3 million or \$.03 per diluted share in the second quarter of 2018 compared to \$117.0 million or \$.35 per diluted share in the second quarter of 2017. As discussed more fully below, our net income from continuing operations attributable to Valhi stockholders decreased from 2017 to 2018 primarily due to the net effects of:

- higher operating income from our Chemicals Segment in 2018 compared to 2017;
- a pre-tax litigation settlement expense of \$62.0 million recognized in the second quarter of 2018;
- a non-cash deferred income tax benefit of \$157.6 million in 2017 as a result of a decrease in our deferred income tax asset valuation allowance related to our Chemicals Segment's German and Belgian operations; and
- higher litigation fees and related expenses in 2018.

Our diluted net income from continuing operations per share in 2018 includes a charge of \$.12 per share related to the litigation settlement expense recognized in the second quarter. Our diluted net income from continuing operations per share in 2017 includes a non-cash deferred income tax benefit of \$.27 per share as a result of the net decrease in our deferred income tax asset valuation allowances associated with our German and Belgian operations.

### Six Months Ended June 30, 2018 Compared to the Six Months Ended June 30, 2017 —

We reported net income from continuing operations attributable to Valhi stockholders of \$63.0 million or \$.18 per diluted share in the first six months of 2018 compared to \$131.4 million or \$.38 per diluted share in the first six months of 2017. As discussed more fully below, our net income from continuing operations attributable to Valhi stockholders decreased from 2017 to 2018 primarily due to the net effects of:

- higher operating income from our Chemicals Segment in 2018 compared to 2017;
- a pre-tax litigation settlement expense of \$62.0 million recognized in the second quarter of 2018;
- recognition of a gain on sale of land of \$12.5 million in 2018;
- a non-cash deferred income tax benefit of \$162.6 million in 2017 as a result of a decrease in our deferred income tax asset valuation allowance related to our Chemicals Segment's German and Belgian operations; and
- higher litigation fees and environmental and related expenses in 2018.

Our diluted net income per share in 2018 includes:

- a gain of \$.03 per share related to the sale of land not used in our operations; and
- a charge of \$.12 per share related to the litigation settlement expense recognized in the second quarter.

Our diluted net income from continuing operations per share in 2017 includes a non-cash deferred income tax benefit of \$.28 per share as a result of the net decrease in our deferred income tax asset valuation allowances associated with our German and Belgian operations.





Current Forecast for 2018—

We currently expect to report higher consolidated operating income for 2018 as compared to 2017 primarily due to the net effects of:

- higher operating income from our Chemicals Segment in 2018, principally as a result of expected higher average selling prices in 2018 as compared to 2017; and
- higher operating income from our Real Estate Management and Development Segment in 2018 as we anticipate increased land development activities.

However, we currently expect to report lower net income from continuing operations attributable to Valhi stockholders for 2018 as compared to 2017, primarily because the favorable impact of higher expected operating income in 2018 would be more than offset by the favorable impact of the aggregate net income tax benefit we recognized in 2017 (mostly in the second, third and fourth quarters of 2017, as discussed in the 2017 Annual Report) and the litigation settlement expense recognized in the second quarter of 2018.

Segment Operating Results—2017 Compared to 2018 –

Chemicals –

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

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

- our TiO<sub>2</sub> sales and production volumes,
- TiO<sub>2</sub> selling prices,
- manufacturing costs, particularly raw materials such as third-party feedstock ore, maintenance and energy-related expenses, and
- currency exchange rates (particularly the exchange rate for the U.S. dollar relative to the euro, the Norwegian krone and the Canadian dollar).

Our Chemicals Segment’s key performance indicators are our TiO<sub>2</sub> average selling prices, our level of TiO<sub>2</sub> sales and production volumes, and the cost of our third-party feedstock ore. TiO<sub>2</sub> selling prices generally follow industry trends and prices will increase or decrease generally as a result of competitive market pressures.

|  | Three months ended<br>June 30, |         |             | Six months ended<br>June 30, |         |             |
|--|--------------------------------|---------|-------------|------------------------------|---------|-------------|
|  | 2017                           | 2018    | %<br>Change | 2017                         | 2018    | %<br>Change |
| Net sales                              | \$441.4                        | \$471.8 | 7 %         | \$811.2                      | \$902.2 | 11 %        |
| Cost of sales                          | 309.6                          | 300.5   | (3 )        | 573.8                        | 556.6   | (3 )        |
| Gross margin                           | \$131.8                        | \$171.3 | 30          | \$237.4                      | \$345.6 | 46          |
| Operating income                       | \$77.2                         | \$123.6 | 60          | \$136.3                      | \$234.2 | 72          |
| Percent of net sales:                  |                                |         |             |                              |         |             |
| Cost of sales                          | 70 %                           | 64 %    |             | 71 %                         | 62      |             |
| Gross margin                           | 30                             | 36      |             | 29                           | 38      |             |
| Operating income                       | 18                             | 26      |             | 17                           | 26      |             |
| TiO <sub>2</sub> operating statistics: |                                |         |             |                              |         |             |
| Sales volumes*                         | 157                            | 137     | (12 )%      | 300                          | 262     | (13 )%      |
| Production volumes*                    | 141                            | 136     | (4 )        | 286                          | 269     | (6 )        |
| Percent change in net sales:           |                                |         |             |                              |         |             |
| TiO <sub>2</sub> product pricing       |                                |         | 20 %        |                              |         | 23 %        |
| TiO <sub>2</sub> sales volumes         |                                |         | (12 )       |                              |         | (13 )       |
| TiO <sub>2</sub> product mix           |                                |         | (6 )        |                              |         | (5 )        |
| Changes in currency exchange rates     |                                |         | 5           |                              |         | 6           |
| Total                                  |                                |         | 7 %         |                              |         | 11 %        |

\*Thousands of metric tons

Industry conditions and 2018 overview – Due to the successful implementation of previously-announced price increases, average selling prices rose throughout 2017 and the first half of 2018. Our Chemicals Segment’s average TiO<sub>2</sub> selling prices at the end of 2017 were 27% higher than at the end of 2016. Our Chemicals Segment’s average selling prices at the end of the second quarter of 2018 were 4% higher than at the end of 2017, with most of such increase occurring in the first quarter. Higher prices in the European, North American and export markets were partially offset by lower prices in Latin America (attributable to changes in customer mix). Our Chemicals Segment’s experienced lower sales volumes in all major markets in the first half of 2018 as compared to the record sales volumes achieved in the same period of 2017.

Our Chemicals Segment’s operated its production facilities at overall average capacity utilization rates of 96% in the first six months of 2018 compared to full practical capacity utilization rates in the first six months of 2017. The table below lists our comparative quarterly capacity utilization rates.

|                | Production<br>Capacity<br>Utilization<br>Rates |      |
|----------------|--|------|
|                | 2017   | 2018 |
| First quarter  | 100%   | 95%  |
| Second quarter | 100%   | 97%  |

Due to a moderate rise in the cost of third-party feedstock ore we procured in 2017 and the first half of 2018, our Chemicals Segment's cost of sales per metric ton of TiO<sub>2</sub> sold in the first six months of 2018 was higher as compared to the first six months of 2017 (excluding the effect of changes in currency exchange rates).

Net sales – Our Chemicals Segment's net sales in the second quarter of 2018 increased 7%, or \$30.4 million, compared to the second quarter of 2017 primarily due to the net effect of a 20% increase in average TiO<sub>2</sub> selling prices (which increased net sales by approximately \$88 million) and a 12% decrease in sales volumes (which decreased net sales by approximately \$53 million). TiO<sub>2</sub> selling prices will increase or decrease generally as a result of competitive market pressures, changes in the relative level of supply and demand as well as changes in raw material and other manufacturing costs.

Our Chemicals Segment's sales volumes decreased 12% in the second quarter of 2018 as compared to the record second quarter sales volumes of 2017 primarily due to lower sales in the European and export markets reflecting the effects of product availability issues during the quarter as well as reduced customer shipments as customer inventory levels returned to more normal levels especially in European and export markets, partially offset by higher sales in the North American market. In addition to the impact of changes in average TiO<sub>2</sub> selling prices and sales volumes, we estimate that changes in currency exchange rates (primarily the euro) increased our Chemicals Segment's net sales by approximately \$22 million as compared to the second quarter of 2017.

Our Chemicals Segment's net sales in the first six months of 2018 increased 11%, or \$91.0 million, compared to the first six months of 2017 primarily due to the net effect of a 23% increase in average TiO<sub>2</sub> selling prices (which increased net sales by

approximately \$187 million) and a 13% decrease in sales volumes (which decreased net sales by approximately \$105 million). TiO<sub>2</sub> selling prices will increase or decrease generally as a result of competitive market pressures, changes in the relative level of supply and demand as well as changes in raw material and other manufacturing costs.

Our Chemicals Segment's sales volumes decreased 13% in the first six months of 2018 as compared to the record first six months of 2017 primarily due to lower sales in all major markets resulting from a controlled ramp-up in January 2018 as we brought the second phase of our new global enterprise resource planning system online, and inventory management to assure adequate supply to our customers during the spring and summer necessitated by the lower production volumes in the first three months of the year (as discussed below), as well as the impact of product availability and customer inventory level changes in the second quarter discussed above. In addition to the impact of changes in average TiO<sub>2</sub> selling prices and sales volumes, we estimate that changes in currency exchange rates increased our Chemicals Segment's net sales by approximately \$53 million as compared to the first six months of 2017.

**Cost of Sales and Gross Margin**—Our Chemicals Segment's cost of sales decreased 3% in the second quarter of 2018 compared to the second quarter of 2017 due to the net effect of a 12% decrease in sales volumes, a 4% decrease in TiO<sub>2</sub> production volumes, higher raw materials and other production costs of approximately \$23 million (primarily caused by higher third-party feedstock ore costs) and currency fluctuations (primarily the euro). The decrease in TiO<sub>2</sub> production volumes in the second quarter of 2018 compared to the production volumes in the second quarter of 2017 was primarily due to the timing of scheduled maintenance at certain facilities in 2018. Our Chemicals Segment's cost of sales as a percentage of net sales decreased to 64% in the second quarter of 2018 compared to 70% in the same period of 2017 as the favorable impact of higher average selling prices more than offset the unfavorable effects related to lower production volumes and higher raw materials and other production costs, as discussed above.

Our Chemicals Segment's gross margin as a percentage of net sales increased to 36% in the second quarter of 2018 compared to 30% in the second quarter of 2017. As discussed and quantified above, our Chemicals Segment's gross margin increased primarily due to the net effect of higher average selling prices, lower sales and production volumes and higher raw materials and other production costs.

Our Chemicals Segment's cost of sales decreased 3% in the first six months of 2018 compared to the same period in 2017 primarily due to the net impact of a 13% decrease in sales volumes, 6% decrease in TiO<sub>2</sub> production volumes, higher raw materials and other production costs of approximately \$35 million (primarily caused by higher third-party feedstock ore costs) and currency fluctuations (primarily the euro). The decrease in TiO<sub>2</sub> production volumes in the first six months of 2018 compared to the production volumes in the first six months of 2017 was primarily due to the timing of scheduled maintenance at certain facilities in 2018 as well as the implementation of a productivity-enhancing improvement project at our Chemicals Segment's Belgian facility in the first quarter of 2018. Our Chemicals Segment's cost of sales as a percentage of net sales decreased to 62% in the first six months of 2018 compared to 71% in the same period of 2017 as the favorable impact of higher average selling prices more than offset the unfavorable effects related to lower production volumes and higher raw materials and other production costs, as discussed above.

Gross margin as a percentage of net sales increased to 38% in the first six months of 2018 compared to 29% in the first six months of 2017. As discussed and quantified above, our gross margin increased primarily due to the net effect of higher average selling prices, lower sales and production volumes and higher raw materials and other production costs.

**Operating Income**—Our Chemicals Segment's operating income increased 60% in the second quarter of 2018 compared to the second quarter of 2017, and operating income as a percentage of net sales increased to 26% in 2018 from 18% in 2017. This increase was driven by the increase in gross margin, discussed above. We estimate that changes in

currency exchange rates increased our Chemicals Segment's operating income by approximately \$18 million in the second quarter of 2018 as compared to the same period in 2017, as discussed below. Our Chemicals Segment's operating income was also effected by increased higher general and administrative costs related to the implementation of a new accounting and manufacturing software system and higher sales support.

Our Chemicals Segment's operating income increased 72% in the first six months of 2018 compared to the first six months of 2017, and operating income as a percentage of net sales increased to 26% in 2018 from 17% in 2017. This increase was driven by the increase in gross margin, discussed above. We estimate that changes in currency exchange rates increased our Chemicals Segment's operating income by approximately \$19 million in the first six months of 2018 as compared to the same period in 2017, as discussed below. Our Chemicals Segment's operating income was also effected by increased higher general and administrative costs related to the implementation of a new accounting and manufacturing software system and higher sales support.

Our Chemicals Segment's operating income is net of amortization of purchase accounting adjustments made in conjunction with our acquisitions of interests in NL and Kronos. As a result, we recognize additional depreciation expense above the amounts Kronos reports separately, substantially all of which is included within cost of sales. We recognized additional depreciation expense of \$1.0 million in the first six months of 2017 and \$1.2 million in the same period of 2018, which reduced our reported Chemicals Segment's operating income as compared to amounts reported by Kronos.

Currency Exchange Rates— Our Chemicals Segment has substantial operations and assets located outside the United States (primarily in Germany, Belgium, Norway and Canada). The majority of our Chemicals Segment’s sales from non-U.S. operations are denominated in currencies other than the U.S. dollar, principally the euro, other major European currencies and the Canadian dollar. A portion of our sales generated from our non-U.S. operations is denominated in the U.S. dollar (and consequently our non-U.S. operations will generally hold U.S. dollars from time to time). Certain raw materials used worldwide, primarily titanium-containing feedstocks, are purchased primarily in U.S. dollars, while labor and other production costs are purchased primarily in local currencies. Consequently, the translated U.S. dollar value of our non-U.S. sales and operating results are subject to currency exchange rate fluctuations which may favorably or unfavorably impact reported earnings and may affect the comparability of period-to-period operating results. In addition to the impact of the translation of sales and expenses over time, our non-U.S. operations also generate currency transaction gains and losses which primarily relate to (i) the difference between the currency exchange rates in effect when non-local currency sales or operating costs (primarily U.S. dollar denominated) are initially accrued and when such amounts are settled with the non-local currency, (ii) changes in currency exchange rates during time periods when our non-U.S. operations are holding non-local currency (primarily U.S. dollars), and (iii) relative changes in the aggregate fair value of currency forward contracts held from time to time. As discussed in Note 18 to our Condensed Consolidated Financial Statements, we periodically use currency forward contracts to manage a portion of our currency exchange risk, and relative changes in the aggregate fair value of any currency forward contracts we hold from time to time serves in part to mitigate the currency transaction gains or losses we would otherwise recognize from the first two items described above.

Overall, we estimate that fluctuations in currency exchange rates had the following effects on the reported amounts of our sales and income from operations for the periods indicated.

Impact of changes in currency exchange rates

three months ended June 30, 2018 vs June 30, 2017

Transaction gains/(losses) Translation

recognized gains – Total currency  
impact of impact

2017 2018 Change rate changes 2018 vs 2017  
(In millions)

Impact on:

|                  |     |     |     |       |       |
|------------------|-----|-----|-----|-------|-------|
| Net sales        | \$— | \$— | \$— | \$ 22 | \$ 22 |
| Operating income | (4) | 10  | 14  | 4     | 18    |

The \$22 million increase in net sales (translation gain) was caused primarily by a weakening of the U.S. dollar relative to the euro, as our euro-denominated sales were translated into more U.S. dollars in 2018 as compared to 2017. The weakening of the U.S. dollar relative to the Canadian dollar and the Norwegian krone in 2018 did not have a significant effect on the reported amount of our Chemicals Segment’s net sales, as a substantial portion of the sales generated by our Chemicals Segment’s Canadian and Norwegian operations are denominated in the U.S. dollar.

The \$18 million increase in operating income was comprised of the following:

• Approximately \$14 million from net currency transaction gains primarily caused by relative changes in currency exchange rates at each applicable balance sheet date between the U.S. dollar and the euro, Canadian dollar and the Norwegian krone, which causes increases or decreases, as applicable, in U.S. dollar-denominated receivables and payables and U.S. dollar currency held by our Chemicals Segment’s non-U.S. operations, and

Approximately \$4 million from net currency translation gains primarily caused by a weakening of the U.S. dollar relative to the euro as the positive effects of the weaker U.S. dollar on euro-denominated sales more than offset the unfavorable effects of euro-denominated operating costs being translated into more U.S. dollars in 2018 as compared to 2017, partially offset by the weakening of the U.S. dollar relative to the Canadian dollar, as its local currency-denominated operating costs were translated into more U.S. dollars in 2018 as compared to 2017.

Impact of changes in currency exchange rates

six months ended June 30, 2018 vs June 30 2017

|                  | Transaction gains/(losses) recognized |      | Translation gains – impact of rate changes |              | Total currency impact 2018 vs 2017 |
|------------------|---------------------------------------|------|--|--------------|------------------------------------|
|                  | 2017                                  | 2018 | Change                                     | rate changes |                                    |
| (In millions)    |                                       |      |  |              |                                    |
| Impact on:       |                                       |      |  |              |                                    |
| Net sales        | \$ —                                  | \$ — | \$ —                                       | \$ 53        | \$ 53                              |
| Operating income | (4)                                   | 5    | 9  | 10           | 19                                 |

The \$53 million increase in net sales (translation gain) was caused primarily by a weakening of the U.S. dollar relative to the euro, as our Chemicals Segment's euro-denominated sales were translated into more U.S. dollars in 2018 as compared to 2017. The weakening of the U.S. dollar relative to the Canadian dollar and the Norwegian krone in 2018 did not have a significant effect on the reported amount of our Chemicals Segment's net sales, as a substantial portion of the sales generated by our Chemicals Segment's Canadian and Norwegian operations are denominated in the U.S. dollar.

The \$19 million increase in operating income was comprised of the following:

- Approximately \$9 million from net currency transaction gains primarily caused by relative changes in currency exchange rates at each applicable balance sheet date between the U.S. dollar and the euro, Canadian dollar and the Norwegian krone, which causes increases or decreases, as applicable, in U.S. dollar-denominated receivables and payables and U.S. dollar currency held by our Chemicals Segment's non-U.S. operations, and
- Approximately \$10 million from net currency translation gains primarily caused by a weakening of the U.S. dollar relative to the euro as the positive effects of the weaker U.S. dollar on euro-denominated sales more than offset the unfavorable effects of euro-denominated operating costs being translated into more U.S. dollars in 2018 as compared to 2017, partially offset by the weakening of the U.S. dollar relative to the Canadian dollar, as its local currency-denominated operating costs were translated into more U.S. dollars in 2018 as compared to 2017.

Outlook— We expect our Chemicals Segment's production volumes in 2018 to be slightly lower as compared to the record 2017 production volumes. Assuming current global economic conditions continue and based on anticipated production levels, we expect our Chemicals Segment's 2018 sales volumes to be somewhat lower as compared to record 2017 sales volumes. However, the percentage decrease in our sales volumes in the first six months of 2018 is not indicative of our expectation for full year sales volumes as we believe customer inventory level changes are short term and will not continue past the third quarter of 2018, and worldwide demand remains solid. We will continue to monitor current and anticipated near-term customer demand levels and align our production and inventories accordingly.

The cost of third-party feedstock ore we purchased in the first half of 2018 was higher as compared to the fourth quarter of 2017, and such higher cost feedstock ore was reflected in our results of operations beginning in the second quarter of 2018. We expect our Chemicals Segment's cost of sales per metric ton of TiO<sub>2</sub> sold in 2018 will be moderately higher than our per-metric ton cost in 2017 primarily due to higher third-party feedstock ore costs.

Our Chemicals Segment's started 2018 with average selling prices 27% higher than the beginning of 2017, and average selling prices increased by an additional 4% in the first six months of 2018 (most of which occurred in the first quarter). Industry data indicates that overall TiO<sub>2</sub> inventory held by producers stood at adequate-to-low levels in the second quarter of 2018. We continue to see evidence of solid demand for our TiO<sub>2</sub> products across nearly all segments, which could lead to some additional selling price increases during the remainder of 2018 (although the magnitude of selling price increases we would achieve for all of 2018 would not be expected to be comparable to the magnitude of selling price increases we achieved during 2017).

Overall, we expect our Chemicals Segment's sales in 2018 will be higher as compared to 2017, principally as a result of expected higher average selling prices, and we expect our Chemicals Segment's operating income in 2018 will be higher as compared to 2017, principally as a result of expected higher average selling prices in 2018 as compared to 2017, partially offset by higher raw material costs (principally feedstock ore).

Due to the constraints of high capital costs and extended lead time associated with adding significant new TiO<sub>2</sub> production capacity, especially for premium grades of TiO<sub>2</sub> products produced from the chloride process, we believe increased and sustained profit margins will be necessary to financially justify major expansions of western producers' TiO<sub>2</sub> production capacity required to meet expected future growth in demand. Any such major expansion of TiO<sub>2</sub>



production capacity, if announced, would take a number of years before such production would become available to meet future growth in demand. Certain Chinese producers have recently announced expansion plans, but the extent to which such expansion plans will be implemented, or if implemented the resulting additional capacity and the timing thereof is uncertain.

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

- 41 -

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## Component Products –

Our Component Products Segment's product offerings consist of a significantly large number of products that have a wide variation in selling price and manufacturing cost, which results in certain practical limitations on our ability to quantify the impact of changes in individual product sales quantities and selling prices on our net sales, cost of sales and gross margin. In addition, small variations in period-to-period net sales, cost of sales and gross margin can result from changes in the relative mix of our products sold. The key performance indicator for our Component Products Segment is operating income margins.

|                       | Three months ended<br>June 30, |        |             | Six months ended<br>June 30, |        |             |
|-----------------------|--------------------------------|--------|-------------|------------------------------|--------|-------------|
|                       | 2017                           | 2018   | %<br>Change | 2017                         | 2018   | %<br>Change |
| Net sales             | \$30.1                         | \$32.4 | 8           | \$60.0                       | \$60.8 | 1           |
| Cost of sales         | 20.5                           | 21.2   | 3           | 40.8                         | 40.1   | (2)         |
| Gross margin          | \$9.6                          | \$11.2 | 18          | \$19.2                       | \$20.7 | 8           |
| Operating income      | \$4.6                          | \$6.0  | 30          | \$9.1                        | \$10.4 | 13          |
| Percent of net sales: |                                |        |             |                              |        |             |
| Cost of sales         | 68                             | 65     |             | 68                           | 66     |             |
| Gross margin          | 32                             | 35     |             | 32                           | 34     |             |
| Operating income      | 15                             | 18     |             | 15                           | 17     |             |

**Net Sales** — Our Component Products Segment's net sales increased \$2.3 million in the second quarter of 2018 compared to the same period in 2017 due to higher sales of security products across the majority of our markets and continued strong growth in sales of marine components to various marine and industrial markets. Our Component Products Segment's net sales increased \$0.8 million in the first six months of 2018 compared to the same period in 2017 due to the higher marine components sales volumes from generally improved demand for products sold to various marine markets, including original equipment manufacturers of recreational towboats and larger center-console boats, as well as increased sales to government and industrial customers, partially offset by lower security products net sales primarily due to approximately \$0.9 million lower sales to existing government security customers and \$0.4 million lower sales to a customer serving the recreational transportation market. Relative changes in selling prices did not have a material impact on net sales comparisons.

**Costs of Sales and Gross Margin** — Our Component Products Segment's cost of sales as a percentage of sales for the second quarter and first six months of 2018 was approximately 3% and 2% less than the same periods in 2017, respectively. As a result, gross margin increased over the same period. The higher gross margin percentage for both comparative periods is the result of favorable changes in customer and product mix in security products and improved manufacturing efficiencies facilitated by increased production volumes and cost reductions in each of our business segments. Gross margin for the second quarter increased over the prior year due to the aforementioned factors as well

as higher sales for both reporting units. Gross margin for the first six months of 2018 increased over 2017 due primarily to lower fixed costs at security products and higher sales and improved manufacturing efficiencies for marine components.

Operating Income — Our Component Products Segment’s operating income as a percentage of net sales for the second quarter and first six months of 2018 increased compared to the same periods of 2017 and was primarily impacted by the factors impacting cost of goods sold, gross margin and operating costs discussed above.

Outlook— Our Component Products Segment’s sales for the first half of 2018 reflect continued strong demand for our Component Products Segment’s products, allowing us to eclipse sales achieved for the first half of 2017 despite lower sales to existing government security customers and lower sales to a significant customer serving the recreational transportation market in 2018. Based upon anticipated sales in other security products markets and continued growth in marine component sales, where we continue to benefit from innovation and diversification in our Component Products Segment’s product offerings to the recreational boat markets, we expect our Component Products Segment’s sales for full year 2018 to meet or exceed 2017 sales. We monitor changes in economic conditions and sales order rates and will respond to fluctuations in customer demand through continuous evaluation of staffing levels and consistent execution of our lean manufacturing and cost improvement initiatives. Additionally, we continue to seek opportunities to gain market share in markets we currently serve, to expand into new markets and to develop new product features in order to mitigate the impact of changes in demand as well as broaden our Component Products Segment’s sales base.

## Real Estate Management and Development –

|                  | Three months ended |          | Six months ended |          |
|------------------|--------------------|----------|------------------|----------|
|                  | June 30,           | June 30, | June 30,         | June 30, |
|                  | 2017               | 2018     | 2017             | 2018     |
|                  | (In millions)      |          |                  |          |
| Net sales        | \$10.3             | \$6.0    | \$15.9           | \$13.2   |
| Cost of sales    | 7.9                | 4.5      | 12.1             | 10.2     |
| Gross margin     | \$2.4              | \$1.5    | \$3.8            | \$3.0    |
| Operating income | \$1.3              | \$.4     | \$1.8            | \$4.2    |

General—Our Real Estate Management and Development Segment consists of BMI and LandWell. BMI provides utility services, among other things, to an industrial park located in Henderson, Nevada, and is responsible for the delivery of water to the city of Henderson and various other users through a water distribution system owned by BMI. LandWell is actively engaged in efforts to develop certain real estate in Henderson, Nevada including approximately 2,100 acres zoned for residential/planned community purposes and approximately 400 acres zoned for commercial and light industrial use.

In December 2013 and through the second quarter of 2018, LandWell has closed or entered into escrow on approximately 520 acres of the residential/planned community and approximately 65 acres zoned for commercial and light industrial use. Contracts for land sales are negotiated on an individual basis and sales terms and prices will vary based on such factors as location (including location within a planned community), expected development work, and individual buyer needs. Although land may be under contract, we do not recognize revenue until we have satisfied the criteria for revenue recognition set forth in ASC Topic 606. In some instances, we will receive cash proceeds at the time the contract closes and record deferred revenue for some or all of the cash amount received, with such deferred revenue being recognized in subsequent periods. Because land held for development was initially recognized at estimated fair value at the acquisition date as required by ASC Topic 805, we do not expect to recognize significant operating income on land sales for the land currently under contract. We expect the development work to continue for 10 to 15 years on the rest of the land held for development, especially the remainder of the residential/planned community.

Net Sales and Operating Income— A substantial portion of the net sales from our Real Estate Management and Development Segment in the second quarter and first six months of 2017 and 2018 consisted of revenues from land sales. We recognized \$3.8 million and \$9.6 million in revenues on land sales during the second quarter and first six months of 2018, respectively, compared to \$8.4 million and \$12.1 million in the same periods of 2017. As noted above we recognize revenue in our residential/planned community over time using cost based input methods (previously known as percentage completion method) and a large majority of the revenue we recognized in 2017 and 2018 was under this method of revenue recognition. The contracts on these sales (both within the planned community and otherwise) include approximately 470 acres of the residential planned community and certain other acreage which closed in December 2015 and through the second quarter of 2018. Cost of sales related to land sales revenues was \$3.1 million and \$7.4 million in the second quarter and first six months of 2018, respectively, compared to \$6.6 million and \$9.3 million in the same periods of 2017. Land sales revenues were lower in both periods of 2018 as compared to 2017 primarily due to lower infrastructure development spending in 2018. Land infrastructure development spending declined in 2018 as we balanced development requirements with home builder outputs during the periods. Operating income in the first six months of 2018 also includes \$3.1 million of income in the first quarter

related to the recognition of tax increment reimbursement note receivables which we now believe we can recognize, as discussed in Note 7 to our Condensed Consolidated Financial Statements.

The remainder of net sales and cost of sales related to this segment primarily relates to water delivery fees and expenses. We deliver water to several customers under long-term contracts.

Outlook—We are actively pursuing opportunities to maximize cash proceeds from the sale of our land held for development. In the near term, we are focused on developing and selling land we manage, primarily to residential builders, for the approximately 2,100 acres zoned for residential/planned community in Henderson, Nevada. We expect the development work for the first phase of the residential/planned community to continue over the next several years, including those parcels currently under contract for which the development work is expected to be completed in 2019. We do not expect to recognize significant amounts of operating income related to these sales for the parcels currently under contract because our basis in the land value is the December 2013 acquisition date fair value; however, we do expect to generate cash proceeds from these sales in excess of our acquisition costs, which proceeds are expected to be used, in part, to fund ongoing development work for the remainder of these properties. Beginning in the fourth quarter of 2017 we began sales of parcels that have a lower book value than the parcels previously sold, as a result we would expect to recognize more land sales related operating income in 2018 than in 2017. In addition we expect land development spending to accelerate in the second half of 2018 as home builder output at the end of the second quarter of 2018 more closely tracked to our development efforts. As noted above land sales revenue is largely driven by the amount of land development spending.

General Corporate Items, Interest Expense, Income Taxes and Noncontrolling Interest—2018 Compared to 2017

**Securities Earnings**—A significant portion of our interest and dividend income in both 2017 and 2018 relates to the distributions we received from The Amalgamated Sugar Company LLC. We recognized dividend income from the LLC of \$6.3 million and \$12.7 million in each of the second quarter and first six months of 2018 and 2017, respectively. See Note 6 to our Condensed Consolidated Financial Statements.

**Gain on Land Sales**—In the first quarter of 2018 we sold two parcels of land not used in our operating activities. See Note 13 to our Condensed Consolidated Financial Statements.

**Insurance Recoveries**—Insurance recoveries relate to amounts NL received from certain of its former insurance carriers, and relate principally to the recovery of prior lead pigment and asbestos litigation defense costs incurred by NL. We have agreements with four former insurance carriers pursuant to which the carriers reimburse us for a portion of our future lead pigment litigation defense costs, and one such carrier reimburses us for a portion of our future asbestos litigation defense costs. We are not able to determine how much we will ultimately recover from these carriers for defense costs incurred by us because of certain issues that arise regarding which defense costs qualify for reimbursement. While we continue to seek additional insurance recoveries for lead pigment and asbestos litigation matters, we do not know the extent to which we will be successful in obtaining additional reimbursement for either defense costs or indemnity. Any additional insurance recoveries would be recognized when the receipt is probable and the amount is determinable. Substantially all of the insurance recoveries recognized in 2017 and 2018 relate to reimbursement of ongoing litigation defense costs. See Note 17 to our Condensed Consolidated Financial Statements.

**Litigation settlement expense** – We recognized a pre-tax \$62.0 million litigation settlement expense charge in the second quarter of 2018 related to the lead pigment litigation in California, see Note 17 to our Condensed Consolidated Financial Statements.

**Other components of net periodic pension and OPEB expense** – We recognized other components of net periodic pension and OPEB expense of \$3.8 million and \$7.5 million in the second quarter and first six months of 2018 compared to \$4.3 million and \$8.4 million in the same periods of 2017. The expense declined in both periods primarily due to pension costs as a result of actuarial amortizations and expected returns on plan assets.

**Other General Corporate Items**— Corporate expenses were 69% higher in the second quarter of 2018 and 52% higher in the first six months of 2018 compared to the same periods in 2017. Corporate expenses increased in both periods due to higher administrative, litigation fees and related costs, and environmental remediation and related costs in 2018 compared to 2017. Included in corporate expense are:

• litigation and related costs at NL of \$2.1 million in the second quarter of 2018 compared to \$1.3 million in second quarter of 2017 and \$4.0 million in the first six months of 2018 compared to \$1.8 million in the first six months of 2017; and

• environmental remediation and related costs of \$.2 million in the second quarter of 2018 compared to \$.1 million in second quarter of 2017 and \$4.5 million in the first six months of 2018 compared to \$3.2 million in the first six months of 2017.

Overall, we currently expect that our net general corporate expenses in 2018 will be higher than in 2017 primarily due to higher expected litigation, environmental remediation and related costs and higher administrative expenses.

The level of our litigation and related expenses varies from period to period depending upon, among other things, the number of cases in which we are currently involved, the nature of such cases and the current stage of such cases (e.g. discovery, pre-trial motions, trial or appeal, if applicable). See Note 17 to our Condensed Consolidated Financial Statements. If our current expectations regarding the number of cases in which we expect to be involved during 2018,

or the nature of such cases, were to change our corporate expenses could be higher than we currently estimate.

Obligations for environmental remediation and related costs are difficult to assess and estimate, and it is possible that actual costs for environmental remediation and related costs will exceed accrued amounts or that costs will be incurred in the future for sites in which we cannot currently estimate the liability. If these events occur in 2018, our corporate expense could be higher than we currently estimate. In addition, we adjust our accruals for environmental remediation and related costs as further information becomes available to us or as circumstances change. Such further information or changed circumstances could result in an increase or reduction in our accrued environmental remediation and related costs. See Note 17 to our Condensed Consolidated Financial Statements.

Interest Expense— Interest expense increased to \$16.0 million in the second quarter of 2018 from \$14.7 million in the second quarter of 2017 and to \$31.4 million in the first six months of 2018 from \$29.2 million in the same period of 2017 primarily due to the net effects of higher average debt levels in 2018 and higher average interest rates on variable-rate indebtedness.

We expect interest expense will be higher in 2018 as compared to 2017 due to higher average debt levels and higher average interest rates on variable-rate indebtedness.

- 44 -

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Provision for Income Taxes (Benefit)—We recognized income tax expense of \$22.0 million in the second quarter of 2018 compared to an income tax benefit of \$100.8 million in the second quarter of 2017 and income tax expense of \$58.2 million in the first six months of 2018 compared to an income tax benefit of \$82.2 million in the first six months of 2017. The difference is primarily due to the effect of the reversal of our deferred income tax asset valuation allowance associated with our Chemicals Segment’s German and Belgian operations in 2017. Our earnings are subject to income tax in various U.S. and non-U.S. jurisdictions, and effective in 2018 the income tax rates applicable to our pre-tax earnings (losses) of our non-U.S. operations are generally higher than the income tax rates applicable to our U.S. operations. Excluding the effect of any increase or decrease in our deferred income tax asset valuation allowance or changes in our reserve for uncertain tax positions, we would generally expect our overall effective tax rate to be higher than the U.S. federal statutory tax rate of 21% primarily because of our non-U.S. operations. Prior to 2018, the income tax rates applicable to our pre-tax earnings (losses) of our non-U.S. operations were generally lower than the U.S. federal statutory tax rate of 35%. See Note 14 to our Condensed Consolidated Financial Statements for a tabular reconciliation of our statutory income tax provision to our actual tax provision.

Our Chemicals Segment has substantial net operating loss (“NOL”) carryforwards in Germany (the equivalent of \$652 million for German corporate purposes and \$.5 million for German trade tax purposes at December 31, 2017) and in Belgium (the equivalent of \$50 million for Belgian corporate tax purposes at December 31, 2017), all of which have an indefinite carryforward period. As a result, we have net deferred income tax assets with respect to these two jurisdictions, primarily related to these NOL carryforwards. The German corporate tax is similar to the U.S. federal income tax, and the German trade tax is similar to the U.S. state income tax. As discussed in the 2017 Annual Report, commencing June 30, 2015, our Chemicals Segment concluded that we were required to recognize a non-cash deferred income tax asset valuation allowance under the more-likely-than-not recognition criteria with respect to our Chemicals Segment’s German and Belgian net deferred income tax assets at such date. During the first six months of 2017, we recognized an aggregate non-cash deferred income tax benefit of \$12.7 million as a result of a net decrease in such deferred income tax asset valuation allowance, due to utilizing a portion of both the German and Belgian NOL during the period, including \$7.7 million in the second quarter of 2017. As also discussed in the 2017 Annual Report, at June 30, 2017, we concluded we had sufficient positive evidence under the more-likely-than-not recognition criteria to support reversal of the entire valuation allowance related to our German and Belgian operations. In accordance with the ASC 740-270 guidance regarding accounting for income taxes at interim dates, the amount of the valuation allowance reversed at June 30, 2017 (\$149.9 million, of which \$141.9 million related to Germany and \$8.0 million related to Belgium) relates to our change in judgment at that date regarding the realizability of the related deferred income tax asset as it relates to future years (i.e. 2018 and after). A change in judgment regarding the realizability of deferred tax assets as it relates to the current year is considered in determining the estimated annual effective tax rate for the year and is recognized throughout the year, including interim periods subsequent to the date of the change in judgment. Accordingly, our income tax benefit in calendar 2017 includes an aggregate non-cash deferred income tax benefit of \$186.7 million related to the reversal of the German and Belgian valuation allowance, comprised of \$12.7 million recognized in the first half of 2017 (noted above) related to the utilization of a portion of both the German and Belgian NOLs during such period, \$149.9 million related to the portion of the valuation allowance reversed as of June 30, 2017 and \$24.1 million recognized in the second half of 2017 related to the utilization of a portion of both the German and Belgian NOLs during such period. Our deferred income tax asset valuation allowance increased \$13.7 million in 2017 as a result of changes in currency exchange rates, which increase was recognized as part of other comprehensive income (loss).

As discussed in the 2017 Annual Report, on December 22, 2017, the 2017 Tax Act was enacted into law. This new tax legislation, among other changes, (i) reduced the U.S. Federal corporate income tax rate from 35% to 21% effective January 1, 2018; (ii) implemented a territorial tax system and imposed a one-time repatriation tax (“Transition Tax”) on the deemed repatriation of the post-1986 undistributed earnings of non-U.S. subsidiaries accumulated up through December 31, 2017, regardless of whether such earnings are repatriated; (iii) eliminated U.S. tax on future non-U.S. earnings (subject to certain exceptions); (iv) eliminated the domestic production activities deduction



beginning in 2018; (v) eliminated the net operating loss carryback and provides for an indefinite carryforward period subject to an 80% annual usage limitation; (vi) allows for the expensing of certain capital expenditures; (vii) imposed a tax on global intangible low-tax income (“GILTI”) beginning in 2018; (viii) imposed a base erosion anti-abuse tax (“BEAT”) beginning in 2018; and (ix) amended the rules limiting the deduction for business interest expense beginning in 2018. Following the enactment of the 2017 Tax Act, the Securities and Exchange Commission issued Staff Accounting Bulletin (“SAB”) 118 to provide guidance on the accounting and reporting impacts of the 2017 Tax Act. SAB 118 states that companies should account for changes related to the 2017 Tax Act in the period of enactment if all information is available and the accounting can be completed. In situations where companies do not have enough information to complete the accounting in the period of enactment, a company must either 1) record an estimated provisional amount if the impact of the change can be reasonably estimated; or 2) continue to apply the accounting guidance that was in effect immediately prior to the 2017 Tax Act if the impact of the change cannot be reasonably estimated. If estimated provisional amounts are recorded, SAB 118 provides a measurement period of no longer than one year during which companies should adjust those amounts as additional information becomes available in the reporting period within the measurement period in which such adjustment is determined.

Under GAAP, we are required to revalue our net deferred tax liability associated with our U.S. net deductible temporary differences in the period in which the new tax legislation is enacted based on deferred tax balances as of the enactment date, to reflect

the effect of such reduction in the corporate income tax rate. Our temporary differences as of December 31, 2017 were not materially different from our temporary differences as of the enactment date, accordingly revaluation of our net taxable temporary differences was based on our net deferred tax as of December 31, 2017. Such revaluation resulted in a provisional non-cash deferred income tax benefit of \$77.1 million recognized as of December 31, 2017 in continuing operations, reducing our net deferred income tax liability. The amounts recorded as of December 31, 2017 as a result of the 2017 Tax Act represent estimates based on information currently available. We have not made any additional measurement-period adjustments to the provisional amounts recorded for this item during the first six months of 2018 because we are still waiting on additional guidance that may impact the income tax effects of the new legislation recognized at December 31, 2017. We will complete our accounting for this item within the prescribed measurement period ending December 22, 2018, pursuant to the guidance under SAB 118, and if we determine an adjustment to the provisional amount recognized at December 31, 2017 is required, we will recognize such adjustment in the reporting period within the SAB 118 measurement period in which such adjustment is determined.

Prior to the enactment of the 2017 Tax Act, the undistributed earnings of our Chemicals Segment European subsidiaries were deemed to be permanently reinvested (we had not made a similar determination with respect to the undistributed earnings of our Chemicals Segment Canadian subsidiary). Pursuant to the Transition Tax provisions imposing a one-time repatriation tax on post-1986 undistributed earnings, we recognized a provisional current income tax expense of \$76.2 million in the fourth quarter of 2017. The amounts recorded as of December 31, 2017 as a result of the 2017 Tax Act represent estimates based on information currently available. We elected to pay such tax over an eight year period beginning in 2018, including approximately \$6.1 million which was paid in April 2018 (for the 2017 tax year) and \$3.1 million which was paid in June 2018 (for the 2018 tax year). Of the remaining \$67.0 million, \$64.0 million is recorded as a noncurrent payable to affiliate (income taxes payable to Contran) classified as a noncurrent liability in our Condensed Consolidated Balance Sheet and \$3.0 million is included with our current payable to affiliate (income taxes payable to Contran) classified as a current liability. Such remaining amount will be paid in quarterly increments over the remainder of the eight year period. We have not made any measurement-period adjustments to the provisional amounts recorded for this item during the first six months of 2018 because no new information became available during the period that required an adjustment. We are continuing to gather information and await further guidance, primarily from the state jurisdictions in which we operate, and given the complexities of these new rules and the long time period over which information about our subsidiaries is needed, further guidance is necessary in order to determine the amount of the Transition Tax, which may impact the Transition Tax recognized in the fourth quarter of 2017. We will complete our accounting for this item within the prescribed measurement period ending December 22, 2018, pursuant to the guidance under SAB 118, and if we determine an adjustment to the provisional amount recognized at December 31, 2017 is required, we will recognize such adjustment in the reporting period within the SAB 118 measurement period in which such adjustment is determined.

Prior to the enactment of the 2017 Tax Act the undistributed earnings of our Chemicals Segment European subsidiaries were deemed to be permanently reinvested (we had not made a similar determination with respect to the undistributed earnings of our Chemicals Segment Canadian subsidiary). As a result of the implementation of a territorial tax system under the 2017 Tax Act, effective January 1, 2018, and the Transition Tax which in effect taxes the post-1986 undistributed earnings of our non-U.S. subsidiaries accumulated up through December 31, 2017, we determined effective December 31, 2017 that all of the post-1986 undistributed earnings of our European subsidiaries are not permanently reinvested. Accordingly, in the fourth quarter of 2017 we recognized an aggregate provisional non-cash deferred income tax expense of \$5.3 million based on our reasonable estimates of the U.S. state and non-U.S. income tax and withholding tax liability attributable to all of such previously-considered permanently reinvested undistributed earnings through December 31, 2017. The amounts recorded as of December 31, 2017 as a result of the 2017 Tax Act represent estimates based on information currently available. We have not made any measurement-period adjustments to the provisional amounts recorded at December 31, 2017 for this item during the

first six months of 2018. However, we recorded a provisional non-cash deferred income tax expense of \$2.3 million for the estimated U.S. state and non-U.S. income tax and withholding tax liability attributable to the 2018 undistributed earnings of our non-U.S. subsidiaries in the first six months of 2018, including withholding taxes related to the undistributed earnings of Kronos' Canadian subsidiary. We are continuing our review of certain other provisions under the 2017 Tax Act and waiting on further guidance primarily from the state jurisdictions in which we operate that may impact our determination of the aggregate temporary differences attributable to our investments in our non-U.S. subsidiaries. We will complete our accounting for this item within the prescribed measurement period ending December 22, 2018, pursuant to the guidance under SAB 118, and if we determine an adjustment to the provisional amount recognized at December 31, 2017 and June 30, 2018 are required, we will recognize such adjustment in the reporting period within the SAB 118 measurement period in which such adjustment is determined.

Under U.S. GAAP, as it relates to the new GILTI tax rules, we are allowed to make an accounting policy choice of either (1) treating taxes due on future U.S. inclusions in taxable income related to GILTI as a current-period expense when incurred (the "period cost method") or (2) factoring such amounts into the measurement of our deferred taxes (the "deferred method"). Our selection of an accounting policy related to the GILTI tax provisions will depend, in part, on analyzing our global income to determine whether we expect to have future U.S. inclusions in taxable income related to GILTI and, if so, what the impact is expected to be. While our future global operations depend on a number of different factors, we do expect to have future U.S. inclusions in taxable income related to GILTI. As such, we performed an analysis of GILTI's impact on our provision and determined the impact is not material. Because

the impact is not material to our tax provision, we have not recorded any adjustments related to potential GILTI tax in our financial statements in the first six months of 2018. Further, we have not made a policy decision regarding whether to record deferred taxes on GILTI or record GILTI tax as a current-period expense when incurred. We will complete our policy election for this item within the prescribed measurement period ending December 22, 2018, pursuant to the guidance under SAB 118 and if we determine such policy election impacts our provision, we will recognize an adjustment in the reporting period within the SAB 118 measurement period in which such adjustment is determined. Similarly, we have evaluated the tax impact of BEAT on our tax provision in the first six months of 2018 and determined that the tax law has no material impact on our tax provision as we have historically not entered into international payments between related parties that are unrelated to cost of goods sold.

**Discontinued Operations**—On January 26, 2018, we completed the sale of the Waste Management Segment to JFL-WCS Partners, LLC, an entity sponsored by certain investment affiliates of J.F. Lehman & Company, for consideration consisting of the assumption of all of the Waste Management Segment's third-party indebtedness and other liabilities. We recognized a pre-tax gain of approximately \$58 million on the transaction in the first quarter of 2018 because the carrying value of the liabilities of the business assumed by the purchaser exceeded the carrying value of the assets sold in large part due to the long-lived asset impairment of \$170.6 million recognized in the second quarter of 2017 with respect to our Waste Management Segment. Such pre-tax gain is classified as part of discontinued operations. See Note 3 to our Consolidated Financial Statements for additional information.

**Noncontrolling Interest in Net Income (Loss) of Subsidiaries**—Noncontrolling interest in operations of subsidiaries decreased from 2017 to 2018 primarily due to decreased earnings at Kronos.

## LIQUIDITY AND CAPITAL RESOURCES

### 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 our operating income. In addition to the impact of the operating, investing and financing cash flows discussed below, changes in the amount of cash, cash equivalents and restricted cash we report from period to period can be impacted by changes in currency exchange rates, since a portion of our cash, cash equivalents and restricted cash is held by our non-U.S. subsidiaries.

Cash flows from operating activities increased to \$159.7 million in the first six months of 2018 from \$88.7 million in the first six months of 2017. This \$71.0 million increase in cash provided by operations was primarily due to the net effect of the following items:

- consolidated operating income of \$248.8 million in the first six months of 2018, an improvement of \$101.6 million compared to an operating income of \$147.2 million in the first six months of 2017;
- lower net cash paid for income taxes in 2018 of \$20.4 million resulting from timing of tax payments;
- lower net distributions from our TiO<sub>2</sub> manufacturing joint venture in 2018 of \$3.6 million, primarily due to the timing of the joint venture's working capital; and
- a \$19.3 million decrease in the amount of net cash used in relative changes in receivables, inventories, payables and accrued liabilities in the first six months of 2018.

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

•Kronos' average days sales outstanding ("DSO") increased from December 31, 2017 to June 30, 2018, primarily as a result of relative changes in the timing of collections.

•Kronos' average days sales in inventory ("DSI"), increased from December 31, 2017 to June 30, 2018 principally due to higher inventory volumes.

•CompX's average DSO increased from December 31, 2017 to June 30, 2018. Generally, we expect our average days sales outstanding to increase from December to June as the result of a seasonal increase in sales during the second quarter as compared to the fourth quarter. Overall, our June 30, 2018 days sales outstanding compared to December 31, 2017 is in line with our expectations.

•CompX's average DSI decreased from December 31, 2017 to June 30, 2018 primarily as a result of the seasonal increase in sales during the second quarter 2018 as compared to the fourth quarter of 2017.

- 47 -

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For comparative purposes, we have also provided comparable prior period numbers below.

|                         | December 31,<br>2016 | June 30,<br>2017 | December 31,<br>2017 | June 30,<br>2018 |
|-------------------------|----------------------|------------------|----------------------|------------------|
| <b>Kronos:</b>          |                      |                  |                      |                  |
| Days sales outstanding  | 65 days              | 68 days          | 63 days              | 70 days          |
| Days sales in inventory | 71 days              | 52 days          | 62 days              | 68 days          |
| <b>CompX:</b>           |                      |                  |                      |                  |
| Days sales outstanding  | 36 days              | 37 days          | 38 days              | 39 days          |
| Days sales in inventory | 79 days              | 68 days          | 79 days              | 71 days          |

We do not have complete access to the cash flows of our majority-owned subsidiaries, due in part to limitations contained in certain credit agreements of our subsidiaries and because we do not own 100% of these subsidiaries. A detail of our consolidated cash flows from operating activities is presented in the table below. Intercompany dividends have been eliminated.

|   | Six months<br>ended |                |
|---|---------------------|----------------|
|   | June 30,<br>2017    | 2018           |
|   | (In millions)       |                |
| <b>Cash provided by (used in) operating activities:</b> |                     |                |
| Valhi exclusive of its subsidiaries                     | \$(2.2 )            | \$27.8         |
| Kronos  | 101.5               | 169.7          |
| NL exclusive of its subsidiaries                        | 6.4                 | 7.2            |
| CompX   | 4.3                 | 6.1            |
| BMI   | 1.3                 | .1             |
| LandWell  | (.9 )               | (3.5 )         |
| WCS   | 8.8                 | 2.3            |
| Tremont exclusive of its subsidiaries                   | (1.2 )              | 4.6            |
| Eliminations  | (29.3 )             | (54.6 )        |
| <b>Total</b>  | <b>\$88.7</b>       | <b>\$159.7</b> |

#### Investing Activities –

We spent \$27.6 million in capital expenditures during the first six months of 2018 including:

- \$24.8 million in our Chemicals Segment;
- \$1.4 million in our Component Products Segment;
- \$1.3 million in our Real Estate Management and Development Segment; and
- \$.1 million in our former Waste Management Segment prior to its sale.

We received cash proceeds from the sale of land not used in our operations of \$19.5 million in the first quarter of 2018.

Financing Activities—

During the six months ended June 30, 2018, we:

repaid \$2.2 million under Tremont's promissory note payable; and  
paid quarterly dividends to Valhi stockholders aggregating \$.04 per share (\$13.6 million).

The declaration and payment of future dividends, and the amount thereof, is discretionary and is dependent upon these and other factors deemed relevant by our Board of Directors. The amount and timing of past dividends is not necessarily indicative of the amount or timing of any future dividends which might be paid. There are currently no contractual restrictions on the amount of dividends which we may pay. Distributions to noncontrolling interest in subsidiaries in the first six months of 2018 are comprised of CompX dividends paid to shareholders other than NL and Kronos dividends paid to shareholders other than us and NL.

- 48 -

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## Outstanding Debt Obligations

At June 30, 2018, our consolidated indebtedness attributable to continuing operations was comprised of:

- Valhi's \$250 million loan from Snake River Sugar Company due in 2027;
- Valhi's \$320.6 million outstanding on its \$360 million credit facility with Contran which is due no earlier than December 31, 2019;
- €400 million aggregate outstanding on our new KII 3.75% Senior Secured Notes (\$458.6 million carrying amount, net of unamortized debt issuance costs) due in September 2025;
- Tremont's promissory note payable (\$10.9 million outstanding) due in December 2023;
- \$18.9 million on BMI's bank loan (\$18.0 million carrying amount, net of unamortized debt issuance costs), due through June 2032;
- \$2.3 million on LandWell's note payable to the City of Henderson due in October 2020; and
- approximately \$2.9 million of other indebtedness, primarily capital lease obligations.

Certain of our credit facilities require the respective borrowers to maintain a number of covenants and restrictions which, among other things, restrict our ability to incur additional debt, incur liens, pay dividends or merge or consolidate with, or sell or transfer substantially all of our assets to, another entity, and contain other provisions and restrictive covenants customary in lending transactions of this type. Certain of our credit agreements contain provisions which could result in the acceleration of indebtedness prior to their stated maturity for reasons other than defaults for failure to comply with typical financial or payment covenants. For example, certain credit agreements allow the lender to accelerate the maturity of the indebtedness upon a change of control (as defined in the agreement) of the borrower. In addition, certain credit agreements could result in the acceleration of all or a portion of the indebtedness following a sale of assets outside the ordinary course of business. Kronos' North American and European revolvers contain a number of covenants and restrictions which, among other things, restrict its ability to incur additional debt, incur liens, pay dividends or merge or consolidate with, or sell or transfer substantially all of its assets to, another entity, and contains other provisions and restrictive covenants customary in lending transactions of this type. Kronos' European revolving credit facility also requires the maintenance of certain financial ratios, and one of such requirements is based on the ratio of net debt to the last twelve months EBITDA of the borrowers. The terms of all of our debt instruments (including revolving lines of credit for which we have no outstanding borrowings at June 30, 2018) are discussed in Note 9 to our 2017 Annual Report. We are in compliance with all of our debt covenants at June 30, 2018. We believe that we will be able to continue to comply with the financial covenants contained in our credit facilities through their maturity; however, if future operating results differ materially from our expectations we may be unable to maintain compliance.

## Future Cash Requirements

### Liquidity –

Our primary source of liquidity on an ongoing basis is our cash flows from operating activities and borrowings under various lines of credit and notes. We generally use these amounts 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 us by our subsidiaries) or treasury stock purchases. From time-to-time we 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 our subsidiaries and affiliates) or (iv) fund major capital expenditures or the acquisition of other assets outside the ordinary course of business. Occasionally we sell assets outside the ordinary course of business, and we generally use the proceeds 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.



We routinely compare our liquidity requirements and alternative uses of capital against the estimated future cash flows we expect to receive from our subsidiaries, and the estimated sales value of those units. As a result of this process, we have in the past sought, and may in the future seek, to raise additional capital, refinance or restructure indebtedness, repurchase indebtedness in the market or otherwise, modify our dividend policies, consider the sale of our interests in our subsidiaries, affiliates, business units, marketable securities or other assets, or take a combination of these and other steps, to increase liquidity, reduce indebtedness and fund future activities. Such activities have in the past and may in the future involve related companies. From time to time, we and our subsidiaries may enter into intercompany loans as a cash management tool. Such notes are structured as revolving demand notes and pay and receive interest on terms we believe are generally more favorable than current debt and investment market rates. The companies that borrow under these notes have sufficient liquidity to repay the notes. All of these notes and related interest expense and income are eliminated in our Condensed Consolidated Financial Statements.

- 49 -

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

We believe we will be able to comply with the financial covenants contained in our credit facilities through their maturities; however, if future operating results differ materially from our expectations we may be unable to maintain compliance. Based upon our expectations of our operating performance, and the anticipated demands on our cash resources, we expect to have sufficient liquidity to meet our short-term (defined as the twelve-month period ending June 30, 2019) and long-term obligations (defined as the five-year period ending June 30, 2023). If actual developments differ from our expectations, our liquidity could be adversely affected.

At June 30, 2018, we had credit available under existing facilities of \$262.2 million, which was comprised of:

\$104.7 <sup>(1)</sup> million under Kronos' European revolving credit facility;  
 \$118.1 million under Kronos' North American revolving credit facility; and  
 \$39.4 <sup>(2)</sup> million under Valhi's Contran credit facility.

(1)Based on Kronos' EBITDA over the last twelve months ending June 30, 2018, the full €90.0 million amount is available for borrowing at such date

(2)Amounts available under this facility are at the sole discretion of Contran.

At June 30, 2018, we had an aggregate of \$586.3 million of restricted and unrestricted cash, cash equivalents and marketable securities, including \$173.5 held by our non-U.S. subsidiaries. Following implementation of a territorial tax system under the 2017 Tax Act, repatriation of any cash and cash equivalents held by our non-U.S. subsidiaries would not be expected to result in any material income tax liability as a result of such repatriation. A detail by entity is presented in the table below.

|   | Total         | Amount<br>held outside<br>U.S. |
|---|---------------|--------------------------------|
|   | (In millions) |                                |
| Kronos  | \$433.3       | \$ 173.4                       |
| CompX   | 33.7          | —                              |
| NL exclusive of its subsidiaries  | 82.0          | .1                             |
| Tremont exclusive of its subsidiaries   | 8.5           | —                              |
| LandWell  | 13.0          | —                              |
| BMI   | 15.7          | —                              |
| Valhi exclusive of its subsidiaries   | .1            | —                              |
| Total restricted and unrestricted cash, cash equivalents and<br>marketable securities | \$586.3       | \$ 173.5                       |

#### Capital Expenditures and Other –

We currently expect our aggregate capital expenditures for 2018 will be approximately \$79 million as follows:

- \$67 million by our Chemicals Segment, including approximately \$26 million in the area of environmental compliance, protection and improvement;  
\$4 million by our Component Products Segment; and  
\$8 million by our Real Estate Management and Development Segment.

Our Waste Management Segment spent approximately \$.1 million in capitalized expenditures in 2018 prior to the sale in January. In addition LandWell expects to spend approximately \$15 million on land development costs during 2018 (which are included in the determination of cash provided by operating activities).

Capital spending for 2018 is expected to be funded primarily through cash generated from operations and borrowing under existing credit facilities. Planned capital expenditures in 2018 at Kronos and CompX will primarily be to maintain and improve the cost-effectiveness of our facilities. In addition, Kronos' capital expenditures in the area of environmental compliance, protection and improvement include expenditures which are primarily focused on increased operating efficiency but also result in improved environmental protection, such as lower emissions from our manufacturing plants.

- 50 -

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Repurchases of Common Stock –

We, Kronos and CompX have programs to repurchase common stock from time to time as market conditions permit. These stock repurchase programs do not include specific price targets or timetables and may be suspended at any time. Depending on market conditions, these programs may be terminated prior to completion. Cash on hand will be used to acquire the shares and repurchased shares will be added to treasury shares and cancelled.

At June 30, 2018 Valhi had approximately 4.0 million shares of our common stock available to repurchase under the authorizations made by our board of directors.

Kronos' board of directors authorized the repurchase of up to 2.0 million shares of its common stock in open market transactions, including block purchases, or in privately-negotiated transactions at unspecified prices and over an unspecified period of time. Kronos may repurchase its common stock from time to time as market conditions permit. At June 30, 2018 approximately 1.95 million shares are available for repurchase.

CompX's board of directors authorized the repurchase of its Class A common stock in open market transactions, including block purchases, or in privately-negotiated transactions at unspecified prices and over an unspecified period of time. At June 30, 2018 approximately 678,000 shares were available for purchase under these authorizations.

Dividends –

Because our operations are conducted primarily through subsidiaries and affiliates, our long-term ability to meet parent company level corporate obligations is largely dependent on the receipt of dividends or other distributions from our subsidiaries and affiliates. Kronos paid a regular dividend of \$.15 per share in each quarter of 2017 for which we received \$34.8 million. In the first quarter of 2018 Kronos announced it was increasing its regular dividend to \$.17 per share. If Kronos were to pay its \$.17 per share in each quarter of 2018 based on the 58.0 million shares we held of Kronos common stock at June 30, 2018, we would receive aggregate annual regular dividends from Kronos of \$39.4 million. NL has not paid a dividend since prior to 2015 and we do not know if we will receive any cash dividends from NL during 2018. BMI and LandWell do pay cash dividends from time to time, but the timing and amount of such dividends are uncertain. In this regard, we received aggregate dividends from BMI and LandWell of \$5.8 million in 2017. We do not know if we will receive additional distributions from BMI and LandWell during 2018. All of our ownership interest in CompX is held through our ownership in NL; as such we do not receive any dividends from CompX. Instead any dividend paid by CompX is paid to NL.

Our subsidiaries have various credit agreements with unrelated third-party lenders which contain customary limitations on the payment of dividends, typically a percentage of net income or cash flow; however, these restrictions in the past have not significantly impacted their ability to pay dividends.

Investment in our Subsidiaries and Affiliates and Other Acquisitions –

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

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

We generally do not guarantee any indebtedness or other obligations of our subsidiaries or affiliates. Our subsidiaries are not required to pay us dividends. If one or more of our subsidiaries were unable to maintain its current level of dividends, either due to restrictions contained in a credit agreement or to satisfy its liabilities or otherwise, our ability to service our liabilities or to pay dividends on our common stock could be adversely impacted. If this were to occur, we might consider reducing or eliminating our dividends or selling interests in subsidiaries or other assets. If we were required to liquidate assets to generate funds to satisfy our liabilities, we might be required to sell at what we believe would be less than what we believe is the long-term value of such assets.

Prior to its sale in January 2018, WCS' primary source of liquidity consisted of intercompany borrowings from one of our wholly-owned subsidiaries under the terms of a revolving credit facility. We eliminated these intercompany borrowings in our Condensed Consolidated Financial Statements. WCS has borrowed substantial amounts from us over the years. Effective with the sale in January 2018, the outstanding balance under this facility of \$35.7 million was contributed to equity and the intercompany note was terminated.

In November 2016 we entered into a \$50 million revolving credit facility with a subsidiary of NL secured with approximately 35.2 million shares of the common stock of Kronos Worldwide, Inc. held by NL's subsidiary as collateral. Outstanding borrowings

under the credit facility bear interest at the prime rate plus 1.875% per annum, payable quarterly, with all amounts due on December 31, 2023. The maximum principal amount which may be outstanding from time-to-time under the credit facility is limited to 50% of the amount of the most recent closing price of the Kronos stock. The credit facility contains a number of covenants and restrictions which, among other things, restrict NL's subsidiary's ability to incur additional debt, incur liens, and merge or consolidated with, or sell or transfer substantially all of NL's subsidiary's assets to, another entity, and require NL's subsidiary to maintain a minimum specified level of consolidated net worth. Upon an event of default (as defined in the credit facility), Valhi will be entitled to terminate its commitment to make further loans to NL's subsidiary, declare the outstanding loans (with interest) immediately due and payable, and exercise its rights with respect to the collateral under the Loan Documents. Such collateral rights include, upon certain insolvency events with respect to NL's subsidiary or NL, the right to purchase all of the Kronos common stock at a purchase price equal to the aggregate market value, less amounts owing to Valhi under the Loan Documents, and up to 50% of such purchase price may be paid by Valhi in the form of an unsecured promissory note bearing interest at the prime rate plus 2.75% per annum, payable quarterly, with all amounts due no later than five years from the date of purchase, with the remainder of such purchase price payable in cash at the date of purchase. We also eliminate any such intercompany borrowings in our Condensed Consolidated Financial Statements. During 2016 NL's subsidiary borrowed \$.5 million under this facility, no additional amounts have been borrowed, and \$.5 million is outstanding under this facility at June 30, 2018.

We have an unsecured revolving demand promissory note with Kronos which, as amended, provides for borrowings from Kronos of up to \$60 million. We also eliminate any such intercompany borrowings in our Condensed Consolidated Financial Statements. The facility, as amended, is due on demand, but in any event no earlier than December 31, 2019. We had gross borrowings of \$2.6 million and gross repayments of \$16.2 million during the first six months of 2018, and no amount was outstanding under this facility at June 30, 2018. We could borrow an additional \$60 million under our current intercompany facility with Kronos at June 30, 2018. Kronos' obligation to loan us money under this note is at Kronos' discretion.

We also have an unsecured revolving demand promissory note with CompX which, as amended, provides for borrowings from CompX of up to \$40 million. We also eliminate these intercompany borrowings in our Condensed Consolidated Financial Statements. The facility, as amended, is due on demand, but in any event no earlier than December 31, 2019. We had gross borrowings of \$25.3 million and gross repayments of \$25.9 million during the first six months of 2018, and a total outstanding balance of \$37.6 million at June 30, 2018. We could borrow an additional \$2.4 million under our current intercompany facility with CompX at June 30, 2018. CompX's obligation to loan us money under this note is at CompX's discretion.

#### Investment in The Amalgamated Sugar Company LLC –

The terms of The Amalgamated Sugar Company LLC Company Agreement provide for an annual "base level" of cash dividend distributions (sometimes referred to as distributable cash) by the LLC of \$26.7 million, from which we are entitled to a 95% preferential share. Distributions from the LLC are dependent, in part, upon the operations of the LLC. We record dividend distributions from the LLC as income when they are declared by the LLC, which is generally the same month in which we receive the distributions, although 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, we are 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 2017, we expect distributions received from the LLC in 2018 will exceed our debt service requirements under our \$250 million loans

from Snake River Sugar Company by approximately \$1.8 million.

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

On May 30, 2018, we entered into an agreement with the LLC in which we agreed to sell our interest in Amalgamated for consideration consisting of \$12.5 million in cash and the deemed payment in full of our \$250 million in loans we owe Snake River. Closing of the sale is scheduled for August 31, 2018 and is contingent on Snake River obtaining all required consents of the secured lenders of Snake River and Amalgamated, see Notes 6 and 8 to our Condensed Consolidated Financial Statements.

#### Off-balance Sheet Financing

We do not have any off-balance sheet financing agreements other than the operating leases discussed in our 2017 Annual Report.

#### Commitments and Contingencies

There have been no material changes in our contractual obligations since we filed our 2017 Annual Report and we refer you to that report for a complete description of these commitments.

We are subject to certain commitments and contingencies, as more fully described in Notes 14 and 18 to our 2017 Annual Report, or in Notes 14 and 17 to our Condensed Consolidated Financial Statements and in Part II, Item 1 of this Quarterly Report, including:

- certain income tax contingencies in various U.S. and non-U.S. jurisdictions;
- certain environmental remediation matters involving NL, and BMI;
- certain litigation related to NL's former involvement in the manufacture of lead pigment and lead-based paint; and
- certain other litigation to which we are a party.

In addition to such legal proceedings various legislation and administrative regulations have, from time to time, been proposed that seek to (i) impose various obligations on present and former manufacturers of lead pigment and lead-based paint (including NL) 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 our consolidated financial position, results of operations or liquidity, enactment of such legislation could have such an effect.

#### Recent Accounting Pronouncements

See Note 19 to our Condensed Consolidated Financial Statements.

#### Critical Accounting Policies

There have been no changes in the first six months of 2018 with respect to our critical accounting policies presented in Management's Discussion and Analysis of Financial Condition and Results of Operation in our 2017 Annual Report.



### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to market risk, including currency exchange rates, interest rates and security prices, and raw material prices. There have been no material changes in these market risks since we filed our 2017 Annual Report, and refer you to Part I, Item 7A.—“Quantitative and Qualitative Disclosure About Market Risk” in our 2017 Annual Report. See also Note 18 to our Condensed Consolidated Financial Statements.

We have substantial operations located outside the United States for which the functional currency is not the U.S. dollar. As a result, our assets and liabilities, results of operations and cash flows will fluctuate based upon changes in currency exchange rates.

We periodically use currency forward contracts to manage a nominal portion of currency exchange rate market risk associated with trade receivables, or similar exchange rate risk associated with future sales, denominated in a currency other than the holder’s functional currency. These contracts generally relate to our Chemicals Segment’s operations. We have not entered into these contracts for trading or speculative purposes in the past, nor do we currently anticipate entering into such contracts for trading or speculative purposes in the future. Some of the currency forward contracts we enter into meet the criteria for hedge accounting under GAAP and are designated as cash flow hedges. For these currency forward contracts, gains and losses representing the effective portion of our hedges are deferred as a component of accumulated other comprehensive income, and are subsequently recognized in earnings at the time the hedged item affects earnings. For the currency forward contracts we enter into which do not meet the criteria for hedge accounting, we mark-to-market the estimated fair value of such contracts at each balance sheet date, with any resulting gain or loss recognized in income currently as part of net currency transactions.

### ITEM 4. CONTROLS AND PROCEDURES

#### Evaluation of Disclosure Controls and Procedures—

We maintain disclosure controls and procedures which, as defined in Exchange Act Rule 13a-15(e), means controls and other procedures that are designed to ensure that information required to be disclosed in the reports we file or submit to the SEC under the Securities Exchange Act of 1934, as amended (the “Act”), is recorded, processed, summarized and reported, within the time periods specified in the SEC’s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information we are required to disclose in the reports we file or submit to the SEC under the Act is accumulated and communicated to our management, including our principal executive officer and our principal financial officer, or persons performing similar functions, as appropriate to allow timely decisions to be made regarding required disclosure. Each of Robert D. Graham, our Vice Chairman of the Board, President and Chief Executive Officer, and Gregory M. Swalwell, our Executive Vice President, Chief Financial Officer and Chief Accounting Officer, have evaluated the design and effectiveness of our disclosure controls and procedures as of June 30, 2018. Based upon their evaluation, these executive officers have concluded that our disclosure controls and procedures were effective as of the date of such evaluation.

#### Management’s report on internal control over financial reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting which, as defined by Exchange Act Rule 13a-15(f) means a process designed by, or under the supervision of, our principal executive and principal financial officers, or persons performing similar functions, and effected by the board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial

reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles, and includes those policies and procedures that:

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

- 54 -

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Other

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

Changes in internal control over financial reporting

In January 2018, our Chemicals Segment implemented a new enterprise resource planning system covering sales, procurement, manufacturing and plant maintenance. We believe we have maintained appropriate internal control over financial reporting during such implementation period. There has been no other change to our internal control over financial reporting during the quarter ended June 30, 2018 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Part II. OTHER INFORMATION

Item 1. Legal Proceedings.

Refer to Note 17 to our Condensed Consolidated Financial Statements and our 2017 Annual Report for descriptions of certain legal proceedings.

Item 1A. Risk Factors.

For a discussion of the risk factors related to our businesses, please refer to Part I, Item 1A, "Risk Factors," in our 2017 Annual report. There have been no material changes to such risk factors during the first six months of 2018.

Item 6. Exhibits.

| Item No. | Exhibit Index                                 |
|----------|---|
| 31.1     | <u>Certification</u>                          |
| 31.2     | <u>Certification</u>                          |
| 32.1     | <u>Certification</u>                          |
| 101.INS  | XBRL Instance Document                        |
| 101.SCH  | XBRL Taxonomy Extension Schema                |
| 101.CAL  | XBRL Taxonomy Extension Calculation Linkbase  |
| 101.DEF  | XBRL Taxonomy Extension Definition Linkbase   |
| 101.LAB  | XBRL Taxonomy Extension Label Linkbase        |
| 101.PRE  | XBRL Taxonomy Extension Presentation Linkbase |

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 August 8, 2018 /s/ Gregory M. Swalwell  
Gregory M. Swalwell

(Executive Vice President, Chief Financial Officer and Chief Accounting Officer)

Date August 8, 2018 /s/ Amy Allbach Samford  
Amy Allbach Samford

(Vice President and Controller)