OM GROUP INC
Form 10-K
February 28, 2007

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 2006 — Commission file number 001-12515

OR

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

OM GROUP, INC.
(Exact name of Registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	**52-1736882** (I.R.S. Employer Identification No.)
127 Public Square, **1500 Key Tower,** **Cleveland, Ohio** (Address of principal executive offices)	**44114-1221** (Zip Code)

216-781-0083
Registrant s telephone number, including area code

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

Title of each class	Name of each exchange on which registered
Common Stock, par value $0.01 per share	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:
None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes o No x

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the Registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.
Large accelerated filer x Accelerated filer o Non-accelerated filer o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of Act). Yes o No x

The aggregate market value of Common Stock, par value $.01 per share, held by nonaffiliates (based upon the closing sale price on the NYSE) on June 30, 2006 was approximately $904.7 million.

As of January 31, 2007 there were 29,749,821 shares of Common Stock, par value $.01 per share, outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Company s Proxy Statement for the 2007 Annual Meeting of Stockholders are incorporated by reference in Part III.

OM Group, Inc.

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PART I

Item 1. Business

General

OM Group, Inc. (OMG or the Company) is a leading, vertically integrated international producer and marketer of value-added, metal-based specialty chemicals and related materials. The Company applies proprietary technology to unrefined cobalt and other raw materials to market more than 775 different product offerings to approximately 1,900 customers in 40 industries. The Company believes that its focus on metal-based specialty chemicals and related materials as a core business and backward raw material integration is a critical component of the Company s current business model.

On November 17, 2006, the Company entered into a definitive agreement to sell its Nickel business to Norilsk Nickel (Norilsk) for $408.0 million in cash, on a debt-free/cash-free basis, plus a potential post-closing adjustment for net working capital. The Nickel business consists of the Harjavalta, Finland nickel refinery, the Cawse, Australia nickel mine and intermediate refining facility, a 20% equity interest in MPI Nickel Pty. Ltd. and an 11% ownership interest in Talvivaara Mining Company, Ltd. The sale of the Nickel business, which is subject to customary closing conditions, is expected to close on or about March 1, 2007.

The Company expects to use the proceeds of the transaction to improve its financial flexibility and strengthen its position to grow operations, including through potential strategic acquisitions and increased new product development. The transaction represents an important step in the Company s effort to re-tool the existing business model into one that delivers more predictable and sustainable financial results, and better position itself to continue to build long-term value for shareholders. The transaction allows the Company to achieve the following objectives in its strategic transformation into a diversified specialty chemicals and advanced materials company: (i) focus on the Company s strengths in developing and producing value-added specialty products for customers that serve dynamic markets; (ii) lessen the impact of metal price volatility and improve earnings predictability; and (iii) enhance the Company s balance sheet and financial flexibility to support the Company s aggressive growth plans.

The Company will enter into five-year supply agreements with Norilsk for cobalt and nickel raw materials that are critical components for the Company s Specialties segment products. The transaction allows the Company to partner with Norilsk, the world s largest producer of nickel and palladium and one of the largest producers of platinum, and provides the Company with a stable supply of cobalt metal through the long-term supply agreements. The complementary geography and operations shortens the supply chain and allows the Company to leverage its cobalt-based refining and chemicals expertise with Norilsk s cobalt mining and processing capabilities. The Company s Specialties segment will continue to sell Nickel-based specialty products to end markets in the electronic chemicals industry. In addition, the Company will enter into two-year agency and distribution agreements for nickel salts.

The Specialties segment produces products using unrefined cobalt and other metals including nickel, copper, zinc, manganese and calcium. The Company s products are essential components in numerous complex chemical and industrial processes, and are used in many end markets, such as rechargeable batteries, coatings, custom catalysts, liquid detergents, lubricants and fuel additives, plastic stabilizers, polyester promoters, adhesion promoters for rubber tires, colorants, petroleum additives, magnetic media, metal finishing agents, cemented carbides for mining and machine tools, diamond tools used in construction, stainless steel, alloy and plating applications. The Company s products are sold in various forms such as solutions, crystals, cathodes and powders.

The Company s business is critically connected to both the price and availability of raw materials. The primary raw material used by the Company is unrefined cobalt. Cobalt raw materials include ore, concentrate, slag and scrap. The cost of the Company s raw materials fluctuates due to actual or perceived changes in supply and demand of raw materials, changes in cobalt reference price and changes in availability from suppliers. The Company attempts to mitigate changes in availability by maintaining adequate inventory levels and long-term supply relationships with a variety of suppliers. Fluctuations in the prices of cobalt have been significant in the past and the Company believes that cobalt price fluctuations are likely to continue in the future. The Company attempts to pass through to its customers increases in raw material prices by increasing the prices of its products. The Company s profitability is

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largely dependent on the Company s ability to maintain the differential between its product prices and product costs. Certain sales contracts and raw material purchase contracts contain variable pricing that adjusts based on changes in the price of cobalt. During periods of rapidly changing metal prices, however, there may be price lags that can impact the short-term profitability and cash flow from operations of the Company both positively and negatively. Reductions in the price of raw materials or declines in the selling prices of the Company s finished goods could also result in the Company s inventory carrying value being written down to a lower market value.

In addition to the United States, the Company has manufacturing and other facilities in Europe, Africa, Canada and Asia-Pacific, and markets its products worldwide. Although most of the Company s raw material purchases and product sales are based on the U.S. dollar, prices of certain raw materials, non-U.S. operating expenses and income taxes are denominated in local currencies. As such, the results of operations are subject to the variability that arises from exchange rate movements (particularly the Euro). In addition, fluctuations in exchange rates may affect product demand and profitability in U.S. dollars of products provided by the Company in foreign markets in cases where payments for its products are made in local currency. Accordingly, fluctuations in currency prices affect the Company s operating results.

The Company has a 55% interest in a smelter joint venture (GTL) in the Democratic Republic of Congo (the DRC). The GTL smelter is a primary source for cobalt raw material feed. GTL is consolidated in the Company s financial statements because the Company has a controlling interest in the joint venture.

Significant Events

Planned Sale of the Nickel business: On November 17, 2006, the Company entered into a definitive agreement to sell its Nickel business to Norilsk for $408 million in cash, on a debt-free/cash-free basis, plus a potential post-closing adjustment for net working capital. The transaction, which has been unanimously approved by the Boards of Directors of both companies, is subject to customary closing conditions. The transaction is expected to close on or about March 1, 2007.

The Nickel business met the criteria to be reported as a discontinued operation in the fourth quarter of 2006. Accordingly, the Nickel segment results of operations have been reclassified to discontinued operations in accordance with U.S. generally accepted accounting principles for all periods presented in the financial statements, accompanying notes to the financial statements, and other information contained in this Form 10-K.

At closing, the Company will enter into five-year supply agreements with Norilsk for up to 2,500 metric tons per year of cobalt metal, up to 2,500 metric tons per year of cobalt in the form of crude cobalt hydroxide concentrate, up to 1,500 metric tons per year of cobalt in the form of crude cobalt sulfate, up to 5,000 metric tons per year of copper in the form of copper cake and various other nickel-based raw materials used in the Company s electronic chemicals business. In addition, the Company will enter into two-year agency and distribution agreements for nickel salts.

Senior Subordinated Notes: On February 2, 2007, the Company notified its noteholders that it had called for redemption all $400.0 million of its outstanding 9.25% Senior Subordinated Notes due 2011 (the Notes). The Notes will be redeemed on March 7, 2007 at a redemption price of 104.625% of the principal amount, or $418.5 million, plus accrued interest. In connection with the redemption of the Notes, the Company entered into a second amendment to its Revolving Credit Agreement (the Revolver) which, in addition to revolving loans of up to $100 million that were previously available under the Revolver, permits the Company to request additional revolving loans of up to $125 million. Such additional revolving loans may only be used to redeem the outstanding Notes. Such additional revolving loans must be repaid when the Company receives the net proceeds from the pending sale of the Nickel business, but not later than July 31, 2007. The Company may not declare and pay any cash dividends on its common stock at any time during which any additional revolving loans are outstanding.

Products

The Company develops, processes, manufactures and markets specialty chemicals, powders, metals and related products from various base metals feeds, primarily cobalt. The Company s products leverage the Company s production capabilities and bring value to its customers through superior product performance. Typically, the Company s products represent a small portion of the customer s total cost of manufacturing or processing, but are

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critical to the customer s product performance. The products frequently are essential components in chemical and industrial processes where they facilitate a chemical or physical reaction and/or enhance the physical properties of end-products. The Company s products are sold in various forms such as solutions, crystals, cathodes and powders.

The following table sets forth key applications for the Company s products:

Applications	Metals Used	OMG s Product Attributes
Rechargeable Batteries	Cobalt, Nickel	Improves the electrical conduction of rechargeable batteries used in cellular phones, video cameras, portable computers, power tools and hybrid electric vehicles
Coatings and paints	Cobalt, Manganese, Calcium, Zirconium, Aluminum	Promotes faster drying in such products as house paints (exterior and interior) and industrial and marine coatings
Printing Inks	Cobalt, Manganese	Promotes faster drying in various printing inks
Tires	Cobalt	Promotes bonding of metal-to-rubber in radial tires
Construction Equipment and Cutting Tools	Cobalt	Strengthens and adds durability to diamond and machine cutting tools and drilling equipment used in construction, oil and gas drilling, and quarrying
Petrochemical Refining	Cobalt, Nickel	Catalyzes reduction of sulfur dioxide and nitrogen emissions
Ceramics and Glassware	Cobalt, Nickel	Provides color for pigments, earthenware and glass and facilitates adhesion of porcelain to metal
Polyester Resins	Cobalt, Copper, Zinc	Accelerates the curing of polyester resins found in reinforced fiberglass boats, storage tanks, bathrooms, sports equipment, automobile and truck components
Memory Disks	Nickel	Enhances information storage on disks for computers and consumer electronics

Financial information, including reportable segment and geographic data, is contained in Note 16 to the consolidated financial statements contained in Item 8 of this Annual Report.

Competition

The Company encounters a variety of competitors in each of its product lines, but no single company competes with the Company across all of its existing product lines. For 2006, the Company believes that it was the largest refiner of cobalt and producer of cobalt-based specialty products and the largest producer of electroless nickel plating chemistry for memory disk applications in the world. Competition in these markets is based primarily on product quality, supply reliability, price, service and technical support capabilities. The markets in which the Company participates have historically been competitive and this environment is expected to continue.

Customers

The Company serves approximately 1,900 customers. During 2006, approximately 34% of the Company s net sales were in Europe, 22% in the Americas and 44% in Asia-Pacific. Sales to Nichia Chemical Corporation represented approximately 19%, 19% and 18% of net sales in 2006, 2005 and 2004, respectively. In addition, sales to Luvata Pori Oy were approximately 11% of net sales in 2006.

While customer demand for the Company s products is generally non-seasonal, supply/demand and price perception dynamics of key raw materials do periodically cause customers to either accelerate or delay purchases of the Company s products, generating short-term results that may not be indicative of longer-term trends. Historically, revenues during July and August have been lower than other months due to the summer holiday season in Europe. Furthermore, the Company uses the summer season to perform its annual maintenance shut-down at its refinery in Finland.

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Raw Materials

The primary raw material used by the Company in manufacturing its products is unrefined cobalt. Cobalt raw materials include ore, concentrates, slag and scrap. The cost of the Company s raw materials fluctuates due to actual or perceived changes in supply and demand of raw materials, changes in cobalt reference price and changes in availability from suppliers.

The Company attempts to mitigate changes in prices by passing through to its customers increases in raw material prices by increasing the prices of its products and by entering into sales contracts that contain variable pricing that adjusts based on changes in the price of cobalt.

A significant portion of the Company s supply of cobalt historically has been sourced from the DRC, Australia and Finland. Upon closing the transaction to sell the Company s Nickel business to Norilsk in the first quarter of 2007, the Company will enter into five-year supply agreements with Norilsk for up to 2,500 metric tons per year of cobalt metal, up to 2,500 metric tons per year of cobalt in the form of crude cobalt hydroxide concentrate, up to 1,500 metric tons per year of cobalt in the form of crude cobalt sulfate, up to 5,000 metric tons per year of copper in the form of copper cake and various other nickel-based raw materials used in the Company s electronic chemicals business. In addition, the Company will enter into two-year agency and distribution agreements for nickel salts.

Production problems and political and civil instability in certain supplier countries as well as increased demand in developing countries can affect the supply and market price of raw material. Such factors may continue to affect supply and price in the future. During 2006, the reference price of 99.3% cobalt listed in the trade publication, Metal Bulletin, increased from an average of $12.43 per pound in the first quarter of 2006 to an average of $18.66 per pound in the fourth quarter of 2006. In December 2006, the reference price of cobalt increased 40% to an average of $23.64 per pound from an average of $16.94 in November 2006. During 2005, the reference price of 99.3% continued the decline from the prices experienced in early 2004, dropping from an average of $17.26 per pound in the first quarter of 2005 to an average of $12.51 per pound in the fourth quarter of 2005. During 2004, cobalt reference prices ranged from an average of $24.63 per pound in the first quarter, and trended downward to an average of $18.38 per pound in the fourth quarter.

GTL shut down its smelter as scheduled during January of 2005 for approximately four months for maintenance and production improvements. The smelter was re-opened in May of 2005. The Company expects the next extended maintenance shut-down will occur in late 2008 or early 2009.

A graph of the end of the month reference price of 99.3% cobalt (as published in Metal Bulletin magazine) per pound for 2001 through 2006 is as follows:

Research and Development

The Company s research and new product development program is an integral part of its business. Research and development focuses on adapting proprietary technologies to develop new products and working with customers to meet their specific requirements, including joint development arrangements with customers that involve innovative products. New products include new chemical formulations, metal-containing compounds, and concentrations of various components and product forms. Research and development expenses were approximately $8.1 million for 2006, $8.3 million for 2005 and $7.8 million for 2004.

The Company s research staff of approximately 56 people conducts research and development in laboratories located in Westlake, Ohio; South Plainfield, New Jersey; Kuching, Malaysia; Manchester, England; Kokkola, Finland and Singapore.

Patents and Trademarks

The Company holds 103 patents comprising 35 patent families and has 31 pending patent applications relating to the manufacturing, processing and use of metal-organic and metal-based compounds. Specifically, the majority of these patents cover proprietary technology for base metal refining, metal and metal oxide powders, catalysts, metal-organic compounds and inorganic salts. The Company does not consider any single patent or group of patents to be material to its business as a whole.

Environmental Matters

The Company is subject to a wide variety of environmental laws and regulations in the United States and in foreign countries as a result of its operations and use of certain substances that are, or have been, used, produced or discharged by its plants. In addition, soil and/or groundwater contamination presently exists and may in the future be discovered at levels that require remediation under environmental laws at properties now or previously owned, operated or used by the Company. At December 31, 2006 and 2005, the Company has environmental reserves of $8.0 million and $8.8 million, respectively.

Ongoing environmental compliance costs, which are expensed as incurred, were approximately $7.1 million in 2006 and $4.9 million in 2005 and include costs relating to waste water analysis, treatment, and disposal; hazardous and non-hazardous solid waste analysis and disposal; air emissions control; groundwater monitoring and related staff costs. The Company anticipates that it will continue to incur compliance costs at moderately increasing levels for the foreseeable future as environmental laws and regulations are becoming increasingly stringent.

The Company also incurred capital expenditures of approximately $0.8 million and $1.3 million in 2006 and 2005, respectively, in connection with ongoing environmental compliance. The Company anticipates that capital expenditure levels for these purposes will increase to approximately $3.2 million in 2007, as it continues to modify certain processes that may have an environmental impact and undertakes new pollution prevention and waste reduction projects.

Due to the ongoing development and understanding of facts and remedial options and due to the possibility of unanticipated regulatory developments, the amount and timing of future environmental expenditures could vary significantly. Although it is difficult to quantify the potential impact of compliance with or liability under environmental protection laws, based on presently available information, the Company believes that its ultimate aggregate cost of environmental remediation as well as liability under environmental protection laws will not result in a material adverse effect upon its financial condition or results of operations.

Employees

At December 31, 2006, the Company had 1,248 full-time employees, of which 217 were located in North America, 464 in Europe, 373 in Africa and 194 in Asia-Pacific. Employees at the Company s production facilities in Franklin, Pennsylvania and Kuching, Malaysia are non-unionized. Employees at the Company s facility in Kokkola, Finland are members of several national workers unions under various union agreements. Generally, these union agreements have two-year terms. Employees at the Company s facility in Manchester, England are members of various trade unions under a recognition agreement. This recognition agreement has an indefinite term. Employees at the Belleville, Canada facility are members of the Communications, Energy and Paperworkers Union of Canada. The Belleville union agreement expires December 31, 2007. Employees in the DRC are members of various trade unions. The union agreements have a term of three years expiring in April 2008. The Company believes that relations with its employees are good.

SEC Reports

The Company makes available free of charge through its website (www.omgi.com) its reports on Forms 10-K, 10-Q and 8-K as soon as reasonably practicable after the reports are electronically filed with the Securities and Exchange Commission.

Item 1A. Risk Factors

Our business faces significant risks. These risks include those described below and may include additional risks and uncertainties not presently known to us or that we currently deem immaterial. Our business, financial condition and results of operations could be materially adversely affected by any of these risks. These risks should be read in conjunction with the other information in this report.

WE ARE UNDERGOING A STRATEGIC TRANSFORMATION.

As a result of changes to our strategic direction, we are currently in a transformational period and may make changes, which could be material, to our business, operations, financial condition and results of operations. These changes include the sale of our Nickel business and the possible expansion of our business through acquisitions and new product development. It is impossible to predict what these changes will be and the impact they will have on our future results of operations.

THE PROPOSED SALE OF THE NICKEL BUSINESS COULD HAVE AN ADVERSE EFFECT ON OUR OPERATING RESULTS OR FINANCIAL CONDITION.

On November 17, 2006, we entered into a definitive agreement to sell our Nickel business. The transaction is subject to customary closing conditions. Any failures or delays in satisfying closing conditions for this divestiture or difficulties in re-deploying the proceeds to minimize the dilutive effect of the sale, including identifying or consummating strategic acquisitions, could have an adverse effect on our operating results or financial condition.

On February 2, 2007, we notified our noteholders that we had called for redemption all of our Notes. The Notes will be redeemed on March 7, 2007 at a redemption price of 104.625% of the principal amount, or $418.5 million, plus accrued interest. Any failures or delays in satisfying closing conditions for this divestiture could require us to draw on the Company s Revolving Credit Agreement which may in turn require us to dedicate a substantial portion of our cash flow from operations to payments on our indebtedness, thereby reducing the availability of our cash flow to fund working capital, capital expenditures, research and development efforts, and for other general corporate purposes.

WE MAY EXPAND OUR OPERATIONS THROUGH ACQUISITIONS THAT COULD DIVERT MANAGEMENT S ATTENTION AND EXPOSE US TO UNANTICIPATED COSTS AND LIABILITIES. WE MAY EXPERIENCE DIFFICULTIES INTEGRATING THE ACQUIRED OPERATIONS, AND WE MAY INCUR COSTS RELATING TO POTENTIAL ACQUISITIONS THAT ARE NEVER CONSUMMATED.

Our strategy anticipates growth through future acquisitions. However, our ability to identify and consummate any future acquisitions on terms that are favorable to us may be limited by the number of attractive acquisition targets, internal demands on our resources and our ability to obtain financing. Our success in integrating newly acquired businesses will depend upon our ability to retain key personnel, avoid diversion of management s attention from operational matters, and integrate general and administrative services and key information processing systems. In addition, future acquisitions could result in the incurrence of additional debt, costs and contingent liabilities. Integration of acquired operations may take longer, or be more costly or disruptive to our business, than originally anticipated. It is also possible that expected synergies from future acquisitions may not materialize. We may also incur costs and divert management attention as regards potential acquisitions that are never consummated.

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There may be liabilities of the acquired companies that we fail to or are unable to discover during the due diligence investigation and for which we, as a successor owner, may be responsible. Indemnities and warranties obtained from the seller may not fully cover the liabilities due to limitations in scope, amount or duration, financial limitations of the indemnitor or warrantor or other reasons.

EXTENDED BUSINESS INTERRUPTION AT OUR FACILITIES COULD HAVE AN ADVERSE IMPACT ON OPERATING RESULTS.

Our results of operations are dependent in large part upon our ability to produce and deliver products promptly upon receipt of orders and to provide prompt and efficient service to our customers. Any disruption of our day-to-day operations could have a material adverse effect on our business, customer relations and profitability. Our Kokkola, Finland facility is the primary refining and production facility for our products. The GTL smelter in the DRC is a primary source for cobalt raw material feed. Our Cleveland, Ohio facility serves as our corporate headquarters. These facilities are critical to our business, and a fire, flood, earthquake or other disaster or condition that damaged or destroyed any of these facilities could disable them. Any such damage to, or other condition interfering with the operation of, these facilities would have a material adverse effect on our business, financial position and results of operations. Our insurance coverage may not be adequate to fully cover the potential risks described above. In addition, our insurance coverage may become more restrictive and/or increasingly costly, and there can be no assurance that we will be able to maintain insurance coverage in the future at an acceptable cost or at all.

WE ARE AT RISK FROM FLUCTUATIONS IN THE PRICE OF OUR PRINCIPAL RAW MATERIALS.

Cobalt is the principal raw material we use in manufacturing base metal chemistry products, and the cost of cobalt fluctuates due to actual or perceived changes in supply and demand, changes in the reference price and changes in availability from suppliers. Fluctuations in the prices of cobalt have been significant in the past and we believe price fluctuations are likely to occur in the future. Our ability to pass increases in raw material prices through to our customers by increasing the prices of our products is an important factor in our business. The extent of our profitability depends, in part, on our ability to maintain the differential between our product prices and raw material prices, and we cannot guarantee that we will be able to maintain an appropriate differential at all times.

We may be required under U.S. GAAP accounting rules to write down the carrying value of our inventory when cobalt and other raw material prices decrease. In periods of raw material metal price declines or declines in the selling price of the Company s finished products, inventory carrying values could exceed the amount the Company could realize on sale, resulting in a charge against inventory that could adversely affect our operating results.

WE ARE AT RISK FROM UNCERTAINTIES IN THE SUPPLY OF SOME OF OUR PRINCIPAL RAW MATERIALS.

There are a limited number of supply sources for cobalt. Production problems or political or civil instability in supplier countries, primarily the DRC, Australia, Finland and Russia, may affect the supply and market price of cobalt. In particular, political and civil instability in the DRC may affect the availability of raw materials from that country. If a substantial interruption should occur in the supply of cobalt from the DRC or elsewhere, we may not be able to obtain as much cobalt from other sources as would be necessary to satisfy our requirements at prices comparable to our current arrangements and our operating results could be adversely impacted.

WE ARE EXPOSED TO FLUCTUATIONS IN FOREIGN EXCHANGE RATES, WHICH MAY ADVERSELY AFFECT OUR OPERATING RESULTS.

We have manufacturing and other facilities in North America, Europe, Asia-Pacific and Africa, and we market our products worldwide. Although most of our raw material purchases and product sales are transacted in U.S. dollars, liabilities for non-U.S. operating expenses and income taxes are denominated in local currencies. In addition, fluctuations in exchange rates may affect product demand and may adversely affect the profitability in U.S. dollars of products provided by us in foreign markets where payment for our products is made in the local currency. Accordingly, fluctuations in currency rates may affect our operating results.

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OUR SUBSTANTIAL INTERNATIONAL OPERATIONS SUBJECT US TO RISKS, WHICH MAY INCLUDE UNFAVORABLE POLITICAL, REGULATORY, LABOR AND TAX CONDITIONS IN OTHER COUNTRIES.

Our business is subject to risks related to the differing legal and regulatory requirements and the social, political and economic conditions of many jurisdictions. In addition to risks associated with fluctuations in foreign exchange rates, risks inherent in international operations include the following:

- potential supply disruptions as a result of political instability or civil unrest in countries in which we have operations, especially the DRC and surrounding countries;
- agreements may be difficult to enforce and receivables difficult to collect through a foreign country s legal system;
- foreign customers may have longer payment cycles;
- foreign countries may impose additional withholding taxes or otherwise tax our foreign income, impose tariffs or adopt other restrictions on foreign trade or investment, including currency exchange controls;
- general economic conditions in the countries in which we operate could have an adverse effect on our earnings from operations in those countries;
- unexpected adverse changes in foreign laws or regulatory requirements may occur, including with respect to export duties and quotas; and
- compliance with a variety of foreign laws and regulations may be difficult.

Our overall success as a global business depends, in part, upon our ability to succeed in differing legal, regulatory, economic, social and political conditions. We cannot assure you that we will implement policies and strategies that will be effective in each location where we do business. Furthermore, we cannot be sure that any of the foregoing factors will not have a material adverse effect on our business, financial condition or results of operations.

WE ARE SUBJECT TO STRINGENT ENVIRONMENTAL REGULATION AND MAY INCUR UNANTICIPATED COSTS OR LIABILITIES ARISING OUT OF ENVIRONMENTAL MATTERS.

We are subject to stringent laws and regulations relating to the storage, handling, disposal, emission and discharge of materials into the environment, and we have expended, and may be required to expend in the future, substantial funds for compliance with such laws and regulations. In addition, we may from time to time be subjected to claims for personal injury, property damages or natural resource damages made by third parties or regulators. Our annual environmental compliance costs were $7.1 million in 2006. In addition, we made capital expenditures of approximately $0.8 million in 2006 in connection with environmental compliance.

As of December 31, 2006, we had reserves of $8.0 million for environmental liabilities. However, given the many uncertainties involved in assessing liability for environmental claims, our current reserves may prove to be insufficient. We continually evaluate the adequacy of our reserves and adjust reserves when determined to be appropriate. In addition, our current reserves are based only on known sites and the known contamination on those sites. It is possible that additional remediation sites will be identified in the future or that unknown contamination at previously identified sites will be discovered. This could require us to make additional expenditures for environmental remediation or could result in exposure to claims in the future.

CHANGES IN ENVIRONMENTAL, HEALTH AND SAFETY REGULATORY REQUIREMENTS COULD AFFECT SALES OF THE COMPANY S PRODUCTS.

New or revised governmental regulations relating to health, safety and the environment may affect demand for our products. The European Union s Registration, Evaluation and Authorization of Chemicals (REACH) legislation, for example, could affect the Company s ability to sell certain products. REACH will establish a new system to register and evaluate chemicals manufactured in, or imported to, the European Union and will require additional testing, documentation and risk assessments for the chemical industry. Such new or revised regulations may result in heightened concerns about the chemicals involved and in additional requirements being placed on the production, handling, or labeling of the subject chemicals and may increase the cost of producing them and/or limit the use of such products, which could lead to a decrease in demand.

SEC INVESTIGATION.

As previously disclosed, the SEC s Division of Enforcement is conducting an informal investigation resulting from the self reporting by us of an internal investigation. This internal investigation was conducted in 2003 and 2004 by the audit committee of our board of directors in connection with the previous restatement of our financial results for the periods prior to December 31, 2003. We are cooperating fully with the SEC informal investigation, but we cannot assure you that the SEC s Division of Enforcement will not take any action that would adversely affect us.

ADVERSE RESOLUTION OF LITIGATION MAY HARM OUR OPERATING RESULTS OR FINANCIAL CONDITION.

We are party to lawsuits in the normal course of business. Litigation can be expensive, lengthy and disruptive to normal business operations. Moreover, the results of complex legal proceedings are difficult to predict. An unfavorable resolution of a particular lawsuit could have a material adverse effect on our business, operating results, or financial condition.

IMPLEMENTATION OF AN ENTERPRISE RESOURCE PLANNING (ERP) PROJECT HAS THE POTENTIAL FOR BUSINESS INTERRUPTION AND ASSOCIATED ADVERSE IMPACT ON OPERATING RESULTS.

We have initiated a multi-year ERP project that is expected to be implemented worldwide to achieve increased efficiency and effectiveness in supply chain and financial processes. During the first quarter of 2007, we will complete implementation at the first location. We will continue to implement the ERP system in a phased approach through 2009. The implementation of the ERP system has the potential to disrupt our business by delaying the processing of key business transactions. In addition, the implementation of the ERP system may take longer than anticipated or be more costly than originally estimated.

WE MAY NOT BE ABLE TO RESPOND EFFECTIVELY TO TECHNOLOGICAL CHANGES IN OUR INDUSTRY OR IN OUR CUSTOMERS PRODUCTS.

Our future business success will depend in part upon our ability to maintain and enhance our technological capabilities, develop and market products and applications that meet changing customer needs and successfully anticipate or respond to technological changes on a cost-effective and timely basis. Our inability to anticipate, respond to or utilize changing technologies could have an adverse effect on our business, financial condition or results of operations. Moreover, technological and other changes in our customers products or processes may render some of our specialty chemicals unnecessary, which would reduce the demand for those chemicals.

WE OPERATE IN VERY COMPETITIVE INDUSTRIES.

We have many competitors. Some of our principal competitors have greater financial and other resources and greater brand recognition than we have. Accordingly, these competitors may be better able to withstand changes in conditions within the industries in which we operate and may have significantly greater operating and financial flexibility than we do. As a result of the competitive environment in the markets in which we operate, we currently face and will continue to face pressure on the sales prices of our products from competitors and large customers. With these pricing pressures, we may experience future reductions in the profit margins on our sales, or may be unable to pass on future raw material price or operating cost increases to our customers, which also would reduce profit margins. In addition, we may encounter increased competition in the future, which could have a material adverse effect on our business. Since we conduct our business mainly on a purchase order basis, with few long-term commitments from our customers, this competitive environment could give rise to a sudden loss of business.

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INDUSTRY CONSOLIDATION MAY LEAD TO INCREASED COMPETITION AND MAY HARM OUR OPERATING RESULTS.

There has been a trend toward industry consolidation in our markets. We believe that industry consolidation may result in stronger competitors with greater financial and other resources that are better able to compete for customers. This could lead to more variability in operating results and could have a material adverse effect on our business, operating results and financial condition.

FAILURE TO RETAIN AND RECRUIT KEY PERSONNEL WOULD HARM OUR ABILITY TO MEET KEY OBJECTIVES.

Our key personnel are critical to the management and direction of our businesses. Our future success depends, in large part, on our ability to retain key personnel and other capable management personnel. It is particularly important that we maintain our senior management group that is responsible for implementing our strategic transformation. Although we believe that we will be able to attract and retain talented personnel and replace key personnel should the need arise, our inability to do so could make it difficult to meet key objectives and disrupt the operations of our operations.

CHANGES IN EFFECTIVE TAX RATES OR ADVERSE OUTCOMES RESULTING FROM EXAMINATION OF OUR INCOME TAX RETURNS COULD ADVERSELY AFFECT OUR RESULTS.

Our future effective tax rates could be adversely affected by earnings being lower than anticipated in countries where we have lower statutory rates, higher than anticipated in countries where we have higher statutory rates, or if we incur losses for which no corresponding tax benefit can be realized, by changes in the valuation of our deferred tax assets and liabilities, or by changes in tax laws, regulations, accounting principles or interpretations thereof. In addition, we are subject to examination of our income tax returns by the Internal Revenue Service and other tax authorities. We regularly assess the likelihood of adverse outcomes resulting from these examinations to determine the adequacy of our provision for income taxes. There can be no assurance that the outcomes from these examinations will not have an adverse effect on our operating results and financial condition.

INADEQUATELY PROTECTING OUR INTELLECTUAL PROPERTY RIGHTS MAY ALLOW OTHER COMPANIES TO COMPETE DIRECTLY AGAINST US, OR WE MIGHT BE FORCED TO DISCONTINUE SELLING CERTAIN PRODUCTS.

We rely on U.S. and foreign patents and trade secrets to protect our intellectual property. We attempt to protect and restrict access to our trade secrets and proprietary information, but it may be possible for a third party to obtain our information and develop similar technologies.

If a competitor infringes upon our patent or other intellectual property rights, enforcing those rights could be difficult, expensive and time-consuming, making the outcome uncertain. Even if we are successful, litigation to enforce our intellectual property rights or to defend our patents against challenge could be costly and could divert management s attention.

In 2006, we filed a lawsuit relating to the use by a third-party of proprietary information. If we are not successful in this lawsuit, there could be an adverse effect on our sales of related products in the future.

OUR STOCK PRICE MAY CONTINUE TO BE VOLATILE.

Our common stock has experienced substantial price volatility, particularly as a result of variations between our actual financial results and the published expectations of analysts. Furthermore, speculation in the press or investment community about our strategic position, direction or pace of our strategic transformation, financial condition, results of operations, business, or significant transactions can cause changes in our stock price. These factors, as well as general economic and political conditions, may materially adversely affect the market price of our common stock in the future.

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Item 1B. Unresolved Staff Comments

The Company has received no written comments regarding its periodic or current reports from the staff of the Securities and Exchange Commission that were issued 180 days or more preceding the end of its 2006 fiscal year and that remain unresolved.

Item 2. Properties

The Company believes that its plants and facilities, which are of varying ages and of different construction types, have been satisfactorily maintained, are suitable for the Company s operations and generally provide sufficient capacity to meet the Company s production requirements. The land on which the Kokkola, Finland (KCO) production facility is located is leased under an agreement which expires in 2091, the land on which the Malaysian facility is located is leased under an agreement which expires in 2056 and the Singapore lease expires in 2011. Otherwise, the land associated with the Company s remaining manufacturing facilities is owned by the Company. The depreciation lives of fixed assets do not exceed the lives of the land leases.

The Company s KCO production facility is situated on property owned by Boliden Kokkola Oy. KCO and Boliden Kokkola Oy share certain physical facilities, services and utilities under agreements with varying expiration dates.

Information regarding the Company s primary offices, research and product development, and manufacturing and refining facilities, is set forth below:

Location	Segment	Facility Function*	Approximate Square Feet	Leased/Owned
Africa:				
Lubumbashi, DRC	Specialties	M	116,000	joint venture (55% owned)
North America:				
Cleveland, Ohio	Corporate	A	24,500	leased
Westlake, Ohio	Specialties	A, R	35,200	owned
Belleville, Ontario	Specialties	M	38,000	owned
Franklin, Pennsylvania	Specialties	M	331,500	owned
Newark, New Jersey	Specialties	A, R	32,000	owned
South Plainfield, New Jersey	Specialties	A, R	18,400	leased
Asia-Pacific:				
Kuching, Malaysia	Specialties	M, A, R, W	55,000	leased
Tokyo, Japan	Specialties	A	2,300	leased
Taipei, Taiwan	Specialties	A	2,350	leased
Suzhou, China	Specialties	M, A W	85,530	owned
Singapore	Specialties	M, A, R	5,375	leased
Europe:				
Manchester, England	Specialties	M, A, R	73,300	owned
Kokkola, Finland	Specialties	M, A, R	470,000	owned