OM GROUP INC
Form 10-K
August 22, 2005

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

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2004

OR

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

For the transition period from_______________ to _______

Commission file number 001-12515
OM GROUP, INC.
(Exact name of Registrant as specified in its charter)

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

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

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

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

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

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

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

Indicate by check mark if the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes x No o

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

The aggregate market value of Common Stock, par value $.01 per share, held by nonaffiliates (based upon the closing sale price on the NYSE) on June 30, 2005 and June 30, 2004 was approximately $704 million and $940 million, respectively.

As of June 30, 2005 there were 28,581,041 shares of Common Stock, par value $.01 per share, outstanding.

Table of Contents

PART I

Item 1. Business

General

The Company is a leading, vertically integrated international producer and marketer of value-added, metal-based specialty chemicals and related materials, primarily from cobalt and nickel. The Company applies proprietary technology to unrefined cobalt and nickel raw materials to market more than 1,500 different product offerings to approximately 3,300 customers in over 30 industries. The Company operates in two business segments Cobalt and Nickel.

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

The Company s business is critically connected to both the price and availability of raw materials. The primary raw materials used by the Company are cobalt and nickel, and the cost of these raw materials fluctuates due to actual or perceived changes in supply and demand, changes in cobalt and nickel reference prices and changes in availability from suppliers. Fluctuations in the prices of cobalt and nickel have been significant in the past and the Company believes that cobalt and nickel price fluctuations are likely to continue in the future. The Company attempts to mitigate changes in prices and availability by maintaining adequate inventory levels and long-term supply relationships with a variety of producers. Generally, the Company is able to pass through to its customers increases and decreases in raw material prices by increasing or decreasing, respectively, the prices of its products. The degree of profitability of the Company principally depends on the Company s ability to maintain the differential between its product prices and product costs. During periods of rapidly changing metal prices, however, there may be price lags that can impact the short-term profitability of the Company both positively and negatively. Reductions in the price of raw materials or declines in the selling prices of the Company s finished goods could also result in the Company s inventory carrying value being written down to a lower market value, or result in a reduction in its gross profit from historical levels.

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

Recent Developments

New President and Chief Executive Officer On June 13, 2005, Joseph M. Scaminace became President and Chief Executive Officer of the Company. Mr. Scaminace comes to the Company from The Sherwin-Williams Company, where he served for 22 years in a variety of positions of increasing responsibility, culminating in the role of president, chief operating officer, and board member. Mr. Scaminace replaced Frank E. Butler, who previously was the non-executive chairman of the board and became the Company s interim chief executive officer in January 2005. On January 11, 2005, James P. Mooney s employment with the Company was terminated and he ceased to be Chief Executive Officer.

Agreements to Settle Class Action and Derivative Lawsuits The Company has reached an agreement to settle the shareholder class action lawsuits filed in November 2002 relating to the decline in the Company s stock price after the third quarter 2002 earnings announcement. The Company and lead plaintiff of these lawsuits have entered into a Stipulation and Agreement of Settlement dated June 6, 2005, which Agreement was preliminary approved on June 24, 2005 by the U.S. District Court hearing the case. The settlement is to be payable $74 million in cash and $8.5 million in common stock of the Company.

On June 15, 2005, the Company reached an agreement in principle to settle the shareholder derivative lawsuits filed in November 2002 against the Company s directors and certain of its then executives, which lawsuits also were related to the decline in the Company s stock price after the third quarter 2002 earnings announcement. The general terms of the proposed settlement are subject to the satisfaction of various conditions and execution of a definitive agreement by the interested parties, including the individual defendants. The proposed settlement provides for the Company to issue 380,000 shares of its common stock in payment of attorneys fees and costs incurred by plaintiffs counsel with respect to this litigation, and also requires the Company to implement various corporate governance changes.

Products

The Company develops, processes, manufactures and markets specialty chemicals, powders and related products from various base metals, primarily cobalt and nickel. The Company s products leverage the Company s production capabilities and bring value to its customers through superior product performance. Typically, the Company s products represent a small portion of the customer s total cost of manufacturing or processing, but are critical to the customer s product performance. The products frequently are essential components in chemical and industrial processes where they facilitate a chemical or physical reaction and/or enhance the physical properties of end-products. These products are sold in various forms such as solutions, crystals, powders, cathodes and briquettes.

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

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

3

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

Competition

The Company encounters a variety of competitors in each of its product lines, and no single company competes with the Company across all of its existing product lines. The Company believes that its focus on metal-based specialty chemicals and related materials as a core business and backward raw material integration is an important competitive advantage. For 2004, the Company believes that it was the largest refiner of cobalt and producer of cobalt-based specialty products in the world and was the sixth largest refiner of primary nickel and the largest producer of electroless nickel plating chemistry. Competition in these markets is based primarily on product quality, supply reliability, price, service and technical support capabilities. The markets in which the Company participates have historically been competitive and this environment is expected to continue.

Customers

The Company serves approximately 3,300 customers. During 2004, approximately 48% of the Company s net sales were in Europe, 22% in the Americas and 30% in Asia-Pacific. Sales to one customer in the Nickel segment were approximately 10% of Nickel s net sales in 2004. Sales to a battery customer in the Cobalt segment were approximately 20% of Cobalt s net sales in 2004. In 2003 and 2002, Glencore AG represented approximately 13% and 12%, respectively, of the Company s net sales.

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

Raw Materials

The primary raw materials used by the Company in manufacturing its products are unrefined cobalt and nickel. Cobalt raw materials include ore, concentrate, slag and scrap. Nickel raw materials include concentrates, ore, intermediate, secondaries, scrap and matte. The cost of the Company s raw materials fluctuates due to actual or perceived changes in supply and demand of raw materials, changes in cobalt and nickel reference prices and changes in availability from suppliers.

The Company s supply of cobalt historically has been sourced from the Democratic Republic of Congo (DRC), Australia and Finland. During 2004, cobalt reference prices ranged from approximately $25-$27 per pound in the first quarter, and trended downward to approximately $17-$22 per pound in the fourth quarter. From November 1, 2003 to December 31, 2003, the reference price of cobalt increased 105%, from $10.00 to $20.50 per pound. This dramatic increase was due primarily to higher demand in the Japanese battery markets, higher demand in the aerospace industry, and actual or perceived tightening of worldwide supplies. Earlier in 2003 and in 2002, the market price of cobalt remained at unusually low levels of $6.00-$7.00 per pound as compared to historical prices of $10.00-$30.00 per pound, due primarily to declining demand for cobalt metal attributable to weak business conditions worldwide, especially in the aerospace sector post-September 11, 2001.

Nickel historically has been sourced from Australia, Finland and Brazil. In December 2001, the Company purchased an intermediate nickel refining facility and associated mine deposits in Australia, which provide the Company with direct access to approximately 8,000 tons of nickel per year. During 2004, nickel market prices ranged from approximately $6-$7 per pound, except for a brief drop to approximately $5 per pound in May 2004. From November 1, 2003 to December 31, 2003, the market price of nickel increased 40%, from $5.40 to $7.54 per pound. This dramatic increase was due primarily to increased demand in the worldwide stainless steel industry, strong demand in China, and perceived supply constraints.

Although the Company has never experienced a significant shortage of raw material, production problems and political and civil instability in certain supplier countries may in the future affect the supply and market price of raw material. The Company attempts to mitigate changes in prices and availability by entering into long-term supply contracts with a variety of producers. Currently, the Company has supply arrangements for approximately 86% of its projected nickel raw material requirements for 2005. The Company does not anticipate any substantial interruption in its raw materials supply that would have a material adverse effect on the Company s results of operations or financial condition; however, a significant long-term nickel raw material contract expired in May 2005, and there is no assurance that the Company will be able to obtain as much nickel from other sources as would be necessary to satisfy the Company s requirements or at prices comparable to its current arrangements. Currently, the Company has supply arrangements for approximately 82% of its projected nickel raw material requirements for 2006. Beyond 2006, the Company s existing nickel supply arrangements represent approximately 60% of its projected nickel raw material requirements. However, the Company is actively pursuing a variety of feed sources to ensure that the Company does not experience any material shortage of nickel over the next several years.

The Company s joint venture in the DRC shut down its smelter as scheduled during January of 2005 for approximately four months for regular maintenance and production improvements. The smelter was re-opened in May of 2005.

A graph of the monthly 99.3% reference price of cobalt (as published in the Metal Bulletin magazine) per pound for 1999 through 2004 is as follows:

A graph of the monthly London Metal Exchange (LME) market price of nickel per pound for 1999 through 2004 is as follows:

Research and Development

The Company s research and new product development program is an integral part of its business. Research and development focuses on adapting proprietary technologies to develop new products and working with customers to meet their specific requirements, including joint development arrangements with customers that involve innovative products. New products include new chemical formulations, metal-containing compounds, and concentrations of various components and product forms. Research and development also focuses on improving refining competency, processes, yield and throughput in each location. Research and development, applied technology and technical service expenses were approximately $14.0 million for 2004, $10.0 million for 2003 and $13.6 million for 2002.

The Company s research staff of approximately 100 full-time persons conducts research and development in laboratories located in Westlake, Ohio; Newark, New Jersey; Kuching, Malaysia; Manchester, England; Kokkola, Finland and Harjavalta, Finland. The Company s Kokkola facility also maintains a research agreement with Outokumpu Research Oy.

Patents and Trademarks

The Company holds 236 patents and has 67 pending patent applications relating to the manufacturing, processing and use of metal-organic and metal-based compounds. Specifically, the majority of these patents cover proprietary technology for base metal refining, metal and metal oxide powders, catalysts, metal-organic compounds and inorganic salts. The Company does not consider any single patent or group of patents to be material to its business as a whole.

Environmental Matters

The Company is subject to a wide variety of environmental laws and regulations in the United States and in foreign countries as a result of its operations and use of certain substances that are, or have been, used, produced or discharged by its plants. In addition, soil and/or groundwater contamination presently exists and may in the future be discovered at levels that require remediation under environmental laws at properties now or previously owned, operated or used by the Company. At December 31, 2004 and 2003, the Company has environmental reserves of $9.5 million and $14.2 million, respectively.

Environmental compliance costs were approximately $7.0 million in 2004 and $6.0 million in 2003. Ongoing expenses include costs relating to waste water analysis, treatment, and disposal; hazardous and non-hazardous solid waste analysis and disposal; air emissions control; groundwater monitoring and related staff costs. The Company anticipates that it will continue to incur compliance costs at moderately increasing levels for the foreseeable future as environmental laws and regulations are becoming increasingly stringent.

The Company also incurred capital expenditures of approximately $3.9 million in 2004 and $1.5 million in 2003 in connection with environmental compliance. The Company anticipates that capital expenditure levels for these purposes will increase to approximately $7.9 million in 2005, as it continues to modify certain processes that may have an environmental impact and undertakes new pollution prevention and waste reduction projects.

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

Employees

At December 31, 2004, the Company had 1,426 full-time employees, of which 233 were located in the North America, 657 in Europe, 350 in Africa and 186 in Asia-Pacific. Employees at the Company s production facilities in Franklin, Pennsylvania; Kuching, Malaysia; and Kalgoorlie, Australia are non-unionized. Employees at the Company s facilities in Harjavalta and Kokkola, Finland are members of several national workers unions under various union agreements. Generally, these union agreements have two-year terms. Employees at the Company s facility in Manchester, England are members of various trade unions under a recognition agreement. This recognition agreement has an indefinite term. Employees at the Belleville, Canada facility are members of the Communications, Energy and Paperworkers Union of Canada. The current Belleville union agreement has a term of two years expiring in December 2005. Employees in the Democratic Republic of Congo are members of various trade unions. The union agreements have a term of three years expiring in April 2008. The Company believes that relations with its employees are good.

SEC Reports

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

Item 2. Properties

The Company believes that its plants and facilities, which are of varying ages and of different construction types, have been satisfactorily maintained, are suitable for the Company s operations and generally provide sufficient capacity to meet the Company s production requirements. The land on which the production facilities in Kalgoorlie, Australia are located; the land on which the Harjavalta, Finland (HNO) production facilities are located (except for the land on which the HNO chemical plant is located); and the land on which the Kokkola, Finland (KCO) production facilities are located is leased under agreements with varying expiration dates. The depreciation lives do not exceed the lives of the land leases. Otherwise, the land associated with the Company s remaining manufacturing facilities is owned by the Company.

The Company s KCO production facility is situated on property owned by Boliden Kokkola Oy. KCO and Boliden Kokkola Oy share certain physical facilities, services and utilities under agreements with varying expiration dates. The Company s HNO production facility is situated on land owned by Boliden Harjavalta Oy. The HNO facility also shares certain physical facilities and has contracts in place for toll smelting, waste disposal, utilities, laboratory services and raw material supply with Boliden Harjavalta Oy with varying expiration dates.

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

Location	Segment	Facility Function*	Approximate Square Feet	Leased/Owned
Africa:				
Lubumbashi, DRC	Cobalt	M	116,000	joint venture (55%)
North America:				
Cleveland, Ohio	Corporate	A	24,500	leased
Westlake, Ohio	Cobalt	A, R	35,200	owned
Belleville, Ontario	Cobalt	M	38,000	owned
Franklin, Pennsylvania	Cobalt	M	331,500	owned
Newark, New Jersey	Nickel	A,R	32,000	owned
Asia-Pacific:				
Kalgoorlie, Australia	Nickel	M	294,400	leased
Kuching, Malaysia	Nickel	M, A, R	25,000	owned
Tokyo, Japan	Cobalt	A	2,300	leased
Taipei, Taiwan	Cobalt	A	4,000	leased
Singapore	Nickel	W,A	4,700	leased

Location	Segment	Facility Function*	Approximate Square Feet	Leased/Owned
Europe:				
Manchester, England	Cobalt	M, A, R	73,300	owned
Espoo, Finland	Nickel	A	3,000	leased
Harjavalta, Finland	Nickel	M, A,R	591,000	owned
Kokkola, Finland	Cobalt	M, A,R	470,000	owned

* M Manufacturing/refining; A Administrative; R Research and Development; W Warehouse

Item 3. Legal Proceedings

In November 2002, the Company received notice that shareholder class action lawsuits were filed in the U.S. District Court for the Northern District of Ohio related to the decline in the Company s stock price after the third quarter 2002 earnings announcement. The lawsuits allege virtually identical claims under Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and SEC Rule 10b-5 against the Company, certain executive officers and the members of the Board of Directors. Plaintiffs seek damages in an unspecified amount to compensate persons who purchased the Company s stock between November 2001 and October 2002 at allegedly inflated market prices. In July 2004, these lawsuits were amended to include the entire restatement period back to and including 1999, and to add the Company s independent auditors, Ernst & Young LLP, as a defendant. The Company and the lead plaintiff of the shareholder class action lawsuits have entered into a Stipulation and Agreement of Settlement (Agreement) dated June 6, 2005, which Agreement was preliminarily approved on June 24, 2005 by the U.S. District Court hearing the cases. The Company recorded a charge to administrative expense of $82.5 million during 2003 related to these lawsuits. Of this amount, $8.5 million is anticipated to be paid by the issuance of common stock and the remainder in cash.

In November 2002, the Company also received notice that shareholder derivative lawsuits had been filed in the U.S. District Court for the Northern District of Ohio against the members of the Company s Board of Directors and certain of its then executives. Derivative plaintiffs allege the directors and executives breached their fiduciary duties to the Company in connection with a decline in the Company s stock price after its third quarter 2002 earnings announcement by failing to institute sufficient financial controls to ensure that the Company and its employees complied with generally accepted accounting principles by writing down the value of the Company s cobalt inventory on or before December 31, 2001. Derivative plaintiffs seek a number of changes to the Company s accounting, financial and management structures and unspecified damages from the directors and executives to compensate the Company for costs incurred in, among other things, defending the aforementioned securities lawsuits. In July 2004, the derivative plaintiffs amended these lawsuits to include conduct allegedly related to the Company s decision to restate its earnings back to and including 1999. The Company has entered into an agreement in principle with the lead plaintiffs of the shareholder derivative lawsuits that outlines the general terms of the proposed settlement of these lawsuits subject to the satisfaction of various conditions and execution of a definitive agreement by the interested parties, including the individual defendants. The proposed settlement provides for the Company to issue 380,000 shares of its common stock in payment of attorneys fees and costs incurred by plaintiffs counsel with respect to this litigation, and also requires the Company to implement various corporate governance changes. The Company recorded a charge to administrative expense of $2.0 million during the fourth quarter of 2003 and an additional charge to administrative expense of $7.5 million during the first quarter of 2004 related to these lawsuits.

At December 31, 2004 and 2003, the Company had an accrual of $92.0 million and $84.5 million, respectively, for the shareholder class action and shareholder derivative lawsuits in the aggregate. The settlements are anticipated to be paid $74.0 million in cash and $18.0 million in common stock. In April 2005, the Company paid $74.0 million into an escrow account in connection with settlement of the shareholder class action lawsuits. Insurance proceeds are expected to be available for contribution to the resolution of the cases but the Company does not expect these lawsuits to be resolved within the limits of applicable insurance. As of June 30, 2005, insurance proceeds of approximately $25 million have been received, representing both reimbursement of legal expenses in 2003, 2004 and 2005 related to the lawsuits (approximately $17 million total), as well as reimbursement of a portion of the settlement amount paid by the Company during 2005 (approximately $8 million). Potential remaining insurance proceeds of up to approximately $19 million are expected to be available and will be recognized when received.

In addition, the Company is a party to various other legal and administrative proceedings incidental to its business. In the opinion of the Company, disposition of all suits and claims related to its ordinary course of business (not including the shareholder litigation described above) should not in the aggregate have a material adverse effect on the Company s financial position or results of operations.

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

No matters were submitted to a vote of security holders during the fourth quarter of the Company s 2004 fiscal year.

PART II

Item 5. Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

The information relating to the recent price and dividend history of the Company s Common Stock is contained in Note U to the consolidated financial statements contained in Item 8 of this Annual Report. Information relating to restrictions on dividends is contained in Note G to the consolidated financial statements contained in Item 8 of this Annual Report. The Company s common stock is traded on the New York Stock Exchange under the symbol OMG . As of December 31, 2004, the Company had 1,685 shareholders.

Item 6. Selected Financial Data

	Year Ended December 31,				
(In millions, except per share data)	**2004**	**2003**	**2002**	**2001**	**2000**
Income Statement Data:					
Net sales	**$ 1,347.3**	$ 912.1	$ 738.9	$ 681.6	$ 764.4
Cost of products sold	**1,016.9**	732.1	690.8	578.0	630.8
Gross profit	**330.4**	180.0	48.1	103.6	133.6
Selling, general and administrative expenses	**129.1**	197.0	136.0	81.3	70.7
Income (loss) from operations	**201.3**	(17.0)	(87.9)	22.3	62.9
Other expense net	**(39.1)**	(25.6)	(44.6)	(36.5)	(36.6)
Income (loss) from continuing operations	**125.7**	(56.3)	(110.7)	(13.1)	1.0
Income (loss) of discontinued operations	**2.9**	140.0	(98.1)	(22.1)	(13.9)
Net income (loss)	**$ 128.6**	$ 83.7	$ (208.8)	$ (35.2)	$ (12.9)
Basic earnings per common share:					
Continuing operations	**$ 4.42**	$ (1.99)	$ (3.95)	$ (0.55)	$ 0.04
Discontinued operations	**0.10**	4.94	(3.50)	(0.91)	(0.58)
Net income (loss)	**$ 4.52**	$ 2.95	$ (7.45)	$ (1.46)	$ (0.54)
Diluted earnings per common share:					
Continuing operations	**$ 4.39**	$ (1.99)	$ (3.95)	$ (0.55)	$ 0.04
Discontinued operations	**0.10**	4.94	(3.50)	(0.91)	(0.58)
Net income (loss)	**$ 4.49**	$ 2.95	$ (7.45)	$ (1.46)	$ (0.54)
Dividends declared and paid per common share			$ 0.42	$ 0.52	$ 0.44
Ratio of earnings to fixed charges(a)	**5.0x**				1.5x
Balance Sheet Data:					
Total assets	**$ 1,333.6**	$ 1,211.4	$ 2,105.3	$ 2,074.0	$ 1,055.1
Long-term debt, excluding current portion(b)	**24.7**	430.5	1,195.6	1,299.7	551.1

(a)

Earnings were inadequate to cover fixed charges by $42.9 million, $134.5 million, and $18.5 million in 2003, 2002 and 2001, respectively.

(b) Amount in 2004 excludes $400 million of long-term debt in default which is classified as current.

Results for 2004 include a charge of $7.5 million for the shareholder derivative lawsuits.

Results for 2003 include the sale of the Company s Precious Metals Group (PMG) for cash proceeds of approximately $814 million, which resulted in a gain on sale of $145.9 million ($131.7 million after tax). Results for PMG are included in discontinued operations for all periods.

In 2003, cost of products sold includes restructuring charges of $5.8 million. Selling, general and administrative expenses include restructuring charges of $14.2 million and the shareholder class action and derivative lawsuit charge of $84.5 million. In addition, discontinued operations include $5.6 million of restructuring charges.

In 2002, cost of products sold includes restructuring charges of $37.8 million. Selling, general and administrative expenses include restructuring charges of $44.7 million. Also, in connection with its restructuring program, the

Company recorded charges of $73.5 million in discontinued operations primarily associated with the planned disposal of such operations.

Net income for 2001 and 2000 includes goodwill amortization expense of approximately $6 million per year, in selling, general and administrative expenses. Goodwill amortization ceased in 2002 in connection with the adoption of Statement of Financial Accounting Standards (SFAS) No. 142, *Goodwill and Other Intangible Assets.*

In August, 2001 the Company acquired dmc2 Degussa Metals Catalysts Cerdec for a purchase price of approximately $1.1 billion. In September, 2001 the Company disposed of the electronic materials, performance pigments, glass systems and Cerdec ceramics divisions of dmc2 for $525.5 million. The remaining portion became the Company s PMG businesses.

On April 4, 2000 the Company acquired Outokumpu Nickel Oy (ONO) in Harjavalta, Finland for a cash purchase price of $206.0 million, which included contingent payments in 2004 and 2003 of $6.7 million and $11.2 million, respectively, to the seller under a contingent consideration arrangement (See Note E to the consolidated financial statements included in Item 8 of this Annual Report). There will be no further contingent consideration payments subsequent to 2004.

Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations

Management s discussion and analysis of financial condition and results of operations should be read in conjunction with the consolidated financial statements and the notes thereto appearing elsewhere in this Annual Report.

Overview

The Company is a leading, vertically integrated international producer and marketer of value-added, metal-based specialty chemicals and related materials, primarily from cobalt and nickel. The Company applies proprietary technology to unrefined cobalt and nickel raw materials to market more than 1,500 different product offerings to approximately 3,300 customers in over 30 industries. The Company operates in two business segments Cobalt and Nickel.

The Company s business is critically connected to both the price and availability of raw materials. The primary raw materials used by the Company are cobalt and nickel, and the cost of these raw materials fluctuates due to actual or perceived changes in supply and demand, changes in cobalt and nickel reference prices and changes in availability from suppliers. Fluctuations in the prices of cobalt and nickel have been significant in the past and the Company believes that cobalt and nickel price fluctuations are likely to continue in the future. The Company attempts to mitigate changes in prices and availability by maintaining adequate inventory levels and long-term supply relationships with a variety of producers. Generally, the Company is able to pass through to its customers increases and decreases in raw material prices by increasing or decreasing, respectively, the prices of its products. The degree of profitability of the Company principally depends on the Company s ability to maintain the differential between its product prices and product costs. During periods of rapidly changing metal prices, however, there may be price lags that can impact the short-term profitability of the Company both positively and negatively. Reductions in the price of raw materials or declines in the selling price of the Company s finished goods could also result in the Company s inventory carrying value being written down to a lower market value, or result in a reduction in its gross profit from historical levels.

The Company has manufacturing and other facilities in North America, Africa, Europe and Asia-Pacific, and markets its products worldwide. Although most of the Company s raw material purchases and product sales are based on the U.S. dollar, prices of certain raw materials, liabilities for non-U.S. operating expenses and income taxes are denominated in local currencies. As such, in periods when certain currencies (particularly the euro) strengthen against the U.S. dollar, the Company s results of operations are negatively impacted. In addition, fluctuations in exchange rates may affect product demand and may adversely affect the profitability in U.S. dollars of products provided by the Company in foreign markets where payments for its products are made in local currency. Accordingly, fluctuations in currency prices affect the Company s operating results.

Dispositions and Restructuring

On July 31, 2003, the Company completed the sale of its Precious Metals Group (PMG) for approximately $814 million in cash. The Company recorded a gain of $145.9 million ($131.7 million after-tax) on the sale of this business. This business was comprised of the Company s former Precious Metal Chemistry and Metal Management reportable segments, which were acquired in August 2001. The PMG business first qualified as a discontinued operation in the second quarter of 2003; all prior periods have been reclassified to reflect this business as a discontinued operation. The net proceeds from the sale of the PMG business were used to repay the remaining indebtedness outstanding under the then-existing senior credit facilities.

On April 1, 2003, the Company completed the sale of its copper powders business, SCM Metal Products, Inc. (SCM), for $63.7 million. The net proceeds were used to repay a portion of the Company s indebtedness outstanding under its credit facilities. There was no gain or loss recorded on the sale as this business was written-down by $2.6 million to its fair value in 2002. This business has been presented as a discontinued operation for all periods presented.

During 2003, the Company recorded restructuring charges of $20.0 million related to its continuing operations, and an additional $5.6 million related to its discontinued operations, to complete its restructuring program that commenced in the fourth quarter of 2002. The primary objectives of the restructuring plan were to de-leverage the balance sheet, focus on cash generation and restore profitability in certain of the Company s core businesses that were impacted by the weak economy as well as a sustained decline in the market price of cobalt through the third quarter of 2003. Specific actions taken in 2003 to accomplish these objectives included closure of the manufacturing facility in Thailand, closure of an administrative office in the United States, relocation of the corporate headquarters, disposal of a corporate aircraft, additional headcount reductions, and certain additional asset write-offs.

During the fourth quarter of 2002, the Company recorded restructuring and other charges related to its continuing operations of $82.5 million and an additional $73.5 million related to its discontinued operations. Specific actions taken in 2002 included development of plans to sell certain non-core businesses; closure of certain non-core facilities; headcount reductions; review and renegotiation of certain raw material and other contracts to reduce costs in light of changing metal prices and business conditions; liquidation of certain inventories; reduction of base metal inventory levels and production; a decision to discontinue funding a nickel venture in Indonesia; and a re-alignment of the management team.

Overall operating results for 2004, 2003 and 2002

Set forth below is a summary of the statements of consolidated operations for the years ended December 31,

(Millions of dollars & percent of net sales)	**2004**		2003		2002	
Net sales	**$ 1,347.3**		$ 912.1		$ 738.9	
Cost of products sold	**1,016.9**		732.1		690.8	
Gross profit	**330.4**	**24.5%**	180.0	19.7%	48.1	6.5%
Selling, general and administrative expenses	**129.1**	**9.6%**	197.0	21.6%	136.0	18.4%
Income (loss) from operations	**201.3**	**14.9%**	(17.0)	(1.9)%	(87.9)	(11.9)%
Other expense, net	**(39.1)**		(25.6)		(44.6)	
Income tax expense (benefit)	**35.1**		14.5		(13.6)	
Income (loss) from continuing operations	**125.7**		(56.3)		(110.7)	
Income (loss) from discontinued operations	**2.9**		140.0		(98.1)	
Net income (loss)	**$ 128.6**		$ 83.7		$ (208.8)	

12

2004 operating results compared to 2003

The increase in net sales for 2004 as compared to 2003 was primarily due to higher selling prices for cobalt and nickel-based products, resulting from higher reference/market prices of these metals in 2004 compared to 2003. Cobalt prices continued to be positively affected by the growth in the battery sector related to demand for cell phones and other portable electronic devices. Nickel prices continued to be positively affected by significant growth in worldwide demand for stainless steel and other alloys, in addition to the limited availability of raw material feeds.

Gross profit was $330.4, or 24.5% of net sales, in 2004 compared to $180.0 million, or 19.7% of net sales, in 2003. The improvement was primarily due to the benefit of selling lower-cost inventory produced prior to the sharp rise in cobalt prices that began in the fourth quarter of 2003 as well as the overall impact of higher average cobalt prices in 2004 versus 2003 ($100 million); the impact of higher average nickel prices in 2004 versus 2003 ($76 million); stronger results from the Fidelity business in 2004 versus 2003 ($5 million); and restructuring charges of $5.8 million in 2003. These benefits were partially offset by the weakening of the dollar versus the euro and the Australian dollar ($33 million); the impact of a new tolling agreement which increased tolling charges at the Finland refinery ($14 million); and a mechanical failure at the Cawse facility in July 2004 ($7 million).

Selling, general and administrative expenses decreased to $129.1 million in 2004 compared to $197.0 million in 2003. The decrease was primarily due to charges for the shareholder lawsuits in 2004 of $7.5 million compared to $84.5 million in 2003; and restructuring charges of $14.2 million in 2003. These factors were partially offset by increased professional fees of approximately $11 million primarily due to the audit committee investigation and the restatement process, and work associated with the requirements of Sarbanes-Oxley.

The increase in other expense, net in 2004 compared to 2003 was due primarily to foreign exchange loss in 2004 of $5.3 million compared to a foreign exchange gain of $3.0 million in 2003 and debt covenant waiver fees of $1.2 million associated with the delay in filing periodic reports with the SEC. The 2003 amount included a gain on the sale of the Company s PVC business of $4.6 million and interest income of $6.9 million in 2003 on amounts receivable from a Congo joint venture partner.

Income tax expense was $35.1 million on pre-tax income of $162.3 million in 2004 (21.6%). The effective rate in 2004 is lower than the statutory rate in the United States due primarily to a higher proportion of earnings in jurisdictions having lower statutory tax rates and a tax holiday from income taxes in Malaysia, both offset by losses in the United States with no corresponding tax benefit. The 2004 effective tax rate includes a change in the Finnish statutory rate from 29% to 26%, effective January 1, 2005, resulting from legislation that was enacted on July 30, 2004. As a result, a benefit of $1.7 million was recorded in the third quarter from the application of the newly enacted rate to existing deferred tax balances. The 2004 effective tax rate also includes a benefit of $1.7 million related to Malaysian income taxes to be refunded. In 2003, income tax expense was $14.5 million on a pre-tax loss of $42.7 million. The 2003 tax expense results from profitability of Finland operations and no tax benefit from losses in the U.S.

Income from discontinued operations was $2.9 million in 2004 compared to income of $140.0 million in 2003, due primarily to the gain on the PMG sale of $131.7 million after-tax in 2003. There were no discontinued operations in 2004. The 2004 amount represents changes in estimates of certain environmental and closure accruals established in 2002 in connection with the exit of the Company s closed manufacturing facilities in St. George, Utah and Midland, Michigan.

Net income was $128.6 million, or $4.49 per diluted share, in 2004 compared to $83.7 million, or $2.95 per diluted share, in 2003, due primarily to the aforementioned factors.

Cobalt segment

The following graph summarizes the average monthly 99.3% reference price of cobalt from January 2003 through December 2004:

Cobalt segment net sales increased to $643.1 million in 2004 from $379.9 million in 2003 due to higher cobalt reference prices. Cobalt prices continued to be positively affected by the growth in the battery sector related to demand for cell phones and other portable electronic devices. Overall volume of products sold in the segment declined 12.6%. The decline in volume was the result of a shift away from the ceramics and catalysts markets to the battery and tire sectors.

Operating profit for 2004 was $146.9 million compared to $55.0 million in 2003. The improvement was due primarily to the benefit of higher cobalt reference prices in 2004 and low cost inventory at the beginning of 2004 ($80 million), and restructuring charges in 2003 of $9.6 million. Additionally, higher production through the company s joint venture in the Democratic Republic of Congo and a shift to higher margin value-added cobalt products added to the improvement. These improvements were offset by the weakening of the U.S. dollar against the euro ($10 million).

See Note S to the consolidated financial statements included in Item 8 of this Annual Report for a reconciliation of segment operating profit (loss) to consolidated income from continuing operations before income taxes and minority interests.

Nickel segment

The following graph summarizes the average monthly LME market price of nickel from January 2003 through December 2004:

Nickel segment net sales increased to $781.8 million in 2004 from $567.9 million in 2003 due to higher nickel LME market prices. Overall volumes in the segment were down 2.7% due to feed limitations and a mechanical failure at the Company s Cawse facility in July 2004 that resulted in a production shutdown.

Operating profit for 2004 was $109.1 million compared to $58.3 million in 2003. The improvement was due primarily to the higher nickel market price ($76 million) and cobalt reference price ($20 million); stronger results from the Fidelity business ($5 million); and charges taken in 2003 for restructuring activities ($4.1 million) and environmental remediation ($2.5 million) that were not present in 2004. These improvements were offset by the weakening of the U.S. dollar against the euro and the Australian dollar ($23 million); the impact of a new tolling agreement which increased tolling charges at the Finland refinery ($14 million); and the impact of the mechanical failure at the Cawse facility ($7 million).

See Note S to the consolidated financial statements included in Item 8 of this Annual Report for a reconciliation of segment operating profit (loss) to consolidated income from continuing operations before income taxes and minority interests.

Corporate expenses

Corporate expenses for 2004 were $54.6 million compared to $130.3 million in 2003. The decrease was due primarily to charges for the shareholder lawsuits in 2004 of $7.5 million compared to $84.5 million in 2003 and restructuring charges of $6.3 million in 2003 compared to a reversal of prior year charges in 2004 of $0.1 million. These improvements were partially offset by increased professional fees in 2004 of approximately $11 million primarily due to the audit committee investigation and the restatement process, and work associated with the requirements of Sarbanes-Oxley.

2003 operating results compared to 2002

The increase in net sales for 2003 as compared to 2002 was primarily due to higher selling prices for cobalt and nickel. Cobalt prices were impacted by significant growth in the battery sector related to demand for cell phones and other portable electronic devices. These higher prices were partially offset by lower overall volumes from the shift in emphasis to capitalize on the growth of these higher margin sectors. Nickel prices were impacted by significant growth in worldwide demand for stainless steel and other alloys. Nickel metal volumes were lower in 2003 due to the limited availability of raw material feeds. Higher selling prices also had the impact of reducing volumes to certain customers and geographic markets.

Cost of products sold includes restructuring charges of $5.8 million and $37.8 million, in 2003 and 2002, respectively. The charges in 2003 relate to inventory write-downs at the Company s facility in Thailand, in connection with its shut-down; and shut-down of the manufacturing operations of the electroless nickel business in Newark, New Jersey. The charges in 2002 were the result of decisions made to exit certain product lines, decrease production at several base metal facilities, sell a higher percentage of certain commodity products to generate cash, shut-down the manufacturing operations of the electroless nickel facility in Newark, New Jersey, and writeoff amounts due from suppliers of $23.3 million as the Company reviewed and renegotiated certain raw material and other contracts to reduce costs in light of changing metal prices and business conditions.

Gross profit was $180.0 million in 2003 compared to $48.1 million in 2002, including restructuring charges of $5.8 million and $37.8 million in 2003 and 2002, respectively. Gross profit percentage was 19.7% in 2003 compared to 6.5% in 2002. The improvement was primarily the result of the benefit of lower cost inventory produced prior to the steady rise in metal prices throughout 2003 ($63 million). Other key impacts include the positive results of nickel hedging ($13 million), higher production from the cobalt joint venture in the Democratic Republic of Congo ($13 million), and shifts to higher margin value-added products. These benefits were partially offset by the weakening of the dollar versus the euro ($32 million). During 2002, the sale of certain commodity cobalt products generated gross losses ($3 million).

The selling, general and administrative expenses increased to $197.0 million compared to $136.0 million in 2002, including restructuring charges of $14.2 million in 2003 and $44.7 million in 2002. The increase was primarily due to the $84.5 million charge in 2003 related to the shareholder and derivative lawsuits, an increase in professional fees and expenses of $6.5 million and higher insurance costs. These increases were partially offset by a $4.1 million charge in 2002 related to product liability litigation. Both years include a charge of $2.5 million related to environmental costs at the closed manufacturing site in Newark, New Jersey. The restructuring charge for 2003 primarily related to headcount reductions, the sale of the Company s manufacturing facility in Thailand, closure of an administrative office in the United States, relocation of the corporate headquarters, and a loss on the disposal of a corporate aircraft.

The decrease in other expense, net in 2003 compared to 2002 was due primarily to the gain on the sale of the Company s PVC business of $4.6 million and interest income of $6.9 million on amounts receivable from a Congo joint venture partner. Interest expense related to the Company s acquisition of the PMG business has been allocated to discontinued operations for all years presented.

Income tax expense was $14.5 million on a pre-tax loss of $42.7 million in 2003, compared to a benefit of $13.6 million on 2002 s pre-tax loss of $132.5 million. The 2003 tax expense results from losses in the U.S. with no corresponding tax benefit and the profitability in Finland. The benefit in 2002 is significantly lower than the statutory rates in the U.S. and Finland due primarily to losses in the U.S. with no corresponding tax benefit.

Income from discontinued operations was $140.0 million in 2003 compared to a loss of $98.1 million in 2002, due primarily to the gain on the PMG sale of $131.7 million after-tax in 2003, and restructuring charges related to discontinued operations in 2003 of $5.6 million compared to charges of $73.5 million in 2002.

Cobalt segment

The following graph summarizes the average monthly 99.3% reference price of cobalt from January 2002 through December 2003:

Cobalt segment net sales increased to $379.9 million in 2003 from $354.0 million in 2002 due primarily to higher cobalt reference prices. Overall volume of products sold in the segment declined 21%. The decline in volume was the result of a shift away from the ceramics and catalysts markets to the battery and tire sectors.

Operating profit for 2003 was $55.0 million compared to a $40.8 million operating loss in 2002, including restructuring charges of $9.6 million in 2003 and $39.1 million in 2002. The improvement was also due to the benefit of higher cobalt reference prices in 2003 which improved margins ($42 million). Margins were also improved due to the completion of the restructuring activities ($16 million). Additionally, higher production through the company s joint venture in the Democratic Republic of Congo and a shift to higher margin value-added cobalt products added to the improvement. These improvements were offset by the weakening of the U.S. dollar against the euro ($11 million). See Note S to the consolidated financial statements included in Item 8 of this Annual Report for a reconciliation of segment operating profit (loss) to consolidated loss from continuing operations before income taxes and minority interests. In 2003, Investment and other income, net includes $6.9 million of interest income from a joint venture partner. See Note R to the consolidated financial statements included in Item 8 of this Annual Report for further discussion.

Nickel segment

The following graph summarizes the average monthly LME market price of nickel from January 2002 through December 2003:

Nickel segment net sales increased to $567.9 million in 2003 from $428.3 million in 2002 due primarily to higher nickel LME market prices. Overall volumes in the segment were 14% higher due to a full year of production from the chemical plant that opened in 2002, and an increase in nickel sulfate sales to the battery and metal finishing markets. The increase was partially offset by a 6% decline in metal volumes due to raw material shortage caused by the closure of a mine in Norway, mining problems at a Brazil supplier and a shift in allocation of available raw materials from metals to nickel chemical products.

Operating profit for 2003 was $58.3 million compared to $22.7 million in 2002, including restructuring charges of $4.1 million in 2003 and $6.4 million in 2002. The improvement was due primarily to the higher nickel reference price in 2003 ($38 million) and the positive results of nickel hedging ($13 million). These improvements were offset by the weakening of the U.S. dollar against the euro ($21 million). Both years include environmental charges of $2.5 million related to the Newark operations.

See Note S to the consolidated financial statements included in Item 8 of this Annual Report for a reconciliation of segment operating profit (loss) to consolidated loss from continuing operations before income taxes and minority interests.

Corporate expenses

Corporate expenses for 2003 were $130.3 million compared to $69.9 million in 2002, including restructuring charges of $6.3 million in 2003 and $37.0 million in 2002. The increase was also due to the shareholder litigation charge ($84.5 million), fees and expenses related to the restatement and litigation processes ($6.5 million), an increase in bonus and profit sharing based on improved operating results in 2003 ($4.0 million), and higher insurance costs primarily related to the directors and officers liability policy ($1.0 million). These increases were partially offset by the reduction in headcount from the completion of the restructuring program ($1.6 million) and lower operating costs due to the disposal of a corporate aircraft.

Liquidity and Capital Resources

Operating Activities

Operating activities had negative cash flow of $4.0 million during 2004 compared with positive operating cash flow of $28.3 million in 2003 due primarily to an increase in inventory values as a result of higher metal prices and the build of inventory due to the planned shutdown of the smelter in the Democratic Republic of Congo (DRC) in January 2005. Income from continuing operations of $125.8 million represents an improvement of

$182.1 million compared to the 2003 loss from continuing operations of $56.3 million. Accounts receivable increased $24.6 million compared to prior year as a result of higher sales due to higher metal prices in the fourth quarter of 2004 compared to the fourth quarter of 2003. Inventories increased $146.3 million compared to prior year due to higher raw material costs as a result of higher metal prices and the build of inventory due to the planned shutdown of the smelter in the DRC in January 2005. The shutdown of the smelter was completed and the smelter was re-opened by May 2005. Retained liabilities of businesses sold decreased to $21.8 million at December 31, 2004 from $41.7 million at December 31, 2003 due to payments of a portion of PMG employee bonuses in 2004 and payment of certain income taxes liabilities in 2004 as required as part of the sale of PMG to Umicore in July 2003.

Investing and Financing Activities

The majority of the Company s debt at December 31, 2004 was $400 million of 9.25% Senior Subordinated Notes due 2011 (the Notes). The delay by the Company in filing its Form 10-K for the year ended December 31, 2003 caused events of default under the indenture governing the Notes. The Company reclassified the Notes from long-term to current as of March 31, 2004, which was the date the 2003 Form 10-K was due. The Company filed its 2003 Form 10-K on March 31, 2005 and filed its Forms 10-Q s for each of the first three quarters of 2004 on June 10, 2005. On June 17, 2005, the trustee for the Notes furnished a notice of default to the Company with respect to the delay by the Company in filing its Form 10-K for the year ended December 31, 2004 and its Form 10-Q for the first quarter of 2005. Since the Company was not able to file its 2004 Form 10-K or its Form 10-Q for the 2005 first quarter within 60 days of the trustee s notice of default, new events of default occurred under the indenture governing the Notes. As a result, the noteholders, or the indenture trustee at the direction of the noteholders, have the right, but are not obligated, to accelerate payment of these Notes. The Company cannot predict whether they will do so. If any such acceleration were to occur, based upon discussions with the Company s lead bank, the Company believes it would be able to refinance such obligation on a long-term basis.

In December 2003, the Company borrowed $22.9 million from a Belgium bank. This loan bore interest at a rate of LIBOR plus 2.75% and was scheduled to mature in December 2008. In November 2004, the Company refinanced this loan with a Finland bank, resulting in a new principle balance of $23.0 million. The refinanced loan has an interest rate of LIBOR plus 1.25% and is payable in 48 equal installments beginning in January 2005 and ending December 2008. Simultaneous to the initial borrowing, the proceeds were loaned by the Company to one of its smelter joint venture partners. The loan is recorded in Receivables from joint venture partners, bears interest at LIBOR plus 2.75% and matures in December 2008.

On August 7, 2003, the Company entered into a $150 million Senior Secured Revolving Credit Facility with a group of lending institutions. The facility bears interest at LIBOR plus 2.00% to 3.00% or PRIME plus .25% to 1.25%, matures in August 2006 and includes various affirmative and negative covenants. There were no borrowings under this facility at December 31, 2004. Because of the delay in filing required periodic reports with the SEC, the Company failed to comply with specific covenants in the related credit agreement and as a result events of default occurred under the credit agreement. The Company obtained temporary waivers from the lenders under the credit agreement but such waivers expired on August 16, 2005. Subsequent to expiration of the waivers, the Company is not entitled to borrow under this credit agreement.

In 2003, the Company entered into two interest rate swap agreements to convert the fixed interest rate on a total of $100 million of the Company s 9.25% Senior Subordinated Notes to variable rates of LIBOR plus 4.10% and LIBOR plus 4.39% for the period ending December 15, 2011. The interest rate swap agreements are designated as fair value hedges. The fair value of the interest rate swaps at December 31, 2004 and 2003 were $0.7 million and $0.2 million, respectively.

Capital expenditures in 2004 were $18.4 million, related primarily to ongoing projects to maintain current operating levels and were funded through cash flows from operations. The Company expects to incur capital spending of approximately $36 million for 2005.

The Company generated sufficient cash from operations during 2004 to provide for its working capital, debt service and capital expenditure requirements. The Company believes it will have sufficient cash generated by operations and available from its credit facility to provide for its working capital, debt service, litigation settlements and capital expenditure requirements in 2005.

As described above, as a result of the delay in filing required SEC reports, there currently are limitations upon the Company s ability to incur additional indebtedness. However, the Company anticipates that it will resolve the existing defaults under the credit facility and the indenture for the outstanding notes in a manner that will permit it to borrow under the credit facility without such limitations in the future.

Shareholder Litigation Obligation

As described under Item 3, Legal Proceedings in this Annual Report, the Company is a defendant in shareholder class action and derivative lawsuits alleging securities law violations relating to the decline in the Company s stock price following the third quarter 2002 earnings announcement.

The Company and the lead plaintiff of the shareholder class action lawsuits have entered into a Stipulation and Agreement of Settlement (Agreement) dated June 6, 2005, which Agreement was preliminarily approved on June 24, 2005 by the U.S. District Court hearing the cases. The Company recorded a charge to administrative expense of $82.5 million during the fourth quarter of 2003 related to these lawsuits. Of this amount, $8.5 million is anticipated to be paid by the issuance of common stock and the remainder in cash.

The Company has entered into an agreement in principle with the lead plaintiffs of the shareholder derivative lawsuits that outlines the general terms of the proposed settlement of these lawsuits subject to the satisfaction of various conditions and execution of a definitive agreement by the interested parties, including the individual defendants. The proposed settlement provides for the Company to issue 380,000 shares of its common stock in payment of attorneys fees and costs incurred by plaintiffs counsel with respect to this litigation, and also requires the Company to implement various corporate governance changes. The Company recorded a charge to administrative expense of $2.0 million in 2003 and an additional charge to administrative expense of $7.5 million in 2004 related to these lawsuits.

At December 31, 2004 and 2003, the Company had an accrual of $92.0 million and $84.5 million, respectively, for the shareholder class action and shareholder derivative lawsuits in the aggregate. The settlements are anticipated to be paid $74.0 million in cash and $18.0 million in common stock. In April 2005, the Company paid $74.0 million into an escrow account in connection with settlement of the shareholder class action lawsuits. Insurance proceeds are expected to be available for contribution to the resolution of the cases but the Company does not expect these lawsuits to be resolved within the limits of applicable insurance. As of June 30, 2005, insurance proceeds of approximately $25 million have been received, representing both reimbursement of legal expenses in 2003, 2004 and 2005 related to the lawsuits (approximately $17 million), as well as reimbursement of a portion of the settlement amount paid by the Company during 2005 (approximately $8 million). Potential remaining insurance proceeds of up to approximately $19 million are expected to be available and will be recognized when received.

Contractual Obligations

The Company has entered into contracts with various third parties in the normal course of business that will require future payments. The following table summarizes the Company s contractual cash obligations and their expected maturities at December 31, 2004 and the periods indicated (in thousands).

	Total	2005-2006	2007-2008	2009-2010	After 2010
Purchase obligations(1)	$ 1,343,663	$ 802,216	$ 413,881	$ 127,566	NCD
Debt obligations(2)	423,000	411,500	11,500		
Interest payments on debt	299,248	75,624	75,624	74,000	$ 74,000
Operating lease obligations	20,806	7,724	5,991	5,028	2,063
Other long-term liabilities(3)	16,371	2,098	2,242	2,543	9,488
Total	$ 2,103,088	$ 1,299,162	$ 509,238	$ 209,137	$ 85,551

(1) For 2005 through 2010, purchase obligations include raw material contractual obligations reflecting estimated future payments based on committed tons of material per the applicable contract multiplied by the reference/market price of each metal. The price used in the computation is the average daily price for the last week of December 2004 for each respective metal. Commitments made under these contracts represent future purchases in line with expected usage. The contractual cash obligations after 2010 are not currently determinable (NCD).

(2) Commencing March 31, 2004, the $400 million of 9.25% Senior Subordinated Notes due 2011 was in default under the indenture governing the notes due to the delay of the Company filing its 2003 Form 10-K with the SEC (see Note G to the consolidated financial statements contained in Item 8 of this Annual Report). Such Form 10-K was filed with the SEC on March 31, 2005.

(3) Represents future pension and other post-employment benefit payments to comply with funding requirements.

Critical Accounting Policies

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires the Company s management to make estimates and assumptions in certain circumstances that affect amounts reported in the accompanying consolidated financial statements. In preparing these financial statements, management has made their best estimates and judgments of certain amounts included in the financial statements related to the critical accounting policies described below. The application of these critical accounting policies involves the exercise of judgment and use of assumptions as to future uncertainties and, as a result, actual results could differ from these estimates.

Revenue Recognition Revenues are recognized when unaffiliated customers take title and assume ownership of products specified in their purchase agreements, which generally occurs upon shipment of product or usage of consignment inventories.

Inventories The Company s inventories are stated at the lower of cost or market and valued using the first-in, first-out (FIFO) method. The cost of the Company s raw materials fluctuates due to actual or perceived changes in supply and demand of raw materials, changes in cobalt and nickel reference prices and changes in availability from suppliers. In periods of raw material metal price declines or declines in the selling prices of the Company s finished products, inventory carrying values may exceed the amount the Company could realize on sale, resulting in a lower of cost or market charge. Monthly, the Company evaluates the need for a lower of cost or market adjustment to inventories based on the end of the month market price.

Long-lived Assets Goodwill must be reviewed at least annually for impairment, in accordance with a specified methodology. Further, goodwill, intangible and other long-lived assets are assessed for impairment whenever events or changes in circumstances indicate that the carrying value may not be recoverable. The Company generally invests in long-lived assets to secure raw material feedstocks, produce new products, or increase production capacity or capability. Because market conditions may change, future cash flows may be difficult to forecast. Furthermore, the assets and related businesses may be in different stages of development. If the Company determined that the future undiscounted cash flows from these investments were not expected to exceed the carrying value of the investments, the Company would record an impairment charge. However, determining future cash flows is subject to estimates and different estimates could yield different results. Additionally, other changes in the estimates and assumptions, including the discount rate and expected long-term growth rate, which drive the valuation techniques employed to estimate the future cash flows of the these investments, could change and, therefore, impact the analysis of impairment in the future.

Income Taxes Deferred income taxes are provided to recognize the effect of temporary differences between financial and tax reporting. Deferred income taxes are not provided for undistributed earnings of foreign consolidated subsidiaries, to the extent such earnings are determined to be reinvested for an indefinite period of time. The Company has significant operations outside the United States, where most of its pre-tax earnings are derived, and in jurisdictions where the statutory tax rate is lower than in the United States. The Company also has significant cash requirements in the United States to pay interest and principal on borrowings. As a result, significant tax and treasury planning and analysis of future operations are necessary to determine the proper amounts of tax assets, liabilities, and tax expense. The Company s tax assets, liabilities, and tax expense are supported by its best estimates and assumptions of its global cash requirements, planned dividend repatriations, and expectations of future earnings. Where the Company has determined that it is more likely than not that deferred tax assets will not be realized, a valuation allowance has been established. The existing valuation allowance pertains to the deferred tax assets resulting principally from net operating loss carryforwards in the United States.

Stock Awards Granted to Employees In December 2002, SFAS No. 148, *Accounting for Stock-Based Compensation Transition and Disclosure,* was issued. SFAS No. 148 amends SFAS No. 123, *Accounting for Stock-Based Compensation,* to provide alternative methods of transition when a company voluntarily changes to the fair value based method of recognizing expense in results of operations for stock-based employee compensation, including stock options granted to employees. Prior to 2003, the Company accounted for stock-based employee compensation under APB No. 25, *Accounting for Stock Issued to Employees,* and related interpretations. Under APB No. 25, compensation expense was recorded for restricted stock granted to certain executive officers, but no expense was recorded for stock options granted to employees, as the exercise price of all such options equaled the fair value on the date of the grant. During the second quarter of 2003, the Company adopted, effective January 1, 2003, the fair value recognition provisions of SFAS No. 123, *Accounting for Stock-Based Compensation.* Under the prospective method of adoption selected by the Company under the provisions of SFAS No. 148, the fair value recognition provisions have been applied to all employee awards granted, modified or settled after January 1, 2003.

Derivative Instruments The Company enters into derivative instruments and hedging activities which are closely monitored and controlled in order to manage, where possible and economically efficient, commodity price risk for nickel, interest rate risk related to borrowings, and, at times, foreign currency risk associated with manufacturing and sales locations where fluctuations in currency prices may affect the Company s operating results.

The Company has certain derivative instruments that are designated as cash flow hedges. For these hedges, the effective portion of the gain or loss from the financial instrument is initially reported as a component of other comprehensive income (loss) in stockholders equity and subsequently reclassified to results of operations when the hedged item affects results of operations. Any ineffective portions of the cash flow hedges are recognized immediately in results of operations.

The gain or loss related to financial instruments that are not designated as hedges are recognized immediately in results of operations. These instruments are entered into to economically hedge certain movements in metal prices.

During 2003, the Company entered into interest rate swap agreements that are designated as fair value hedges. For these hedges, changes in the fair value of both the hedging instruments and the underlying debt obligations are immediately recognized in earnings as equal and offsetting gains and losses in the interest expense component of the statement of operations. All fair value hedges are 100% effective and, therefore, there is no impact on earnings due to hedge ineffectiveness.

Cautionary Statement for Safe Harbor Purposes Under the Private Securities Litigation Reform Act of 1995

The Company is making this statement in order to satisfy the safe harbor provisions contained in the Private Securities Litigation Reform Act of 1995. This report contains statements that the Company believes may be forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934. These forward-looking statements are not historical facts and generally can be identified by use of statements that include phrases such as believe, expect, anticipate, intend, plan, foresee or other words or phrases of similar import. Similarly, statem describe the Company s objectives, plans or goals also are forward-looking statements. These forward-looking statements are subject to risks and uncertainties that are difficult to predict, may be beyond the Company s control and could cause actual results to differ materially from those currently anticipated.

Important factors that may affect the Company s expectations, estimates or projections include:

- the completion of the settlements of the shareholder class action and derivative lawsuits filed against the Company, certain of its executives and its directors in a manner that is consistent with the definite agreement and agreement in principle reached with the lead plaintiffs in such lawsuits;
- the speed and sustainability of price changes in cobalt and nickel;
- the potential for lower of cost or market write-downs of the carrying value of inventory necessitated by decreases in the market prices of cobalt and nickel;
- the availability of competitively priced supplies of raw materials, particularly cobalt and nickel;
- the effect of the Company s inability to meet the SEC and NYSE filing obligations on a timely basis upon funding availability under the Company s credit facilities or upon debt obligations outstanding;
- the effect of the Company not completing the documentation and testing of its internal controls over financial reporting such that management of the Company and its independent registered public accounting firm are unable to report as to such internal control over financial reporting;
- the risk that new or modified internal controls, implemented in response to the 2004 investigation by the audit committee of the Company s board of directors and the Company s examination of its internal control over financial reporting pursuant to Section 404 of the Sarbanes-Oxley Act, are not effective and need to be improved, resulting in additional expense;
- the demand for metal-based specialty chemicals and products in the Company s markets;
- the effect of fluctuations in currency exchange rates on the Company s international operations;
- the effect of non-currency risks of investing and conducting operations in foreign countries, including political, social, economic and regulatory factors;
- the outcome of the previously announced SEC Division of Enforcement review of the investigation conducted by the Company s audit committee; and
- the general level of global economic activity and demand for the Company s products.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Quantitative and Qualitative Disclosures About Market Risk

The Company, as a result of its global operating and financing activities, is exposed to changes in metal prices, interest rates and foreign currency exchange rates which may adversely affect its results of operations and financial position. In seeking to minimize the risks and/or costs associated with such activities, the Company manages exposures to changes in metal prices, interest rates and, at times, foreign currency exchange rates through its regular operating and financing activities, which include the use of derivative instruments.

The primary raw materials used by the Company in manufacturing its products are cobalt and nickel. The Company s supply of cobalt has historically been sourced from the Democratic Republic of Congo (DRC), Australia and Finland. Although the Company has never experienced a significant shortage of cobalt raw material, production problems and political and civil instability in certain supplier countries may in the future affect the supply and market price of cobalt raw materials. Nickel historically has been sourced from Australia, Finland and Brazil. The Company does not anticipate any substantial interruption in its raw materials supply that would have a material adverse effect on the Company s operations; however, a significant long-term nickel contract expired in May 2005, and there is no assurance that the Company will be able to obtain as much nickel from other sources as would be necessary to satisfy the Company s requirements or at prices comparable to its current arrangements. However, the Company is actively pursuing a variety of feed sources to ensure that the Company does not experience any material shortage of nickel over the next several years.

The Company also attempts to mitigate changes in prices and availability by maintaining adequate inventory levels and long-term supply relationships with a variety of producers. The cost of raw materials fluctuates due to both actual and perceived changes in supply and demand of raw materials, changes in cobalt reference prices and nickel LME market prices and changes in availability from suppliers. Generally, the Company is able to pass through to its customers increases and decreases in raw material prices by increasing or decreasing, respectively, the prices of its products. The degree of profitability of the Company principally depends on the Company s ability to maintain the differential between its product prices and product costs. During periods of rapidly changing metal prices, however, there may be price lags that can impact the short-term profitability of the Company both positively and negatively. Reductions in the price of raw materials or the selling prices of the Company s finished products could also result in the Company s inventory carrying value being written down to a lower market value, or result in a reduction in its gross profit from historical levels. The Company also undertakes to minimize the effect on profitability of changes in the market price of nickel through hedging activities. The Company enters into forward contracts to hedge the purchase of nickel raw material and the sale of nickel products.

The Company is exposed to interest rate risk primarily through its borrowing activities. The Company predominantly utilizes U.S. dollar denominated borrowings to fund its working capital and investment needs. The majority of the Company s borrowings are in fixed rate instruments. The Company entered into interest rate swap agreements to convert a portion of the fixed rate instruments to variable rate contracts. There is an inherent rollover risk for borrowings as they mature and are renewed at current market rates. The extent of this risk is not quantifiable or predictable because of the variability of future interest rates and business financing requirements (see Note G to the consolidated financial statements contained in Item 8 of this Annual Report). The following table presents principal cash flows and related weighted-average interest rates by expected maturity dates of the Company s long term-debt.

	December 31, 2004							
	2005	2006	2007	2008	2009	There-after	Total	Fair Value
(Thousands of dollars)								
Long-term debt, including current portion								
Fixed rate	$ 400,000(a)						$ 400,000	$ 426,000
Fixed interest rate	9.25%							
Variable rate	$ 5,750	$ 5,750	$ 5,750	$ 5,750			$ 23,000	23,000
Average interest rate(b)	3.53%	3.53%	3.53%	3.53%				

	December 31, 2003							
	2004	2005	2006	2007	2008	There-after	Total	Fair Value
(Thousands of dollars)								
Long-term debt, including current portion								
Fixed rate						$ 400,000	$ 400,000	$ 416,000
Average interest rate						9.25%		
Variable rate					$ 22,900	$	$ 22,900	$ 22,900
Average interest rate					3.91%			

(a) Represents long-term debt in default. See Note G to the consolidated financial statements contained in Item 8 of this Annual Report for further discussion.

(b) The interest rate is based on the LIBOR rate (as of November 1, 2004) plus 2.75%. See Note G to the consolidated financial statements contained in Item 8 of this Annual Report for further discussion.

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

Item 8. Financial Statements and Supplementary Data

Report of Independent Registered Public Accounting Firm

Board of Directors and Stockholders
OM Group, Inc.

We have audited the accompanying consolidated balance sheets of OM Group, Inc. and subsidiaries as of December 31, 2004 and 2003, and the related consolidated statements of operations, stockholders equity, and cash flows for each of the three years in the period ended December 31, 2004. Our audits also included the financial statement schedule listed in the index at Item 15. These financial statements and schedule are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with auditing standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of OM Group, Inc. and subsidiaries at December 31, 2004 and 2003, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2004, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

The accompanying consolidated financial statements have been prepared assuming that OM Group, Inc. will continue as a going concern. As more fully described in Note G, the Company has not complied with a covenant under the indenture governing its Senior Subordinated Notes. Accordingly, the notes are in default and are classified as a current liability as the noteholders have the right to accelerate payment of the notes. Further, the Company has not complied with a covenant under its Senior Secured Revolving Credit Facility. These conditions raise substantial doubt about the Company s ability to continue as a going concern. Management s plans in regard to this matter are also described in Note G. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

As discussed in Note A to the consolidated financial statements, the Company adopted the provisions of Statement of Financial Accounting Standards (SFAS) No. 123, *Accounting for Stock-Based Compensation* as of January 1, 2003.

We were also engaged to audit, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Company s internal control over financial reporting as of December 31, 2004, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Since management was unable to complete its assessment of internal control over financial reporting as of December 31, 2004, and therefore we were unable to apply other procedures to satisfy ourselves as to the effectiveness of the Company s internal control over financial reporting, the scope of our work was not sufficient to enable us to express, and we did not express, an opinion either on management s assessment or on the effectiveness of the Company s internal control over financial reporting in our report dated August 19, 2005.

/s/ Ernst & Young LLP

Cleveland, Ohio
August 19, 2005

Report of Independent Registered Public Accounting Firm
On Internal Control over Financial Reporting
The Board of Directors and Shareholders of OM Group, Inc.

We were engaged to audit management s assessment, included in the accompanying Management s Report on Internal Control over Financial Reporting located in Item 9A of the Form 10-K, that OM Group, Inc. (the Company) maintained effective internal control over financial reporting as of December 31, 2004, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting.

An audit of management s assessment that the Company maintained effective internal control over financial reporting includes obtaining an understanding of, and evaluating, management s process for assessing the effectiveness of the Company s internal control over financial reporting. In obtaining an understanding of management s process, we determined that management did not support its evaluation with sufficient evidence, including documentation. Because management s process did not include sufficient evidence, including documentation, we were unable to apply the procedures required to express an opinion on management s assessment and on the effectiveness of internal control over financial reporting.

A company s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Since management did not support its evaluation with sufficient evidence, including documentation, and we were unable to apply other procedures to satisfy ourselves as to the effectiveness of the Company s internal control over financial reporting, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion either on management s assessment or on the effectiveness of the Company s internal control over financial reporting.

In performing our procedures, we identified the following material weaknesses that also have been identified and included in management s assessment. A material weakness is a control deficiency, or a combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. The presence of a material weakness would preclude a conclusion that the Company maintained effective internal control over financial reporting.

The Company maintained inadequate controls over the financial statement close process. These control deficiencies, which relate primarily to the Americas operating location, resulted in errors in the depreciation of fixed assets, amortization of intangible assets, deferral of costs, valuation of inventory, recording of accruals, revenue recognition, classification of certain assets and liabilities and elimination of intercompany profit in inventory. These errors resulted in adjustments to such accounts. When aggregated, these control deficiencies constitute a material weakness over the financial statement close process.

The Company maintained inadequate controls over the recording of income tax contingency reserves and deferred income tax assets, liabilities and the related valuation allowance. These control deficiencies resulted in adjustments to such accounts.

These material weaknesses were considered in determining the nature, timing, and extent of audit tests applied in our audit of the 2004 consolidated financial statements, and this report does not affect our report dated August 19, 2005 on those consolidated financial statements.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of OM Group, Inc. as of December 31, 2004 and 2003, and the related consolidated statements of operations, shareholders equity, and cash flows for each of the three years in the period ended December 31, 2004 and our report dated August 19, 2005 expressed an unqualified opinion thereon with an explanatory paragraph indicating conditions that raise substantial doubt about the Company s ability to continue as a going concern.

/s/ Ernst & Young LLP

Cleveland, Ohio
August 19, 2005

Consolidated Balance Sheets

	December 31	
(Thousands of dollars, except share data)	**2004**	**2003**
Assets		
Current assets:		
Cash and cash equivalents	**$ 26,779**	$ 54,719
Accounts receivable, less allowance of $1,960 in 2004 and $2,022 in 2003	**161,346**	136,700
Inventories	**415,517**	269,201
Advances to suppliers	**32,498**	19,400
Other	**52,719**	45,669
Total current assets	**688,859**	525,689
Property, plant and equipment, at cost		
Land	**4,982**	5,511
Buildings and improvements	**161,566**	157,738
Machinery and equipment	**493,930**	470,435
Furniture and fixtures	**17,130**	16,287
	677,608	649,971
Less accumulated depreciation	**287,796**	238,611
	389,812	411,360
Other assets:		
Goodwill	**181,871**	178,678
Receivables from joint venture partners	**29,379**	51,187