Delaware Investments National Municipal Income Fund
Form DEF 14A
September 25, 2009

SCHEDULE 14A

(Rule 14a-101)

INFORMATION REQUIRED IN PROXY STATEMENT

SCHEDULE 14A INFORMATION

Proxy Statement Pursuant to Section 14(a) of the
Securities Exchange Act of 1934 (Amendment No. )

Filed by the Registrant [x]
Filed by a Party other than the Registrant [_]

Check the appropriate box:
[_] Preliminary Proxy Statement
[_] Confidential, For Use of the Commission Only (as permitted by Rule 14a-6(e)(2))
[x] Definitive Proxy Statement
[_] Definitive Additional Materials
[_] Soliciting Material Under Rule 14a-12

Delaware Investments Dividend and Income Fund, Inc.

Delaware Investments Global Dividend and Income Fund, Inc.

Delaware Enhanced Global Dividend and Income Fund

Delaware Investments Arizona Municipal Income Fund, Inc.

Delaware Investments Colorado Municipal Income Fund, Inc.

Delaware Investments Minnesota Municipal Income Fund II, Inc.

Delaware Investments National Municipal Income Fund

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(Name of Registrant as Specified In Its Charter)

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(Name of Person(s) Filing Proxy Statement, if Other Than the Registrant)

Payment of Filing Fee (Check the appropriate box):
[x] No fee required.
[_] Fee computed on table below per Exchange Act Rules 14a-6(i)(4) and 0-11.

1) Title of each class of securities to which transaction applies:

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2) Aggregate number of securities to which transaction applies:

3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the
amount on which the filing fee is calculated and state how it was determined):

4) Proposed maximum aggregate value of transaction:

5) Total fee paid:

[_] Fee paid previously with preliminary materials:

[_] Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the form or schedule and the date of its filing.

1) Amount previously paid:

2) Form, Schedule or Registration Statement No.:

3) Filing Party:

4) Date Filed:

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**PROXY MATERIALS**

**Delaware Investments Dividend and Income Fund, Inc.**
**Delaware Investments Global Dividend and Income Fund, Inc.**
**Delaware Enhanced Global Dividend and Income Fund**
**Delaware Investments Arizona Municipal Income Fund, Inc.**
**Delaware Investments Colorado Municipal Income Fund, Inc.**
**Delaware Investments Minnesota Municipal Income Fund II, Inc.**
**Delaware Investments National Municipal Income Fund**

**(each, a Fund, and collectively, the Funds)**

Dear Shareholder:

I am writing to let you know that a joint special meeting of shareholders (the Meeting) of the Funds will be held at the offices of Stradley Ronon Stevens & Young, LLP, 2005 Market Street, 21st Floor, Philadelphia, Pennsylvania 19103 on November 12, 2009 at 3:00 p.m., Eastern time. The purpose of the Meeting is to vote on an important proposal that affects the Funds and your investment in one or more of them. The Meeting will be held concurrently with the meetings of shareholders of other funds within the Delaware Investments® Family of Funds. As a shareholder, you have the opportunity to voice your opinion on a matter that affects your Fund(s). This package contains information about the proposal and the materials to use when voting by mail, telephone, or through the Internet.

Please read the enclosed materials and cast your vote on the proxy card(s) or by telephone or via the Internet. **Please vote your shares promptly. Your vote is extremely important, no matter how large or small your holdings may be.**

The proposal has been carefully reviewed by the Board of Trustees/Directors of each Fund. The Trustees/Directors, all but one of whom are not affiliated with Delaware Investments, are responsible for protecting your interests as a shareholder. The Trustees/Directors believe this proposal is in the best interests of shareholders.

**The Boards of Trustees/Directors recommend that you vote FOR the proposal.**

The enclosed Q&A is provided to assist you in understanding the proposal. The proposal is described in greater detail in the enclosed Proxy Statement.

**Voting is quick and easy. Everything you need is enclosed.** To cast your vote, simply complete the proxy card(s) enclosed in this package. Be sure to sign the card(s) before mailing it (them) in the postage-paid envelope.

You may also vote your shares by touch-tone telephone or through the Internet. Simply call the toll-free number or visit the Web site indicated on your proxy card(s), enter the control number found on the card(s), and follow the recorded or online instructions.

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If you have any questions before you vote, please call Computershare Fund Services, Inc. (Computershare), the Funds proxy solicitor, at 877 520-8548. Computershare will help you get your vote in quickly. You may also receive a telephone call from Computershare reminding you to vote your shares. Thank you for your participation in this important initiative.

Sincerely,

/s/ Patrick P. Coyne
Patrick P. Coyne
Chairman, President, and Chief Executive Officer

September 25, 2009

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## NOTICE OF JOINT SPECIAL MEETING OF SHAREHOLDERS

**To be held on November 12, 2009**

**Important notice regarding the availability of proxy materials for the shareholder meeting to be held on November 12, 2009: this proxy statement is available at www.delawareinvestments.com/proxy.**

To the Shareholders of:

**Delaware Investments Dividend and Income Fund, Inc.**
**Delaware Investments Global Dividend and Income Fund, Inc.**
**Delaware Enhanced Global Dividend and Income Fund**
**Delaware Investments Arizona Municipal Income Fund, Inc.**
**Delaware Investments Colorado Municipal Income Fund, Inc.**
**Delaware Investments Minnesota Municipal Income Fund II, Inc.**
**Delaware Investments National Municipal Income Fund**

NOTICE IS HEREBY GIVEN that a joint special meeting (the Meeting) of shareholders of the closed-end registered investment companies listed above (each, a Fund, and collectively, the Funds), along with certain other funds within the Delaware Investments® Family of Funds, each of which is issuing proxy solicitation materials, will be held at the offices of Stradley Ronon Stevens & Young, LLP, 2005 Market Street, 21st Floor, Philadelphia, Pennsylvania 19103 on November 12, 2009 at 3:00 p.m., Eastern time. The Meeting is being called to approve a new investment advisory agreement for each Fund.

Shareholders of record of the Funds as of the close of business on September 18, 2009 are entitled to notice of, and to vote at, the Meeting or any adjournment thereof. **Whether or not you plan to attend the Meeting, please vote your shares by returning the proxy card(s) by mail in the enclosed postage-paid envelope provided, or by voting by telephone or over the Internet. Your vote is important.**

By order of the Boards of Trustees/Directors,

/s/ Patrick P. Coyne
Patrick P. Coyne
Chairman, President, and Chief Executive Officer

September 25, 2009

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**To secure the largest possible representation and to save the expense of further mailings, please mark your proxy card(s), sign, and return it (them) in the enclosed envelope, which requires no postage if mailed from the United States. If you prefer, you may instead vote by telephone or the Internet. You may revoke your proxy at any time before or at the Meeting or vote in person if you attend the Meeting, as provided in the attached Proxy Statement.**

**SOME SHAREHOLDERS HOLD SHARES IN MORE THAN ONE FUND AND MAY RECEIVE PROXY CARDS AND/OR PROXY MATERIALS FOR EACH FUND OWNED. PLEASE SIGN AND PROMPTLY RETURN EACH PROXY CARD IN THE SELF-ADDRESSED ENVELOPE REGARDLESS OF THE NUMBER OF SHARES OWNED.**

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## JOINT PROXY STATEMENT

## FOR

Delaware Investments Dividend and Income Fund, Inc.
Delaware Investments Global Dividend and Income Fund, Inc.
Delaware Enhanced Global Dividend and Income Fund
Delaware Investments Arizona Municipal Income Fund, Inc.

Delaware Investments Colorado Municipal Income Fund, Inc.
Delaware Investments Minnesota Municipal Income Fund II, Inc.
Delaware Investments National Municipal Income Fund

(each, a Fund, and collectively, the Funds)

Dated September 25, 2009

**Important notice regarding the availability of proxy materials for the shareholder meeting to be held on November 12, 2009: this proxy statement is available at www.delawareinvestments.com/proxy.**

This joint proxy statement (the Proxy Statement) solicits proxies to be voted at a joint special meeting of shareholders (the Meeting) of each of the Funds, along with registered open-end management investment companies within the Delaware Investments® Family of Funds, each of which is issuing proxy solicitation materials. The Meeting was called by the Board of Trustees or Directors of each Fund (each Board is hereafter referred to as a Board or a Board of Directors and Board members are referred to as Directors) to vote to approve a new investment advisory agreement for each Fund, as is described more fully below.

The principal offices of the Funds are located at 2005 Market Street, Philadelphia, Pennsylvania 19103. You can reach the offices of the Funds by telephone by calling 800 523-1918. Each of the Funds is a diversified closed-end management investment company registered under the Investment Company Act of 1940, as amended (the 1940 Act). Delaware Investments Dividend and Income Fund, Inc. and Delaware Investments Global Dividend and Income Fund, Inc. are organized as Maryland corporations; Delaware Investments Arizona Municipal Income Fund, Inc., Delaware Investments Colorado Municipal Income Fund, Inc., and Delaware Investments Minnesota Municipal Income Fund II, Inc. are organized as Minnesota corporations; Delaware Enhanced Global Dividend and Income Fund is organized as a Delaware statutory trust; and Delaware Investments National Municipal Income Fund is organized as a Massachusetts business trust.

The Meeting will be held at the offices of Stradley Ronon Stevens & Young, LLP, 2005 Market Street, 21st Floor, Philadelphia, Pennsylvania 19103 on November 12, 2009 at 3:00 p.m., Eastern time. Only Fund shareholders will be admitted to the Meeting. The Boards, on behalf of each Fund, are soliciting these proxies. This Proxy Statement is first being sent to shareholders on or about September 30, 2009.

This Proxy Statement gives you information about the new investment advisory agreements, and other matters that you should know before voting. The Boards have determined that the joint use of this Proxy Statement for the Meeting is in the best interests of each Fund and its shareholders in light of the similar matters being considered and voted on by the shareholders of all of the Funds.

Each Funds annual report to shareholders is sent to shareholders of record following the Funds fiscal year end. Each Fund will furnish, without charge, a copy of its most recent annual report and most recent succeeding semiannual report, if any, to a shareholder upon request. Such requests should be directed to a Fund by calling 800 523-1918 or by writing to the Fund at 2005 Market Street, Philadelphia, Pennsylvania 19103. Each Funds most recent annual report and most recent succeeding semiannual report, if any, are also available free of charge through the Funds Web site at www.delawareinvestments.com.



## THE PROPOSAL: TO APPROVE A NEW INVESTMENT ADVISORY AGREEMENT FOR EACH FUND

In the proposal, you are being asked to approve a new investment advisory agreement between your Fund and Delaware Management Company (DMC) (each, a New Investment Advisory Agreement). DMC currently serves as investment adviser for each Fund, but, for the reasons discussed below, a New Investment Advisory Agreement will be required if the Transaction (as defined below) is completed. For a general description of the proposed New Investment Advisory Agreements and a comparison of the proposed New Investment Advisory Agreements and the investment advisory agreements currently in effect for each Fund (each, a Current Investment Advisory Agreement), see The New Investment Advisory Agreements below. The form of the New Investment Advisory Agreement is presented in Appendix A. The date of each Funds Current Investment Advisory Agreement and the date on which it was last approved by shareholders are provided in Appendix B.

The Boards are proposing the approval of the New Investment Advisory Agreements because the Current Investment Advisory Agreements will terminate upon completion of the Transaction. As required by the 1940 Act, each Current Investment Advisory Agreement terminates automatically upon its “assignment.” Under the 1940 Act, a change in control of an investment adviser constitutes an “assignment.” The consummation of the Transaction will result in a change of control of DMC, and thus, the assignment and automatic termination of the Current Investment Advisory Agreements. Shareholders of each Fund are therefore being asked to approve a New Investment Advisory Agreement for their Fund. Each New Investment Advisory Agreement would become effective only if approved by the shareholders of the applicable Fund and if the Transaction is completed. Although the closing of the Transaction (the “Closing”) is currently expected to take place on or about December 31, 2009, if the Transaction is not completed or the Transaction Agreement (as defined below) is terminated, the New Investment Advisory Agreements will not go into effect and the Current Investment Advisory Agreements will continue in effect.

**Description of the Transaction**

Lincoln National Corporation (“LNC”) and its indirect, wholly owned subsidiary, Lincoln National Investment Companies, Inc. (“LNIC”), entered into a definitive agreement (the “Transaction Agreement”), dated as of August 18, 2009, with Macquarie Bank Limited, whereby LNIC will sell all of the issued and outstanding capital stock of Delaware Management Holdings, Inc. (“DMHI”) to Macquarie Bank Limited (or a subsidiary thereof) (the “Transaction”). Certain Fund service providers



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are subsidiaries of DMHI and will be included in the Transaction, including DMC, Delaware Service Company, Inc. (“DSC”), the fund accounting and financial administration oversight provider for the Funds. DMHI and its subsidiaries are referred to collectively as “Delaware Investments.”

Macquarie Group Limited and its various subsidiaries (including Macquarie Bank Limited) are referred to collectively as “Macquarie Group.” The Transaction Agreement requires Macquarie Bank Limited (or a permitted assignee) to pay LNIC approximately $428 million in cash at the Closing to acquire DMHI and its subsidiaries, subject to certain specified closing adjustments at and after the Closing. The Closing is subject to the satisfaction or waiver of customary closing conditions, including (i) annualized advisory fees payable to Delaware Investments by all clients that have consented to the assignment of their investment advisory agreements or approved a new investment advisory agreement (including the Funds) not being less than a minimum percentage of annualized advisory fees payable to Delaware Investments as of April 30, 2009 and (ii) the parties obtaining certain domestic and international regulatory approvals (including expiration of the required waiting period under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended).

DMC manages the assets of each Fund and makes each Fund’s investment decisions, subject to the supervision of the Board of each Fund. DMC is a series of Delaware Management Business Trust (“DMBT”), which is an indirect subsidiary of DMHI. DMC, DMBT, and DMHI are located at 2005 Market Street, Philadelphia, Pennsylvania 19103. Delaware Investments has been managing mutual funds since 1938. As of June 30, 2009, Delaware Investments managed, in the aggregate, more than $120 billion in assets in various institutional, separately managed, investment company, and insurance accounts. DMHI, a Delaware corporation, is a holding company that, through its subsidiaries and affiliates, provides investment advisory, asset management, administrative, broker/dealer, and related products and services. DMHI’s asset management capabilities include the ability to manage equity, fixed income, and money market securities, which are offered through vehicles such as mutual funds, closed-end funds, privately managed accounts, and institutional separate accounts. DMHI is an indirect, wholly owned subsidiary of, and subject to ultimate majority control of, LNC, which is a publicly traded corporation. LNC is a diversified organization with operations in many aspects of the financial services industry, including insurance and investment management. LNIC is an Indiana corporation and an indirect, wholly owned subsidiary of LNC. LNIC owns 100% of the issued and outstanding common stock of DMHI. After the Transaction, DMHI will be an indirect, wholly owned subsidiary of Macquarie Group Limited.

Macquarie Group is a global provider of banking, financial, advisory, investment and fund management services. Macquarie Group Limited, No. 1 Martin Place, Sydney, New South Wales 2000, Australia, is listed on the Australian Securities

Exchange (ASX:MQG) and is regulated by the Australian Prudential Regulation Authority, the Australian banking regulator, as the owner of Macquarie Bank Limited, an authorized deposit taker. Founded in 1969, Macquarie Group now operates in more than 70 office locations in over 26 countries. Macquarie Group employed approximately 12,500 people and had assets under management of $190 billion as of July 31, 2009. Macquarie Group has been active in North America for over a decade. Macquarie Group currently has more than 1,900 professionals in offices in 25 North American locations. Macquarie Funds Group, the asset management arm of Macquarie Group, is a full service global fund manager with over 25 years' experience and offers a range of investments for retail and institutional investors across a variety of asset classes including fixed income, cash, currencies, equities, commodities, emerging markets, listed infrastructure and listed real estate as well as private equity and hedge fund of funds. Macquarie Funds Group employs over 600 staff across 19 locations globally with assets under management of approximately $67 billion as of July 31, 2009. More information on Macquarie Group's operations is available at www.macquarie.com.au and at www.macquarie.com/us.

Australian Banking Regulations require the following disclaimer to be made: **Investments in the Funds are not and will not be deposits with or liabilities of Macquarie Bank Limited ABN 46 008 583 542 and its holding companies including their subsidiaries or related companies, and are subject to investment risk, including possible delays in repayment and loss of income and capital invested. No Macquarie Group company guarantees or will guarantee the performance of any Fund, the repayment of capital from any Fund, or any particular rate of return.**

The Transaction is part of Macquarie Group's strategy to develop a global asset management capability through building a highly regarded team of investment professionals, offering an attractive suite of investment products and gaining broader access to markets in the United States. Macquarie Group values DMC's focus on the advisory segment of the U.S. market, its significant investment management capabilities, and its experienced management team. The Transaction is not currently expected to result in a change in the persons responsible for the day-to-day management of the Funds or in the operation of the Funds. Moreover, it is currently anticipated that following the Closing, DMHI, DMC, DSC, and the Funds will continue to operate in substantially the same manner as at present, and the Delaware Investments brand will remain with the business. Upon completion of the Transaction, the combined assets under management of Macquarie Group, including DMHI and its subsidiaries, are expected to be over $300 billion. After the Transaction, DMHI and its subsidiaries (including DMC) will remain headquartered in Philadelphia. Investment management professionals serving DMC's clients are currently not expected to change as a result of the Transaction. Clients of DMC may be offered opportunities to invest in new products with access to Macquarie



Group's investment strategies, notably in real assets, global fixed income securities, and alternative investments. Macquarie Group clients across its global network may be offered investment products involving Delaware Investments' investment strategies in structures designed specifically for them. Macquarie Group also currently anticipates providing additional funding to support the growth of DMC and its affiliates, for example through potential investment in operations and distribution and a commitment to expanding its multi-boutique approach.

In anticipation of the Transaction, the Boards have had a number of telephonic and in-person meetings and met both formally and in informational sessions between April 16, 2009 and September 3, 2009, for purposes of, among other things, considering whether it would be in the best interests of each Fund and its shareholders to approve a New Investment Advisory Agreement. The 1940 Act requires that each Fund's New Investment Advisory Agreement be approved by the Fund's shareholders in order to become effective. At the in-person meeting held on September 3, 2009, for the reasons discussed below under "Board considerations in approving the New Investment Advisory Agreements," the Boards, including a majority of the Directors on each Board who are not "interested persons" of the applicable Fund, as that term is defined in the 1940 Act ("Independent Directors"), approved the New Investment Advisory Agreements as being in the best interests of the Funds and their shareholders and recommended their approval by shareholders. In the event shareholders of a Fund do not approve a New Investment Advisory Agreement, the Fund's Board will take such action as it deems to be in the best interests of the Fund and its shareholders, including entering into a temporary, interim advisory agreement with DMC pursuant to Rule 15a-4 of the 1940 Act pending further solicitation of shareholder approval.

**Section 15(f) of the 1940 Act**

The Boards have been advised that the parties intend to rely on Section 15(f) of the 1940 Act, which provides a non-exclusive safe harbor whereby an owner (such as LNC and LNIC) of an investment adviser (such as DMC) to an investment company (such as a Fund) may receive payment or benefit in connection with the sale of an interest in the investment adviser if two conditions are satisfied. The first condition is that during the three-year period following the transaction, at least 75% of the investment company’s board must not be “interested persons” (as defined in the 1940 Act) of the investment adviser or its predecessor. Each Board currently meets this test and is expected to do so after the Transaction is completed. Second, no “unfair burden” can be imposed on the investment company as a result of the transaction. An “unfair burden” includes any arrangement during the two-year period after the transaction where the investment adviser (or predecessor or successor adviser), or any of its “interested persons” (as defined in the 1940 Act), receive or is entitled to receive any compensation, directly or indirectly, (i) from any person



in connection with the purchase or sale of securities or other property to, from or on behalf of the investment company (other than bona fide ordinary compensation as principal underwriter for the investment company) or (ii) from the investment company or its shareholders (other than fees for bona fide investment advisory or other services). Macquarie Bank Limited has agreed as part of the Transaction Agreement that, following the Closing, to the extent within its control, it will not take or fail to take (and will not cause its affiliates to take or fail to take) any action, if such action or failure to take action would have the effect, directly or indirectly, of causing the requirements of Section 15(f) of the 1940 Act not to be met with respect to the Transaction. In that regard, from and after the Closing date and to the extent within its control, Macquarie Bank Limited has agreed to conduct its business (and to cause each of its affiliates to conduct its business) so as to assure that the two aforementioned conditions are satisfied.

**The New Investment Advisory Agreements**

Each Fund’s New Investment Advisory Agreement will be substantially similar to its Current Investment Advisory Agreement. Appendix A contains the form of the New Investment Advisory Agreement. The following is a comparison of certain provisions of the New Investment Advisory Agreements and Current Investment Advisory Agreements.

***Fees.*** There will be no change in the fee schedule applicable to any Fund under its New Investment Advisory Agreement. The New Investment Advisory Agreements have been modified, with regard to the calculation of each Fund’s management fees, to exclude from a Fund’s average daily net assets the liquidation or other involuntary liquidation preference of any outstanding senior security which is a stock. This modification gives the Funds increased flexibility in issuing senior securities by allowing them to treat advisory fees on assets attributable to any other form of senior equity security that they may issue in the future in the same way that assets attributable to preferred shares were previously treated. Additional approval from a Fund’s Board and/or shareholders would be required before any such new senior securities are issued.

***Investment Advisory Services.*** Each New Investment Advisory Agreement requires DMC to provide the same services to the applicable Funds as it does under the Current Investment Advisory Agreement. Each Fund’s New Investment Advisory Agreement generally provides that, subject to the direction and control of the Fund’s Board, DMC shall (i) regularly make decisions as to what securities and other instruments to purchase and sell on behalf of the Fund; (ii) effect the purchase and sale of those investments in furtherance of the Fund’s objectives and policies; and (iii) furnish the Board with information and reports regarding the Fund’s investments as DMC deems appropriate or as the Board may reasonably request.



Subject to the primary objective of obtaining best execution, DMC may place orders for the purchase and sale of portfolio securities and other instruments with broker/dealers that provide statistical, factual, or financial information and services to a Fund, to DMC, or to other clients of DMC. Both the Current and New Investment Advisory Agreement for each Fund provide that the services of DMC are not exclusive to the Funds, and DMC and its affiliates may render services to others.

The New Investment Advisory Agreements provide that DMC may, to the extent permitted by applicable law, appoint at its own expense one or more sub-advisers, including affiliates of DMC, to perform investment advisory services for the Funds. DMC may terminate a sub-adviser in its sole discretion at any time to the extent permitted by applicable law. A similar provision is included in the Current Investment Advisory Agreements.

***Fund Administration Services.*** DMC and Macquarie Group have advised the Boards that they anticipate and intend that the nature and level of administrative services provided to the Funds under their Current Investment Advisory Agreements, in combination with any administrative services agreements, will not be diminished as a result of the Transaction or the implementation of the New Investment Advisory Agreements. In addition, any fees for administrative services, whether payable under a Current Investment Advisory Agreement or a separate administrative agreement, will not increase as a direct result of the Transaction or the New Investment Advisory Agreement.

***Payment of Expenses.*** The provisions contained in each Fund's New Investment Advisory Agreement addressing allocation of expenses are substantially similar in all material respects to those contained in that Fund's Current Investment Advisory Agreement. Both the Current and New Investment Advisory Agreements provide that each Fund is responsible for its own expenses, including costs incurred in the maintenance of a Fund's corporate existence; the maintenance of the Fund's books, records and procedures; dealing with the Fund's shareholders; the payment of dividends; transfer of shares, including issuance, redemption and repurchase of shares; preparation of share certificates; reports and notices to shareholders; calling and holding of shareholders' and Board meetings; miscellaneous office expenses; brokerage commissions; custodian fees; legal and accounting fees; taxes; and federal and state registration fees. In addition, to avoid uncertainty, certain other expenses paid by the Funds under the Current Investment Advisory Agreements are listed expressly as Fund expenses in the New Investment Advisory Agreements. These expenses include auditing, fund accounting and financial administration fees, and other costs and expenses approved by the Board. Except as expressly provided for in the Current and New Investment Advisory Agreements, DMC is not responsible



for a Fund's expenses. The costs of the Transaction, however, are treated differently. See "Board considerations in approving the New Investment Advisory Agreements — Comparative Expenses."

Trustees, officers, and employees of DMC may be Directors and officers of the Funds, but trustees, officers, and employees of DMC who are Directors, officers and/ or employees of the Funds do not receive any compensation from the Funds for acting in a dual capacity. DMC and the Funds may share common facilities, which may include legal and accounting personnel, with appropriate proration of expenses between the applicable Fund and DMC.

***Limitation on Liability.*** Under the Current and New Investment Advisory Agreements, in the absence of willful misfeasance, bad faith, gross negligence, or a reckless disregard of the performance of its duties as the investment adviser to a Fund, DMC shall not be liable to a Fund or to any shareholder for any action or omission arising in the course of, or connected with, rendering its services under the Agreement or for any losses arising from the purchase, holding or sale of any security, or otherwise.

***Term and Continuance.*** If approved by shareholders of a Fund, the New Investment Advisory Agreement for the Fund will continue in effect for an initial period of two years from the date of implementation, and may be renewed thereafter provided that its renewal is specifically approved at least annually by both (i) the vote of a majority of the Fund's Board or the vote of a 1940 Act Majority (as defined below) of the outstanding voting securities of the Fund, and (ii) the vote of a majority of the Independent Directors cast in person at a meeting called for the purpose of voting on the approval. The Current Investment Advisory Agreements have similar provisions for their term and continuance. The initial two year period has elapsed for the Current Investment Advisory Agreements, which were most recently approved by the applicable Fund's Board in May 2009.

A "1940 Act Majority" of the outstanding voting securities of a Fund means the lesser of: (i) 67% or more of the voting securities of the Fund that are present in person or by proxy at a meeting if holders of shares representing more than 50% of the outstanding voting securities of the Fund are present in person or by proxy or (ii) more than 50% of the outstanding voting securities of the Fund.

***Termination.*** Each Fund's New Investment Advisory Agreement generally provides that the Agreement may be terminated at any time, without the payment of any penalty, by the Fund upon giving DMC 60 days' written notice, provided that the termination is directed or approved by the vote of a majority of the Fund's Board or by the vote of a 1940 Act Majority of the Fund's outstanding voting securities. The New Investment Advisory Agreements may also be terminated by DMC on



60 days' written notice. As required by the 1940 Act, each New Investment Advisory Agreement will also immediately terminate in the event of its "assignment" (as defined in the 1940 Act). The Current Investment Advisory Agreements contain similar termination provisions.

***Proxy Voting.*** Each Fund's New Investment Advisory Agreement provides explicitly that DMC shall be responsible for voting proxies of portfolio securities of each Fund and discretion relating to consent to corporate action and any other rights pertaining to each Fund's investment securities, a service currently provided by DMC but not provided for explicitly in the Current Investment Advisory Agreements.

***Amendments.*** Reflecting the requirements of the 1940 Act, both the Current Investment Advisory Agreements and the New Investment Advisory Agreements provide that an Agreement may not be amended without a shareholder vote and a vote of the Independent Directors, but that it may be amended without shareholder approval if the amendment relates solely to a change for which applicable laws and regulations do not require shareholder approval. The New Investment Advisory Agreements provide that they may be amended pursuant to a written agreement executed by a Fund and DMC.

***Other Changes.*** Each Fund's New Investment Advisory Agreement conforms the Fund's Current Investment Advisory Agreement to currently applicable laws and regulations and includes a number of minor wording changes that clarify non-material ambiguities in the Current Investment Advisory Agreement.

***Additional Information.*** A discussion of the basis for a Board's approval of each Fund's Current Investment Advisory Agreement is available, or will be made available, in the Fund's most recent or next-published annual or semiannual report to shareholders. Appendix B provides information on the Current Investment Advisory Agreements, including the dates of the Current Investment Advisory Agreements, the dates of last shareholder approval, and the reason for the most recent submission to shareholders. Exhibit A to Appendix A discloses the rate of compensation of DMC under both the Current Investment Advisory Agreements and the New Investment Advisory Agreements. Appendix C describes for each Fund the aggregate amount of DMC's fees and the amount and purpose of any other material payments to DMC (including any affiliated person of DMC) for services provided to each Fund during the last fiscal year of the Fund. These services will continue to be provided if the New Investment Advisory Agreements are approved. For other registered funds advised by DMC that have investment objectives similar to those of the Funds, Appendix D sets forth the fund's name, the fund's net assets as of July 31, 2009, the rate of DMC's compensation, and whether DMC has waived, reduced, or otherwise agreed to reduce its compensation under the applicable contract.



**Additional information about DMC**

Appendix E provides the name, address and principal occupation of each executive officer and each trustee of DMC, and each individual who is an officer or Director of the Funds and who is also an officer, employee or shareholder of DMC. Mr. Coyne, a Director and executive officer of the Funds, and certain other executive officers of the Funds, may be deemed to have a substantial interest in the proposal arising from equity interests (the "Equity Interests") they hold in Delaware Investments U.S., Inc. ("DIUS"), a subsidiary of DMHI and indirect parent of DMC. These persons may indirectly receive a portion of the purchase consideration for the Transaction as a result of the accelerated vesting of the Equity Interests caused by the Transaction. Based on the purchase consideration described above and other valuations, the approximate Equity Interests as a percentage of issued and outstanding equity of DIUS held by these persons as of August 18, 2009 are as follows: Patrick P. Coyne 0.32%; Michael J. Hogan 0.25%; See Yeng Quek 0.29%; David P. O'Connor 0.17%; and Richard Salus 0.01%. See Appendix E for a list of the executive officer positions with the Funds of each of the above named individuals. Generally, the Equity Interests will be fully vested and may be put back to DIUS or called by DIUS not later than thirteen months following the Closing. The holders of the Equity Interests will only obtain a portion of the purchase consideration if they put their vested Equity Interests back to DIUS or their Equity Interests are called by DIUS, and the dollar value of the Equity Interests will be ascertained at the time of the put or call, as the case may be. Certain other officers of DMC who are also officers of the Funds own or hold vested or unvested stock or options on stock of LNC.

**Board considerations in approving the New Investment Advisory Agreements**

At an in-person meeting held on September 3, 2009, the Boards, including the Independent Directors, discussed and unanimously approved the New Investment Advisory Agreement between each Fund and DMC. Concluding that approval of the New Investment Advisory Agreement would be in the best interests of each Fund and its shareholders, the Boards also directed that each New Investment Advisory Agreement be submitted to the applicable Fund shareholders for approval, and recommended that shareholders vote **FOR** approval of each New Investment Advisory Agreement.

Prior to their consideration of the New Investment Advisory Agreements, pursuant to letters from their independent legal counsel addressed to Macquarie Group and DMC, the Independent Directors requested extensive materials about the Transaction and matters related to the proposed approvals. To assist the Boards in considering the New Investment Advisory Agreements, Macquarie Group provided materials and information about Macquarie Group, including detailed



written responses to the questions posed to it by the Independent Directors. DMC also provided materials and information about the Transaction, including detailed written responses to the questions posed to it by the Independent Directors. The Boards requested and received certain information regarding the policies of DMC with respect to advisory fee levels and DMC's philosophy with respect to breakpoints; the structure of portfolio manager compensation; DMC's profitability; as well as any constraints or limitations on the availability of securities in certain investment styles that might inhibit DMC's ability to invest fully in accordance with Fund policies.

The Coordinating Director and the Chair of each committee of the Boards, together with their independent legal counsel and Fund counsel, met with representatives of DMC and Macquarie Group to discuss the Transaction in very preliminary terms. Thereafter, the Independent Directors, together with their independent legal counsel and Fund counsel, participated in a combination of four separate in-person meetings and telephone conference calls with representatives of DMC and Macquarie Group. In addition, management of DMC and certain Independent Directors met in person or by telephone on several other occasions during the months preceding the Boards' in-person meeting on September 3, 2009. At these meetings and on these telephone calls, the Transaction and future plans for DMC and the Funds were discussed at length. Finally, the Independent Directors consulted with their independent legal counsel in executive sessions on numerous occasions during the time period covered by the negotiation of the Transaction and discussed, among other things, the legal standards applicable to their review of the New Investment Advisory Agreements and certain other contracts and considerations relevant to their deliberations on whether to approve the New Investment Advisory Agreements.

At the in-person meetings and telephonic conference calls, the Directors discussed the Transaction with DMC management and with key Macquarie Group representatives. The meetings included discussions of the strategic rationale for the Transaction as discussed above under "Description of the Transaction," and Macquarie Group's general plans and intentions regarding the Funds and DMC. On these occasions, representatives of DMC and Macquarie Group made presentations to, and responded to questions from, the Directors. The Board members also inquired about the plans for, and anticipated roles and responsibilities of, key employees and officers of DMHI and DMC in connection with the Transaction.

In connection with the Directors' review of the New Investment Advisory Agreements, DMC and/or Macquarie Group emphasized that:

- They expected that there will be no adverse changes as a result of the Transaction in the nature, quality, or extent of services currently provided to the Funds and their shareholders, including investment management, distribution, or other shareholder services;

- No material changes in personnel or operations are currently contemplated in the operation of DMC under Macquarie Group as a result of the Transaction and no material changes are currently contemplated in connection with third party service providers to the Funds; and
- Under the Transaction Agreement, Macquarie Bank Limited has agreed to conduct, and to cause its affiliates to conduct, their respective businesses in compliance with the conditions of Section 15(f) of the 1940 Act with respect to the Funds to the extent within its control, including maintaining Board composition of at least 75% of the Board members qualifying as Independent Directors and not imposing any unfair burden on the Funds for at least two years from the Closing.

In addition to the information provided by DMC and Macquarie Group as described above, the Directors also considered all other factors they believed to be relevant to evaluating the New Investment Advisory Agreements, including the specific matters discussed below. In their deliberations, the Directors did not identify any particular information that was controlling, and different Directors may have attributed different weights to the various factors. However, for each Fund, the Directors determined that the overall arrangements between the Fund and DMC, as provided in its respective New Investment Advisory Agreement, including the proposed advisory fees and the related administration arrangements between the Fund and DMC, were fair and reasonable in light of the services to be performed, expenses incurred and such other matters as the Directors considered relevant. Factors evaluated included:

- The reputation, financial strength, and resources of Macquarie Group as well as its historic and ongoing commitment to the asset management business in Australia and other parts of the world;
- The terms and conditions of the New Investment Advisory Agreements, including that each Funds contractual fee rate under the New Investment Advisory Agreements will remain the same (see The New Investment Advisory Agreements above);
- The Boards full annual review of the Current Investment Advisory Agreements at their in-person meeting in May 2009 as required by the 1940 Act and their determination at that time that (i) DMC had the capabilities, resources, and personnel necessary to provide the satisfactory advisory and administrative services currently provided to each Fund and (ii) the advisory and/or management fees paid by each Fund represented reasonable compensation to DMC in light of the services provided, the



costs to DMC of providing those services, economies of scale, and the fees and other expenses paid by similar funds and such other matters that the Boards considered relevant in the exercise of their reasonable judgment;

- The portfolio management teams for the Funds are not currently expected to change as a result of the Transaction;
- LNICs and Macquarie Bank Limiteds execution of an agreement with the Funds (the Expense Agreement) pursuant to which LNIC and Macquarie Bank Limited have agreed to pay (or reimburse) all reasonable out-of-pocket costs and expenses of the Funds in connection with the Boards consideration of the Transaction, the New Investment Advisory Agreements and related agreements, and all costs related to proxy solicitation (subject to certain limited exceptions);
- The likelihood that Macquarie Group would invest additional amounts in Delaware Investments, including DMC, which could result in increased assets under management, which would in turn allow some Funds the potential opportunity to achieve economies of scale and lower fees payable by Fund shareholders; and
- The compliance and regulatory history of Macquarie Group and its affiliates.

Certain of these considerations are discussed in more detail below.

In making their decision relating to the approval of each Funds New Investment Advisory Agreement, the Independent Directors gave attention to all information furnished. The following discussion, however, identifies the primary factors taken into account by the Directors and the conclusions reached in approving the New Investment Advisory Agreements.

***Nature, Extent, and Quality of Service.*** The Directors considered the services historically provided by DMC to the Funds and their shareholders. In reviewing the nature, extent, and quality of services, the Boards considered that the New Investment Advisory Agreements will be substantially similar to the Current Investment Advisory Agreements (as discussed above under The New Investment Advisory Agreements), and they therefore, considered the many reports furnished to them throughout 2008 and 2009 at regular Board meetings covering matters such as the relative performance of the Funds; the compliance of portfolio managers with the investment policies, strategies, and restrictions for the Funds; the compliance of management personnel with the Code of Ethics adopted throughout the Delaware Investments® Family of Funds; and the adherence to fair value pricing procedures as established by the Boards. The Directors were pleased with the current staffing of DMC and the emphasis placed



on research and risk management in the investment process. Favorable consideration was given to DMCs efforts to maintain expenditures and, in some instances, increase financial and human resources committed to Fund matters.

The Boards were assured that shareholders would continue to receive the benefits provided to Fund shareholders by being part of the Delaware Investments® Family of Funds. Based on the information provided by DMC and Macquarie Group, including that Macquarie Group and DMC currently expected no material changes as a result of the Transaction in (i) personnel or operations of DMC or (ii) third party service providers to the Funds, the Boards concluded that the satisfactory nature, extent, and quality of services currently provided to the Funds and their shareholders were very likely to continue under the New Investment Advisory Agreements. The Boards concluded that it was very unlikely that any unfair burden would be imposed on any of the Funds for the first two years following the Closing as a result of the Transaction. Consequently, the Boards concluded that they did not expect the Transaction to result in any adverse changes in the nature, quality, or extent of services (including investment management and other shareholder services) currently provided to the Funds and their shareholders.

***Investment Performance.*** The Boards considered the overall investment performance of DMC and the Funds. The Directors placed significant emphasis on the investment performance of the Funds in view of its importance to shareholders. Although the Directors gave appropriate consideration to performance reports and discussions with portfolio managers at Board meetings throughout the year, the Directors gave particular weight to their review of investment performance in connection with the approval of the Current Investment Advisory Agreements at the Board meeting held in May 2009. At that meeting, the Directors reviewed reports for each Fund prepared by Lipper, Inc., an independent statistical compilation organization (Lipper), which showed the Funds investment performance as of December 31, 2008 in comparison to a group of funds selected by Lipper as being similar to the Fund (the Performance Universe). A fund with the best performance ranked first, and a fund with the poorest performance ranked last. The highest/best performing 25% of funds in the Performance Universe made up the first quartile; the next 25% made up the second quartile; the next 25% made up the third quartile; and the poorest/worst performing 25% of funds in the Performance Universe made up the fourth quartile. Annualized investment performance for each Fund was shown for the past 1-, 3-, 5-, and 10-year periods, to the extent applicable, compared to that of the Performance Universe. The Boards objective was that each Funds performance for the periods considered be at or above the median of its Performance Universe. During the May 2009 review process, the Directors observed the significant improvements to relative investment performance of the funds in the Delaware Investments Family of Funds as compared to the funds performance as of December 31, 2007.



At their meeting on September 3, 2009, the Directors, including the Independent Directors in consultation with their independent counsel, updated their examination of the investment performance of each fund in the Delaware Investments® Family of Funds. The Directors compared the performance of each fund in the Delaware Investments Family of Funds to that of its respective Performance Universe for the 1-, 3-, 5-, and 10-year periods ended June 30, 2009 and compared its relative investment performance against the corresponding relative investment performance of each fund in the Delaware Investments Family of Funds for such time periods ended December 31, 2008, to the extent applicable. As of June 30, 2009, 30 of the funds in the Delaware Investments Family of Funds had investment performance relative to that of the respective Performance Universe that was better than the corresponding relative investment performance at December 31, 2008 for all applicable time periods. At June 30, 2009, an additional six funds in the Delaware Investments Family of Funds had investment performance relative to that of their respective Performance Universe that was better than the corresponding relative investment performance at December 31, 2008 for a majority of the applicable time periods. At June 30, 2009, 15 additional funds in the Delaware Investments Family of Funds had investment performance relative to that of their respective Performance Universe that was better than the corresponding relative investment performance at December 31, 2008 for an equal number of the applicable time periods, and only 29 funds in the Delaware Investments Family of Funds had poorer relative investment performance at June 30, 2009 compared to that at December 31, 2008.

The Boards therefore concluded that the investment performance of the funds in the Delaware Investments Family of Funds on an aggregate basis had continued to improve relative to their respective Performance Universe since the data reviewed at the May 2009 meeting. Based on information provided by DMC and Macquarie Group, the Boards concluded that neither the Transaction nor the New Investment Advisory Agreements would likely have an adverse effect on the investment performance of any Fund because (i) DMC and Macquarie Group did not currently expect the Transaction to cause any material change to the Funds' portfolio management teams responsible for investment performance, which the Boards found to be satisfactory and improving, (ii) as discussed in more detail below, the Funds' expenses were not expected to increase as a result of the Transaction, (iii) the Directors thought it was extremely unlikely that the Funds would bear any Transaction-related expenses, and (iv) there was not expected to be any "unfair burden" imposed on the Funds as a result of the Transaction.

***Comparative Expenses.*** The Directors also evaluated expense comparison data for the Funds previously considered in May 2009. At that meeting, DMC had provided the Boards with information on pricing levels and fee structures for the Funds and comparative funds. The Directors focused on the comparative analysis of the



effective management fees and total expense ratios of each Fund versus the effective management fees and expense ratios of a group of funds selected by Lipper as being similar to each Fund (the "Expense Group"). In reviewing comparative costs, each Fund's contractual management fee and the actual management fee incurred by the Fund were compared with the contractual management fees (assuming all funds in the Expense Group were similar in size to the Fund) and actual management fees (as reported by each fund) of other funds within the Expense Group, taking into account any applicable breakpoints and fee limitations. Each Fund's total expenses were also compared with those of its Expense Group. The Directors also considered fees paid to Delaware Investments for non-management services. The Directors' objective was for each Fund's total expense ratio to be competitive with that of the funds in the Expense Group. According to the Lipper reports furnished for the May 2009 meeting, the effective management fees and total expense ratios for a majority of the funds in the Delaware Investments® Family of Funds were below the respective Expense Group median. At the September 3, 2009 meeting, DMC advised the Boards that the more recent comparative expenses for the Funds remained consistent with the previous review in May 2009, and consequently the Directors concluded that expenses of the Funds were satisfactory.

The Boards also considered the Expense Agreement in evaluating Fund expenses. The Expense Agreement provides that LNIC and Macquarie Bank Limited will pay or reimburse the Funds for all reasonable out-of-pocket costs and expenses in connection with the Transaction, and the consideration of the New Investment Advisory Agreements (subject to certain limited exceptions). These obligations of LNIC and Macquarie Bank Limited apply regardless of whether or not the Transaction is consummated. As a result, the Funds will bear no costs in connection with or related to evaluating the Transaction or seeking or obtaining shareholder approval of the New Investment Advisory Agreements (other than as described above).

Based on information provided by DMC and Macquarie Group, the Boards concluded that neither the Transaction nor the New Investment Advisory Agreements would likely have an adverse effect on the Funds' expenses because (i) each Fund's contractual fee rates under the New Investment Advisory Agreements would remain the same, (ii) under the Expense Agreement, the Funds would be reimbursed for all reasonable out-of-pocket costs and expenses in connection with the Transaction and the related proxy solicitation (subject to certain limited exceptions), (iii) consistent with Section 15(f) of the 1940 Act, no "unfair burden" would be imposed on the Funds for the first two years after the Closing, and (iv) the expense ratios of certain Funds might decline as a result of the possible increased investment in Delaware Investments by Macquarie Group, as discussed below under “Economies of Scale.”



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***Management Profitability.*** At their meeting on September 3, 2009, the Boards evaluated DMC’s profitability in connection with the operation of the Funds. The Boards had previously considered DMC’s profitability in connection with the operation of the Funds at their May 2009 meeting. At that meeting, the Boards reviewed an analysis that addressed the overall profitability of Delaware Investments’ business in providing management and other services to each of the Funds and the Delaware Investments® Family of Funds as a whole. Specific attention was given to the methodology followed in allocating costs for the purpose of determining profitability.

At the May 2009 meeting, representatives of DMC had stated that the level of profits of DMC, to a certain extent, reflected operational cost savings and efficiencies initiated by Delaware Investments (including DMC and its affiliates that provide services to the Funds). The Boards considered Delaware Investments’ efforts to improve services provided to Fund shareholders and to meet additional regulatory and compliance requirements resulting from recent industry-wide SEC initiatives. At that meeting, the Boards found that the management fees charged were reasonable in light of the services rendered and the level of profitability of DMC. At the September 3, 2009 meeting, DMC advised the Boards that DMC did not expect the Transaction to affect materially the profitability of Delaware Investments compared to the level of profitability considered during the May 2009 review. Moreover, the Directors reviewed *pro forma* balance sheets of certain key companies in Delaware Investments as of June 30, 2009 (which were provided by Macquarie Group and DMC in response to the Directors’ requests), and evaluated the projections of Delaware Investments’ capitalization following the Transaction for purposes of evaluating the financial ability of Delaware Investments to continue to provide the nature, extent, and quality of services as it had under the Current Investment Advisory Agreements.

Based on information provided by DMC and Macquarie Group, the Boards concluded that DMC and Delaware Investments would be sufficiently capitalized following the Transaction to continue the same level and quality of services to the Funds under the New Investment Advisory Agreements as was the case under the Current Investment Advisory Agreements. The Boards also concluded that Macquarie Group had sufficient financial strength and resources, as well as an ongoing commitment to a global asset management business, to continue investing in Delaware Investments, including DMC to the extent that Macquarie Group determined it was appropriate. Finally, because services and costs were expected to be substantially the same (and DMC had represented that, correspondingly, profitability would be about the same), under the New Investment Advisory Agreements as under the Current Investment Advisory Agreements, the Directors concluded that the profitability of Delaware Investments would not result in an inequitable charge on



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the Funds or their shareholders. Accordingly, the Boards concluded that the fees charged under the New Investment Advisory Agreements would be reasonable in light of the services to be provided and the expected profitability of DMC.

***Economies of Scale.*** The Directors considered whether economies of scale would be realized by Delaware Investments as each Fund’s assets increase and the extent to which any economies of scale would be reflected in the management fees charged. The Directors took into account DMC’s practice of maintaining the competitive nature of management fees based on its analysis of fees charged by comparable funds. DMC management believed, and the Boards agreed, that the Funds were priced with breakpoints and relatively low management fees to reflect potential economies of scale to Fund shareholders. The Boards also acknowledged Macquarie Group’s statement that the Transaction would not by itself immediately provide additional economies of scale given Macquarie Group’s limited presence in the U.S. mutual fund market.

Nonetheless, the Directors concluded that additional economies of scale could potentially be achieved in the future if DMC were owned by Macquarie Group as a result of Macquarie Group’s willingness to invest additional amounts in Delaware Investments if appropriate opportunities arise.

***Fall-Out Benefits.*** The Boards acknowledged that DMC would continue to benefit from soft dollar arrangements using portfolio brokerage of each Fund that invests in equity securities and that DMCs profitability would likely be somewhat lower without the benefit of practices with respect to allocating Fund portfolio brokerage for brokerage and research services. The Boards also considered that Macquarie Group and Delaware Investments may derive reputational, strategic, and other benefits from their association with the Delaware Investments Family of Funds and evaluated the extent to which Delaware Investments might derive ancillary benefits from fund operations, including the potential for procuring additional business as a result of the prestige and visibility associated with its role as service provider to the Delaware Investments® Family of Funds and the benefits from allocation of fund brokerage to improve trading efficiencies. However, the Boards concluded that (i) any such benefits under the New Investment Advisory Agreements would not be dissimilar from those existing under the Current Investment Advisory Agreements, (ii) such benefits did not impose a cost or burden on the Funds or their shareholders, and (iii) such benefits would probably have an indirectly beneficial effect on the Funds and their shareholders because of the added importance that DMC and Macquarie Group might attach to the Funds as a result of the fall-out benefits that the Funds conveyed.

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***The Transaction Agreement.*** The Directors reviewed the Transaction Agreement in advance of the September 3, 2009 meeting. The Directors considered the terms of the Transaction Agreement, including those related to Section 15(f) of the 1940 Act and that LNIC and Macquarie Bank Limited will bear the expenses related to the Funds proxy solicitations. At the meeting, the Directors discussed the purchase price to be paid and noted the conditions to the Closing, including the requirements for obtaining consents to the change in control from Delaware Investments advisory clients, such as the Funds. The Directors believed that Delaware Investments ability to continue to manage the general account assets of certain LNC subsidiaries was important because it allowed Delaware Investments overhead expenses to be spread over a larger base of assets under management and thus potentially reduce costs to the Funds and their shareholders as compared to the costs that might apply if Delaware Investments did not manage the general account assets. Consequently, the Directors evaluated the provisions of the Transaction Agreement related to the management of those assets and concluded that those provisions were satisfactory and likely to be beneficial to Fund shareholders.

***Board Review of Macquarie Group.*** The Directors reviewed detailed information supplied by Macquarie Group about its operations as well as other information regarding Macquarie Group provided by independent legal counsel to the Independent Directors. As previously noted, to consider Delaware Investments ability to continue to provide the same level and quality of services to the Funds, the Boards requested, received and reviewed pro forma balance sheets of certain key companies in Delaware Investments as of June 30, 2009, which projected Delaware Investments capitalization following the Transaction. Based on this review, the Directors concluded that Delaware Investments would continue to have the financial ability to maintain the high quality of services required by the Funds. The Directors noted that there would be a limited transition period during which some services previously provided by LNC to Delaware Investments would continue to be provided by LNC after the Closing, and concluded that this arrangement would help minimize disruption in Delaware Investments provision of services to the Funds following the Transaction.

Macquarie Group described its proposed changes to Delaware Investments corporate governance, primarily through the anticipated addition of certain Macquarie Group officers to DMHIs board of directors and to Delaware Investments distribution and product management affiliates. The Directors considered favorably Macquarie Groups statement that it had no current intention to change the executive, administrative, investment, or support staff of Delaware Investments in any significant way as a result of the Transaction. Macquarie Group described the proposed harmonization of the compensation system in use at Delaware Investments with the compensation plan used by Macquarie Group, including short-term and

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long-term incentive compensation and equity interests for executive officers and investment personnel. Macquarie Group described its current intention to enhance certain administrative and operational areas of DMC following the Transaction, including information technology, product management, and risk management.

The Boards considered Macquarie Groups current intention to leave the Funds other service providers in place. The Boards also considered Macquarie Groups current strategic plans to increase its asset management activities, one of its core businesses, particularly in North America, and its statement that its acquisition of DMC is an important component of this strategic growth and the establishment of a significant presence in the United States. Based in part on the information provided by DMC and Macquarie Group, the Boards concluded that Macquarie Groups acquisition of Delaware Investments could potentially enhance the nature, quality, and extent of services provided to the Funds and their shareholders.

DMC and Macquarie Group explained to the Boards that, as a subsidiary of an Australian authorized deposit-taking institution, Delaware Investments would become subject to certain Australian regulatory oversight and requirements following the Transaction, including those related to disclosure, fund holdings, affiliated transactions, advisory agreements, and expense limitation agreements. DMC and Macquarie Group also explained to the Boards that certain exemptive relief had been provided to Macquarie Group by the Australian bank regulator in anticipation of the Transaction, and the Boards were informed of the nature of future relief that may be required. Based on the information provided and representations made by DMC and Macquarie Group, the Boards concluded that the Australian bank regulatory requirements would not have a material effect on the operations of DMC or the Funds, including DMCs ability in its discretion to provide voluntary expense limitations and reimbursements to the Funds or to contribute appropriate levels of seed capital to new funds.

The Boards noted that DMC has placed brokerage transactions with a broker/ dealer affiliate of Macquarie Group and received research in connection with those transactions. In addition, certain other Macquarie Group affiliates participate as underwriters for securities offerings outside of the United States. Consequently, the Boards determined to have DMC report to them regularly to monitor any brokerage transactions with Macquarie Group affiliates for compliance with the requirements of Section 15(f) and Section 17(e) of the 1940 Act, and to ensure compliance with the Funds procedures under Rule 10f-3 promulgated under the 1940 Act for offerings in which a Macquarie Group affiliate is a member of the underwriting syndicate.

***Conclusion.*** The Independent Directors of each Fund deliberated in executive session; the entire Board of each Fund, including the Independent Directors, then approved each New Investment Advisory Agreement. The Boards concluded that the



advisory fee rate under each New Investment Advisory Agreement is reasonable in relation to the services provided and that execution of the New Investment Advisory Agreements is in the best interests of the shareholders. For each Fund, the Directors noted that they had concluded in their most recent advisory agreement continuance considerations in May 2009 that the management fees and total expense ratios were at acceptable levels in light of the quality of services provided to the Funds and in comparison to those of the Funds respective peer groups; that the advisory fee schedule would not be increased and would stay the same for all of the Funds; that the total expense ratio had not changed materially since that determination; and that DMC had represented that the overall expenses for each Fund were not expected to be adversely affected by the Transaction. On that basis, the Directors concluded that the total expense ratio and proposed advisory fee for the Funds anticipated to result from the Transaction was acceptable. In approving each New Investment Advisory Agreement, each Board stated that it anticipated reviewing the continuance of the agreement in advance of the expiration of the initial two-year period.

**Required vote**

To become effective with respect to a particular Fund, the New Investment Advisory Agreement for that Fund must be approved by a 1940 Act Majority vote of the Funds outstanding voting securities. The approval of one Funds New Investment Advisory Agreement is not contingent on the approval of any other Funds New Investment Advisory Agreement. Each New Investment Advisory Agreement was approved separately by the Independent Directors and by the Board of the applicable Fund as a whole after consideration of all factors that it determined to be relevant to its deliberations, including those discussed above. The Board of each Fund also determined to submit each applicable Funds New Investment Advisory Agreement for consideration by the shareholders of the Fund. If the shareholders of a Fund do not approve the Funds New Investment Advisory Agreement, the Board of that Fund will consider other possible courses of action for the Fund, including entering into an interim advisory agreement with DMC pursuant to Rule 15a-4 of the 1940 Act.

**FOR THE REASONS DISCUSSED ABOVE, THE BOARD OF EACH FUND UNANIMOUSLY RECOMMENDS THAT YOU VOTE FOR THE APPROVAL OF THE NEW INVESTMENT ADVISORY AGREEMENT.**

## VOTING INFORMATION

**How will shareholder voting be handled?**

Only shareholders of record of the Funds at the close of business on September 18, 2009 (the “Record Date”), will be entitled to notice of, and to vote at, the Meeting on the proposal described in this Proxy Statement. Shareholders will be entitled to one vote for each full share and a fractional vote for each fractional share that they hold. If sufficient votes to approve the proposal for a Fund are not received by the date of the Meeting, the Meeting may be adjourned for that Fund to permit further solicitations of proxies. Any adjournment would require a vote in favor of the adjournment by the holders of a majority of the shares present at the Meeting in person or by proxy (or, for some Funds, an adjournment may be called by an officer of the Fund, the chairperson of the Board, or the chairperson of the Meeting). The persons named as proxies on the enclosed proxy cards will vote their proxies in their discretion on questions of adjournment and any other items (other than the proposal) that properly come before the Meeting.

Abstentions and broker non-votes (if any) will be counted for purposes of determining whether a quorum is present at the Meeting. Abstentions and broker non-votes (if any) will have the same effect as a vote “against” the proposal. Because no discretionary proposals are included in this Proxy Statement, the Funds do not anticipate receiving broker non-votes.

**How do I ensure my vote is accurately recorded?**

You may attend the Meeting and vote in person. You may also vote by completing, signing, and returning the enclosed proxy card in the enclosed postage paid envelope, or by telephone or through the Internet. If you return your signed proxy card or vote by telephone or through the Internet, your vote will be officially cast at the Meeting by the persons appointed as proxies. A proxy card is, in essence, a ballot. If you sign and date the proxy card but give no voting instructions, your shares will be voted “For” the proposal. Your proxies will also be voted in the discretion of the persons appointed as proxies on any other matters that may properly come before the Meeting or any adjournment or postponement of the Meeting, although management of the Funds does not expect any such matters to come before the Meeting. If your shares are held of record by a broker/dealer and you wish to vote in person at the Meeting, you must obtain a legal proxy from the broker of record and present it at the Meeting.



**May I revoke my proxy?**

You may revoke your proxy for a Fund at any time before it is voted by sending a written notice to the Fund expressly revoking your proxy, by signing and forwarding to the Fund a later-dated proxy, or by attending the Meeting and voting in person. If your shares are held in the name of your broker, you will have to make arrangements with your broker to revoke a previously executed proxy. If you wish to vote in-person at the Meeting, you must obtain a legal proxy from your broker of record and present it at the Meeting.

**What other matters will be voted upon at the Meeting?**

The Boards do not intend to bring any matters before the Meeting other than as described in this Proxy Statement. Because the Meeting is a special meeting, the Boards do not anticipate that any other matters will be brought before the Meeting by others. However, if any other matter legally comes before the Meeting, proxies will be voted in the discretion of the persons appointed as proxies.

**Who is entitled to vote?**

Only shareholders of record on the Record Date will be entitled to vote at the Meeting on the matters described in this Proxy Statement. The table in Appendix F shows the number of shares outstanding for each Fund as of July 31, 2009.

**What is the Quorum requirement?**

A "Quorum" is the minimum number of shares that must be present in order to conduct the Meeting. A Quorum for a particular Fund means the presence in person or by proxy of holders of a majority of outstanding shares entitled to vote at the Meeting.

**Who will pay the expenses of the Meeting?**

Under the Expense Agreement, all reasonable out-of-pocket costs and expenses incurred by the Funds related to the Meeting, including the costs of preparing proxy solicitation materials and soliciting proxies in connection with the Meeting, will be reimbursed by Macquarie Bank Limited and LNIC (subject to certain limited exceptions). The Funds have engaged Computershare Fund Services, Inc. ("Computershare") to solicit proxies from brokers, banks, other institutional holders and individual shareholders at an anticipated cost of approximately $45,000. Fees and expenses may be greater depending on the effort necessary to obtain shareholder votes. The agreement with Computershare provides that Computershare shall be indemnified against certain liabilities and expenses, including liabilities under the federal securities laws.

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**What other solicitations will be made?**

This proxy solicitation is being made by the Boards for use at the Meeting. In addition to solicitations by mail, solicitations also may be made by advertisement, telephone, telegram, facsimile transmission or other electronic media, or personal contacts. The Funds will request broker/dealer firms, custodians, nominees, and fiduciaries to forward proxy materials to the beneficial owners of the shares of record. Reasonable out-of-pocket expenses of broker/dealer firms, custodians, nominees, and fiduciaries for their reasonable expenses incurred in connection with the proxy solicitation will be shared equally by LNIC and Macquarie Bank Limited as provided above. In addition to solicitations by mail, officers and employees of the Funds, DMC, and their affiliates may, without extra pay, conduct additional solicitations by telephone, telecopy, and personal interviews. The Funds expect that any solicitations will be primarily by mail, but also may include telephone, telecopy, or oral solicitations.

As the Meeting date approaches, you may receive a telephone call from a representative of Computershare if your votes have not yet been received. Proxies that are obtained telephonically will be recorded in accordance with the procedures described below. These procedures are designed to ensure that both the identity of the shareholder casting the vote and the voting instructions of the shareholder are accurately determined.

In all cases where a telephonic proxy is solicited, the Computershare representative is required to ask for each shareholder's full name and address, and to confirm that the shareholder has received the proxy materials in the mail. If the shareholder is a corporation or other entity, the Computershare representative is required to ask for the person's title and confirmation that the person is authorized to direct the voting of the shares. If the information elicited matches the information previously provided to Computershare, then the Computershare representative has the responsibility to explain the voting process, read the proposal listed on the proxy card and ask for the shareholder's instructions on the proposal. Although the Computershare representative is permitted to answer questions about the process, he or she is not permitted to recommend to the shareholder how to vote, other than to read any recommendation set forth in this Proxy Statement. Computershare will record the shareholder's instructions on the card. Within 72 hours, the shareholder will be sent a letter or mailgram to confirm his or her vote and asking the shareholder to call Computershare immediately if his or her instructions are not correctly reflected in the confirmation.

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**Why did my household receive only one copy of this Proxy Statement?**

Unless you have instructed the Funds not to do so, only one copy of this Proxy Statement will be mailed to multiple Fund shareholders sharing an address (a "Household"), even if more than one shareholder in a Household is a Fund shareholder of record. If you need additional copies of this Proxy Statement, please contact your participating broker/dealer firm or other financial intermediary. If you do not want the mailing of proxy solicitation materials to be combined with those of other members of your Household in the future, or if you are receiving multiple copies and would rather receive just one copy for the Household, please contact your participating broker/dealer firm or other financial intermediary or, if you hold Fund shares directly with the Funds, you may write to the Funds c/o BNY Mellon Shareowner Services, 480 Washington Boulevard, Jersey City, New Jersey 07310 or call toll-free 800 851-9677.

**How do I submit a shareholder proposal for inclusion in the Funds' proxy statement for the Funds' next annual shareholder meeting?**

Instructions for the submission of shareholder proposals for the Funds' 2010 annual meeting of shareholders were included in the Funds' proxy statement for their 2009 Annual Meeting of Shareholders, which is available on the Web site of the SEC at www.sec.gov.

**How may I communicate with the Boards?**

Shareholders who wish to communicate with the Boards may address correspondence to Ann R. Leven, Coordinating Director for the Funds, c/o the applicable Fund at 2005 Market Street, Philadelphia, Pennsylvania 19103. Shareholders may also send correspondence to the Coordinating Director, or any individual Director, c/o the applicable Fund at 2005 Market Street, Philadelphia, Pennsylvania 19103. Without opening any such correspondence, Fund management will promptly forward all such correspondence to the intended recipient(s).

## MORE INFORMATION ABOUT THE FUNDS

***Fund Accountants.*** The Bank of New York Mellon ("BNY Mellon"), One Wall Street, New York, New York 10286-0001, provides fund accounting and financial administration services to each Fund. Those services include providing financial reporting information, regulatory compliance testing, and other related accounting services. For these services, the Funds pay BNY Mellon an asset-based fee, subject to certain fee minimums plus certain out-of-pocket expenses and transactional charges.



DSC provides fund accounting and financial administration oversight services to the Funds. Those services include overseeing the Funds' pricing process, the calculation and payment of fund expenses, and financial reporting in shareholder reports, registration statements and other regulatory filings. DSC also manages the process for the payment of dividends and distributions and the dissemination of Fund performance data. For these services, the Funds pay DSC fees based on the aggregate daily net assets of the funds in the Delaware Investments® Family of Funds. The fees payable to BNY Mellon and DSC for the services described above are allocated among all funds in the Delaware Investments Family of Funds on a relative net asset value basis.

***Registrar and Stock Transfer Agent.*** BNY Mellon Shareowner Services, 480 Washington Boulevard, Jersey City, New Jersey 07310, serves as registrar and stock transfer agent for the Funds.

***Independent Auditors.*** Ernst & Young LLP ("E&Y") serves as the Funds' independent registered public accounting firm. Representatives of E&Y are not expected to be present at the Meeting, but will be available telephonically if necessary.

## PRINCIPAL HOLDERS OF SHARES

As of July 31, 2009, the officers and Directors of the Funds, as a group, owned less than 1% of the outstanding voting shares of each of the Funds.

To the best knowledge of the Funds, as of July 31, 2009, no person, except as set forth in Appendix G, owned of record 5% or more of the outstanding shares of any Fund. Except as noted in Appendix G, the Funds have no knowledge of beneficial ownership of 5% or more of the outstanding shares of any Fund.

**APPENDICES TO**
**PROXY STATEMENT**





**APPENDIX A  FORM OF NEW INVESTMENT ADVISORY AGREEMENT**

AGREEMENT, made by and between **[NAME OF INVESTMENT COMPANY]**, a [Delaware statutory trust] [Maryland corporation] [Minnesota corporation] Massachusetts business trust] (the Company), and **DELAWARE MANAGEMENT COMPANY**, a series of Delaware Management Business Trust, a Delaware statutory trust (the Investment Manager).

**W I T N E S S E T H:**

WHEREAS, the Company has been organized and operates as an investment company registered under the Investment Company Act of 1940, as amended (the 1940 Act);

WHEREAS, the Company engages in the business of investing and reinvesting its assets in securities;

WHEREAS, the Investment Manager is registered under the Investment Advisers Act of 1940, as amended (the Advisers Act), as an investment adviser and engages in the business of providing investment management services; and

WHEREAS, the Company and the Investment Manager desire to enter into this Agreement so that the Investment Manager may provide investment management services to the Company.

NOW, THEREFORE, in consideration of the mutual covenants herein contained, and each of the parties hereto intending to be legally bound, it is agreed as follows:

1. The Company hereby employs the Investment Manager to manage the investment and reinvestment of the Companys assets and to administer the Companys affairs, subject to the direction of the Companys Board of Trustees/ Directors and officers for the period and on the terms hereinafter set forth. The Investment Manager hereby accepts such employment and agrees during such period to render the services and assume the obligations herein set forth for the compensation herein provided. The Investment Manager shall for all purposes herein be deemed to be an independent contractor, and shall, unless otherwise expressly provided and authorized, have no authority to act for or represent the Company in any way, or in any way be deemed an agent of the Company. The Investment Manager shall regularly make decisions as to what securities and other instruments to purchase and sell on behalf of the Company and shall effect the purchase and sale of such investments in furtherance of the Companys investment objectives and policies and shall furnish the Board of Trustees/Directors of the Company with such information and reports regarding the Companys investments as the Investment Manager deems appropriate or as the Trustees/Directors of the Company may reasonably request.



Such decisions and services shall include exercising discretion regarding any voting rights, rights to consent to corporate actions and any other rights pertaining to the Companys investment securities.

2. The Company shall conduct its own business and affairs and shall bear the expenses and salaries necessary and incidental thereto, including, but not in limitation of the foregoing, the costs incurred in: the maintenance of its corporate existence; the maintenance of its own books, records and procedures; dealing with its own shareholders; the payment of dividends; transfer of shares, including issuance, redemption and repurchase of shares; preparation of share certificates; reports and notices to shareholders; calling and holding of shareholders’ and Trustees’/Directors’ meetings; miscellaneous office expenses; brokerage commissions; custodian fees; legal, auditing, fund accounting and financial administration fees; taxes; federal and state registration fees; and other costs and expenses approved by the Board of Directors/Trustees. Trustees, officers and employees of the Investment Manager may be directors, trustees, officers and employees of any of the investment companies within the Delaware Investments family of funds (including the Company). Trustees, officers and employees of the Investment Manager who are directors, trustees, officers and/or employees of these investment companies shall not receive any compensation from such companies for acting in such dual capacity.

In the conduct of the respective businesses of the parties hereto and in the performance of this Agreement, the Company and Investment Manager may share facilities common to each, which may include legal and accounting personnel, with appropriate proration of expenses between them.

3. (a) Subject to the primary objective of obtaining the best execution, the Investment Manager may place orders for the purchase and sale of portfolio securities and other instruments with such broker/dealers selected by the Investment Manager who provide statistical, factual and financial information and services to the Company, to the Investment Manager, to any sub-adviser (as defined in Paragraph 5 hereof, a “Sub-Adviser”) or to any other fund or account for which the Investment Manager or any Sub-Adviser provides investment advisory services and/ or with broker/dealers who sell shares of the Company or who sell shares of any other investment company (or series thereof) for which the Investment Manager or any Sub-Adviser provides investment advisory services. Broker/dealers who sell shares of any investment companies or series thereof for which the Investment Manager or Sub-Adviser provides investment advisory services shall only receive orders for the purchase or sale of portfolio securities to the extent that the placing of such orders is in compliance with the rules of the Securities and Exchange Commission (the “SEC”) and Financial Industry Regulatory Authority, Inc. (“FINRA”) and does not take into account such broker/dealer’s promotion or sale of such shares.



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(b) Notwithstanding the provisions of subparagraph (a) above and subject to such policies and procedures as may be adopted by the Board of Trustees/Directors and officers of the Company, the Investment Manager may cause the Company to pay a member of an exchange, broker or dealer an amount of commission for effecting a securities transaction in excess of the amount of commission another member of an exchange, broker or dealer would have charged for effecting that transaction, in such instances where the Investment Manager has determined in good faith that such amount of commission was reasonable in relation to the value of the brokerage and research services provided by such member, broker or dealer, viewed in terms of either that particular transaction or the Investment Manager’s overall responsibilities with respect to the Company and to other investment companies (or series thereof) and other advisory accounts for which the Investment Manager exercises investment discretion.

4. As compensation for the investment services to be rendered to the Company by the Investment Manager under the provisions of this Agreement, the Company shall pay monthly to the Investment Manager exclusively from the Company’s assets, a fee based on the average daily net assets of the Company during the month. Such fee shall be calculated in accordance with the fee schedule applicable to the Company as set forth in Exhibit A hereto.

If this Agreement is terminated prior to the end of any calendar month, the management fee for the Company shall be prorated for the portion of any month in which this Agreement is in effect according to the proportion which the number of calendar days during which the Agreement is in effect bears to the number of calendar days in the month, and shall be payable within 10 calendar days after the date of termination.

5. The Investment Manager may, at its expense, select and contract with one or more investment advisers registered under the Advisers Act (“Sub-Advisers”) to perform some or all of the services for the Company for which it is responsible under this Agreement. The Investment Manager will compensate any Sub-Adviser for its services to the Company. The Investment Manager may terminate the services of any Sub-Adviser at any time in its sole discretion, and shall at such time assume the responsibilities of such Sub-Adviser unless and until a

successor Sub-Adviser is selected and the requisite approval of the Company’s shareholders, if any is required, is obtained. The Investment Manager will continue to have responsibility for all advisory services furnished by any Sub-Adviser.

6. The services to be rendered by the Investment Manager to the Company under the provisions of this Agreement are not to be deemed to be exclusive. The Investment Manager, its trustees, officers, employees, agents and shareholders may engage in other businesses, may render investment advisory services to other



investment companies, or to any other corporation, association, firm or individual, and may render underwriting services to the Company or to any other investment company, corporation, association, firm or individual, so long as the Investment Manager’s other activities do not impair its ability to render the services provided for in this Agreement.

7. It is understood and agreed that so long as the Investment Manager and/or its advisory affiliates shall continue to serve as the investment adviser to the Company, other investment companies as may be sponsored or advised by the Investment Manager or its affiliates may have the right permanently to adopt and to use the words “Delaware,” “Delaware Investments” or “Delaware Group” in their names and in the names of any series or class of shares of such funds.

8. In the absence of willful misfeasance, bad faith, gross negligence, or a reckless disregard of the performance of its duties as the Investment Manager to the Company, the Investment Manager shall not be subject to liability to the Company or to any shareholder of the Company for any action or omission in the course of, or connected with, rendering services hereunder or for any losses that may be sustained in the purchase, holding or sale of any security, or otherwise.

9. (a) This Agreement shall be executed and become effective as of the date written below, only if approved by the vote of a majority of the outstanding voting securities of the Company. It shall continue in effect for an initial period of two years and may be renewed thereafter only so long as such renewal and continuance is specifically approved at least annually by the Board of Trustees/Directors or by the vote of a majority of the outstanding voting securities of the Company and only if the terms and the renewal hereof have been approved by the vote of a majority of the Trustees/Directors of the Company who are not parties hereto or interested persons of any such party (“Independent Trustees/Directors”), cast in person at a meeting called for the purpose of voting on such approval.

(b) This Agreement (and Exhibit A hereto) may be amended without the approval of a majority of the outstanding voting securities of the Company if the amendment relates solely to a management fee reduction or other change that is permitted or not prohibited under the then current federal law, rule, regulation or SEC staff interpretation thereof to be made without shareholder approval. This Agreement may be amended from time to time pursuant to a written agreement executed by the Company and the Investment Manager.

(c) This Agreement may be terminated by the Company at any time, without the payment of a penalty, on sixty days’ written notice to the Investment Manager of the Company’s intention to do so, pursuant to action by the Board of Trustees/ Directors of the Company or pursuant to the vote of a majority of the outstanding



voting securities of the Company. The Investment Manager may terminate this Agreement at any time, without the payment of a penalty, on sixty days’ written notice to the Company of its intention to do so. Upon termination of this Agreement, the obligations of all the parties hereunder shall cease and terminate as of the date of such termination, except for any obligation to respond for a breach of this Agreement committed prior to such termination, and except for the obligation of the Company to pay to the Investment Manager the fee provided in Paragraph 4 hereof, prorated to the date of termination. This Agreement shall automatically terminate in the event of its assignment.

10. This Agreement shall extend to and bind the administrators, successors and permitted assigns of the parties hereto.

11. For the purposes of this Agreement, (i) the terms vote of a majority of the outstanding voting securities; interested persons; and assignment shall have the meaning ascribed to them in the 1940 Act; and (ii) references to the SEC and FINRA shall be deemed to include any successor regulators.

IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be signed by their duly authorized officers as of the ______ day of _______, 200__.

**DELAWARE MANAGEMENT COMPANY,**
**a series of Delaware Management Business Trust**

By
Name
Title

**[NAME OF INVESTMENT COMPANY]**

By
Name
Title



**EXHIBIT A**

THIS EXHIBIT to the Investment Advisory Agreement between **[INVESTMENT COMPANY]** (the Company) and **DELAWARE MANAGEMENT COMPANY**, a series of Delaware Management Business Trust (the Investment Manager) entered into as of the __ day of _____, 200_ (the Agreement) provides the management fee rate schedule for the Company and the date on which the Agreement became effective for the Company.

| | Effective Date | Management Fee Schedule (as a percentage of average daily net assets) Annual Rate* |
|---|---|---|
| Delaware Investments Dividend and Income Fund, Inc. | _______, 200__ | 0.55% |
| Delaware Enhanced Global Dividend and Income Fund | _______, 200__ | 1.00% |
| Delaware Investments Global Dividend and Income Fund, Inc. | _______, 200__ | 0.70% |
| Delaware Investments Arizona Municipal Income Fund, Inc. | _______, 200__ | 0.40% |
| Delaware Investments Colorado Municipal Income Fund, Inc. | _______, 200__ | 0.40% |
| Delaware Investments Minnesota Municipal Income Fund II, Inc. | _______, 200__ | 0.40% |
| Delaware Investments National Municipal Income Fund | _______, 200__ | 0.40% |

* *For the purposes of calculating the fee, the Companys average daily net assets shall be calculated without regard to (i) the liquidation value or other involuntary liquidation preference of any outstanding senior security which is a stock (including shares of preferred stock) of the Company (as those terms are used in Section 18 of the 1940 Act) and (ii) liabilities arising from other senior securities, borrowings or other forms of leveraging.*

**APPENDIX B  CURRENT INVESTMENT ADVISORY AGREEMENTS: DATES OF APPROVAL**

| Fund | Date of Current Investment Advisory Agreement* | Date Last Approved by Shareholders |
|---|---|---|
| Delaware Investments Dividend and Income Fund, Inc. | 1/1/99 | 12/4/98 |
| Delaware Investments Global Dividend and Income Fund, Inc. | 1/1/99 | 12/4/98 |
| Delaware Enhanced Global Dividend and Income Fund | 6/27/07 | 5/21/07 |
| Delaware Investments Arizona Municipal Income Fund, Inc. | 1/1/99 | 12/4/98 |
| Delaware Investments Colorado Municipal Income Fund, Inc. | 1/1/99 | 12/4/98 |
| Delaware Investments Minnesota Municipal Income Fund II, Inc. | 1/1/99 | 12/4/98 |
| Delaware Investments National Municipal Income Fund | 1/1/99 | 12/4/98 |

* *In general, each Current Investment Advisory Agreement was last approved by shareholders (or, to the extent applicable, the initial shareholder) of the relevant Fund either in connection with the initial approval of such agreement or in connection with any later amendment requiring such approval.*



**APPENDIX C  FEES PAID TO DMC AND AFFILIATES**

The following table lists the Funds by investment category, and includes for the fiscal years indicated the aggregate amount of DMCs fee paid by each Fund indicated and the amounts paid by each Fund to affiliates of DMC during the fiscal year and for the purposes indicated. All fees are shown net of any applicable waivers and reimbursements.

| Fund | Fiscal Year Ended | Advisory Fees ($) | Administration Fees ($) | Distribution Fees ($) | Transfer Agency Fees ($) |
|---|---|---|---|---|---|
| **EQUITY** | | | | | |
| Delaware Enhanced Global Dividend and Income Fund | 11/31/08 | 2,029,426 | 35,904 | - | 71,030 |
| Delaware Investments Dividend and Income Fund, Inc. | 11/31/08 | 766,423 | 81,115 | - | 48,795 |
| Delaware Investments Global Dividend and Income Fund, Inc. | 11/31/08 | 502,602 | 3,592 | - | 71,030 |
| **FIXED INCOME TAX EXEMPT** | | | | | |
| Delaware Investments Arizona Municipal Income Fund, Inc. | 3/31/09 | 211,193 | 2,637 | - | 17,596 |
| Delaware Investments Colorado Municipal Income Fund, Inc. | 3/31/09 | 350,519 | 4,376 | - | 27,859 |
| Delaware Investments Minnesota Municipal Income Fund II, Inc. | 3/31/09 | 832,313 | 10,392 | - | 64,291 |
| Delaware Investments National Municipal Income Fund | 3/31/09 | 164,555 | 2,054 | - | 25,786 |

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**APPENDIX D OTHER FUNDS ADVISED BY DMC**

DMC provides investment advisory services to other registered funds that have investment objectives similar to those of the Funds. For each such fund, the following table sets forth by investment category the fund's name, the fund's net assets as of July 31, 2009, the rate of DMC's compensation, and whether DMC has waived, reduced, or otherwise agreed to reduce its compensation under the applicable contract. For funds subadvised by DMC, the net assets shown are only the portion of the fund's assets that are under the management of DMC.

| Fund | Fund Net Assets (as of 7/31/09) ($) | Management Fee Schedule (as a percentage of average daily net assets) Annual Rate | Waiver (Y/N) |
|---|---|---|---|
| **EQUITY** | | | |
| Delaware Aggressive Allocation Portfolio | 49,597,075 | 0.65% on first $500 million<br>0.60% on next $500 million<br>0.55% on next $1.5 billion<br>0.50% on assets in excess of $2.5 billion | Y |
| Delaware American Services Fund | 165,871,237 | 0.75% on first $500 million<br>0.70% on next $500 million<br>0.65% on next $1.5 billion<br>0.60% on assets in excess of $2.5 billion | Y |
| Delaware Conservative Allocation Portfolio | 51,620,209 | 0.65% on first $500 million<br>0.60% on next $500 million<br>0.55% on next $1.5 billion<br>0.50% on assets in excess of $2.5 billion | Y |
| Delaware Dividend Income Fund | 376,294,484 | 0.65% on first $500 million<br>0.60% on next $500 million<br>0.55% on next $1.5 billion<br>0.50% on assets in excess of $2.5 billion | Y |

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| Fund | Fund Net Assets (as of 7/31/09) ($) | Management Fee Schedule (as a percentage of average daily net assets) Annual Rate | Waiver (Y/N) |
|---|---|---|---|
| Delaware Emerging Markets Fund | 566,312,347 | 1.25% on first $500 million<br>1.20% on next $500 million<br>1.15% on next $1.5 billion<br>1.10% on assets in excess of $2.5 billion | N |
| Delaware Focus Global Growth Fund | 4,867,071 | 0.85% on first $500 million<br>0.80% on next $500 million<br>0.75% on next $1.5 billion<br>0.70% on assets in excess of $2.5 billion | N/A |
| Delaware Foundation® Equity Fund[1] | N/A | 0.65% on first $500 million<br>0.60% on next $500 million<br>0.55% on next $1.5 billion<br>0.50% on assets in excess of $2.5 billion | N/A |
| Delaware Global Value Fund | 38,943,506 | 0.85% on first $500 million<br>0.80% on next $500 million<br>0.75% on next $1.5 billion<br>0.70% on assets in excess of $2.5 billion | Y |
| Delaware Growth Opportunities Fund | 221,862,433 | 0.75% on first $500 million<br>0.70% on next $500 million<br>0.65% on next $1.5 billion<br>0.60% on assets in excess of $2.5 billion | Y |
| Delaware Healthcare Fund | 3,391,264 | 0.85% on first $500 million<br>0.80% on next $500 million<br>0.75% on next $1.5 billion | Y |

0.70% on assets in excess of $2.5 billion

D-2

| Fund | Fund Net Assets (as of 7/31/09) ($) | Management Fee Schedule (as a percentage of average daily net assets) Annual Rate | Waiver (Y/N) |
|---|---|---|---|
| Delaware International Value Equity Fund | 359,015,223 | 0.85% on first $500 million<br>0.80% on next $500 million<br>0.75% on next $1.5 billion<br>0.70% on assets in excess of $2.5 billion | Y |
| Delaware Large Cap Core Fund | 1,625,300 | 0.65% on the first $500 million<br>0.60% on the next $500 million<br>0.55% on the next $1.5 billion<br>0.50% on assets in excess of $2.5 billion | Y |
| Delaware Large Cap Value Fund | 655,924,118 | 0.65% on first $500 million<br>0.60% on next $500 million<br>0.55% on next $1.5 billion<br>0.50% on assets in excess of $2.5 billion | N |
| Delaware Mid Cap Value Fund | 8,888,367 | 0.75% on first $500 million<br>0.70% on next $500 million<br>0.65% on next $1.5 billion<br>0.60% on assets in excess of $2.5 billion | Y |
| Delaware Moderate Allocation Portfolio | 235,959,745 | 0.65% on first $500 million<br>0.60% on next $500 million<br>0.55% on next $1.5 billion<br>0.50% on assets in excess of $2.5 billion | Y |
| The Emerging Markets Portfolio[2] | 608,767,439 | 1.00% | N |
| The Focus Smid-Cap Growth Equity Portfolio[2] | 2,800,870 | 0.75% | Y |
| The International Equity Portfolio[2] | 901,424,861 | 0.75% | N |
| The Labor Select International Equity Portfolio[2] | 747,573,551 | 0.75% | N |

D-3

| Fund | Fund Net Assets (as of 7/31/09) ($) | Management Fee Schedule (as a percentage of average daily net assets) Annual Rate | Waiver (Y/N) |
|---|---|---|---|
| The Large-Cap Growth Equity Portfolio[2] | 245,411,670 | 0.55% | Y |
| The Large-Cap Value Equity Portfolio[2] | 9,686,377 | 0.55% | Y |
| The Mid-Cap Growth Equity Portfolio[2] | 4,065,931 | 0.75% | Y |
| The Select 20 Portfolio[2] | 9,816,096 | 0.75% | Y |
| The Small-Cap Growth Equity Portfolio[2] | 507,668 | 0.75% | Y |
| Delaware Select Growth Fund | 238,312,832 | 0.75% on first $500 million<br>0.70% on next $500 million<br>0.65% on next $1.5 billion<br>0.60% on assets in excess of $2.5 billion | Y |
| Delaware Small Cap Core Fund | 60,932,993 | 0.75% on first $500 million<br>0.70% on next $500 million<br>0.65% on next $1.5 billion<br>0.60% on assets in excess of $2.5 billion | Y |
| Delaware Small Cap Growth Fund | 11,390,960 | 1.00% on first $250 million<br>0.90% on next $250 million<br>0.75% on assets in excess of $500 million | Y |
| Delaware Small Cap Value Fund | 316,722,748 | 0.75% on first $500 million<br>0.70% on next $500 million<br>0.65% on next $1.5 billion<br>0.60% on assets in excess of $2.5 billion | Y |
| Delaware Trend® Fund | 345,331,552 | 0.75% on first $500 million<br>0.70% on next $500 million<br>0.65% on next $1.5 billion | Y |

0.60% on assets in excess of $2.5 billion

D-4

| Fund | Fund Net Assets (as of 7/31/09) ($) | Management Fee Schedule (as a percentage of average daily net assets) Annual Rate | Waiver (Y/N) |
|---|---|---|---|
| Delaware U.S. Growth Fund | 577,585,096 | 0.65% on first $500 million<br>0.60% on next $500 million<br>0.55% on next $1.5 billion<br>0.50% on assets in excess of $2.5 billion | Y |
| Delaware Value® Fund | 359,029,563 | 0.65% on first $500 million<br>0.60% on next $500 million<br>0.55% on next $1.5 billion<br>0.50% on assets in excess of $2.5 billion | Y |
| Delaware VIP® Emerging Markets Series | 442,609,293 | 1.25% on first $500 million<br>1.20% on next $500 million<br>1.15% on next $1.5 billion<br>1.10% on assets in excess of $2.5 billion | N |
| Delaware VIP Growth Opportunities Series | 24,047,567 | 0.75% on first $500 million<br>0.70% on next $500 million<br>0.65% on next $1.5 billion<br>0.60% on assets in excess of $2.5 billion | N |
| Delaware VIP International Value Equity Series | 97,145,078 | 0.85% on the first $500 million<br>0.80% on the next $500 million<br>0.75% on the next $1.5 billion<br>0.70% on assets in excess of $2.5 billion | Y |
| Delaware VIP Small Cap Value Series | 691,218,393 | 0.75% on first $500 million<br>0.70% on next $500 million<br>0.65% on next $1.5 billion<br>0.60% on assets in excess of $2.5 billion | N |

D-5

| Fund | Fund Net Assets (as of 7/31/09) ($) | Management Fee Schedule (as a percentage of average daily net assets) Annual Rate | Waiver (Y/N) |
|---|---|---|---|
| Delaware VIP® Trend Series | 281,638,575 | 0.75% on first $500 million<br>0.70% on next $500 million<br>0.65% on next $1.5 billion<br>0.60% on assets in excess of $2.5 billion | N |
| Delaware VIP U.S. Growth Series | 166,486,594 | 0.65% on first $500 million<br>0.60% on next $500 million<br>0.55% on next $1.5 billion<br>0.50% on assets in excess of $2.5 billion | N |
| Delaware VIP Value Series | 452,864,697 | 0.65% on first $500 million<br>0.60% on next $500 million<br>0.55% on next $1.5 billion<br>0.50% on assets in excess of $2.5 billion | Y |
| Optimum International Fund | 162,317,432 | 0.8750% up to $50 million<br>0.8000% from $50 to $100 million<br>0.7800% from $100 to $300 million<br>0.7650% from $300 to $400 million<br>0.7300% over $400 million | Y |
| Optimum Large Cap Growth Fund | 614,887,900 | 0.8000% up to $250 million<br>0.7875% from $250 million to $300 million<br>0.7625% from $300 million to $400 million<br>0.7375% from $400 million to $500 million<br>0.7250% from $500 million to $1 billion<br>0.7100% from $1 billion to $1.5 billion | Y |

| | | | |
|---|---|---|---|
| | | 0.7000% over $1.5 billion | |

D-6

| Fund | Fund Net Assets (as of 7/31/09) ($) | Management Fee Schedule (as a percentage of average daily net assets) Annual Rate | Waiver (Y/N) |
|---|---|---|---|
| Optimum Large Cap Value Fund | 548,159,133 | 0.8000% up to $100 million<br>0.7375% from $100 million to $250 million<br>0.7125% from $250 million to $500 million<br>0.6875% from $500 million to $1 billion<br>0.6675% from $1 billion to $1.5 billion<br>0.6475% over $1.5 billion | Y |
| Optimum Small-Mid Cap Growth Fund | 163,600,949 | 1.1000% | Y |
| Optimum Small-Mid Cap Value Fund | 133,415,186 | 1.0500% up to $75 million<br>1.0250% from $75 million to $150 million<br>1.0000% over $150 million | Y |
| Subadvised Equity Fund A | 421,150,657 | 0.40% | N |
| Subadvised Equity Fund B | 90,675,085 | 0.50% | N |
| Subadvised Equity Fund C | 141,442,959 | 0.35% up to $200 million<br>0.20% over $200 million | N |
| Subadvised Equity Fund D | 138,929,930 | 0.45% | N |
| Subadvised Equity Fund E | 24,685,274 | 0.35% up to $500 million<br>0.30% over $500 million (assets aggregated with those of other accounts having similar investment objectives subadvised by DMC for the same investment manager) | N |
| Subadvised Equity Fund F | 26,740,544 | 0.40% up to $200 million<br>0.35% over $200 million | N |
| Subadvised Equity Fund G | 66,390,469 | 0.40% up to $200 million<br>0.35% over $200 million | N |

D-7

| Fund | Fund Net Assets (as of 7/31/09) ($) | Management Fee Schedule (as a percentage of average daily net assets) Annual Rate | Waiver (Y/N) |
|---|---|---|---|
| Subadvised Equity Fund H | 299,933,951 | 0.20% | N |
| Subadvised Equity Fund I | 201,788,849 | 0.40% | N |
| Subadvised Equity Fund J | 638,932,185 | 0.20% | N |
| Subadvised Equity Fund K | 275,580,815 | 0.35% | N |
| Subadvised Equity Fund L | 74,309,777 | 0.35% | N |
| Subadvised Equity Fund M | 1,110,154,464 | 0.20% | N |
| Subadvised Equity Fund N | 469,430,328 | 0.20% | N |
| Subadvised Equity Fund O | 80,390,330 | 0.40% up to $200 million<br>0.35% over $200 million | N |
| Subadvised Equity Fund P | 158,593,379 | 0.20% | N |
| Subadvised Equity Fund Q | 371,403,316 | 0.35% | N |
| **FIXED INCOME TAX EXEMPT** | | | |
| Delaware Minnesota High-Yield Municipal Bond Fund | 136,173,985 | 0.55% on first $500 million<br>0.50% on next $500 million<br>0.45% on next $1.5 billion<br>0.425% on assets in excess of $2.5 billion | Y |
| Delaware National High-Yield Municipal Bond Fund | 74,306,095 | 0.55% on first $500 million<br>0.50% on next $500 million<br>0.45% on next $1.5 billion | Y |

| | | | |
|---|---|---|---|
| | | 0.425% on assets in excess of $2.5 billion | |



| Fund | Fund Net Assets (as of 7/31/09) ($) | Management Fee Schedule (as a percentage of average daily net assets) Annual Rate | Waiver (Y/N) | | |
|---|---|---|---|---|---|
| Delaware Tax-Free Arizona Fund | 124,554,577 | 0.50% on first $500 million<br>0.475% on next $500 million<br>0.45% on next $1.5 billion<br>0.425% on assets in excess of $2.5 billion | Y | | |
| Delaware Tax-Free California Fund | 78,089,669 | 0.55% on first $500 million<br>0.50% on next $500 million<br>0.45% on next $1.5 billion<br>0.425% on assets in excess of $2.5 billion | Y | | |
| Delaware Tax-Free Colorado Fund | 235,014,874 | 0.55% on first $500 million<br>0.50% on next $500 mid> **$** | Y | **(1,530)** | $ |
| | | Basic and diluted net income (loss) per share | | $ .06 | **$** |

| | | | |
|---|---|---|---|
| Weighted-average shares used in the calculation of net income per share: | | | |
| Basic | 48,565 | **48,589** | 4 |
| Dilutive impact of stock options | 18 | **9** | |
| Diluted | 48,583 | **48,598** | 4 |

See accompanying Notes to Condensed Consolidated Financial Statements.

**NL INDUSTRIES, INC. AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY AND COMPREHENSIVE INCOME**

**Six months ended June 30, 2007**

**(In thousands)**

| | Common stock | Additional paid-in capital | Retained earnings (deficit) | Accumulated other comprehensive loss | Total stockholders' equity | Comprehensive income |
|---|---|---|---|---|---|---|
| | | | (unaudited) | | | |
| Balance at December 31, 2006 | $ 6,073 | $ 363,472 | $ 1,826 | $ (122,859) | $ 248,512 | |
| Net income | - | - | 4,236 | - | 4,236 | $ 4,236 |
| Issuance of common stock | - | 63 | - | - | 63 | - |
| Other comprehensive income, net | - | - | - | 21,971 | 21,971 | 21,971 |
| Dividends | - | (6,074) | (6,073) | - | (12,147) | - |
| Change in accounting – FIN No. 48 | - | - | (97) | - | (97) | - |
| Other | - | 38 | - | - | 38 | - |
| Balance at June 30, 2007 | $ 6,073 | $ 357,499 | $ (108) | $ (100,888) | $ 262,576 | |
| Comprehensive income | | | | | | $ 26,207 |

See accompanying Notes to Condensed Consolidated Financial Statements.

**NL INDUSTRIES, INC. AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

**(In thousands)**

| | Six months ended June 30, 2006 (as adjusted) | Six months ended June 30, 2007 |
|---|---|---|
| | (unaudited) | |
| Cash flows from operating activities: | | |
| Net income | $ 9,329 | **$ 4,236** |
| Depreciation and amortization | 5,752 | **5,695** |
| Deferred income taxes | 3,934 | **(1,770)** |
| Minority interest: | | |
| Continuing operations | 1,873 | **1,675** |
| Discontinued operations | (148) | **-** |
| Equity in earnings of Kronos Worldwide, Inc. | (10,201) | **(4,599)** |
| Dividends from Kronos Worldwide, Inc. | 8,758 | **8,758** |
| Benefit plan expense greater (less) than cash funding: | | |
| Defined benefit pension expense | (1,041) | **(1,220)** |
| Other postretirement benefit expense | (881) | **315** |
| Other, net | 437 | **219** |
| Change in assets and liabilities: | | |
| Accounts and other receivables, net | (1,208) | **(632)** |
| Inventories, net | 1,050 | **(3,565)** |
| Prepaid expenses and other | 336 | **524** |
| Accrued environmental costs | (2,286) | **(2,688)** |
| Accounts payable and accrued liabilities | (4,861) | **718** |
| Income taxes | (1,622) | **(587)** |
| Accounts with affiliates | (1,231) | **(6,667)** |
| Other, net | (1,790) | **(1,613)** |
| Net cash provided by (used in) operating activities | 6,200 | **(1,201)** |
| Cash flows from investing activities: | | |
| Capital expenditures | (5,393) | **(5,603)** |
| Acquisition, net of cash acquired | (9,832) | **-** |
| Collection of note receivable | 1,306 | **1,306** |
| Change in restricted cash equivalents and marketable debt securities, net | (1,397) | **1,928** |
| Proceeds from disposal of: | | |
| Marketable securities | 4,640 | **9,608** |
| Property and equipment | 37 | **43** |
| Purchase of: | | |
| CompX common stock | (1,834) | **-** |
| Marketable securities | (4,786) | **(5,861)** |

| | | |
|---|---|---|
| Net cash provided by (used in) investing activities | (17,259) | **1,421** |

**NL INDUSTRIES, INC. AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)**

**(In thousands)**

| | Six months ended June 30, | |
|---|---|---|
| | 2006 (as adjusted) | 2007 |
| | (unaudited) | |
| Cash flows from financing activities: | | |
| Indebtedness: | | |
| Principal payments | $ (1,490) | **$ -** |
| Deferred financing costs paid | (105) | **-** |
| Cash dividends paid | (12,142) | **(12,147)** |
| Distributions to minority interest | (1,144) | **(1,131)** |
| Other, net | 9 | **203** |
| Net cash used in financing activities | (14,872) | **(13,075)** |
| Cash and cash equivalents - net change from: | | |
| Operating, investing and financing activities | (25,931) | **(12,855)** |
| Currency translation | 249 | **695** |
| Cash and cash equivalents at beginning of period | 76,912 | **52,742** |
| Cash and cash equivalents at end of period | $ 51,230 | **$ 40,582** |
| Supplemental disclosures – cash paid for: | | |
| Interest, net of amounts capitalized | $ 181 | **$ 56** |
| Income taxes, net | 3,201 | **9,003** |
| Noncash investing activity - receipt of TIMET shares | $ - | **$ 11,410** |

See accompanying Notes to Condensed Consolidated Financial Statements.

**NL INDUSTRIES, INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**June 30, 2007**

**(Unaudited)**

**Note 1 - Organization and basis of presentation:**

***Organization*** - We are majority-owned by Valhi, Inc. (NYSE: VHI), which owns approximately 83% of our outstanding common stock at June 30, 2007. Valhi is majority-owned by Contran Corporation. Substantially all of Contran's outstanding voting stock is held by trusts established for the benefit of certain children and grandchildren of Harold C. Simmons (for which Mr. Simmons is the sole trustee) or is held directly by Mr. Simmons or persons or companies related to Mr. Simmons. Consequently, Mr. Simmons may be deemed to control Contran, Valhi and us.

***Basis of presentation*** - Consolidated in this Quarterly Report are the results of our majority-owned subsidiary, CompX International Inc. Our ownership of CompX is primarily through CompX Group, Inc., our majority-owned subsidiary. CompX Group's sole asset consists of 82% of the outstanding common stock of CompX. We also own an additional 2% of CompX directly. We also own 36% of Kronos Worldwide, Inc. which we account for by the equity method. CompX (NYSE: CIX) and Kronos (NYSE: KRO) each file periodic reports with the Securities and Exchange Commission ("SEC").

The unaudited Condensed Consolidated Financial Statements contained in this Quarterly Report have been prepared on the same basis as the audited Consolidated Financial Statements in our Annual Report on Form 10-K for the year ended December 31, 2006 that we filed with the SEC on March 13, 2007 (the "2006 Annual Report"), except as discussed in Note 11. In our opinion, we have made all necessary adjustments (which include only normal recurring adjustments) 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, 2006 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, 2006) normally included in financial statements prepared in accordance with accounting principals generally accepted in the United States of America ("GAAP"). Our results of operations for the interim period ended June 30, 2007 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 2006 Consolidated Financial Statements contained in our 2006 Annual Report.

Unless otherwise indicated, references in this report to "NL," "we," "us" or "our" refer to NL Industries, Inc. and its subsidiaries and affiliates, including Kronos, taken as a whole.

**Note 2 – Accounts and other receivables, net:**

| | December 31, 2006 | June 30, 2007 |
|---|---|---|
| | (In thousands) | |

| | | | | |
|---|---|---|---|---|
| Trade receivables | $ | 20,698 | **$** | **22,431** |
| Other receivables | | 1,941 | | **1,466** |
| Receivable from affiliate – Kronos | | 238 | | **3** |
| Refundable income taxes | | 215 | | **-** |
| Allowance for doubtful accounts | | (716) | | **(795)** |
| Total | $ | 22,376 | **$** | **23,105** |

**Note 3 – Inventories, net:**

| | | December 31, 2006 | | June 30, 2007 |
|---|---|---|---|---|
| | | (In thousands) | | |
| Raw materials | $ | 5,892 | **$** | **7,330** |
| In process products | | 8,744 | | **10,471** |
| Finished products | | 7,097 | | **7,725** |
| Total | $ | 21,733 | **$** | **25,526** |

**Note 4 - Marketable equity securities:**

| | | December 31, 2006 | | June 30, 2007 |
|---|---|---|---|---|
| | | (In thousands) | | |
| Current assets (available-for-sale): | | | | |
| Restricted debt securities | $ | 5,301 | **$** | **5,299** |
| Other marketable securities | | 4,688 | | **1,052** |
| Total | $ | 9,989 | **$** | **6,351** |
| Noncurrent assets (available-for-sale): | | | | |
| Valhi common stock | $ | 122,344 | **$** | **76,760** |
| TIMET common stock | | - | | **71,746** |
| Total | $ | 122,344 | **$** | **148,506** |

The restricted debt securities at December 31, 2006 and June 30, 2007 collateralize certain of our outstanding letters of credit.

At December 31, 2006 and June 30, 2007, we owned approximately 4.7 million shares of Valhi common stock. At June 30, 2007, the quoted market price of Valhi's common stock was $––––16.30 per share, or an aggregate market value of $76.8 million. At December 31, 2006, the quoted market price was $25.98 per share, or an aggregate market value of $122.3 million.

In March 2007, Valhi paid a special dividend to its stockholders in the form of the shares of Titanium Metals Corporation ("TIMET") common stock owned by Valhi. Prior to the special dividend, Valhi owned approximately 35%

of TIMET's outstanding common stock. As a result of the special dividend, each Valhi stockholder, including us, received .4776 of a share of TIMET common stock for each share of Valhi common stock held. We received approximately 2.2 million shares of TIMET common stock in the special dividend. For financial reporting purposes, Valhi's carrying value of the 2.2 million TIMET shares we received was approximately $11.4 million at the date of distribution. We accounted for our receipt of the 2.2 million shares of TIMET common stock by reducing the cost basis of our shares of Valhi common stock by this $11.4 million carryover basis, since we and Valhi are under the common control of Contran.

We have classified our shares of TIMET common stock as an available-for-sale marketable security carried at fair value. At June 30, 2007, the quoted market price of TIMET's common stock was $––––31.90 per share, or an aggregate market value of $71.7 million.

Our unrealized other comprehensive income in 2007 relates primarily to the increase in the aggregate market value of our Valhi and TIMET common stocks during the year-to-date period.

**Note 5 – Investment in Kronos:**

At December 31, 2006 and June 30, 2007, we owned approximately 17.5 million shares of Kronos common stock. At June 30, 2007, the quoted market price of Kronos' common stock was $25.25 per share, or an aggregate market value of $442.3 million. At December 31, 2006, the quoted market price was $32.56, or an aggregate market value of $570.3 million.

Selected financial information of Kronos is summarized below:

| | **December 31, 2006** | **June 30, 2007** |
|---|---|---|
| | **(In millions)** | |
| Current assets | $ 562.9 | **$ 609.7** |
| Property and equipment, net | 462.0 | **469.4** |
| Investment in $TiO_2$ joint venture | 113.6 | **115.0** |
| Other noncurrent assets | 283.0 | **291.6** |
| Total assets | $ 1,421.5 | **$ 1,485.7** |
| Current liabilities | $ 179.5 | **$ 193.1** |
| Long-term debt | 535.3 | **564.0** |
| Accrued pension and postretirement benefits | 195.7 | **197.3** |
| Other noncurrent liabilities | 62.6 | **79.6** |
| Stockholders' equity | 448.4 | **451.7** |
| Total liabilities and stockholders' equity | $ 1,421.5 | **$ 1,485.7** |

| | **Three months ended June 30,** | | **Six months ended June 30,** | |
|---|---|---|---|---|
| | **2006 (As adjusted)** | **2007** | **2006 (As adjusted)** | **2007** |
| | **(In millions)** | | | |

| | | | | |
|---|---|---|---|---|
| Net sales | $ 345.1 | **$ 342.6** | $ 649.4 | **$ 656.6** |
| Cost of sales | 264.2 | **279.0** | 492.7 | **522.6** |
| Income from operations | 35.6 | **23.6** | 71.0 | **52.9** |
| Net income | 12.8 | **-** | 28.5 | **12.9** |

**Note 6 – Accrued liabilities:**

| | December 31, 2006 | June 30, 2007 |
|---|---|---|
| | (In thousands) | |
| Employee benefits | $ 9,506 | **$ 9,107** |
| Professional fees | 3,220 | **5,355** |
| Payable to affiliates: | | |
| Income taxes – Valhi | 1,179 | **7,154** |
| Other | 369 | **369** |
| Reserve for uncertain tax positions | - | **345** |
| Other | 12,804 | **12,901** |
| Total | $ 27,078 | **$ 35,231** |

Our reserve for uncertain tax positions is discussed in Note 11.

**Note 7 – Other noncurrent liabilities:**

| | December 31, 2006 | June 30, 2007 |
|---|---|---|
| | (In thousands) | |
| Reserve for uncertain tax positions | $ - | **$ 23,462** |
| Insurance claims and expenses | 1,007 | **973** |
| Other | 1,475 | **1,602** |
| Total | $ 2,482 | **$ 26,037** |

Our reserve for uncertain tax positions is discussed in Note 11.

**Note 8 - Provision for income taxes:**

| | Six months ended June 30, | |
|---|---|---|
| | 2006 | 2007 |
| | (In millions) | |
| Expected tax expense at U.S. federal statutory income tax rate of 35% | $ 5.5 | **$ 2.1** |
| Incremental U.S. tax and rate differences on equity in earnings | (1.1) | **(2.2)** |
| Other, net | - | **.3** |
| Total | $ 4.4 | **$ .2** |

As discussed in Note 4, we received 2.2 million shares of TIMET common stock in March 2007 when Valhi paid a special dividend. For income tax purposes, the tax basis in the shares of TIMET we received is equal to the fair value of such TIMET shares on the date we received them. However, if the fair value of all of the TIMET shares distributed by Valhi exceeds Valhi's cumulative earnings and profits as of the end of 2007, we are required to reduce the tax basis of the shares of Valhi common stock we own by an amount equal to the lesser of our tax basis in such Valhi shares and our pro-rata share of the amount by which the aggregate fair value of the TIMET shares distributed by Valhi exceeds Valhi's earnings and profits. Additionally, if our pro-rata share of the amount by which the aggregate fair value of the TIMET shares distributed by Valhi exceeds Valhi's earnings and profits is greater than the tax basis of our Valhi shares, we are required to recognize a capital gain for the difference. Valhi has estimated it will have no cumulative earnings and profits as of the end of 2007. In addition, the fair value of the TIMET shares we received exceeds the aggregate tax basis of our Valhi shares. Accordingly, the benefit associated with receiving a fair-value tax basis in our TIMET shares has been completely offset by the elimination of the tax basis in our Valhi shares and the capital gain we are required to recognize for the excess. The income tax generated from this capital gain is approximately $13.5 million. For financial reporting purposes, we provide deferred income taxes for the excess of the carrying value over the tax basis of our shares of both Valhi and TIMET common stock, and as a result the $13.5 million current income tax generated is offset by deferred income taxes we previously provided on our shares of Valhi common stock.

We and our qualifying subsidiaries, and Valhi, are members of Contran's consolidated U.S. federal income tax group (the "Contran Tax Group"), and we make payments to Valhi for income taxes in amounts that we would have paid to the U.S. Internal Revenue Service had we not been a member of the Contran Tax Group. Approximately $12.6 million of the $13.5 million tax related to the TIMET distribution is payable to Valhi (the remaining $.9 million relates to one of our subsidiaries that is not a member of the Contran Tax Group). Valhi is not currently required to pay this $12.6 million tax liability to Contran, nor is Contran currently required to pay this tax liability to the applicable tax authority, because the related taxable gain is currently deferred at the Valhi and Contran levels since Valhi and NL are members of the Valhi tax group on a separate company basis and of the Contran Tax Group. This income tax liability would become payable by Valhi to Contran, and by Contran to the applicable tax authority, when the shares of Valhi common stock held by NL are sold or otherwise transferred outside the Contran Tax Group or in the event of certain restructuring transactions involving NL and Valhi. We anticipate that our cash tax payments to Valhi for 2007 will be less than $12.6 million as such amount will be reduced by the income tax benefit related to our current year net corporate expenses.

**Note 9 – Employee benefit plans:**

***Defined benefit plans*** - The components of net periodic defined benefit pension cost (income) are presented in the table below.

| | Three months ended June 30, | | Six months ended June 30, | |
|---|---|---|---|---|
| | 2006 | 2007 | 2006 | 2007 |
| | (In thousands) | | | |
| Interest cost | $ 718 | **$ 777** | $ 1,483 | **$ 1,533** |
| Expected return on plan assets | (1,348) | **(1,451)** | (2,693) | **(2,899)** |
| Amortization of net transition obligations | (17) | **-** | (33) | **-** |
| Recognized actuarial losses | 102 | **74** | 201 | **146** |
| Total | $ (545) | **$ (600)** | $ (1,042) | **$ (1,220)** |

***Postretirement benefits*** - The components of net periodic postretirement benefits cost are presented in the table below.

| | Three months ended June 30, 2006 | Three months ended June 30, 2007 | Six months ended June 30, 2006 | Six months ended June 30, 2007 |
|---|---|---|---|---|
| | (In thousands) | | | |
| Interest cost | $ 183 | **$ 182** | $ 367 | **$ 363** |
| Amortization of prior service credit | (28) | **(28)** | (56) | **(56)** |
| Recognized actuarial losses | - | **4** | - | **8** |
| Total | $ 155 | **$ 158** | $ 311 | **$ 315** |

***Contributions*** – We expect our 2007 contributions for our pension and postretirement benefit plans to be consistent with the amount disclosed in our 2006 Annual Report.

**Note 10 – Commitments and contingencies:**

**Lead pigment litigation**

Our former operations included the manufacture of lead pigments for use in paint and lead-based paint. We, 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. A number of cases are inactive or have been dismissed or withdrawn. Most of the remaining cases are in various pre-trial stages. Some are on appeal following dismissal or summary judgment rulings in favor of either the defendants or the plaintiffs. In addition, various other cases are pending (in which we are not a defendant) seeking recovery for injury allegedly caused by lead pigment and lead-based paint. Although we are not a defendant in these cases, the outcome of these cases may have an impact on cases that might be filed against us in the future.

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. We have never settled any of these cases, nor have any final adverse judgments against us been entered. However, see the discussion below in *The State of Rhode Island* case.

In October 1999, we were served with a complaint in *State of Rhode Island v. Lead Industries Association, et al.* (Superior Court of Rhode Island, No. 99-5226). In 2002, a trial was held on the sole question of whether lead pigment in paint on Rhode Island buildings is a public nuisance and resulted in a mistrial when the jury was unable to reach a unanimous decision. A second trial commenced in 2005, and in February 2006, the jury found that we and two other defendants: (i) substantially contributed to the creation of a public nuisance as a result of the collective presence of lead pigment in paints and coatings on buildings in Rhode Island; and (ii) should be ordered to abate the public nuisance. In March 2007, after the trial court denied our post-trial motions, we appealed to the Rhode Island Supreme Court; thereafter, the State cross-appealed the issue of exclusion of past and punitive damages, as well as the dismissal of one of the defendants. The appeal is proceeding, and concurrently therewith, the trial court is moving forward with the abatement phase of the matter. The parties have submitted their respective recommendations regarding the appointment of one or more special masters to advise the trial court in its consideration of a remedial order to implement the abatement remedy. In June 2007, the trial court issued an order enumerating the powers, duties and responsibilities of the special master and establishing a schedule for the State's submission of a detailed proposal for abatement and the defendants' responsive submissions. The trial court further indicated that it anticipated appointing a special master by September 2007. The extent, nature and cost of any abatement remedy will be determined only following the resolution of the pending appeal and the conclusion of the trial court's proceedings relating to the abatement remedy.

The Rhode Island case is unique in that this is the first time that an adverse verdict in the lead pigment litigation has been entered against us. We believe there are a number of meritorious issues which we have raised in the appeal in this case; therefore we currently believe it is not probable that we will ultimately be found liable in this matter. In addition, we cannot reasonably estimate potential liability, if any, with respect to this and the other lead pigment litigation. However, legal proceedings are subject to inherent uncertainties, and we cannot assure you that any appeal would be successful. Therefore it is reasonably possible we could in the near term conclude that it is probable we have incurred some liability in the Rhode Island matter that would result in recognizing a loss contingency accrual. The potential liability could have a material adverse impact on net income for the interim or annual period during which such liability is recognized, and a material adverse impact on our consolidated financial condition and liquidity.

We have not accrued any amounts for any of the pending lead pigment and lead-based paint litigation cases, including the Rhode Island case. Liability that may result, if any, cannot be reasonably estimated. In addition, new cases may continue to be filed against us. 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. The resolution of any of these cases could result in 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 operating companies 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. Our operating companies have implemented and continue to implement various policies and programs in an effort to minimize these risks. Our policy is for our operating companies to maintain compliance with applicable environmental laws and regulations at all plants and to strive to improve environmental performance. From time to time, our operating companies may be subject to environmental regulatory enforcement under U.S. and foreign statutes, resolution of which typically involves the establishment of compliance programs. It is possible that future developments, such as stricter requirements of environmental laws and enforcement policies thereunder, could adversely affect our operating companies' production, handling, use, storage, transportation, sale or disposal of such substances. We believe that all of our operating companies' plants are in substantial compliance with applicable environmental laws.

Certain properties and facilities used in our 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. 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 currently or previously owned, operated or used by us or our subsidiaries, or their predecessors, 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 such costs, in most cases we are only one of a number of PRPs who may also be jointly and severally liable. In addition, we are a party to a number of personal injury lawsuits filed in various jurisdictions alleging claims related to environmental conditions alleged to have resulted from our operations.

Environmental obligations are difficult to assess and estimate for numerous reasons including:

- 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,
- solvency of other PRPs,
- multiplicity of possible solutions, and
- number of years of investigatory, remedial and monitoring activity required.

In addition, the imposition of more stringent standards or requirements under environmental laws or regulations, new developments or changes regarding site cleanup costs or allocation of such costs among PRPs, solvency of other PRPs, the results of future testing and analysis undertaken with respect to certain sites or a determination that we are potentially responsible for the release of hazardous substances at other sites, could result in expenditures in excess of amounts currently estimated by us to be required for such matters. In addition, with respect to other PRPs and the fact that we may be jointly and severally liable for the total remediation cost at certain sites, we ultimately could be liable for amounts in excess of our accruals due to, among other things, the reallocation of costs among PRPs or the insolvency of one or more PRPs. 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 with respect to sites as to which no estimate presently can be made. Further, we cannot assure you that additional environmental matters will not arise in the future. If we were to incur any such 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 obligations when estimated future expenditures are probable and reasonably estimable. We adjust such accruals as further information becomes available or circumstances change. We generally do not discount estimated future expenditures to their present value. We recognize recoveries of remediation costs from other parties, if any, as assets when their receipt is deemed probable. We have not recognized any receivables for such recoveries in 2007.

We do not know and cannot estimate the exact time frame over which we will make payments with respect to our accrued environmental costs. The timing of payments depends upon a number of factors including, among other things, the timing of the actual remediation process which in turn depends on factors outside our control. At each balance sheet date, we estimate the amount of our accrued environmental costs which we expect to pay over the subsequent 12 months, and we classify such amount as a current liability. We classify the remainder of the accrued environmental costs as a noncurrent liability.

Changes in the accrued environmental costs during the first six months of 2007 are as follows:

| | Amount (In thousands) |
|---|---|

| | | |
|---|---|---|
| Balance at the beginning of the period | $ | **50,713** |
| Reductions charged against expense, net | | **(229)** |
| Payments, net | | **(2,459)** |
| Balance at the end of the period | $ | **48,025** |
| Amounts recognized in the balance sheet at the end of the period: | | |
| Current liability | $ | **9,716** |
| Noncurrent liability | | **38,309** |
| Total | $ | **48,025** |

On a quarterly basis, we evaluate the potential range of our liability at sites where we have been named as a PRP or defendant, including sites for which our wholly-owned environmental management subsidiary, NL Environmental Management Services, Inc. ("EMS") has contractually assumed our obligations. At June 30, 2007, we had accrued $48 million for those environmental matters which we believe are reasonably estimable. We believe that it is not possible to estimate the range of costs for certain sites. The upper end of the range of reasonably possible costs to us for sites for which we believe it is possible to estimate costs is approximately $71 million. We have not discounted these estimates of such liabilities to present value.

At June 30, 2007, there are approximately 20 sites for which we are currently unable to estimate a range of costs. For these sites, generally the investigation is in the early stages, and we are unable to determine whether or not we actually had any association with the site, the nature of our responsibility, if any, for the contamination at the site and the extent of contamination at the site. The timing on when information would become available to us to allow us to estimate a range of loss is unknown and dependent on events outside of our control, such as when the party alleging liability provides information to us. At certain of these sites that had previously been inactive, we have received general and special notices of liability from the EPA alleging that we, along with other PRPs, are liable for past and future costs of remediating environmental contamination allegedly caused by former operations conducted at such sites. These notifications may assert that we, along with other PRPs, are liable for past clean-up costs that could be material to us if we are ultimately found liable.

**Insurance coverage claims**

We are involved in various legal proceedings with certain 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 not considered any potential insurance recoveries for lead pigment or asbestos litigation matters in determining related accruals.

We have agreements with two former insurance carriers pursuant to which the carriers reimburse us for a portion of our past and future lead pigment litigation defense costs. We are not able to determine how much we will ultimately recover from these carriers for past defense costs incurred by us, because of certain issues that arise regarding which past 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. We have not considered any additional potential insurance recoveries in determining accruals for lead pigment or asbestos litigation matters. Any additional insurance recoveries would be recognized when the receipt is probable and the amount is determinable.

We have settled insurance coverage claims concerning environmental claims with certain of our principal former carriers. We do not expect further material settlements relating to environmental remediation coverage.

For a complete discussion of certain litigation involving us and certain of our former insurance carriers, refer to our 2006 Annual Report.

**Income tax matters**

Tax authorities are examining certain of our U.S. and non-U.S. tax returns and have or may propose tax deficiencies, including penalties and interest. We cannot guarantee that these tax matters will be resolved in our favor due to the inherent uncertainties involved in settlement initiatives and court and tax proceedings. 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.

**Other litigation**

We have 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. Approximately 470 of these types of cases remain pending, involving a total of approximately 7,000 plaintiffs and their spouses. In addition, the claims of approximately 3,300 former plaintiffs have been administratively dismissed from Ohio State 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 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.

For a discussion of other legal proceedings to which we are a party, refer to our 2006 Annual Report.

In addition to the litigation described above, we and our affiliates are also involved in various other environmental, contractual, product liability, patent (or intellectual property), employment and other claims and disputes incidental to present and former businesses. In certain cases, we have insurance coverage for these items, although we do not expect additional material insurance coverage for environmental claims.

We currently believe that the disposition of all claims and disputes, 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 11 – Recent accounting pronouncements:**

**Uncertain Tax Positions -** On January 1, 2007, we adopted Financial Accounting Standards Board ("FASB") FASB Interpretation ("FIN") No. 48, *Accounting for Uncertain Tax Positions*. FIN 48 clarifies when and how much of a benefit we can recognize in our Consolidated Financial Statements for certain positions taken in our income tax returns under Statement of Financial Accounting Standards ("SFAS") 109, *Accounting for Income Taxes*, and enhances the disclosure requirements for our income tax policies and reserves. Among other things, FIN 48 prohibits us from recognizing the benefits of a tax position unless we believe it is more-likely-than-not our position will prevail with the applicable tax authorities and limits the amount of the benefit to the largest amount for which we believe the likelihood of realization is greater than 50%. FIN 48 also requires companies to accrue penalties and interest on the difference between tax positions taken on their tax returns and the amount of benefit recognized for financial reporting purposes under the new standard; our prior income tax accounting policies had already complied with this aspect of the new standard. We are also required to reclassify any reserves we have for uncertain tax positions from deferred income tax liabilities, where they were classified under prior GAAP, to a separate current or noncurrent liability, depending on the nature of the tax position.

We accrue interest and penalties on our uncertain tax positions as a component of our provision for income taxes. The amount of interest and penalties we accrued during the first six months of 2007 was not material, and at June 30, 2007 we had approximately $.7 million accrued for interest and penalties on our uncertain tax positions.

Upon adoption of FIN 48 effective January 1, 2007, we reduced our existing reserves for uncertain tax positions, which we had previously classified as part of our deferred income taxes, by $.4 million which was accounted for as an increase in our retained earnings in accordance with the transition provisions of the new standard. We reclassified the remaining $23.9 million to our reserve for uncertain tax positions. At June 30, 2007, we had approximately $23.8 million accrued for uncertain tax positions. At June 30, 2007, the benefit associated with approximately $20.5 million of our reserve for uncertain tax positions would, if recognized, affect our effective income tax rate. We do not currently believe that the unrecognized tax benefits will change significantly within the next twelve months.

Kronos also adopted FIN No. 48 as of January 1, 2007. The amount of our pro-rata share of the impact to Kronos from adopting FIN No. 48, net of our applicable deferred income taxes, resulted in a $.5 million decrease in our retained earnings in accordance with the transition provisions of the new standard.

We file income tax returns in various U.S. federal, state and local jurisdictions. We also file income tax returns in various foreign jurisdictions, principally in Canada and Taiwan. Our domestic income tax returns prior to 2003 are generally considered closed to examination by applicable tax authorities. Our foreign income tax returns are generally considered closed to examination for years prior to 2002.

**Planned Major Maintenance Activities -** In September 2006, the FASB issued FASB Staff Position ("FSP") No. AUG AIR-1, *Accounting for Planned Major Maintenance Activities*. Under FSP No. AUG AIR-1, accruing in advance for major maintenance is no longer permitted. Upon adoption of this standard, companies, such as Kronos, that previously accrued in advance for major maintenance activities are required to retroactively restate their financial statements to reflect a permitted method of recording expense for all periods presented. We adopted this standard effective December 31, 2006. Accordingly, we retroactively adjusted our Consolidated Financial Statements at December 31, 2006 to reflect the direct expense method of accounting for planned major maintenance (a method permitted under this standard). The effect of adopting this standard on our previously reported Consolidated Financial Statements is summarized in our December 31, 2006 Annual Report.

**Fair Value Option** - In the first quarter of 2007 the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*. SFAS 159 permits companies to choose, at specified election dates, to measure eligible items at fair value, with unrealized gains and losses included in the determination of net income. The decision to elect the fair value option is generally applied on an instrument-by-instrument basis, is irrevocable unless a new election date occurs, and is applied to the entire instrument and not to only specified risks or cash flows or a portion of the instrument. Items eligible for the fair value option include recognized financial assets and liabilities, other than an investment in a consolidated subsidiary, defined benefit pension plans, OPEB plans, leases and financial instruments classified in equity. An investment accounted for by the equity method is an eligible item. The specified election dates include the date the company first recognizes the eligible item, the date the company enters into an eligible commitment, the date an investment first becomes eligible to be accounted for by the equity method and the date

SFAS No. 159 first becomes effective for the company. If we elect to measure eligible items at fair value under the standard, we would be required to present certain additional disclosures for each item we elect. SFAS No. 159 becomes effective for us on January 1, 2008. We have not yet determined which, if any, of our eligible items we will elect to measure at fair value under the new standard. Therefore, we are currently unable to determine the impact, if any, this standard will have on our consolidated financial position or results of operations.

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

## RESULTS OF OPERATIONS

### Business and results of operations overview

We are primarily a holding company. We operate in the component products industry through our majority-owned subsidiary, CompX International Inc. We also own a non-controlling interest in Kronos Worldwide, Inc. Both CompX (NYSE: CIX) and Kronos (NYSE: KRO) file periodic reports with the Securities and Exchange Commission ("SEC").

CompX is a leading manufacturer of security products, precision ball bearing slides and ergonomic computer support systems used in the office furniture, transportation, tool storage and a variety of other industries. CompX is also a leading manufacturer of stainless steel exhaust systems, gauges and throttle controls for the performance marine industry.

We account for our 36% non-controlling interest in Kronos by the equity method. Kronos is a leading global producer and marketer of value-added titanium dioxide pigments ("$TiO_2$"). $TiO_2$ is used for a variety of manufacturing applications including plastics, paints, paper and other industrial products.

### Forward-looking information

This report contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Statements in this Quarterly Report on Form 10-Q that are not historical facts are forward-looking in nature. Statements found in this report including, but not limited to, the statements found in Item 2 - "Management's Discussion and Analysis of Financial Condition and Results of Operations," are forward-looking statements that represent our beliefs and assumptions based on currently available information. In some cases you can identify these forward-looking statements by the use of words such as "believes," "intends," "may," "should," "could," "anticipates," "expected" or comparable terminology, or by discussions of strategies or trends. Although we believe the expectations reflected in forward-looking statements are reasonable, we do not know if these expectations will be correct. Forward-looking statements by their nature involve substantial risks and uncertainties that could significantly impact expected results. Actual future results could differ materially from those predicted. While it is not possible to identify all factors, we continue to face many risks and uncertainties. Among the factors that could cause our 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 including, but 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 cyclicality of our businesses (such as Kronos' $TiO_2$ operations),
- The impact of certain long-term contracts on certain of our businesses,
- Customer inventory levels (such as the extent to which Kronos' customers may, from time to time, accelerate purchases of $TiO_2$ in advance of anticipated price increases or defer purchases of $TiO_2$ in advance of anticipated price decreases),
- Changes in raw material and other operating costs (such as energy costs),
- The possibility of labor disruptions,
- 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 $TiO_2$),
- Demand for office furniture,
- 

Competitive products and substitute products, including increased competition from low-cost manufacturing sources (such as China),

- Customer and competitor strategies,
- Potential consolidation of our competitors,
- The impact of pricing and production decisions,
- Competitive technology positions,
- Service industry employment levels,
- Possible disruption of our business or increases in the cost of doing business resulting from terrorist activities or global conflicts,
- The introduction of trade barriers,
- Fluctuations in currency exchange rates (such as changes in the exchange rate between the U.S. dollar and each of the euro, the Norwegian kroner and the Canadian dollar),
- Operating interruptions (including, but not limited to, labor disputes, leaks, natural disasters, fires, explosions, unscheduled or unplanned downtime and transportation interruptions),
- The timing and amounts of insurance recoveries,
- The ability to renew or refinance credit facilities,
- The extent to which our subsidiaries were to become unable to pay us dividends,
- Uncertainties associated with new product development,
- The ultimate outcome of income tax audits, tax settlement initiatives or other tax matters,
- The ultimate ability to utilize income tax attributes or change in income tax rates related to such attributes, the benefit of which has been recognized under the more likely than not recognition criteria (such as Kronos' ability to utilize its German net operating loss carryforwards),
- 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 present and former manufacturers, including us, of lead pigment and lead-based paint, with respect to asserted health concerns associated with the use of such products),
- The ultimate resolution of pending litigation (such as our lead pigment and environmental litigation and litigation), and
- Possible future litigation.

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

**Results of Operations**

***Net Income Overview***

*Quarter Ended June 30, 2007 Compared to Quarter Ended June 30, 2006*

Our net loss was $1.5 million, or $.03 per diluted share, in the second quarter of 2007 compared to net income of $2.7 million, or $.06 per diluted share, in the second quarter of 2006. Our diluted earnings per share decreased from 2006 to 2007 due primarily to the combined effects of:

- lower equity in earnings from Kronos in 2007,
- higher legal defense costs in 2007, and
- lower component products income from operations in 2007.

Our net income in 2007 includes a charge included in our equity in earnings of Kronos of $.04 per diluted share, net of tax benefit, related to an adjustment of certain income tax attributes of Kronos in Germany as discussed below.

Our net income in 2006 includes:

- a charge included in our equity in earnings of Kronos of $.11 per diluted share, net of tax benefit, related to Kronos' redemption of its 8.875% Senior Secured Notes,
- income included in our equity in earnings of Kronos of $.06 per diluted share, net of income tax, related to Kronos' aggregate income tax benefit associated with the withdrawal of certain income tax assessments previously made by the Belgian and Norwegian tax authorities, favorable developments with certain income tax issues related to Belgium and the enactment of a reduction in the Canadian federal income tax rate, and
- income of $.01 per diluted share related to certain insurance recoveries we received.

*Six Months Ended June 30, 2007 Compared to Six Months Ended June 30, 2006*

Our net income was $4.2 million, or $.09 per diluted share, in the first six months of 2007 compared to income of $9.3 million, or $.19 per diluted share, in the first six months of 2006.

The decrease in our diluted earnings per share from 2006 to 2007 is due primarily to the combined effects of:

- lower equity in net income of Kronos in 2007,
- higher legal defense costs in 2007, and
- lower component products income from operations in 2007.

Our net loss in 2007 includes:

- a charge included in our equity in earnings of Kronos of $.04 per diluted share, net of tax benefit, related to an adjustment of certain income tax attributes of Kronos in Germany, and
- income of $.03 per diluted share related to certain insurance recoveries.

Our net income in 2006 includes:

- a charge included in our equity in earnings of Kronos of $.11 per diluted share, net of income tax benefit, related to Kronos' redemption of its 8.875% Senior Secured Notes,
- income included in our equity in earnings of Kronos of $.06 per diluted share related to Kronos' aggregate income tax benefit associated with the withdrawal of certain income tax assessments previously made by the Belgian and Norwegian tax authorities, favorable developments with certain income tax issues related to Belgium and Germany and the enactment of a reduction in the Canadian federal income tax rate, and
- income of $.04 per diluted share related to certain insurance recoveries.

***Outlook Overview***

We currently expect to report a net loss for the full year 2007, primarily due to reporting equity in losses of Kronos resulting from a third quarter charge of $89 million that Kronos is expected to recognize concurrently with the enactment of certain changes in the German income tax laws, as further discussed below. We expect to report approximately $20.5 million of equity in losses of Kronos, net of tax benefit, related to this charge in the third quarter of 2007.

***Income from Operations***

The following table shows the components of our income from operations.

| | Three months ended June 30, | | % | Six months ended June 30, | | % |
|---|---|---|---|---|---|---|
| | 2006 | 2007 | Change | 2006 | 2007 | Change |
| | (In millions) | | | (In millions) | | |

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| CompX | $ | 5.8 | $ | **4.4** | **(24)%** | $ | 10.6 | $ | **9.9** | **(7)%** |
| Insurance recoveries | | .6 | | **.1** | **(81)%** | | 2.8 | | **2.6** | **(8)%** |
| Corporate expense and other, net | | (6.4) | | **(8.3)** | **30 %** | | (10.5) | | **(13.4)** | **28 %** |
| Income (loss) from operations | $ | - | $ | **(3.8)** | **(348)%** | $ | 2.9 | $ | **(.9)** | **(131)%** |

Amounts attributable to CompX relate to its components products business, while the other amounts generally relate to NL. Each of these items is more fully discussed below.

***CompX International Inc.***

| | Three months ended June 30, | | | | % | Six months ended June 30, | | | | % |
|---|---|---|---|---|---|---|---|---|---|---|
| | 2006 | | 2007 | | Change | 2006 | | 2007 | | Change |
| | (In millions) | | | | | (In millions) | | | | |
| Net sales | $ | 50.1 | $ | **45.2** | **(10)%** | $ | 97.2 | $ | **88.8** | **(9)%** |
| Cost of sales | | 37.8 | | **33.3** | **(12)%** | | 73.2 | | **64.8** | **(11)%** |
| Gross margin | $ | 12.3 | $ | **11.9** | | $ | 24.0 | $ | **24.0** | |
| Income from operations | $ | 5.8 | $ | **4.4** | **(24)%** | $ | 10.6 | $ | **9.9** | **(7)%** |
| Percentage of net sales: | | | | | | | | | | |
| Cost of sales | | 75% | | **74%** | | | 75% | | **73%** | |
| Income from operations | | 12% | | **10%** | | | 11% | | **11%** | |

***Net sales –*** Our component products sales decreased 10% in the second quarter of 2007 as compared to the second quarter of 2006, and decreased 9% in the first six months of 2007 compared to the first six months of 2006. The decrease is primarily due to lower sales of certain products to the office furniture market where Asian competitors have established selling prices at a level below which we consider would return a minimal margin and lower order rates from many of our customers due to unfavorable economic conditions.

***Cost of sales and gross margin –*** Our component products cost of sales as a percentage of sales decreased from 75% in the second quarter of 2006 to 74% in the second quarter of 2007. Similarly, cost of sales as a percentage of sales decreased from 75% in the first six months of 2006 to 73% in the first six months of 2007. As a result, gross margin percentage increased from 25% in the second quarter of 2006 to 26% in the second quarter of 2007, and increased from 25% to 27% in the year-to-date period. The improvements in our gross margin percentages are primarily due to an improved product mix and full realization in 2007 of certain cost reductions implemented during 2006, offset in part by relative changes in foreign currency exchange rates. While CompX has experienced higher raw material costs, the unfavorable impact on gross margin was mitigated through the implementation of sales price increases across most products that were affected.

***Income from operations –*** Our component products income from operations decreased to $4.4 million in the second quarter of 2007 from $5.8 million in the second quarter of 2006. Income from operations in the first six months of 2007 decreased to $9.9 million compared to $10.6 million for the first six months of 2006. Income from operations decreased in 2007 as compared to the same periods in 2006 as the unfavorable effect of lower sales volume for certain furniture components products resulting from competition from lower priced Asian manufacturers, the effect of lower order rates from many of our customers due to unfavorable economic conditions and the effect of relative changes in foreign currency exchange rates more than offset the favorable effect of a change in product mix and our ongoing focus on reducing costs. As mentioned above, while CompX has experienced higher raw material costs, the unfavorable impact on gross margin was mitigated through the implementation of sales price increases across most products that were affected. Although sales declined for the first half of 2007 compared to the same period in 2006, income from operations as a percentage of net sales in 2007 was comparable to 2006 due to a more favorable product mix and to the favorable impact of a continuous focus on reducing costs across all product lines.

***Currency -*** CompX has substantial operations and assets located outside the United States (in Canada and Taiwan). The majority of sales generated from CompX's non-U.S. operations are denominated in the U.S. dollar with the remainder denominated in foreign currencies, principally the Canadian dollar and the New Taiwan dollar. Most raw materials, labor and other production costs for these non-U.S. operations are denominated primarily in local currencies. Consequently, the translated U.S. dollar values of CompX's 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 comparability of period-to-period operating results. Overall, fluctuations in foreign currency exchange rates had the following effects on sales and income from operations in 2007 as compared to 2006.

| | Three months ended June 30, 2007 vs. 2006 | Six months ended June 30, 2007 vs. 2006 |
|---|---|---|
| | (Increase (decrease), in thousands) | |
| Impact on: | | |
| Sales | $ 77 | $ 16 |
| Income from operations | (652) | (502) |

***Outlook –*** Demand is slowing across most of our component product lines as customers react to the condition of the overall economy. Asian-sourced competitive pricing pressures are expected to continue to be a challenge for us as Asian manufacturers, particularly those located in China, gain share in certain markets. We believe the impact of this environment will be mitigated through our ongoing initiatives to expand both new products and new market opportunities. Our strategy in responding to the competitive pricing pressure has included reducing production cost through product reengineering, improvement in manufacturing processes through lean manufacturing techniques and moving production to lower-cost facilities, including our own Asian-based manufacturing facilities. In addition, we continue to develop sources for lower cost components for certain product lines to strengthen our ability to meet competitive pricing when practical. We also emphasize and focus on opportunities where we can provide value-added customer support services that Asian-based manufacturers are generally unable to provide. As a result of pursuing this strategy, we will forgo certain product sales in favor of developing new products and new market opportunities where we believe the combination of our cost control initiatives and value-added approach will produce better results for our shareholders. We also expect raw material cost volatility to continue during the remainder of 2007, which we may not be able to fully recover through price increases or surcharges due to the competitive nature of the markets we serve.

***General corporate and other items***

***Insurance recoveries***– Insurance recoveries relate to amounts we received from certain of our former insurance carriers, and relate principally to recovery of prior lead pigment litigation defense costs incurred by us. We have agreements with two former insurance carriers pursuant to which the carriers reimburse us for a portion of our past and future lead pigment litigation defense costs, and the insurance recoveries we recognized in both years include amounts we received from these carriers. We are not able to determine how much we will ultimately recover from these carriers for the past defense costs we incurred because of certain issues that arise regarding which past defense costs qualify for reimbursement. Insurance recoveries in 2006 also include amounts we received for prior legal defense and indemnity coverage for certain of our environmental expenditures. We do not expect to receive any further material insurance settlements relating to environmental remediation matters.

While we continue to seek additional insurance recoveries for lead pigment and asbestos litigation matters, we do not know if we will be successful in obtaining additional reimbursement for either defense costs or indemnity. We have not considered any additional potential insurance recoveries in determining accruals for lead pigment litigation matters. Any additional insurance recoveries would be recognized when the receipt is probable and the amount is determinable.

***Corporate expense*** – Corporate expenses were $8.5 million in the second quarter of 2007, $2.1 million or 33% higher than in the second quarter of 2006 primarily due to higher litigation and related expenses partially offset by lower environmental remediation expenses. Corporate expenses were $13.4 million, 28% higher, in the first six months of 2007 compared to the first six months of 2006 due mainly to higher litigation and related expenses, partially offset by lower environmental remediation expenses. We expect corporate expenses in 2007 to be higher than in 2006, in part due to higher expected litigation and related expenses.

Obligations for environmental remediation costs are difficult to assess and estimate, and it is possible that actual costs for environmental remediation will exceed accrued amounts or that costs will be incurred in the future for sites for which we cannot currently estimate our liability. If these events were to occur in the remainder of 2007, our corporate expenses would be higher than we currently estimate. See Note –––––10 to the Condensed Consolidated Financial Statements.

***Equity in earnings of Kronos Worldwide, Inc.***

| | **Three months ended June 30, 2006 (As adjusted)** | **Three months ended June 30, 2007** | **% Change** | **Six months ended June 30, 2006 (As adjusted)** | **Six months ended June 30, 2007** | **% Change** |
|---|---|---|---|---|---|---|
| | **(In millions)** | | | **(In millions)** | | |
| Kronos historical: | | | | | | |
| Net sales | $ 345.1 | **$ 342.6** | **(1)%** | $ 649.4 | **$ 656.6** | **1 %** |
| Cost of sales | 264.2 | **279.0** | **6 %** | 492.7 | **522.6** | **6 %** |
| Gross margin | $ 80.9 | **$ 63.6** | | $ 156.7 | **$ 134.0** | |
| Income from operations | $ 35.6 | **$ 23.6** | **(34)%** | $ 71.0 | **$ 52.9** | **(25)%** |
| Other general corporate, net | 1.4 | **.4** | | 1.9 | **1.0** | |
| Loss on prepayment of debt | (22.3) | **-** | | (22.3) | **-** | |
| Interest expense | (13.1) | **(9.8)** | | (23.8) | **(19.3)** | |
| | 1.6 | **14.2** | | 26.8 | **34.6** | |
| Income tax expense (benefit) | (11.2) | **14.2** | | (1.7) | **21.7** | |
| Net income | $ 12.8 | **$ -** | | $ 28.5 | **$ 12.9** | |
| Percentage of net sales: | | | | | | |
| Cost of sales | 77% | **81%** | | 76% | **80%** | |
| Income from operations | 10% | **7%** | | 11% | **8%** | |

| | | | | | | |
|---|---|---|---|---|---|---|
| Equity in earnings of Kronos Worldwide, Inc. | $ 4.6 | **$ -** | | $ 10.2 | **$ 4.6** | |
| $TiO_2$ operating statistics: | | | | | | |
| Sales volumes* | 139 | **137** | **(2)%** | 264 | **262** | **(1)%** |
| Production volumes* | 130 | **128** | **(2)%** | 257 | **261** | **2 %** |
| Change in $Ti0_2$ net sales: | | | | | | |
| $Ti0_2$ product pricing | | | **(4)%** | | | **(3)%** |
| $Ti0_2$ sales volume | | | **(2)%** | | | **(1)%** |
| $Ti0_2$ product mix | | | **1 %** | | | **- %** |
| Changes in currency exchange rates | | | **4 %** | | | **5 %** |
| Total | | | **(1)%** | | | **1 %** |

* Thousands of metric tons

The key performance indicators for Kronos are $TiO_2$ average selling prices and $TiO_2$ sales and production volumes.

***Net sales***– Kronos' net sales decreased 1% or $2.5 million compared to the second quarter of 2006 primarily due to a 4% decrease in average $TiO_2$ selling prices and a 2% decrease in sales volumes, offset somewhat by the favorable effect of changes in currency exchange rates. Kronos estimates that the favorable effect of changes in currency exchange rates increased net sales by approximately $15 million, or 4%, compared to the same period in 2006. Kronos expects that selling prices in the second half of 2007 to be lower than the selling prices in the first half of 2007.

Kronos' net sales increased 1% or $7.2 million compared to the six months ended June 30, 2006 as the favorable effect of changes in currency exchange rates more than offset the unfavorable impact of a 3% decrease in average prices and a 1% decrease in sales volume. Kronos estimates that the favorable effect of changes in currency exchange rates increased net sales by approximately $31 million, or 5%, compared to the same period in 2006.

Kronos' sales volumes were 2% lower in the second quarter of 2007 compared to 2006 and 1% lower in the six months ended June 30, 2007 compared to 2006 due to lower sales volumes in North America, partially offset by higher sales volumes in Europe and export markets. Sales volumes in North America have been impacted by a decrease in demand for $TiO_2$. Kronos expects that overall demand will continue to remain high for the remainder of the year in Europe and export markets, and will be somewhat weaker in North America.

***Cost of sales***– Kronos' cost of sales increased $14.8 million or 6% in the second quarter of 2007 as compared to the same period in 2006 due to lower production volumes, a slight increase in raw material costs and currency fluctuations (primarily the euro). Cost of sales as a percentage of net sales increased to 81% in the second quarter of 2007 compared to 77% in the second quarter of 2006 due to the unfavorable effects of lower average $TiO_2$ selling prices and production volumes. $TiO_2$ production volumes decreased 2% in the second quarter of 2007 compared to the same period in 2006.

Kronos' cost of sales increased $29.9 million or 6% in the six months ended June 30, 2007 as compared to the same period in 2006 due to the net effect of a 2% increase in utility costs (primarily energy costs), a 1% increase in raw material costs, higher production volumes and currency fluctuations (primarily the euro). The cost of sales percentage of net sales increased to 80% in the six months ended June 30, 2007, compared to 76% in the same period of 2006 as the unfavorable effect of higher raw material and other operating costs (including energy costs) and lower average selling prices more than offset the favorable effect of higher production volumes. $TiO_2$ production volumes increased 2% in the first six months of 2007 compared to the same period in 2006, and Kronos' operating rates were near full capacity in both periods. Kronos' production volumes were a record for the first six months of 2007.

***Income from operations***– Kronos' income from operations for the second quarter of 2007 declined by 34% to $23.6 million compared to the same period in 2006 and declined by 25% to $52.9 million for the six months ended June 30, 2007 compared to the same period in 2006. Income from operations as a percentage of net sales declined to 7% in the second quarter of 2007 from 10% in the same period for 2006 and declined to 8% in the first six months ended June 30, 2007 from 11% in the same period for 2006. This decrease is driven by the decline in gross margin, which fell to 19% for the second quarter of 2007 compared to 23% for the second quarter of 2006 and fell to 20% in the first half of 2007 compared to 24% in the same period in 2006. Kronos' gross margin has decreased as pricing has not improved to offset the negative impact of higher raw materials and energy costs and lower sales volumes. Changes in currency rates have positively affected Kronos' gross margin and income from operations.

***Currency***– Kronos hassubstantial operations and assets located outside the United States (primarily in Germany, Belgium, Norway and Canada). The majority of Kronos' foreign operations' sales are denominated in foreign currencies, principally the euro, other major European currencies and the Canadian dollar. A portion of sales generated from Kronos' foreign operations are denominated in the U.S. dollar. Certain raw materials used worldwide, primarily titanium-containing feedstocks, are purchased in U.S. dollars, while labor and other production costs are purchased primarily in local currencies. Consequently, the translated U.S. dollar value of Kronos' foreign sales and operating results are subject to currency exchange rate fluctuations which may favorably or adversely impact reported earnings and may affect the comparability of period-to-period operating results. Overall, fluctuations in foreign currency exchange rates had the following effects on Kronos' sales and income from operations in 2007 as compared to 2006.

| | Three months ended June 30, 2007 vs. 2006 | Six months ended June 30, 2007 vs. 2006 |
|---|---|---|
| | (Increase, in millions) | |
| Impact on: | | |
| Sales | $ 15 | $ 31 |
| Income from operations | 4 | 7 |

***Interest expense*** – Kronos' interest expense decreased $3.3 million to $9.8 million in the second quarter of 2007, and decreased $4.5 million to $19.3 million in the six months ended June 30, 2007 from the same periods in 2006 due to the redemption of its 8.875% Senior Secured Notes and the issuance of its 6.5% Senior Secured Notes in the second quarter of 2006. Excluding the effect of currency exchange rates, Kronos expects that interest expense in the second half of 2007 will be consistent with the first half of the year.

In May 2006, Kronos International, Inc. ("KII"), a wholly-owned subsidiary of Kronos, redeemed its 8.875% Senior Secured Notes at 104.437% of their aggregate principal amount of euro 375 million (an aggregate of $470.5 million). Funds for the redemption were provided by KII's April 2006 issuance of an aggregate euro 400 million principal amount of new 6.5% Senior Secured Notes due April 2013. Kronos recognized a $22.3 million pre-tax charge in the second quarter of 2006 related to the early extinguishment of the 8.875% Senior Secured Notes, consisting of the call premium on the Notes and the net write-off of deferred financing costs and unamortized premium related to the Notes.

Kronos has a significant amount of indebtedness denominated in the euro, primarily the 6.5% Senior Secured Notes. The interest expense Kronos recognizes will vary with fluctuations in the euro exchange rate.

***Provision for income taxes*** – Kronos' provision for income taxes was $14.2 million in the second quarter of 2007 compared to a benefit of $11.2 million in the same period last year and $21.7 million in the first six months of 2007 compared to an income tax benefit of $1.7 million in the same period last year. Following a European Union Court of Justice decision and subsequent proceedings which concluded in the second quarter of 2007 that Kronos believes may favorably impact it, Kronos initiated a new tax planning strategy. If Kronos is successful, it would generate a substantial cash tax benefit in the form of refunds of income taxes Kronos has previously paid in Europe which Kronos does not currently expect would affect its future earnings when received. It may be a number of years before Kronos knows if its implementation of this tax planning strategy will be successful, and accordingly Kronos has not currently recognized any refundable income taxes that it might ultimately receive. Partially as a result of and consistent with Kronos' initiation of this tax planning strategy, in the second quarter of 2007 Kronos amended prior-year income tax returns in Germany. As a consequence of amending its tax returns, Kronos' German corporate and trade tax net operating loss carryforwards were reduced by an aggregate of euro 13.4 million and euro 22.6 million, respectively, and accordingly, Kronos recognized an $8.7 million provision for deferred income taxes in the second quarter of 2007 related to the adjustment of its German tax attributes. Kronos' income tax benefit in 2006 was primarily due to a $9.5 million reduction in its income tax contingency reserves related to favorable developments with income tax audits for its Belgian and Norwegian operations, a $2 million benefit associated with favorable developments with certain income tax issues related to its Belgian and German operations and a $1.1 million benefit resulting from the enactment of a reduction in Canadian income tax rates.

In July 2007, Germany enacted certain changes in their income tax laws. The most significant change for us is the reduction of the German corporate and trade income tax rates. Kronos has a significant net deferred income tax asset in Germany, primarily related to its corporate and trade tax net operating loss carryforwards. Kronos measures net deferred taxes using the applicable enacted tax rates, and the effect of any change in the applicable enacted tax rate is recognized in the period of enactment. Accordingly, we estimate that Kronos will report a decrease in its net deferred tax asset in Germany of approximately $89 million in the third quarter of 2007.

***Outlook*** - Through its debottlenecking program, Kronos has added capacity to its German chloride-process facility, and equipment upgrades and enhancements in several locations have allowed Kronos to reduce downtime for maintenance activities. Kronos' production capacity has increased by approximately 30% over the past ten years with only moderate capital expenditures. Kronos believes that its annual attainable $TiO_2$ production capacity for 2007 is approximately 525,000 metric tons, with some additional capacity expected to be available in 2008 through continued debottlenecking efforts.

Kronos expects that income from operations for the remainder of 2007 will be lower than 2006. Kronos' expectations as to the future of the $TiO_2$ industry are based upon a number of factors beyond its control, including worldwide growth of gross domestic product, competition in the marketplace, unexpected or earlier than expected capacity additions and technological advances. If actual developments differ from Kronos' expectations, Kronos' results of operations could be unfavorably affected.

In addition, as discussed above Kronos expects to report a net loss for 2007 due primarily to the effect of a reduction in the enacted German income tax rates.

***Other items***

***Interest expense*** - Substantially all of our interest expense relates to CompX. Interest expense declined in 2007 compared to 2006 due primarily to lower average debt levels.

***Provision for income taxes*** - See Note 8 to the Condensed Consolidated Financial Statements for a tabular reconciliation of our statutory tax expense to our actual tax benefit.

In accordance with GAAP, we recognize deferred income taxes on our undistributed equity in earnings of Kronos. We do not recognize, and we are not required to pay, income taxes to the extent we receive dividends from Kronos. Because we and Kronos are part of the same U.S. federal income tax group, we are entitled to a 100% dividends received deduction on the dividends we receive from Kronos. Therefore, our effective income tax rate will generally be lower than the U.S. federal statutory income tax rate.

***Minority interest*** - Minority interest in earnings decreased $198,000 in the first six months of 2007 as compared to 2006 due primarily to lower earnings of CompX in 2007.

**LIQUIDITY AND CAPITAL RESOURCES**

**Consolidated cash flows**

***Operating activities***

Trends in cash flows from operating activities (excluding the impact of significant securities transactions, deferred taxes and relative changes in assets and liabilities) are generally similar to trends in our earnings. Changes in assets and liabilities result primarily from the timing of production, sales and purchases.

Cash flows from operating activities decreased from $6.2 million provided by operating activities in the first six months of 2006 to a net use of cash of $1.2 million in the first six months of 2007. This $7.4 million decline in cash provided by operating activities is due primarily to:

- lower income from operations in 2007 of $3.8 million; and
- higher cash paid for income taxes in 2007 of $5.8 million due in part to income tax payments we made related to the capital gain generated from Valhi's distribution of TIMET common stock.

We do not have complete access to CompX's cash flows in part because we do not own 100% of CompX. A detail of our consolidated cash flows from operating activities is presented in the table below. Intercompany dividends have been eliminated.

| | Six months ended June 30, 2006 | Six months ended June 30, 2007 |
|---|---|---|
| | (In millions) | |
| Cash provided (used) by operating activities: | | |
| CompX | $ 11.3 | **$ 5.3** |
| NL Parent and wholly-owned subsidiaries | (2.4) | **(3.8)** |
| Eliminations | (2.7) | **(2.7)** |
| Total | $ 6.2 | **$ (1.2)** |

Relative changes in working capital can have a significant effect on cash flows from operating activities. Our average days sales outstanding ("DSO") increased from 41 days at December 31, 2006 to 44 days at June 30, 2007 due to timing of collection on the higher accounts receivable balance at the end of June. For comparative purposes, our average DSO increased from 40 days at December 31, 2005 to 41 days at June 30, 2006. Our average number of days in inventory ("DII") was 57 days at December 31, 2006 and 70 days at June 30, 2007. The increase in days in inventory is primarily due to the higher cost of commodity raw materials at June 30, 2007. For comparative purposes, our average

DII decreased from 59 to 57 days at December 31, 2005 and June 30, 2006, respectively, primarily as a result of a lower commodity raw material balance at June 30, 2006 as a result of the utilization of a higher than normal commodity raw material inventory balance acquired in the latter part of 2005.

*Investing and financing activities*

Net cash provided by investing activities totaled $1.4 million in the second quarter of 2007 compared to net cash used of $17.3 million in the second quarter of 2006. This $18.7 million increase is primarily due to the net effect of:

- CompX's 2006 acquisition of a Marine component products company for $9.8 million, net of cash acquired,
- our 2006 purchase of approximately 117,000 shares of CompX common stock in market transactions for $1.8 million, and
- net proceeds from the sale of marketable securities during the second quarter 2007.

Net cash used in financing activities totaled $13.1 million in the first six months of 2007 compared to $14.9 million in the first six months of 2006. During 2006, CompX prepaid $1.5 million in certain industrial revenue bonds. In addition, we paid aggregate cash dividends of $12.1 million, or $.125 per share, during the first six months of 2006 and 2007. Distributions to minority interests consist of CompX dividends paid to shareholders other than us.

At June 30, 2007, there were no amounts outstanding under CompX's $50 million revolving credit facility that matures in January 2009 and the entire balance was available for future borrowings. We do not expect to use any of our cash flow from operating activities generated during 2007 to repay indebtedness.

Provisions contained in certain of CompX's and Kronos' credit agreements could result in the acceleration of the applicable indebtedness prior to its stated maturity for reasons other than defaults from failing to comply with typical financial covenants. For example, certain credit agreements allow the lender to accelerate the maturity of the indebtedness upon a change of control (as defined) of the borrower. 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.

**Future cash requirements**

*Liquidity*

Our primary source of liquidity on an ongoing basis is our cash flow from operating activities, including the dividends Kronos pays to us. We generally use these amounts to i) fund capital expenditures, ii) pay ongoing environmental remediation and legal expenses and iii) provide for the payment of dividends.

At June 30, 2007, we had an aggregate of $52.4 million of restricted and unrestricted cash, cash equivalents and debt securities. A detail by entity is presented in the table below.

| | Amount (In millions) |
|---|---|
| CompX | $ 28.0 |
| NL Parent and wholly-owned subsidiaries | 24.4 |
| Total | $ 52.4 |

In addition, at June 30, 2007 we owned 4.7 million shares of Valhi common stock and 2.2 million shares of TIMET common stock with an aggregate market value of $148.5 million. See Note 4 to the Condensed Consolidated Financial Statements.

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 affiliates. As a result of this process, we have in the past and may in the future seek to raise additional capital, incur debt, 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.

We periodically evaluate acquisitions of interests in or combinations with companies (including related companies) perceived by management to be undervalued in the marketplace. These companies may or may not be engaged in businesses related to 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.

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 obligations (defined as the twelve-month period ending June 30, 2008) and our long-term obligations (defined as the five-year period ending December 31, 2012, our time period for long-term budgeting). If actual developments differ from our expectations, our liquidity could be adversely affected.

*Capital Expenditures*

Firm purchase commitments for capital projects in process at June 30, 2007 approximated $5 million.

*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 currently pays a regular quarterly cash dividend of $.25 per share. At that rate, and based on the 17.5 million shares of Kronos we held at June 30, 2007, we would receive annual dividends from Kronos of $17.5 million. CompX currently pays a regular quarterly dividend of $.125 per share rate. At that rate, and based on the 10.8 million shares of CompX we held directly or indirectly at June 30, 2007, we would receive annual dividends from CompX of $5.4 million. Our ability to service our liabilities and pay dividends on common stock could be adversely affected if our subsidiaries and affiliates were to become unable to make sufficient cash dividends or other distributions. In addition, a significant portion of our assets consists of ownership interests in our subsidiaries and affiliates. If we were required to liquidate securities in order to generate funds to satisfy our liabilities, we may be required to sell such securities on the open market and may not be able to realize the book value of the assets.

*Investments 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 decisions 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.

*Off-balance sheet financing arrangements*

We do not have any off-balance sheet financing agreements other than the operating leases discussed in our 2006 Annual Report.

*Commitments and contingencies*

There have been no material changes in our contractual obligations since we filed our 2006 Annual Report, and we refer you to the report for a complete description of these commitments.

We are subject to certain commitments and contingencies, as more fully described in Note 10 to the Condensed Consolidated Financial Statements or in Part II, Item 1 of this report. In addition to those legal proceedings described in Note 10 to the Condensed Consolidated Financial Statements, various legislation and administrative regulations have, from time to time, been proposed that seek to (i) impose various obligations on present and former manufacturers of lead pigment and lead-based paint (including NL) with respect to asserted health concerns associated with the use of such products and (ii) effectively overturn court decisions in which we 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 11 to the Condensed Consolidated Financial Statements.

**Critical accounting policies and estimates**

For a discussion of our critical accounting policies, refer to Part I, Item 7 - “Management’s Discussion and Analysis of Financial Condition and Results of Operations” in our 2006 Annual Report. There have been no changes in our critical accounting policies during the first six months of 2007.

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK**

We are exposed to market risk, including foreign currency exchange rates, interest rates and security prices. For a discussion of such market risk items, refer to Part I, Item 7A. - “Quantitative and Qualitative Disclosure About Market Risk” in our 2006 Annual Report. There have been no material changes in these market risks during the first six months of 2007.

Certain of CompX’s sales generated by our foreign operations are denominated in U.S. dollars. CompX periodically uses currency forward contracts to manage a portion of currency exchange rate market risk associated with receivables, or similar exchange rate risk associated with future sales, denominated in a currency other than the holder's functional currency. Additionally, CompX periodically uses currency forward contracts to manage risk associated with other currency transactions such as intercompany dividends from non-U.S. subsidiaries. CompX has not entered into any of these contracts for trading or speculative purposes in the past, nor do they anticipate entering into such contracts for trading or speculative purposes in the future. A majority of the currency forward contracts CompX enters 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 the 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. Occasionally CompX enters into currency forward contracts for specific transactions which do not meet the criteria for hedge accounting, CompX marks-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. At June 30, 2007, CompX had one contract outstanding to manage exchange rate risk to exchange an aggregate of U.S. $2.1 million for Canadian dollars at an exchange rate of Cdn $1.13 per U.S. dollar. This contract does not qualify for hedge accounting and matures in July 2007. The exchange rate was Cdn $1.06 per U.S. dollar at June 30, 2007.

**ITEM 4. CONTROLS AND PROCEDURES**

***Evaluation of Disclosure Controls and Procedures*** - We maintain a system of disclosure controls and procedures. The term "disclosure controls and procedures," as defined by regulations of the SEC, means controls and other procedures that are designed to ensure that information required to be disclosed in the reports 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 Harold C. Simmons, our Chief Executive Officer, and Gregory M. Swalwell, our Vice President, Finance and Chief Financial Officer, have evaluated the design and operating effectiveness of our disclosure controls and procedures as of June 30, 2007. Based upon their evaluation, these executive officers have concluded that our disclosure controls and procedures are effective as of June 30, 2007.

***Internal Control over Financial Reporting*** - We also maintain internal control over financial reporting. The term “internal control over financial reporting,” as defined by SEC regulations, 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 our board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP, and includes those policies and procedures that:

- Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect our 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 our receipts and expenditures are made only in accordance with authorizations of our management and directors, and
- Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on our Condensed Consolidated Financial Statements.

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

***Changes in Internal Control over Financial Reporting -*** There has been no change to our internal control over financial reporting during the quarter ended June 30, 2007 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**

In addition to the matters discussed below, refer to Note 10 to our Condensed Consolidated Financial Statements and to our 2006 Annual Report and to our Quarterly Report on Form 10-Q for the quarter ended March 31, 2007.

*Jackson, et al. v. The Glidden Co., et al.*, Court of Common Pleas, Cuyahoga County, Cleveland, Ohio (Case No. 236835). In June 2007, the Ohio Supreme Court denied review of the appellate court's affirmation of the summary judgment order. This decision concludes the case in our favor.

*State of Rhode Island v. Lead Industries Association, et al.* (Superior Court of Rhode Island, No. 99-5226). Please refer to Note 10 to our Condensed Consolidated Financial Statements.

*City of St. Louis v. Lead Industries Association, et al.* (Missouri Circuit Court 22nd Judicial Circuit, St. Louis City, Cause No. 002-245, Division 1). In June 2007, the Missouri Supreme Court affirmed the dismissal of this case. This decision concludes the case in our favor.

*County of Santa Clara v. Atlantic Richfield Company, et al.* (Superior Court of the State of California, County of Santa Clara, Case No. CV788657). In May 2007, plaintiffs appealed the trial court's ruling that the contingency fee arrangement between plaintiffs and their counsel was unlawful, and the trial court granted a stay of the case pending resolution of this appeal.

*City of Milwaukee v. NL Industries, Inc. and Mautz Paint* (Circuit Court, Civil Division, Milwaukee County, Wisconsin, Case No. 01CV003066). The case was tried in May and June 2007, and in June 2007 the jury returned a verdict in favor of NL. In July 2007, plaintiff filed motions to set aside the verdict and requested a new trial, including a motion to change the verdict. The court has scheduled a hearing on these motions in September 2007.

*In re: Lead Paint Litigation* (Superior Court of New Jersey, Middlesex County, Case Code 702). In June 2007, the New Jersey Supreme Court reversed the appellate court's ruling on the state's public nuisance count, with instruction to dismiss the case. This decision concludes the case in our favor.

*Jackson, et al., v. Phillips Building Supply of Laurel, et al.* (Circuit Court of Jones County, Mississippi, Dkt. Co. 2002-10-CV1). The time for appeal of the order granting our summary judgment motion has expired. The decision granting summary judgment concludes the case in our favor.

*Jones v. NL Industries, Inc., et al.* (United States District Court, Northern District of Mississippi, Case No. 4:03cv229-M-B). In July 2007, the Fifth Circuit Court of Appeals rejected the appeal and thus affirmed the trial court's decisions and verdict. This decision concludes the case in our favor.

*Terry, et al. v. NL Industries, Inc., et al.* (United States District Court, Southern District of Mississippi, Case No. 4:04 CV 269 PB). In May 2007, the court dismissed the plaintiffs' fraudulent concealment count.

*City of E. Cleveland, Ohio v. Sherwin-Williams Company et al.* (Court of Common Pleas, Cuyahoga County, Ohio, Case No. CV06602785); and *City of Cincinnati, Ohio v. Sherwin-Williams Company et al.* (Court of Common Pleas, Hamilton County, Ohio, Case No. A 0611226). In June 2007, each of these Cities voluntarily dismissed their respective case without prejudice.

*City of Lancaster, Ohio v. Sherwin-Williams Company et al.* (Court of Common Pleas, Fairfield County, Ohio, Case No. 2006 CV 01055); *City of Toledo, Ohio v. Sherwin-Williams Company et al.* (Court of Common Pleas, Lucas County, Ohio, Case No. G-4801-CI-200606040-000); and *Columbus City, Ohio v. Sherwin-Williams Company et al.* (Court of Common Pleas, Franklin County, Ohio, Case No. 06CVH-12-16480). In May 2007, each of the courts stayed these cases pending a decision by the Ohio Supreme Court, which was issued on August 1, 2007, upholding the enactment of 2006 SB 117, a bill which clarified the State's product liability law as applicable to public nuisance actions.

*State of Ohio, ex rel. Marc Dann Attorney General v. Sherwin-Williams Company et al.* (Court of Common Pleas, Franklin County, Ohio, Case No. 07 CVC 04 4587). In May 2007, this case was consolidated with the *Columbus* case.

*City of Canton, Ohio v. Sherwin-Williams Company et al.* (Court of Common Pleas, Stark County, Ohio, Case No. 2006CV05048). In May 2007, the court granted the Stark County Housing Authority's motion to intervene. Also in May, the court consolidated the *City ofMassillon* case, which was also pending before the court, with this case. In July 2007, the court heard arguments on the defendants' motion to dismiss and took the matter under advisement.

*City of Massillon, Ohio v. Sherwin-Williams Company et al.* (Court of Common Pleas, Stark County, Ohio, Case No. 2007CV01224). In May 2007, this case was consolidated with the *Canton* case.

*City of Youngstown, Ohio v. Sherwin-Williams Company et al.* (Court of Common Pleas, Mahoning County, Ohio, Case No. 2007 CV 01167); *City of Athens, Ohio v. Sherwin-Williams Company et al.* (Court of Common Pleas, Athens County, Ohio, Case No. 07CI136); and *City of Dayton, Ohio v. Sherwin-Williams Company et al.* (Court of Common Pleas, Montgomery County, Ohio, Case No. 2007 CV 02701). In May 2007, defendants in each of these cases filed a motion to dismiss the case.

*Circuit Court cases in Milwaukee County, Wisconsin*. During the second quarter of 2007, four of the cases were removed to Federal court.

In June 2007, we were served with crossclaims by a third-party defendant in *Michel et al. v. Brothers Services, Inc. et al.* (Superior Court of New Jersey, Monmouth County, New Jersey, Case No. MON-L-2240-07). Plaintiffs, a minor child and his parents, seek damages for injuries purportedly caused by lead on the surfaces of the home in which they reside. We intend to deny all liability and to defend against all of the crossclaims vigorously.

*The Quapaw Tribe of Oklahoma et al. v. Blue Tee Corp. et al.* (United States District Court, Northern District of Oklahoma, Case No. 03-CII-846H(J)), formerly *The Quapaw Tribe of Oklahoma et al. v. ASARCO Incorporated et al*. In June 2007, plaintiffs amended the complaint to drop the class allegations.

*Brown et al. v. NL Industries, Inc. et al.* (Circuit Court Wayne County, Michigan, Case No. 06-602096 CZ). In May 2007, we moved to dismiss several plaintiffs who failed to respond to discovery requests.

**Item 1A. Risk Factors**

For a discussion of the risk factors related to our businesses, refer to Part I, Item 1A., "Risk Factors," in our 2006 Annual report. There have been no material changes to such risk factors during the six months ended June 30, 2007.

**Item 4. Submission of Matters to a Vote of Security Holders**

Our 2007 Annual Meeting of Shareholders was held on May 25, 2007. Cecil H. Moore, Jr., Glenn R. Simmons, Harold C. Simmons, Thomas P. Stafford, Steven L. Watson and Terry N. Worrell were elected as directors, each receiving votes "For" their election from at least 95.8% of the 48.6 million common shares eligible to vote at the Annual

Meeting.

**Item 6.** **Exhibits**

31.1 - Certification

31.2 - Certification

32.1 - Certification

## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

NL INDUSTRIES, INC.
(Registrant)

Date August 6, 2007

/s/ Gregory M. Swalwell
Gregory M. Swalwell
(Vice President, Finance and
Chief Financial Officer,
Principal Financial Officer)

Date August 6, 2007

/s/ Tim C. Hafer
Tim C. Hafer
(Vice President and Controller,
Principal Accounting Officer)