CROSS COUNTRY HEALTHCARE INC
Form 10-K
March 18, 2013

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

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FORM 10-K

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

For the Fiscal Year Ended December 31, 2012

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 0-33169
Cross Country Healthcare, Inc.
(Exact name of registrant as specified in its charter)

Delaware	13-4066229
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

6551 Park of Commerce Boulevard, N.W.
Boca Raton, Florida 33487
(Address of principal executive offices, zip code)

Registrant's telephone number, including area code: (561) 998-2232

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 $0.0001 per share	The NASDAQ Stock Market

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

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

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

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 þ No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes þ No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. þ

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act: Large accelerated filer o Accelerated filer þ Non-accelerated filer o Smaller reporting company o

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

The aggregate market value of the voting stock held by non-affiliates of the Registrant, based on the closing price of Common Stock on June 29, 2012 of $4.37 as reported on the NASDAQ National Market, was $131,163,868. This calculation does not reflect a determination that persons are affiliated for any other purpose.

As of February 28, 2013, 30,902,314 shares of Common Stock, $0.0001 par value per share, were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's definitive proxy statement, for the 2012 Annual Meeting of Stockholders, which statement will be filed pursuant to Regulation 14A not later than 120 days after the end of the fiscal year covered by this Report, are incorporated by reference into Part III hereof.

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All references to “we,” “us,” “our,” or “Cross Country” in this Report on Form 10-K means Cross Country Healthcare, Inc., its subsidiaries and affiliates.

Forward-Looking Statements

In addition to historical information, this Form 10-K contains statements relating to our future results (including certain projections and business trends) that are "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act), and are subject to the "safe harbor" created by those sections. Words such as "expects", "anticipates", "intends", "plans", "believes", "estimates", "suggests", "appears", "seeks", "will" and variations of such words and similar exp are intended to identify forward-looking statements. These statements involve known and unknown risks, uncertainties and other factors that may cause our actual results and performance to be materially different from any future results or performance expressed or implied by these forward-looking statements. Factors that might cause such differences include, but are not limited to, those discussed in the section entitled "Item 1A – Risk Factors." Readers should also carefully review the "Risk Factors" section contained in other documents we file from time to time with the Securities and Exchange Commission, including the Quarterly Reports on Form 10-Q to be filed by us in fiscal year 2013.

Although we believe that these statements are based upon reasonable assumptions, we cannot guarantee future results and readers are cautioned not to place undue reliance on these forward-looking statements, which reflect management's opinions only as of the date of this filing. There can be no assurance that (i) we have correctly measured or identified all of the factors affecting our business or the extent of these factors' likely impact, (ii) the available information with respect to these factors on which such analysis is based is complete or accurate, (iii) such analysis is correct or (iv) our strategy, which is based in part on this analysis, will be successful. The Company undertakes no obligation to update or revise forward-looking statements.

PART I

Item 1. Business.

Overview of Our Company

We are a leader in healthcare staffing with a primary focus on providing nurse, allied and physician (locum tenens) staffing services and workforce solutions to the healthcare market. We believe we are one of the top two providers of nurse and allied staffing services, one of the top four providers of temporary physician staffing (locum tenens) services, and one of the top five providers of retained physician and healthcare executive search services. We are also a leading provider of education and training programs specifically for the healthcare marketplace. We report our financial results according to three business segments: (1) nurse and allied staffing, (2) physician staffing, and (3) other human capital management services.

In February 2013, we sold our clinical trial services business. Accordingly, this business segment has been reclassified as discontinued operations on our consolidated financial statements contained in this Report. For additional information, see Footnote 3 – Assets Held for Sale and Discontinued Operations contained elsewhere in this report.

Our operations reflect a diversified revenue mix across healthcare customers. For the full year 2012, our revenue from continuing operations was $442.6 million. Our nurse and allied staffing business segment was 63% of revenue and is comprised of travel nurse, per diem nurse and allied health staffing. Our physician staffing business segment was 28% of our revenue and consists of temporary physician staffing services with placements across multiple specialties. Our other human capital management services business segment was 9% of our revenue and consists of education and training, as well as retained search services related primarily to physicians, allied health and healthcare executives. On a company-wide basis, we have approximately 4,000 contracts with hospitals and healthcare facilities, and other healthcare organizations to provide our staffing services and workforce solutions. In 2012, no single client accounted

for more than 3% of our revenue. Our fees are paid directly by our clients, and in certain instances, by third-party vendor managers. As a result, we have no direct exposure to Medicare or Medicaid reimbursements. For additional financial information concerning our business segments see Note 17 to the consolidated financial statements - Segment Information, contained elsewhere in this report.

Healthcare and Demographic Influences on Our Business

Health Care Reform and the Health Workforce

Health care reform legislation known as the Affordable Care Act was enacted into law in March 2010, and incorporates the Patient Protection and Affordable Care Act and the Health Care and Education Reconciliation Act of 2010. The primary objective of the Affordable Care Act is to decrease the number of uninsured Americans and reduce the overall costs of health care by improving healthcare outcomes and streamlining the delivery of health care. A number of provisions of the Affordable Care Act take effect over several years and began in 2010 and are directed at employers, individuals, insurance providers and the health workforce. One of the major aspects of the Affordable Care Act is providing health insurance coverage for uninsured nonelderly people. According to an NBC News report of the Congressional Budget Office's Estimate of the Effects of the Affordable Care Act on Health Insurance Coverage (February 2013), the Congressional Budget Office projects approximately 27 million previously uninsured people will be covered by health insurance by 2017. This number was revised from its March 2012 projection that 32 million to 34 million previously uninsured people would receive health insurance coverage under the Affordable Care Act.

The Affordable Care Act is expected to create a large demand for medical professionals to accommodate the significant number of new patients that will begin using their health benefits. With respect to healthcare workforce, provisions of the Affordable Care Act are intended to: improve access by increasing the supply of needed health workers, particularly primary care practitioners; increase efficiency and effectiveness by encouraging systems redesign; address problems of mal-distribution; and improve the quality of care through improved education and training. It also establishes an infrastructure to collect and disseminate better data and information to inform public and private decision making around the supply, education and training and use of healthcare workers (Association of American Medical Colleges (AAMC) Center for Workforce Studies, April 2010).

Demand Influences

The long-term macro drivers of our business are demographic in nature and consist of a growing and aging U.S. population demanding more healthcare services and an aging workforce of healthcare professionals. Additionally, there are projected shortages of healthcare professionals including registered nurses (RNs) and physicians.

According to the most recent report by the Centers for Medicare & Medicaid Services (CMS), in 2011 health spending in the U.S. grew by 3.9%, which was the slowest annual rate of increase in the 52 years that federal agencies have been tracking such data. In 2011, health expenditures increased to $2.7 trillion from $2.6 trillion in 2010 and from $2.5 trillion in 2009. The low rate of growth in overall health spending in 2011 largely reflects the lingering effects of the 2008 recession and the modest recovery that followed, which contributed to slower growth in the use of health care goods and services, lower medical inflation, reduced private health insurance enrollment, and employer efforts to control spending.

In 2011, Medicare spending grew 6.2% to $554 billion and Medicaid spending increased 2.5% to $408 billion over the prior year. Hospital spending grew 4.3% to $850 billion. Physician and clinical services spending grew 4.3% to $541 billion. The CMS analysis also noted that provisions of healthcare legislation under the Patient Protection and Affordable Care Act had minimal effects on health spending growth in 2010 and 2011 as the main provisions – the individual mandate and health insurance exchanges – do not take effect until 2014.

In 2012 and 2013, health spending was estimated to continue to grow modestly at 4.2% and 3.8%, respectively. In 2014, national health spending is projected to accelerate to 7.4% primarily due to implementation or expansion of provisions under the Affordable Care Act. Longer-term, CMS expects national health spending over the period of 2015-2021 to grow at an average rate of 6.2% annually, reflecting greater demand for healthcare services due to both an increasing and aging population, several provisions of the Affordable Care Act, and generally improving economic conditions.

The U.S. population grew by 9.7% to 308.7 million people in the decade from 2000 to 2010, according to U.S. Census Bureau data; and life expectancy for Americans is nearly 78 years, the highest in U.S. history, according to the most recent government data for 2007. Between 2010 and 2050, the U.S. Census Bureau projects the American population to grow 42% to 439 million people and also to grow older driven largely by the baby boomer generation moving into the ranks of the 65 and older population. The number of people age 65 and older is projected to more than double from 40.2 million in 2010 to 88.5 million in 2050, while over this same period the number of people age 85 and older is projected to grow from 5.8 million to 19 million, according to a May 2010 report by the U.S. Department of Commerce.

Utilization of healthcare services is significantly higher among older people. In 2007, people age 65 and older averaged seven doctor visits per year while people aged 45-65 average less than four visits annually, according to a 2010 report by the U.S. Department of Health and Human Services. This report also found that approximately one-third of people age 65 and older were admitted to acute care hospitals for treatment, which is about three times

the comparable rate for people under age 65. The American Hospital Association (AHA) projects the share of hospital admissions for the over-65 age group to rise from 38% in 2004 to 56% in 2030.

We believe demand for our nurse, allied and physician staffing services is primarily influenced by two factors: (1) national labor market dynamics that affect the number of hours worked by healthcare professionals, especially nurses, and (2) the strength or weakness in acute care hospital admissions relative to expectations, as well as the volume of patients at other medical facilities and physician offices. During 2012, demand (defined as open orders from clients) improved significantly for our nurse and allied staffing services and also improved for our physician staffing services. However, overall demand for our healthcare staffing services remains below levels prior to the economic downturn that began in the fall of 2008.

With respect to temporary healthcare professionals, a significant downturn in the national labor market following the recession of 2008 triggered RNs to offer more hours of service directly to hospital employers at wages hospitals were willing and able to pay. This resulted in a steep decline in the demand for our temporary nurse and allied staffing services, and to a lesser extent, our physician staffing services. Physicians have historically been revenue generators for hospitals, healthcare facilities and practice groups while nurses are not a specifically reimbursed cost in the delivery of care.

Supply Influences

Overlaid on an expected increase in demand for healthcare services is a projected shortage of RNs that is caused by an aging nurse workforce and a nurse education system constrained by both an aging faculty and lack of accredited teaching facilities. There is also a growing shortage of physicians in both hospitals and practice groups that is influenced by constraints in the number of graduates from U.S. medical schools combined with an aging workforce that is expected to experience substantial retirements over the next decade. Healthcare reform legislation is also expected to have a future impact on the shortage of RNs and physicians caused by adding tens of millions of new patients to the reimbursement system.

Despite a high national unemployment rate in 2012 and flat job growth compared to the prior year, the U.S. healthcare workforce continued to expand. The Bureau of Labor Statistics reported that healthcare employers added 45,000 new jobs in December 2012, bringing the 2012 total of new jobs created in this sector to 338,000, a 7.3% increase from the prior year.

RNs are projected to be the top occupation in terms of job growth through 2020, according to the Bureau of Labor Statistics in its February 2012 report, Employment Projections 2010-2020, in which the number of employed nurses is expected to grow 26% from 2.74 million in 2010 to 3.45 million in 2020. During the past several years, hospital employment of RNs increased significantly due to several factors related to the effects of the economic downturn and weak national labor market: full and part-time staff RNs increased the number of shifts working directly for hospital employers, many retired RNs returned to bedside care, older RNs contemplating retirement remained in the workforce longer to maintain household income, and there was an increase in younger RNs entering the workforce. In the last recession, in 2007 and 2008, hospital employment of RNs increased by an estimated 243,000 full-time equivalents – the largest increase during any 2-year period in the prior four decades. These factors served to substantially ease the shortage of RNs working in hospitals. Looking ahead, knowledgeable industry researchers believe that over the next several years, many RNs who entered the workforce during the economic downturn are likely to leave their jobs once the economy fully recovers, making it likely that growth in demand for RNs over the next few years will exceed the projected growth in the workforce, leading to renewed shortages of RNs in the near-term (New England Journal of Medicine, April 2012). And in the longer-term, large shortages of RNs are projected nationwide with the onset of a substantial shortfall of RNs expected to occur around 2018 and growing to approximately 260,000 by 2025 (Health Affairs, June 2009).

Physicians are expected to be in short supply as well. While the root cause of this shortage dates back to the 1980s and 1990s when medical schools capped enrollment, the U.S. is expected to face a shortage of more than 90,000

primary care, surgical and medical specialty physicians by 2020 – a number that will grow to more than 130,000 by 2025, according to analysis by the Association of American Medical Colleges (AAMC) Center for Workforce Studies (June 2010). This analysis factored in an expansion of health care insurance as a result of the Affordable Care Act along with physician retirements. The AAMC expects nearly one-third of all physicians will retire in the next decade. Additionally, while the number of applicants to U.S. medical schools is increasing, it will not keep pace with expected future demand. The U.S. Department of Health and Human Services estimates that the physician supply will increase by only 7% in the next 10 years.

The supply of healthcare professionals (HCPs) in the marketplace is dependent upon the number of HCPs entering or already active in their respective professions, less the number of professionals leaving or retiring from the workforce. The supply of RNs available for our staffing services is variable and impacted by national labor market dynamics and demand-related factors which influence RNs to gauge their willingness to work temporary assignments, be directly employed by hospitals as staff nurses or working in non-hospital settings such as insurance companies, health clinics and doctor offices. The supply of physicians available for our physician staffing services is variable and is influenced by several factors, including the desire of physicians to work temporary assignments, along with the desire of older physicians to work fewer hours, work-lifestyle balance among younger physicians, and the trend toward more female physicians in the workforce who traditionally work fewer hours than their male counterparts.

Influences on Our Customers

Hospital and healthcare facility customers comprise the majority of our revenue base. Typically, they provide medical care on a 24 hour/7 day a week basis, which requires RNs, physicians and other healthcare professionals to be staffed around the clock. Labor costs have historically been the largest component of a hospital's operating budget with nursing care accounting for about half of this amount or a quarter of total expenditures. Hospitals are capital-intensive organizations that are paid for their services through reimbursements from the CMS, by insurance companies paying their members' covered claims, and by private-pay individuals. Our fees are paid directly by our clients and in certain instances by vendor managers. As a result, we have no direct exposure to Medicare or Medicaid reimbursements.

Since the beginning of 2003, growth in hospital in-patient admissions has been relatively flat. In addition, hospitals, healthcare facilities and physician practice groups have had to contend with changes to government reimbursements for their services and changes in legislation and agency regulations, along with a large pool of uninsured patients. In addition, in 2011, uncompensated care (bad debt and charity care) by hospitals reached a record $41.1 billion and represented 5.9% of total expenses, which was relatively consistent with the prior 5-year period. Among other things, these factors have been compounded by high unemployment and higher deductibles and co-pays for those with health insurance coverage.

During 2012, hospitals and health systems continued to operate in an environment characterized by a slow recovering economy and emerging healthcare policy changes. These factors have turned up the pressure in the near- and longer-term to increase efficiency, devise new payment models and create new models of coordinated care across hospitals, health systems, other medical providers and the community with the result of improved quality of care and better health outcomes, according to the American Hospital Association (AHA). More specifically, hospitals and other health care providers were reacting to and complying with the Patient Protection and Affordable Care Act, and subsequent changes.

In addition, many hospitals are currently undergoing electronic medical record (EMR) implementations aided by grants available to healthcare facilities under the Health Information Technology for Economic and Clinical Act (HITECH Act) – adopted as part of the American Recovery and Reinvestment Act – to improve the quality of healthcare by reducing medical errors and lowering costs through the computerization of America's health records by 2015. See Regulations Affecting Our Clients for more information about this Act. Hospitals are also going through ICD-10 implementation (International Classification of Diseases, Tenth Revision), which is a new version of the medical procedure codes used for reimbursement, quality and patient safety reporting. Transitioning to the new coding system is a significant undertaking that requires not just technology upgrades, but also training of clinical, coding and financial staffs. As a comparison, the new ICD-10 coding system contains more than 141,000 codes and accommodates a host of new diagnoses and procedures, whereas the prior ICD-9 coding system contains approximately 17,000 codes.

Physicians are increasingly becoming employees of hospitals or health systems due to business pressures and costs of operating private practices. Hospitals seek to gain market share by increasing their referral base and capturing admissions while physicians are facing a combination of factors that include stagnant reimbursement rates, increased regulatory burden, rising costs, greater risk associated with operating a private practice, and an increased desire for a better work-life balance. We believe this shift has reduced the demand from hospitals for temporary physicians. In 2009, more than 50% of medical practices were hospital-owned as compared to about 26% in 2005, according to annual physician compensation surveys by the Medical Group Management Association (MGMA).

Looking ahead, there are a number of key issues hospitals and health systems are expected to face in 2013, according to Becker's Hospital Review (September 2012) including:

Hospital-hospital consolidation

Hospital-physician alignment

Payor-payor and payor-provider consolidation

Physician shortage and physician burnout

Sustainability of physician employment

Accountable care organizations

Nurse and Allied Staffing

We are a leading provider of nurse and allied staffing services in the U.S. Nurse and allied staffing is our largest business segment with revenue of $277.8 million in 2012. The majority of our revenue is generated from staffing RNs on long-term contract assignments (typically 13-weeks in length) at hospitals and health systems. We also staff allied health professionals on long-term contract assignments and staff RNs, licensed practical nurses and certified nurse assistants on short-term per diem assignments through our network of local offices. Our allied and other healthcare professionals represent a wide range of specialties that include operating room technicians, rehabilitation therapists, radiology technicians, respiratory therapists, radiation therapy technicians, nurse practitioners, and physician assistants.

We market our nurse and allied staffing services primarily to acute care hospitals and health systems, and provide our clients with staffing solutions through our Cross Country Staffing (CCS) and Allied Health Group brands. Our clients provide health and medical services across a broad range of clinical settings in the for-profit and not-for-profit sectors throughout the U.S., including acute care hospitals, physician practice groups, skilled nursing facilities, nursing homes and sports medicine clinics, and, to a lesser degree, non-clinical settings such as home care and schools.

Our nurse and allied staffing businesses are certified by The Joint Commission under its Health Care Staffing Services Certification Program.

CCS is our largest brand. The vast majority of our activities are designed to help a diverse customer base of hospitals and health system clients meet their ongoing staffing needs for temporary nurses and allied health professionals. During 2012, we worked with more than a thousand hospitals and health system clients. Additionally, as a part of its business strategy, CCS provides comprehensive Managed Service Provider (MSP) solutions to large hospitals and health systems throughout the U.S. to manage their temporary clinical staffing. These MSP contracts are specifically tailored to each client based on their workforce goals and financial targets. Our MSP engagements typically incorporate one or more of our contract nurse, contract allied and/or per diem staffing solutions. Typically, such arrangements require CCS to:

- negotiate contracts with subcontractors in order to help meet the client’s fill rate expectations
- verify that all nurses provided both by CCS and subcontractors meet CCS’ credential requirements and other standards and testing requirements established by the client
- verify insurance coverage of the subcontractors and their candidates
- manage orders for open positions from the client and distribute those needs to subcontractors as required
- interview candidates presented to ensure they meet the client’s specifications
- consolidate and reconcile the timecard approval and invoicing process for services provided by CCS and all subcontractors
- distribute payments to subcontractors for services provided to the client
- capture and analyze data for the benefit of the client

These services are particularly beneficial to larger facilities and systems that require many healthcare professionals across a broad spectrum of medical disciplines and specialties. For the full year 2012, approximately 29% of our nurse

and allied staffing volume was at MSP client facilities. In addition to directly supplying a large majority of client needs under these MSP programs, CCS has relationships with hundreds of subcontractors throughout the U.S. to ensure that clients have access to a large pool of candidates to meet their staffing needs.

Another component of our business is contract staffing for hospitals and health systems undergoing electronic medical record (EMR) technology implementations. In these situations, we supply contract temporary healthcare professionals to provide patient care while hospital staff RNs are away in classroom settings undergoing training and to provide support to the staff RNs in utilizing the EMR technology upon their return to bedside care. We expect that staffing related to EMR technology implementations will be one of the growth drivers of our nurse and allied staffing segment in 2013.

Overview of the Nurse and Allied Staffing Industry

Clients today select between contract and/or per diem staffing solutions in order to meet their temporary staffing needs. The term “contract staffing” is typically associated with travel nurse or travel allied health professionals. Contract staffing involves placement of nursing or allied healthcare professionals on a contract basis, typically for a 13-week assignment although assignments may range from several weeks or longer than three months. Contract assignments usually involve relocation to the geographic area of the assignment. Both the contract and per diem models provide our clients with a more flexible cost model to better manage variability in their staffing needs due to changes in demand. Often, the contract model is preferred because it also provides a pool of potential full-time job candidates from outside the local market, and enables healthcare facilities to provide their patients with a greater degree of continuity of care versus a per diem solution. The staffing company generally employs the healthcare professional and is responsible for providing them with customary employment benefits, including travel reimbursements, and for coordinating housing arrangements. Per diem nurse staffing comprises the majority of the outsourced temporary nurse staffing market and involves the placement of locally-based healthcare professionals on short-term assignments, often for daily shift work, with little advance notice by the hospital client. Consequently, housing and travel reimbursements are generally not required for this mode of staffing. In 2012, the market for travel nurse and allied staffing was estimated to be approximately $4.4 billion and the market for per diem staffing was estimated to be $2.8 billion, according to industry sources.

Recruiting

We operate differentiated brands – Cross Country TravCorps, MedStaff Healthcare Solutions, NovaPro, Cross Country Per Diem, CRU-48, Allied Health Group, MRA Search and Assignment America – to recruit nurses and allied healthcare professionals on a domestic and international basis. We believe RNs and allied health professionals are attracted to us because we offer a wide range of diverse assignments in attractive locations, competitive compensation and benefit packages, as well as a high level of customer service. In 2012, more than ten thousand healthcare professionals applied with us through our recruitment brands.

Historically, more than half of our field employees have been referred to us by other healthcare professionals. We market our brands on the Internet including extensive utilization of social media, which has become an increasingly important component of our recruitment efforts. We maintain a number of websites to allow potential applicants to obtain information about our brands and assignment opportunities, as well as to apply online. We also advertise in trade publications.

Our recruiters are an essential element of our staffing business, responsible for establishing and maintaining key relationships with candidates for the duration of their employment with our Company. Our recruiters work with candidates before, during and after their employment with us. We believe our retention rate of healthcare professionals is a direct result of these relationships. Recruiters match the supply of qualified candidates in our databases with the demand for open orders posted by our hospital clients. At year-end 2012, we had 96 recruiters in our nurse and allied staffing segment.

Our recruiters utilize proprietary computerized databases of positions to match assignment requirements with the experience, skills and geographic preferences of candidates. Once an assignment is selected, our account managers review the candidate’s application package before submitting it to a hospital client for consideration. Account managers are knowledgeable about the specific requirements and operating environment of the hospitals that they service.

Contracts with Field Employees and Hospital Clients

Each of our contracted field employees works for us under the terms of a written agreement. Contract assignments are typically 13-weeks in duration and can be shorter or longer. The vast majority of our field employees are hourly whose agreements with us specify the hourly rate they will be paid and any other benefits they are entitled to receive during the assignment period. We bill clients at an hourly rate and assume all employer costs, including payroll, withholding taxes, benefits, professional liability insurance and Occupational Safety and Health Administration (OSHA) requirements, as well as any travel and housing arrangements.

Operations

We operate our contract staffing business through a relatively centralized business model servicing all of the assignment needs of our field employees and client healthcare facilities through operation centers located in Boca Raton, Florida; Malden, Massachusetts; Tampa, Florida; Newtown Square, Pennsylvania; and Norcross, Georgia. In addition to the key sales and recruitment activities, these centers also perform support activities such as coordinating housing, payroll processing, benefits administration, billing and collections, travel reimbursement processing, customer service and risk management. Our per diem staffing services are provided through a network of 19 branch offices serving major metropolitan markets predominantly located on the east and west coasts of the U.S.

Hours worked by field employees are recorded by our operations system, which then transmits the data directly to Automatic Data Processing, Inc. for payroll processing. Client billings are typically generated using time and attendance data captured by our payroll system. Our payroll department also provides customer support services for field employees.

During 2012, we had an average of approximately 1,100 apartments open under lease throughout the U.S. Our housing staff typically secures leases and arranges for furniture rental and utilities for field employees at their assignment locations. Apartment leases are typically three months in duration to match the assignment length of our field employees. Beyond the initial term, leases can generally be extended on a month-to-month basis. We typically provide accommodations at no cost to the healthcare professional on assignment with us based on our respective recruitment brand's practices. We believe that our economies of scale help us secure competitive pricing and favorable lease terms.

Demand and Supply Drivers

Using temporary personnel enables healthcare providers to manage their total staffing levels of internal and external nursing resources to better match variability of in-patient admissions, seasonal fluctuations, and other factors such as facility expansion and staff training activities.

The market for our nurse staffing services is determined by the demand from hospital and health system clients and the available supply of RNs and other healthcare professionals. We believe demand is a function of both the dynamics of the national labor market and its impact on RNs and their spouses (approximately 75% of RNs in the U.S. are married), as well as hospital admission trends relative to expectations (Health Resources and Services Administration (HRSA) (September 2010)). Each of these factors influences the number of shifts or hours that full and part-time RNs are willing to work directly for hospitals at prevailing wages that hospitals are able to pay. In general, we believe nurses are more willing to seek contract assignments with us during relatively high levels of industry demand for contract employment, and conversely, are more reluctant to seek contract assignments during and immediately following periods of weak industry demand for contract employment. We also believe demand for contract nurse staffing services will be favorably impacted in the long-term by an expanding and aging population and an increasing shortage of nurses. From 2008 to 2010, RN turnover and vacancy rates at hospitals decreased year-over-year due primarily to economic conditions, according to a 2012 Advisory Board report. However, from 2010 to 2011, these metrics reversed the trend of the prior several years likely reflecting increasing confidence in the labor market. Exhibiting the greatest increase was the vacancy rate for bedside nurses, which the Advisory Board report states may be an early indicator of the return of nursing shortage conditions.

During 2012, while hospital admission trends continued to remain relatively flat and the U.S. economy achieved a slight improvement and national unemployment improved somewhat but remained high, we experienced an increase in demand for our nurse and allied staffing services that strengthened over the course of the year from a very weak start. The improvement in demand was broad-based and reflected staffing associated with hospital electronic medical record implementations and staffing needs at our MSP accounts.

Historically, high national unemployment typically results in RNs increasingly seeking employment as hospital staff nurses and those already employed as staff nurses become more willing to work more hours at prevailing wages, which combine to reduce the need for our outsourced staffing services. The reverse begins to occur as the economy and more specifically the labor markets improve, although there is a lag between the improvement in demand for our nurse and allied staffing services and the improvement in supply of RNs and other healthcare professionals.

In connection with a statement by the Tri-Council of Nursing (July 2010), Dr. Peter Buerhaus, Associate Dean of Vanderbilt University's School of Nursing, stated that he believes it is important to look beyond the short-term

environment where hospitals have largely been able to employ all the RNs they want at prevailing wages due to the uncertainty over key economic factors. Buerhaus outlined that once the jobs recovery begins and RNs' spouses rejoin the labor market, many currently employed RNs could leave the workforce where their exit could be swift and deep. This includes many of the more than 100,000 RNs over the age of 50 that re-entered the workforce during 2007 and 2008, who are a part of the nearly 900,000 working RNs over the age of 50, of which Buerhaus expects large numbers of them to retire in the years ahead – independent of the pace and intensity of a jobs recovery. More recently, Buerhaus found a 62% increase in the number of 23-26 year olds who entered the RN workforce between 2002 and 2009 (Health Affairs, December 5, 2011). Despite this increase in younger RNs, the study concluded that the nursing shortage is not over given the demand for nursing care by older adults, new opportunities for nurses through healthcare reform, and the need for more highly educated RNs.

Educating Nurses

The most commonly reported initial nursing education of RNs in the U.S. is the Associate Degree in Nursing, representing 45.4% of nurses. Bachelor's or graduate degrees were received by 34.2% of RNs, and 20.4% graduated from hospital-based diploma programs. More than 21% of RNs earned an academic degree prior to their initial nursing degree. More than two-thirds of RNs reported working in a health occupation prior to their initial nursing education (HRSA, September 2010). In contrast, 57% of the RNs we placed on our contract assignments in 2012 earned their bachelor's or graduate degrees.

Enrollment in all types of professional nursing programs increased from 2011 to 2012, including a 3.5% increase in entry-level Bachelor of Science in Nursing programs, according to preliminary survey data from the American Association of Colleges of Nursing (AACN) issued in December 2012. In addition, the AACN survey results showed a 22.2% increase in the number of students enrolled in baccalaureate degree completion programs – called RN to BSN programs – marking the 10th year of increased enrollment in these programs. Enrollment in master's and doctoral degree nursing programs increased significantly in 2012, according to the AACN. Nursing schools with master's programs reported an 8.2% increase in enrollment in 2012 and doctoral nursing programs enrollment increased 19.6% while enrollment in research-focused doctoral programs increased slightly by 1.3%.

Nursing schools continue to receive more qualified applications than can be accommodated. The AACN preliminary data reflects that 52,212 qualified applications for entry-level baccalaureate nursing programs in 2012 were turned away. The primary barriers to accepting all qualified students at nursing colleges and universities continue to be a shortage of clinical placement sites, faculty and funding.

According to the AACN, the national nursing school full-time faculty vacancy rate decreased slightly to 7.6% in 2012 from 7.7% in 2011, and represented a total of 1,181 faculty vacancies at nursing schools with baccalaureate and/or graduate programs across the country. Most of the vacancies (88.3%) were faculty positions requiring or preferring a doctoral degree. The major reasons precluding schools from hiring additional faculty are insufficient funds to hire new faculty (64.1%), and unwillingness by school administrators to commit to hiring additional faculty (55.5%), and competition with practice for graduate-prepared nurses (35.9%).

Physician Staffing

The physician staffing or "locum tenens" industry most commonly refers to temporary physicians that contract with staffing agencies to perform medical services over a specified period of time as independent contractors at hospitals, group practices or other healthcare organizations. Physicians consider this way of practicing medicine an excellent alternative to traditional practice while healthcare organizations appreciate the value of this flexible staffing model.

In using temporary physicians, the staffing needs of healthcare facilities are met while physicians gain flexibility in their schedules and professional experience in multiple practice settings. Utilization of temporary physician coverage ranges from rural solo physician practices to major health systems and managed care organizations. Healthcare facilities have found that supplemental healthcare professionals are needed for a variety of reasons: to compensate for a physician shortage, to fill in for an absent staff member who may be ill, on vacation, on maternity leave or sabbatical, as well as to cover while physicians attend continuing medical education courses, to supplement regular staff during busy times, or to staff new facilities while permanent providers are recruited. Many healthcare facilities across the country use temporary physicians as an integral part of their master staffing plan. In many cases, it is less costly and more efficient for them to staff at a minimum level and use temporary physicians to supplement their permanent staff, rather than always trying to staff at the maximum level and having many periods of time when the staff are not fully utilized.

Physicians choose temporary assignments for a variety of reasons and at various points in their careers. For example, it is an especially appealing option for new physicians just out of residency training. It provides them with the opportunity to sample different practices and areas of the country before making a long-term commitment in any one spot. While medical schools and residency programs teach the art of practicing medicine, new physicians frequently emerge from training without knowing just what style of practice will suit them best and many report being unhappy with their first practice setting. With temporary physician staffing, there is no pressure to rush into a permanent decision, and there are no immediate financial burdens such as “buying in” to a practice or permanently locating to what could turn out to be the wrong place.

Temporary staffing is also the choice of many seasoned physicians who are not ready to retire, but who want to scale back from the rigors and administrative burdens of a full-time practice and/or supplement their income. These physicians enjoy the opportunity to keep more reasonable hours and combine work with travel and time spent with family and friends. Other physicians choose temporary physician staffing work while in mid-career as a way to find the right position in a new area, while they are in professional transition such as from military to civilian practice, or while in the process of starting their own business.

Overview of the Physician Industry

The physician industry is characterized by several trends including: (1) growing demand for services from an aging population, (2) an aging of the physician workforce, and (3) increased direct employment by hospitals partly in response to anticipated effects of healthcare reform.

Demand for physicians is projected to grow 29.7% between 2008 and 2025, from 706,500 to 916,000, according to the AAMC Center for Workforce Studies (June 2010), which attributed the increase to the projected aging of the population and the passage of health care reform that will insure approximately 27-30 million Americans. On the supply side, the AAMC projects that over the same period the number of physicians will only increase 12.3% reflecting expectations that nearly one-third of all physicians will retire in the next decade and enrollments in medical schools will not be enough to meet demand just as more people will need health care. As a result, the AAMC projects by 2020 a shortage of more than 90,000 primary care, surgery physicians and medical specialists.

An earlier AAMC report (November 2008) concluded that the hospital inpatient setting is projected to experience the greatest increase in demand of 36.6%, while all the other settings are projected to grow by increases that exceed 20%.

Of the nearly 700,000 physicians practicing medicine today in the U.S., approximately one-third of physicians are over age 55. Approximately 38% of these physicians report they are considering retirement in the next one to three years, according to the American Medical Association (AMA). In absolute terms, the number of physician retirements is expected to rise to 23,000 per year in 2025 from approximately 9,000 in 2000, according to the AAMC.

Shortages exist for all types of physicians, especially for physicians specializing in emergency medicine, cardiology, family practice, general surgery, internal medicine, hospital medicine (hospitalists), oncology, orthopedics, psychiatry and urology. Of particular concern is the shortage of primary care physicians. The AAMC sites numerous reasons for the decline in interest in a career in primary care.

- There is a significant income gap – and perception of status and prestige – between generalists and specialists.

- Consequently, while primary care physicians have consistently comprised about one-third of all physicians over the past 30 years, the number of U.S. medical school graduates selecting a family medicine career fell nearly 27% from 5,746 in 2002 to 4,210 in 2007.

- Medical education and training appear to have less impact on the career choice of new physicians than the practice environment for primary care. Medical students often cite factors such as an ability to control workload, flexibility in scheduling, and career satisfaction as elements in their decisions.

Since the recent economic downturn and in the face of health care reform, physicians have looked increasingly for stability in an environment of decreasing reimbursement for professional fees, as well as increased pressure and cost for physician practices to comply with new electronic health records standards. At the same time, selected hospitals are trying to manage rising costs and the CMS is moving to a coordinated care model via Accountable Care Organizations (ACOs) in an effort to enable healthcare providers to control costs and improve quality by working together with other providers and payers.

As hospitals and health systems position themselves for health care reform, including establishing ACOs, hospital employment of physicians has risen sharply in recent years in a quest to gain market share, revenue, shore up referral bases and capture admissions, according to the Center For Studying Health System Change report based on site visits

to 12 nationally representative metropolitan communities in 2010. The American Hospital Association reported in its annual hospital survey that full and part-time physician hiring at hospitals accelerated from 88,384 in 2005 to 115,421 in 2010. In 2011, hospitals increased their hiring of physicians, according to a survey released in January 2012 by Sullivan, Cotter and Associates, in which nearly three-quarters of health care organizations reported they had increased physician staffing levels. More recently, a study by The Physician's Foundation (September 2012) found that more than 50% of physicians will cut back on patients seen, switch to part-time, switch to concierge medicine, or retire. In reporting on this survey, HealthLeaders Media (September 2012) said that 75% of physicians don't believe the migration to employment is a positive trend, including 62% of employed physicians who consider it a negative. Those physicians opting for employment are doing so for economic security and relief from an extreme regulatory environment.

Educating Physicians

The root cause of the projected physician shortage dates back to the 1980s and 1990s when enrollment in medical schools was capped. Although medical school enrollments and graduations have increased somewhat since 2005, the education and training of more physicians will not be enough to address the shortage, according to the AAMC (December 2008). In 2012, the total number of applicants to U.S. medical schools increased 3.1% to 45,266, according to the AAMC, while enrollment in medical schools was at an all-time high and increased 1.5% to 19,517 students. Graduations from U.S. medical schools declined slightly to 17,338 in 2012 from 17,363 the prior year.

Temporary Physician Staffing Drivers

According to industry sources, the temporary physician staffing industry was estimated to be approximately $2.1 billion in revenue in 2012. Using temporary physicians enables healthcare providers to manage their resources to better match variability of in-patient admissions, seasonal fluctuations, and other factors such as vacations, facility expansion and staff training activities. Locum tenens gives a physician the opportunity to practice medicine and focus almost exclusively on patient care without the burden of the administrative aspects of managing a business, reimbursement concerns, hospital politics or malpractice costs. In addition, locum tenens can be an attractive career opportunity for physicians for other reasons depending on their age, financial situation and stage of career. Most recently, since the economic downturn, the demand for locum tenens has been influenced by the delay in retirement of many older physicians and increased direct employment of physicians by hospitals.

Our Physician Staffing Business

MDA is one of the largest providers of physician staffing services in the U.S. It was founded in 1987 and is headquartered in Norcross, Georgia. Segment revenue was $123.5 million in 2012. During 2012, MDA handled more than 5,000 assignments for 833 clients utilizing its database of over 400,000 providers who represent a wide range of medical specialties.

During 2012, our physician staffing revenue grew 4% from the prior year in a marketplace that reflected a modest improvement in the economy and continuing concerns by hospital administrators and practice group leaders with respect to changes in the delivery of health care under the Patient Protection and Affordable Care Act. Given these ongoing uncertainties, physicians have increasingly opted to become employees of hospitals and health care systems. While we expect this trend to continue in the short-term, we believe the future outlook for the physician staffing industry is positive as demand for physicians is projected to increase by 2025 due to the demographics of a growing and aging population along with healthcare reform that is expected to be directionally favorable to our business. The needs will be particularly strong in the primary care specialties due to recent decreases in medical school graduates entering the primary care field. Locum tenens should benefit from these shortage trends and demands particularly with an ever increasing aging population. We believe MDA is well positioned to respond to the current and future needs of its healthcare partners.

MDA is one of only four locum tenens companies with an in-house Credentials Verification Organization certified by the NCQA (National Committee for Quality Assurance), which verifies critical credentials prior to a physician’s assignment. This process uses an extensive proprietary database and interfaces with MDA’s professional liability carrier to obtain approvals of providers. It takes risk management decisions out of the sales process by verifying credentials of providers and approving specific assignments.

Additionally, MDA currently is one of the largest multi-specialty physician staffing companies that has procured an occurrence-based professional liability policy that provides coverage in all 50 states from a national insurance company, which is AA+-rated by Standard & Poor’s. We believe this is an important competitive advantage for MDA

in the recruitment of physicians. The occurrence-based policy is of particular importance to physicians as it covers incidents occurring during the policy period regardless of when they are reported. The more common claims-made policy only covers physicians for claims “reported” during the policy period, which may leave a physician without coverage if the claim is not timely reported or if they fail to secure “tail” coverage. Quality medical malpractice liability insurance coverage is a critical component of the MDA business model. Clients usually require MDA to refer physicians with medical professional liability coverage, and physicians are attracted to MDA, in part, because it offers this malpractice coverage.

When it was initially founded, the locum tenens industry primarily served clinics, group practices and rural hospitals. As the physician staffing industry has matured, an increasing amount of business has been generated from serving hospitals in both urban and suburban settings. Large, nationwide hospital systems and associations continuously use MDA’s services due to its ability to respond quickly to the hospital’s needs, and offer quality physicians on a temporary basis. MDA also provides services to various U.S. government institutions, including the Department of Veterans Affairs, the Indian Health Services, the Army, Air Force and other agencies. In 2012, approximately 60% of MDA’s business was from hospitals and approximately 40% was from physician practice groups and other healthcare facilities.

Recruiting

MDA successfully operates a multi-site business model with employees at several locations. Recruiters go through extensive training in both sales and recruitment of physician specialties in order to have continuity with providers and hospitals to facilitate quick and personal service to every customer. Each recruiter typically covers one specialty and one geographic region whereas competitors typically have separate sales and marketing personnel which can add confusion to the staffing process. Recruiters are also responsible for managing accounts, including the responsibility for collecting amounts due from customers, enabling MDA to have a single point of contact for customers. MDA currently employs approximately 83 physician staffing recruiters.

Contracts with Physicians and Healthcare Facility Customers

MDA contracts with physicians to provide medical services at MDA's healthcare customers. Each physician is an independent contractor and enters into an agreement with MDA to provide medical services at a particular healthcare facility or physician practice group based on terms and conditions of the customer. Physicians are staffed on assignments that may last from a few days up to and including a year depending on client needs and on the willingness of a physician to agree to the duration required by a particular healthcare customer.

Operations

We operate our physician staffing business from a relatively centralized business model servicing all of the assignment needs of the independent contractor physicians through operation centers located in Norcross, Georgia and Dallas, Texas. The support functions of credentials verification, accounts payable, billing and collections, and risk management are all performed from our Norcross, Georgia location. Assignment management is performed by recruiters in various locations. Hours worked by independent contractor physicians are reported to our office in Norcross, Georgia. We bill our clients for our management fee and hours worked by independent contractor physicians. We keep a recruitment fee and pass on an agreed amount to the independent contractor physician.

Other Human Capital Management Services

We provide education and training programs to the healthcare industry and we also provide retained search services for physicians and healthcare executives. Segment revenue was $41.3 million in 2012.

Education and Training Services

Our Cross Country Education (CCE) subsidiary, headquartered in Brentwood, Tennessee, coordinates with various independent contractors in order to offer one-day seminars, conferences and e-learning to healthcare professionals on topics pertaining to healthcare. CCE is an approved provider of continuing education with more than 35 professional healthcare associations, and also works with national and state boards and associations. CCE offers one-day seminars and e-learning, as well as national and regional conferences on topics relevant to healthcare professionals. Since 1995, CCE has trained more than 1,200,000 licensed professionals in the fields of physical and occupational therapy, behavioral health, nursing, long-term care, coding and billing, regulatory compliance, dentistry, health information and healthcare administration. In 2012, CCE held approximately 5,330 seminars and conferences that were attended by more than 140,000 registrants in 175 cities in the U.S. and Canada. We extend these educational services to our field employees on favorable terms as a recruitment and retention tool.

In 2012, CCE's live seminar attendance decreased approximately 7% from the prior year due to what we believe are several factors. First, significant budget cuts to both non-Medicaid and Medicaid-based mental health services negatively impacted employment for public mental health programs. We believe this reduced demand for our

programs as these professionals may have obtained to a greater degree continuing education credits via e-learning offerings. Second, the education industry is increasingly offering live webcasting and rebroadcasting of seminars. To address this shift, CCE has significantly expanded its offerings in this area while continuing to provide thousands of live seminars each year. CCE is also expanding its online presence and will continue to move toward a greater offering of blended learning opportunities for a professional that combines live seminar offerings with audio and e-learning products. CCE is also focusing greater efforts on developing strategic partnerships with provider organizations that can extend our learning programs to their licensed employees.

Retained Search

Our Cejka Search subsidiary is headquartered in Creve Coeur, Missouri, a business district centered within the St. Louis metropolitan area. Cejka Search has been a leading physician, executive, advanced practice and allied health search firm for more than 30 years, recruiting top healthcare talent for organizations nationwide through a team of experienced professionals, advanced use of recruitment technology and commitment to service excellence. Serving clients nationwide, Cejka Search annually completes hundreds of search assignments for organizations spanning the continuum of healthcare, including physician group practices, hospitals and health systems, academic medical centers, accountable care organizations (ACOs), managed care and other healthcare organizations.

In 2012, ongoing uncertainty about health care reform, Medicare reimbursement rules and the pace of economic recovery continued to limit or delay implementation of the industry's medical staff and administrative leadership recruitment plans, which extended the challenging and competitive environment for retained search services. Despite these market conditions, Cejka Search experienced improved year-over-year growth in revenue and contribution income, particularly in the second half of the year, due to strong performance in executive search, the implementation of strategies to expand market reach and improve operating efficiency. We believe Cejka Search is well-positioned to benefit from further economic recovery, the intensifying shortage of physicians and midlevel providers, and the critical need for effective healthcare executive leadership, in particular physician executive leaders, to meet the challenges of health care reform.

Additional Information About Our Business

Growth and Investment Strategy

Our long-term corporate strategy for growth includes:

- Expand and leverage sales efforts with high level consultative sales professionals focused on optimizing the total revenue potential of strategic accounts
- Expand per diem capacity and market share; increase the number of branches in support of MSP services
- Expand allied health placement settings and broaden mix of specialties
- Create integrated temporary and permanent physician services solution in support of MSP and strategic healthcare facilities
- Attract additional healthcare customers, healthcare professionals and providers
- Seek additional MSP contracts and EMR engagements with hospitals and health systems
- Strengthen our market position and margins in our businesses
- Generate strong cash flow
- Make strategic acquisitions in high growth, high margin businesses that will strengthen and broaden our market presence
- Maintain a strong balance sheet to provide financial flexibility

Competitive Strengths

We are a leader in healthcare staffing with a primary focus on providing nurse, allied and physician (locum tenens) staffing services and workforce solutions to the healthcare market. We believe we are one of the top two providers of nurse and allied staffing services, one of the top four providers of temporary physician staffing (locum tenens) services, and one of the top five providers of retained physician and healthcare executive search services. We are also a leading provider of education and training programs specifically for the healthcare marketplace. Since becoming a public company in 2001, we have expanded our revenue mix across sectors of healthcare staffing services and customers. In 2012, our nurse and allied staffing business segment was 63% of our revenue; our physician staffing business segment was 28% of our revenue and our other human capital management services business segment was 9% of our revenue. This compares to our 2001 revenue mix in which 87% was from our nurse and allied staffing business segment, 7% from our other human capital management services business segment, and 6% from our discontinued clinical trial services business segment.

Within our business segments, we also believe we benefit from the following:

Brand Recognition. We have operated in the travel nurse staffing industry for more than 25 years. Our Cross Country Staffing brand is well-recognized among leading hospitals and healthcare facilities and our Cross Country TravCorps and MedStaff brands are well-recognized by RNs and other healthcare professionals. We believe that through our relationships with hospitals and healthcare facilities in supplying our travel nurse staffing services that we also are positioned to effectively market our allied health and per diem nurse staffing services to them. Our physician staffing business, Medical Doctor Associates, was founded in 1987 and has built a strong national brand reputation among hospital and physician practice group clients as well as physician providers. It has grown to become one of the largest physician staffing companies in the U.S. Our Cejka Search brand is ranked among the top five physician placement firms in the U.S.

Strong and Diverse Client Relationships. We provide healthcare staffing and outsourcing solutions to a national client base represented by approximately 4,000 contracts with hospitals and healthcare facilities, and other healthcare providers. No single client accounts for more than 3% of our revenue.

Managed Service Provider Capabilities. Our Cross Country Staffing brand offers its MSP services to large acute care hospitals and health systems. By leveraging technology and its single-point of contact service model, Cross Country Staffing can manage all job orders, credential verification, candidate testing, invoicing, and management reporting. In addition, Cross Country Staffing received the highest ranking overall and in each category among five leading MSP providers in a survey of subcontractors in the following key areas: Quality Service and Processes, Protection of Subcontractor Candidates, Fairness and Transparency of MSP Fees, Thoroughness of Credentialing Process, Responsiveness of the MSP to the needs of Subcontractor, and Technology Platform Usability (TMP Worldwide – December 2011).

Recruiting and Placement of Healthcare Professionals. We are a leader in recruiting and retaining highly qualified healthcare professionals from the U.S. and Canada. In 2012, thousands of healthcare professionals applied with us through our differentiated recruitment brands. We believe we offer appealing assignments, competitive compensation packages, attractive housing options and other valuable benefits. Our size and centralized staffing structure provide us with operating efficiencies in key areas such as recruiting, marketing and advertising, training, housing and insurance. Our proprietary information systems enable us to manage our recruitment and placement operations. Our systems are scalable and designed to accommodate significant future growth. At year-end 2012, the databases for our travel nurse and allied staffing business included more than 345,000 RNs and other healthcare professionals who completed job applications with us. Similarly, the database for our physician staffing business included more than 400,000 physicians representing dozens of specialties.

Joint Commission Certification. The staffing businesses of our Cross Country Staffing, MedStaff and Allied Health Group brands are certified by The Joint Commission under its Health Care Staffing Services Certification Program.

Quality Assurance. MDA’s Credent credential verification subsidiary is NCQA certified, one of only a handful of competitors to achieve such certification.

Continuing Education. We have internal educational and training capabilities through Cross Country University (CCU), a division of CCS, that we believe give us a competitive advantage by enhancing both the quality of our working nurses and the effectiveness of our recruitment efforts. CCU is the first educational program in the travel nurse industry to be accredited by the American Nurse Credentialing Center, and enables us to provide continuing education credits to our RN field employees, as well as to provide accredited continuing education to healthcare professionals not on an assignment with us. CCU offers our RNs and other healthcare professionals additional training, professional development and assistance in completing continuing education for state licensing requirements.

Strong Management Team with Extensive Healthcare Staffing and Acquisition Experience. Our management has played a key role in the growth and development of the healthcare staffing industry. Our management averages more than 15 years of experience in the healthcare industry.

Competitive Environment

All of our businesses operate in highly competitive and regulated markets. In our nurse, allied and physician staffing businesses, the principal competitive factors in attracting and retaining healthcare clients include the ability to fill client needs on a timely basis, price, customer service, quality assurance and screening capabilities, having an understanding of the client's work environment, risk management policies and coverages, and general industry reputation. The level of demand for our temporary staffing and outsourcing services is influenced by, among other things, the number and acuity of patients requiring medical care in hospitals and physician offices, availability and affordability of healthcare insurance coverage, national healthcare spending and reimbursement for medical care, general economic conditions and their impact on labor markets and healthcare employment, and the corresponding supply of healthcare professionals available to us for placement on assignments.

The principal competitive factors in attracting qualified candidates for temporary employment include a large national pool of desirable assignments based on geographic location and clinical setting, pay and benefits, speed of placements, customer service to both healthcare professionals and client facilities, quality of accommodations, and overall industry reputation. We believe that healthcare professionals seeking temporary assignments through us are also pursuing assignments through other means, including other temporary staffing firms. Therefore, the ability to respond more quickly than our competitors to candidate inquiries and submit candidates for consideration, are important factors in our ability to fill assignments. In our nurse and allied staffing segment, we focus on retaining healthcare professionals by providing high-quality customer service as well as providing long-term benefits, such as 401(k) plans and bonuses for field employees. Although we believe that the size and efficiencies of our operations make us attractive for healthcare professionals seeking assignment opportunities, we expect competition for candidates to continue.

Nurse and Allied Staffing

The nurse and allied staffing market is highly competitive. While barriers to entry historically had been relatively low, they have increased significantly and the achievement of substantial scale is very challenging. We believe the utilization of temporary nurse staffing services by hospitals has historically been approximately one-quarter to one-third travel nurse staffing and approximately two-thirds to three-quarters per diem nurse staffing. We compete with a relatively small number of national travel nurse staffing companies, as well as hundreds of smaller and more localized staffing firms that have the capabilities to relocate nurses. We also compete in per diem nurse staffing with a small number of national or regional staffing firms along with hundreds of small local providers. National competitors include AMN Healthcare Services, Inc., CHG Healthcare Services, and Medical Staffing Network Holdings, Inc.

Physician Staffing

Our physician staffing business competes in the healthcare staffing market on a national, regional and local basis with other staffing companies that offer comprehensive and or specialized services providing hospitals, physician practice groups, healthcare facilities and systems, and government agencies with temporary physicians to fill assignments across a wide range of specialties. We also compete in the recruitment for qualified physicians with other staffing companies as well as hospitals, physician practice groups, and healthcare facilities and systems that have their own internal recruitment capabilities to attract and retain healthcare providers. Competitors include AMN Healthcare Services, Inc., CHG Healthcare Services, On Assignment, Inc., Jackson Healthcare, Team Health and several other privately-held companies providing locum tenens.

Systems

Our placement and support operations are enhanced by sophisticated information systems that facilitate smooth interaction between our recruitment and support activities. Our proprietary information systems enable us to manage

virtually all aspects of our operations. These systems can accommodate significant future growth of our business. In addition, their scalable design allows further capacity to be added to the existing hardware platform. We have proprietary software that handles most facets of our business, including contract pricing and profitability, contract processing, job posting, housing management, billing/payroll and insurance. Our systems provide support to our facility clients, field employees and independent contractors, and enable us to efficiently fulfill and renew job assignments. Our systems also provide detailed information on the status and skill set of each registered field employee and independent contractor. In addition to our domestic information systems team, certain software development and information technology support is provided by our employees based in Pune, India.

Our financial, management reporting and human resources systems are managed on PeopleSoft, a leading enterprise resource planning software suite that provides modules used to manage our accounts receivable, accounts payable, general ledger, billing and human resources. This system is designed to accommodate significant future growth in our business.

Workers' Compensation Insurance, Professional Liability Coverage and Health Care Benefits

We provide workers' compensation insurance coverage, professional liability coverage and health care benefits for our eligible temporary healthcare professionals. We record our estimate of the ultimate cost of, and reserves for workers compensation and professional liability benefits based on actuarial models prepared or reviewed by an independent actuary using our loss history as well as industry statistics. In determining our reserves, we include reserves for estimated claims incurred but not reported. The health care insurance accrual is for claims that have occurred but have not been reported and is based on our historical claim submission patterns. The ultimate cost of workers' compensation, professional liability and health insurance claims will depend on actual amounts incurred to settle those claims and may differ from the amounts reserved by us for those claims.

Workers' compensation benefits are provided under a partially self-insured plan. We have a letter of credit structure to guarantee payments of claims. At December 31, 2012 and 2011, respectively, we had outstanding approximately $6,899,096 and $7,049,096 standby letters of credit as collateral to secure the self-insured portion of this plan.

In October 2009, we purchased an occurrence-based primary professional liability policy that provides each working nurse and each allied healthcare professional with coverage of $1,000,000 per occurrence and $3,000,000 in the aggregate. Those individual limits are shared with the healthcare provider's employer (e.g., Cross Country TravCorps or MedStaff, our wholly-owned subsidiaries) in the event of vicarious liability and/or negligent hiring allegations on a claim. This policy does not have a deductible. In addition, in October 2009, we purchased an excess layer of professional liability insurance having limits of $1,000,000 per occurrence and $6,000,000 in the aggregate for all working nurses and allied healthcare professionals of Cross Country Travcorps and $1,000,000 per occurrence and $3,000,000 in the aggregate for all working nurses of MedStaff. Those limits are also shared with the corporations on applicable claims. MedStaff also secured insurance coverage having the same terms as the primary and excess coverage described above for acts occurring on or after October 25, 2002.

Since October 2009, all primary professional liability insurance has been provided under occurrence-based plans. Prior to that period, primary professional liability coverage was provided under various self-insured, claims-made and occurrence-based plans depending on the subsidiary and the applicable policy year. In October 2004, we secured individual occurrence-based primary professional liability insurance policies with no deductible for virtually all of our working nurses and allied professionals, except those employed through our MedStaff, Inc. (Medstaff) subsidiary.

In October 2012 we merged the separate primary professional liability policies for Cross Country TravCorps and MedStaff into one occurrence-based primary policy that provides each working nurse and each allied healthcare professional with coverage of $1,000,000 per occurrence and $3,000,000 in the aggregate. Those limits are also shared with the corporations on applicable claims. We also merged the excess layer of professional liability insurance having limits of $1,000,000 per occurrence and $6,000,000 in the aggregate for all working nurses and allied healthcare professionals of both Cross Country TravCorps and MedStaff. Those limits are also shared with the corporations on applicable claims.

These occurrence-based individual policies replaced a $2,000,000 per-claim layer of self-insured exposure. We continued to provide primary coverage through a $2,000,000 self-insured retention for nurses and allied professionals who did not qualify for the individual occurrence-based coverage, as well as for our independent liabilities (such as

negligent hiring) during these policy years. Effective October 1, 2008, the individual primary professional liability insurance policies were replaced with one policy that insured each individual nurse for $2,000,000 per occurrence and $4,000,000 in the aggregate, as well as the corporation which shared those limits. This policy had no deductible and did not cover healthcare professionals working through MedStaff or MDA Holdings, Inc. or its subsidiaries (collectively, MDA). Separately, prior to October 1, 2009, our MedStaff subsidiary had a claims-made professional liability policy with a limit of $2,000,000 per occurrence, $4,000,000 in the aggregate and a $25,000 deductible per claim.

MDA has an occurrence-based professional liability policy with a limit of $1,000,000 per occurrence, $3,000,000 in the aggregate and a $500,000 deductible for MDA, its independent contractor physicians, Certified Registered Nurse Anesthetists (CRNAs) and allied health professionals. MDA's $500,000 deductible is insured by Jamestown Indemnity Ltd., a Cayman Island company and a wholly-owned subsidiary of MDA Holdings, Inc. (the Captive). Under the terms of the Captive's reinsurance policy there is a requirement to guarantee the payment of claims to its insured party's primary medical malpractice insurance carrier via a letter of credit. The value of the letter of credit was secured by $5,000,000 of cash held by the Captive as restricted cash at December 31, 2008. During 2009, the cash was released from restriction and replaced by a letter of credit under our credit facility. Currently, the value of the letter of credit is $5,000,000.

Subject to certain limitations, we also have $5,000,000 per occurrence and $10,000,000 in the aggregate in umbrella liability coverage after $2,000,000 is exhausted under the primary and excess professional liability policies covering the working nurses and allied healthcare professionals. While this umbrella coverage does not extend to professional liability claims against MDA, its independent contractor physicians, CRNAs and allied health professionals, it does cover claims brought against all of our subsidiaries for non-patient general liability ($250,000 deductible), employee liability ($1,000,000 deductible), non-owned hired auto ($1,000,000 deductible) and errors and omissions ($500,000 deductible and a cap of $5,000,000 in coverage under the umbrella policy). The Company purchased tail insurance for its former clinical trials business with a $500,000 deductible and a $5,000,000 cap in coverage under the umbrella policy.

Professional Licensure

Nurses and most other healthcare professionals employed by us and physicians contracted by us are required to be individually licensed or certified under applicable state law. Our comprehensive compliance and credentials verification programs are designed to ensure that employed and contracted providers possess all necessary licenses and certifications, and we endeavor to ensure that our employees (including nurses and therapists) and contractors (including physicians and other mid-level providers), comply with all applicable state laws.

Business Licenses

A number of states require state licensure for businesses that, for a fee, employ and assign personnel, including healthcare personnel, to provide services on-site at hospitals and other healthcare facilities to support or supplement the hospitals' or healthcare facilities' workforces. A number of states also require state licensure for businesses that operate placement services for individuals attempting to secure employment. Failure to obtain the necessary licenses can result in injunctions against operating, cease and desist orders, and/or fines. We endeavor to maintain in effect all required state licenses.

Regulations Affecting Our Clients

Many of our clients are reimbursed under the federal Medicare program and state Medicaid programs for the services they provide. In recent years, federal and state governments have made significant changes in these programs that have reduced reimbursement rates. In addition, insurance companies and managed care organizations seek to control costs by requiring that healthcare providers, such as hospitals, discount their services in exchange for exclusive or preferred participation in their benefit plans. Future federal and state legislation or evolving commercial reimbursement trends may further reduce, or change conditions for, our clients' reimbursement. Such limitations on reimbursement could reduce our clients' cash flows, hampering their ability to pay us.

The HITECH Act was adopted on February 17, 2009 as part of the American Recovery and Reinvestment Act and it became effective on February 17, 2010. Among other things, this legislation established a process for the development of standards for the secure electronic exchange and use of health information by hospitals, physicians, and others. The general purpose of the HITECH Act is to improve the quality of healthcare by reducing medical errors and lowering costs through the computerization of America's medical records by 2015. Approximately $20 billion was allocated to the HITECH Act incentives to encourage and accelerate the widespread adoption of EMR technology by physicians, hospitals and others. The Medicare and Medicaid EMR/EHR incentive programs provide incentives payments to eligible professionals, eligible hospitals and critical access hospitals as they adopt, implement, upgrade or demonstrate the meaningful use of certified EMR/EHR technology. To further promote the timely adoption of EMR/EHR, the HITECH Act penalizes eligible healthcare providers and hospitals that do not adopt and use EMR/EHR that meets the federal requirements by 2015. For example, under the Medicare EMR/EHR Incentive Program, Medicare eligible professionals, hospitals and critical access hospitals that do not successfully show meaningful use of EMR/EHR will

have a payment adjustment in their Medicare reimbursement. The Medicaid EMR/EHR Incentive Program is being voluntarily offered by individual states and states can receive a 90% federal funding match for incentive payments distributed to Medicaid providers who adopt EMR/EHRs under the meaningful use criteria. As a result, many eligible hospitals are implementing new or enhanced EMR/EHR technology to capitalize on these incentives and avoid the penalties and their staff must undergo training of the new technology systems out of the clinical setting, which creates an opportunity for our healthcare professionals to fill positions on a temporary basis while full-time staff is receiving such training.

Regulations Applicable to Our Business

Our business is subject to regulation by numerous governmental authorities in the United States and the foreign jurisdictions in which we operate. In the U.S., complex federal and state laws and regulations govern, among other things, the licensure of professionals, the payment of our employees (e.g., wage and hour laws, employment taxes and income tax withholdings, etc.) and the operations of our business generally. We conduct business primarily in the U.S. and are subject to the laws and regulations applicable to our business in such states, which may be amended from time to time. Future federal and state legislation or interpretations thereof may require us to change our business practices. Compliance with all of these applicable rules and regulations require a significant amount of resources. We endeavor to be in compliance with all such rules and regulations.

Employees

As of December 31, 2012, we had approximately 1,150 corporate employees. During 2012, we maintained an average of 2,446 full-time equivalent field employees in our nurse and allied staffing segment. We utilized approximately 1,500 independent contractor physicians and approximately 175 independent contractors related to non-physician staffing. We are not subject to a collective bargaining agreement with any of our employees. We consider our relationship with employees to be good.

Available Information

Financial reports and filings with the Securities and Exchange Commission (SEC), including this Annual Report on Form 10-K, are available free of charge as soon as reasonably practicable after filing such material with, or furnishing it to, the SEC, on or through our corporate website at www.crosscountryhealthcare.com.

Item 1A. Risk Factors.

You should carefully consider the following risk factors, as well as the other information contained in this Annual Report on Form 10-K.

Decreases in demand by our clients may adversely affect the profitability of our business.

Among other things, changes in the economy which result in higher unemployment and low job growth, a decrease or stagnation in the general level of in-patient admissions at our clients' facilities, uncertainty regarding federal healthcare law and the willingness of our hospital, healthcare facilities and physician group clients to develop their own temporary staffing pools and increase the productivity of their permanent staff may, individually or in the aggregate, significantly affect demand for our temporary healthcare staffing services and hamper our ability to attract, develop and retain clients. When a hospital's admissions increase, temporary employees or other healthcare professionals are often added before full-time employees are hired. As admissions decrease, clients typically reduce their use of temporary employees or other healthcare professionals before undertaking layoffs of their permanent employees. In a down market, healthcare professionals may be less likely to leave a full-time position to work on temporary assignments and clients are also more likely to focus on internal solutions for their temporary staffing needs. In addition, we also may experience more competitive pricing pressure during periods when in-patient admissions are stagnant for periods of time or declining. In addition, if the trend towards providing healthcare in alternative settings, as opposed to acute care hospitals intensifies, it could result in a decline in in-patient admissions at our clients' facilities. These events individually or in the aggregate may cause a reduction in admissions that could negatively affect the demand for our services. Decreases in demand for our services may affect our ability to provide attractive assignments to our healthcare professionals thereby reducing our profitability.

Our clients may terminate or not renew their contracts with us.

Our arrangements with hospitals, healthcare facilities and physician group clients are generally terminable upon 30 to 90 days' notice. These arrangements may also require us to, among other things, guarantee a percentage of open positions that we will fill, and if we are unable to meet those obligations a client may terminate our contract which could have a negative impact on our profitability. We may have fixed costs, including housing costs, associated with terminated arrangements that we will be obligated to pay post-termination.

We may be unable to recruit enough healthcare professionals to meet our clients' demands.

We rely significantly on our ability to attract, develop and retain healthcare professionals who possess the skills, experience and, as required, licensure necessary to meet the specified requirements of our healthcare clients. We compete for healthcare staffing personnel with other temporary healthcare staffing companies, as well as actual and potential clients such as healthcare facilities and physician groups, some of which seek to fill positions with either permanent or temporary employees. Currently, there is a shortage of certain qualified nurses and physicians in many areas of the United States and competition for these professionals remains intense. The current economic conditions may make these healthcare professionals less willing to travel to temporary assignments, thus further intensifying the competition with other temporary healthcare staffing companies to recruit these healthcare professionals. Although demand is below historically normal levels, at this time we still do not have enough nurses and physicians to meet all of our clients' demands for these staffing services. This shortage of healthcare professionals generally and their willingness to leave stable full-time jobs to travel on temporary assignments in the current environment may limit our ability to increase the number of healthcare professionals that we successfully recruit, decreasing our ability to grow our business.

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The costs of attracting and retaining healthcare professionals may rise more than we anticipate.

We compete with hospitals, healthcare facilities, physician groups and other healthcare staffing companies for qualified healthcare professionals. Because there is currently a shortage of certain qualified healthcare professionals, competition for them is intense. Our ability to recruit and retain healthcare professionals depends on our ability to, among other things, offer assignments that are attractive to healthcare professionals and offer them competitive wages and benefits or payments, as applicable. Our competitors might increase hourly wages or the value of benefits to induce healthcare professionals to take assignments with them. If we do not raise wages or increase the value of benefits in response to such increases by our competitors, we could face difficulties attracting and retaining qualified healthcare professionals. If we raise wages or increase benefits in response to our competitors' increases and are unable to pass such cost increases on to our clients, our margins could decline.

Our costs of providing housing for our healthcare professionals may be higher than we anticipate and, as a result, our margins could decline.

We provide housing for certain of our healthcare professionals when on an assignment with us. At any given time, we have over a thousand apartments on lease throughout the U.S. Typically, the length of an apartment lease is coterminous with the length of the assignment of a nurse or allied healthcare professional. If the costs of renting apartments and furniture for these healthcare professionals increase more than we anticipate and we are unable to pass such increases on to our clients, our margins may decline. To the extent the length of a nurse's housing lease exceeds the term of the nurse's staffing contract, we bear the risk that we will be obligated to pay rent for housing we do not use. To limit the costs of unutilized housing, we try to secure leases with term lengths that match the term lengths of our staffing contracts, typically 13 weeks. In some housing markets we have had, and believe we will continue to have, difficulty identifying short-term leases. If we cannot identify a sufficient number of appropriate short-term leases in regional markets, or, if for any reason, we are unable to efficiently utilize the apartments we do lease, we may be required to pay rent for unutilized housing, or, to avoid such risk, we may have to forego otherwise profitable opportunities.

We are dependent on the proper functioning of our information systems.

We are dependent on the proper functioning of our information systems in operating our business. Critical information systems used in daily operations identify and match staffing resources and client assignments and perform billing and accounts receivable functions. Additionally, we rely on our information systems in managing our accounting and financial reporting. If these systems are damaged or disrupted and unable to function properly in order to support our business operations or require significant costs to repair, maintain or further develop, our business and financial results could be materially adversely affected. Our information systems are protected through a secure hosting facility and additional backup remote processing capabilities also exist in the event our primary systems fail or are not accessible. However, the business is still vulnerable to fire, storm, flood, power loss, telecommunications failures, physical or software break-ins and similar events which may prevent personnel from gaining access to systems necessary to perform their tasks in an automated fashion. In the event that critical information systems fail or are otherwise unavailable, these functions would have to be accomplished manually, which could impact our ability to identify business opportunities quickly, to maintain billing and clinical records reliably, to bill for services efficiently and to maintain our accounting and financial reporting accurately.

Losses caused by natural disasters, such as hurricanes could cause us to suffer material financial losses.

Catastrophes can be caused by various events, including, but not limited to, hurricanes and other severe weather. The incidence and severity of catastrophes are inherently unpredictable. The extent of losses from a catastrophe is a function of both the total amount of insured exposure and the severity of the event. We do not maintain business

interruption insurance for these events. We could suffer material financial losses as a result of such catastrophes.

If applicable government regulations change, we may face increased costs that reduce our revenue and profitability.

The temporary healthcare staffing industry is regulated in many states. For example, in some states, firms such as our nurse staffing companies must be registered to establish and advertise as a nurse-staffing agency or must qualify for an exemption from registration in those states. If we were to lose any required state licenses, we could be required to cease operating in those states. The introduction of new regulatory provisions could substantially raise the costs associated with hiring temporary employees. For example, some states could impose sales taxes or increase sales tax rates on temporary healthcare staffing services. These increased costs may not be able to be passed on to clients without a decrease in demand for temporary employees. In addition, if government regulations were implemented that limited the amounts we could charge for our services, our profitability could be adversely affected.

If certain of our healthcare professionals are reclassified from independent contractors to employees our profitability could be materially adversely impacted.

Federal or state taxing authorities could re-classify our locum tenens physicians and certified registered nurse anesthetists as employees, despite both the general industry standard to treat them as independent contractors and many state laws prohibiting non-physician owned companies from employing physicians (e.g., the "corporate practice of medicine"). If they were re-classified as employees, we would be subject to, among other things, employment and payroll-related tax claims, as well as any applicable penalties and interest. Any such reclassification would have a material adverse impact on our business model for that business segment and would negatively impact our profitability.

We are exposed to increased costs and risks associated with complying with increasing and new regulation of corporate governance and disclosure standards.

We spend significant time and resources to comply with changing laws, regulations and standards relating to corporate governance and public disclosures. Compliance requires management's annual review and evaluation of our internal control systems and attestations of the effectiveness of these systems by our independent auditors. We may encounter problems or delays in completing the review and evaluation, the implementation of improvements and the receipt of a positive attestation by our independent auditors. If we are not able to timely comply with the requirements set forth in Section 404 of the Sarbanes-Oxley Act of 2002, we might be subject to sanctions or investigation by regulatory authorities. Any such action could adversely affect our business and financial results.

Our financial results could be adversely impacted by the loss of key management

If members of our senior management team become unable or unwilling to continue their present positions, our business and financial results could be adversely affected.

Substantial changes in healthcare reform or reimbursement trends could hinder our clients' ability to pay us.

While in most cases our fees are paid directly by our clients rather than by governmental or third-party payers, many of our clients are reimbursed under the federal Medicare program and state Medicaid programs for the services they provide. Changes made by federal and state governments could reduce reimbursement rates. In addition, insurance companies and managed care organizations seek to control costs by requiring that healthcare providers, such as hospitals, discount their services in exchange for participation in their benefit plans. Future federal and state legislation or evolving commercial reimbursement trends may further reduce, or change conditions for, our clients' reimbursement. Limitations on reimbursement could reduce our clients' cash flows, hampering their ability to pay us.

Competition for acquisition opportunities may restrict our future growth by limiting our ability to make acquisitions at reasonable valuations and lack of liquidity in the credit markets may restrict our ability to make certain acquisitions.

Our business strategy includes strategic acquisitions of companies that complement or enhance our business. We have historically faced competition for acquisitions. In the future, this could limit our ability to grow by acquisition or could raise the prices of acquisitions and make them less accretive to our earnings. In addition, even if we are able to negotiate acceptable terms at reasonable valuations, there can be no assurance that there will be sufficient liquidity available on terms favorable to us to complete acquisitions. If we are unable to secure necessary financing under our credit facility or otherwise, we may be unable to complete desirable acquisitions. Certain restrictive covenants in our credit facility may also limit our ability to complete acquisitions.

We may face difficulties integrating our acquisitions into our operations and our acquisitions may be unsuccessful, involve significant cash expenditures or expose us to unforeseen liabilities.

We continually evaluate opportunities to acquire companies that would complement or enhance our business and at times have preliminary acquisition discussions with some of these companies.

These acquisitions involve numerous risks, including:

Potential loss of key employees or clients of acquired companies;

Difficulties integrating acquired personnel and distinct cultures into our business;

Difficulties integrating acquired companies into our operating, financial planning and financial reporting systems;

Diversion of management attention from existing operations; and

Assumptions of liabilities and exposure to unforeseen liabilities of acquired companies, including liabilities for their failure to comply with healthcare and tax regulations.

These acquisitions may also involve significant cash expenditures, debt incurrence and integration expenses that could have a material adverse effect on our financial condition and results of operations. Any a F-14 Sales, gross margin, operating income (loss), inventory and receivables are the key management measures used to evaluate segment performance. The following table provides supplemental segment information to the Company's Consolidated Balance Sheets and Consolidated Statements of Operations: Year ended December 31, ---------- 2002 2001 2000 ---------- ---------- ---------- ($ in thousands, except selling price data) Net sales - Titanium melted and mill products: Mill product net sales $ 278,204 $ 363,257 $ 326,319 Melted product net sales 34,800 64,063 47,366 Other 53,497 59,615 53,113 ---------- ---------- ---------- $ 366,501 $ 486,935 $ 426,798 ========== ========== ========== Mill product shipments: Volume (metric tons) 8,860 12,180 11,370 Average price ($ per kilogram) $ 31.40 $ 29.80 $ 28.70 Melted product shipments: Volume (metric tons) 2,400 4,415 3,470 Average price ($ per kilogram) $ 14.50 $ 14.50 $ 13.65 Geographic segments: Net sales - point of origin: United States $ 311,194 $ 399,708 $ 345,370 United Kingdom 91,467 139,210 139,599 Other Europe 68,487 70,079 74,432 Eliminations (104,647) (122,062) (132,603) ---------- ---------- ---------- $ 366,501 $ 486,935 $ 426,798 ========== ========== ========== Net sales - point of destination: United States $ 193,740 $ 247,410 $ 234,350 Europe 145,118 188,729 163,661 Other 27,643 50,796 28,787 ---------- ---------- ---------- $ 366,501 $ 486,935 $ 426,798 ========== ========== ========== Long-lived assets - property and equipment, net: United States $ 186,777 $ 208,069 $ 227,994 United Kingdom 62,369 62,463 69,212 Other Europe 5,526 4,776 4,924 ---------- ---------- ---------- $ 254,672 $ 275,308 $ 302,130 ========== ========== ========== Export sales from U.S. based operations approximated $18 million in 2002, $37 million in 2001 and $24 million in 2000. F-15 Note 3 - Inventories December 31, ---------- 2002 2001 ---------- ---------- (In thousands) Raw materials $ 53,830 $ 43,863 Work-in-process 81,185 94,709 Finished products 63,458 54,074 Supplies 13,829 13,476 ---------- ---------- 212,302 206,122 Less adjustment of certain inventories to LIFO basis 30,370 21,070 ---------- ---------- $ 181,932 $ 185,052 ========== ========== Note 4 - Investment in joint ventures December 31, ---------- 2002 2001 ---------- ---------- (In thousands) Joint ventures: VALTIMET $ 22,017 $ 20,214 Other 270 371 ---------- ---------- $ 22,287 $ 20,585 ========== ========== VALTIMET SAS ("VALTIMET") is a manufacturer of welded stainless steel and titanium tubing with operations in the United States, France and China. At December 31, 2002, VALTIMET was owned 43.7% by TIMET, 51.3% by Valinox Welded, a French manufacturer of welded tubing, and 5.0% by Sumitomo Metals Industries, Ltd., a Japanese manufacturer of steel products. At December 31, 2002, the unamortized net difference between the Company's carrying amount of its investment in VALTIMET and its proportionate share of VALTIMET's net assets was approximately $4.8 million, and is principally attributable to the difference between the carrying amount and fair value of fixed assets initially contributed by TIMET. This difference is being amortized over 15 years and reduces the amount of equity in earnings or increases the amount of equity in losses that the Company reports related to its investment in VALTIMET. The consolidated financial statements of

VALTIMET reflected the following summarized financial information: Year ended December 31, ---------- 2002 2001 2000 ---------- ---------- ---------- (In thousands) Net sales $ 90,318 $ 80,800 $ 67,970 Gross margin $ 18,911 $ 19,017 $ 12,908 Net income (loss) $ 4,523 $ 4,251 $ (238) F-16 December 31, ---------- 2002 2001 ---------- ---------- (In thousands) Current assets $ 52,021 $ 46,537 Noncurrent assets $ 19,730 $ 15,409 Current liabilities $ 25,972 $ 21,687 Noncurrent liabilities $ 3,004 $ 2,616 Minority interest $ 2,235 $ 2,096 In 1998, the Company completed a series of strategic transactions with Wyman-Gordon Company ("Wyman-Gordon") in which (i) the Company exchanged certain of its titanium castings assets and $5 million in cash for Wyman-Gordon's Millbury, Massachusetts vacuum arc re-melting equipment, which produced titanium ingot, (ii) Wyman-Gordon and the Company combined their respective titanium castings businesses into a new joint venture, Wyman-Gordon Titanium Castings LLC, 80% owned by Wyman-Gordon and 20% by the Company and (iii) the Company and Wyman-Gordon entered into a contract pursuant to which the Company expects to be the principal supplier of titanium material to Wyman-Gordon through 2007. The Company accounted for the castings business/melting facility transaction at fair value, which approximated the $18 million net carrying value of the assets exchanged, and, accordingly, recognized no gain on the transaction. The Company accounted for its interest in the castings joint venture by the equity method. Early in 2000, the Company sold its interest in the castings joint venture to Wyman-Gordon for approximately $7 million and recorded a pre-tax gain of approximately $1.2 million. Other joint ventures in 2002 and 2001 consist primarily of investments in outside providers of certain testing services. Note 5 - Preferred securities of Special Metals Corporation In 1998, the Company purchased $80 million in non-voting convertible preferred securities of SMC, a U.S. manufacturer of wrought nickel-based superalloys and special alloy long products. The convertible preferred securities accrue dividends at the annual rate of 6.625%, are mandatorily redeemable in April 2006 and are convertible into SMC common stock at $16.50 per share. SMC's common stock is traded on the NASDAQ under the symbol "SMCXQ.OB" and had a quoted market price on December 31, 2002 of $0.07 per share. From October 1998 through December 1999, SMC deferred payment of dividends on the preferred securities. In April 2000, SMC resumed dividend payments on the securities; however, dividends and interest in arrears due the Company were not paid. On October 11, 2001, SMC notified the Company of its intention to again defer dividend payments effective with the dividend due on October 28, 2001, and the Company believes such dividends are likely to be deferred indefinitely. Subsequently, on March 27, 2002, SMC and its U.S. subsidiaries filed a voluntary petition for reorganization under Chapter 11 of the U.S. Bankruptcy Code. F-17 Because of various factors affecting SMC subsequent to the terrorist attacks of September 11, 2001, the Company undertook an assessment of its investment in the SMC securities in the fourth quarter of 2001 with the assistance of an external valuation specialist. The SMC convertible preferred securities are not publicly traded and, accordingly, quoted market prices are unavailable. As such, the assessment of fair value of these securities required significant judgment and considered a number of factors, including, but not limited to, the financial health and prospects of SMC and market yields of comparable securities. The assessment indicated that it was unlikely the Company would recover its then existing carrying amount, including accrued dividends and interest, of the securities in accordance with the securities' contractual terms and that an other than temporary decline in the fair value of its investment had occurred. The Company recorded a $61.5 million pre-tax impairment charge in the fourth quarter of 2001 to reduce the carrying amount of this investment, including accrued dividends and interest, to an estimated fair value of $27.5 million. At that time the Company also ceased accruing for any additional dividends due on these securities. As a result of the SMC bankruptcy filing in March 2002, the Company undertook a further assessment of its investment in SMC, again with the assistance of the same external valuation specialist, and recorded an additional $27.5 million impairment charge during the first quarter of 2002 for an other than temporary decline in the estimated fair value of its investment in SMC. This charge reduced the Company's carrying amount of its investment in the SMC securities to zero. As of December 31, 2002, unrecorded dividends and interest due the Company approximated $15.8 million. The ultimate amount, if any, which the Company may realize from its investment in the SMC securities is unknown due to the uncertainties associated with SMC's bankruptcy proceedings; however, the Company believes it is unlikely that it will recover any amount from this investment. Note 6 - Property and equipment December 31, ---------- 2002 2001 ---------- ---------- (In thousands) Land $ 6,224 $ 6,138 Buildings 38,874 36,574 Information technology systems 58,217 55,112 Manufacturing and other 312,163 300,315 Construction in progress 3,493 11,631 ---------- ---------- 418,971 409,770 Less accumulated depreciation 164,299 134,462 ---------- ---------- $ 254,672 $ 275,308 ==========

========== In 2001, the Company recorded a $10.8 million charge to cost of sales for the impairment of the melting equipment acquired from Wyman-Gordon in 1998. The Company completed studies of the potential uses of this equipment in the foreseeable future as well as the economic viability of those alternatives, resulting in the determination that the equipment's undiscounted future cash flows could no longer support its carrying value. The loss on impairment represented the difference between the equipment's estimated fair value, as determined through a third-party appraisal, and its previous carrying amount. In 2000, the Company recorded a $3.5 million charge to cost of sales for the impairment of certain other equipment. F-18 Note 7 - Goodwill and intangible assets The Company's goodwill, arising from several previous business combinations accounted for under the purchase method, was stated net of accumulated amortization recognized through December 31, 2001. On January 1, 2002, the Company adopted SFAS No. 142, Goodwill and Other Intangible Assets. Under SFAS No. 142, goodwill is no longer amortized on a periodic basis, but instead is subject to a two-step impairment test to be performed on at least an annual basis. In order to test for transitional impairment, SFAS No. 142 required the Company to identify its reporting units and determine the carrying amount of each reporting unit by assigning its assets and liabilities, including existing goodwill and intangible assets, to those reporting units as of January 1, 2002. The Company determined that it operates one reporting unit, as that term is defined by SFAS No. 142, consisting of the Company in total. The first step of the impairment test required the Company to determine the fair value of its reporting unit and compare it to that reporting unit's carrying amount. This evaluation was completed with the assistance of an external valuation specialist and considered a combination of fair value indicators including quoted market prices, prices of comparable businesses and discounted cash flows. The evaluation, which was completed during the second quarter of 2002, indicated that the Company's recorded goodwill might be impaired and required the Company to complete the second step of the impairment test. The second step of the impairment test, which was completed during the third quarter of 2002, required the Company to compare the implied fair value of its reporting unit's goodwill with the carrying amount of that goodwill. With the assistance of the external valuation specialist utilized in the step one testing, the Company determined the implied fair value of its goodwill was zero. Accordingly, the Company recorded a non-cash goodwill impairment charge of $44.3 million, representing the entire balance of the Company's recorded goodwill at January 1, 2002. No income tax benefit associated with this charge was recognized. While the goodwill associated with the Company's U.S. operations is deductible for income tax purposes, the Company does not currently recognize an income tax benefit associated with its U.S. losses. In addition the goodwill associated with the Company's European operations is not deductible for income tax purposes. Pursuant to the transition requirements of SFAS No. 142, this charge has been reported in the Company's Consolidated Statements of Operations as a cumulative effect of a change in accounting principle as of January 1, 2002. F-19 The following table reflects what the Company's reported consolidated net loss before the cumulative effect of the change in accounting principle would have been in 2001 and 2000 had the goodwill amortization included in the Company's reported consolidated net loss not been recognized: Year ended December 31, ---------- 2002 2001 2000 ---------- ---------- ---------- (In thousands, except per share data) Net loss before cumulative effect of change in accounting principle, as reported $ (67,220) $ (41,766) $ (38,902) Adjustments for: Goodwill amortization - 4,604 4,775 Tax provision on amortization - - (1,229) ---------- ---------- ---------- Adjusted net loss before cumulative effect of change in accounting principle (67,220) (37,162) (35,356) Cumulative effect of change in accounting principle (44,310) - - ---------- ---------- ---------- Adjusted net loss $ (111,530) $ (37,162) $ (35,356) ========== ========== ========== Net loss per basic and diluted share before cumulative effect of change in accounting principle, as reported $ (21.27) $ (13.26) $ (12.40) Adjustments for: Goodwill amortization - 1.46 1.52 Tax provision on amortization - - (.39) ---------- ---------- ---------- Adjusted net loss per basic and diluted share before cumulative effect of change in accounting principle (21.27) (11.80) (11.27) Cumulative effect of change in accounting principle (14.02) - - ---------- ---------- ---------- Adjusted net loss per basic and diluted share $ (35.29) $ (11.80) $ (11.27) ========== ========== ========== F-20 As required by SFAS No. 142, the Company has evaluated the remaining useful lives of its intangible assets with definite lives, comprised of patents and covenants not to compete. Based on this evaluation, the Company's patents will continue to be amortized over their weighted average remaining amortization periods of just over three years as of December 31, 2002. The Company's covenants not to compete will become fully amortized during the first half of 2003. The carrying amount and accumulated amortization of the Company's intangible assets are as follows: December 31, 2002 December 31, 2001 ----------

---------- Carrying Accumulated Carrying Accumulated Amount Amortization Amount Amortization ---------- ---------- ---------- ---------- (In thousands) Intangible assets: Definite lives, subject to amortization: Patents $ 13,903 $ 9,375 $ 13,405 $ 7,606 Covenants not to compete 3,967 3,769 8,353 7,514 Other intangible asset - pension asset (1) 3,716 - 3,198 - ---------- ---------- ---------- ---------- $ 21,586 $ 13,144 $ 24,956 $ 15,120 ========== ========== ========== ========== (1) Not covered by the scope of SFAS No. 142. The Company's amortization expense relating to its intangible assets was $2.1 million in 2002, $2.8 million in 2001 and $3.1 million in 2000. The estimated aggregate annual amortization expense for the Company's patents and covenants not to compete for the next five fiscal years is summarized in the table below: Estimated Annual Amortization Expense ---------- (In thousands) Year ending December 31, 2003 $1,655 2004 $1,456 2005 $ 937 2006 $ 678 2007 $ - Note 8 - Other noncurrent assets December 31, ---------- 2002 2001 ---------- ---------- (In thousands) Deferred financing costs $ 8,244 $ 8,212 Notes receivable from officers 163 163 Prepaid pension cost 7,295 4,006 Other 149 720 ---------- ---------- $ 15,851 $ 13,101 ========== ========== F-21 Note 9 - Accrued liabilities December 31, ---------- 2002 2001 ---------- ---------- (In thousands) OPEB cost $ 3,818 $ 2,969 Pension cost 7,969 555 Incentive compensation 1,326 6,077 Severance benefits 1,195 - Other employee benefits 15,953 14,616 Deferred income 1,679 325 Environmental costs 803 654 Accrued tungsten costs 2,190 2,743 Taxes, other than income 3,519 4,867 Dividends on Convertible Preferred Securities (Note 12) - 1,111 Other 8,059 7,882 ---------- ---------- $ 46,511 $ 41,799 ========== ========== During the third quarter of 2002, the Company implemented a program to reduce global employment levels by approximately 300 employees or approximately 13% of the workforce. Severance costs aggregating $2.4 million were recorded during the third and fourth quarter of 2002 for actual and probable terminations based upon benefit agreements and/or arrangements applicable to the affected salaried and hourly positions. Depending upon the terminated employees' years of service and payroll classification, severance benefits could include continuation of pay as well as continuation of certain health and life insurance benefits. During the fourth quarter of 2002 the Company made payments of $1.2 million to terminated employees, and as of December 31, 2002, severance benefits of $1.2 million remain accrued and are expected to be paid during 2003. In April 2001, the Company reached a settlement of the litigation between TIMET and The Boeing Company ("Boeing") related to the parties' long-term agreement ("LTA") entered into in 1997. Under the terms of the LTA, as amended, Boeing is required to purchase from the Company a buffer inventory of titanium products for use by the Company in the production of titanium products ordered by Boeing in the future. As the buffer inventory is completed, Boeing is billed and takes title to the inventory, although the Company may retain an obligation to further process the material as directed by Boeing. Accordingly, the revenue and costs of sales on the buffer inventory is deferred and subsequently recognized at the time the final product is delivered to Boeing. As of December 31, 2002, approximately $1.6 million of deferred revenue related to the Boeing buffer inventory. In 1999, the Company had customer orders for approximately $16 million of titanium ingot for which the customer had not yet determined the final mill product specifications. At the customer's request, the Company manufactured the ingots and stored the material at the Company's facilities. As agreed with the customer, the customer was billed for and took title to the ingots in 1999; however, the Company retained an obligation to convert the ingots into mill products in the future. Accordingly, the revenue (and related cost of sales) on this product was deferred and subsequently recognized during 2002, 2001 and 2000 in the amounts of $0.1 million, $2.5 million and $13.4 million, respectively. F-22 Note 10 - Boeing advance Under the terms of the amended Boeing LTA, in years 2002 through 2007, Boeing is required to advance TIMET $28.5 million annually less $3.80 per pound of titanium product purchased by Boeing subcontractors during the preceding year. Effectively, the Company collects $3.80 less from Boeing than the LTA selling price for each pound of titanium product sold directly to Boeing and reduces the related customer advance recorded by the Company. For titanium products sold to Boeing subcontractors, the Company collects the full LTA selling price, but gives Boeing credit by reducing the next year's annual advance by $3.80 per pound of titanium product sold to Boeing subcontractors. The Boeing customer advance is also reduced as take-or-pay benefits are earned, as described in Note 14. As of December 31, 2002, approximately $0.8 million of customer advances related to the Company's LTA with Boeing and represented amounts to be credited against the 2003 advance for 2002 subcontractor purchases. Note 11 - Notes payable, long-term debt and capital lease obligations December 31, ---------- 2002 2001 ---------- ---------- (In thousands) Notes payable: U.S. credit agreement $ 11,944 $ 30 European credit agreements 1,050 1,492 ---------- ---------- $ 12,994 $ 1,522

========== ========== Long-term debt: Bank credit agreement - U.K. $ 6,401 $ 10,712 Other - 172 ---------- ---------- 6,401 10,884 Less current maturities - 172 ---------- ---------- $ 6,401 $ 10,712 ========== ========== Capital lease obligations $ 10,217 $ 8,938 Less current maturities 642 340 ---------- ---------- $ 9,575 $ 8,598 ========== ========== F-23 Long-term bank credit agreements. On October 23, 2002, the Company amended its existing U.S. asset-based revolving credit agreement, extending the maturity date to February 2006. Under the terms of the amendment, borrowings are limited to the lesser of $105 million or a formula-determined borrowing base derived from the value of accounts receivable, inventory and equipment ("borrowing availability"). This facility requires the Company's U.S. daily cash receipts to be used to reduce outstanding borrowings, which may then be reborrowed, subject to the terms of the agreement. Interest generally accrues at rates that vary from LIBOR plus 2% to LIBOR plus 2.5%. Borrowings are collateralized by substantially all of the Company's U.S. assets. The credit agreement prohibits the payment of dividends on TIMET's Convertible Preferred Securities if "excess availability," as defined, is less than $25 million, limits additional indebtedness, prohibits the payment of dividends on the Company's common stock if excess availability is less than $40 million, requires compliance with certain financial covenants and contains other covenants customary in lending transactions of this type. The Company was in compliance in all material respects with all covenants for all periods during the years ended December 31, 2002 and 2001. Excess availability is essentially unused borrowing availability and is defined as borrowing availability less outstanding borrowings and certain contractual commitments such as letters of credit. As of December 31, 2002 excess availability was approximately $85 million. The weighted average interest rate on borrowings outstanding under these credit agreements was 3.7% and 5.3% as of December 31, 2002 and 2001, respectively. The Company's U.S. credit agreement allows the lender to modify the borrowing base formulas at its discretion, subject to certain conditions. During the second quarter of 2002, the Company's lender elected to exercise such discretion and modified the Company's borrowing base formulas, which reduced the amount that the Company could have borrowed against its inventory and equipment by approximately $7 million. In the event the lender exercises such discretion in the future, such event could have a material adverse impact on the Company's liquidity. Borrowings outstanding under this U.S. facility are classified as a current liability. The Company's subsidiary, TIMET UK, has a credit agreement that provides for borrowings limited to the lesser of (pound)22.5 million or a formula-determined borrowing base derived from the value of accounts receivable, inventory and equipment ("borrowing availability"). The credit agreement includes a revolving and term loan facility and an overdraft facility (the "U.K. facilities"). On December 20, 2002, the Company renewed and amended its existing U.K. facilities, extending the maturity date to December 20, 2005 and reducing the maximum borrowing base from (pound)30.0 million to (pound)22.5 million to more appropriately match TIMET UK's collateral base. Borrowings under the U.K. facilities can be in various currencies including U.S. dollars, British pounds sterling and euros; accrue interest at rates that vary from LIBOR plus 1% to LIBOR plus 1.25%; and are collateralized by substantially all of TIMET UK's assets. The U.K. facilities require the maintenance of certain financial ratios and amounts and other covenants customary in lending transactions of this type. TIMET UK was in compliance in all material respects with all covenants for all periods during the years ended December 31, 2002 and 2001. The U.K. overdraft facility is subject to annual review in December of each year. In the event the overdraft facility is not renewed, the Company believes it could refinance any outstanding overdraft borrowings under either the revolving or term loan features of the U.K. facilities. Unused borrowing availability as of December 31, 2002 under the U.K. facilities was approximately $30 million. The weighted average interest rate on borrowings outstanding under these credit agreements was 4.6% and 3.6% as of December 31, 2002 and 2001, respectively. F-24 The Company also has overdraft and other credit facilities at certain of its other European subsidiaries. These facilities accrue interest at various rates and are payable on demand. Unused borrowing availability as of December 31, 2002 under these facilities was approximately $16 million. The weighted average interest rate on borrowings outstanding under these credit agreements was 3.7% and 3.5% as of December 31, 2002 and 2001, respectively. Capital lease obligations. Certain of the Company's U.K. production facilities are under thirty year leases expiring in 2026. The rents under the U.K. leases are subject to adjustment every five years based on changes in certain published price indices. TIMET has guaranteed TIMET UK's obligations under its leases. The Company's 70%-owned French subsidiary, TIMET Savoie, S.A. ("TIMET Savoie"), leases certain machinery and equipment from Compagnie Europeenne du Zirconium-CEZUS, S.A. ("CEZUS"), the 30% minority shareholder, under a ten year agreement expiring in 2006. Certain of the Company's U.S. equipment is under three year leases expiring at various times during

2003, 2004 and 2005. Assets held under capital leases included in buildings were $9.4 million and $8.5 million, and assets included in equipment were $2.6 million and $1.5 million at December 31, 2002 and 2001, respectively. The related aggregate accumulated depreciation was $3.5 million and $2.4 million at December 31, 2002 and 2001, respectively. Aggregate maturities of long-term debt and capital lease obligations are reflected in the following table: Capital Long-term Leases Debt ---------- ---------- (In thousands) Year ending December 31, 2003 $ 1,570 $ - 2004 1,496 - 2005 1,095 6,401 2006 1,043 - 2007 979 - 2008 and thereafter 17,278 - ---------- ---------- 23,461 6,401 Less amounts representing interest 13,244 - ---------- ---------- $ 10,217 $ 6,401 ========== ========== F-25 Note 12 - Minority interest Convertible Preferred Securities. In November 1996, TIMET Capital Trust I (the "Trust"), a wholly-owned subsidiary of TIMET, issued $201 million of 6.625% Company-obligated mandatorily redeemable convertible preferred securities and $6 million of common securities. TIMET holds all of the outstanding common securities of the Trust. The Trust used the proceeds from such issuance to purchase from the Company $207 million principal amount of TIMET's 6.625% convertible junior subordinated debentures due 2026 (the "Subordinated Debentures"). TIMET's guarantee of payment of the Convertible Preferred Securities (in accordance with the terms thereof) and its obligations under the Trust documents constitute, in the aggregate, a full and unconditional guarantee by the Company of the Trust's obligations under the Convertible Preferred Securities. The sole assets of the Trust are the Subordinated Debentures. The Convertible Preferred Securities represent undivided beneficial ownership interests in the Trust, are entitled to cumulative preferred distributions from the Trust of 6.625% per annum, compounded quarterly, and are convertible, at the option of the holder, into TIMET common stock at the rate of 0.1339 shares of common stock per Convertible Preferred Security (an equivalent price of $373.40 per share), for an aggregate of approximately 0.5 million common shares if fully converted. Based on limited trading data, the fair value of the Convertible Preferred Securities was approximately $56.6 million at December 31, 2002. The Convertible Preferred Securities mature December 2026, do not require principal amortization and are redeemable at the Company's option. The redemption price approximates 103% of the principal amount as of December 1, 2002 and declines annually to 100% on December 1, 2006. The Company's U.S. credit agreement prohibits the payment of dividends on these securities if excess availability, as determined under the agreement, is less than $25 million. The Convertible Preferred Securities allow the Company the right to defer dividend payments for a period of up to 20 consecutive quarters, although interest continues to accrue at the coupon rate on the principal and unpaid dividends. In April 2000, the Company exercised its right to defer future dividend payments on these securities. On June 1, 2001, the Company resumed payment of dividends on these securities, made the scheduled payment of $3.3 million and paid the previously deferred aggregate dividends of $13.9 million. In October 2002, the Company again exercised its right to defer future dividend payments on these securities, effective beginning with the Company's December 1, 2002 scheduled dividend payment. The Company will consider resuming payment of dividends on the Convertible Preferred Securities once the outlook for the Company's business improves substantially. Based on the deferral, accrued dividends on the Convertible Preferred Securities are reflected as long-term liabilities in the Consolidated Balance Sheet at December 31, 2002. Dividends on the Convertible Preferred Securities are reported in the Consolidated Statements of Operations as minority interest, which is recorded net of allocable income tax benefits in 2000. Since the Company exercised its right to defer dividend payments, it is unable under the terms of these securities to, among other things, pay dividends on or reacquire its capital stock during the deferral period. However, the Company is permitted to reacquire the Convertible Preferred Securities during the deferral period provided the Company has satisfied certain conditions under its U.S. credit facility, including maintenance of the Company's excess availability above $25 million before and after such reacquisition. F-26 Other. Other minority interest relates principally to the Company's 70%-owned French subsidiary, TIMET Savoie. The Company has the right to purchase from CEZUS, the holder of the remaining 30% interest, CEZUS' interest in TIMET Savoie for 30% of TIMET Savoie's equity determined under French accounting principles, or approximately $10.5 million as of December 31, 2002. CEZUS has the right to require the Company to purchase its interest in TIMET Savoie for 30% of TIMET Savoie's registered capital, or approximately $2.6 million as of December 31, 2002. During the second quarter of 2002, TIMET Savoie made a dividend payment of $1.1 million to CEZUS. Note 13 - Stockholders' equity Preferred stock. At December 31, 2002, the Company was authorized to issue one million shares of preferred stock. In conjunction with the previously discussed one-for-ten reverse stock split, the Company's Board of Directors (based upon prior shareholder approval) also reduced the number of preferred shares authorized for issuance to 100,000 shares. The Board of Directors determines the rights of preferred stock as to, among other things,

dividends, liquidation, redemption, conversions and voting rights. Common stock. At December 31, 2002, the Company was authorized to issue 99 million shares of common stock. In conjunction with the previously discussed one-for-ten reverse stock split of its common stock, the Company's Board of Directors (based upon prior shareholder approval) also reduced the number of common shares authorized for issuance to 9.9 million shares. The Company's U.S. credit agreement, as amended, limits the payment of common stock dividends. See Note 11. Restricted stock and common stock options. The Company's 1996 Long-Term Performance Incentive Plan (the "Incentive Plan") provides for the discretionary grant of restricted common stock, stock options, stock appreciation rights and other incentive compensation to officers and other key employees of the Company. Options generally vest over five years and expire ten years from date of grant. During 2000, the Company awarded 46,750 shares of TIMET restricted common stock under the Incentive Plan to certain officers and employees. No shares were awarded during 2001 or 2002. The restrictions on the stock grants lapse ratably on an annual basis over a five-year period. Since holders of restricted stock have all of the rights of other common stockholders, subject to forfeiture unless certain periods of employment are completed, all such shares of restricted stock are considered to be currently issued and outstanding. During 2002 and 2001, 6,560 and 3,370 shares of restricted stock were forfeited, respectively. The market value of the restricted stock awards was approximately $2.0 million on the date of grant ($43.75 per share), and this amount has been recorded as deferred compensation, a separate component of stockholders' equity. The Company amortizes deferred compensation to expense on a straight-line basis for each tranche of the award over the period during which the restrictions lapse. Compensation expense recognized by the Company related to restricted stock awards was $0.2 million in 2002, $0.5 million in 2001 and $0.7 million in 2000. Additionally, a separate plan (the "Director Plan") provides for annual grants to eligible non-employee directors of options to purchase 500 shares of the Company's common stock at a price equal to the market price on the date of grant and to receive, as partial payment of director fees, annual grants of 100 shares of common stock (50 shares prior to 2001). Options granted to eligible directors vest in one year and expire ten years from date of grant (five year expiration for grants prior to 1998). F-27 The weighted average remaining life of options outstanding at December 31, 2002 was 4.8 years (2001 - 6.1 years). At December 31, 2002, 2001 and 2000, options to purchase 105,386, 89,594 and 66,175 shares, respectively, were exercisable at average exercise prices of $217.74, $237.79 and $257.54, respectively. Options to purchase 18,300 shares become exercisable in 2003. In February 2001, the Director Plan was amended to authorize an additional 20,000 shares for future grants under such plan. At December 31, 2002, 128,679 shares and 16,475 shares were available for future grant under the Incentive Plan and the Director Plan, respectively. The following table summarizes information about the Company's stock options: Amount payable Weighted Weighted Exercise upon average average fair price per exercise exercise value at Options option (thousands) price grant date ---------- ---------- ---------- ---------- ---------- Outstanding at December 31, 1999 173,820 $ 73.80-353.10 $ 37,059 $ 213.20 Granted: At market 2,500 39.40 98 39.40 $ 19.90 Above market 25,000 70.00-110.00 2,150 86.00 15.30 Canceled (36,170) 79.70-353.10 (7,285) 201.40 ---------- ---------- ---------- ---------- Outstanding at December 31, 2000 165,150 39.40-353.10 32,022 193.90 Granted: At market 3,000 36.00-142.10 362 120.70 $ 81.10 Canceled (12,840) 79.70-353.10 (2,427) 163.50 ---------- ---------- ---------- ---------- Outstanding at December 31, 2001 155,310 36.00-353.10 29,957 195.40 Granted: At market 3,000 16.60-38.60 105 34.90 $ 23.00 Canceled (18,568) 79.70-353.10 (3,385) 182.30 ---------- ---------- ---------- ---------- Outstanding at December 31, 2002 139,742 $ 16.60-353.10 $ 26,677 $ 190.90 ========== ========== ========== ========== F-28 The following table summarizes the Company's options outstanding and exercisable as of December 31, 2002 by price range: Options Outstanding Options Exercisable ---------- ---------- Weighted average remaining Weighted Weighted Range of Outstanding at contractual average Exercisable average exercise prices 12/31/02 life exercise price at 12/31/02 exercise price ---------- ---------- ---------- ---------- ---------- $ 16.60-35.30 500 10.0 $ 16.60 - $ - 35.31-70.62 13,500 7.6 61.79 5,000 63.54 70.63-105.93 44,176 5.8 85.71 26,096 85.16 105.94-141.25 5,000 7.1 110.00 2,000 110.00 141.26-176.56 1,500 8.4 142.10 1,500 142.10 211.88-247.18 15,260 3.0 230.00 15,260 230.00 247.19-282.50 17,116 3.3 274.64 17,116 274.64 282.51-317.81 30,810 3.9 293.77 27,854 293.84 317.82-353.10 11,880 3.4 338.76 10,560 338.84 ---------- ---------- ---------- ---------- ---------- 139,742 4.8 $ 190.90 105,386 $ 217.74 ========== ========== ========== ========== ========== Weighted average fair values of options at grant date were estimated using the Black-Scholes model and assumptions listed below: 2002 2001 2000 ---------- ---------- ---------- Assumptions at date of grant: Expected life

(years) 6 7 6 Risk-free interest rate 2.01% 3.44% 4.95% Volatility 74% 68% 45% Dividend yield 0% 0% 0% F-29 Note 14 - Other income (expense) Year ended December 31, ---------- 2002 2001 2000 ---------- ---------- ---------- (In thousands) Other operating income (expense): Boeing settlement, net $ - $ 73,000 (1) $ - Boeing take-or-pay income 23,408 - - Gain on termination of UTSC agreement - - 2,000 Other income (expense) (126) 640 156 ---------- ---------- ---------- $ 23,282 $ 73,640 $ 2,156 ========== ========== ========== Other non-operating income (expense): Dividends and interest income $ 118 $ 5,460 $ 6,154 Surety bond guarantee (1,575) - - Impairment of investment in SMC (27,500) (61,519) - Gain on sale of castings joint venture - - 1,205 Loss on early extinguishment of debt - - (1,343) Foreign exchange gain (loss) (587) 92 (1,085) Other income (expense) (761) 18 (53) ---------- ---------- ---------- $ (30,305) $ (55,949) $ 4,878 ========== ========== ========== (1) The Boeing settlement includes cash received from Boeing at settlement of $82.0 million less legal fees of $9.0 million. Additionally, $6.2 million in related employee incentive compensation was recorded as a component of selling, general administrative and development expense. The terms of the amended Boeing LTA allow Boeing to purchase up to 7.5 million pounds of titanium product annually from TIMET through 2007, but limit TIMET's maximum quarterly volume obligation to 3.0 million pounds. The LTA is structured as a take-or-pay agreement such that, beginning in calendar year 2002, Boeing forfeits $3.80 per pound of its advance payment in the event that its orders for delivery are less than 7.5 million pounds in any given calendar year. The Company recognizes income to the extent Boeing's year-to-date orders for delivery plus TIMET's maximum quarterly volume obligations for the remainder of the year total less than 7.5 million pounds. This income is recognized as other operating income and is not included in sales revenue, sales volume or gross margin. Based on actual purchases of approximately 1.3 million pounds during 2002, the Company recognized $23.4 million of income for the year ended December 31, 2002 related to the take-or-pay provisions for 6.2 million pounds that Boeing did not purchase under the LTA during 2002. Recognition of the take-or-pay income reduces the Boeing customer advance as described in Note 10. F-30 Note 15 - Restructuring charges In 2000 and 1999, the Company implemented restructuring plans designed to address then-current market and operating conditions. The 2000 plan included the termination of approximately 170 people, primarily in the Company's manufacturing operations. The 1999 plan included the disposition of one plant and termination of an aggregate of 100 people. The components of the 2000 and 1999 restructuring plan charges are summarized in the following table: 2000 Plan 1999 Plan ---------- ---------- (In millions) Titanium Melted and Mill Products Segment: Property and equipment $ 0.3 $ 0.3 Disposition of German subsidiary 0.1 2.0 Pension and OPEB costs, net - (0.1) Personnel severance and benefits 2.6 2.5 ---------- ---------- $ 3.0 $ 4.7 ========== ========== Substantially all of the property and equipment charges relate to items sold, scrapped or abandoned. Depreciation of equipment temporarily idled but not impaired was not suspended. The disposition of the German subsidiary was completed in the second quarter of 2000. The pension and OPEB costs relate to actuarial valuations of accelerated defined benefits for employees terminated and curtailment of pension and OPEB liabilities. During each of 2001, 2000 and 1999, the Company recorded income of $0.2 million related to revisions to estimates of previously established restructuring accruals. The 1999 credit was related to the Company's previously-operated "Other" segment. Total net restructuring charges recognized in the Company's results of operations for 2000 and 1999 were $2.8 million and $4.5 million, respectively. Payments applied against the accrued costs related to the 2000 plan were $0.1 million and $0.5 million during 2002 and 2001, respectively. There was no remaining balance related to the 2000 plan as of December 31, 2002. Payments applied against the accrued costs related to the 1999 plan were zero and $0.1 million during 2002 and 2001, respectively. As of December 31, 2002, the remaining balance of accrued restructuring costs related to the 1999 plan was $0.1 million related to personnel severance and benefits for terminated employees. The Company expects to pay the remaining balance of the accrued costs under the 1999 restructuring plan during 2003. F-31 Note 16 - Income taxes Summarized in the following table are (i) the components of income (loss) before income taxes and minority interest ("pre-tax income (loss)"), (ii) the difference between the income tax expense (benefit) attributable to pre-tax income (loss) and the amounts that would be expected using the U.S. federal statutory income tax rate of 35%, (iii) the components of the income tax expense (benefit) attributable to pre-tax income (loss) and (iv) the components of the comprehensive tax provision (benefit): Year ended December 31, ---------- 2002 2001 2000 ---------- ---------- ---------- (In thousands) Pre-tax income (loss): U.S. $ (51,354) $ (6,719) $ (44,173) Non-U.S. (3,181) 11,190 (303) ---------- ---------- ---------- $ (54,535) $ 4,471 $ (44,476) ========== ========== ========== Expected income tax expense (benefit), at 35% $

(19,087) $ 1,565 $ (15,567) Non-U.S. tax rates 950 521 1,121 U.S. state income taxes, net (1,650) 307 8 Dividends received deduction (241) (1,110) (1,367) Extraterritorial income exclusion (373) (462) - Change in valuation allowance: Effect of change in tax law (1,797) - - Adjustment of deferred tax valuation allowance 20,022 30,102 49 Other, net 224 189 189 ---------- ---------- ---------- $ (1,952) $ 31,112 $ (15,567) ========== ========== ========== Income tax expense (benefit): Current income taxes (benefit): U.S. $ (1,688) $ 787 $ (548) Non-U.S. 3,430 3,503 2,696 ---------- ---------- ---------- 1,742 4,290 2,148 ---------- ---------- ---------- Deferred income taxes (benefit): U.S. - 26,061 (16,082) Non-U.S. (3,694) 761 (1,633) (3,694) 26,822 (17,715) ---------- ---------- ---------- $ (1,952) $ 31,112 $ (15,567) ========== ========== ========== Comprehensive tax provision (benefit) allocable to: Pre-tax income (loss) $ (1,952) $ 31,112 $ (15,567) Minority interest - Convertible Preferred Securities - - (4,675) Stockholders' equity, including amounts allocated to other comprehensive income (1,588) (4,834) (1,057) ---------- ---------- ---------- $ (3,540) $ 26,278 $ (21,299) ========== ========== ========== F-32 The following table summarizes the Company's deferred tax assets and deferred tax liabilities as of December 31, 2002 and 2001: December 31, ---------- 2002 2001 ---------- ---------- Assets Liabilities Assets Liabilities ---------- ---------- ---------- ---------- (In millions) Temporary differences relating to net assets: Inventories $ 0.3 $ - $ 0.3 $ (6.6) Property and equipment, including software - (39.6) - (25.0) Goodwill 10.0 - - (0.6) Accrued OPEB cost 6.2 - 9.0 - Accrued liabilities and other deductible differences 58.9 - 33.1 - Other taxable differences - (3.0) - (9.5) Tax loss and credit carryforwards 51.0 - 31.5 - Valuation allowance (84.0) - (37.4) - ---------- ---------- ---------- ---------- Gross deferred tax assets (liabilities) 42.4 (42.6) 36.5 (41.7) Netting (41.6) 41.6 (36.1) 36.1 ---------- ---------- ---------- ---------- Total deferred taxes 0.8 (1.0) 0.4 (5.6) Less current deferred taxes 0.8 - 0.4 (0.1) ---------- ---------- ---------- ---------- Net noncurrent deferred taxes $ - $ (1.0) $ - $ (5.5) ========== ========== ========== ========== Based on the Company's recent history of U.S. losses, its near-term outlook and management's evaluation of available tax planning strategies, in the fourth quarter of 2001 the Company concluded that realization of its previously recorded U.S. deferred tax assets did not continue to meet the "more-likely-than-not" recognition criteria. Accordingly, during 2001 the Company increased its U.S. deferred tax valuation allowance by $35.5 million to offset deferred tax benefits related to net U.S. deferred tax assets, primarily net operating loss and minimum tax credit carryforwards. Additionally, the Company determined that it would not recognize a deferred tax benefit related to future U.S. losses continuing for an uncertain period of time. The Company increased its U.S. deferred tax valuation allowance by $39.4 million in 2002 based upon additional U.S. losses and increases to the U.S. minimum pension liability. During the fourth quarter of 2002, the Company was required to record a charge to other comprehensive loss to reflect an increase in its U.K. minimum pension liability. The related tax effect of this charge resulted in the Company changing from a net deferred tax liability position to a net deferred tax asset position. Based on the Company's recent history of U.K. losses, its near-term outlook and management's evaluation of available tax planning strategies, the Company determined that it would not recognize this deferred tax asset because it did not meet the "more-likely-than-not" recognition criteria. Accordingly, the Company recorded a U.K. deferred tax asset valuation allowance of $7.2 million through other comprehensive income in the fourth quarter to offset the related U.K. deferred tax asset that arose due to the increase in U.K. minimum pension liabilities. Commencing in the first quarter of 2003 and continuing for an uncertain period of time, the Company will not recognize deferred tax benefits related to either future U.K. losses or future increases in U.K. minimum pension liabilities. F-33 The following table summarizes the components of the change in the Company's deferred tax asset valuation allowance in 2002, 2001 and 2000: Year ended December 31, ---------- 2002 2001 2000 ---------- ---------- ---------- (In thousands) Income (loss) before income taxes $ 18,225 $ 30,102 $ 49 Minority interest - Convertible Preferred Securities 4,673 4,848 - Cumulative effect of change in accounting principle 11,761 - - Accumulated other comprehensive loss 11,966 554 - ---------- ---------- ---------- $ 46,625 $ 35,504 $ 49 ========== ========== ========== During the first quarter of 2002, the Job Creation and Worker Assistance Act of 2002 (the "JCWA Act") was signed into law. The Company benefits from certain provisions of the JCWA Act, which liberalized certain net operating loss ("NOL") and alternative minimum tax ("AMT") restrictions. Prior to the law change, NOLs could be carried back two years and forward 20 years. The JCWA Act increases the carryback period for losses generated in 2001 and 2002 to five years with no change to the carryforward period. In addition, losses generated in 2001 and 2002 can be carried back and offset against 100% of a

taxpayer's alternative minimum taxable income ("AMTI"). Prior to the law change, an NOL could offset no more than 90% of a taxpayer's AMTI. The suspension of the 90% limitation is also applicable to NOLs carried forward into 2001 and 2002. Based on these changes, the Company recognized $1.8 million of refundable U.S. income taxes during the first quarter of 2002. The Company received $0.8 million of this refund in the fourth quarter of 2002. At December 31, 2002 the Company had, for U.S. federal income tax purposes, NOL carryforwards of approximately $115 million, which will expire in 2020 through 2022. At December 31, 2002, the Company had AMT credit carryforwards of approximately $4 million, which can be utilized to offset regular income taxes payable in future years. The AMT credit carryforward has an indefinite carryforward period. At December 31, 2002, the Company had the equivalent of a $19 million NOL carryforward in the United Kingdom and a $2 million NOL carryforward in Germany, both of which have indefinite carryforward periods. The German government has proposed certain changes to its income tax laws that would limit the annual utilization of NOL carryforwards. However, because the deferred tax benefit associated with the German NOL carryforward is fully offset by a deferred tax valuation allowance, the anticipated enactment of these changes is not expected to materially affect the Company's deferred income tax assets or liabilities. Note 17 - Employee benefit plans Variable compensation plans. The majority of the Company's total worldwide employees, including a significant portion of its U.S. hourly employees, participate in compensation programs providing for variable compensation based upon the financial performance of the Company and, in certain circumstances, the individual performance of the employee. The cost of these plans was $1.3 million, $7.2 million and $0.9 million in 2002, 2001 and 2000, respectively. F-34 Defined contribution plans. Approximately 38% of the Company's worldwide employees at December 31, 2002 participate in a defined contribution pension plan with employer contributions based upon a fixed percentage of the employee's eligible earnings. All of the Company's U.S. hourly and salaried employees (60% of worldwide employees at December 31, 2002) are also eligible to participate in contributory savings plans with partial matching employer contributions. For approximately 80% of these participants, the Company makes additional matching contributions based on higher levels of Company annual financial performance. The cost of these pension and savings plans approximated $2.4 million in 2002, $2.8 million in 2001 and $2.0 million in 2000. Defined benefit pension plans. The Company maintains contributory and noncontributory defined benefit pension plans covering the majority of its European employees and a minority of its U.S. workforce. Defined pension benefits are generally based on years of service and compensation, and the related expense is based upon independent actuarial valuations. The Company's funding policy for U.S. plans is to annually contribute amounts satisfying the funding requirements of the Employee Retirement Income Security Act of 1974, as amended. The Company's European defined benefit pension plans are funded in accordance with applicable statutory requirements. Between 1989 and 1995, the U.S. defined benefit pension plans were closed to new participants and have remained closed. Additionally, in some cases, benefit levels have been frozen. The U.K. defined benefit plan was closed to new participants in 1996; however, employees participating in the plan continue to earn benefits based on current compensation and service. The key rate assumptions used in determining the actuarial present value of the Company's benefit obligations at December 31, 2002 were (i) discount rates - 6.25% for the U.S. plans, 5.70% for the U.K. plan and 5.70% for the Savoie plan (7.0%, 6.0% and 6.0% at December 31, 2001), (ii) rates of increase in future compensation levels - 2.0% for the U.S. plans, 3.0% for the U.K. plan and 2.0% for the Savoie plan (3.0%, 3.0% and 2.0% at December 31, 2001) and (iii) expected long-term rates of return on assets - 8.5% for the U.S. plans, 6.7% for the U.K. plan and 6.0% for the Savoie plan (9.0%, 7.5% and 6.0% at December 31, 2001). The benefit obligations are sensitive to changes in these estimated rates, and actual results may differ from the obligations noted below. Information concerning the Company's defined benefit pension plans is set forth in the following table: F-35 Year ended December 31, ---------- 2002 2001 ---------- ---------- (In thousands) Change in projected benefit obligations: Balance at beginning of year $ 161,668 $ 153,280 Service cost 3,960 3,657 Interest cost 10,410 9,534 Plan amendments 48 - Actuarial loss 8,825 6,050 Benefits paid (9,486) (8,743) Change in currency exchange rates 11,184 (2,110) ---------- ---------- Balance at end of year $ 186,609 $ 161,668 ========== ========== Change in plan assets: Fair value at beginning of year $ 135,762 $ 149,687 Actual return on plan assets (22,436) (9,830) Employer contribution 7,357 6,267 Plan participants' contributions 716 737 Benefits paid (9,486) (8,743) Change in currency exchange rates 7,290 (2,356) Other (923) - ---------- ---------- Fair value at end of year $ 118,280 $ 135,762 ========== ========== Funded status: Plan assets under projected benefit obligations $ (68,329) $ (25,906) Unrecognized: Actuarial loss 79,382 34,407 Prior service cost 3,716 3,198 ---------- ---------- Total

prepaid pension cost $ 14,769 $ 11,699 ========== ========== Amounts recognized in balance sheets: Intangible pension asset $ 3,716 $ 3,198 Noncurrent prepaid pension cost 7,295 4,006 Current pension liability (7,969) (555) Noncurrent pension liability (61,080) (23,690) Accumulated other comprehensive loss 72,807 28,740 ---------- ---------- $ 14,769 $ 11,699 ========== ========== F-36 At December 31, 2002, the assets of the plans are primarily comprised of government obligations, corporate stocks and bonds. Selected information related to the Company's defined benefit pension plans that have accumulated benefit obligations in excess of fair value of plan assets are presented below: December 31, ---------- 2002 2001 ---------- ---------- (In thousands) Projected benefit obligation $ 186,609 $ 161,668 Accumulated benefit obligation $ 179,586 $ 156,001 Fair value of plan assets $ 118,280 $ 135,762 The components of the net periodic defined benefit pension expense are set forth below: Year ended December 31, ---------- 2002 2001 2000 ---------- ---------- ---------- (In thousands) Service cost benefits earned $ 3,410 $ 2,919 $ 3,768 Interest cost on projected benefit obligations 10,410 9,534 9,182 Expected return on plan assets (11,035) (11,737) (11,907) Net amortization 2,077 732 342 ---------- ---------- ---------- Net pension expense $ 4,862 $ 1,448 $ 1,385 ========== ========== ========== Postretirement benefits other than pensions. The Company provides certain postretirement health care and life insurance benefits on a cost-sharing basis to certain of its U.S. employees upon retirement. Health care coverage under the plans terminates once the retiree (or eligible dependent) becomes Medicare-eligible, effectively limiting coverage for most participants to less than five years. The Company funds such benefits as they are incurred, net of any contributions by the retirees. Under plans currently in effect, a majority of TIMET's active U.S. employees would become eligible for these benefits if they reach normal retirement age while working for TIMET. The components of the periodic OPEB cost and change in the accumulated OPEB obligations are set forth in the following table. The plan is unfunded and contributions to the plan during the year equal benefits paid. The key rate assumptions used in determining the actuarial present value of the accumulated OPEB obligations at December 31, 2002 were (i) discount rate - 6.25% (7.0% at December 31, 2001), (ii) rate of increase in health care costs for the following period - 11.35% (11.15% at December 31, 2001) and (iii) ultimate health care trend rate (achieved in 2010) - 4.25% (5.00% at December 31, 2001). The accrued OPEB cost is sensitive to changes in these estimated rates and actual results may differ from the obligations noted. F-37 December 31, ---------- 2002 2001 ---------- ---------- (In thousands) Actuarial present value of accumulated OPEB obligations: Balance at beginning of year $ 23,245 $ 22,757 Service cost 565 271 Interest cost 1,799 1,686 Amendments 731 - Actuarial loss 5,383 2,499 Benefits paid, net of participant contributions (4,607) (3,968) ---------- ---------- Balance at end of year 27,116 23,245 Unrecognized net actuarial loss (10,471) (5,518) Unrecognized prior service credits 590 1,222 ---------- ---------- Total accrued OPEB cost 17,235 18,949 Less current portion 3,818 2,969 ---------- ---------- Noncurrent accrued OPEB cost $ 13,417 $ 15,980 ========== ========== Year ended December 31, ---------- 2002 2001 2000 ---------- ---------- ---------- (In thousands) Service cost benefits earned $ 565 $ 271 $ 176 Interest cost on accumulated OPEB obligations 1,799 1,686 1,709 Curtailment gain - - (443) Net amortization and deferrals 529 (203) (324) ---------- ---------- ---------- Net OPEB expense $ 2,893 $ 1,754 $ 1,118 ========== ========== ========== If the health care cost trend rate were increased by one percentage point for each year, OPEB expense would have increased approximately $0.3 million in 2002, and the actuarial present value of accumulated OPEB obligations at December 31, 2002 would have increased approximately $3.0 million. A one-percentage point decrease would have a similar, but opposite, effect. F-38 Note 18 - Related party transactions During 2002, Tremont Corporation ("Tremont") purchased 26,450 shares of TIMET common stock in market transactions, and at December 31, 2002, Tremont held approximately 39.4% of TIMET's outstanding common stock. During 2002, the Combined Master Retirement Trust ("CMRT"), a trust formed by Valhi, Inc. ("Valhi") to permit the collective investment by trusts that maintain the assets of certain employee benefit plans adopted by Valhi and related companies (excluding TIMET), purchased shares of TIMET common stock in market transactions, and at December 31, 2002, the CMRT held approximately 9% of TIMET's common stock. At December 31, 2002, subsidiaries of Valhi held an aggregate of approximately 80% of Tremont's outstanding common stock. On February 7, 2003, Valhi completed a merger with Tremont whereby, in a series of transactions, Tremont was merged into Tremont LLC, a wholly-owned subsidiary of Valhi. Between January 1, 2003 and February 26, 2003, Tremont, or its successor Tremont LLC, purchased 7,400 additional shares of TIMET common stock in market

transactions. At December 31, 2002, Contran Corporation ("Contran") held, directly or through subsidiaries, approximately 93% of Valhi's outstanding common stock, which was reduced to 89% as of February 26, 2003, primarily as a result of shares issued by Valhi to transact the Tremont merger. Substantially all of Contran's outstanding voting stock is held by trusts established for the benefit of certain children and grandchildren of Harold C. Simmons, of which Mr. Simmons is sole trustee. In addition, Mr. Simmons, Chairman of the Board of Contran and Valhi, is the sole trustee of the CMRT and is a member of the trust investment committee for the CMRT. Mr. Simmons may be deemed to control each of Contran, Valhi and TIMET. Corporations that may be deemed to be controlled by or affiliated with Mr. Simmons sometimes engage in (i) intercorporate transactions such as guarantees, management and expense sharing arrangements, shared fee arrangements, joint ventures, partnerships, loans, options, advances of funds on open account, and sales, leases and exchanges of assets, including securities issued by both related and unrelated parties, and (ii) common investment and acquisition strategies, business combinations, reorganizations, recapitalizations, securities repurchases, and purchases and sales (and other acquisitions and dispositions) of subsidiaries, divisions or other business units, which transactions have involved both related and unrelated parties and have included transactions which resulted in the acquisition by one related party of a publicly-held minority equity interest in another related party. The Company continuously considers, reviews and evaluates, and understands that Contran, Valhi and related entities consider, review and evaluate such transactions. Depending upon the business, tax and other objectives then relevant, it is possible that the Company might be a party to one or more such transactions in the future. F-39 Receivables from and payables to related parties are summarized in the following table: December 31, ---------- 2002 2001 ---------- ---------- (In thousands) Receivables from related parties: Tremont $ - $ 1,281 VALTIMET 2,398 4,898 ---------- ---------- $ 2,398 $ 6,179 ========== ========== Payables to related parties: Tremont $ - $ 1,261 NL Industries, Inc. - 379 VALTIMET 1,246 925 ---------- ---------- $ 1,246 $ 2,565 ========== ========== Under the terms of various intercorporate services agreements ("ISAs") entered into between the Company and various related parties, employees of one company provide certain management, tax planning, financial and administrative services to the other company on a fee basis. Such charges are based upon estimates of the time devoted by the employees of the provider of the services to the affairs of the recipient and the compensation of such persons. These ISAs are reviewed and approved by the applicable independent directors of the companies that are parties to the agreements. The Company had an ISA with Tremont whereby the Company provided certain management, financial and other services to Tremont for approximately $0.4 million in 2002 and 2001 and $0.3 million in 2000. The Company anticipates entering into an ISA with Contran in 2003 to replace the Tremont ISA. Payments under a Contran ISA will likely be less than those under the Tremont ISA since Contran will now perform certain of the functions previously performed on behalf of Tremont by TIMET. Additionally, Contran may provide certain financial services to TIMET during 2003. The Company had an ISA with NL Industries, Inc. ("NL"), a majority-owned subsidiary of Valhi. Under the terms of the agreement, NL provided certain financial and other services to TIMET for approximately $0.3 million in each of 2002, 2001 and 2000. The Company expects to renew this agreement for 2003 at a reduced amount, as the Company now performs a portion of these financial and other services internally. The Company previously extended market-rate loans to certain officers pursuant to a Board-approved program to facilitate the purchase of Company stock and its Convertible Preferred Securities and to pay applicable taxes on shares of restricted Company stock as such shares vest. The loans were generally payable in five annual installments beginning six years from date of loan and bore interest at a rate tied to the Company's borrowing rate, payable quarterly. At December 31, 2002, approximately $0.2 million of officer notes receivable remain outstanding. The Company terminated this program effective July 30, 2002, subject to continuing only those loans outstanding at that time in accordance with their then-current terms. F-40 EWI RE, Inc. ("EWI") acts as a broker for certain of the Company's insurance policies. At December 31, 2001, parties related to Contran owned all of the outstanding common stock of EWI. On January 7, 2002, NL purchased EWI from its previous owners and EWI became a wholly-owned subsidiary of NL. Through December 31, 2000, a son-in-law of Harold C. Simmons managed the operations of EWI. Subsequent to December 31, 2000, and pursuant to an agreement that, as amended, is effective until terminated by either party with 90 days notice, such son-in-law provides advisory services to EWI as requested by EWI. The Company generally does not compensate EWI directly for insurance, but understands that, consistent with insurance industry practices, EWI receives a commission from the insurance underwriters for the policies that it arranges or brokers. The Company's aggregate premiums for such policies were approximately $3.4

million in 2002, $2.8 million in 2001 and $2.4 million in 2000. The Company expects that these relationships with EWI will continue in 2003. TIMET, together with other companies within the Contran group of companies, purchase certain of their insurance coverages as a group, with the costs of the jointly-owned policies being apportioned among the participating companies. With respect to certain of these policies, it is possible that unusually large losses incurred by one or more insureds during a given policy period could leave the other participating companies without adequate coverage under that policy for the balance of such policy period, which could dictate that such companies purchase replacement coverage or could result in the need to negotiate a loss sharing agreement. TIMET supplies titanium strip product to VALTIMET under a long-term contract as the preferred supplier and previously supplied casting ingot to Wyman-Gordon Titanium Castings. Sales to VALTIMET were $17 million in 2002 and $22 million in 2001 and 2000. Early in 2000, TIMET sold its interest in the castings joint venture at a pre-tax gain of $1.2 million. In connection with the construction and financing of TIMET's vacuum distillation process ("VDP") titanium sponge plant, Union Titanium Sponge Corporation ("UTSC") licensed certain technology to TIMET in exchange for the right to acquire up to 20% of TIMET's annual production capacity of VDP sponge at agreed-upon prices through early 1997 and higher formula-determined prices thereafter through 2008. The agreement also obligated UTSC to pay certain amounts in the event that UTSC purchases were below contractual volume minimums. In the fourth quarter of 2000, UTSC paid TIMET $2.0 million, which was included in other operating income, in connection with the termination of this agreement. Tremont LLC owns 32% of Basic Management, Inc. ("BMI"). Among other things, BMI provides utility services (primarily water distribution, maintenance of a common electrical facility and sewage disposal monitoring) to the Company and other manufacturers within an industrial complex located in Henderson, Nevada. Power transmission and sewer services are provided on a cost reimbursement basis, similar to a cooperative, while water delivery is currently provided at the same rates as are charged by BMI to an unrelated third party. Amounts paid by the Company to BMI for these utility services were $1.5 million in 2002 and 2001 and $1.6 million in 2000. The Company paid BMI an electrical facilities usage fee of $1.3 million in each of 2002, 2001 and 2000. This usage fee continues at $1.3 million per year through 2004 and declines to $0.6 million for 2005, to $0.5 million annually for 2006 through 2009, and terminates completely after January 2010. F-41 Note 19 - Commitments and contingencies Long-term agreements. The Company has LTAs with certain major aerospace customers, including, but not limited to, Boeing, Rolls-Royce plc ("Rolls-Royce"), United Technologies Corporation ("UTC", Pratt & Whitney and related companies) and Wyman-Gordon Company (a unit of Precision Castparts Corporation ("PCC")). These agreements initially became effective in 1998 and 1999 and expire in 2007 through 2008, subject to certain conditions. The LTAs generally provide for (i) minimum market shares of the customers' titanium requirements or firm annual volume commitments and (ii) fixed or formula-determined prices generally for at least the first five years. Generally, the LTAs require the Company's service and product performance to meet specified criteria and contain a number of other terms and conditions customary in transactions of these types. In certain events of nonperformance by the Company, the LTAs may be terminated early. Additionally, under a group of related LTAs (which group represents approximately 12% of the Company's 2002 sales revenue) which currently have fixed prices that convert to formula-derived prices in 2004, the customer may terminate the agreement as of the end of 2003 if the effect of the initiation of formula-derived pricing would cause such customer "material harm." If any of such agreements within the group were to be terminated by the customer on this basis, it is possible that some portion of the business represented by that group of related LTAs would continue on a non-LTA basis. However, the termination of one or more of the LTAs, including any of those within the group of related LTAs, could result in a material and adverse effect on the Company's business, results of operations, financial position or liquidity. During 2001, the Company recorded a charge of $3.0 million relating to a titanium sponge supplier's agreement to renegotiate certain components of an agreement entered into in 1997, including minimum purchase commitments for 1999 through 2001. As of December 31, 2002 and 2001, $1.7 million and $2.0 million of this amount remained accrued and unpaid, respectively. In September 2002, the Company entered into a new agreement with this supplier, effective from January 1, 2002 through December 31, 2007. This new agreement replaced and superceded the 1997 agreement. The new agreement requires minimum annual purchases by the Company of approximately $10 million in 2002 through 2007. In April 2001, the Company reached a settlement of the litigation between TIMET and Boeing related to the parties' LTA entered into in 1997. Pursuant to the settlement, the Company received a cash payment of $82 million. The Company's 2001 results reflect approximately $73 million (cash settlement less legal fees) as other operating income, with partially offsetting operating expenses of approximately $6.2 million for employee incentive compensation and other

costs reported as a component of selling, general, administrative and development expense, resulting in a net pre-tax income effect of $66.8 million in 2001. F-42 In connection with the settlement, TIMET and Boeing also entered into an amended LTA that, among other things, allows Boeing to purchase up to 7.5 million pounds of titanium product annually from TIMET through 2007, subject to certain maximum quarterly volume levels. Under the amended LTA, Boeing is required to advance TIMET $28.5 million annually for 2002 through 2007. The annual advance for contract years 2002 and 2003 were made in December 2001 and January 2003, respectively, with subsequent advances scheduled to occur in January of each calendar year through 2007. The LTA is structured as a take-or-pay agreement such that, beginning in calendar year 2002, Boeing forfeits a proportionate part of the $28.5 million annual advance, or effectively $3.80 per pound, in the event that its annual orders for delivery for such calendar year are less than 7.5 million pounds. Under a separate agreement TIMET must establish and hold buffer stock for Boeing at TIMET's facilities, for which Boeing pays TIMET as such stock is produced. See Notes 10 and 14. Concentration of credit and other risks. Substantially all of the Company's sales and operating income (loss) are derived from operations based in the U.S., the U.K. and France. Over 67% of the Company's sales revenue is generated by sales to customers in the aerospace industry (including airframe and engine construction). As described previously, the Company has LTAs with certain major aerospace customers, including Boeing, Rolls-Royce, UTC and Wyman-Gordon. These agreements and others accounted for approximately 37%, 43% and 35% of sales revenue in 2002, 2001 and 2000, respectively. Sales to PCC and related entities approximated 9% of the Company's sales revenue in 2002. Sales to Rolls-Royce and other Rolls-Royce suppliers under the Rolls-Royce LTAs (including sales to certain of the PCC-related entities) represented approximately 12% of the Company's sales revenue in 2002. The Company's ten largest customers accounted for about 40% of sales revenue in 2002 and about 50% of sales revenue in 2001 and 2000. Such concentration of customers may impact the Company's overall exposure to credit and other risks, either positively or negatively, in that such customers may be similarly affected by economic or other conditions. Operating leases. The Company leases certain manufacturing and office facilities and various equipment. Most of the leases contain purchase and/or various term renewal options at fair market and fair rental values, respectively. In most cases management expects that leases will be renewed or replaced by other leases in the normal course of business. Net rent expense was approximately $5.0 million in 2002, $6.1 million in 2001 and $6.6 million in 2000. At December 31, 2002, future minimum payments under noncancellable operating leases having an initial or remaining term in excess of one year were as follows: Amount ---------- (In thousands) Year ending December 31, 2003 $ 3,384 2004 1,579 2005 757 2006 629 2007 318 2008 and thereafter 339 ---------- $ 7,006 ========== F-43 Environmental matters. In 1999, TIMET and certain other companies (the "Steering Committee Companies") that currently have or formerly had operations within a Henderson, Nevada industrial complex (the "BMI Complex") entered into a series of agreements with BMI and certain related companies pursuant to which, among other things, BMI assumed responsibility for the conduct of soils remediation activities on the properties described, including the responsibility to complete all outstanding requirements pertaining to such activities under existing consent agreements with the Nevada Division of Environmental Protection. The Company contributed $2.8 million to the cost of this remediation. The Company also agreed to convey to BMI, at no additional cost, certain lands owned by the Company adjacent to its plant site (the "TIMET Pond Property") upon payment by BMI of the cost to design, purchase, and install the technology and equipment necessary to allow the Company to stop discharging liquid and solid effluents and co-products into settling ponds located on the TIMET Pond Property. BMI will pay 100% of the first $15.9 million cost for this project, and TIMET agreed to contribute 50% of the cost in excess of $15.9 million, up to a maximum payment by TIMET of $2 million. Preliminary estimates indicate that one possible design of such a system may cost up to approximately $20 million; however, the Company and BMI are continuing to review various design alternatives in order to minimize the ultimate project costs, and no design has yet been selected. The Company has not accrued any amount with respect to the potential liability to fund 50% of the cost of the project in excess of $15.9 million (subject to the $2 million cap) because it is not probable such excess cost will be incurred. The Company, BMI and the other Steering Committee Companies are continuing investigation with respect to certain additional issues associated with the properties described above, including any possible groundwater issues at the BMI Complex and the TIMET Pond Property. The Company is also continuing assessment work with respect to its own active plant site in Henderson, Nevada. During 2000, a preliminary study was completed of certain groundwater remediation issues at the Company's plant site and other Company-owned sites within the BMI Complex. The Company accrued $3.3 million in 2000 based on the undiscounted cost estimates set forth in the study. During 2002, the Company

updated this study and accrued an additional $0.3 million based on revised cost estimates. These expenses are expected to be paid over a period of up to thirty years. In February 2002, the Company fulfilled all of its remaining obligations under the 2000 Settlement Agreement of the U. S. Environmental Protection Agency's 1998 civil action against TIMET (United States of America v. Titanium Metals Corporation; Civil Action No. CV-S-98-682-HDM (RLH), U. S. District Court, District of Nevada). F-44 At December 31, 2002, the Company had accrued an aggregate of approximately $4.3 million for environmental matters, including those discussed above. The Company records liabilities related to environmental remediation obligations when estimated future costs are probable and reasonably estimable. Such accruals are adjusted as further information becomes available or circumstances change. Estimated future costs are not discounted to their present value. It is not possible to estimate the range of costs for certain sites. The imposition of more stringent standards or requirements under environmental laws or regulations, the results of future testing and analysis undertaken by the Company at its operating facilities, or a determination that the Company is potentially responsible for the release of hazardous substances at other sites, could result in costs in excess of amounts currently estimated to be required for such matters. No assurance can be given that actual costs will not exceed accrued amounts or that costs will not be incurred with respect to sites as to which no problem is currently known or where no estimate can presently be made. Further, there can be no assurance that additional environmental matters will not arise in the future. Legal proceedings. In September 2000, the Company was named in an action filed by the U.S. Equal Employment Opportunity Commission ("EEOC") in Federal District Court in Las Vegas, Nevada (U.S. Equal Employment Opportunity Commission v. Titanium Metals Corporation, CV-S-00-1172DWH-RJJ). The complaint, as amended, alleges that several female employees at the Company's Henderson, Nevada plant were the subject of sexual harassment and retaliation. In August 2002, TIMET filed a motion for summary judgment as to all claims of one employee who had intervened as a separate party, and as to all other claims involved in the EEOC's complaint. In December 2002, TIMET's motion was granted in part as to the individual employee's state law claims, but denied as to the Federal law claims of the individual employee and of the EEOC. The court also denied TIMET's motion to stay and compel arbitration of one employee's claims. TIMET has appealed this ruling. TIMET subsequently filed a motion to stay all proceedings until its appeal is concluded, on which the court has not yet ruled. The Company continues to vigorously defend this action. No trial date has been set. At December 31, 2002, the Company had accrued an aggregate of $0.6 million for expected costs related to various legal proceedings, including the proceeding discussed above. The Company records liabilities related to legal proceedings when estimated costs, including estimated legal fees, are probable and reasonably estimable. Such accruals are adjusted as further information becomes available or circumstances change. Estimated future costs are not discounted to their present value. It is not possible to estimate the range of costs for certain matters. No assurance can be given that actual costs will not exceed accrued amounts or that costs will not be incurred with respect to matters as to which no problem is currently known or where no estimate can presently be made. Further, there can be no assurance that additional legal proceedings will not arise in the future. F-45 Other. TIMET is the primary obligor on two workers' compensation bonds issued on behalf of a former subsidiary, Freedom Forge Corporation ("Freedom Forge"), which TIMET sold in 1989. The bonds were provided as part of the conditions imposed on Freedom Forge in order to self-insure its workers' compensation obligations. Each of the bonds has a maximum obligation of $1.5 million. Freedom Forge filed for Chapter 11 bankruptcy protection on July 13, 2001, and discontinued payment on the underlying workers' compensation claims in November 2001. During the third quarter of 2002, TIMET received notices that the issuers of the bonds were required to make payments on one of the bonds with respect to certain of these claims and were requesting reimbursement from TIMET. Based upon current loss projections, the Company anticipates claims will be incurred up to the maximum amount payable under the bond and, therefore, recorded $1.6 million for this bond (including $0.1 million in legal fees reimbursable to the issuer of the bonds) as other non-operating expense in 2002. Through December 31, 2002, TIMET has reimbursed the issuer approximately $0.4 million under this bond and $1.2 million remains accrued for future payments. At this time the Company understands that no claims have been paid under the second bond, and no such payments are currently anticipated. Accordingly, no accrual has been recorded for potential claims that could be filed under the second bond. TIMET may revise its estimated liability under these bonds in the future as additional facts become known or claims develop. In March 2001, the Company was notified by one of its customers that a product the customer manufactured from standard grade titanium produced by the Company contained what has been confirmed to be a tungsten inclusion. At the present time, the Company is aware of six standard grade ingots that have been demonstrated to contain tungsten inclusions. Based upon the Company's

assessment of possible losses, TIMET recorded an aggregate charge to cost of sales for this matter of $3.3 million during 2001. During 2001, the Company charged $0.3 million against this accrual to write down its remaining on-hand inventory and made $0.3 million in settlement payments, resulting in a $2.7 million accrual as of December 31, 2001 for potential future claims. During 2002, the Company made settlement payments aggregating $0.3 million and has also revised its estimate of the most likely amount of loss to be incurred, resulting in a credit of $0.2 million to cost of sales during 2002. As of December 31, 2002, $2.2 million is accrued for pending and potential future claims. This amount represents the Company's best estimate of the most likely amount of loss to be incurred. This amount does not represent the maximum possible loss, which is not possible for the Company to estimate at this time, and may be periodically revised in the future as more facts become known. As of December 31, 2002, the Company has received claims aggregating approximately $5 million and has made settlement payments aggregating $0.6 million. Pending claims are being investigated and negotiated. The Company believes that certain claims are without merit or can be settled for less than the amount of the original claim. There is no assurance that all potential claims have yet been submitted to the Company. The Company has filed suit seeking full recovery from its silicon supplier for any liability the Company might incur, although no assurances can be given that the Company will ultimately be able to recover all or any portion of such amounts. The Company has not recorded any recoveries related to this matter as of December 31, 2002. F-46 The Company is involved in various employment, environmental, contractual, product liability and other claims, disputes and litigation incidental to its business including those discussed above. While management, including internal counsel, currently believes that the outcome of these matters, individually and in the aggregate, will not have a material adverse effect on the Company's financial position, liquidity or overall trends in results of operations, all such matters are subject to inherent uncertainties. Were an unfavorable outcome to occur in any given period, it is possible that it could have a material adverse impact on the results of operations or cash flows in that particular period. Note 20 - Earnings per share Basic earnings (loss) per share is based on the weighted average number of unrestricted common shares outstanding during each year. Diluted earnings (loss) per share reflect the dilutive effect of common stock options, restricted stock and the assumed conversion of the Convertible Preferred Securities, if applicable. Basic and diluted earnings (loss) per share amounts for all periods presented have been retroactively adjusted for the effects of the Company's one-for-ten reverse stock split, which was effective after the close of trading on February 14, 2003. The assumed conversion of the Convertible Preferred Securities was omitted from the diluted earnings (loss) per share calculation for 2002, 2001 and 2000 because the effect was antidilutive. Had the Convertible Preferred Securities not been antidilutive, diluted losses would have been decreased by $13.4 million in 2002, $13.9 million in 2001 and $8.7 million in 2000. Diluted average shares outstanding would have been increased by approximately 540,000 shares for each of these periods. Stock options and restricted shares omitted from the calculation because they were antidilutive approximated 158,000 in 2002, 185,000 in 2001 and 213,000 in 2000. Dilutive stock options of 10 in 2002, 1,800 in 2001 and 8,800 in 2000 were excluded from the calculation of diluted earnings per share because their effect would have been antidilutive due to the losses in those years. F-47 Note 21 - Quarterly results of operations (unaudited) For the quarter ended ---------- March 31 June 30 Sept. 30 Dec. 31 ---------- ---------- ---------- ---------- (In millions, except per share data) Year ended December 31, 2002: Net sales $ 104.4 $ 94.3 $ 82.8 $ 85.0 Gross margin 5.1 1.4 (4.9) (4.7) Operating loss (1) (4.7) (7.0) (4.4) (4.8) Loss before cumulative effect of change in accounting principle (1) (36.1) (12.3) (9.1) (9.6) Net loss (1) (2) (80.4) (12.3) (9.1) (9.6) Basic and diluted loss per share (2) (3): Before cumulative effect of change in accounting principle $ (11.43) $ (3.91) $ (2.89) $ (3.05) Basic and diluted loss per share$ $ (25.47) $ (3.91) $ (2.89) $ (3.05) Year ended December 31, 2001: Net sales $ 124.0 $ 120.0 $ 126.4 $ 116.5 Gross margin 7.3 (3.5) 20.8 15.3 Operating (loss) income (1.8) 48.6 10.0 7.7 Net (loss) income (1) (3.6) 29.6 4.3 (72.0) (Loss) earnings per share (3): Basic $ (1.15) $ 9.38 $ 1.38 $ (22.85) Diluted $ (1.15) $ 8.62 $ 1.37 $ (22.85) (1) The sum of quarterly amounts do not agree to the full year results due to rounding. (2) As compared to amounts previously reported on Form 10-Q, net loss and loss per share for the quarter ended March 31, 2002 were increased by the $44.3 million ($14.04 per share) cumulative effect of change in accounting principle recorded for the Company's goodwill impairment charge determined during the third quarter of 2002. (3) The sum of quarterly amounts may not agree to the full year results due to rounding and the timing of potential conversion of options to common stock, which would have an antidilutive effect on the calculation. All per share amounts have been adjusted to reflect the Company's one-for-ten reverse stock split which became effective after the close of trading on February 14, 2003. The first quarter 2002 results included a $27.5 million impairment charge related to the impairment of the Company's investment in SMC securities, as

discussed in Note 5. The fourth quarter 2001 results included a $61.5 million pre-tax impairment charge related to the impairment of the Company's investment in SMC securities, as discussed in Note 5, and a $35.5 million increase in the Company's deferred tax asset valuation allowance, as discussed in Note 16. The second quarter 2001 operating results included $73.0 million of income from the Boeing settlement, with partially offsetting expenses of $10.2 million for employee incentive compensation (which was subsequently reduced by $4.1 million in the fourth quarter of 2001), as discussed in Note 14. F-48 Note 22 - Subsequent event As previously discussed in Note 1, on February 4, 2003, the Company's stockholders approved a proposal to amend TIMET's Certificate of Incorporation to effect a reverse stock split of TIMET's common stock at a ratio of one share of post-split common stock for each eight, nine or ten shares of pre-split common stock issued and outstanding, with the final ratio to be selected by the Board of Directors. Subsequently, the Board of Directors of TIMET unanimously approved a reverse stock split on the basis of one share of post-split common stock for each outstanding ten shares of pre-split common stock. The reverse stock split became effective after the close of trading on February 14, 2003. All share and per share disclosures for all periods presented in the accompanying Consolidated Financial Statements have been adjusted to give effect to the reverse stock split. F-49 REPORT OF INDEPENDENT ACCOUNTANTS ON FINANCIAL STATEMENT SCHEDULE To the Stockholders and Board of Directors of Titanium Metals Corporation: Our audits of the consolidated financial statements referred to in our report dated January 28, 2003, except for Note 22 as to which the date is February 14, 2003, appearing in this 2002 Annual Report on Form 10-K of Titanium Metals Corporation also included an audit of the financial statement schedule listed in the Index on page F of this Form 10-K. In our opinion, this financial statement schedule presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. /s/ PricewaterhouseCoopers LLP Denver, Colorado January 28, 2003, except for Note 22, as to which the date is February 14, 2003 S-1 TITANIUM METALS CORPORATION SCHEDULE II - VALUATION AND QUALIFYING ACCOUNTS (In thousands) Additions ---------- Balance Charged at to Charged Balance beginning costs and to other at end Description of year expenses accounts Deductions of year ---------- ---------- ---------- ---------- ---------- Year ended December 31, 2002: Allowance for doubtful accounts $ 2,739 $ 1,000 $ 152 (1) $ (1,032) (2) $ 2,859 ========== ========== ========== ========== ========== Allowance for excess and slow moving inventories $ 13,621 $ 3,757 $ 901 (1) $ (3,189) $ 15,090 ========== ========== ========== ========== ========== Reserve for business restructuring $ 198 $ - $ - $ (118) (3) $ 80 ========== ========== ========== ========== ========== Year ended December 31, 2001: Allowance for doubtful accounts $ 2,927 $ 4 $ (22) (1) $ (170) (2) $ 2,739 ========== ========== ========== ========== ========== Allowance for excess and slow moving inventories $ 14,846 $ 1,755 $ (218) (1) $ (2,762) $ 13,621 ========== ========== ========== ========== ========== Reserve for business restructuring $ 1,012 $ (227) $ - $ (587) (3) $ 198 ========== ========== ========== ========== ========== Year ended December 31, 2000: Allowance for doubtful accounts $ 3,330 $ 185 $ (223) (1) $ (365) (2) $ 2,927 ========== ========== ========== ========== ========== Allowance for excess and slow moving inventories $ 14,764 $ 2,707 $ (774) (1) $ (1,851) $ 14,846 ========== ========== ========== ========== ========== Reserve for business restructuring $ 1,490 $ 3,219 $ - $ (3,697) (3) $ 1,012 ========== ========== ========== ========== ========== (1) Amount represent foreign currency translation adjustments for the related account. (2) Amounts written off, less recoveries. (3) Amounts represent cash payments for restructuring severance obligations and credits to reduce the initial restructuring charge. S-2