

Edgar Filing: TITANIUM METALS CORP - Form 10-K

TITANIUM METALS CORP
Form 10-K
March 24, 2006

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, 2005

Commission file number 0-28538

Titanium Metals Corporation

(Exact name of registrant as specified in its charter)

Delaware

13-5630895

(State or other jurisdiction of
incorporation or organization)

(IRS employer identification no.)

5430 LBJ Freeway, Suite 1700, Dallas, Texas 75240

(Address of principal executive offices, including zip code)

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

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

Common Stock (\$.01 par value)

New York Stock Exchange

(Title of each class)

(Name of each exchange on which registered)

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

6 3/4% Series A Convertible Preferred Stock (\$.01 par value)

(Title of class)

Indicate by check mark:

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

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

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

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

Edgar Filing: TITANIUM METALS CORP - Form 10-K

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

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

The aggregate market value of the 25,185,912 shares of voting stock held by nonaffiliates of Titanium Metals Corporation as of June 30, 2005 approximated \$357.6 million. There are no shares of non-voting stock outstanding. As of March 10, 2006, 73,725,762 shares of common stock were outstanding.

Documents incorporated by reference:

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

Forward-Looking Information

The statements contained in this Annual Report on Form 10-K ("Annual Report") that are not historical facts, including, but not limited to, statements found in the Notes to Consolidated Financial Statements and in Item 1 - Business, Item 1A - Risk Factors, Item 2 - Properties, Item 3 - Legal Proceedings and Item 7 - Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A"), are forward-looking statements that represent management's beliefs and assumptions based on currently available information. Forward-looking statements can generally be identified by the use of words such as "believes," "intends," "may," "will," "looks," "should," "could," "anticipates," "expects" or comparable terminology or by discussions of strategies or trends. Although the Company believes that the expectations reflected in such forward-looking statements are reasonable, it cannot give any assurance that these expectations will prove to be correct. Such statements by their nature involve substantial risks and uncertainties that could significantly affect expected results. Actual future results could differ materially from those described in such forward-looking statements, and the Company disclaims any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. Among the factors that could cause actual results to differ materially are the risks and uncertainties discussed in this Quarterly Report, including risks and uncertainties in those portions referenced above and those described from time to time in the Company's other filings with the Securities and Exchange Commission ("SEC") which include, but are not limited to, the cyclical nature of the commercial aerospace industry, the performance of aerospace manufacturers and the Company under their long-term agreements, the existence or renewal of certain long-term agreements, the difficulty in forecasting demand for titanium products, global economic and political conditions, global productive capacity for titanium, changes in product pricing and costs, the impact of long-term contracts with vendors on the ability of the Company to reduce or increase supply, the possibility of labor disruptions, fluctuations in currency exchange rates, fluctuations in the market price of marketable securities, control by certain stockholders and possible conflicts of interest, uncertainties associated with new product or new market development, the availability of raw materials and services, changes in raw material prices and

Edgar Filing: TITANIUM METALS CORP - Form 10-K

other operating costs (including energy costs), possible disruption of business or increases in the cost of doing business resulting from terrorist activities or global conflicts, the potential for adjustment of the Company's deferred income tax asset valuation allowance and other risks and uncertainties. Should one or more of these risks materialize (or the consequences of such a development worsen), or should the underlying assumptions prove incorrect, actual results could differ materially from those forecasted or expected.

PART I

ITEM 1: BUSINESS

General. Titanium Metals Corporation ("TIMET" or the "Company") was originally formed in 1950 and was incorporated in Delaware in 1955. TIMET is one of the world's leading producers of titanium melted and mill products. The Company is the only producer with major titanium production facilities in both the United States and Europe, the world's principal markets for titanium consumption. TIMET is currently the only major producer of titanium sponge, a key raw material, in the United States.

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

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

The Company's long-term strategy is to maximize the value of its core aerospace business while also developing new markets, applications and products to help reduce its historical dependence on the commercial aerospace industry. In the near-term, the Company continues to focus on maintaining a lean cost structure, managing its raw material requirements, improving the quality of its products and processes and taking other actions to maximize its cash flow and profitability.

Industry. The Company develops certain industry estimates based on its extensive experience within the titanium industry as well as information obtained from publicly available external resources (e.g., United States Geological Survey, International Titanium Association and Japan Titanium Society). The Company estimates that it accounted for approximately 18% and 19% of worldwide industry shipments of titanium mill products in 2005 and 2004, respectively, and approximately 8% and 10% of worldwide titanium sponge production in 2005 and 2004, respectively. The following table illustrates the Company's estimates of aggregate titanium industry mill product shipments during

Edgar Filing: TITANIUM METALS CORP - Form 10-K

2005 and 2004:

	Year ended December 31,	
	2005	2004
	(metric tons)	
Mill product shipments to:		
Commercial aerospace sector	24,000	20,900
Military sector	6,200	4,700
Industrial sector	35,600	32,300
Emerging markets sector	2,700	2,300
	68,500	60,200
Aggregate mill product shipments to all sectors	68,500	60,200

The titanium industry historically has derived a substantial portion of its business from the commercial aerospace sector. Demand for titanium products within the commercial aerospace sector is derived from both jet engine components (e.g., blades, discs, rings and engine cases) and airframe components (e.g., bulkheads, tail sections, landing gear, wing supports and fasteners). The commercial aerospace sector has a significant influence on titanium companies, particularly mill product producers such as TIMET.

The Company's business is more dependent on commercial aerospace demand than is the overall titanium industry, as approximately 59% of the Company's mill product shipment volume in 2005 was to the commercial aerospace sector, whereas, as indicated by the above table, approximately 35% of the overall titanium industry's shipment volume in 2005 was to the commercial aerospace sector.

The cyclical nature of the commercial aerospace industry has been the principal driver of the historical fluctuations in the performance of most titanium companies. Over the past 20 years, the titanium industry had cyclical peaks in mill product shipments in 1989, 1997 and 2001 and cyclical lows in 1983, 1991, 1999 and 2003. Prior to 2004, demand for titanium reached its highest level in 1997 when industry mill product shipments reached approximately 60,700 metric tons. However, since 1997, industry mill product shipments have fluctuated significantly, primarily due to a continued change in demand for titanium from the commercial aerospace sector. The Company estimates that industry shipments approximated 60,200 metric tons in 2004 and 68,500 metric tons in 2005. The Company currently expects 2006 total industry mill product shipments to increase by only 5% to 10% as compared to 2005, due to tightness of raw material supply.

The Airline Monitor, a leading aerospace publication, traditionally issues forecasts for commercial aircraft deliveries each January and July. According to The Airline Monitor, large commercial aircraft deliveries for the 1996 to 2005 period peaked in 1999 with 889 aircraft, including 254 wide body aircraft that use substantially more titanium than their narrow body counterparts. Large commercial aircraft deliveries totaled 650 (including 152 wide bodies) in 2005. The following table summarizes The Airline Monitor's most recently issued

Edgar Filing: TITANIUM METALS CORP - Form 10-K

forecast (January 2006) for large commercial aircraft deliveries over the next five years:

Year	Forecasted deliveries		% increase (decrease) over previous year	
	Total	Wide bodies	Total	Wide bodies
2006	840	193	29.2%	
2007	920	217	9.5%	
2008	985	259	7.1%	
2009	1,030	294	4.6%	
2010	1,030	314	-	

The latest forecast from The Airline Monitor reflects a significant increase from earlier such forecasts, in large part due to record levels of new orders placed for Boeing and Airbus models during 2005. Total order bookings for Boeing and Airbus in 2005 were 2,109 planes. Expectations are that new orders in 2006 will be significantly lower than 2005; however, the strong bookings in 2005 have increased the order backlog for both Boeing and Airbus in support of this increased forecast.

Deliveries of titanium generally precede aircraft deliveries by about one year, although this varies considerably by titanium product. This correlates to the Company's cycle, which historically precedes the cycle of the aircraft industry and related deliveries. Although persistently high oil prices have had an adverse impact on the commercial airline industry, global commercial airline traffic increased in 2005 compared to 2004. The Company estimates that 2006 industry mill product shipments into the commercial aerospace sector will increase 15% to 20%, as compared to 2005.

Wide body planes tend to use a higher percentage of titanium in their airframes, engines and parts than narrow body planes. Newer models of planes tend to use a higher percentage of titanium than older models. Newer wide body models such as the Airbus A380 and the Boeing 787 Dreamliner are expected to use an even greater quantity of titanium than previous wide body models. See further discussion of titanium usage for these new planes in "Business - Markets and customer base."

Titanium shipments into the military sector are largely driven by government defense spending in North America and Europe. Military aerospace programs were the first to utilize titanium's unique properties on a large scale, beginning in the 1950s. Titanium shipments to military aerospace markets reached a peak in the 1980s before falling to historical lows in the early 1990s after the end of the Cold War. In recent years, titanium has become an accepted use in ground combat vehicles as well as in Naval applications. The importance of military markets to the titanium industry is expected to continue to rise in coming years as defense spending budgets increase in reaction to terrorist activities and global conflicts.

Several of today's active U.S. military programs, including the C-17, F/A-18, F-16 and F-15 are expected to continue in production through the end of

Edgar Filing: TITANIUM METALS CORP - Form 10-K

the current decade. However, a recent Quadrennial Defense Review (QDR) recommends that the US Air Force stop procurement of the C-17 with the 180 planes it now has on order, but this recommendation still must go through the federal budget process. Without further orders, the C-17 production line will close in 2008.

In addition to the established C-17, F/A-18 and F-16 programs, new U.S. programs offer growth opportunities for increased titanium consumption. The F/A-22 Raptor was given full-rate production approval in April 2005. According to The Teal Group, a leading independent aerospace publication, the U.S. Air Force would like to purchase 381 aircraft, but the Department of Defense is now planning for only 179. However, additional F/A-22 Raptors may be manufactured for sale to foreign nations.

In October 2001, Lockheed-Martin Corporation was awarded the contract for construction of the F-35 Joint Strike Fighter ("JSF"). The JSF is expected to enter low-rate initial production in late 2006, with delivery of the first production aircraft in 2009. Although no specific delivery patterns have been established, procurement is expected to extend over the next 30 to 40 years and to include as many as 3,000 to 4,000 planes, including sales to foreign nations. European military programs also have active aerospace programs offering the possibility for increased titanium consumption. Production levels for the Saab Gripen, Eurofighter Typhoon, Dassault Rafale and Dassault Mirage 2000 are all forecasted to remain steady through the end of the decade.

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

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

Titanium continues to gain acceptance in many emerging market applications, including automotive, energy (including oil and gas) and architecture. Although titanium is generally higher cost than other competing metals, in many cases customers find the physical properties of titanium to be attractive from the standpoint of weight, performance, longevity, design alternatives, life cycle value and other factors. The Company continues to explore opportunities in these emerging market applications through marketing initiatives, research and development and proprietary alloys designed to provide more cost effective alternatives for these markets.

Edgar Filing: TITANIUM METALS CORP - Form 10-K

Although the Company estimates that emerging market demand presently represents only about 4% of the 2005 total industry demand for titanium mill products, the Company believes emerging market demand, in the aggregate, could grow at double-digit rates over the next several years. The Company continues to actively pursue these markets and was able to grow its mill product shipments into emerging markets by more than 50% during 2005 as compared to 2004. Beginning in 2005, the Company no longer includes armor and armament related sales as part of its emerging markets sector, as titanium usage has become widely accepted for such applications. Accordingly, all such sales are now included in the Company's military sector and all prior periods have been restated to conform to this presentation.

The automotive market continues to be an attractive emerging market due to its potential for sustainable long-term growth. TiMET Automotive is focused on developing and marketing proprietary alloys and processes specifically suited for automotive applications. Titanium is now used in several consumer car applications as well as in numerous motorcycles. At the present time, titanium is primarily used for exhaust systems, suspension springs, engine valves, connecting rods and turbocharger compressor wheels in consumer and commercial vehicles. In exhaust systems, titanium provides for significant weight savings, while its corrosion resistance provides life-of-vehicle durability. In suspension spring applications, titanium's low modulus of elasticity allows the spring's height to be reduced by 20% to 40% compared to a steel spring, which, when combined with the titanium's low density, permits 30% to 60% weight savings over steel spring suspension systems. Titanium engine components provide mass-reduction benefits that directly improve vehicle performance and fuel economy. The application of titanium to turbocharger compressor wheels is part of a solution to meet U.S. and European Union government-regulated diesel engine emissions requirements. TiMETAL proprietary alloys provide cost effective optimized performance for the various target applications. The decision to select titanium components for consumer car, truck and motorcycle components remains highly cost sensitive; however, the Company believes titanium's acceptance in consumer vehicles will expand as the automotive industry continues to better understand the benefits titanium offers.

The oil and gas market utilizes titanium for down-hole logging tools, critical riser components, fire water systems and saltwater-cooling systems. Additionally, as offshore development of new oil and gas fields moves into the ultra deep-water depths, market demand for titanium's light-weight, high-strength and corrosion-resistance properties is creating new opportunities for the material. The Company has a group dedicated to developing the expansion of titanium use in this market and in other non-aerospace applications.

Products and operations. The Company is a vertically integrated titanium manufacturer whose products include:

- (i) titanium sponge, the basic form of titanium metal used in titanium products;
- (ii) melted products (ingot, electrodes and slab), the result of melting sponge and titanium scrap, either alone or with various alloys;
- (iii) mill products that are forged and rolled from ingot or slab, including long products (billet and bar), flat products (plate, sheet and strip) and pipe; and

Edgar Filing: TITANIUM METALS CORP - Form 10-K

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

During the past three years, all of TIMET's net sales were generated by the Company's integrated titanium operations (its "Titanium melted and mill products" segment), its only business segment. Business and geographic financial information is included in Note 21 to the Consolidated Financial Statements.

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

Titanium ingot is a cylindrical solid shape that, in TIMET's case, weighs up to 8 metric tons. Titanium slab is a rectangular solid shape that, in TIMET's case, weighs up to 16 metric tons. Each ingot or slab is formed by melting titanium sponge, scrap or both, usually with various other alloys such as vanadium, aluminum, molybdenum, tin and zirconium. The melting process for ingot and slab is closely controlled and monitored utilizing computer control systems to maintain product quality and consistency and to meet customer specifications. In most cases, TIMET uses its ingot and slab as the starting material for further processing into mill products. However, it also sells ingot, electrodes and slab to third parties. Titanium scrap is a by-product of the forging, rolling, milling and machining operations, and significant quantities of scrap are generated in the production process for finished titanium products and components.

The Company sends certain products either to the Company's service centers or to outside vendors for further processing before being shipped to customers. The Company's customers either process the Company's products for their ultimate end-use or for sale to third parties.

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

The Company currently is reliant on several outside processors (one of which is owned by a competitor) to perform certain rolling, finishing and other processing steps in the U.S., and certain melting and forging steps in France. In France, the processor is also a joint venture partner in the Company's 70%-owned subsidiary, TIMET Savoie, S.A. ("TIMET Savoie"). During the past several years, the Company has made significant strides toward reducing the reliance on competitor-owned sources for these services, so that any interruption in these functions should not have a material adverse effect on the Company's business, results of operations, financial position or liquidity.

Edgar Filing: TITANIUM METALS CORP - Form 10-K

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

Raw materials. The principal raw materials used in the production of titanium ingot, slab and mill products are titanium sponge, titanium scrap and alloys. The following table summarizes the Company's 2005 raw material usage requirements in the production of its melted and mill products:

	Percentage of total raw material requirements
<hr/>	
Internally produced sponge	29%
Purchased sponge	25%
Titanium scrap	40%
Alloys	6%
<hr/>	
	100%
<hr/> <hr/>	

The primary raw materials used in the production of titanium sponge are titanium-containing rutile ore, chlorine, magnesium and petroleum coke. Rutile ore is currently available from a limited number of suppliers around the world, principally located in Australia, South Africa and Sri Lanka. The Company purchases the majority of its supply of rutile ore from Australia. The Company believes the availability of rutile ore will be adequate for the foreseeable future and does not anticipate any interruptions of its rutile supplies. However, there can be no assurance that the Company will not experience interruptions.

Chlorine is currently obtained from a single supplier near the Company's sponge plant in Henderson, Nevada. While the Company does not presently anticipate any chlorine supply problems, there can be no assurances the chlorine supply will not be interrupted. In the event of supply disruption, the Company has taken steps to mitigate this risk, including establishing the feasibility of certain equipment modifications to enable it to utilize material from alternative chlorine suppliers or to purchase and utilize an intermediate product which will allow the Company to eliminate the purchase of chlorine if needed. Magnesium and petroleum coke are generally available from a number of suppliers.

Edgar Filing: TITANIUM METALS CORP - Form 10-K

During 2005, the Company was the only major U.S. producer of titanium sponge and one of only six major worldwide producers (the others are located in Russia, Kazakhstan, the Ukraine and two in Japan). Additionally, there are two smaller sponge producers located in China. However, the Company cannot supply all of its needs for all grades of titanium sponge internally and is dependent, therefore, on third parties for a substantial portion of its sponge requirements. Titanium melted and mill products require varying grades of sponge and/or scrap depending on the customers' specifications and expected end use. Presently, TIMET and certain companies in Japan are the only producers of premium quality sponge that currently have complete approval for all significant demanding aerospace applications. Over the past few years, sponge producers in Russia and Kazakhstan have progressed in their efforts to obtain approval for the use of their sponge into all aerospace applications. This qualification process is likely to continue for several more years. Historically, the Company has purchased sponge predominantly from producers in Kazakhstan and Japan. In September 2002, the Company entered into a sponge supply agreement, effective from January 1, 2002 through December 31, 2007, which requires minimum annual purchases by the Company. The Company has no other long-term sponge supply agreements. Since 2000, the Company has also purchased sponge from the U.S. Defense Logistics Agency ("DLA") stockpile; however, the DLA stockpile became fully depleted during 2005. The Company expects to continue to purchase sponge from a variety of sources during 2006.

The Company utilizes titanium scrap at its melting locations that is either generated internally, purchased from certain of its customers under various buyback arrangements or purchased externally on the open market. Such scrap consists of alloyed and commercially pure solids and turnings. Internally produced scrap is generated in the Company's factories during both melting and mill product processing. Scrap obtained through customer buyback arrangements provides a "closed loop" arrangement resulting in greater supply and cost stability. Externally purchased scrap comes from a wide range of sources, including customers, collectors, processors and brokers. The Company anticipates that 30% to 35% of the scrap it will utilize during 2006 will be purchased from external suppliers, as compared to 35% to 40% for 2005, due to the Company's successful efforts to increase its closed loop arrangements. The Company also occasionally sells scrap, usually in a form or grade it cannot economically recycle.

Market forces can significantly impact the supply or cost of externally produced scrap. The amount of scrap generated in the supply chain varies during the titanium business cycles. During the middle of the cycle, scrap generation and consumption are in relative equilibrium, minimizing disruptions in supply or significant changes in the available supply and market prices for scrap. Increasing or decreasing cycles tend to cause significant changes in both the supply and market price of scrap. Early in the titanium cycle, when the demand for titanium melted and mill products begins to increase, the Company's requirements (and those of other titanium manufacturers) precede the increase in scrap generation by downstream customers and the supply chain, placing upward pressure on the market price of scrap. The opposite situation occurs when demand for titanium melted and mill products begins to decline, resulting in greater availability of supply and placing downward pressure on the market price of scrap. As a net purchaser of scrap, the Company is susceptible to price increases during periods of increasing demand. This phenomenon normally results in higher selling prices for melted and mill products, which tends to offset the increased material costs.

Edgar Filing: TITANIUM METALS CORP - Form 10-K

All of the Company's major competitors utilize scrap as a raw material in their melt operations. In addition to use by titanium manufacturers, titanium scrap is used in steel-making operations during production of interstitial-free steels, stainless steels and high-strength-low-alloy steels. Recent strong demand for these steel products, especially from China, has produced a significant increase in demand for titanium scrap at a time when titanium scrap generation rates are at low levels, partly due to lower commercial aircraft build rates over the past few years. These events created a significantly tightened supply of titanium scrap during 2004 and 2005, and the Company expects this trend to continue during 2006. For TIMET, this will translate to lower availability and higher cost for externally purchased scrap in the near-term.

In 2005 the Company was somewhat limited in its ability to raise prices for the portion of its business that is subject to long-term pricing agreements. The Company's ability to offset these increased material costs with higher selling prices should improve in 2006, as many of the Company's long-term agreements ("LTAs") have either expired or have been renegotiated for 2006 with price adjustments that take into account raw material cost fluctuations. Additionally, the expected increase in commercial aircraft build rates over the next several years, as previously discussed, could have the effect of lessening the shortage of titanium scrap. Further, several titanium producers, including TIMET, have recently announced plans to expand their respective sponge producing capabilities. Although these expansions should help reduce the current imbalance of global supply and demand for raw materials, the Company does not believe the raw material shortage will be fully relieved at any time in the near future and therefore expects relatively high prices for raw materials to continue for at least the near term.

Various alloys used in the production of titanium products are also available from a number of suppliers. However, the recent high level of global demand for steel products has also resulted in a significant increase in the costs for several alloys, such as vanadium and molybdenum. The cost of these alloys during 2005 was significantly higher than at any point during the past 10 years. Vanadium and Molybdenum costs peaked in the spring of 2005 and finished the year well below those levels. Although availability is not expected to be a concern and the Company has negotiated certain price and cost protection with suppliers and customers, there is no assurance that such alloy costs will not continue to fluctuate significantly in the near future.

Customer agreements. The Company has LTAs with certain major customers, including, among others, The Boeing Company ("Boeing"), Rolls-Royce plc and its German and U.S. affiliates ("Rolls-Royce"), United Technologies Corporation ("UTC," Pratt & Whitney and related companies), Societe Nationale d