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

FORM 10-Q

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

For the quarterly period ended June 30, 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 1-71

MOMENTIVE SPECIALTY CHEMICALS INC.

(Exact name of registrant as specified in its charter)

New Jersey	**13-0511250**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
180 East Broad St., Columbus, OH 43215	**614-225-4000**
(Address of principal executive offices including zip code)	**(Registrant's telephone number including area code)**

(Former name, former address and former fiscal year, if changed since last report)

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

Indicate by check mark 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 x No o

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 definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	o	Accelerated filer	o
Non-accelerated filer	x	Smaller reporting company	o

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

Number of shares of common stock, par value $0.01 per share, outstanding as of the close of business on August 1, 2012: 82,556,847

MOMENTIVE SPECIALTY CHEMICALS INC.

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MOMENTIVE SPECIALTY CHEMICALS INC.
CONDENSED CONSOLIDATED BALANCE SHEETS (Unaudited)

(In millions, except share data)	June 30, 2012	December 31, 2011
Assets		
Current assets		
Cash and cash equivalents (including restricted cash of $3)	$ 336	$ 431
Short-term investments	5	7
Accounts receivable (net of allowance for doubtful accounts of $16 and $19, respectively)	695	592
Inventories:		
Finished and in-process goods	310	254
Raw materials and supplies	126	103
Other current assets	69	72
Total current assets	1,541	1,459
Other assets, net	168	169
Property and equipment		
Land	88	88
Buildings	292	298
Machinery and equipment	2,299	2,300
	2,679	2,686
Less accumulated depreciation	(1,532)	(1,477)
	1,147	1,209
Goodwill	166	167
Other intangible assets, net	96	104
Total assets	$ 3,118	$ 3,108
Liabilities and Deficit		
Current liabilities		
Accounts and drafts payable	$ 490	$ 393
Debt payable within one year	65	117
Affiliated debt payable within one year	2	2
Interest payable	66	61
Income taxes payable	8	15
Accrued payroll and incentive compensation	38	57
Other current liabilities	137	132
Total current liabilities	806	777
Long-term liabilities		
Long-term debt	3,430	3,420
Long-term pension and post employment benefit obligations	212	223
Deferred income taxes	60	72
Other long-term liabilities	152	156
Advance from affiliates	225	225
Total liabilities	4,885	4,873
Commitments and contingencies (See Note 9)		
Deficit		
Common stock—$0.01 par value; 300,000,000 shares authorized, 170,605,906 issued and 82,556,847 outstanding at June 30, 2012 and December 31, 2011	1	1
Paid-in capital	533	533
Treasury stock, at cost—88,049,059 shares	(296)	(296)
Note receivable from parent	(24)	(24)
Accumulated other comprehensive income	3	17
Accumulated deficit	(1,985)	(1,997)
Total Momentive Specialty Chemicals Inc. shareholder’s deficit	(1,768)	(1,766)
Noncontrolling interest	1	1
Total deficit	(1,767)	(1,765)
Total liabilities and deficit	$ 3,118	$ 3,108

See Notes to Condensed Consolidated Financial Statements

MOMENTIVE SPECIALTY CHEMICALS INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)

(In millions)	Three Months Ended June 30, 2012	Three Months Ended June 30, 2011	Six Months Ended June 30, 2012	Six Months Ended June 30, 2011
Net sales	$ 1,259	$ 1,438	$ 2,495	$ 2,732
Cost of sales	1,087	1,223	2,145	2,308
Gross profit	172	215	350	424
Selling, general and administrative expense	79	87	164	171
Asset impairments	—	18	23	18
Business realignment costs	3	5	18	8
Other operating (income) expense, net	(2)	(23)	9	(21)
Operating income	92	128	136	248
Interest expense, net	67	65	132	129
Other non-operating (income) expense, net	(1)	—	1	(2)
Income from continuing operations before income tax and earnings from unconsolidated entities	26	63	3	121
Income tax expense	4	—	2	3
Income from continuing operations before earnings from unconsolidated entities	22	63	1	118
Earnings from unconsolidated entities, net of taxes	6	3	11	6
Net income from continuing operations	28	66	12	124
Net (loss) income from discontinued operations, net of taxes	—	(3)	—	2
Net income	$ 28	$ 63	$ 12	$ 126

See Notes to Condensed Consolidated Financial Statements

MOMENTIVE SPECIALTY CHEMICALS INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (Unaudited)

(In millions)	Three Months Ended June 30, 2012	Three Months Ended June 30, 2011	Six Months Ended June 30, 2012	Six Months Ended June 30, 2011
Net income	$ 28	$ 63	$ 12	$ 126
Other comprehensive (loss) income, net of tax:				
Foreign currency translation adjustments	(44)	21	(15)	51
Gain recognized from pension and postretirement benefits	—	1	—	—
Net gain (loss) from cash flow hedge activity	1	(1)	1	—
Other comprehensive (loss) income	(43)	21	(14)	51
Comprehensive (loss) income	$ (15)	$ 84	$ (2)	$ 177

See Notes to Condensed Consolidated Financial Statements

MOMENTIVE SPECIALTY CHEMICALS INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

	Six Months Ended June 30,	
(In millions)	2012	2011
Cash flows used in operating activities		
Net income	$ 12	$ 126
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization	77	86
Deferred tax benefit	(12)	(12)
Non-cash asset impairments and accelerated depreciation	30	18
Other non-cash adjustments	18	(5)
Net change in assets and liabilities:		
Accounts receivable	(141)	(218)
Inventories	(88)	(83)
Accounts and drafts payable	113	138
Income taxes payable	(8)	2
Other assets, current and non-current	25	(22)
Other liabilities, current and long-term	(37)	(73)
Net cash used in operating activities	(11)	(43)
Cash flows (used in) provided by investing activities		
Capital expenditures	(58)	(71)
Proceeds from matured debt securities, net	2	—
Change in restricted cash	—	2
Funds remitted to unconsolidated affiliates	(3)	(1)
Proceeds from sale of business, net of cash transferred	—	173
Proceeds from sale of assets	9	—
Net cash (used in) provided by investing activities	(50)	103
Cash flows used in financing activities		
Net short-term debt repayments	(15)	(8)
Borrowings of long-term debt	451	409
Repayments of long-term debt	(473)	(451)
Capital contribution from parent	16	—
Long-term debt and credit facility financing fees	(13)	(1)
Distribution paid to parent	(2)	—
Net cash used in financing activities	(36)	(51)
Effect of exchange rates on cash and cash equivalents	2	3
(Decrease) increase in cash and cash equivalents	(95)	12
Cash and cash equivalents (unrestricted) at beginning of period	428	180
Cash and cash equivalents (unrestricted) at end of period	$ 333	$ 192
Supplemental disclosures of cash flow information		
Cash paid for:		
Interest, net	$ 122	$ 135
Income taxes, net of cash refunds	18	12

See Notes to Condensed Consolidated Financial Statements

MOMENTIVE SPECIALTY CHEMICALS INC.
CONDENSED CONSOLIDATED STATEMENT OF DEFICIT (Unaudited)

(In millions)	Common Stock	Paid-in Capital	Treasury Stock	Note Receivable From Parent	Accumulated Other Comprehensive Income (a)	Accumulated Deficit	Total Momentive Specialty Chemicals Inc. Deficit	Non-controlling Interest	Total
Balance at December 31, 2011	$ 1	$ 533	$ (296)	$ (24)	$ 17	$ (1,997)	$ (1,766)	$ 1	$ (1,765)
Net income	—	—	—	—	—	12	12	—	12
Other comprehensive loss	—	—	—	—	(14)	—	(14)	—	(14)
Stock-based compensation expense	—	2	—	—	—	—	2	—	2
Distribution declared to parent ($0.02 per share)	—	(2)	—	—	—	—	(2)	—	(2)
Balance at June 30, 2012	$ 1	$ 533	$ (296)	$ (24)	$ 3	$ (1,985)	$ (1,768)	$ 1	$ (1,767)

(a) Accumulated other comprehensive income at June 30, 2012 represents $115 of net foreign currency translation gains, net of tax and a $112 unrealized loss, net of tax, related to net actuarial losses and prior service costs for the Company's defined benefit pension and postretirement plans. Accumulated other comprehensive income at December 31, 2011 represents $130 of net foreign currency translation gains, net of tax, $1 of net deferred losses on cash flow hedges and a $112 unrealized loss, net of tax, related to net actuarial losses and prior service costs for the Company's defined benefit pension and postretirement benefit plans.

See Notes to Condensed Consolidated Financial Statements

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)
(In millions, except share and common unit data)

1. Background and Basis of Presentation

Based in Columbus, Ohio, Momentive Specialty Chemicals Inc., (which may be referred to as “MSC” or the “Company”) serves global industrial markets through a broad range of thermoset technologies, specialty products and technical support for customers in a diverse range of applications and industries. The Company's business is organized based on the products offered and the markets served. At June 30, 2012, the Company had two reportable segments: Epoxy, Phenolic and Coating Resins and Forest Products Resins.

The Company's direct parent is Momentive Specialty Chemicals Holdings LLC (“MSC Holdings”), a holding company and wholly owned subsidiary of Momentive Performance Materials Holdings LLC (“Momentive Holdings”), the ultimate parent entity of MSC. On October 1, 2010, MSC Holdings and Momentive Performance Materials Holdings Inc. (“MPM Holdings”), the parent company of Momentive Performance Materials Inc. (“MPM”), became subsidiaries of Momentive Holdings. This transaction is referred to as the “Momentive Combination”. Momentive Holdings is controlled by investment funds managed by affiliates of Apollo Management Holdings, L.P. (together with Apollo Global Management, LLC and its subsidiaries, “Apollo”). Apollo may also be referred to as the Company's owner.

During the first quarter of 2012, the Company recorded an out of period loss of approximately $3 related to the disposal of long-lived assets. As a result of this adjustment, the Company’s Income from continuing operations before income tax and Net income decreased by $3 and $2, respectively, for the six months ended June 30, 2012. Of the $3 decrease to Income from continuing operations before income tax, approximately $1 and $2 should have been recorded in the years ended December 31, 2011 and 2010, respectively. Management does not believe that this out of period error is material to the unaudited Condensed Consolidated Financial Statements for the six months ended June 30, 2012, or to any prior periods.

Basis of Presentation—The unaudited Condensed Consolidated Financial Statements include the accounts of the Company, its majority-owned subsidiaries in which minority shareholders hold no substantive participating rights and variable interest entities (“VIEs”) in which the Company is the primary beneficiary. Intercompany accounts and transactions are eliminated in consolidation. In the opinion of management, all adjustments consisting of normal, recurring adjustments considered necessary for a fair statement have been included. Results for the interim periods are not necessarily indicative of results for the entire year.

Year-end condensed consolidated balance sheet data was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America.

Pursuant to the rules and regulations of the Securities and Exchange Commission, certain information and disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted. These unaudited Condensed Consolidated Financial Statements should be read in conjunction with the audited Consolidated Financial Statements and the accompanying notes included in the Company's most recent Annual Report on Form 10-K.

2. Summary of Significant Accounting Policies

Use of Estimates—The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities. It also requires the disclosure of contingent assets and liabilities at the date of the financial statements, as well as the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

Impairment—The Company reviews long-lived definite-lived assets for recoverability whenever events or changes in circumstances indicate that the carrying amount of these assets may not be recoverable. Recoverability is based on estimated undiscounted cash flows. Measurement of the loss, if any, is based on the difference between the carrying value and fair value.

During the six months ended June 30, 2012, the Company recorded the following asset impairments:

As a result of the likelihood that certain assets would be disposed of before the end of their estimated useful lives, resulting in lower future cash flows associated with these assets, the Company recorded impairments of $15 and $6 on certain of its long-lived assets in its Epoxy, Phenolic and Coating Resins and Forest Products Resins segments, respectively.

As a result of market weakness and the loss of a customer, resulting in lower future cash flows associated with certain assets within the Company's European forest products business, the Company recorded impairments of $2 on these long-lived assets in its Forest Products Resins segment.

In addition, the Company recorded accelerated depreciation of $1 and $7 related to closing facilities during the three and six months ended June 30, 2012, respectively.

Subsequent Events—The Company has evaluated events and transactions subsequent to June 30, 2012 through August 8, 2012, the date of issuance of its unaudited Condensed Consolidated Financial Statements.

Reclassifications—Certain prior period balances have been reclassified to conform with current presentations.

Recently Issued Accounting Standards

Newly Adopted Accounting Standards

On January 1, 2012, the Company adopted the provisions of *Accounting Standards Update No. 2011-04: Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs* ("ASU 2011-04"). ASU 2011-04 amended existing fair value measurement guidance and is intended to align U.S. GAAP and International Financial Reporting Standards. The guidance requires several new disclosures, including additional quantitative information about significant unobservable inputs used in Level 3 fair value measurements and a qualitative description of the valuation process for both recurring and nonrecurring Level 2 and Level 3 fair value measurements. ASU 2011-04 also requires the disclosure of all fair value measurements by fair value hierarchy level, amongst other requirements. The adoption of ASU 2011-04 did not have a material impact on the Company's unaudited Condensed Consolidated Financial Statements. See Note 6 for the disclosures required by the adoption of ASU 2011-04.

On January 1, 2012, the Company adopted the provisions of *Accounting Standards Update No. 2011-05: Comprehensive Income* ("ASU 2011-05"), which was issued by the FASB in June 2011 and amended by *Accounting Standards Update No. 2011-12: Comprehensive Income* ("ASU 2011-12") issued in December 2011. ASU 2011-05 amended presentation guidance by eliminating the option for an entity to present the components of comprehensive income as part of the statement of changes in stockholders' equity and required presentation of comprehensive income in a single continuous financial statement or in two separate but consecutive financial statements. ASU 2011-12 deferred the effective date for amendments to the presentation of reclassifications of items out of accumulated other comprehensive income in ASU 2011-05. The amendments in ASU 2011-05 did not change the items that must be reported in other comprehensive income or when an item of comprehensive income must be reclassified to net income. The Company has presented comprehensive income in a separate and consecutive statement entitled, "Condensed Consolidated Statements of Comprehensive Income."

Newly Issued Accounting Standards

There were no newly issued accounting standards in the first half of 2012 applicable to the Company's unaudited Condensed Consolidated Financial Statements.

3. Discontinued Operations

North American Coatings and Composite Resins Business

On May 31, 2011, the Company sold its North American coatings and composite resins business ("CCR Business") to PCCR USA, Inc., a subsidiary of Investindustrial, a European investment group. The CCR Business is engaged in the production of coating resins for architectural and original equipment manufacturers, alkyd resins, as well as composite resins for construction, transportation, consumer goods, marine and other applications and includes four manufacturing facilities in the United States.

For the three and six months ended June 30, 2011, the CCR Business had net sales of $49 and $114 and a pre-tax loss of $3 and $3, respectively. The CCR Business is reported as a discontinued operation for all periods presented.

Global Inks and Adhesive Resins Business

On January 31, 2011, the Company sold its global inks and adhesive resins business ("IAR Business") to Harima Chemicals Inc. The IAR Business had net sales of $31 and pretax income of $6 for the six months ended June 30, 2011. The IAR Business is reported as a discontinued operation for all periods presented.

4. Restructuring

In 2012, in response to softening demand in certain of its businesses in the second half of 2011, the Company initiated significant restructuring programs with the intent to optimize its cost structure and bring manufacturing capacity in line with demand. At June 30, 2012, the Company had $24 of in-process cost reduction programs savings expected to be achieved over the remaining life of the projects. The Company estimates that these restructuring cost activities will occur over the next 12 to 15 months. As of June 30, 2012, the costs expected to be incurred on restructuring activities are estimated at $35, consisting mainly of workforce reduction and site closure-related costs.

The following table summarizes restructuring information by type of cost:

	Workforce Reductions	Site Closure Costs	Other Projects	Total
Restructuring costs expected to be incurred	$ 28	$ 6	$ 1	$ 35
Cumulative restructuring costs incurred through June 30, 2012	$ 15	$ 4	$ —	$ 19
Accrued liability at December 31, 2011	$ 6	$ —	$ —	$ 6
Restructuring charges	9	4	—	13
Payments	(3)	(4)	—	(7)
Accrued liability at June 30, 2012	$ 12	$ —	$ —	$ 12

Workforce reduction costs primarily relate to non-voluntary employee termination benefits and are accounted for under the guidance for nonretirement postemployment benefits or as exit and disposal costs, as applicable. During the three and six months ended June 30, 2012 charges of $1 and $13 were recorded in “Business realignment costs” in the unaudited Condensed Consolidated Statements of Operations. At June 30, 2012 and December 31, 2011, the Company had accrued $12 and $6, respectively, for restructuring liabilities in “Other current liabilities” in the unaudited Condensed Consolidated Balance Sheets.

The following table summarizes restructuring information by reporting segment:

	Epoxy, Phenolic and Coating Resins	Forest Products Resins	Corporate and Other	Total
Restructuring costs expected to be incurred	$ 14	$ 19	$ 2	$ 35
Cumulative restructuring costs incurred through June 30, 2012	$ 4	$ 14	$ 1	$ 19
Accrued liability at December 31, 2011	$ 1	$ 2	$ 3	$ 6
Restructuring charges (release)	3	12	(2)	13
Payments	(2)	(5)	—	(7)
Accrued liability at June 30, 2012	$ 2	$ 9	$ 1	$ 12

5. Related Party Transactions

Administrative Service, Management and Consulting Arrangement

The Company is subject to an Amended and Restated Management Consulting Agreement with Apollo (the “Management Consulting Agreement”) that renews on an annual basis, unless notice to the contrary is given by either party. Under the Management Consulting Agreement, the Company receives certain structuring and advisory services from Apollo and its affiliates. The Management Consulting Agreement provides indemnification to Apollo, its affiliates and their directors, officers and representatives for potential losses arising from these services. Apollo is entitled to an annual fee equal to the greater of $3 or 2% of the Company's Adjusted EBITDA. Apollo elected to waive charges of any portion of the annual management fee due in excess of $3 for the calendar year 2012.

During the three and six months ended June 30, 2012 the Company recognized expense under the Management Consulting Agreement of $1 and $2, respectively. These amounts are included in “Other operating (income) expense, net” in the Company’s unaudited Condensed Consolidated Statements of Operations.

Apollo Notes Registration Rights Agreement

On November 5, 2010, in connection with the issuance of the Company's 9.00% Second-Priority Senior Secured Notes due 2020, the Company entered into a separate registration rights agreement with Apollo. The registration rights agreement gives Apollo the right to make three requests by written notice to the Company specifying the maximum aggregate principal amount of notes to be registered. The agreement requires the Company to file a registration statement with respect to the notes it issued to Apollo as promptly as possible following receipt of each such notice. There are no cash or additional penalties under the registration rights agreement resulting from delays in registering the notes.

In September 2011, the Company filed a registration statement on Form S-1 with the SEC to register the resale of $134 of Second-Priority Senior Secured Notes due 2020 held by Apollo, which was subsequently declared effective on May 7, 2012.

Shared Services Agreement

On October 1, 2010, in conjunction with the Momentive Combination, the Company entered into a shared services agreement with MPM, as amended on March 17, 2011 (the “Shared Services Agreement”). Under this agreement, the Company provides to MPM, and MPM provides to the Company, certain services, including, but not limited to, executive and senior management, administrative support, human resources, information technology support, accounting, finance, technology development, legal and procurement services. The Shared Services Agreement establishes certain criteria upon which the costs of such services are allocated between the Company and MPM. Pursuant to this agreement, during the six months ended June 30, 2012 and 2011, the Company incurred approximately $79 and $90, respectively, of net costs for shared services and MPM incurred approximately $75 and $86, respectively, of net costs for shared services. Included in the net costs incurred during the six months ended June 30, 2012 and 2011, were net billings from MSC to MPM of $9 and $3, respectively, to bring the percentage of total net incurred costs for shared services under the Shared Services Agreement to 51% for the Company and 49% for MPM, as well as to reflect costs allocated 100% to one party. During the six months ended June 30, 2012 and 2011, the Company realized approximately $12 and $14, respectively, in cost savings as a result of the Shared Services Agreement. The Company had accounts receivable from MPM of $7 and $15 as of June 30, 2012 and December 31, 2011, respectively, and accounts payable to MPM of $1 and $3 at June 30, 2012 and December 31, 2011, respectively.

Apollo Advance

In connection with the terminated Huntsman merger and related litigation settlement agreement and release among the Company, Huntsman and other parties entered into on December 14, 2008, the Company paid Huntsman $225. The settlement payment was funded to the Company by an advance from Apollo, while reserving all rights with respect to reallocation of the payments to other affiliates of Apollo. Under the provisions of the settlement agreement and release, the Company is only contractually obligated to reimburse Apollo for any insurance recoveries on the $225 settlement payment, net of expense incurred in obtaining such recoveries. Apollo has agreed that the payment of any such insurance recoveries will satisfy the Company’s obligation to repay amounts received under the $225 advance. The Company has recorded the $225 settlement payment advance as a long-term liability at June 30, 2012.

In April 2012, the Company agreed to a settlement with its insurers to recover $10 in proceeds associated with the $225 settlement payment made to Huntsman in 2008. During the three months ended June 30, 2012, the Company recognized the $10 settlement, which was recorded net of approximately $2 of fees related to the settlement, and is included in “Other operating (income) expense, net” in the unaudited Condensed Consolidated Statements of Operations. In July 2012, the Company received approximately $1 from its insurers for reimbursement of expenses incurred in obtaining the recoveries, and Apollo received the remaining approximately $7 of the settlement from the Company's insurers. Following receipt of the settlement payment from the Company's insurers, Apollo acknowledged the satisfaction of the Company's obligations to Apollo with respect to the $225 advance. The remaining $218 will be reclassified from a long-term liability to equity as a capital contribution from Apollo in August 2012.

Preferred Equity Commitment and Issuance

In December 2011, in conjunction with a previous commitment, Momentive Holdings issued 28,785,935 preferred units and 28,785,935 warrants to purchase common units of Momentive Holdings to affiliates of Apollo for a purchase price of $205 (the “Preferred Equity Issuance”), representing the initial $200 face amount, plus amounts earned from the interim liquidity facilities, less related fees and expenses. Momentive Holdings contributed $189 of the proceeds from the Preferred Equity Issuance to MSC Holdings and MSC Holdings contributed the amount to the Company. As of December 31, 2011, the Company had recognized a capital contribution of $204, representing the total proceeds from the Preferred Equity Issuance, less related fees and expenses. The remaining $16 was held in a reserve account at December 31, 2011 by Momentive Holdings to redeem any additional preferred units from Apollo equal to the aggregate number of preferred units and warrants subscribed for by all other members of Momentive Holdings. In January 2012, the remaining $16 of proceeds held in the reserve account were contributed to the Company.

Purchase of MSC Holdings Debt

In 2009, the Company purchased $180 in face value of the outstanding MSC Holdings LLC PIK Debt Facility for $24, including accrued interest. The loan receivable from MSC Holdings has been recorded at its acquisition value of $24 as a reduction of equity in the unaudited Condensed Consolidated Balance Sheets as MSC Holdings is the Company’s parent. In addition, at June 30, 2012 the Company has not recorded accretion of the purchase discount or interest income as ultimate receipt of these cash flows is under the control of MSC Holdings. The Company will continue to assess the collectibility of these cash flows to determine future amounts to record, if any.

Purchases and Sales of Products and Services with Apollo Affiliates and Other Related Parties

The Company sells products to certain Apollo affiliates, members of Momentive Holdings and other related parties. These sales were $4 and less than $1 for the three months ended June 30, 2012 and 2011, respectively, and $6 and $1 for the six months ended June 30, 2012 and 2011, respectively. Accounts receivable from these affiliates were $3 and $1 at June 30, 2012 and December 31, 2011, respectively. The Company also purchases raw materials and services from certain Apollo affiliates. These purchases were $11 and $14 for the three months ended June 30, 2012 and 2011, respectively, and $18 and $20 for the six months ended June 30, 2012 and 2011, respectively. The Company had accounts payable to Apollo affiliates of $1 at both June 30, 2012 and December 31, 2011.

Other Transactions and Arrangements

Momentive Holdings purchases insurance policies which also cover the Company and MPM. Amounts are billed to the Company based on the Company's relative share of the insurance premiums. No amounts were billed to the Company by Momentive Holdings for the three or six months ended June 30, 2012. The Company had accounts payable to Momentive Holdings of less than $1 and $3 under these arrangements at June 30, 2012 and December 31, 2011, respectively.

The Company sells finished goods to and purchases raw materials from its foundry joint venture between the Company and Delta-HA, Inc. (“HAI”). The Company also provides toll-manufacturing and other services to HAI. The Company’s investment in HAI is recorded under the equity method of accounting, and the related sales and purchases are not eliminated from the Company’s unaudited Condensed Consolidated Financial Statements. However, any profit on these transactions is eliminated in the Company’s unaudited Condensed Consolidated Financial Statements to the extent of the Company’s 50% interest in HAI. Sales and services provided to HAI were $28 and $48 for the three months ended June 30, 2012 and 2011, respectively, and $56 and $77 for the six months ended June 30, 2012 and 2011, respectively. Accounts receivable from HAI were $23 and $14 at June 30, 2012 and December 31, 2011, respectively. Purchases from HAI were $14 and $32 for the three months ended June 30, 2012 and 2011, respectively, and $24 and $46 for the six months ended June 30, 2012 and 2011, respectively. The Company had accounts payable to HAI of $2 and $4 at June 30, 2012 and December 31, 2011, respectively. Additionally, HAI declared dividends to the Company of $3 and $5 during the three months ended June 30, 2012 and 2011, respectively, and $13 and $5 during the six months ended June 30, 2012 and 2011, respectively. $3 remains outstanding related to these previously declared dividends as of June 30, 2012.

The Company’s purchase contracts with HAI represent a significant portion of HAI’s total revenue, and this factor results in the Company absorbing the majority of the risk from potential losses or the majority of the gains from potential returns. However, the Company does not have the power to direct the activities that most significantly impact HAI, and therefore, does not consolidate HAI. The carrying value of HAI’s assets were $50 and $48 at June 30, 2012 and December 31, 2011, respectively. The carrying value of HAI’s liabilities were $31 and $21 at June 30, 2012 and December 31, 2011, respectively.

The Company had a loan receivable from its unconsolidated forest products joint venture in Russia of $2 and $3 as of June 30, 2012 and December 31, 2011, respectively. The Company had royalties receivable from its unconsolidated forest products joint venture in Russia of $3 and $2 as of June 30, 2012 and December 31, 2011, respectively.

6. Fair Value

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Fair value measurement provisions establish a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. This guidance describes three levels of inputs that may be used to measure fair value:

- **Level 1:** Inputs are quoted prices (unadjusted) for identical assets or liabilities in active markets.
- **Level 2:** Pricing inputs are other than quoted prices in active markets included in Level 1, which are either directly or indirectly observable as of the reported date.
- **Level 3:** Unobservable inputs that are supported by little or no market activity and are developed based on the best information available in the circumstances. For example, inputs derived through extrapolation or interpolation that cannot be corroborated by observable market data.

Recurring Fair Value Measurements

Following is a summary of assets and liabilities measured at fair value on a recurring basis as of June 30, 2012 and December 31, 2011:

	Fair Value Measurements Using			
	Level 1	**Level 2**	**Level 3**	**Total**
June 30, 2012				
Derivative liabilities	$ (1)	$ (1)	$ —	$ (2)
December 31, 2011				
Derivative liabilities	—	(3)	—	(3)

Level 1 derivative liabilities primarily consists of financial instruments traded on exchange or futures markets. Level 2 derivative liabilities includes those derivative instruments transacted primarily in over the counter markets.

There were no transfers between Level 1, Level 2 or Level 3 measurements during the three or six months ended June 30, 2012.

The Company calculates the fair value of its Level 1 derivative liabilities using quoted market prices. The Company calculates the fair value of its Level 2 derivative liabilities using standard pricing models with market-based inputs, adjusted for nonperformance risk. When its financial instruments are in a liability position, the Company evaluates its credit risk as a component of fair value. At June 30, 2012 and December 31, 2011, no adjustment was made by the Company to reduce its derivative liabilities for nonperformance risk.

When its financial instruments are in an asset position, the Company is exposed to credit loss in the event of nonperformance by other parties to these contracts and evaluates their credit risk as a component of fair value.

Non-recurring Fair Value Measurements

Following is a summary of losses as a result of the Company measuring assets at fair value on a non-recurring basis during the three and six months ended June 30, 2012 and 2011, all of which were valued using Level 3 inputs:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	**2011**	**2012**	**2011**
Long-lived assets held and used	$ —	$ 18	$ 23	$ 18

During the six months ended June 30, 2012, as a result of the likelihood that certain assets would be disposed of before the end of their estimated useful lives, resulting in lower future cash flows associated with these assets, the Company wrote down long-lived assets with a carrying value of $26 to fair value of $5, resulting in impairment charges of $15 and $6 on certain assets within its Epoxy, Phenolic and Coating Resins and Forest Products Resins segments, respectively. These long-lived assets were valued by using a discounted cash flow analysis based on assumptions that market participants would use. Significant unobservable inputs in the model included projected short-term future cash flows, projected growth rates and discount rates associated with these long-lived assets. Future projected short-term cash flows and growth rates were derived from probability-weighted forecast models based upon budgets prepared by the Company's management. These projected future cash flows were discounted using rates ranging from 2% to 3%.

During the six months ended June 30, 2012, as a result of market weakness and the loss of a customer, resulting in lower future cash flows associated with certain assets, the Company wrote-down long-lived assets with a carrying value of $22 to a fair value of $20, resulting in an impairment charge of $2 within its Forest Products Resins segment. These long-lived assets were valued using a discounted cash flow analysis based on assumptions that market participants would use and incorporates probability-weighted cash flows based on the likelihood of various possible scenarios. Significant unobservable inputs in the model included projected future cash flows, projected growth rates and discount rates associated with these long-lived assets. Future projected cash flows and growth rates were derived from probability-weighted forecast models based upon budgets prepared by the Company's management. These projected future cash flows were discounted using rates ranging from 2% to 10%.

As a result of the permanent closure of a large customer in the second quarter of 2011 and continued competitive pressures resulting in successive periods of negative cash flows associated with certain assets within the Company's European forest products business, the Company wrote down long-lived assets with a carrying value of $29 to fair value of $11, resulting in an impairment charge of $18 for the three and six months ended June 30, 2011. These assets were valued using a discounted cash flow analysis based on assumptions that market participants would use, and incorporates probability-weighted cash flows based on the likelihood of various possible scenarios. Significant unobservable inputs in the model included projected future cash flows, projected growth rates, discount rates and asset usage charges associated with certain intangible assets.

Non-derivative Financial Instruments

The following table summarizes the carrying amount and fair value of the Company’s non-derivative financial instruments:

		Fair Value			
	Carrying Amount	**Level 1**	**Level 2**	**Level 3**	**Total**
June 30, 2012					
Debt	$ 3,497	$ —	$ 3,331	$ 11	$ 3,342
December 31, 2011					
Debt	3,539	—	3,214	12	3,226

Fair values of debt classified as Level 2 are determined based on other similar financial instruments, or based upon interest rates that are currently available to the Company for the issuance of debt with similar terms and maturities. Level 3 amounts represent capital leases whose value is determined through the use of present value and specific contract terms. The carrying amounts of cash and cash equivalents, short term investments, accounts receivable, accounts and drafts payable and other accrued liabilities are considered reasonable estimates of their fair values due to the short-term maturity of these financial instruments.

7. Derivative Instruments and Hedging Activities

Derivative Financial Instruments

The Company is exposed to certain risks related to its ongoing business operations. The primary risks managed by using derivative instruments are foreign currency exchange risk, interest rate risk and commodity price risk. The Company does not hold or issue derivative financial instruments for trading purposes.

Foreign Exchange Rate Swaps

International operations account for a significant portion of the Company’s revenue and operating income. The Company’s policy is to reduce foreign currency cash flow exposure from exchange rate fluctuations by hedging anticipated and firmly committed transactions when it is economically feasible. The Company periodically enters into forward contracts to buy and sell foreign currencies to reduce foreign exchange exposure and protect the U.S. dollar value of certain transactions to the extent of the amount under contract. The counter-parties to our forward contracts are financial institutions with investment grade ratings. The Company does not apply hedge accounting to these derivative instruments.

Interest Rate Swaps

The Company periodically uses interest rate swaps to alter interest rate exposures between fixed and floating rates on certain long-term debt. Under interest rate swaps, the Company agrees with other parties to exchange, at specified intervals, the difference between fixed rate and floating rate interest amounts calculated using an agreed-upon notional principal amount. The counter-parties to the interest rate swap agreements are financial institutions with investment grade ratings.

In July 2010, the Company entered into a two-year interest rate swap agreement . This swap is designed to offset the cash flow variability that results from interest rate fluctuations on the Company’s variable rate debt. This swap became effective on January 4, 2011 upon the expiration of the January 2007 interest rate swap. The initial notional amount of the swap is $350, and will subsequently be amortized down to $325. The Company pays a fixed rate of 1.032% and will receive a variable one month LIBOR rate. The Company accounts for the swap as a qualifying cash flow hedge.

In December 2011, the Company entered into a three-year interest rate swap agreement with a notional amount of AUD $6, which became effective on January 3, 2012 and will mature on December 5, 2014. The Company pays a fixed rate of 4.140% and receives a variable rate based on the 3 month Australian Bank Bill Rate. The Company has not applied hedge accounting to this derivative instrument.

Commodity Contracts

The Company hedges a portion of its electricity purchases for certain North American plants. The Company enters into forward contracts with fixed prices to hedge electricity pricing at these plants. Any unused electricity is net settled for cash each month based on the market electricity price versus the contract price. The Company also hedges a portion of its natural gas purchases for certain North American plants. The Company uses futures contracts to hedge natural gas pricing at these plants. The natural gas contracts are settled for cash each month based on the closing market price on the last day the contract trades on the New York Mercantile Exchange. The Company does not apply hedge accounting to these electricity or natural gas future contracts.

The following tables summarize the Company's derivative financial instruments:

		June 30, 2012		December 31, 2011	
Liability Derivatives	**Balance Sheet Location**	**Notional Amount**	**Fair Value Liability**	**Notional Amount**	**Fair Value Liability**
Derivatives designated as hedging instruments:					
Interest Rate Swaps					
Interest swap – 2010	Other current liabilities	$ 325	$ (1)	$ 350	$ (2)
Total			$ (1)		$ (2)
Derivatives not designated as hedging instruments:					
Interest Rate Swap					
Australian dollar interest swap	Other current liabilities	$ 6	$ —	$ 6	$ —
Commodity Contracts					
Electricity contracts	Other current liabilities	2	—	3	(1)
Natural gas futures	Other current liabilities	2	(1)	5	—
Total			$ (1)		$ (1)

	Amount of Loss Recognized in OCI on Derivative for the Three Months Ended:			Amount of Loss Reclassified from Accumulated OCI into Income for the Three Months Ended:	
Derivatives in Cash Flow Hedging Relationship	**June 30, 2012**	**June 30, 2011**	**Location of Loss Reclassified from Accumulated OCI into Income**	**June 30, 2012**	**June 30, 2011**
Interest Rate Swaps					
Interest swap – 2010	$ —	$ (2)	Interest expense, net	$ (1)	$ (1)
Total	$ —	$ (2)		$ (1)	$ (1)

	Amount of Loss Recognized in OCI on Derivative for the Six Months Ended:			Amount of Loss Reclassified from Accumulated OCI into Income for the Six Months Ended:	
Derivatives in Cash Flow Hedging Relationship	**June 30, 2012**	**June 30, 2011**	**Location of Loss Reclassified from Accumulated OCI into Income**	**June 30, 2012**	**June 30, 2011**
Interest Rate Swaps					
Interest swap – 2010	$ —	$ (2)	Interest expense, net	$ (1)	$ (2)
Total	$ —	$ (2)		$ (1)	$ (2)

As of June 30, 2012, the Company expects to reclassify $1 of losses recognized in Accumulated other comprehensive income to earnings over the next twelve months.

	Amount of Gain (Loss) Recognized in Income on Derivative for the Three Months Ended:		
Derivatives Not Designated as Hedging Instruments	**June 30, 2012**	**June 30, 2011**	**Location of Gain (Loss) Recognized in Income on Derivative**
Foreign Exchange and Interest Rate Swaps			
Cross-Currency and Interest Rate Swap	$ —	$ —	Other non-operating expense, net
Commodity Contracts			
Electricity contracts	—	(1)	Cost of sales
Natural gas futures	1	—	Cost of sales
Total	$ 1	$ (1)	

Derivatives Not Designated as Hedging Instruments	Amount of Gain (Loss) Recognized in Income on Derivative for the Six Months Ended: June 30, 2012	June 30, 2011	Location of Gain (Loss) Recognized in Income on Derivative
Foreign Exchange and Interest Rate Swaps			
Cross-Currency and Interest Rate Swap	$ —	$ (2)	Other non-operating expense, net
Commodity Contracts			
Electricity contracts	1	(1)	Cost of sales
Natural gas futures	(1)	—	Cost of sales
Total	$ —	$ (3)	

8. Debt Obligations

Debt outstanding at June 30, 2012 and December 31, 2011 is as follows:

	June 30, 2012		December 31, 2011	
	Long-Term	Due Within One Year	Long-Term	Due Within One Year
Non-affiliated debt:				
Senior Secured Credit Facilities:				
Floating rate term loans due May 2013	$ —	$ —	$ 446	$ 8
Floating rate term loans due May 2015	901	15	910	15
Senior Secured Notes:				
6.625% First Priority Senior Notes due 2020	450	—	—	—
8.875% senior secured notes due 2018 (includes $6 of unamortized debt discount at June 30, 2012 and December 31, 2011)	994	—	994	—
Floating rate second-priority senior secured notes due 2014	120	—	120	—
9.00% Second-priority senior secured notes due 2020	574	—	574	—
Debentures:				
9.2% debentures due 2021	74	—	74	—
7.875% debentures due 2023	189	—	189	—
8.375% sinking fund debentures due 2016	62	—	62	—
Other Borrowings:				
Australia Facility due 2014	31	5	36	5
Brazilian bank loans	20	34	—	65
Capital Leases	10	1	11	1
Other	5	10	4	23
Total non-affiliated debt	3,430	65	3,420	117
Affiliated debt:				
Affiliated borrowings due on demand	—	2	—	2
Total affiliated debt	—	2	—	2
Total debt	$ 3,430	$ 67	$ 3,420	$ 119

2012 Refinancing Activities

In March 2012, the Company issued $450 aggregate principal amount of 6.625% First-Priority Senior Secured Notes due 2020 at an issue price of 100%. The Company used the net proceeds, together with cash on hand to repay approximately $454 aggregate principal amount of existing term loans maturing May 5, 2013 under the Company’s senior secured credit facilities, effectively extending these maturities by an additional seven years. In conjunction with the Offering Transaction, the Company extended $171 of its $200 revolving line of credit facility commitments from lenders from February 2013 to December 2014. In connection with the refinancing activities, the lender commitments to the revolving line of credit facility were decreased to approximately $192 in the aggregate. The interest rate for loans made under the extended revolver commitments was increased to adjusted LIBOR plus 4.75% from adjusted LIBOR plus 4.50%. The commitment fee for the extended revolver commitments was decreased to 0.5% of the unused line from 4.5% of the unused line. Collectively, these transactions are referred to as the “March Refinancing Transactions.” The priority of the liens securing the collateral for the 6.625% Senior Secured Notes is pari passu to the liens in such collateral securing the Company's senior secured credit facilities.

The Company incurred approximately $13 in fees associated with the March Refinancing Transactions, which have been deferred and are recorded in “Other assets, net” in the unaudited Condensed Consolidated Balance Sheets. The deferred fees will be amortized over the contractual life of the respective debt obligations on an effective interest basis. Additionally, $1 in unamortized deferred financing fees were written-off related to the $454 of term loans under the Company's senior secured credit facility that were repaid and extinguished. These fees are included in “Other non-operating (income) expense, net” in the unaudited Condensed Consolidated Statements of Operations.

Covenant Compliance

Two of the Company’s wholly-owned international subsidiaries were not in compliance with a financial covenant under their respective loan agreements when they delivered their audited financial statements for the year ended December 31, 2011 in the second quarter of 2012. As of December 31, 2011, outstanding debt of approximately $31 was classified as “Debt payable within one year” in the unaudited Condensed Consolidated Balance Sheets. In March 2012, the Company subsequently obtained a covenant waiver from one of the respective banks, representing approximately $25 of the $31. As of June 30, 2012, the Company has reclassified $25 of the respective debt to “Long-term debt” in the unaudited Condensed Consolidated Balance Sheets.

9. Commitments and Contingencies

Environmental Matters

The Company’s operations involve the use, handling, processing, storage, transportation and disposal of hazardous materials. The Company is subject to extensive environmental regulation at the federal, state and local levels as well as foreign laws and regulations, and is therefore exposed to the risk of claims for environmental remediation or restoration. In addition, violations of environmental laws or permits may result in restrictions being imposed on operating activities, substantial fines, penalties, damages or other costs, any of which could have a material adverse effect on the Company’s business, financial condition, results of operations or cash flows.

Environmental Institution of Paraná IAP—On August 10, 2005, the Environmental Institute of Paraná (IAP), an environmental agency in the State of Paraná, provided Hexion Quimica Industria, the Company’s Brazilian subsidiary, with notice of an environmental assessment in the amount of 12 Brazilian reais. The assessment related to alleged environmental damages to the Paranagua Bay caused in November 2004 from an explosion on a shipping vessel carrying methanol purchased by the Company. The investigations performed by the public authorities have not identified any actions of the Company that contributed to or caused the accident. The Company responded to the assessment by filing a request to have it cancelled and by obtaining an injunction precluding execution of the assessment pending adjudication of the issue. In November 2010, the Court denied the Company’s request to cancel the assessment and lifted the injunction that had been issued. The Company responded to the ruling by filing an appeal in the State of Paraná Court of Appeals. In March 2012, the Company was informed that the Court of Appeals had denied the Company’s appeal. The Company continues to believe that the assessment is invalid, and on June 4, 2012 it filed appeals to the Superior Court of Justice and the Supreme Court of Brazil. Because the Company continues to believe it has strong defenses against the validity of the assessment, it does not believe that a loss is probable. At June 30, 2012, the amount of the assessment, including tax, penalties, monetary correction and interest, is 28 Brazilian reais, or approximately $14.

The following table summarizes all probable environmental remediation, indemnification and restoration liabilities, including related legal expenses, at June 30, 2012 and December 31, 2011:

	Number of Sites		Liability		Range of Reasonably Possible Costs	
Site Description	**June 30, 2012**	**December 31, 2011**	**June 30, 2012**	**December 31, 2011**	**Low**	**High**
Geismar, LA	1	1	$ 17	$ 17	$ 10	$ 24
Superfund and offsite landfills – allocated share:						
Less than 1%	23	31	1	1	1	2
Equal to or greater than 1%	12	12	6	7	5	15
Currently-owned	13	12	5	5	4	11
Formerly-owned:						
Remediation	10	10	2	1	1	12
Monitoring only	4	5	1	1	—	1
Total	63	71	$ 32	$ 32	$ 21	$ 65

These amounts include estimates for unasserted claims that the Company believes are probable of loss and reasonably estimable. The estimate of the range of reasonably possible costs is less certain than the estimates upon which the liabilities are based. To establish the upper end of a range, assumptions less favorable to the Company among the range of reasonably possible outcomes were used. As with any estimate, if facts or circumstances change, the final outcome could differ materially from these estimates. At June 30, 2012 and December 31, 2011, $8 and $6, respectively, has been included in “Other current liabilities” in the unaudited Condensed Consolidated Balance Sheets with the remaining amount included in “Other long-term liabilities”.

Following is a discussion of the Company's environmental liabilities and the related assumptions at June 30, 2012:

Geismar, LA Site—The Company formerly owned a basic chemicals and polyvinyl chloride business that was taken public as Borden Chemicals and Plastics Operating Limited Partnership ("BCPOLP") in 1987. The Company retained a 1% interest, the general partner interest and the liability for certain environmental matters after BCPOLP's formation. Under a Settlement Agreement approved by the United States Bankruptcy Court for the District of Delaware among the Company, BCPOLP, the United States Environmental Protection Agency and the Louisiana Department of Environmental Quality, the Company agreed to perform certain of BCPOLP's obligations for soil and groundwater contamination at BCPOLP's Geismar, Louisiana site. The Company bears the sole responsibility for these obligations because there are no other potentially responsible parties ("PRP") or third parties from whom the Company could seek reimbursement.

A groundwater pump and treat system to remove contaminants is operational, and natural attenuation studies are proceeding. If closure procedures and remediation systems prove to be inadequate, or if additional contamination is discovered, costs that would approach the higher end of the range of possible outcomes could result.

Due to the long-term nature of the project, the reliability of timing and the ability to estimate remediation payments, a portion of this liability was recorded at its net present value, assuming a 3% discount rate and a time period of 28 years. The range of possible outcomes is discounted in a similar manner. The undiscounted liability, which is expected to be paid over the next 28 years, is approximately $24. Over the next five years, the Company expects to make ratable payments totaling $6.

Superfund Sites and Offsite Landfills—The Company is currently involved in environmental remediation activities at a number of sites for which it has been notified that it is, or may be, a PRP under the United States Comprehensive Environmental Response, Compensation and Liability Act or similar state "superfund" laws. The Company anticipates approximately 50% of the estimated liability for these sites will be paid within the next five years, with the remainder over the next twenty-five years. The Company generally does not bear a significant level of responsibility for these sites, and as a result, has little control over the costs and timing of cash flows.

The Company's ultimate liability will depend on many factors including its share of waste volume, the financial viability of other PRPs, the remediation methods and technology used, the amount of time necessary to accomplish remediation and the availability of insurance coverage. The range of possible outcomes takes into account the maturity of each project, resulting in a more narrow range as the project progresses. To estimate both its current reserves for environmental remediation at these sites and the possible range of additional costs, the Company has not assumed that it will bear the entire cost of remediation of every site to the exclusion of other known PRPs who may be jointly and severally liable. The Company has limited information to assess the viability of other PRPs and their probable contribution on a per site basis. The Company's insurance provides very limited, if any, coverage for these environmental matters.

Sites Under Current Ownership—The Company is conducting environmental remediation at a number of locations that it currently owns, of which eight sites are no longer in operation. As the Company is performing a portion of the remediation on a voluntary basis, it has some control over the costs to be incurred and the timing of cash flows. The Company expects to pay approximately $5 of these liabilities within the next five years, with the remainder over the next five years. The factors influencing the ultimate outcome include the methods of remediation elected, the conclusions and assessment of site studies remaining to be completed, and the time period required to complete the work. No other parties are responsible for remediation at these sites.

Formerly-Owned Sites—The Company is conducting environmental remediation at a number of locations that it formerly owned. The final costs to the Company will depend on the method of remediation chosen and the level of participation of third parties.

In addition, the Company is responsible for a number of sites that require monitoring where no additional remediation is expected. The Company has established reserves for costs related to these sites. Payment of these liabilities is anticipated to occur over the next ten or more years. The ultimate cost to the Company will be influenced by fluctuations in projected monitoring periods or by findings that are different than anticipated.

Indemnifications —In connection with the acquisition of certain of the Company's operating businesses, the Company has been indemnified by the sellers against certain liabilities of the acquired businesses, including liabilities relating to both known and unknown environmental contamination arising prior to the date of the purchase. The indemnifications may be subject to certain exceptions and limitations, deductibles and indemnity caps. While it is reasonably possible that some costs could be incurred, except for those sites identified above, the Company has inadequate information to allow it to estimate a potential range of liability, if any.

Non-Environmental Legal Matters

The Company is involved in various legal proceedings in the ordinary course of business and has reserves of $11 and $7 at June 30, 2012 and December 31, 2011, respectively, for all non-environmental legal defense costs incurred and settlement costs that it believes are probable and estimable. At June 30, 2012 and December 31, 2011, $8 and $3, respectively, has been included in "Other current liabilities" in the unaudited Condensed Consolidated Balance Sheets with the remaining amount included in "Other long-term liabilities."

Following is a discussion of significant non-environmental legal proceedings:

Brazil Tax Claim— In 1992, the State of Sao Paulo Administrative Tax Bureau issued an assessment against the Company's Brazilian subsidiary claiming that excise taxes were owed on certain intercompany loans made for centralized cash management purposes. These loans were characterized by the Tax Bureau as intercompany sales. Since that time, management and the Tax Bureau have held discussions and the subsidiary filed an administrative appeal seeking cancellation of the assessment. The Administrative Court upheld the assessment in December 2001. In 2002, the subsidiary filed a second appeal with the highest-level Administrative Court, again seeking cancellation of the assessment. In February 2007, the highest-level Administrative Court upheld the assessment. The Company requested a review of this decision. On April 23, 2008, the Brazilian Administrative Tax Tribunal issued its final decision upholding the assessment against the subsidiary. The Company filed an Annulment action in the Brazilian Judicial Courts in May 2008 along with a request for an injunction to suspend the tax collection. The injunction was denied but the Annulment action is being pursued. The Company has pledged certain properties and assets in Brazil during the pendency of the Annulment action in lieu of paying the assessment. In September 2010, in the Company's favor, the Court adopted its appointed expert's report finding that the transactions in question were intercompany loans. The State Tax Bureau filed an appeal of this decision in December 2010, which is still pending. The Company continues to believe that a loss contingency is not probable. At June 30, 2012, the amount of the assessment, including tax, penalties, monetary correction and interest, is 69 Brazilian reais, or approximately $34.

Hillsborough County—The Company is named in a lawsuit filed on July 12, 2004 in Hillsborough County, Florida Circuit Court, for an animal feed supplement processing site formerly operated by the Company and sold in 1980. The lawsuit is filed on behalf of multiple residents of Hillsborough County living near the site and it alleges various injuries from exposure to toxic chemicals. The Company does not have adequate information from which to estimate a potential range of liability, if any. The court dismissed a similar lawsuit brought on behalf of a class of plaintiffs in November 2005.

Other Legal Matters—The Company is involved in various other product liability, commercial and employment litigation, personal injury, property damage and other legal proceedings in addition to those described above, including actions that allege harm caused by products the Company has allegedly made or used, containing silica, vinyl chloride monomer and asbestos. The Company believes it has adequate reserves and that it is not reasonably possible that a loss exceeding amounts already reserved would be material. Furthermore, the Company has insurance to cover claims of these types.

10. Pension and Postretirement Expense

Following are the components of net pension and postretirement expense (benefit) recognized by the Company for the three and six months ended June 30, 2012 and 2011:

	Pension Benefits				Non-Pension Postretirement Benefits			
	Three Months Ended June 30,				Three Months Ended June 30,			
	2012		2011		2012		2011	
	U.S. Plans	Non-U.S. Plans	U.S. Plans	Non-U.S. Plans	U.S. Plans	Non-U.S. Plans	U.S. Plans	Non-U.S. Plans
Service cost	$ —	$ 2	$ —	$ 2	$ —	$ —	$ —	$ —
Interest cost on projected benefit obligation	3	5	3	5	—	—	—	—
Expected return on assets	(4)	(4)	(4)	(3)	—	—	—	—
Amortization of prior service cost (benefit)	2	—	—	—	(2)	—	(2)	—
Recognized actuarial loss	—	—	2	—	—	—	—	—
Net expense (benefit)	$ 1	$ 3	$ 1	$ 4	$ (2)	$ —	$ (2)	$ —

	Pension Benefits				Non-Pension Postretirement Benefits			
	Six Months Ended June 30,				Six Months Ended June 30,			
	2012		2011		2012		2011	
	U.S. Plans	Non-U.S. Plans	U.S. Plans	Non-U.S. Plans	U.S. Plans	Non-U.S. Plans	U.S. Plans	Non-U.S. Plans
Service cost	$ 1	$ 4	$ 1	$ 4	$ —	$ —	$ —	$ —
Interest cost on projected benefit obligation	6	9	6	9	—	—	—	—
Expected return on assets	(8)	(7)	(8)	(6)	—	—	—	—
Amortization of prior service cost (benefit)	4	—	—	—	(4)	—	(5)	—
Recognized actuarial loss	—	—	4	—	—	—	—	—
Net expense (benefit)	$ 3	$ 6	$ 3	$ 7	$ (4)	$ —	$ (5)	$ —

11. Segment Information

The Company's business segments are based on the products that the Company offers and the markets that it serves. At June 30, 2012, the Company had two reportable segments: Epoxy, Phenolic and Coating Resins and Forest Products Resins. A summary of the major products of the Company's reportable segments follows:

- Epoxy, Phenolic and Coating Resins: epoxy specialty resins, oil field products, versatic acids and derivatives, basic epoxy resins and intermediates, phenolic specialty resins and molding compounds, polyester resins, acrylic resins and vinylic resins
- Forest Products Resins: forest products resins and formaldehyde applications

Reportable Segments

Following are net sales and Segment EBITDA (earnings before interest, income taxes, depreciation and amortization) by reportable segment. Segment EBITDA is defined as EBITDA adjusted to exclude certain non-cash, other income and expenses and discontinued operations. Segment EBITDA is the primary performance measure used by the Company's senior management, the chief operating decision-maker and the board of directors to evaluate operating results and allocate capital resources among segments. Segment EBITDA is also the profitability measure used to set management and executive incentive compensation goals. Corporate and Other is primarily corporate general and administrative expenses that are not allocated to the segments, such as shared service and administrative functions, foreign exchange gains and losses and legacy company costs not allocated to continuing segments.

Net Sales to Unaffiliated Customers[(1)]:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Epoxy, Phenolic and Coating Resins	$ 796	$ 972	$ 1,590	$ 1,818
Forest Products Resins	463	466	905	914
Total	$ 1,259	$ 1,438	$ 2,495	$ 2,732

(1) Intersegment sales are not significant and, as such, are eliminated within the selling segment.

Segment EBITDA:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Epoxy, Phenolic and Coating Resins	$ 101	$ 157	$ 215	$ 307
Forest Products Resins	56	50	102	95
Corporate and Other[(2)]	(12)	(18)	(26)	(35)

(2) For the six months ended June 30, 2012, the Company has reclassified approximately $3 of costs into Corporate and Other Segment EBITDA which relate to the three months ended March 31, 2012.

Reconciliation of Segment EBITDA to Net Income:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Segment EBITDA:				
Epoxy, Phenolic and Coating Resins	$ 101	$ 157	$ 215	$ 307
Forest Products Resins	56	50	102	95
Corporate and Other	(12)	(18)	(26)	(35)
Reconciliation:				
Items not included in Segment EBITDA:				
Asset impairments and other non-cash charges	—	(21)	(48)	(21)
Business realignment costs	(3)	(5)	(18)	(8)
Integration costs	(1)	(5)	(6)	(10)
Net (loss) income from discontinued operations	—	(3)	—	2
Other	(3)	16	4	12
Total adjustments	(7)	(18)	(68)	(25)
Interest expense, net	(67)	(65)	(132)	(129)
Income tax expense	(4)	—	(2)	(3)
Depreciation and amortization	(39)	(43)	(77)	(84)
Net income	$ 28	$ 63	$ 12	$ 126

Items Not Included in Segment EBITDA

Asset impairments and non-cash charges primarily represent asset impairments, stock-based compensation expense, accelerated depreciation on closing facilities and unrealized derivative and foreign exchange gains and losses. Business realignment costs for the three and six months ended June 30, 2012 primarily include expenses from the Company's restructuring and cost optimization programs. Business realignment costs for the three and six months ended June 30, 2011 primarily relate to expenses from minor restructuring programs. Integration costs relate primarily to the Momentive Combination. Net income from discontinued operations represents the results of the IAR and CCR businesses.

Not included in Segment EBITDA are certain non-cash and other income and expenses. For the three and six months ended June 30, 2012, these items primarily include net realized foreign exchange transaction gains and insurance recoveries related to the terminated Huntsman merger, partially offset by losses on the disposal of assets. For the three and six months ended June 30, 2011, these items include primarily business optimization expenses and retention program costs, offset by realized foreign exchange transaction gains and a gain recognized on the termination of an operator agreement with a customer.

12. Summarized Financial Information of Unconsolidated Affiliate

Summarized financial information of the unconsolidated affiliate HAI as of June 30, 2012 and December 31, 2011 and for the three and six months ended June 30, 2012 and 2011 is as follows:

	June 30, 2012	December 31, 2011
Current assets	$ 38	$ 35
Non-current assets	12	13
Current liabilities	31	21
Non-current liabilities	—	—

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Net sales	$ 49	$ 48	$ 99	$ 91
Gross profit	12	11	25	20
Pre-tax income	9	7	18	13
Net income	8	7	17	12

13. Guarantor/Non-Guarantor Subsidiary Financial Information

The Company and certain of its U.S. subsidiaries guarantee debt issued by its wholly owned subsidiaries Hexion Nova Scotia, ULC and Hexion U.S. Finance Corporation (together, the “Subsidiary Issuers”), which includes the 6.625% first priority notes due 2020, 8.875% senior secured notes due 2018, the floating rate second-priority senior secured notes due 2014 and the 9% second-priority notes due 2020.

The following information contains the condensed consolidating financial information for MSC (the parent), the Subsidiary Issuers, the combined subsidiary guarantors (Momentive Specialty Chemical Investments Inc.; Borden Chemical Foundry; LLC, Lawter International, Inc.; HSC Capital Corporation; Momentive International, Inc.; Momentive CI Holding Company; NL COOP Holdings LLC and Oilfield Technology Group, Inc.) and the combined non-guarantor subsidiaries, which includes all of the Company’s foreign subsidiaries.

All of the subsidiary issuers and subsidiary guarantors are 100% owned by MSC. All guarantees are full and unconditional, and are joint and several. There are no significant restrictions on the ability of the Company to obtain funds from its domestic subsidiaries by dividend or loan. While the Company’s Australian, New Zealand and Brazilian subsidiaries are restricted in the payment of dividends and intercompany loans due to the terms of their credit facilities, there are no material restrictions on the Company’s ability to obtain cash from the remaining non-guarantor subsidiaries.

This information includes allocations of corporate overhead to the combined non-guarantor subsidiaries based on net sales. Income tax expense has been provided on the combined non-guarantor subsidiaries based on actual effective tax rates.

MOMENTIVE SPECIALTY CHEMICALS INC.
THREE MONTHS ENDED JUNE 30, 2012
CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS (Unaudited)

	Momentive Specialty Chemicals Inc.	Subsidiary Issuers	Combined Subsidiary Guarantors	Combined Non-Guarantor Subsidiaries	Eliminations	Consolidated
Net sales	$ 576	$ —	$ —	$ 761	$ (78)	$ 1,259
Cost of sales	484	—	—	681	(78)	1,087
Gross profit	92	—	—	80	—	172
Selling, general and administrative expense	17	—	—	62	—	79
Business realignment costs	2	—	—	1	—	3
Other operating (income) expense, net	(4)	—	—	2	—	(2)
Operating income	77	—	—	15	—	92
Interest expense, net	14	46	—	7	—	67
Intercompany interest expense (income)	35	(49)	—	14	—	—
Other non-operating expense (income), net	22	—	1	(24)	—	(1)
Income (loss) from continuing operations before income tax, earnings from unconsolidated entities	6	3	(1)	18	—	26
Income tax expense	3	—	—	1	—	4
Income (loss) from continuing operations before earnings from unconsolidated entities	3	3	(1)	17	—	22
Earnings from unconsolidated entities, net of taxes	25	—	5	2	(26)	6
Net income	$ 28	$ 3	$ 4	$ 19	$ (26)	$ 28
Comprehensive (loss) income	$ (15)	$ —	$ 5	$ (2)	$ (3)	$ (15)

MOMENTIVE SPECIALTY CHEMICALS INC.
THREE MONTHS ENDED JUNE 30, 2011
CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS (Unaudited)

	Momentive Specialty Chemicals Inc.	Subsidiary Issuers	Combined Subsidiary Guarantors	Combined Non-Guarantor Subsidiaries	Eliminations	Consolidated
Net sales	$ 617	$ —	$ —	$ 912	$ (91)	$ 1,438
Cost of sales	488	—	—	826	(91)	1,223
Gross profit	129	—	—	86	—	215
Selling, general and administrative expense	34	—	—	53	—	87
Asset impairments	—	—	—	18	—	18
Business realignment costs	—	—	—	5	—	5
Other operating income, net	(4)	—	—	(19)	—	(23)
Operating income	99	—	—	29	—	128
Interest expense, net	17	38	—	10	—	65
Intercompany interest expense (income)	35	(48)	—	13	—	—
Other non-operating (income) expense, net	(9)	—	—	9	—	—
Income (loss) from continuing operations before income tax, earnings from unconsolidated entities	56	10	—	(3)	—	63
Income tax (benefit) expense	(11)	1	—	10	—	—
Income (loss) from continuing operations before earnings from unconsolidated entities	67	9	—	(13)	—	63
(Losses) earnings from unconsolidated entities, net of taxes	(3)	—	(3)	—	9	3
Net income (loss) from continuing operations	64	9	(3)	(13)	9	66
Net loss from discontinued operations, net of tax	(1)	—	—	(2)	—	(3)
Net income (loss)	$ 63	$ 9	$ (3)	$ (15)	$ 9	$ 63
Comprehensive income (loss)	$ 84	$ 10	$ (3)	$ 2	$ (9)	$ 84

MOMENTIVE SPECIALTY CHEMICALS INC.
SIX MONTHS ENDED JUNE 30, 2012
CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS (Unaudited)

	Momentive Specialty Chemicals Inc.	Subsidiary Issuers	Combined Subsidiary Guarantors	Combined Non-Guarantor Subsidiaries	Eliminations	Consolidated
Net sales	$ 1,114	$ —	$ —	$ 1,530	$ (149)	$ 2,495
Cost of sales	938	—	—	1,356	(149)	2,145
Gross profit	176	—	—	174	—	350
Selling, general and administrative expense	47	—	—	117	—	164
Asset impairments	—	—	—	23	—	23
Business realignment costs	4	—	—	14	—	18
Other operating expense, net	1	—	—	8	—	9
Operating income	124	—	—	12	—	136
Interest expense, net	30	85	—	17	—	132
Intercompany interest expense (income)	65	(91)	—	26	—	—
Other non-operating expense (income), net	11	—	—	(10)	—	1
Income (loss) from continuing operations before income tax, earnings from unconsolidated entities	18	6	—	(21)	—	3
Income tax expense	2	—	—	—	—	2
Income (loss) from continuing operations before earnings from unconsolidated entities	16	6	—	(21)	—	1
(Losses) earnings from unconsolidated entities, net of taxes	(4)	—	3	2	10	11
Net income (loss)	$ 12	$ 6	$ 3	$ (19)	$ 10	$ 12
Comprehensive (loss) income	$ (2)	$ 4	$ 4	$ (23)	$ 15	$ (2)

MOMENTIVE SPECIALTY CHEMICALS INC.
SIX MONTHS ENDED JUNE 30, 2011
CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS (Unaudited)

	Momentive Specialty Chemicals Inc.	Subsidiary Issuers	Combined Subsidiary Guarantors	Combined Non-Guarantor Subsidiaries	Eliminations	Consolidated
Net sales	$ 1,180	$ —	$ —	$ 1,725	$ (173)	$ 2,732
Cost of sales	955	—	—	1,526	(173)	2,308
Gross profit	225	—	—	199	—	424
Selling, general and administrative expense	64	—	—	107	—	171
Asset impairments	—	—	—	18	—	18
Business realignment costs	2	—	—	6	—	8
Other operating income, net	(21)	—	—	—	—	(21)
Operating income	180	—	—	68	—	248
Interest expense, net	35	75	—	19	—	129
Intercompany interest expense (income)	64	(90)	—	26	—	—
Other non-operating (income) expense , net	(36)	—	(1)	35	—	(2)
Income (loss) from continuing operations before income tax, earnings from unconsolidated entities	117	15	1	(12)	—	121
Income tax (benefit) expense	(19)	2	—	20	—	3
Income (loss) from continuing operations before earnings from unconsolidated entities	136	13	1	(32)	—	118
Earnings from unconsolidated entities, net of taxes	8	—	15	—	(17)	6
Net income (loss) from continuing operations	144	13	16	(32)	(17)	124
Net (loss) income from discontinued operations, net of tax	(18)	—	—	20	—	2
Net income (loss)	$ 126	$ 13	$ 16	$ (12)	$ (17)	$ 126
Comprehensive income	$ 177	$ 18	$ 16	$ 3	$ (37)	$ 177

MOMENTIVE SPECIALTY CHEMICALS INC.
JUNE 30, 2012
CONDENSED CONSOLIDATING BALANCE SHEET (Unaudited)

	Momentive Specialty Chemicals Inc.	Subsidiary Issuers	Combined Subsidiary Guarantors	Combined Non-Guarantor Subsidiaries	Eliminations	Consolidated
Assets						
Current assets						
Cash and cash equivalents (including restricted cash of $0 and $3, respectively)	$ 255	$ —	$ —	$ 81	$ —	$ 336
Short-term investments	—	—	—	5	—	5
Accounts receivable, net	207	—	—	488	—	695
Inventories:						
Finished and in-process goods	124	—	—	186	—	310
Raw materials and supplies	44	—	—	82	—	126
Other current assets	19	—	—	50	—	69
Total current assets	649	—	—	892	—	1,541
Other assets, net	85	45	29	98	(89)	168
Property and equipment, net	494	—	—	653	—	1,147
Goodwill	93	—	—	73	—	166
Other intangible assets, net	56	—	—	40	—	96
Total assets	$ 1,377	$ 45	$ 29	$ 1,756	$ (89)	$ 3,118
Liabilities and (Deficit) Equity						
Current liabilities						
Accounts and drafts payable	$ 173	$ —	$ —	$ 317	$ —	$ 490
Intercompany accounts payable (receivable)	28	(51)	1	22	—	—
Debt payable within one year	11	—	—	54	—	65
Intercompany loans (receivable) payable	(118)	—	—	118	—	—
Affiliated debt payable within one year	2	—	—	—	—	2
Interest payable	12	53	—	1	—	66
Income taxes (receivable) payable	(7)	—	—	15	—	8
Accrued payroll and incentive compensation	9	—	—	29	—	38
Other current liabilities	75	—	—	62	—	137
Total current liabilities	185	2	1	618	—	806
Long-term debt	868	2,137	—	425	—	3,430
Intercompany loans payable (receivable)	1,650	(2,341)	(19)	710	—	—
Long-term pension and post employment benefit obligations	90	—	—	122	—	212
Deferred income taxes	15	2	—	43	—	60
Other long-term liabilities	112	6	—	34	—	152
Advance from affiliates	225	—	—	—	—	225
Total liabilities	3,145	(194)	(18)	1,952	—	4,885
Total Momentive Specialty Chemicals Inc. shareholders (deficit) equity	(1,768)	239	47	(197)	(89)	(1,768)
Noncontrolling interest	—	—	—	1	—	1
Total (deficit) equity	(1,768)	239	47	(196)	(89)	(1,767)
Total liabilities and (deficit) equity	$ 1,377	$ 45	$ 29	$ 1,756	$ (89)	$ 3,118

MOMENTIVE SPECIALTY CHEMICALS INC.
DECEMBER 31, 2011
CONDENSED CONSOLIDATING BALANCE SHEET

	Momentive Specialty Chemicals Inc.	Subsidiary Issuers	Combined Subsidiary Guarantors	Combined Non-Guarantor Subsidiaries	Eliminations	Consolidated
Assets						
Current assets						
Cash and cash equivalents (including restricted cash of $0 and $3, respectively)	$ 221	$ —	$ —	$ 210	$ —	$ 431
Short-term investments	—	—	—	7	—	7
Accounts receivable, net	206	—	—	386	—	592
Inventories:						
Finished and in-process goods	116	—	—	138	—	254
Raw materials and supplies	33	—	—	70	—	103
Other current assets	27	—	—	45	—	72
Total current assets	603	—	—	856	—	1,459
Other assets, net	107	36	40	89	(103)	169
Property and equipment, net	504	—	—	705	—	1,209
Goodwill	93	—	—	74	—	167
Other intangible assets, net	59	—	—	45	—	104
Total assets	$ 1,366	$ 36	$ 40	$ 1,769	$ (103)	$ 3,108
Liabilities and (Deficit) Equity						
Current liabilities						
Accounts and drafts payable	$ 134	$ —	$ —	$ 259	$ —	$ 393
Intercompany accounts (receivable) payable	(24)	(42)	1	65	—	—
Debt payable within one year	17	—	—	100	—	117
Intercompany loans payable (receivable)	35	—	—	(35)	—	—
Affiliated debt payable within one year	2	—	—	—	—	2
Interest payable	14	44	—	3	—	61
Income taxes payable	1	—	—	14	—	15
Accrued payroll and incentive compensation	26	—	—	31	—	57
Other current liabilities	69	—	—	63	—	132
Total current liabilities	274	2	1	500	—	777
Long-term debt	1,134	1,688	—	598	—	3,420
Intercompany loans payable (receivable)	1,254	(1,903)	(16)	665	—	—
Long-term pension and post employment benefit obligations	99	—	—	124	—	223
Deferred income taxes	30	2	—	40	—	72
Other long-term liabilities	116	6	—	34	—	156
Advance from affiliates	225	—	—	—	—	225
Total liabilities	3,132	(205)	(15)	1,961	—	4,873
Total Momentive Specialty Chemicals Inc. shareholders (deficit) equity	(1,766)	241	55	(193)	(103)	(1,766)
Noncontrolling interest	—	—	—	1	—	1
Total (deficit) equity	(1,766)	241	55	(192)	(103)	(1,765)
Total liabilities and (deficit) equity	$ 1,366	$ 36	$ 40	$ 1,769	$ (103)	$ 3,108

MOMENTIVE SPECIALTY CHEMICALS INC.
SIX MONTHS ENDED JUNE 30, 2012
CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS (Unaudited)

	Momentive Specialty Chemicals Inc.	Subsidiary Issuers	Combined Subsidiary Guarantors	Combined Non-Guarantor Subsidiaries	Eliminations	Consolidated
Cash flows provided by (used in) operating activities	$ 13	$ 8	$ 12	$ (26)	$ (18)	$ (11)
Cash flows provided by (used in) investing activities						
Capital expenditures	(25)	—	—	(33)	—	(58)
Proceeds from matured debt securities, net	—	—	—	2	—	2
Funds remitted to unconsolidated affiliates	—	—	—	(3)	—	(3)
Capital contribution to subsidiary	(15)	—	(10)	—	25	—
Proceeds from the return of capital from subsidiary	42	—	—	—	(42)	—
Proceeds from sale of assets	9	—	—	—	—	9
	11	—	(10)	(34)	(17)	(50)
Cash flows provided by (used in) financing activities						
Net short-term debt repayments	—	—	—	(15)	—	(15)
Borrowings of long-term debt	—	450	—	1	—	451
Repayments of long-term debt	(272)	—	—	(201)	—	(473)
Net intercompany loan borrowings (repayments)	270	(439)	(2)	171	—	—
Capital contribution from parent	16	—	10	15	(25)	16
Long-term debt and credit facility financing fees	(2)	(11)	—	—	—	(13)
Common stock dividends paid	(2)	(8)	(10)	—	18	(2)
Return of capital to parent	—	—	—	(42)	42	—
	10	(8)	(2)	(71)	35	(36)
Effect of exchange rates on cash and cash equivalents	—	—	—	2	—	2
Increase (decrease) in cash and cash equivalents	34	—	—	(129)	—	(95)
Cash and cash equivalents (unrestricted) at beginning of period	221	—	—	207	—	428
Cash and cash equivalents (unrestricted) at end of period	$ 255	$ —	$ —	$ 78	$ —	$ 333

MOMENTIVE SPECIALTY CHEMICALS INC.
SIX MONTHS ENDED JUNE 30, 2011
CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS (Unaudited)

	Momentive Specialty Chemicals Inc.	Subsidiary Issuers	Combined Subsidiary Guarantors	Combined Non-Guarantor Subsidiaries	Eliminations	Consolidated
Cash flows (used in) provided by operating activities	$ (46)	$ —	$ 6	$ 53	$ (56)	$ (43)
Cash flows provided by (used in) investing activities						
Capital expenditures	(46)	—	—	(25)	—	(71)
Change in restricted cash	—	—	—	2	—	2
Funds remitted to unconsolidated affiliates, net of dividend	5	—	(1)	(5)	—	(1)
Proceeds from sale of business, net of cash transferred	173	—	—	—	—	173
Proceeds from the return of capital from subsidiary	33	—	—	—	(33)	—
	165	—	(1)	(28)	(33)	103
Cash flows used in financing activities						
Net short-term debt repayments	(8)	—	—	—	—	(8)
Borrowings of long-term debt	144	—	—	265	—	409
Repayments of long-term debt	(153)	—	—	(298)	—	(451)
Return of capital to parent	—	—	—	(33)	33	—
Common stock dividends paid	—	(4)	(5)	(47)	56	—
Net intercompany loan (repayments) borrowings	(93)	4	—	89	—	—
Long-term debt and credit facility financing fees	(1)	—	—	—	—	(1)
	(111)	—	(5)	(24)	89	(51)
Effect of exchange rates on cash and cash equivalents	—	—	—	3	—	3
Increase in cash and cash equivalents	8	—	—	4	—	12
Cash and cash equivalents (unrestricted) at beginning of period	56	—	—	124	—	180
Cash and cash equivalents (unrestricted) at end of period	$ 64	$ —	$ —	$ 128	$ —	$ 192

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (dollar amounts in millions)

The following commentary should be read in conjunction with the audited financial statements and the accompanying notes and Management's Discussion and Analysis of Financial Condition and Results of Operations included in our most recent Annual Report on Form 10-K.

Within the following discussion, unless otherwise stated, "the quarter ended June 30, 2012," and "the second quarter of 2012" refer to the three months ended June 30, 2012, and "the quarter ended June 30, 2011" and "the second quarter of 2011" refer to the three months ended June 30, 2011.

Forward-Looking and Cautionary Statements

Certain statements in this report, including without limitation, certain statements made under the caption "Overview and Outlook," are forward-looking statements within the meaning of and made pursuant to the safe harbor provisions of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. In addition, our management may from time to time make oral forward-looking statements. All statements, other than statements of historical facts, are forward-looking statements. Forward-looking statements may be identified by the words "believe," "expect," "anticipate," "project," "plan," "estimate," "may," "will," "could," "should," "seek" or "intend" and similar expressions. Forward-looking statements reflect our current expectations and assumptions regarding our business, the economy and other future events and conditions and are based on currently available financial, economic and competitive data and our current business plans. Actual results could vary materially depending on risks and uncertainties that may affect our operations, markets, services, prices and other factors as discussed in the Risk Factors section of this report and our other filings with the Securities and Exchange Commission (the "SEC"). While we believe our assumptions are reasonable, we caution you against relying on any forward-looking statements as it is very difficult to predict the impact of known factors, and it is impossible for us to anticipate all factors that could affect our actual results. Important factors that could cause actual results to differ materially from those in the forward-looking statements include, but are not limited to, a weakening of global economic and financial conditions, interruptions in the supply of or increased cost of raw materials, changes in governmental regulations and related compliance and litigation costs, difficulties with the realization of cost savings in connection with our strategic initiatives, including transactions with our affiliate, Momentive Performance Materials Inc., pricing actions by our competitors that could affect our operating margins, the impact of our substantial indebtedness, our failure to comply with financial covenants under our credit facilities or other debt, and the other factors listed in the Risk Factors section of this report and in our other SEC filings. For a more detailed discussion of these and other risk factors, see the Risk Factors section in our most recent Annual Report on Form 10-K, our other filings made with the SEC and this report. All forward-looking statements are expressly qualified in their entirety by this cautionary notice. The forward-looking statements made by us speak only as of the date on which they are made. Factors or events that could cause our actual results to differ may emerge from time to time. We undertake no obligation to publicly update or revise any forward-looking statement as a result of new information, future events or otherwise, except as otherwise required by law.

Overview and Outlook

Business Overview

We are a large participant in the specialty chemicals industry, and a leading producer of adhesive and structural resins and coatings. Thermosets are a critical ingredient for virtually all paints, coatings, glues and other adhesives produced for consumer or industrial uses. We provide a broad array of thermosets and associated technologies and have significant market positions in all of the key markets that we serve.

Our products are used in thousands of applications and are sold into diverse markets, such as forest products, architectural and industrial paints, packaging, consumer products and automotive coatings, as well as higher growth markets, such as composites, UV cured coatings and electrical composites. Major industry sectors that we serve include industrial/marine, construction, consumer/durable goods, automotive, wind energy, aviation, electronics, architectural, civil engineering, repair/remodeling and oil and gas field support. Key drivers for our business include general economic and industrial conditions, including housing starts, auto build rates and active gas drilling rigs. In addition, due to the nature of our products and the markets we serve, competitor capacity constraints and the availability of similar products in the market may impact our results. As is true for many industries, our financial results are impacted by the effect on our customers of economic upturns or downturns, as well as by the impact on our own costs to produce, sell and deliver our products. Our customers use most of our products in their production processes. As a result, factors that impact their industries have significantly affected our results.

Through our worldwide network of strategically located production facilities, we serve more than 6,400 customers in over 100 countries. Our global customers include large companies in their respective industries, such as 3M, Ashland Chemical, BASF, Bayer, DuPont, GE, Halliburton, Honeywell, Louisiana Pacific, Owens Corning, PPG Industries, Sumitomo, Valspar and Weyerhaeuser.

Momentive Combination and Shared Services Agreement

In October 2010, our parent, Momentive Specialty Chemicals Holdings LLC ("MSC Holdings"), and Momentive Performance Materials Holdings Inc., the parent company of Momentive Performance Materials Inc. ("MPM"), became subsidiaries of a newly formed holding company, Momentive Performance Materials Holdings LLC ("Momentive Holdings"). We refer to this transaction as the "Momentive Combination." In connection with the closing of the Momentive Combination, we entered into a shared services agreement with MPM, as amended on March 17, 2011 (the "Shared Services Agreement"), pursuant to which we will provide to MPM, and MPM will provide to us, certain services, including, but not limited to, executive and senior management, administrative support, human resources, information technology support, accounting, finance, technology development, legal and procurement services. The Shared Services Agreement establishes certain criteria upon which the costs of such services are allocated between us and MPM.

The Momentive Combination, including the Shared Services Agreement, has, and we expect it to continue to, result in significant synergies for us, including shared services and logistics optimization, best-of-source contractual terms, procurement savings, regional site rationalization, and administrative and overhead savings. We expect to achieve a total of approximately $60 of cost savings in connection with the Shared Services Agreement and recent divestitures. Through June 30, 2012, we have realized $52 of these savings on a run-rate basis, and anticipate fully realizing the remaining anticipated savings over the next 12 to 18 months.

Reportable Segments

The Company's business segments are based on the products that we offer and the markets that we serve. At June 30, 2012, the Company had two reportable segments: Epoxy, Phenolic and Coating Resins and Forest Products Resins. A summary of the major products of the Company's reportable segments follows:

- Epoxy, Phenolic and Coating Resins: epoxy specialty resins, oil field products, versatic acids and derivatives, basic epoxy resins and intermediates, phenolic specialty resins and molding compounds, polyester resins, acrylic resins and vinylic resins

- Forest Products Resins: forest products resins and formaldehyde applications

First Half 2012 Overview

- Net sales decreased 9% in the first half of 2012 as compared to the first half of 2011, due primarily to increased competition in certain markets and a decrease in demand in several of our product lines, as well as unfavorable foreign currency translation due to the strengthening of the U.S. dollar against the euro and Brazilian real. These impacts were partially offset by raw material-driven price increases to our customers.

- In March 2012, we issued $450 aggregate principal amount of 6.625% First-Priority Senior Secured Notes due 2020 at an issue price of 100%. We used the net proceeds, together with cash on hand to repay approximately $454 aggregate principal amount of existing term loans maturing May 5, 2013 under our senior secured credit facilities, effectively extending these maturities by an additional seven years. In conjunction with the transaction, we extended $171 of our $200 revolving line of credit facility commitments from lenders from February 2013 to December 2014. We refer to these transactions collectively as the "March Refinancing Transactions."

- In the first half of 2012, we realized approximately $12 in cost savings as a result of the Shared Services Agreement, bringing our total cumulative savings since the Momentive Combination to $42. In addition, we also realized approximately $3 in cost savings related to other cost reduction programs. As of June 30, 2012, we have approximately $18 and $24 of in-process cost savings and synergies that we expect to achieve over the next 12 to 18 months in connection with the Shared Services Agreement and other cost reduction programs, respectively.

- In response to softening demand in certain of our businesses in the second half of 2011 and continued efforts to optimize our manufacturing footprint and reduce our cost structure, in the first half of 2012 we closed three facilities and announced our intent to close one additional facility in our Forest Products Resins segment. Additionally, we announced our intent to close two facilities in our Epoxy, Phenolic and Coating Resins segment.

- At the same time, we continue our strategy to expand in markets in which we expect opportunities for growth.

  Recently completed expansion efforts include:

  - A joint venture to construct a versatics manufacturing facility in China, which began operations in the second quarter of 2012. The facility produces VeoVa® monomers, a versatic acid derivative, used as a key raw material in environmentally advanced paints and coatings.

  Future growth initiatives include:

  - A joint venture to construct a phenolic specialty resins manufacturing facility in China, which is expected to be operational by early 2013. The new facility will produce a full range of specialty novolac and resole phenolic resins used in a diverse range of applications, including refractories, friction and abrasives to support the growing auto and consumer markets in China.

Short-term Outlook

Our business is impacted by general economic and industrial conditions, including housing starts, automotive builds, oil and natural gas drilling activity and general industrial production. Our business has both geographic and end market diversity which often reduces the impact of any one of these factors on our overall performance.

Due to recent worldwide economic developments, the short-term outlook for 2012 for our business is difficult to predict. In the first half of 2012, we experienced sequential volume increases, although this was largely due to seasonal re-stocking. We expect the continued volatility in the global financial markets, the ongoing debt crisis in Europe, economic softness within China and Asia Pacific regions and lack of consumer confidence will continue to lead to stagnant demand for products within both of our reportable segments in 2012. We expect overall volumes to remain relatively flat in 2012 as compared to 2011 due to the factors cited above.

An additional economic recession or further postponement of the modest economic recovery could have an adverse impact on our business and results of operations. If global economic growth remains slow for an extended period of time or another economic recession occurs, the fair value of our reporting units and long-lived assets could be more adversely affected than we estimated in earlier periods. This may result in goodwill or other additional asset impairments beyond amounts that have already been recognized.

More specifically, we expect volumes within our oil field business to be volatile during the remainder of 2012 due to continuing pricing pressures in this business as a result of increased competition and low natural gas prices. We also continue to see weak demand and increased competition in China, which will negatively impact volumes and pricing within our epoxy specialty business, including our wind energy products, throughout the remainder of 2012. Further, the anticipated expiration of the production tax credit is expected to negatively impact volumes within our U.S. wind energy business in the fourth quarter of 2012.

We anticipate moderate growth in volumes in our Latin American forest products business due to continued growth in construction and industrial production activities within this region. We also anticipate volumes in our North American forest products resins product line to grow slightly in 2012, reflecting growth in North American construction activity, namely U.S. housing starts. We anticipate moderate general economic growth in the North American automobile and industrial markets to positively impact our Epoxy, Phenolic and Coating Resins segment in 2012. We expect the European automobile and construction industries to remain slow due to the continuing economic concerns in this region.

In response to the uncertain economic outlook, we are reviewing our plans to aggressively accelerate savings from the Shared Services Agreement in order to capture these cost savings as quickly as possible, while also reviewing our cost structure and manufacturing footprint across all businesses. We have begun to execute restructuring and cost reduction programs that will continue to be finalized throughout 2012. These actions have led to more significant restructuring, exit and disposal costs and asset impairments to be incurred by the Company, as indicated by our results of operations for the first half of 2012, and may continue to do so through the remainder of 2012. As of June 30, 2012, we have incurred costs of $19 related to these programs, which are estimated to occur over the next 12 to 15 months. The expected costs to be incurred on restructuring activities are estimated at $35.

We expect long-term raw material cost volatility to continue because of price movements of key feedstocks. To help mitigate raw material volatility, we have purchase and sale contracts and commercial arrangements with many of our vendors and customers that contain periodic price adjustment mechanisms. Due to differences in the timing of pricing mechanism trigger points between our sales and purchase contracts, there is often a lead-lag impact during which margins are negatively impacted in the short term when raw material prices increase and are positively impacted in the short term when raw material prices fall. We continue to implement pricing actions to compensate for the increase in raw material prices experienced during the first half of 2012, and expected to continue for the remainder of 2012, which should benefit our operating cash flows in 2012.

We remain optimistic about our position in the global markets when they do recover to more stable conditions.

Matters Impacting Comparability of Results

Our unaudited Condensed Consolidated Financial Statements include the accounts of the Company, its majority-owned subsidiaries in which minority shareholders hold no substantive participating rights and variable interest entities in which we are the primary beneficiary. Intercompany accounts and transactions are eliminated in consolidation.

Raw materials comprise approximately 70% of our cost of sales. The three largest raw materials used in our production processes are phenol, methanol and urea. These materials represent about half of our total raw material costs. Fluctuations in energy costs, such as volatility in the price of crude oil and related petrochemical products, as well as the cost of natural gas have historically caused volatility in our raw material and utility costs. The average prices of phenol, methanol, and urea increased by approximately 1%, 6%, and 31%, respectively, in the first half of 2012 compared to the first half of 2011. The impact of passing through raw material price changes to customers can result in significant variances in sales comparisons from year to year.

Results of Operations

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

	Three Months Ended June 30,			
	2012		2011	
(in millions)	$	% of Net Sales	$	% of Net Sales
Net sales	$ 1,259	100 %	$ 1,438	100 %
Cost of sales	1,087	86 %	1,223	85 %
Gross profit	172	14 %	215	15 %
Selling, general and administrative expense	79	6 %	87	6 %
Asset impairments	—	— %	18	1 %
Business realignment costs	3	— %	5	— %
Other operating income, net	(2)	— %	(23)	(2)%
Operating income	92	8 %	128	10 %
Interest expense, net	67	5 %	65	5 %
Other non-operating income, net	(1)	— %	—	— %
Total non-operating expense	66	5 %	65	5 %
Income before income tax and earnings from unconsolidated entities	26	3 %	63	5 %
Income tax expense	4	— %	—	— %
Income before earnings from unconsolidated entities	22	3 %	63	5 %
Earnings from unconsolidated entities, net of taxes	6	— %	3	— %
Net Income from continuing operations	28	3 %	66	5 %
Net loss from discontinued operations, net of taxes	—	— %	(3)	— %
Net Income	$ 28	3 %	$ 63	5 %

Three Months Ended June 30, 2012 vs. Three Months Ended June 30, 2011

Sales

In the second quarter of 2012, net sales decreased by $179, or 12%, compared with the second quarter of 2011. Volume decreases negatively impacted net sales by $114, and were primarily driven by our base epoxy, epoxy specialty and oilfield businesses. Volume decreases in our base epoxy business were due to decreases in demand and increased competitive pressures in certain markets. Volume decreases in our epoxy specialty business were due to increased competition in certain wind-energy markets. Volume decreases in our oil field business were primarily due to a decrease in natural gas prices, which drove a decrease in drilling activity, as well as increased competition in certain markets. Volume decreases were also driven by our European forest products business due to continued competitive pressures and the loss of key customers, as well as attrition of customers after we announced our intent to close a production facility. Pricing had a positive impact of $9 on net sales, as pricing decreases in certain businesses due to competitive pricing pressures were offset by the pass through of raw material-driven price increases in several other businesses. In addition, foreign currency translation negatively impacted sales by $74, primarily as a result of the strengthening of the U.S. dollar against the euro, Australian dollar, Brazilian real and Canadian dollar in the second quarter of 2012 compared to the second quarter of 2011.

Gross Profit

In the second quarter of 2012, gross profit decreased by $43 compared with the second quarter of 2011. As a percentage of sales, gross profit decreased by 1%, primarily as a result of the decrease in sales volumes as discussed above, particularly in certain of our specialty businesses.

Operating Income

In the second quarter of 2012, operating income decreased by $36 compared with the second quarter of 2011. The decrease was partially due to the $43 decrease in gross profit as discussed above. Selling, general and administrative expense decreased by $8 due primarily to lower compensation costs and functional cost savings realized from the Momentive Combination. In addition, we recorded asset impairments of $18 in the second quarter of 2011 against certain long-lived assets in our Forest Products Resins segment, which did not recur in the second quarter of 2012. Other operating income, net decreased by $21 compared with the second quarter of 2011. In the second quarter of 2012 we recognized income of $8, net of related expenses, from insurance recoveries related to the terminated Huntsman merger, which were partially offset by losses on the disposal of certain assets and accelerated depreciation recorded on closing manufacturing facilities. In the second quarter of 2011 we recognized a $21 gain related to a compensation payment received by us from a customer as consideration to terminate an operator agreement, which did not recur in the second quarter of 2012.

Non-Operating Expense

In the second quarter of 2012, total non-operating expenses increased by $1 compared with the second quarter of 2011 due primarily to a slight increase in interest expense.

Income Tax Expense

Income tax expense in the second quarter of 2012 relates primarily to income from foreign operations. In the second quarter of 2012, income tax expense increased by $4 compared to the second quarter of 2011, primarily due to the geographic mix of foreign earnings. In the second quarter of 2011, due to losses in certain foreign jurisdictions in which the Company is recording a tax benefit, income tax expense was zero. For both periods, tax on the profits in the U.S. are being offset by reducing the valuation allowance on deferred tax assets expected to be utilized.

	Six Months Ended June 30,			
	2012		2011	
(in millions)	$	% of Net Sales	$	% of Net Sales
Net sales	$ 2,495	100%	$ 2,732	100 %
Cost of sales	2,145	86%	2,308	84 %
Gross profit	350	14%	424	16 %
Selling, general and administrative expense	164	7%	171	6 %
Asset impairments	23	1%	18	1 %
Business realignment costs	18	1%	8	— %
Other operating expense (income), net	9	—%	(21)	(1)%
Operating income	136	5%	248	10 %
Interest expense, net	132	5%	129	5 %
Other non-operating expense (income), net	1	—%	(2)	— %
Total non-operating expense	133	5%	127	5 %
Income before income tax and earnings from unconsolidated entities	3	—%	121	5 %
Income tax expense	2	—%	3	— %
Income before earnings from unconsolidated entities	1	—%	118	5 %
Earnings from unconsolidated entities, net of taxes	11	—%	6	— %
Net income from continuing operations	12	—%	124	5 %
Net income from discontinued operations, net of taxes	—	—%	2	— %
Net income	$ 12	—%	$ 126	5 %

Six Months Ended June 30, 2012 vs. Six Months Ended June 30, 2011

Sales

In the first half of 2012, net sales decreased by $237, or 9%, compared with the first half of 2011. Volume decreases negatively impacted net sales by $156, and were primarily driven by our epoxy specialty, oilfield and European forest products businesses. Volume decreases in our epoxy specialty business were due to increased competition in certain wind-energy markets. Volume decreases in our oil field business were primarily due to a decrease in natural gas prices, which drove a decrease in drilling activity, as well as increased competition in certain markets. Volume decreases were also driven by our European forest products business due to continued competitive pressures and the loss of key customers, as well as attrition of customers after we announced our intent to close a production facility. Pricing had a positive impact of $10 on net sales, as pricing decreases in certain businesses due to competitive pricing pressures were offset by the pass through of raw material-driven price increases in several other businesses. In addition, foreign currency translation negatively impacted sales by $91, primarily as a result of the strengthening of the U.S. dollar against the euro and Brazilian real in the first half of 2012 compared to the first half of 2011.

Gross Profit

In the first half of 2012, gross profit decreased by $74 compared with the first half of 2011. As a percentage of sales, gross profit decreased by 2%, primarily as a result of the decrease in sales volumes as discussed above, particularly in certain of our specialty businesses.

Operating Income

In the first half of 2012, operating income decreased by $112 compared with the first half of 2011. The decrease was partially due to the $74 decrease in gross profit as discussed above. Selling, general and administrative expense decreased by $7 due to lower compensation costs and lower project and transaction costs, as well as functional cost savings realized from the Momentive Combination. Asset impairments increased by $5 compared to the first half of 2011. In the first half of 2012 we recorded asset impairments of $23, as a result of the likelihood that certain assets would be sold before the end of their estimated useful lives and continued competitive pressures. In the first half of 2011 we recorded asset impairments of $18 against certain long-lived assets in our Forest Products Resins segment. Business realignment costs increased by $10 due to severance costs associated with newly implemented restructuring and cost reduction programs. Other operating expense, net increased by $30, from income of $21 to expense of $9, due primarily to a $21 gain recognized in the second quarter of 2011 related to a compensation payment received by us from a customer as consideration to terminate an operator agreement, which did not recur in the second quarter of 2012, as well as accelerated depreciation recorded on closing manufacturing facilities during the first half of 2012.

Non-Operating Expense

In the first half of 2012, total non-operating expenses increased by $6 compared with the first half of 2011, primarily due to a decrease in foreign exchange transaction gains related to our debt, as well as a slight increase in interest expense. In addition, we wrote-off $1 in deferred financing costs associated with the March Refinancing Transactions.

Income Tax Expense

In the first half of 2012, income tax expense decreased by $1 compared to the first half of 2011, primarily due to a significant decrease in pre-tax income in certain foreign jurisdictions. Income tax expense relates primarily to income from certain foreign operations, with tax on the profits in the U.S. being offset by reducing the valuation allowance on deferred tax assets expected to be utilized.

Results of Operations by Segment

Following are net sales and Segment EBITDA (earnings before interest, income taxes, depreciation and amortization) by reportable segment. Segment EBITDA is defined as EBITDA adjusted to exclude certain non-cash, other income and expenses and discontinued operations. Segment EBITDA is the primary performance measure used by our senior management, the chief operating decision-maker and the board of directors to evaluate operating results and allocate capital resources among segments. Segment EBITDA is also the profitability measure used to set management and executive incentive compensation goals.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Net Sales to Unaffiliated Customers[1]:				
Epoxy, Phenolic and Coating Resins	$ 796	$ 972	$ 1,590	$ 1,818
Forest Products Resins	463	466	905	914
Total	$ 1,259	$ 1,438	$ 2,495	$ 2,732
Segment EBITDA:				
Epoxy, Phenolic and Coating Resins	$ 101	$ 157	$ 215	$ 307
Forest Products Resins	56	50	102	95
Corporate and Other[2]	(12)	(18)	(26)	(35)

(1) Intersegment sales are not significant and, as such, are eliminated within the selling segment.

(2) For the six months ended June 30, 2012, the Company has reclassified approximately $3 of costs into Corporate and Other Segment EBITDA which relate to the three months ended March 31, 2012.

Three Months Ended June 30, 2012 vs. Three Months Ended June 30, 2011 Segment Results

Following is an analysis of the percentage change in sales by segment from the three months ended June 30, 2011 to the three months ended June 30, 2012:

	Volume	Price/Mix	Currency Translation	Total
Epoxy, Phenolic and Coating Resins	(11)%	(2)%	(5)%	(18)%
Forest Products Resins	(2)%	6 %	(5)%	(1)%

Epoxy, Phenolic and Coating Resins

Net sales in the second quarter of 2012 decreased by $176, or 18%, when compared to the second quarter of 2011. Lower volumes negatively impacted sales by $104. This decrease was primarily driven by decreased demand within our base epoxy, epoxy specialty and oil field businesses. The decrease in volumes in our base epoxy business was due to a decrease in demand and increased competitive pressures in certain markets. Volume decreases in our epoxy specialty business were due to increased competition in certain wind-energy markets. Volume decreases in our oil field business were primarily due to a decrease in natural gas prices, which drove a decrease in drilling activity, as well as increased competition in certain markets. Pricing had a negative impact of $22 due primarily to the impact of positive pricing within the second quarter of 2011 driven by supply shortages in the market for our base epoxy business, which was not experienced in the second quarter of 2012. Foreign exchange translation negatively impacted net sales by $50, primarily due to the strengthening of the U.S. dollar against the euro in the second quarter of 2012 compared to the second quarter of 2011.

Segment EBITDA in the second quarter of 2012 decreased by $56 to $101 compared to the second quarter of 2011. The decrease is primarily due to the volume and pricing decreases discussed above, as well as the absence of the $9 positive impact of insurance recoveries related to unplanned production line outages at certain facilities in the second quarter of 2011, which did not recur in the second quarter of 2012.

Forest Products Resins

Net sales in the second quarter of 2012 decreased by $3, or 1%, when compared to the second quarter of 2011. Lower volumes negatively impacted sales by $10, driven primarily by decreased volumes in our European forest products resins business. These decreases were primarily driven by the loss of customers in this business in 2011 and early 2012 as the result of market weakness and competitive losses, as well as attrition of customers after we announced our intent to close a production facility. Raw material price increases passed through to customers led to pricing increases of $31. Foreign exchange translation negatively impacted net sales by $24 due to the strengthening of the U.S. dollar against the euro and the Brazilian real in the second quarter of 2012 compared to the second quarter of 2011.

Segment EBITDA in the second quarter of 2012 increased by $6 to $56 compared to the second quarter of 2011. Segment EBITDA increases were driven by cost control and favorable geographic and product mix.

Corporate and Other

Corporate and Other is primarily corporate, general and administrative expenses that are not allocated to the segments, such as shared service and administrative functions, unallocated foreign exchange gains and losses and legacy company costs not allocated to continuing segments. Corporate and Other charges decreased by $6 to $12 compared to the second quarter of 2011, primarily due to decreased incentive compensation costs and functional cost savings realized from the Momentive Combination, as well as higher unallocated foreign currency transaction gains.

Six Months Ended June 30, 2012 vs. Six Months Ended June 30, 2011 Segment Results

Following is an analysis of the percentage change in sales by segment from the six months ended June 30, 2011 to the six months ended June 30, 2012:

	Volume	Price/Mix	Currency Translation	Total
Epoxy, Phenolic and Coating Resins	(7)%	(2)%	(4)%	(13)%
Forest Products Resins	(3)%	5 %	(3)%	(1)%

Epoxy, Phenolic and Coating Resins

Net sales in the first half of 2012 decreased by $228, or 13%, when compared to the first half of 2011. Lower volumes negatively impacted sales by $125. This decrease was primarily driven by decreased demand within our epoxy specialty and oil field businesses. The decrease in volumes in our epoxy specialty business was due to increased competition in certain wind-energy markets. Volume decreases in our oil field business were primarily due to a decrease in natural gas prices, which drove a decrease in drilling activity, as well as increased competition in certain markets. These volume decreases were partially offset by volume increases in our base epoxy business due to the impacts of unplanned production line outages which led to lost volumes in the first half of 2011. Pricing had a negative impact of $40 due primarily to the impact of positive pricing mix within the first half of 2011 driven by supply shortages in the market for our base epoxy business, which was not experienced in the first half of 2012. Foreign exchange translation negatively impacted net sales by $63 due to the strengthening of the U.S. dollar against the euro in the first half of 2012 compared to the first half of 2011.

Segment EBITDA in the first half of 2012 decreased by $92 to $215 compared to the first half of 2011. The decrease is primarily due to the volume and pricing decreases discussed above, as well as the absence of the $9 positive impact of insurance recoveries related to unplanned production line outages at certain facilities in the first half of 2011, which did not recur in the first half of 2012.

Forest Products Resins

Net sales in the first half of 2012 decreased by $9, or 1%, when compared to the first half of 2011. Lower volumes negatively impacted sales by $31, driven by decreased volumes in our North American formaldehyde and European forest products resins businesses. Volumes in our North American formaldehyde business decreased due to a large customer's planned site outage in the first half of 2012 which did not occur in the first half of 2011. Volume decreases in our European forest products resins business were primarily driven by the loss of customers in this business in 2011 and early 2012 as the result of market weakness and competitive losses, as well as attrition of customers after we announced our intent to close a production facility. Raw material price increases passed through to customers led to pricing increases of $50. Foreign exchange translation negatively impacted net sales by $28 due to the strengthening of the U.S. dollar against the euro and the Brazilian real in the first half of 2012 compared to the first half of 2011.

Segment EBITDA in the first half of 2012 increased by $7 to $102 compared to the first half of 2011. Segment EBITDA increases were driven by cost control and favorable geographic and product mix.

Corporate and Other

Corporate and Other is primarily corporate, general and administrative expenses that are not allocated to the segments, such as shared service and administrative functions, unallocated foreign exchange gains and losses and legacy company costs not allocated to continuing segments. Corporate and Other charges decreased by $9 to $26 compared to the first half of 2011, primarily due to decreased incentive compensation costs and functional cost savings realized from the Momentive Combination, as well as higher unallocated foreign currency transaction gains.

Reconciliation of Segment EBITDA to Net Income:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Segment EBITDA:				
Epoxy, Phenolic and Coating Resins	$ 101	$ 157	$ 215	$ 307
Forest Products Resins	56	50	102	95
Corporate and Other	(12)	(18)	(26)	(35)
Reconciliation:				
Items not included in Segment EBITDA				
Asset impairments and other non-cash charges	—	(21)	(48)	(21)
Business realignment costs	(3)	(5)	(18)	(8)
Integration costs	(1)	(5)	(6)	(10)
Net (loss) income from discontinued operations	—	(3)	—	2
Other	(3)	16	4	12
Total adjustments	(7)	(18)	(68)	(25)
Interest expense, net	(67)	(65)	(132)	(129)
Income tax expense	(4)	—	(2)	(3)
Depreciation and amortization	(39)	(43)	(77)	(84)
Net income	$ 28	$ 63	$ 12	$ 126

Items Not Included in Segment EBITDA

Asset impairments and non-cash charges primarily represent asset impairments, stock-based compensation expense, accelerated depreciation on closing facilities and unrealized derivative and foreign exchange gains and losses. Business realignment costs for the three and six months ended June 30, 2012 primarily include expenses from the Company's restructuring and cost optimization programs. Business realignment costs for the three and six months ended June 30, 2011 primarily relate to expenses from minor restructuring programs. Integration costs relate primarily to the Momentive Combination. Net income from discontinued operations represents the results of the IAR and CCR businesses.

Not included in Segment EBITDA are certain non-cash and other income and expenses. For the three and six months ended June 30, 2012, these items primarily include net realized foreign exchange transaction gains and insurance recoveries related to the terminated Huntsman merger, partially offset by losses on the disposal of assets. For the three and six months ended June 30, 2011, these items include primarily business optimization expenses and retention program costs, offset by realized foreign exchange transaction gains and a gain recognized on the termination of an operator agreement with a customer.

Liquidity and Capital Resources

Sources and Uses of Cash

We are a highly leveraged company. Our primary sources of liquidity are cash flows generated from operations and availability under our senior secured credit facilities. Our primary liquidity requirements are interest, working capital and capital expenditures.

At June 30, 2012, we had $3,495 of unaffiliated debt, including $65 of short-term debt and capital lease maturities. In addition, at June 30, 2012, we had $602 in liquidity consisting of the following:

- $333 of unrestricted cash and cash equivalents;
- $187 of borrowings available under our senior secured revolving credit facilities; and
- $82 of borrowings available under credit facilities at certain international subsidiaries

We do not believe there is any risk to funding our liquidity requirements in any particular jurisdiction.

Our net working capital (defined as accounts receivable and inventories less accounts and drafts payable) at June 30, 2012 and December 31, 2011 was $641 and $556, respectively. A summary of the components of our net working capital as of June 30, 2012 and December 31, 2011 is as follows:

	June 30, 2012	% of LTM Net Sales	December 31, 2011	% of LTM Net Sales
Accounts receivable	$ 695	14 %	$ 592	11 %
Inventories	436	9 %	357	7 %
Accounts and drafts payable	(490)	(10)%	(393)	(8)%
Net working capital	$ 641	13 %	$ 556	10 %

The increase in net working capital of $85 from December 31, 2011 was a result of the increase in volumes and raw material prices in the first half of 2012, which drove increases in accounts receivable and inventory. The inventory increase was more than offset by an increase in accounts payable, driven by the same factors. We continue to aggressively manage inventory levels. To minimize the impact of net working capital on cash flows, we continue to review inventory safety stock levels, focus on receivable collections by offering incentives to customers to encourage early payment or accelerate receipts through the sale of receivables and negotiate with vendors to contractually extend payment terms whenever possible. In the six months ended June 30, 2012, in partnership with certain customers, we entered into accounts receivable sale agreements to sell a portion of our trade accounts receivable. As of June 30, 2012, through these agreements, we effectively accelerated the timing of cash receipts by $28. We may continue to accelerate cash receipts under these agreements, as appropriate, in order to minimize our investment in working capital.

We periodically borrow from the revolving credit facility under our senior secured credit facilities to support our short-term liquidity requirements, particularly when net working capital requirements increase in response to seasonality of our volumes in the summer months. During the first half of 2012 and at June 30, 2012 there were no outstanding borrowings under the revolving facility.

Preferred Equity Commitment and Issuance

In December 2011, in connection with a previous commitment, Momentive Holdings issued 28,785,935 preferred units and 28,785,935 warrants to purchase common units of Momentive Holdings to affiliates of Apollo for a purchase price of $205 (the “Preferred Equity Issuance”). Momentive Holdings contributed $205 of the proceeds from the Preferred Equity Issuance to MSC Holdings at the end of December 2011 and MSC Holdings contributed the amount to the Company in December 2011 and early January 2012. As a result, the Company's unrestricted cash position benefited on a net basis by approximately $100.

2012 Refinancing Activities

In March 2012, we issued $450 aggregate principal amount of 6.625% First-Priority Senior Secured Notes due 2020 at an issue price of 100%. We used the net proceeds together with cash on hand to repay approximately $454 aggregate principal amount of existing term loans maturing May 5, 2013 under our senior secured credit facilities, effectively extending these maturities by an additional eight years. In conjunction with this issuance we extended $171 of our $200 revolving line of credit facility commitments from lenders from February 2013 to December 2014. In connection with the refinancing activities, the lender commitments to the revolving line of credit facility were decreased to approximately $192 in the aggregate.

Short-term Outlook

In the remainder of 2012, we expect net working capital to decrease, primarily driven by the seasonal slowdown in the fourth quarter. Given our strong liquidity at the outset of 2012 and increased cash position as a result of the Preferred Equity Issuance, coupled with the March Refinancing Transactions, we feel that we are favorably positioned to maintain adequate liquidity throughout 2012 and the foreseeable future to fund our ongoing operations, cash debt service obligations and any additional investment in net working capital.

Two of the Company's wholly owned international subsidiaries were not in compliance with a financial covenant under their respective loan agreements when they delivered their audited financial statements for the year ended December 31, 2011 in the second quarter of 2012. As of December 31, 2011, outstanding debt of approximately $31 was classified as "Debt payable within one year" in the unaudited Condensed Consolidated Balance Sheets. In March 2012, the Company subsequently obtained a covenant waiver from one of the respective banks, representing approximately $25 of the $31. As of June 30, 2012, the Company has reclassified $25 of the respective debt to "Long-term debt" in the unaudited Condensed Consolidated Balance Sheets.

We continue to review possible sales of certain non-core assets, which would further increase our liquidity. Opportunities for these sales could depend to some degree on improvement in the credit markets. If the global economic environment begins to weaken again or remains slow for an extended period of time our liquidity, future results of operations and flexibility to execute liquidity enhancing actions could be negatively impacted.

Debt Repurchases and Other Financing Transactions

From time to time, depending upon market, pricing and other conditions, as well as our cash balances and liquidity, we or our affiliates, including Apollo, may seek to acquire notes or other indebtedness of the Company through open market purchases, privately negotiated transactions, tender offers, redemption or otherwise, upon such terms and at such prices as we or our affiliates may determine (or as may be provided for in the indentures governing the notes), for cash or other consideration. In addition, we have considered and will continue to evaluate potential transactions to reduce net debt, such as debt for debt exchanges or other transactions. There can be no assurance as to which, if any, of these alternatives or combinations thereof we or our affiliates may choose to pursue in the future, as the pursuit of any alternative will depend upon numerous factors such as market conditions, our financial performance and the limitations applicable to such transactions under our financing documents.

Following are highlights from our unaudited Condensed Consolidated Statements of Cash Flows for the six months ended June 30:

	2012	2011
Sources (uses) of cash:		
Operating activities	$ (11)	$ (43)
Investing activities	(50)	103
Financing activities	(36)	(51)
Effect of exchange rates on cash flow	2	3
Net change in cash and cash equivalents	$ (95)	$ 12

Operating Activities

In the first half of 2012, operations used $11 of cash. Net income of $12 included $113 of net non-cash expense items, of which $77 was for depreciation and amortization. Working capital (defined as accounts receivable and inventories less accounts and drafts payable) used $116, which was driven by increases in accounts receivable and inventory due to sequential sales volume increases and increased sales pricing driven by raw material price increases. These increases were partially offset by increases in accounts payable, driven by the same factors. Changes in other assets and liabilities and income taxes payable used $20 due to the timing of when items were expensed versus paid, which primarily included interest expense, employee retention programs, taxes and restructuring expenses.

In the first half of 2011, operations used $43 of cash. Net income of $126 included $87 of net non-cash items, of which $86 was for depreciation and amortization. Working capital used $163, which was driven by higher sales volumes and increased sales pricing driven by raw material price increases. Changes in other assets and liabilities and income taxes payable used $93 due to the payout of prior year incentive compensation programs and the timing of when items were expensed versus paid.

Investing Activities

In the first half of 2012, investing activities used $50. We spent $58 for capital expenditures, which primarily related to plant expansions, improvements and maintenance related capital expenditures. We also generated $9 from the sale of certain assets and $2 of proceeds from matured debt securities. Additionally, we extended loans of $3 to unconsolidated affiliates.

In the first half of 2011, investing activities provided $103. We generated cash of $173 from the sale of our IAR and CCR businesses, and spent $71 for capital expenditures, which primarily relates to plant expansions and improvements.

Financing Activities

In the first half of 2012, financing activities used $36. This consisted of net long-term debt repayments of $22 and credit facility fees of $13 as a result of the March Refinancing Transactions. Net-short term debt repayments were $15. We also received $16 of the remaining proceeds from our parent as a result of the Preferred Equity Issuance.

In the first half of 2011, financing activities used $51. This consisted of net long-term debt repayments and credit facility fees of $43 and net-short term debt repayments of $8.

Covenant Compliance

The instruments that govern our indebtedness contain, among other provisions, restrictive covenants and incurrence tests regarding indebtedness, payments and distributions, mergers and acquisitions, asset sales, affiliate transactions, capital expenditures and the maintenance of certain financial ratios. Payment of borrowings under the senior secured credit facilities may be accelerated if there is an event of default. Events of default include the failure to pay principal and interest when due, a material breach of representation or warranty, most covenant defaults, events of bankruptcy and a change of control. Certain covenants contained in the credit agreement that governs our senior secured credit facilities require us to have a senior secured debt to Adjusted EBITDA ratio less than 4.25:1. The indentures that govern our First Priority 6.625% Senior Notes, 8.875% Senior Secured Notes and Second-Priority Senior Secured Notes contain an Adjusted EBITDA to Fixed Charges ratio incurrence test which restricts our ability to take certain actions such as incurring additional debt or making acquisitions if we are unable to meet this ratio (measured on a last twelve months, or LTM, basis) of at least 2.0:1.

Fixed Charges are defined as net interest expense excluding the amortization or write-off of deferred financing costs. Adjusted EBITDA is defined as EBITDA adjusted to exclude certain non-cash and certain non-recurring items. Adjusted EBITDA is calculated on a pro-forma basis, and also includes expected future cost savings from business optimization programs, including those related to acquisitions, and other synergy and productivity programs. As we are highly leveraged, we believe that including the supplemental adjustments that are made to calculate Adjusted EBITDA provides additional information to investors about our ability to comply with our financial covenants and to obtain additional debt in the future. Adjusted EBITDA and Fixed Charges are not defined terms under GAAP. Adjusted EBITDA is not a measure of financial condition, liquidity or profitability, and should not be considered as an alternative to net income (loss) determined in accordance with GAAP or operating cash flows determined in accordance with GAAP. Additionally, EBITDA is not intended to be a measure of free cash flow for management's discretionary use, as it does not take into account certain items such as interest and principal payments on our indebtedness, depreciation and amortization expense (because we use capital assets, depreciation and amortization expense is a necessary element of our costs and ability to generate revenue), working capital needs, tax payments (because the payment of taxes is part of our operations, it is a necessary element of our costs and ability to operate), non-recurring expenses and capital expenditures. Fixed Charges should not be considered an alternative to interest expense.

As of June 30, 2012, we were in compliance with all financial covenants that govern our senior secured credit facilities, including our senior secured debt to Adjusted EBITDA ratio. The Company believes that a default under its senior secured bank leverage ratio covenant in our Senior Secured Credit Facility is not reasonably likely to occur.

	June 30, 2012 LTM Period	
Reconciliation of Net Income to Adjusted EBITDA		
Net income	$	3
Income tax expense		1
Interest expense, net		265
Depreciation and amortization		160
EBITDA		429
Adjustments to EBITDA:		
Asset impairments and other non-cash charges (1)		72
Business realignments (2)		25
Integration costs (3)		22
Other (4)		27
Cost reduction programs savings (5)		24
Savings from Shared Services Agreement (6)		18
Adjusted EBITDA	$	617
Fixed charges (7)	$	254
Ratio of Adjusted EBITDA to Fixed Charges (8)		2.43

(1) Represents asset impairments, stock-based compensation, accelerated depreciation on closing facilities and unrealized foreign exchange and derivative activity.
(2) Represents headcount reduction expenses and plant rationalization costs related to cost reduction programs and other costs associated with business realignments.
(3) Primarily represents integration costs associated with the Momentive Combination.
(4) Primarily includes pension expense related to formerly owned businesses, business optimization expenses, management fees, retention program costs, and certain intercompany or non-operational realized foreign currency activity.
(5) Represents pro forma impact of in-process cost reduction programs savings.
(6) Primarily represents pro forma impact of expected savings from the Shared Services Agreement with MPM in conjunction with the Momentive Combination.
(7) Reflects pro forma interest expense based on interest rates at July 19, 2012, as if the March Refinancing Transactions had taken place at the beginning of the period.
(8) The Company's ability to incur additional indebtedness is restricted under the indentures governing certain notes, unless the Company has an Adjusted EBITDA to Fixed Charges ratio of 2.0 to 1.0. As of June 30, 2012, the Company was able to satisfy this test.

Contractual Obligations

The following table presents our contractual cash obligations as of December 31, 2011 related to our long-term debt, as adjusted for the March Refinancing Transactions.

We do not believe our other cash obligations have changed materially since December 31, 2011.

	Payments Due By Year						
Contractual Obligations	**2012**	**2013**	**2014**	**2015**	**2016**	**2017 and beyond**	**Total**
Operating activities:							
Interest on fixed rate debt obligations	$ 215	$ 199	$ 197	$ 195	$ 194	$ 512	$ 1,512
Interest on variable rate debt obligations	40	46	44	13	—	—	143
Financing activities:							
Non-affiliated long-term debt, including current maturities	108	24	188	900	20	2,287	3,527

Recently Issued Accounting Standards

Newly Adopted Accounting Standards

On January 1, 2012, we adopted the provisions of *Accounting Standards Update No. 2011-04: Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs* ("ASU 2011-04"). ASU 2011-04 amended existing fair value measurement guidance and is intended to align U.S. GAAP and International Financial Reporting Standards. The guidance requires several new disclosures, including additional quantitative information about significant unobservable inputs used in Level 3 fair value measurements and a qualitative description of the valuation process for both recurring and nonrecurring Level 2 and Level 3 fair value measurements. ASU 2011-04 also requires the disclosure of all fair value measurements by fair value hierarchy level, amongst other requirements. The adoption of ASU 2011-04 did not have a material impact on our unaudited Condensed Consolidated Financial Statements.

On January 1, 2012, we adopted the provisions of *Accounting Standards Update No. 2011-05: Comprehensive Income* ("ASU 2011-05"), which was issued by the FASB in June 2011 and amended by *Accounting Standards Update No. 2011-12: Comprehensive Income* ("ASU 2011-12") issued in December 2011. ASU 2011-05 amended presentation guidance by eliminating the option for an entity to present the components of comprehensive income as part of the statement of changes in stockholders' equity and required presentation of comprehensive income in a single continuous financial statement or in two separate but consecutive financial statements. ASU 2011-12 deferred the effective date for amendments to the presentation of reclassifications of items out of accumulated other comprehensive income in ASU 2011-05. The amendments in ASU 2011-05 did not change the items that must be reported in other comprehensive income or when an item of comprehensive income must be reclassified to net income. We have presented comprehensive income in a separate and consecutive statement entitled, "Condensed Consolidated Statements of Comprehensive Income."

Newly Issued Accounting Standards

There were no newly issued accounting standards in the first half of 2012 applicable to our unaudited Condensed Consolidated Financial Statements.

Critical Accounting Estimates

While we continue to remain in full valuation allowance against our deferred income tax assets in various taxing jurisdictions as of June 30, 2012, due to the current and continued growth of earnings in these jurisdictions, it is reasonably possible that we could release a portion of these valuation allowances to income over the next 12 months as a result of positive evidence to support the realization of such assets. Conversely, for certain unrelated jurisdictions, it is reasonably possible due to potential settlements with tax authorities, that a material valuation allowance could be established within the next 12 months.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

There have been no material developments during the first half of 2012 on the matters we have previously disclosed about quantitative and qualitative market risk in our Annual Report on Form 10-K for the year ended December 31, 2011.

Item 4T. Controls and Procedures

As of the end of the period covered by this Quarterly Report on Form 10-Q, we, under the supervision and with the participation of our Disclosure Committee and our management, including our President and Chief Executive Officer and our Executive Vice President and Chief Financial Officer, carried out an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Exchange Act Rules 13a-15(e) and 15d-15(e). Based on that evaluation, our President and Chief Executive Officer, and Executive Vice President and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of June 30, 2012.

Changes in Internal Controls

There have been no changes in the Company's internal control over financial reporting during our most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Part II

Item 1. Legal Proceedings

Environmental Institution of Paraná IAP—On August 10, 2005, the Environmental Institute of Paraná (IAP), an environmental agency in the State of Paraná, provided Hexion Quimica Industria, the Company's Brazilian subsidiary, with notice of an environmental assessment in the amount of 12 Brazilian reais. The assessment related to alleged environmental damages to the Paranagua Bay caused in November 2004 from an explosion on a shipping vessel carrying methanol purchased by the Company. The investigations performed by the public authorities have not identified any actions of the Company that contributed to or caused the accident. The Company responded to the assessment by filing a request to have it cancelled and by obtaining an injunction precluding execution of the assessment pending adjudication of the issue. In November 2010, the Court denied the Company's request to cancel the assessment and lifted the injunction that had been issued. The Company responded to the ruling by filing an appeal in the State of Paraná Court of Appeals. In March 2012, the Company was informed that the Court of Appeals had denied the Company's appeal. The Company continues to believe that the assessment is invalid, and on June 4, 2012 it filed appeals to the Superior Court of Justice and the Supreme Court of Brazil. Because the Company continues to believe it has strong defenses against the validity of the assessment, it does not believe that a loss is probable. At June 30, 2012, the amount of the assessment, including tax, penalties, monetary correction and interest, is 28 Brazilian reais, or approximately $14.

There have been no other material developments during the second quarter of 2012 in any of the ongoing legal proceedings that are included in our Annual Report on Form 10-K for the year ended December 31, 2011 or our Quarterly Report on Form 10-Q for the three months ended March 31, 2012.

Item 1A. Risk Factors

Risks Related to our Business

If global economic conditions weaken again, it will negatively impact our business operations, results of operations and financial condition.

Global economic and financial market conditions, including severe market disruptions like in late 2008 and 2009 and the potential for a significant and prolonged global economic downturn, have impacted or could impact our business operations in a number of ways including, but not limited to, the following:

- reduced demand in key customer segments, such as automotive, building, construction and electronics, compared to prior years;
- payment delays by customers and reduced demand for our products caused by customer insolvencies and/or the inability of customers to obtain adequate financing to maintain operations. This situation could cause customers to terminate existing purchase orders and reduce the volume of products they purchase from us and further impact our customers' ability to pay our receivables, requiring us to assume additional credit risk related to these receivables or limit our ability to collect receivables from that customer;
- insolvency of suppliers or the failure of suppliers to meet their commitments resulting in product delays;
- more onerous credit and commercial terms from our suppliers such as shortening the required payment period for outstanding accounts receivable or reducing or eliminating the amount of trade credit available to us; and
- potential delays in accessing our senior secured credit facilities or obtaining new credit facilities on terms we deem commercially reasonable or at all, and the potential inability of one or more of the financial institutions included in our syndicated revolving credit facility to fulfill their funding obligations. Should a bank in our syndicated revolving credit facility be unable to fund a future draw request, we could find it difficult to replace that bank in the facility.

Global economic conditions may weaken again. Any further weakening of economic conditions would likely exacerbate the negative effects described above, could significantly affect our liquidity which may cause us to defer needed capital expenditures, reduce research and development or other spending, defer costs to achieve productivity and synergy programs or sell assets or incur additional borrowings which may not be available or may only be available on terms significantly less advantageous than our current credit terms and could result in a wide-ranging and prolonged impact on general business conditions, thereby negatively impacting our business, results of operations and financial condition. In addition, if the global economic environment weakens again or remains slow for an extended period of time, the fair value of our reporting units could be more adversely affected than we estimated in our analysis of reporting unit fair values at October 1, 2011. This could result in additional goodwill or other asset impairments, which could negatively impact our business, results of operations and financial condition.

Due to recent worldwide economic developments, the short-term outlook for 2012 for our business is difficult to predict. In the first half of 2012, we experienced sequential volume increases, although this was largely due to seasonal re-stocking. We expect the continued volatility in the global financial markets, the ongoing debt crisis in Europe, economic softness within China and Asia Pacific regions and lack of consumer confidence will continue to lead to stagnant demand for products within both of our reportable segments in 2012. We expect overall volumes to remain relatively flat in 2012 as compared to 2011 due to the factors cited above; however, we cannot assure you that volumes will not decline.

Fluctuations in direct or indirect raw material costs could have an adverse impact on our business.

Raw materials costs made up approximately 70% of our cost of sales in 2011. The prices of our direct and indirect raw materials have been, and we expect them to continue to be, volatile. If the cost of direct or indirect raw materials increases significantly and we are unable to offset the increased costs with higher selling prices, our profitability will decline. Increases in prices for our products could also hurt our ability to remain both competitive and profitable in the markets in which we compete.

Although some of our materials contracts include competitive price clauses that allow us to buy outside the contract if market pricing falls below contract pricing, and certain contracts have minimum-maximum monthly volume commitments that allow us to take advantage of spot pricing, we may be unable to purchase raw materials at market prices. In addition, some of our customer contracts have fixed prices for a certain term, and as a result, we may not be able to pass on raw material price increases to our customers immediately, if at all. Due to differences in timing of the pricing trigger points between our sales and purchase contracts, there is often a “lead-lag” impact that can negatively impact our margins in the short term in periods of rising raw material prices and positively impact them in the short term in periods of falling raw material prices. Future raw material prices may be impacted by new laws or regulations, suppliers’ allocations to other purchasers, changes in our supplier manufacturing processes as some of our products are byproducts of these processes, interruptions in production by suppliers, natural disasters, volatility in the price of crude oil and related petrochemical products and changes in exchange rates.

An inadequate supply of direct or indirect raw materials and intermediate products could have a material adverse effect on our business.

Our manufacturing operations require adequate supplies of raw materials and intermediate products on a timely basis. The loss of a key source or a delay in shipments could have a material adverse effect on our business. Raw material availability may be subject to curtailment or change due to, among other things:

- new or existing laws or regulations;
- suppliers’ allocations to other purchasers;
- interruptions in production by suppliers; and
- natural disasters.

Many of our raw materials and intermediate products are available in the quantities we require from a limited number of suppliers. Should any of our key suppliers fail to deliver these raw materials or intermediate products to us or no longer supply us, we may be unable to purchase these materials in necessary quantities, which could adversely affect our volumes, or may not be able to purchase them at prices that would allow us to remain competitive. During the past several years, certain of our suppliers have experienced force majeure events rendering them unable to deliver all, or a portion of, the contracted-for raw materials. On these occasions, we were forced to purchase replacement raw materials in the open market at significantly higher costs or place our customers on an allocation of our products. In addition, we cannot predict whether new regulations or restrictions may be imposed in the future which may result in reduced supply or further increases in prices. We cannot assure investors that we will be able to renew our current materials contracts or enter into replacement contracts on commercially acceptable terms, or at all. Fluctuations in the price of these or other raw materials or intermediate products, the loss of a key source of supply or any delay in the supply could result in a material adverse effect on our business.

Our production facilities are subject to significant operating hazards which could cause environmental contamination, personal injury and loss of life, and severe damage to, or destruction of, property and equipment.

Our production facilities are subject to hazards associated with the manufacturing, handling, storage and transportation of chemical materials and products, including human exposure to hazardous substances, pipeline and equipment leaks and ruptures, explosions, fires, inclement weather and natural disasters, mechanical failures, unscheduled downtime, transportation interruptions, remedial complications, chemical spills, discharges or releases of toxic or hazardous substances or gases, storage tank leaks and other environmental risks. Additionally, a number of our operations are adjacent to operations of independent entities that engage in hazardous and potentially dangerous activities. Our operations or adjacent operations could result in personal injury or loss of life, severe damage to or destruction of property or equipment, environmental damage, or a loss of the use of all or a portion of one of our key manufacturing facilities. Such events at our facilities or adjacent third-party facilities, could have a material adverse effect on us.

We may incur losses beyond the limits or coverage of our insurance policies for liabilities that are associated with these hazards. In addition, various kinds of insurance for companies in the chemical industry have not been available on commercially acceptable terms, or, in some cases, have been unavailable altogether. In the future, we may not be able to obtain coverage at current levels, and our premiums may increase significantly on coverage that we maintain.

Environmental obligations and liabilities could have a substantial negative impact on our financial condition, cash flows and profitability.

Our operations involve the use, handling, processing, storage, transportation and disposal of hazardous materials and are subject to extensive and complex U.S. federal, state, local and non-U.S. supranational, national, provincial, and local environmental, health and safety laws and regulations. These environmental laws and regulations include those that govern the discharge of pollutants into the air and water, the generation, use, storage, transportation, treatment and disposal of hazardous materials and wastes, the cleanup of contaminated sites, occupational health and safety and those requiring permits, licenses, or other government approvals for specified operations or activities. Our products are also subject to a variety of international, national, regional, state, and provincial requirements and restrictions applicable to the manufacture, import, export or subsequent use of such products. In addition, we are required to maintain, and may be required to obtain in the future, environmental, health and safety permits, licenses, or government approvals to continue current operations at most of our manufacturing and research facilities throughout the world.

Compliance with environmental, health and safety laws and regulations, and maintenance of permits, can be costly and complex, and we have incurred and will continue to incur costs, including capital expenditures and costs associated with the issuance and maintenance of letters of credit, to comply with these requirements. In 2011, we incurred capital expenditures of $26 to comply with environmental laws and regulations and to make other environmental improvements. If we are unable to comply with environmental, health and safety laws and regulations, or maintain our permits, we could incur substantial costs, including fines and civil or criminal sanctions, third party property damage or personal injury claims or costs associated with upgrades to our facilities or changes in our manufacturing processes in order to achieve and maintain compliance, and may also be required to halt permitted activities or operations until any necessary permits can be obtained or complied with. In addition, future developments or increasingly stringent regulations could require us to make additional unforeseen environmental expenditures, which could have a material adverse effect on our business.

Environmental, health and safety requirements change frequently and have tended to become more stringent over time. We cannot predict what environmental, health and safety laws and regulations or permit requirements will be enacted or amended in the future, how existing or future laws or regulations will be interpreted or enforced or the impact of such laws, regulations or permits on future production expenditures, supply chain or sales. Our costs of compliance with current and future environmental, health and safety requirements could be material. Such future requirements include legislation designed to reduce emissions of carbon dioxide and other substances associated with climate change (“greenhouse gases”). The European Union has enacted greenhouse gas emissions legislation and continues to expand the scope of such legislation. The U.S. Environmental Protection Agency (“USEPA”) has promulgated regulations applicable to projects involving greenhouse gas emissions above a certain threshold, and the United States and certain states within the United States have enacted, or are considering, limitations on greenhouse gas emissions. These requirements to limit greenhouse gas emissions could significantly increase our energy costs, and may also require us to incur material capital costs to modify our manufacturing facilities.

In addition, we are subject to liability associated with hazardous substances in soil, groundwater and elsewhere at a number of sites. These include sites that we formerly owned or operated and sites where hazardous wastes and other substances from our current and former facilities and operations have been sent, treated, stored or disposed of, as well as sites that we currently own or operate. Depending upon the circumstances, our liability may be strict, joint and several, meaning that we may be held responsible for more than our proportionate share, or even all, of the liability involved regardless of our fault or whether we are aware of the conditions giving rise to the liability. Environmental conditions at these sites can lead to environmental cleanup liability and claims against us for personal injury or wrongful death, property damages and natural resource damages, as well as to claims and obligations for the investigation and cleanup of environmental conditions. The extent of any of these liabilities is difficult to predict, but in the aggregate such liabilities could be material.

We have been notified that we are or may be responsible for environmental remediation at a number of sites in North America, Europe and South America. We are also performing a number of voluntary cleanups. One of the most significant sites at which we are performing or participating in environmental remediation is a site formerly owned by us in Geismar, Louisiana. As the result of former, current or future operations, there may be additional environmental remediation or restoration liabilities or claims of personal injury by employees or members of the public due to exposure or alleged exposure to hazardous materials in connection with our operations, properties or products. Sites sold by us in past years may have significant site closure or remediation costs and our share, if any, may be unknown to us at this time. These environmental liabilities or obligations, or any that may arise or become known to us in the future, could have a material adverse effect on our financial condition, cash flows and profitability.

Future chemical regulatory actions may decrease our profitability.

Several governmental entities have enacted, are considering or may consider in the future, regulations that may impact our ability to sell certain chemical products in certain geographic areas. In December 2006, the European Union enacted a regulation known as REACH, which stands for Registration, Evaluation and Authorization of Chemicals. This regulation requires manufacturers, importers and consumers of certain chemicals manufactured in, or imported into, the European Union to register such chemicals and evaluate their potential impacts on human health and the environment. The implementing agency is currently in the process of determining if any chemicals should be further tested, regulated, restricted or banned from use in the European Union. Other countries have implemented, or are considering implementation of, similar chemical regulatory programs. When fully implemented, REACH and other similar regulatory programs may result in significant adverse market impacts on the affected chemical products. If we fail to comply with REACH or other similar laws and regulations, we may be subject to penalties or other enforcement actions, including fines, injunctions, recalls or seizures, which would have a material adverse effect on our financial condition, cash flows and profitability.

We participate with other companies in trade associations and regularly contribute to the research and study of the safety and environmental impact of our products and raw materials, including silica, formaldehyde and BPA. These programs are part of a program to review the environmental impacts, safety and efficacy of our products. In addition, government and academic institutions periodically conduct research on potential environmental and health concerns posed by various chemical substances, including substances we manufacture and sell. These research results are periodically reviewed by state, national and international regulatory agencies and potential customers. Such research could result in future regulations restricting the manufacture or use of our products, liability for adverse environmental or health effects linked to our products, and/or de-selection of our products for specific applications. These restrictions, liability, and product de-selection could have a material adverse effect on our business, our financial condition and/or liquidity.

Because of certain government public health agencies' concerns regarding the potential for adverse human health effects, formaldehyde is a regulated chemical and public health agencies continue to evaluate its safety. In 2004, a division of the World Health Organization, the International Agency for Research on Cancer, or IARC, reclassified formaldehyde as "carcinogenic to humans," a higher classification than set forth in previous IARC evaluations. In 2009, the IARC determined that there is sufficient evidence in human beings of a causal association between formaldehyde exposure and leukemia. In 2011, the National Toxicology Program within the U.S. Department of Health and Human Services, or NTP, issued its 12th Report on Carcinogens, or RoC, which lists formaldehyde as "known to be a human carcinogen." This NTP listing was based, in part, upon certain studies reporting an increased risk of certain types of cancers, including myeloid leukemia, in individuals with higher measures of formaldehyde exposure (exposure level or duration). The USEPA is considering regulatory options for setting limits on formaldehyde emissions from composite wood products that use formaldehyde-based adhesives. The USEPA, under its Integrated Risk Information System, or IRIS, has also released a draft in June 2010 of its toxicological review of formaldehyde. This draft review states that formaldehyde meets the criteria to be described as "carcinogenic to humans" by the inhalation route of exposure based upon evidence of causal links to certain cancers, including leukemia. The National Academy of Sciences, or NAS, was requested by the USEPA to serve as the external peer review body for the draft review. The NAS reviewed the draft IRIS toxicological review and issued a report in April 2011 that criticized the draft IRIS toxicological review and stated that the methodologies and the underlying science used in the draft IRIS review did not clearly support a conclusion of a causal link between formaldehyde exposure and leukemia. It is possible that USEPA may revise the IRIS toxicological review to reflect the NAS findings, including the conclusions regarding a causal link between formaldehyde exposure and leukemia. According to NTP, a listing in the RoC indicates a potential hazard and does not assess cancer risks to individuals associated with exposures in their daily lives. However, the 2011 NTP report, as it exists now, could have material adverse effects on our business. In October 2011, the European Chemical Agency (ECHA) publicly released for comment the "Proposal for Harmonized Classification and Labelling Based on Regulation (EC) No 1272/2008 (C.I.P. Regulation), Annex VI, Part 2, Substance Name: FORMALDEHYDE Version Number 2, Date: 28 September 2011." The French Member State Competent Authorities (MSCA) proposes that formaldehyde be reclassified as a Category 1A Carcinogen and Category 2 Mutagen based upon their current review of the available evidence. The proposal cites a relationship to nasopharyngeal cancer (NPC). NPC is a rare cancer of the upper respiratory tract. The Risk Assessment Committee (RAC) of ECHA will be evaluating the proposal through 2012. The RAC is made up of representatives from all EU member states. It is possible that new regulatory requirements could be promulgated to limit human exposure to formaldehyde, that we could incur substantial additional costs to meet any such regulatory requirements, and that there could be a reduction in demand for our formaldehyde-based products. These additional costs and reduced demand could have a material adverse effect on our operations and profitability.

Bis-phenol A (BPA), which is used as an intermediate at our Deer Park, Texas and Pernis, Netherlands manufacturing facilities, and is also sold directly to third parties, is currently under evaluation as an "endocrine disrupter." Endocrine disrupters are chemicals that have been alleged to interact with the endocrine systems of human beings and wildlife and disrupt their normal processes. BPA continues to be subject to scientific, regulatory and legislative review and negative publicity. Several significant reviews on the safety of BPA were performed by prestigious regulatory and scientific bodies around the globe. These include the World Health Organization (WHO), U.S. Food and Drug Administration (FDA), European Food Safety Authority (EFSA), Japanese Research Institute of Science for Safety and Sustainability, The German Society of Toxicology and Health Canada. We do not believe it is possible at this time to predict the outcome of regulatory and legislative initiatives relating to BPA. In the event that BPA is further regulated or banned for use in certain products, substantial additional operating costs would be likely in order to meet more stringent regulation of this chemical and could reduce demand for the chemical and have a material adverse effect on our operations and profitability.

We manufacture resin-encapsulated sand. Because sand consists primarily of crystalline silica, potential exposure to silica particulate exists. Overexposure to crystalline silica is a recognized health hazard. The Occupational Safety and Health Administration ("OSHA") continues to maintain on its regulatory calendar the possibility of promulgating a comprehensive occupational health standard for crystalline silica. A proposed rule, which would, among other things, lower the permissible occupational exposure limits to airborne crystalline silica particulate to which workers would be allowed to be exposed was sent to the Office of Management and Budget (OMB) for review in February 2011, but OMB has extended its review period indefinitely. We may incur substantial additional costs to comply with any new OSHA regulations.

In addition, we sell resin-encapsulated sand (proppants) to oil and natural gas drilling operators for use in a process known as hydraulic fracturing. Drilling and hydraulic fracturing of wells is under public and governmental scrutiny due to potential environmental and physical impacts, including possible contamination of groundwater and drinking water and possible links to earthquakes. Currently, studies and reviews of hydraulic fracturing environmental impacts are underway by the USEPA, as directed by the U.S. Congress in 2010. Legislation is being considered or has been adopted by various U.S. states and localities to require public disclosure of the contents of the fracking fluids and/or to further regulate oil and natural gas drilling. New laws and regulations could affect the confidential business information of fracking fluids, including those associated with our proppant technologies and the number of wells drilled by operators, decrease demand for our resin-coated sands and cause a decline in our operations and financial performance. Such a decline in demand could also increase competition and decrease pricing of our products, which could also have a negative impact on our profitability and financial performance.

Scientists periodically conduct studies on the potential human health and environmental impacts of chemicals, including products we manufacture and sell. Also, nongovernmenal advocacy organizations and individuals periodically issue public statements alleging human health and environmental impacts of chemicals, including products we manufacture and sell. Based upon such studies or public statements, our customers may elect to discontinue the purchase and use of our products, even in the absence of any government regulation. Such actions could significantly decrease the demand for our products and, accordingly, have a material adverse effect on our business, financial condition, cash flows and profitability. In July 2012, the FDA concluded that polycarbonate, a plastic resin made from BPA, was no longer being used in the manufacture of certain infant and toddler beverage containers and, accordingly, approved a petition from the American Chemistry Council to remove polycarbonate from the list of material approved for the use in the manufacture of such beverage containers. Abandonment of such uses of polycarbonate was due at least in part to public statements alleging health effects on infants and toddlers of small amounts of BPA released from the polycarbonate. Although the FDA's determination will not have a direct impact on our business, it could eventually result in a determination by some of our customers to discontinue or decrease the use of our products made from BPA.

We are subject to certain risks related to litigation filed by or against us, and adverse results may harm our business.

We cannot predict with certainty the cost of defense, of prosecution or of the ultimate outcome of litigation and other proceedings filed by or against us, including penalties or other civil or criminal sanctions, or remedies or damage awards, and adverse results in any litigation and other proceedings may materially harm our business. Litigation and other proceedings may include, but are not limited to, actions relating to intellectual property, international trade, commercial arrangements, product liability, environmental, health and safety, joint venture agreements, labor and employment or other harms resulting from the actions of individuals or entities outside of our control. In the case of intellectual property litigation and proceedings, adverse outcomes could include the cancellation, invalidation or other loss of material intellectual property rights used in our business and injunctions prohibiting our use of business processes or technology that are subject to third-party patents or other third-party intellectual property rights. Litigation based on environmental matters or exposure to hazardous substances in the workplace or based upon the use of our products could result in significant liability for us, which could have a material adverse effect on our business, financial condition and/or profitability.

Because we manufacture and use materials that are known to be hazardous, we are subject to, or affected by, certain product and manufacturing regulations, for which compliance can be costly and time consuming. In addition, we may be subject to personal injury or product liability claims as a result of human exposure to such hazardous materials.

We produce hazardous chemicals that require care in handling and use that are subject to regulation by many U.S. and non-U.S. national, supra-national, state and local governmental authorities. In some circumstances, these authorities must review and, in some cases approve, our products and/or manufacturing processes and facilities before we may manufacture and sell some of these chemicals. To be able to manufacture and sell certain new chemical products, we may be required, among other things, to demonstrate to the relevant authority that the product does not pose an unreasonable risk during its intended uses and/or that we are capable of manufacturing the product in compliance with current regulations. The process of seeking any necessary approvals can be costly, time consuming and subject to unanticipated and significant delays. Approvals may not be granted to us on a timely basis, or at all. Any delay in obtaining, or any failure to obtain or maintain, these approvals would adversely affect our ability to introduce new products and to generate revenue from those products. New laws and regulations may be introduced in the future that could result in additional compliance costs, bans on product sales or use, seizures, confiscation, recall or monetary fines, any of which could prevent or inhibit the development, distribution or sale of our products and could increase our customers' efforts to find less hazardous substitutes for our products. We are subject to ongoing reviews of our products and manufacturing processes.

As discussed above, we manufacture and sell products containing formaldehyde, and certain governmental bodies have stated that there is a causal link between formaldehyde exposure and certain types of cancer, including myeloid leukemia and nasopharyngeal cancer. These conclusions could also become the basis of product liability litigation.

Other products we have made or used have been and could be the focus of legal claims based upon allegations of harm to human health. While we cannot predict the outcome of pending suits and claims, we believe that we maintain adequate reserves, in accordance with our policy, to address currently pending litigation and are adequately insured to cover currently pending and foreseeable future claims. However, an unfavorable outcome in these litigation matters could have a material adverse effect on our business, financial condition and/or profitability and cause our reputation to decline.

We are subject to claims from our customers and their employees, environmental action groups and neighbors living near our production facilities.

We produce and use hazardous chemicals that require appropriate procedures and care to be used in handling them or in using them to manufacture other products. As a result of the hazardous nature of some of the products we produce and use, we may face claims relating to incidents that involve our customers' improper handling, storage and use of our products. We have historically faced lawsuits, including class action lawsuits that claim liability for death, injury or property damage caused by products that we manufacture or that contain our components. Additionally, we may face lawsuits alleging personal injury or property damage by neighbors living near our production facilities. These lawsuits, and any future lawsuits, could result in substantial damage awards against us, which in turn could encourage additional lawsuits and could cause us to incur significant legal fees to defend such lawsuits, either of which could have a material adverse effect on our business, financial condition and/or profitability. In addition, the activities of environmental action groups could result in litigation or damage to our reputation.

As a global business, we are subject to numerous risks associated with our international operations that could have a material adverse effect on our business.

We have significant manufacturing and other operations outside the United States. Some of these operations are in jurisdictions with unstable political or economic conditions. There are numerous inherent risks in international operations, including, but not limited to:

- exchange controls and currency restrictions;
- currency fluctuations and devaluations;
- tariffs and trade barriers;
- export duties and quotas;
- changes in local economic conditions;
- changes in laws and regulations;
- exposure to possible expropriation or other government actions;

- hostility from local populations;
- diminished ability to legally enforce our contractual rights in non-U.S. countries;
- restrictions on our ability to repatriate dividends from our subsidiaries;
- unsettled political conditions and possible terrorist attacks against U.S. interests; and
- natural disasters or other catastrophic events.

Our international operations expose us to different local political and business risks and challenges. For example, we face potential difficulties in staffing and managing local operations, and we have to design local solutions to manage credit risks of local customers and distributors. In addition, some of our operations are located in regions that may be politically unstable, having particular exposure to riots, civil commotion or civil unrests, acts of war (declared or undeclared) or armed hostilities or other national or international calamity. In some of these regions, our status as a U.S. company also exposes us to increased risk of sabotage, terrorist attacks, interference by civil or military authorities or to greater impact from the national and global military, diplomatic and financial response to any future attacks or other threats.

Some of our operations are located in regions with particular exposure to natural disasters such as storms, floods, fires and earthquakes. It would be difficult or impossible for us to relocate these operations and, as a result, any of the aforementioned occurrences could materially adversely affect our business.

In addition, intellectual property rights may be more difficult to enforce in non-U.S. or non-Western Europe countries.

Our overall success as a global business depends, in part, upon our ability to succeed under different economic, social and political conditions. We may fail to develop and implement policies and strategies that are effective in each location where we do business, and failure to do so could have a material adverse effect on our business, financial condition and results of operations.

Our business is subject to foreign currency risk.

In 2011, approximately 59% of our net sales originated outside the United States. In our Consolidated Financial Statements, we translate our local currency financial results into U.S. dollars based on average exchange rates prevailing during a reporting period or the exchange rate at the end of that period. During times of a strengthening U.S. dollar, at a constant level of business, our reported international revenues and earnings would be reduced because the local currency would translate into fewer U.S. dollars.

In addition to currency translation risks, we incur a currency transaction risk whenever we enter into a purchase or a sales transaction or indebtedness transaction using a different currency from the currency in which we record revenues. Given the volatility of exchange rates, we may not manage our currency transaction and/or translation risks effectively, and volatility in currency exchange rates may materially adversely affect our financial condition or results of operations, including our tax obligations. Since most of our indebtedness is denominated in U.S. dollars, a strengthening of the U.S. dollar could make it more difficult for us to repay our indebtedness.

We have entered and expect to continue to enter into various hedging and other programs in an effort to protect against adverse changes in the non-U.S. exchange markets and attempt to minimize potential material adverse effects. These hedging and other programs may be unsuccessful in protecting against these risks. Our results of operations could be materially adversely affected if the U.S. dollar strengthens against non-U.S. currencies and our protective strategies are not successful. Likewise, a strengthening U.S. dollar provides opportunities to source raw materials more cheaply from foreign countries.

The recent European debt crisis and related European financial restructuring efforts have contributed to instability in global credit markets and may cause the value of the Euro to further deteriorate. If global economic and market conditions, or economic conditions in Europe, the United States or other key markets remain uncertain or deteriorate further, the value of the Euro and the global credit markets may weaken. While we do not transact a significant amount of business in Greece, Italy or Spain, the general financial instability in those countries could have a contagion effect on the region and contribute to the general instability and uncertainty in the European Union. If this were to occur, it could adversely affect our European customers and suppliers and in turn have a materially adverse effect on our international business and results of operations.

Increased energy costs could increase our operating expenses, reduce net income and negatively affect our financial condition.

Natural gas and electricity are essential to our manufacturing processes, which are energy-intensive. Oil and natural gas prices have fluctuated greatly over the past several years and we anticipate that they will continue to do so. Our energy costs represented 5% of our total costs of sales in 2011, 2010 and 2009.

Our operating expenses will increase if our energy prices increase. Increased energy prices may also result in greater raw materials costs. If we cannot pass these costs through to our customers, our profitability may decline. In addition, increased energy costs may also negatively affect our customers and the demand for our products.

We face increased competition from other companies and from substitute products, which could force us to lower our prices, which would adversely affect our profitability and financial condition.

The markets that we operate in are highly competitive, and this competition could harm our results of operations, cash flows and financial condition. Our competitors include major international producers as well as smaller regional competitors. We believe that the most significant competitive factor that impacts demand for certain of our products is selling price. We may be forced to lower our selling price based on our competitors' pricing decisions, which would reduce our profitability. Certain markets that we serve have become commoditized in recent years and have given rise to several industry participants, resulting in fierce price competition in these markets. This has been further magnified by the impact of the recent global economic downturn, as companies have focused more on price to retain business and market share. In addition, we face competition from a number of products that are potential substitutes for our products. Growth in substitute products could adversely affect our market share, net sales and profit margins.

Additional trends include current and anticipated consolidation among our competitors and customers which may cause us to lose market share as well as put downward pressure on pricing. There is also a trend in our industries toward relocating manufacturing facilities to lower cost regions, such as Asia, which may permit some of our competitors to lower their costs and improve their competitive position. Furthermore, there has been an increase in new competitors based in these regions.

Some of our competitors are larger, have greater financial resources, have a lower cost structure, and/or have less debt than we do. As a result, those competitors may be better able to withstand a change in conditions within our industry and in the economy as a whole. If we do not compete successfully, our operating margins, financial condition, cash flows and profitability could be adversely affected. Furthermore, if we do not have adequate capital to invest in technology, including expenditures for research and development, our technology could be rendered uneconomical or obsolete, negatively affecting our ability to remain competitive.

We may be unable to achieve the cost savings or synergies that we expect to achieve from our strategic initiatives, including the Momentive Combination, which would adversely affect our profitability and financial condition.

We have not yet realized all of the cost savings and synergies we expect to achieve from our current strategic initiatives, including the Momentive Combination and those related to shared services and logistics optimization, best-of-source contractual terms, procurement savings, regional site rationalization, administrative and overhead savings, and new product development, and may not be able to realize such cost savings or synergies. A variety of risks could cause us not to realize the expected cost savings and synergies, including but not limited to, the following: the shared services agreement between us and MPM entered into on October 1, 2010, and amended on March 17, 2011, and referred to herein as the Shared Services Agreement, may be viewed negatively by vendors, customers or financing sources, negatively impacting potential benefits; any difficulty or inability to integrate shared services with our business; higher than expected severance costs related to staff reductions; higher than expected retention costs for employees that will be retained; higher than expected stand-alone overhead expenses; delays in the anticipated timing of activities related to our cost-saving plan; increased complexity and cost in collaborating between us and MPM and establishing and maintaining shared services; and other unexpected costs associated with operating our business.

Our ability to realize the benefits of the Momentive Combination also may be limited by applicable limitations under the terms of our debt instruments. These debt instruments generally require that transactions between us and MPM with a value in excess of a de minimis threshold be entered into on an arm's-length basis. These constraints could result in significantly fewer cost savings and synergies than would occur if these limitations did not exist. Our ability to realize intended savings also may be limited by existing contracts to which we are a party, the need for consents with respect to agreements with third parties, and other logistical difficulties associated with integration.

The Shared Services Agreement expires in October 2015 (subject to one-year renewals every year thereafter, absent contrary notice from either party). Moreover, the Shared Services Agreement is also subject to termination by either MSC or MPM, without cause, on not less than thirty days prior written notice subject to a one year transition assistance period. If the Shared Services Agreement is terminated, it could have a negative effect on our business operations, results of operations, and financial condition, as we would need to replace the services that were being provided by MPM, and would lose the benefits we were generating under the agreement at the time.

If we are unable to achieve the cost savings or synergies that we expect to achieve from our strategic initiatives, including the Shared Services Agreement, it would adversely affect our profitability and financial condition. In addition, while we have been successful in reducing costs and generating savings, factors may arise that may not allow us to sustain our current cost structure. As market and economic conditions change, we may also make changes to our operating cost structure. To the extent we are permitted to include the pro forma impact of such cost savings initiatives in the calculation of financial covenant ratios under our senior credit agreements, our failure to realize such savings could impact our compliance with such covenants.

Our success depends in part on our ability to protect our intellectual property rights, and our inability to enforce these rights could have a material adverse effect on our competitive position.

We rely on the patent, trademark, copyright and trade-secret laws of the United States and the countries where we do business to protect our intellectual property rights. We may be unable to prevent third parties from using our intellectual property without our authorization. The unauthorized use of our intellectual property could reduce any competitive advantage we have developed, reduce our market share or otherwise harm our business. In the event of unauthorized use of our intellectual property, litigation to protect or enforce our rights could be costly, and we may not prevail.

Many of our technologies are not covered by any patent or patent application, and our issued and pending U.S. and non-U.S. patents may not provide us with any competitive advantage and could be challenged by third parties. Our inability to secure issuance of our pending patent applications may limit our ability to protect the intellectual property rights these pending patent applications were intended to cover. Our competitors may attempt to design around our patents to avoid liability for infringement and, if successful, our competitors could adversely affect our market share. Furthermore, the expiration of our patents may lead to increased competition.

Our pending trademark applications may not be approved by the responsible governmental authorities and, even if these trademark applications are granted, third parties may seek to oppose or otherwise challenge these trademark applications. A failure to obtain trademark registrations in the United States and in other countries could limit our ability to protect our products and their associated trademarks and impede our marketing efforts in those jurisdictions.

In addition, effective patent, trademark, copyright and trade secret protection may be unavailable or limited in some foreign countries. In some countries we do not apply for patent, trademark or copyright protection. We also rely on unpatented proprietary manufacturing expertise, continuing technological innovation and other trade secrets to develop and maintain our competitive position. While we generally enter into confidentiality agreements with our employees and third parties to protect our intellectual property, these confidentiality agreements are limited in duration and could be breached, and may not provide meaningful protection of our trade secrets or proprietary manufacturing expertise. Adequate remedies may not be available if there is an unauthorized use or disclosure of our trade secrets and manufacturing expertise. In addition, others may obtain knowledge about our trade secrets through independent development or by legal means. The failure to protect our processes, apparatuses, technology, trade secrets and proprietary manufacturing expertise, methods and compounds could have a material adverse effect on our business by jeopardizing critical intellectual property.

Where a product formulation or process is kept as a trade secret, third parties may independently develop or invent and patent products or processes identical to our trade-secret products or processes. This could have an adverse impact on our ability to make and sell products or use such processes and could potentially result in costly litigation in which we might not prevail.

We could face intellectual property infringement claims that could result in significant legal costs and damages and impede our ability to produce key products, which could have a material adverse effect on our business, financial condition and results of operations.

Our production processes and products are specialized; however, we could face intellectual property infringement claims from our competitors or others alleging that our processes or products infringe on their proprietary technology. If we were subject to an infringement suit, we may be required to change our processes or products, or stop using certain technologies or producing the infringing product entirely. Even if we ultimately prevail in an infringement suit, the existence of the suit could cause our customers to seek other products that are not subject to infringement suits. Any infringement suit could result in significant legal costs and damages and impede our ability to produce key products, which could have a material adverse effect on our business, financial condition and results of operations.

We depend on certain of our key executives and our ability to attract and retain qualified employees.

Our ability to operate our business and implement our strategies depends, in part, on the skills, experience and efforts of Craig O. Morrison, our chief executive officer, and William H. Carter, our chief financial officer, and other key members of our leadership team. We do not maintain any key-man insurance on any of these individuals. In addition, our success will depend on, among other factors, our ability to attract and retain other managerial, scientific and technical qualified personnel, particularly research scientists, technical sales professionals, and engineers who have specialized skills required by our business and focused on the industries in which we compete. Competition for qualified employees in the chemicals industry is intense and the loss of the services of any of our key employees or the failure to attract or retain other qualified personnel could have a material adverse effect on our business or business prospects. Further, if any of these executives or employees joins a competitor, we could lose customers and suppliers and incur additional expenses to recruit and train personnel, who require time to become productive and to learn our business.

Our and MPM's majority shareholder's interest may conflict with or differ from our interests.

Apollo controls our ultimate parent company, Momentive Performance Materials Holdings LLC, or Momentive Holdings, which indirectly owns 100% of our common equity. In addition, representatives of Apollo comprise a majority of our directors. As a result, Apollo can control our ability to enter into significant corporate transactions such as mergers, tender offers and the sale of all or substantially all of our assets. The interests of Apollo and its affiliates could conflict with or differ from our interests. For example, the concentration of ownership held by Apollo could delay, defer or prevent a change of control of our company or impede a merger, takeover or other business combination which may otherwise be favorable for us.

Our ultimate parent company, Momentive Holdings, is also the ultimate parent company of our affiliate, MPM. Therefore, in addition to controlling our activities through its control of Momentive Holdings, Apollo can also control the activities of MPM through this same ownership and control structure. There can be no assurance that Apollo (and our senior management team, many of whom hold the same position with, or also provide services to, MPM) will not decide to focus its attention and resources on matters relating to MPM or Momentive Holdings that otherwise could be directed to our business and operations. If Apollo determines to focus attention and resources on MPM or any new business lines of MPM instead of us, it could adversely affect our ability to expand our existing business or develop new business.

Additionally, Apollo is in the business of making investments in companies and may, from time to time, acquire and hold interests in businesses that compete, directly or indirectly with us. Apollo may also pursue acquisition opportunities that may be complementary to our business, and as a result, those acquisition opportunities may not be available to us. Additionally, even if Apollo invests in competing businesses through Momentive Holdings, such investments may be made through MPM or a newly-formed subsidiary of Momentive Holdings. Any such investment may increase the potential for the conflicts of interest discussed in this risk factor.

So long as Apollo continues to indirectly own a significant amount of the equity of Momentive Holdings, even if such amount is less than 50%, they will continue to be able to substantially influence or effectively control our ability to enter into any corporate transactions.

Because our equity securities are not and will not be registered under the securities laws of the United States or in any other jurisdiction and are not listed on any U.S. securities exchange, we are not subject to certain of the corporate governance requirements of U.S. securities authorities or to any corporate governance requirements of any U.S. securities exchanges.

The diversion of our key personnel's attention to other businesses could adversely affect our business and results of operations.

Certain members of our senior management team, including Mr. Morrison, our chief executive officer, and Mr. Carter, our chief financial officer, and certain of our other employees, who provide substantial services to our businesses, also act in such capacities and provide services with respect to our affiliate MPM. Certain individuals employed by MPM also provide services to our business. The services of such individuals are provided by us to MPM, or by MPM to us, pursuant to the Shared Services Agreement. Any or all of these individuals may be required to focus their time and energies on matters relating to MPM that otherwise could be directed to our business and operations. If the attention of our senior management team, and/or such other individuals providing substantial services to our business, is significantly diverted from their responsibilities to us, it could affect our ability to service our existing business and develop new business, which could have a material adverse effect on our business and results of operations. We cannot assure you that the Shared Services Agreement will not be disruptive to our business.

If we fail to extend or renegotiate our collective bargaining agreements with our works councils and labor unions as they expire from time to time, if disputes with our works councils or unions arise, or if our unionized or represented employees were to engage in a strike or other work stoppage, our business and operating results could be materially adversely affected.

As of December 31, 2011, approximately 45% of our employees were unionized or represented by works councils that were covered by collective bargaining agreements. In addition, some of our employees reside in countries in which employment laws provide greater bargaining or other employee rights than the laws of the United States. These rights may require us to expend more time and money altering or amending employees' terms of employment or making staff reductions. For example, most of our employees in Europe are represented by works councils, which generally must approve changes in conditions of employment, including restructuring initiatives and changes in salaries and benefits. A significant dispute could divert our management's attention and otherwise hinder our ability to conduct our business or to achieve planned cost savings.

We may be unable to timely extend or renegotiate our collective bargaining agreements as they expire. We have collective bargaining agreements which will expire during the next two years. We also may be subject to strikes or work stoppages by, or disputes with, our labor unions. If we fail to extend or renegotiate our collective bargaining agreements, if disputes with our works councils or unions arise or if our unionized or represented workers engage in a strike or other work stoppage, we could incur higher labor costs or experience a significant disruption of operations, which could have a material adverse effect on our business, financial position and results of operations.

Our pension plans are unfunded or under-funded, and our required cash contributions could be higher than we expect, having a material adverse effect on our financial condition and liquidity.

We sponsor various pension and similar benefit plans worldwide.

Our non-U.S. defined benefit pension plans were under-funded in the aggregate by $87 as of December 31, 2011. Our U.S. defined benefit pension plans were under-funded in the aggregate by $86 as of December 31, 2011.

We are legally required to make contributions to our pension plans in the future, and those contributions could be material. The need to make these cash contributions will reduce the amount of cash that would be available to meet other obligations or the needs of our business, which could have a material adverse effect on our financial condition and liquidity.

In 2012, we expect to contribute approximately $20 and $17 to our U.S. and non-U.S. defined benefit pension plans, respectively, which we believe is sufficient to meet the minimum funding requirements as set forth in employee benefit and tax laws.

Our future funding obligations for our employee benefit plans depend upon the levels of benefits provided for by the plans, the future performance of assets set aside for these plans, the rates of interest used to determine funding levels, the impact of potential business dispositions, actuarial data and experience, and any changes in government laws and regulations. In addition, our employee benefit plans hold a significant amount of equity securities. If the market values of these securities decline, our pension expense and funding requirements would increase and, as a result, could have a material adverse effect on our business.

Any decrease in interest rates and asset returns, if and to the extent not offset by contributions, could increase our obligations under these plans. If the performance of assets in the funded plans does not meet our expectations, our cash contributions for these plans could be higher than we expect, which could have a material adverse effect on our financial condition and liquidity.

Natural or other disasters have, and could in the future, disrupt our business and result in loss of revenue or higher expenses.

Any serious disruption at any of our facilities or our suppliers' facilities due to hurricane, fire, earthquake, flood, terrorist attack or any other natural or man-made disaster could impair our ability to use our facilities and have a material adverse impact on our revenues and increase our costs and expenses. If there is a natural disaster or other serious disruption at any of our facilities or our suppliers' facilities, it could impair our ability to adequately supply our customers and negatively impact our operating results. For example, our manufacturing facilities in the U.S. Gulf Coast region were also impacted by Hurricanes Katrina and Rita in 2005 and Hurricanes Gustav and Ike in 2008. In addition, many of our current and potential customers are concentrated in specific geographic areas. A disaster in one of these regions could have a material adverse impact on our operations, operating results and financial condition. Our business interruption insurance may not be sufficient to cover all of our losses from a disaster, in which case our unreimbursed losses could be substantial.

Security breaches and other disruptions to our information technology infrastructure could interfere with our operations, and could compromise our information and the information of our customers and suppliers, exposing us to liability which would cause our business and reputation to suffer.

In the ordinary course of business, we rely upon information technology networks and systems, some of which are managed by third parties, to process, transmit and store electronic information, and to manage or support a variety of business processes and activities, including supply chain, manufacturing, distribution, invoicing, and collection of payments from customers. We use information technology systems to record, process and summarize financial information and results of operations for internal reporting purposes and to comply with regulatory financial reporting, legal and tax requirements. Additionally, we collect and store sensitive data, including intellectual property, proprietary business information, the propriety business information of our customers and suppliers, as well as personally identifiable information of our customers and employees, in data centers and on information technology networks. The secure operation of these information technology networks, and the processing and maintenance of this information is critical to our business operations and strategy. Despite security measures and business continuity plans, our information technology networks and infrastructure may be vulnerable to damage, disruptions or shutdowns due to attacks by hackers or breaches due to employee error or malfeasance, or other disruptions during the process of upgrading or replacing computer software or hardware, power outages, computer viruses, telecommunication or utility failures or natural disasters or other catastrophic events. The occurrence of any of these events could compromise our networks and the information stored there could be accessed, publicly disclosed, lost or stolen. Any such access, disclosure or other loss of information could result in legal claims or proceedings, liability or regulatory penalties under laws protecting the privacy of personal information, disrupt operations, and damage our reputation, which could adversely affect our business, financial condition and results of operations.

Acquisitions and joint ventures that we pursue may present unforeseen integration obstacles and costs, increase our leverage and negatively impact our performance. Divestitures that we pursue also may present unforeseen obstacles and costs and alter the synergies we expect to achieve from the Momentive Combination.

We have made acquisitions of related businesses, and entered into joint ventures in the past and intend to selectively pursue acquisitions of, and joint ventures with, related businesses as one element of our growth strategy. Acquisitions may require us to assume or incur additional debt financing, resulting in additional leverage and complex debt structures. If such acquisitions are consummated, the risk factors we describe above and below, and for our business generally, may be intensified.

Our ability to implement our growth strategy is limited by covenants in our senior secured credit facilities, indentures and other indebtedness, our financial resources, including available cash and borrowing capacity, and our ability to integrate or identify appropriate acquisition and joint venture candidates.

The expense incurred in consummating acquisitions of related businesses, or our failure to integrate such businesses successfully into our existing businesses, could result in our incurring unanticipated expenses and losses. Furthermore, we may not be able to realize any anticipated benefits from acquisitions or joint ventures. The process of integrating acquired operations into our existing operations may result in unforeseen operating difficulties and may require significant financial resources that would otherwise be available for the ongoing development or expansion of existing operations. Some of the risks associated with our acquisition and joint venture strategy include:

- potential disruptions of our ongoing business and distraction of management;
- unexpected loss of key employees or customers of the acquired company;
- conforming the acquired company’s standards, processes, procedures and controls with our operations;
- coordinating new product and process development;
- hiring additional management and other critical personnel; and
- increasing the scope, geographic diversity and complexity of our operations.

In addition, we may encounter unforeseen obstacles or costs in the integration of acquired businesses. For example, if we were to acquire an international business, the preparation of the U.S. GAAP financial statements could require significant management resources. Also, the presence of one or more material liabilities of an acquired company that are unknown to us at the time of acquisition may have a material adverse effect on our business. Our acquisition and joint venture strategy may not be successfully received by customers, and we may not realize any anticipated benefits from acquisitions or joint ventures.

In addition, we have selectively made, and may in the future, pursue divestitures of certain of our businesses as one element of our portfolio optimization strategy. Divestitures may require us to separate integrated assets and personnel from our retained businesses and devote our resources to transitioning assets and services to purchasers, resulting in disruptions to our ongoing business and distraction of management. Divestitures may alter synergies we expect to achieve from the Momentive Combination.

Risks Related to our Indebtedness

We may be unable to generate sufficient cash flows from operations to meet our consolidated debt service payments.

We have substantial consolidated indebtedness. As of June 30, 2012 we had approximately $3.5 billion of consolidated outstanding indebtedness, including payments due within the next twelve months and short-term borrowings. Based on the amount of indebtedness outstanding at June 30, 2012, our annualized cash interest expense is projected to be approximately $247 based on interest rates at June 30, 2012, of which $199 represents cash interest expense on fixed-rate obligations, including variable rate debt subject to interest rate swap agreements.

Our ability to generate sufficient cash flows from operations to make scheduled debt service payments depends on a range of economic, competitive and business factors, many of which are outside of our control. Our business may generate insufficient cash flows from operations to meet our debt service and other obligations, and currently anticipated cost savings, working capital reductions and operating improvements may not be realized on schedule, or at all. If we are unable to meet our expenses and debt service obligations, we may need to refinance all or a portion of our indebtedness on or before maturity, sell assets or issue additional equity securities. We may be unable to refinance any of our indebtedness, sell assets or issue equity securities on commercially reasonable terms, or at all, which could cause us to default on our obligations and result in the acceleration of our debt obligations. Our inability to generate sufficient cash flows to satisfy our outstanding debt obligations, or to refinance our obligations on commercially reasonable terms, would have a material adverse effect on our business, financial condition and results of operations.

Our substantial indebtedness exposes us to significant interest expense increases if interest rates increase.

As of June 30, 2012, approximately $809, or 23%, of our borrowings were at variable interest rates and expose us to interest rate risk. If interest rates increase, our debt service obligations on the variable rate indebtedness would increase even though the amount borrowed remained the same, and our net income would decrease. Assuming our consolidated variable interest rate indebtedness outstanding as of June 30, 2012 remains the same, an increase of 1% in the interest rates payable on our variable rate indebtedness would increase our annual estimated debt-service requirements by approximately $9. Accordingly, an increase in interest rates from current levels could cause our annual debt-service obligations to increase significantly.

Our substantial indebtedness could adversely affect our ability to raise additional capital to fund our operations and limit our ability to react to changes in the economy or our industry.

Our substantial consolidated indebtedness could have other important consequences, including but not limited to the following:

- it may limit our flexibility in planning for, or reacting to, changes in our operations or business;
- we are more highly leveraged than many of our competitors, which may place us at a competitive disadvantage;
- it may make us more vulnerable to downturns in our business or in the economy;
- a substantial portion of our cash flows from operations will be dedicated to the repayment of our indebtedness and will not be available for other purposes;
- it may restrict us from making strategic acquisitions, introducing new technologies or exploiting business opportunities;
- it may make it more difficult for us to satisfy our obligations with respect to our existing indebtedness;
- it may adversely affect terms under which suppliers provide material and services to us;
- it may limit our ability to borrow additional funds or dispose of assets; and
- it may limit our ability to fully achieve possible cost savings from the Momentive Combination.

There would be a material adverse effect on our business and financial condition if we were unable to service our indebtedness or obtain additional financing, as needed.

Despite our substantial indebtedness, we may still be able to incur significant additional indebtedness. This could intensify the risks described above and below.

We may be able to incur substantial additional indebtedness in the future. Although the terms governing our indebtedness contain restrictions on our ability to incur additional indebtedness, these restrictions are subject to numerous qualifications and exceptions, and the indebtedness we may incur in compliance with these restrictions could be substantial. Increasing our indebtedness could intensify the risks described above and below.

The terms governing our outstanding debt, including restrictive covenants, may adversely affect our operations.

The terms governing our outstanding debt contain, and any future indebtedness we incur would likely contain, numerous restrictive covenants that impose significant operating and financial restrictions on our ability to, among other things:

- incur or guarantee additional debt;
- pay dividends and make other distributions to our shareholders;
- create or incur certain liens;
- make certain loans, acquisitions, capital expenditures or investments;
- engage in sales of assets and subsidiary stock;
- enter into sale/leaseback transactions;
- enter into transactions with affiliates; and
- transfer all or substantially all of our assets or enter into merger or consolidation transactions.

In addition, at any time that loans or letters of credit are outstanding and not cash collateralized thereunder, the agreement governing our revolving credit facility, which is part of our senior secured credit facilities, requires us to maintain a specified leverage ratio. At June 30, 2012, we were in compliance with our leverage ratio maintenance covenant set forth in our senior secured credit facilities. If business conditions weaken, we may not comply with our leverage ratio covenant for future periods. If we are at risk of failing to comply with our leverage ratio covenant, we would pursue additional cost saving actions, restructuring initiatives or other business or capital structure optimization measures available to us to remain in compliance with these covenants, but any such measures may be unsuccessful or may be insufficient to maintain compliance with our leverage ratio covenants.

A failure to comply with the covenants contained in our senior secured credit facilities, the indentures governing notes issued or guaranteed by our subsidiaries or their other existing indebtedness could result in an event of default under the existing agreements that, if not cured or waived, would have a material adverse effect on our business, financial condition and results of operations.

In particular, a breach of a leverage ratio covenant would result in an event of default under our revolving credit facility. Pursuant to the terms of our credit agreement, our direct parent company has the right, but not the obligation, to cure such default through the purchase of additional equity in up to three of any four consecutive quarters. If a breach of a leverage ratio covenant is not cured or waived, or if any other event of default under a senior secured credit facility occurs, the lenders under such credit agreement:

- would not be required to lend any additional amounts to us;
- could elect to declare all borrowings outstanding under such revolving credit facility, together with accrued and unpaid interest and fees, due and payable and could demand cash collateral for all letters of credit issued thereunder;
- could elect to declare all borrowings outstanding under the term loan facility, together with accrued and unpaid interest and fees, due and payable;
- could require us to apply all of our available cash to repay these borrowings; and/or
- could prevent us from making payments on our notes;

any or all of which could result in an event of default under our notes.

If the indebtedness under our senior secured credit facilities or our existing notes were to be accelerated after an event of default, our respective assets may be insufficient to repay such indebtedness in full and our lenders could foreclose on the assets pledged under the applicable facility. Under these circumstances, a refinancing or additional financing may not be obtainable on acceptable terms, or at all, and we may be forced to explore a restructuring.

In addition, the terms governing our indebtedness limit our ability to sell assets and also restrict the use of proceeds from that sale, including restrictions on transfers from us to MPM and vice versa. We may be unable to sell assets quickly enough or for sufficient amounts to enable us to meet our obligations. Furthermore, a substantial portion of our assets is, and may continue to be, intangible assets. Therefore, it may be difficult for us to pay our consolidated debt obligations in the event of an acceleration of any of our consolidated indebtedness.

We may be unable to generate sufficient cash flows from operations to pay dividends or distributions to our direct parent company in amounts sufficient for it to pay its debt.

Our direct parent company has incurred substantial indebtedness, and likely will need to rely upon distributions from us to pay such indebtedness. As of June 30, 2012, the aggregate principal amount outstanding of MSC Holdings’ term loans was $236. These loans accrue interest in-kind until maturity in December 2014 if elected by MSC Holdings.

We and our subsidiaries may not generate sufficient cash flows from operations to pay dividends or distributions in amounts sufficient to allow our direct parent company to pay principal and cash interest on its debt upon maturity. If our direct parent company is unable to meet its debt service obligations, it could attempt to restructure or refinance their indebtedness or seek additional equity capital. It may be unable to accomplish these actions on satisfactory terms, if at all. A default under our direct parent company's debt instruments could lead to a change of control under our debt instruments and lead to an acceleration of all outstanding loans under our senior secured credit facilities and other indebtedness.

Repayment of our debt, including required principal and interest payments, depends on cash flows generated by our subsidiaries, which may be subject to limitations beyond our control.

Our subsidiaries own a significant portion of our consolidated assets and conduct a significant portion of our consolidated operations. Repayment of our indebtedness depends, to a significant extent, on the generation of cash flows and the ability of our subsidiaries to make cash available to us by dividend, debt repayment or otherwise. Our subsidiaries may not be able to, or may not be permitted to, make distributions to enable us to make payments on our indebtedness. Each subsidiary is a distinct legal entity and, under certain circumstances, legal and contractual restrictions may limit our ability to obtain cash from subsidiaries. While there are limitations on the ability of our subsidiaries to incur consensual restrictions on their ability to pay dividends or make intercompany payments, these limitations are subject to certain qualifications and exceptions. In the event that we are unable to receive distributions from our subsidiaries, we may be unable to make required principal and interest payments on our indebtedness.

A downgrade in our debt ratings could restrict our access to, and negatively impact the terms of, current or future financings or trade credit.

Standard & Poor's Ratings Services and Moody's Investors Service maintain credit ratings on us and certain of our debt. Each of these ratings is currently below investment grade. Any decision by these or other ratings agencies to downgrade such ratings or put us on negative watch in the future could restrict our access to, and negatively impact the terms of, current or future financings and trade credit extended by our suppliers of raw materials or other vendors.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

Item 3. Defaults upon Senior Securities

There were no defaults upon senior securities during the first half of 2012.

Item 4. Mine Safety Disclosures

This item is not applicable to the registrant.

Item 5. Other Information

None.

Item 6. Exhibits

31.1	Rule 13a-14 Certifications
	(a) Certificate of the Chief Executive Officer
	(b) Certificate of the Chief Financial Officer
32.1	Section 1350 Certifications
101.INS*	XBRL Instance Document
101.SCH	XBRL Schema Document
101.CAL	XBRL Calculation Linkbase Document
101.LAB	XBRL Label Linkbase Document
101.PRE	XBRL Presentation Linkbase Document
101.DEF	XBRL Definition Linkbase Document

* Attached as Exhibit 101 to this report are documents formatted in XBRL (Extensible Business Reporting Language). Users of this data are advised pursuant to Rule 406T of Regulation S-T that the interactive data file is deemed not filed or part of a registration statement or prospectus for purposes of section 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of section 18 of the Securities Exchange Act of 1934, and otherwise not subject to liability under these sections. The financial information contained in the XBRL-related documents is "unaudited" or "unreviewed."

SIGNATURE

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

MOMENTIVE SPECIALTY CHEMICALS INC.

Date: August 8, 2012

/s/ William H. Carter

William H. Carter
Executive Vice President and Chief Financial Officer
(Principal Financial Officer)

Certification of Financial Statements and Internal Controls

I, Craig O. Morrison, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Momentive Specialty Chemicals Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
    a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
    b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
    c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
    d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
    a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
    b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 8, 2012

/s/ Craig O. Morrison

Craig O. Morrison
Chief Executive Officer

Certification of Financial Statements and Internal Controls

I, William H. Carter, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Momentive Specialty Chemicals Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

    a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

    b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

    c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

    d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

    a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

    b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 8, 2012

/s/ William H. Carter

William H. Carter
Chief Financial Officer

Certification Pursuant To
18 U.S.C. Section 1350,
As Adopted Pursuant to
Section 906 Of The Sarbanes-Oxley Act of 2002

In connection with the Quarterly Report of Momentive Specialty Chemicals Inc. (the "Company") on Form 10-Q for the period ended June 30, 2012 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of Section 13(a) or 15 (d) of the Securities Exchange Act of 1934; and

2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Craig O. Morrison	/s/ William H. Carter
Craig O. Morrison	William H. Carter
Chief Executive Officer	Chief Financial Officer
August 8, 2012	August 8, 2012

A signed original of this statement required by Section 906 has been provided to Momentive Specialty Chemicals Inc. and will be retained by Momentive Specialty Chemicals Inc. and furnished to the Securities and Exchange Commission or its staff upon request.