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MTX - Q3 2016 Minerals Technologies Inc Earnings Call

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PRESENTATION

Operator

Good day and welcome could the Q3 2016 Minerals Technologies earnings conference call. Today's call is being recorded. At this time I would like to turn the conference to your host, Mr. Paul Donnelly. Please go ahead.

Paul Donnelly - *Minerals Technologies - IR*

Thanks, Paula. Good morning. And welcome to our third quarter 2016 earnings conference call. On today's call our prepared remarks will be prepared by Doug Dietrich, our co-Chief Executive Officer and Chief Financial Officer. Following that we will take questions.

Before we begin, I'll remind you that beginning on page 13 of our 2015 10-K, we list the various factors and conditions that may affect our future results and I will also point out the Safe Harbor disclaimer on slide two here. Statements related to future performance by members of our management are subject to these limitations, cautionary remarks, and conditions. Now let me turn the call over to Doug. Doug?

Doug Dietrich - *Minerals Technologies - Co-CEO, CFO*

Thanks, Paul. Good morning, everyone.

Before I begin my review for the quarter, let me first thank all of you who have been so supportive in the days and weeks after Joe Muscari's passing. Your kind words and expressions of support have been very much appreciated by all of us here at MTI. While losing Joe so suddenly came as a shock to all of us here, it's because of his leadership that we're well equipped to continue on the path that he laid out.

During his near decade-long tenure here at MTI, Joe worked diligently to create his vision of a high-performing company driven by principles of continuous improvement and employee engagement. He fostered a culture of safety, integrity, transparency, and discipline, and he put into place a business system that leveraged this foundation. Today we continue to manage MTI through that same highly disciplined structure, and we remain committed to our key growth strategies of geographic expansion, new product innovation, and M&A to improve shareholder value.

Let's look at our third quarter results. Once again we posted solid financial results for the third quarter, with earnings per share of $1.17. Our operating income grew 7% over last year, operating margins were strong at 16.7%, and each of our reporting segments achieved double digit operating margins. We also saw productivity improvements across the company, as well as savings throughout our supply chain. Our minerals-based businesses were again the primary drivers of these results, posting an operating margin of more than 18% for the quarter, with the Specialty Minerals segment generating record operating income.

We also continued to see growing market acceptance of our innovative Resistex solution for environmental remediation and I'll provide more details on this in a few minutes. The services business has also had a solid quarter despite facing continued challenging market conditions in the oil and gas and steel sectors. Energy services returned to profitability from the restructuring initiated in the second quarter and is now focused primarily on offshore produced water filtration and well testing -- areas where we have competitive advantage and where we expect to grow profits over time.

Our growth in China continues to gain traction as company sales grew 8% over last year with the main contributors being a 7% increase in paper PCC sales and a 20% increase in Performance Materials. Efficient, we continued to use our free cash flow to repay $50 million of our term loan this quarter.

The slide shows our quarterly earnings trend. You can see earnings were strong at $1.17 per share and 10% higher than last year -- achieved despite the significant challenges we've been facing in energy services and the softness in the global steel industry which has affected our refractories business.

As we look at our minerals businesses -- Specialty Minerals, Performance Materials and Construction Technologies -- operating income grew 8% or more than $4 million over last year. Operating margins increased 18.3% of sales, and margins improved in all three segments. We continue to make progress through penetration of our products in China, for combined sales in these three segments grew 12% over last year.

In Paper PCC, sales in China grew 7% as we began operations during the third quarter at a new 100,000-ton filler satellite with Sun Paper. This is our eighth satellite in China. In addition, our New Yield and fulfill innovations, as well as packaging applications continue to gain traction and overall we're pursuing more than 20 opportunities for these technologies throughout Asia. Performance Materials sales in China grew 20% and we continue to make progress there through our penetration strategy as we convert foundry customers to our premixed green sand bonds.

In our Construction Technologies business, new products such as Resistex are growing rapidly and the business is well positioned globally with its ability to supply innovative geosynthetic clay liners from multiple production facilities around the world.

Let me go into a little more detail about Resistex. We talked about this product in past calls, but today I'd like to provide you some insight into the growth potential of this relatively new innovation. Resistex is an EPA approved, cost effective remediation solution for corrosive contaminants such as coal ash from coal fired electrical generation and red mud from the production of aluminum out of the bauxite refining process. The product is now generating strong interest in the US and also in other markets such as China where US EPA regulations are a key influence on developing regulatory requirements.

We're building on our sales momentum in the US and we've organized focused business development efforts in major markets like China, as well as at large companies facing global remediation needs to lay the ground work for future growth. We're working with government agencies charged with implementing regulatory frameworks and with key decision makers at corporate customers that are in need of the remediation solution Resistex provides. In particular, we're helping these governmental centers of influence as they design their baseline regulations. We've seen strong interest in this innovation and in our broader portfolio of environmental solutions across MTI as we establish our reputation through field tests of these products.

These efforts are beginning to pay off. We've increased our year to date sales of Resistex products by almost $14 million and this product line now represents 25% of the revenues for the environmental products business.

Our service related segments of Energy Services and Refractories also had a solid quarter despite facing the challenging market conditions. We saw improvement in Energy Services as we completed our exit from the onshore service lines to focus on offshore filtration and well testing. And refractory sales were weaker than expected this quarter, as US steel mill capacity utilization dropped from 75% in June to below 69% in September. Presently capacity utilization is at 66%. This represents a significant decline from June levels, resulting in lower demand for refractories and metallurgical wire, particularly from electrical furnace-based steel producers. Despite the reduced revenue in these two segments, we were able to maintain similar levels of profitability to last year and to improve operating margins as a result of the restructuring initiative within Energy Services and productivity gains, supply chain savings, and expense reduction in the Refractories segment.

During the past several months we've addressed questions from many of you regarding acquisitions. I would like to reiterate that we continue to focus on acquisitions as a significant contributor to MTI's long-term growth. Our acquisition and integration capability remains strong, and we continue to focus on minerals-based businesses, companies where we can leverage our expertise in Crystal engineering, fine particle technology and polymers.

I'll give you a more detailed financial review for each segment. I'll start with our consolidated results for the quarter. Again, this was a solid quarter for us with earnings per share of $1.17, excluding special items, compared to $1.06 per share last year. Quarter earnings this quarter were $1.18 reflecting gains on sale of assets which more than offset restructuring and some integration costs. Total sales for the quarter were $400 million, down $51 million from last year. $35 million of this decline occurred in our two services businesses, in Energy Services due primarily to the exit from our onshore service lines and in Refractories due to weaker conditions in the steel sector. In addition, foreign exchange had an unfavorable impact on sales of approximately $5 million.

Sales on a constant currency basis increased over last year in several product lines. GCC sales grew 5%. Environmental products increased 15%. Global fabric care products increased 3%, and Metalcasting 2%. In addition, sales for our combined businesses in China grew 8% this quarter over last year, driven by a 12% increase in our minerals business.

Operating income, excluding special items improved 7% over last year to $67 million due to strong growth in our three minerals businesses. Our service businesses achieved the same level of profitability as last year despite lower sales levels. We maintained profitability through productivity improvements, supply chain savings and overhead expenses.

Company operating margins were strong at 16.7% of sales, with all segments achieving double digit margins. Specialty Minerals had a record operating income for the quarter and Construction Technologies profits improved 20% over last year. Performance Materials operating margins were more than 19%.

We continue to generate strong operating cash flow, $62 million for the quarter, and used it primarily for debt repayment. Year to date operating cash flow was $164 million. Year to date repayments on our term loan totaled $140 million, and we're on track to reach our goal of $190 million in debt repayment for the full year.

Now let's go through the minerals businesses and I'll start with the specialty minerals segment. Segment sales were $147 million, decreased 5% on a constant currency basis from last year. PCC sales were down 8% due to the previously announced paper machine closures in the US at Verso Wickliffe, Domtar/Ashdown, and Madison Paper in Maine. These machines, if you remember, were fully operational last year.

PCC sales in China grew 7% over last year, driven by volumes from our new 100,000-ton PCC filler plant at Sun Paper. This new satellite will be ramping up over the next six months and will contribute to the continued growth of our PCC volumes in Asia.

Our process minerals business had a very strong quarter with sales 3% higher than last year driven by 5% growth in ground calcium carbonates primarily due to strong market conditions in the northeast. Operating income was $27.8 million, a record quarter for the segment and grew 11% over last year. Operating margins were very strong, close to 19% bolstered by a 5% improvement in productivity, lower energy and raw material costs, as well as reduced overhead expenses.

Moving on to our outlook for the segment for the fourth quarter, Paper PCC volumes will continue to grow in China as we ramp up the new satellite with Sun Paper. However, for Performance Minerals, the fourth quarter is the low point of demand in the year for our end markets and sales are typically 7% to 10% lower than the third quarter. As a result we expect segment operating income to be approximately $2 million lower than the third quarter and it's due primarily to the normal seasonal decline in Performance Minerals.

Now let me take you through the Performance Materials segment. Sales this quarter were $120 million, 3% lower than last year on a constant currency basis. Sales in metal casting increased 2% on a constant currency basis due to an 8% increase in sales in Asia that was partially offset by lower US green sand bond sales to the Agricultural heavy equipment casting market.

In the Household and Personal Care product line, Global Fabric Care sales rose 3% over last year and the Pet Care products were 1% higher due to increased sales in Asia. Basic Minerals accounted for the majority of this segment sales decline. Sales in this business decreased 29%, or $6 million from last year. This decrease was primarily the result of lower bulk sales of Chromite due to the weaker global steel market and lower drilling sales to the oil and gas industry. Operating income for the segment was $23 million and represented over 19% of sales. The increase in operating margins was due to productivity improvements and lower clay mining costs.

Moving to the fourth quarter, we expect similar sequential sales and operating income for the segment, although the product mix will be somewhat different. One of our customers in China is changing their laundry detergent formulation which will reduce demand for a surfactant granule that we supply. However, Chromite pricing and demand has increased recently, and we expect higher bulk sales through the fourth quarter.

Now let's take a look at the results in the construction technology segment. Sales for this segment were approximately $50 million, 2% higher than last year on a constant currency basis. Environmental product sales were up by 15% on a constant currency basis driven by incremental Resistex shipments to both coal ash and red mud applications. Holding materials and other product sales were down $3 million due to smaller scale waterproofing projects completed this year primarily in the western United States and Europe.

Operating income was up 20% over last year to $7.3 million and the segment operating margin improved to 14.7% for the quarter. The improvement was due to the increase sales of higher margin Resistex products and to lower overhead expenses.

Looking into the fourth quarter, we expect operating income to decrease by about $3 million from third quarter levels. Fourth quarter is the seasonally weakest period for this and as commercial construction and environmental remediation projects starts begin to slow moving into the winter months.

Now let's turn to our services businesses, and I'll start with the energy services segment. Net sales in Energy Services were $19.8 million, which was $21 million lower than last year. Sales decrease was primarily due to the shutdown of our US onshore service lines, including nitrogen pipeline and land-based well testing in the second quarter, and the closure of the coiled tubing services line in August of last year.

Completed the restructuring that we initiated in the second quarter and achieved the savings we targeted. Energy Services is now focused on global offshore filtration and well testing, while we have a competitive advantage from our differentiated technologies. As a result of these efforts, the business posted a double digit operating margin for the first time in several quarters. We're seeing good opportunities in the Gulf of Mexico, Brazil, Saudi Arabia, and Malaysia and we continue to develop and test new filtration technologies for challenging produced water applications. We're now well-positioned to do grow sales and profits as energy markets recover.

As we move into the fourth quarter, visibility to any meaningful improvement in the energy markets remain limited. At this point we're expecting operating income to be at similar levels for the third quarter.

Now let's go through refractories. Sales in the segment were weaker than expected and decreased 18% over last year to $63.4 million. As I mentioned earlier, steel market conditions softened in the quarter. US steel mill capacity utilization was around 75% in June. It dropped to 69% in September, and now stands at 66%. As a result, sales in refractory and wire products, specifically to electric arc furnace producers in the US were off significantly as these producers curtailed production in the quarter because of low steel service centered demand.

Operating income for the segment was approximately the same as last year at $8 million, and operating margin improved to 12.6% of sales. This was the result of the significant focus on increased productivity and variable cost improvements, supply chain savings, and lower overhead expenses.

Looking to the fourth quarter, given that US steel mill utilization rates are currently lower than the third quarter, we expect that our refractory and wire volumes will continue to be impacted. We do typically see higher equipment sales in the fourth quarter, but due to the current market conditions, some of these customers may delay capital spending into next year. We expect profits for the total segment to be similar and maybe slightly lower than the third quarter, depending on the level of these equipment sales.

I will give you a quick update on the progress of debt repayment. This chart shows our principal debt principal payments and associated net leverage ratio for the past nine quarters. Over this period, we've made a total of $430 million in debt principal payments and have reduced our net leverage from 4.5 times EBITDA to 2.6 times currently. We expect to continue this pace of debt repayment and we're still projecting to be at 2.5 times net leverage by the end of the year. Also cash and short-term investments totaled $205 million at the end of the quarter.

Our third quarter earnings of $1.17 per share reflect a solid financial performance for the company. They improved earnings over last year and maintained strong cash generation.

Let me summarize what we're currently seeing for the fourth quarter. First off, I do want to point out that this year's fourth quarter has five fewer days in the accounting period compared to last year, which will impact year over year comparisons. For our Specialty Minerals segment, we expect fourth quarter operating income to be approximately $2 million lower than the third quarter. We'll see improved volumes from the new Paper PCC facility in China, however, Performance Minerals is moving into its seasonally low period.

Performance Materials, we expect fourth quarter operating income to be approximately the same as the third quarter, but with the somewhat different product mix, lower fabric care sales in Asia and higher sails of basic minerals from improved demand and prices for chromite. Construction Technologies we expect segment operating income to be about $3 million lower than the third quarter as we enter this business's seasonally slower quarter.

Energy Services, we expect operating profit to be about the same as the third quarter, but as I mentioned earlier, visibility to any significant near term improvement in the market remains limited. Finally for Refractories, with weaker market conditions, we expect profits to be similar to slightly lower than third quarter levels. In total we expect or to be around $1.05 per share, which is approximately 5% higher than last year despite the fewer reporting days.

Now let's open it up for questions.

QUESTIONS AND ANSWERS

Operator

Thank you. (Operator Instructions). We'll take our first question from Daniel Moore with CJS Securities.

Daniel Moore - *CJS Securities - Analyst*

Good morning.

Doug Dietrich - *Minerals Technologies - Co-CEO, CFO*

Hey, Dan.

Daniel Moore - *CJS Securities - Analyst*

Just quickly, I wanted to relay, Doug, our thoughts go out to you, all the employees of MTI and especially Joe's family. He'll be deeply missed.

Doug Dietrich - *Minerals Technologies - Co-CEO, CFO*

Appreciate that, Dan. Thanks.

Daniel Moore - *CJS Securities - Analyst*

Wanted to touch on PCC. In North America, it seems like capacity reductions have outpaced volume declines over the last year or two. Do you feel like we're now at a more stable base or level or do you -- based on your conversations, are there additional closers that are a possibility over the next few quarters?

Doug Dietrich - *Minerals Technologies - Co-CEO, CFO*

Let me take that in two parts. First piece of that, slightly different markets. The coated paper market and the uncoated free sheet. Start with uncoated free sheet. Right now, utilization rates for uncoated free sheet or copy paper are probably in the low 90s. That's a pretty healthy level. We saw some closures in the past when those operating rates were down in the 80s, mid 80s. So I think for at least the time being and uncoated free sheet, we're not seeing any closures of our facilities or paper mills.

On the coated side, that's where we've seen the Verso, the Wickliffe paper machine and some recent machine closures, the Jay. So the coated side I think we've seen a number of them over the past year. Those are the ones that were -- had been impacting us, they're fully closed the second quarter and we'll probably see that, at least from a comparison basis, through the second quarter of next year. Two different markets. Don't see anything in uncoated free sheet, but the coated paper we've seen some declines.

Daniel Moore - *CJS Securities - Analyst*

Very helpful. Switching gears a little, Resistex. Can you remind us of kind of the size there or range of size of the total market opportunity there?

Doug Dietrich - *Minerals Technologies - Co-CEO, CFO*

Well, we targeted about $35 million to $45 million of total growth from that product globally in our 2020 growth targets. But that's primarily, I think we're looking at dimensioning that in out North America, Europe, western markets. Right now -- I mentioned in the comments, we're doing a lot of ground work in China. We've done a lot of work with our Eco partnership, I'll let Jon Hastings comment on that in a moment. That's a whole other dimension for potential growth for us. You can imagine what the remediation needs and the focus on environmental remediation in China, that's a very large opportunity for the company in terms of this product Resistex.

What we're working on right now is working with those kind of regulation agencies to begin to specify geosynthetic clay liners, such as Resistex, for those applications. That's a longer term process. So what we're doing is laying the ground work today for some significant sales potential in the future. We've got a broad range of environmental products in the company that we've been working on with the eco partnership. I'm going to let Jon Hastings talk about some of the recent activities he's been involved in.

Jon Hastings - *Minerals Technologies - SVP, Corporate Development*

Good morning, Dan. Thanks, Doug. A couple comments on what's happening in China as we continue with our China government marketing. I think we've commented before if you look at the 13th five-year plan, the Chinese government has a pretty intense effort in improving the environment in the air, water and soil. And as you know, we've got a wide variety of solutions that help in the environmental products area. Resistex certainly is one of them.

But we also have our New Yield for line mud and paper. We have Enersol for enhancing the yield for wide variety of crops. We've got our water filtration, water treatment technologies for cleaning up polluted waters as well. So in addition to the Resistex, we see really a wide landscape of opportunities there.

Speaking specifically about Resistex, though, this is what we also call our specialty DCLs and you think about some of the applications there used in lining of retention ponds for coal ash, coal fire power plants, retention ponds for red mud and aluminum, and retention ponds for bauxite, gypsum and the fertilizer industry, also used for riverbed remediation for capping existing landfills and also providing solutions for waterproofing building foundations, tunnels and other construction projects.

We're pretty excited about all this. We see a lot of potential growth and recently we've had a host of activities. We hosted a contingent from the Ministry of Environmental Protection in New York. We talked about the technologies for preventing further water pollution and cleaning up the environmental, and certainly that ties into the Resistex product. We hosted a contingent from the Ministry of Agriculture in Chicago. And again, we're talking about Enersol. We've been working with the Guangzhou Water Bureau, the International Water Valley, also the USTDA, the Trade and Development Agency.

So again, a lot of exciting activities and a lot of growth potential, Dan.

Doug Dietrich - *Minerals Technologies - Co-CEO, CFO*

Dan, I know we didn't give you a number for China, but I guess what you heard is it's pretty early. So we think the opportunity is large, but we're doing really just more of the ground work now to develop that as an opportunity for the company and that's going to be over a three to five-year time frame.

Daniel Moore - *CJS Securities - Analyst*

Got it. Very helpful. Last question, I'll jump back in queue. But Refractories, obviously remains -- utilization where we are remains uncertain. Any signs of bottoming or are we just remaining in a little bit of uncertainty and then the other is just housekeeping, what tax rate is embedded in your Q4 guide?

Doug Dietrich - *Minerals Technologies - Co-CEO, CFO*

Got you. I think the Refractories, right now we have utilization rates are still pretty low. We've seen some positive signs in steel. I've been reading some articles that we are seeing a bottom, hearing some commentary from some of the steel producers, our customers that we might be seeing a bottom -- scrap prices on the way up potentially.

Inventories, what we've been seeing through since July is kind of this kind of battle between purchasing and producers where inventories have been drawn down and we thought that that we'd see an inflection point through the fourth quarter. Haven't seen that yet. That's probably going to be an inflection point that happens later in the fourth quarter, maybe in the first. So we do see some positive signs. We just don't see it impacting our fourth quarter at this point.

Daniel Moore - *CJS Securities - Analyst*

Got it. And then the tax rate.

Doug Dietrich - *Minerals Technologies - Co-CEO, CFO*

Tax rate. We had a tax rate this quarter was a little lower due to discrete items, some dividends that we took that had some favorable impact on our tax rate. It's going to be probably about 23 to 24% in the fourth quarter.

Daniel Moore - *CJS Securities - Analyst*

Perfect. Thank you very much.

Operator

Moving on, we'll go to Ivan Marcuse with KeyBanc Capital Markets.

Ivan Marcuse - *Keybanc - Analyst*

Hi. Thanks for taking my question. In the Metalcasting business, how much of sales are related to auto and have you seen any sort of impact from -- there has been some announcements that there is more down time coming in termination of production rates. How sensitive is that business to I guess movements in production in auto?

Doug Dietrich - *Minerals Technologies - Co-CEO, CFO*

We have a Metalcastingbusiness. I'll let Gary comment on this to give you more color. Metalcastingbusiness, we're probably 35% automotive. So it's a significant piece of automotive casting. That's both in North America and China. I think we've got a pretty -- I'd call it a stable outlook on auto. Still looking at 2017, the rest of 2016 being pretty healthy market and we've seen some growth lately in China. Let me let Gary give you a little more color on the market.

Gary Castagna - *Minerals Technologies - SVP, MD of Performance Materials*

Yes. Hi, Ivan. In metal casting, the principal components again really around brake parts and the assembly areas in the automobile and the crank case, as example. So those are pretty steady demand areas and all the OEM, as well as replacement market. And so on the US side, you see the data, I think the latest reports show $17.9 million of vehicle sales and that's a pretty steady rate. The outlook there is probably flat, at least for the period of time. Obviously certain elements of the economy that impact us in that would be a direct correlation to our business.

The other area, of course, that we focus on is China. We've been there for 15 years and marketing different products as we've been moving along in the market. Doug mentioned before about our strategy there to upgrade to products that we sell now in the US and sell those in China. And that's progressing pretty well.

Automotive market is becoming a larger component for China for casting. It's not quite as large as the US market yet. There is a lot of infrastructure-related castings. But the underlying growth in terms of long-term demand looks pretty solid as that economy, particularly changing to a more consumer-oriented move. So that's our number one and number two. India, farthest behind, not much registering there yet, but well implanted there with teams and assets and looking for that really to kind of roll up into maybe a five-year to ten-year behind China type trajectory.

Ivan Marcuse - *Keybanc - Analyst*

Thank you, thanks for that detail. Moving over to PCC, how much did recent expansions contribute to overall sales in the quarter? I guess if you looked at -- I guess you have one business that's sort of -- how much of sales are related to expansion?

Doug Dietrich - *Minerals Technologies - Co-CEO, CFO*

The one expansion in China, Ivan?

Ivan Marcuse - *Keybanc - Analyst*

That or just in -- you have a lot of plants coming up that may not have been in last year's numbers. I'm curious how much is this growing, I guess?

Doug Dietrich - *Minerals Technologies - Co-CEO, CFO*

So that 100,000-ton satellite is just ramping up in the quarter. So it hasn't contributed -- on a company wide basis a significant amount. But it's probably halfway there and it will continue to ramp up through the fourth quarter. I'd say in the third quarter it probably added $2 million to $3 million of revenue in Asia. But that was the primary source of kind of bolstering the 7% of volume growth. And that's going to continue to go through the first, through the first quarter.

Beyond that, Ivan, we've got two other satellites for next year. The first one will probably be late -- right now it's looking like late second quarter. That's our first satellite for packaging applications. That's about a 65,000-ton satellite and then probably now as it looks further into the second half, second one that's a smaller facility, 35,000-ton facility probably sometime in the second half. We see another 100,000-tons of capacity moving in through 2017, which will keep that -- our volume growth in Asia rolling.

Ivan Marcuse - *Keybanc - Analyst*

If you remind me, when are we going to lap the -- I guess the plant shutdowns or the mill shutdowns that we've seen in North America? Basically when are these sales going to stop declining within PCC?

Doug Dietrich - *Minerals Technologies - Co-CEO, CFO*

Well, we had the majority of those tons came out pretty fully in the second quarter. So the Ashtown, the Wickliffe mill, the Jay mill, and Madison closed fully in the second quarter of this year. The one that I just mentioned ramping up in China is going to offset some of that, but not entirely. We'll probably not see a lapse of that volume until the second quarter of next year, at least the North America comp won't be until the second quarter. Again, barring any other adjustments in the North America market. It's probably going to be late first quarter, second quarter before we lap that volume decline.

Ivan Marcuse - *Keybanc - Analyst*

For the next few quarters it should be down in the high single digits?

Doug Dietrich - *Minerals Technologies - Co-CEO, CFO*

Yes. We see probably the first quarter total global volumes probably flat, Ivan, as we start to offset the closures. But then I think in the second quarter, as we ramp up this 100,000-ton satellite and as we launch that second satellite, you're going to see the global volume growth increase.

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Ivan Marcuse - *Keybanc - Analyst*

Okay. Great. Thanks for taking my questions.

Doug Dietrich - *Minerals Technologies - Co-CEO, CFO*

Yes.

Operator

Moving on, we'll go to Rosemarie Morbelli with Gabelli and Company.

Rosemarie Morbelli - *Gabelli - Analyst*

Thank you. Good morning, everyone.

Doug Dietrich - *Minerals Technologies - Co-CEO, CFO*

Hi, Rosemarie.

Rosemarie Morbelli - *Gabelli - Analyst*

Again, our best thoughts with you, Joe will be missed by all.

Doug Dietrich - *Minerals Technologies - Co-CEO, CFO*

Yes, he will.

Rosemarie Morbelli - *Gabelli - Analyst*

I was wondering on the energy side, you are done with your restructuring and this 12% margin is quite impressive compared to the history of that business. Without any pickup on the energy side on oil and gas, is this a margin level that you can maintain going forward? And when the energy market improves, how high do you think we can see the margin go?

Doug Dietrich - *Minerals Technologies - Co-CEO, CFO*

Let me give you a little insight. So as we restructured this business, we had targeted at these sales levels to be able to achieve a 10% margin. We did that, although -- and Rosemarie, I do believe that those margins are sustainable. Again, though, I'll caution you, the energy markets is a little bit volatile as we see pricing, there is a lot of pricing pressure out there as mentioned. Right now we're focused on filtration and offshore well testing and filtration. There is still pricing pressure on us. So we do think that given the overhead structure and where we sit globally in our positions, we can continue to achieve around a 10% margin at current market levels. That may bounce around depending on the type and the mix of projects that we have in any given quarter.

Longer term, we've also left an inherent $100 million of potential expansion, revenue expansion, in the business. Given our overhead structure, our positions globally, kind of equipment in place, other than some small pending capital expenditures, we think we can grow the business as market recovers, about $100 million without a substantial increase in fixed costs.

So we do think that there will be some -- as markets recover, some substantial margin improvement in the business. But again, some of that -- the viewpoint of when that will happen is a little bit vague right now. We don't see any meaningful improvements in the market through at least the fourth quarter, probably into the first. Maybe I'll let Andy Jones give you a little bit more color on what he's seeing out there in the market in terms of some of the projects.

Andy Jones - *Minerals Technologies - VP, MD of Energy Services*

Thanks, Doug. Yes, Rosemarie. We're kind of stuck in that $45 to $50 a barrel oil category at the moment. That's a fairly stable position. But it's not an incentive for any of the operators to really invest in new CapEx in terms of infrastructure. Although we have that stability, we do have a lot of pricing pressure. We're very cognizant of that. And we have to stay very alert going forward in order to keep our market share. I think we're in a fairly stable, comfortable place at the moment. And as Doug said, we do have that capacity to go two times as and when the market picks up.

Rosemarie Morbelli - *Gabelli - Analyst*

Do you have any interest in acquiring attractive technologies or product lines in this environment or you have made the decision to stick to what you understand and what you are good at?

Doug Dietrich - *Minerals Technologies - Co-CEO, CFO*

I think what we understand and what we're good at are filtration technologies and well testing. I don't see acquiring perhaps a business, I'd say. But I do think we absolutely have interest in acquiring new technologies around water filtration technologies. We do license some technologies and then apply them. So yes, I think there is absolutely an interest in terms of broadening our scope of produced water services and technologies. But I don't see a specific business that we would acquire. If that helps.

Rosemarie Morbelli - *Gabelli - Analyst*

Yes, no, it does help. Thanks. And then just one question on the green sand. As you see the automotive industry maybe slowing down in China, do you find that they are adopting the premix faster than they would otherwise do and therefore, you could grow that business a lot faster than the auto industry itself?

Doug Dietrich - *Minerals Technologies - Co-CEO, CFO*

Let me start, maybe I'll let Gary again give you some color. We don't necessarily see the automotive market slowing in China. We see it is pretty stable. We have quarter over quarter changes. But we've actually seen some pretty healthy growth in the third quarter in China's automotive market. I still think we're producing 20 million, 21 million automobiles in China at an annualized pace.

So but what we're seeing is there is some consolidation in the metal casting market where we see that helping the conversion to green sand bond. We see a pretty stable Chinese market and then we see some opportunities for further penetration. Gary, do you have anything to add? Do you want to color into that?

Gary Castagna - *Minerals Technologies - SVP, MD of Performance Materials*

Excuse me, Rosemarie. The market in China has a lot of capacity. I'm talking about automotive production as well as actually casting production. But depending on the segment of the market, there is a quite a bit of growth. General Motors announced yesterday, I think yesterday that their sales grew year over year by 7%. Ford's announced growth, there is a lot of auto makers over there right now. So they're all kind of fighting for the same type of capacity. But there is definitely growth in let's call it the higher end of the vehicle market. So where that allows us to go is -- a lot of the OEM producers there will need to boost quality, productivity, and casting shops and that's usually where it affords us the capability to grow the premix materials. So we can grow at or faster than whatever is happening in the outlying market dynamics because we see the metal casting operations there becoming more sophisticated over the longer term.

Rosemarie Morbelli - *Gabelli - Analyst*

Okay, thank you very much.

Operator

Once again it is (Operator Instructions). Moving on we'll go to Silke Kueck with JPMorgan.

Silke Kueck - *JPMorgan - Analyst*

Good morning, how are you?

Doug Dietrich - *Minerals Technologies - Co-CEO, CFO*

Hi, Silke.

Silke Kueck - *JPMorgan - Analyst*

I was wondering whether you can talk about the components of your 280 basis points operating margin expansion in the quarter. How much came from materials savings, how much energy savings, productivity improvement, head count reductions?

Doug Dietrich - *Minerals Technologies - Co-CEO, CFO*

I'd say half of it, Silke, comes from energy, raw materials savings. Now, how much of that energy savings obviously is something we can take advantage of. It's kind of hurt us on the Energy Services segment side, but yes, it does help us in terms of our natural gas consumption and Performance Minerals, from our lime kilns in our Adams location. Also in a lot of our mobile equipment. That's shown itself in lower clay mining costs in terms of transportation of clay from the mine to the processing facilities and over the road hauling diesel costs. A number of places where we've seen some energy savings.

We've had some lower magnesium oxide cost as market for steel has softened. We've seen some lower costs for MgO. That said, those things may come back. They may go the other direction and you'll see some of that margin, as energy markets tighten up in the future, that could bring our margins back down a little bit.

But the other half of it are things that we've been doing productivity improvements, variable cost improvements. We target those every year in our planning process. A lot of our operational influence initiatives of removing waste are targeted at productivity and variable cost improvements in our plant.

The other thing I'll give you that's more structural is through the integration of AMCOL, one of the last pieces is we've moved the supply chain functions into the MTI business model. And that is we've integrated strategic supply chain into our strategic supply chain group while we're looking at groups of commodity purchases and major purchases around the company and leveraging that team to find opportunities for savings. And we've also moved the more transaction piece of our supply chain, of procurement activities et cetera, into our shared services group.

So I think what that's yielded is despite kind of commodity movements around that have helped us in our margins, we've really put in a focused effort to leverage transportation saving throughout the company, leverage other commodities spent throughout the company, even leveraging some of our energy purchases -- not associated necessarily with ups and downs in energy markets, but we've become more efficient with how we purchase and where we purchase. So there is some structural things that have added to our margins and those I think will continue on and then there is some things, yes, like energy that have helped our margin so far this year.

Silke Kueck - *JPMorgan - Analyst*

And then in terms of your restructuring costs, it seems like those are coming down because we're getting to the end of the right sizing the Energy Services business. Do you expect future restructuring charges or what's sort of left to do to right size the remaining assets?

Doug Dietrich - *Minerals Technologies - Co-CEO, CFO*

Those restructuring charges are mostly due to still the integration of some of our IT systems. We've got some kind of associated costs with the rollout of our Oracle ERP system which is going to continue through the first quarter, just other small charges that continue to happen as we restructure. So I think -- they're going to continue, but as you mentioned at a reduced level as we got into next year, early part of next year.

Silke Kueck - *JPMorgan - Analyst*

Thanks very much. I'll get back in the queue.

Doug Dietrich - *Minerals Technologies - Co-CEO, CFO*

Sure.

Operator

(Operator Instructions). Moving on, we'll go to Dana Walker with Kalmar Investments.

Dana Walker - *Kalmar - Analyst*

Good morning, everybody.

Doug Dietrich - *Minerals Technologies - Co-CEO, CFO*

Hi, Dana.

Dana Walker - *Kalmar - Analyst*

Fabric Care and Pet Care have been stronger deliverers in terms of volume growth over the past couple of years you've described three in one, I believe it was, in the most recent quarter and a formulation change at a customer. Is that formulation change taking your product out permanently or is there just an adjustment process?

Doug Dietrich - *Minerals Technologies - Co-CEO, CFO*

It's more of an adjustment process. So we sell a number of different technologies and we have a number of different surfactant technologies in the works with a number of our consumer products companies, or customers. What's happening is this is a particular customer in China that's reformulating their dry laundry detergent to a different technology. As they switch over that technology, that's going to remove volumes probably over the next quarter to two quarters from our China operations in Tianjin. We continue to work with them on new technologies We see other ones in the queue that will take its place. So it's not a lost business. It's more of a changeover and a delay in some of the sales. You'll see that in some of the comparisons.

Dana Walker - *Kalmar - Analyst*

Would you expect your long-term contents per ton of material to be similar with that customer or is that not knowable?

Doug Dietrich - *Minerals Technologies - Co-CEO, CFO*

I think it's knowable. Gary, you want to give us a little more feel for kind of the technologies and what's in the pipeline?

Gary Castagna - *Minerals Technologies - SVP, MD of Performance Materials*

Right. There might be components that change over time. So this particular component, surfactant granule is, like Doug said, is going through an adjustment. Really what's happening is is that the customer phases it out of certain applications, and then later on phases it back in in other applications. So we've got a portfolio of different both aesthetic as well as performance oriented materials that go along into these formulations. And they ebb and flow in terms of both consumer demand, as well as their structure in the particular compounds. So this is the way it's been going for many years and we expect the way our technologies being positioned that it would continue on in the foreseeable future. So there is just sometimes that there is ebbs and flows in the way the demand works for the different products.

Dana Walker - *Kalmar - Analyst*

Are there still the very strong secular drivers, though, to Fabric Care as well as Pet Care, even if the numbers were more moderate growth wise this quarter?

Gary Castagna - *Minerals Technologies - SVP, MD of Performance Materials*

Our focus in Fabric Aare is principally in emerging markets and in entry level, basic laundry detergent materials, mainly in the dry laundry end. So a significant portion of our sales go to China, India, Southeast Asia, et cetera. And of course, as the consumer demand goes along, you see more migration, if you will, in washing technology. That's generally a benefit for us. Pet Care, pet ownership continuing on to increase in these economies of the world, both not only China, but in other areas of the Pacific Rim as well. So we see the domestication, if you will, in pets as a long-term driver for us.

Doug Dietrich - *Minerals Technologies - Co-CEO, CFO*

Dana, I didn't mention, but pet care in China grew over 200% from this quarter to last quarter. I didn't mention it because it's off a low base. But at this mention the fact that that was the driver of the percent growth starting to get to a size that is actually affecting -- it has a measurable effect on the global pet care products we sell. We sell Pet Care in both bulk to other pet litter suppliers, we sell private label packaged goods and then we have our own packaged labels. So we're in all channels here in North America. As we continue to grow our Pet Care business in China, its growth -- it's been 100% or 200% for the past several quarters, starting to build a base of meaningful sales.

Dana Walker - *Kalmar - Analyst*

You have a variety of specialized applications in your Performance Materials segment for calcium carbonate type products. How are they going in what appears to be a relatively lackluster environment?

Doug Dietrich - *Minerals Technologies - Co-CEO, CFO*

Are you talking about in our specialty -- are you referring --

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Dana Walker - *Kalmar - Analyst*

Maybe Specialty Minerals. Pardon me.

Doug Dietrich - *Minerals Technologies - Co-CEO, CFO*

Specialty Minerals. We have -- most of those more specialized products are probably in our Specialty PCC. Those are pretty much all PCC applications that are not paper. Those products go into automotive. They go into consumer products, pharmaceutical, food and beverage type applications. So we do see continued growth globally for those products. We do sell from our facilities in England and the United States into Asia and we see that as a growth opportunity for the business going forward. So yes, we do have a portfolio of specialty products. We do see growth globally for them.

Dana Walker - *Kalmar - Analyst*

Two last questions. Your bulk mineral sales have been weak, although you describe how the chromite opportunity seems to be picking up, whether that's for a quarter or a burgeoning trend. But with energy stabilizing, is that a part of your business where you're likely to see more stability, if not some growth compared to what we've seen over the last year and a half?

Doug Dietrich - *Minerals Technologies - Co-CEO, CFO*

Actually if you're referring specifically to Basic Minerals?

Dana Walker - *Kalmar - Analyst*

Yes.

Doug Dietrich - *Minerals Technologies - Co-CEO, CFO*

Yes. So basic, yes. The three components of the Basic Minerals business are the bulk chromite going to steel. Iron ore pelletizing, so it's bentonite for the pelletizing application, that's also steel-related, and drilling mud, bentonite into drilling fluids for primarily oil and gas. So steel and oil and gas, that's been the major impact over the last several quarters in that product line.

But we're seeing and what I commented on in Chromite, there has actually been a pretty significant and rapid shift in Chromite demand and pricing over literally the past probably four to six weeks. So we saw that weak demand in the third quarter and chromite prices have changed upward pretty significantly and we see that our ability to sell some inventories that we have at our mines at pretty favorable pricing will help us through the fourth quarter. It's been a pretty volatile market for chromite, so not going to project too much further that opportunity. But we'll see more as prices continue through the fourth and maybe into the first.

Dana Walker - *Kalmar - Analyst*

And then final question, it would relate to -- and I think you alluded to this earlier, Doug, longer term planning on Paper PCC type projects in China, whether it be traditional or New Yield. What do you see after these next couple of projects go into effect?

Doug Dietrich - *Minerals Technologies - Co-CEO, CFO*

We have -- I think Paper PCC offers tremendous growth item. We've always said that in Asia and China in particular with our base satellite filler, with coated paper applications. We're building our first satellite for packaging, as I mentioned here next year, for coated packaging. This is that glossy kind of high end cartons, white carton board. For New Yield, where in terms of making the paper process, we're targeting over 20 opportunities, maybe, Rand, if you give us a feel for the activity level we're seeing in our pipeline in China right now.

Rand Mendez - *Minerals Technologies - SVP, MD of PCC*

Yes, Doug. As you said, we do have 20 targets in our current pipeline and the activity level is high. In fact, what we're seeing is a number of active targets in the interest of our technology is really validating our vision for growth in China. We're seeing some different types of execution challenges as we go ahead because our target list is mostly domestically focused companies, not really multi-nationals. And the decision making is at a higher level in the company, usually the chairman, which requires some more extensive education and also requires a high degree of product development and machine trials.

So that indication and the expansive number of machine trials we're doing this year is a good indicator of the high level of activity and interest. We have 20 targets, about a half a dozen of them are New Yield and the rest are PCC across Asia.

Doug Dietrich - *Minerals Technologies - Co-CEO, CFO*

So Dana, I think beyond the ones that we're building, it's a very active market for us and we see the opportunity there as the same as we saw it a year ago in terms of potential for both PCC and filler and also our new technologies. And it's a pretty active market for us right now.

Dana Walker - *Kalmar - Analyst*

Do you have precedent where you've been able to break through with one of these more domestically focused paper makers?

THOMSON REUTERS

Doug Dietrich - *Minerals Technologies - Co-CEO, CFO*

Oh, yes. I think we have two currently that -- active satellites. The Jianghe paper we've built two years ago. It's more the domestic type customer. These coated packaging customer is what you'd refer to as more of kind of the domestic producer. So there is a longer, larger body of domestic, but sizable, very sizable paper and carton producers.

Also we have Sun Paper. To recognize the size of that customer for us and the potential growth with that existing, Sun Paper represents about 25% of our capacity installed in China. That's just over the past 2.5 years. And there is room to grow there as well. So again, we see the opportunity in China the same way we always have. And continue to execute on that growth over the next few years.

Dana Walker - *Kalmar - Analyst*

Are all these folks in the very referenceable column?

Doug Dietrich - *Minerals Technologies - Co-CEO, CFO*

Very referenceable?

Dana Walker - *Kalmar - Analyst*

Meaning they're happy and there wouldn't be any quarreling or quibbling about expectations versus reality?

Doug Dietrich - *Minerals Technologies - Co-CEO, CFO*

I think they're in the very -- yes. I'd like to say yes, our customers are very happy with the products we provide them and they're not into quarreling and quibbling. They do vie for market share in China and as some of the tariffs in North America changed last year, a lot of volume went back into China. They've had to absorb that business. That's been part of the challenge in terms of their focus of their paper production.

But in total, our solutions provide cost savings. So we're not looking to -- we're not dependent on their growth in terms of our ability to grow our product line. What we're doing is substituting other pigments for a higher value, meaning higher performance and lower cost to produce pigment and that's the real driver, that penetration strategy. But that takes some time and that takes a lot of selling effort, as Rand just mentioned.

Dana Walker - *Kalmar - Analyst*

Thank you.

Operator

And there are no further questions. I'd like to turn it back to Mr. Donnelly for any additional or closing comments.

Paul Donnelly - *Minerals Technologies - IR*

Thanks, everyone, for joining us on the call today. We look forward to talking to you again in a few months. Good day.

Operator

And that will conclude today's conference. We'd like to thank everyone for their participation. You may now disconnect.