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CCC - Q4 2011 Calgon Carbon Earnings Conference Call

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PRESENTATION

Operator

Welcome to the Calgon Carbon Corporation fourth quarter results call.

All lines have been placed on mute to prevent any background noise. After the speaker's remarks there will be a question-and-answer session.

(Operator Instructions)

We do ask that you please limit to one question and one follow up question. For any further questions, please return into queue.

Thank you. I would now like to turn the conference over to Gail Gerono, Vice President of Investor Relations. You may begin your conference.

Gail Gerono - *Calgon Carbon Corp - VP of IR*

Thank you, Paula. Good morning, everyone.

Our first speaker today will be Steve Schott, Calgon Carbon's CFO. Steve will provide a brief review of our Company's fourth quarter financials. Then John Stanik, our CEO, will discuss the quarter in more depth and report on developments that may have an impact on results going forward.

Before we start I would like to remind you that the Private Securities Litigation Reform Act of 1995 provides a Safe Harbor for forward-looking statements. John's or Steve's presentations, or perhaps some of the comments that they make during the Q&A, may contain statements that are forward-looking. Forward-looking statements typically contain words such as expect, believe, estimate, anticipate, or similar words indicating that future outcomes are uncertain. Statements looking forward in time, including statements regarding future growth and profitability, price increases, cost savings, broader product lines, enhanced competitive position and acquisitions, are included in the Company's most recent annual report, pursuant to the Safe Harbor provision of the Private Securities Litigation Reform Act of 1995.

They involve known and unknown risks and uncertainties that may cause the Company's actual results in future periods to be materially different from any future performance suggested in the presentations or during the Q&A. Further, the Company operates in an industry sector where securities values may be volatile and may be influenced by economic and other factors beyond the Company's control. Some of the factors that could affect the Company's future performance are higher energy and raw material costs, cost of imports and related tariffs, labor relations, availability of capital, and environmental requirements as they relate both to our operations and to our customers, changes in foreign currency exchange rates, borrowing restrictions, validity of patents and other intellectual property, and pension costs. In the context of the forward-looking information provided in this webcast, please refer to the discussions of risk factors and other information detailed in, as well as the other information contained in, the Company's most recent annual report.

Steve?

Steve Schott - *Calgon Carbon Corp - CFO*

Thanks, Gail. Good morning, everyone.

Total sales for the fourth quarter of 2011 were $138.2 million, compared to $131.5 million in the fourth quarter of 2010. The sales increase of $6.7 million, or 5.1%, was primarily due to higher sales at Calgon Carbon Japan, up $3.9 million. CCJ's $3.9 million increase includes $1.3 million of favorability from foreign exchange. Other sales increases resulted from higher prices for certain activated carbon and service products within the Company's activated carbon and service segment. Foreign exchange on a consolidated basis was not significant, apart from the CCJ impact.

Regarding our segments -- sales in the activated carbon and service segment increased $5.2 million, or 4.4%, for the fourth quarter of 2011, compared to 2010's fourth quarter. Excluding CCJ's quarterly sales increase of $3.9 million, the remaining sales growth of $1.3 million is attributable to activated carbon and service products in the environmental water, food, and environmental air markets. Sales in the equipment segment increased approximately $1.3 million, or 10.3%, for the fourth quarter of 2011; compared to 2010's fourth quarter, primarily due to higher revenue for UV systems, including Ballast water treatment systems, whose 2011 fourth quarter sales increased by 41%. This increase was partially offset by lower demand and sales of the Company's traditional carbon absorption systems.

Sales in the consumer segment benefited from increased sales of activated carbon cloth, which was offset by lower sales related to the Company's former PreZerve product line. Consolidated gross profit before depreciation and amortization as a percent of net sales was 30.9% for the fourth quarter of 2011, compared to 33% in the fourth quarter of 2010, a decrease of 2.1 percentage points. Higher coal costs, sales of low-margin outsourced products, particularly at CCJ, as well as cost related to equipment failures during the startup of the Company's reactivation facilities in Europe and China, adversely affected our margins in the fourth quarter of 2011, and more than offset the positive impact from our November 2010 price increase.

Depreciation and amortization expense was $7 million in the fourth quarter of 2011, compared to $6.3 million in the fourth quarter of 2010. The increase of $700,000, or 11%, is primarily the result of accelerated depreciation for certain assets in the US during the fourth quarter of 2011. Selling, administrative, and research expenses were $27 million during the fourth quarter of 2011, versus $21.6 million in 2010; an increase of $5.4 million, or approximately 25%. The increase was primarily due to employee-related expenses, which included a $2.2 million separation charge due to a change in senior leadership, as well as $1.9 million in increased personnel-related costs, due primarily to the growth of our Hyde Marine business.

During the fourth quarter of 2011, the Company also incurred $600,000 of costs related to the testing of its advanced products for mercury removal. The Company recorded a tax provision of $2.7 million, or 35%, for the fourth quarter of 2011; versus a provision of $2.5 million, or 17%, for the fourth quarter of 2010. The 2010 fourth quarter benefited from the reversal of valuation allowances on foreign tax credits. In summary, our net income for the fourth quarter of 2011 was $4.9 million, or $0.09 per diluted share, versus net income of $12.5 million, or $0.22 per diluted share in 2010.

Turning briefly to our Company's business segments, the activated carbon and service segment recognized $16.4 million in operating income before depreciation and amortization in the fourth quarter of 2011, compared to $23.4 million in the fourth quarter of 2010, primarily due to the previously discussed 2011 fourth quarter issues -- higher coal costs, low-margin outsourced product sales at CCJ, equipment failures in Europe and China, and employee separation costs. The operating margin for this segment decreased by 6.7 percentage points, from 20.1% to 13.4%, in comparison of those two periods. In addition, the fourth quarter of 2010 included $2.8 million related to the reversal of a legal accrual. This accounted for 2.4 percentage points of the decline.

The equipment and consumer segments operating results, before depreciation and amortization, were not material in either 2011 or 2010, excluding the $3.3 million legal charge related to the exit of the former PreZerve product line that occurred in the fourth quarter of 2010 and adversely impacted the consumer segment. At year end 2011, backlog in the equipment segment had increased $2 million from the end of the third quarter, and is approximately $40 million.

Regarding our balance sheet, cash declined during the fourth quarter of 2011 due to the funding of the Company's various capital expenditure initiatives, including the Feluy, Belgium, and Suzhou, China, reactivation projects. At December 31, 2011, we have approximately $15 million of unrestricted and restricted cash. Receivables were $102.5 million at year end 2011, or approximately $8 million higher than year end 2010, primarily as a result of increased sales.

Inventories have increased by approximately $17 million from year end 2010, primarily due to an increase of US granular activated carbon products; related to lower than expected sales, including delays in shipments, primarily in the Americas and Asia. However, some inventory growth in Q4 is typical and desired, as we prepare for the onset of the municipal water business in March in Q2.

As of December 31, the Company's total debt outstanding was $27 million, which represents a decrease of approximately $1 million from year end 2010. Operating cash flow was $20 million for the fourth quarter of 2011, as compared to only $8 million in the fourth quarter of 2010. The full year operating cash flow for 2011 was $53 million, approximately $19 million better than 2010's operating cash flow. Increased earnings and lower pension contributions for 2011 as compared to 2010, contributed to the year-over-year improvement. Capital expenditures totaled $17 million for the fourth quarter of 2011, and were approximately $72 million for the full year 2011. Our estimated spending on capital for the 2012 year is currently estimated at $70 million to $80 million, including capital expenditures for the Phoenix, Arizona, reactivation project.

I will now turn it over to John.

John Stanik - *Calgon Carbon Corp - CEO*

Good morning.

Our results in the fourth quarter were very disappointing to us. Within my prepared comments, I want to provide you with an explanation of the major issues that occurred during Q4, and the lingering effects that will roll into Q1. I plan to take more time during this call covering Q1 of 2012, especially since it is now nearly the end of February. But remember, Q1 is always difficult to judge for us because of the seasonality of our business and the weakness that historically occurs in the first two months of the year. However, we can draw comparisons to January and February of 2011, and we will. Following the Q1 discussion, I will provide a longer term outlook containing developments that will affect the remainder of 2012 and/or beyond.

Let's start with Q4. New reactivation plant problems. Because our reactivation process operates at temperatures sometimes exceeding 1800 degrees Fahrenheit, refractory material is used to protect the steel shell of our furnaces and kilns. The reactivation vessels at Feluy and Suzhou are a different design. However, they both use refractory. The bottom line is, both experienced failures. The castable used in both applications is a material that we have successfully used in other existing reactivation plants. Our forensic analysis leads us to believe that the failures were due to inadequate mixing of the material and poor application within the equipment during construction.

Shortly after startup, and while operating at high temperature, the refractory began to fail at both locations. At Feluy the refractory was replaced, and the unit restarted in January, and it's been operating smoothly since. In Suzhou, the failure is of a different nature, due to the design of the equipment. The corrective measures must begin with manually jackhammering the refractory material out of the kiln. During this process, many or all of the metal anchors that are used to keep the refractory attached to the steel shell get damaged and must be replaced. There are hundreds of these in each kiln. Consequently, the repairs in Suzhou are expected to go into April for the first kiln, and beyond for the second.

While our contractors have responsibility for their workmanship and the material cost, the losses associated with such failures are not without cost to us. Lost volume, less absorption of overhead, replacement of reactivation product with virgin product, to supply customers needs, and consequential failures to other equipment which require repair, are all examples of how we accumulated such a significant unfavorability.

Severance. I elected to reorganize the Company's senior leadership, and this resulted in a $2.2 million severance expense in Q4. I'll talk more about the reorganization a little later and explain why I chose this path.

Calgon Carbon Japan. There were numerous issues in Japan, they can be summarized into the commercial part of the organization, which allowed the sales of a particular mix of products, and those sales in some cases at extremely low margins. The lack of an enterprise resource planning system such as SAP and poor local leadership decision making caused these results to occur. SAP was activated February 1; consequently, we will now have an accurate representation of what products were sold, and at what price, on a daily basis. Additionally, we are in the process of replacing the senior leadership in Japan. Significant improvement in gross margin occurred in January, but we have not yet returned completely to pre-Q4 2011 levels.

PreZerve product line. In the fourth quarter, we completed the final disposition of our PreZerve product line, and resolved a lingering legal dispute. The total impact was $400,000. The process is now complete.

Look ahead to Q1. We've covered the major items that adversely affected Q4. There will be a continuation of a couple of the issues that will impact the Q1 financials. Let's start with revenue. Americas revenue in November and December was weaker than expected. In January, it rebounded somewhat and increased over January of 2011. It appears that February will follow January's pattern. However, I am cautious about March's expectation, due to contract postponements valued at approximately $5 million that have just been communicated to us by our customers. Therefore, we are being cautious about the Americas Q1 revenue, even though it was up January-over-January.

In Europe, the deep freeze that occurred at the end of January and the beginning weeks of February has caused many of our European customers numerous plant problems, which have resulted in delays in placing orders to us. Once these plants resolve their issues, we expect the orders to resume. However, February's European revenue appears to be light. Bottom line -- revenue is expected to fall between Q4 of 2011 and Q1 of [2011].

Moving to margins. For Feluy there will be about $900,000 of costs from the hearth failure that continue in the first quarter and will hit our margins, along with a $200,000 stemming from Suzhou. In January, Japan's margin improved somewhat, but not to pre-Q4 2011 levels. As the first quarter continues, we expect additional improvement to the levels achieved in the first nine months of 2011.

Operating expense. Additional separations in Q1 are expected to create global expense of approximately $500,000. Expense associated with the final CCJ SAP implementation is expected to be approximately $300,000. We have scheduled more FLUEPAC testing that we expect will hit the first quarter for $200,000, and there is the Q1-over-Q1 2011 ongoing expense of new Hyde employees of approximately $2 million. Adding all of these items together, I believe it will be, at best, a major challenge to achieve Q1 2011 earnings. I expect us to surpass Q4 2011 results, but fall well short of Q1 2011.

Our longer term outlook is promising. Following Q1, we expect our performance to improve and follow our normal seasonal cycle. There have been a number of developments that have occurred over the past months that should have a positive impact on the Company going forward. The first is the reorganization. I have named Bob O'Brien Chief Operating Officer, and placed the three geographic regions -- Americas, Europe, and Asia -- under his responsibility. All three regional leaders are new, but we have been preparing them for these roles for some period of time. They are very experienced in their specific region, and I have no concerns that they will assimilate quickly into these important leadership positions.

The purposes for reorganization are several-fold. Perhaps most importantly, it was time to unify the Company, and implement best practices across the world as quickly as possible. Also, I believe this structure will be faster, increase our return on assets, and provide better commercial coverage of all of our products and technologies around the world. Third, we need to focus our attention on the key growth initiatives and less on non-core or peripheral activities. I believe this organization will deliver that. Until we build a new virgin activated carbon plant, we must continue to focus on product and pricing optimization. In other words, we must sell the products that we manufacture to the place where we can get the highest margin. That message has been delivered. While I feel there may be some minor changes ongoing within the regions, I believe the reorganization will cause little disruption and not have a long learning curve.

Coal. We have secured most of 2012's coal supply in multi-year agreements. I recently signed a new three-year contract at attractive pricing. The extensive amount of work and testing that our operations people completed in 2011 and thus far in 2012, has really paid off. We have more viable

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suppliers of coal than I can remember at any time in the last 20 years in the Company. The cost increase for 2012 over 2011 is expected to be small. And if some of the coal trials planned for March and April are successful, we may even decrease coal costs over 2011 levels. This should have a positive effect on margins. In fact, we expect our coal costs to be at their highest in Q1.

Reactivation updates. Regarding our sizable opportunity in Phoenix, I am happy to announce that the negotiations have been successfully completed. We are waiting for signatures on the contract, and to purchase the land for the plant. As a reminder, once all of the Phoenix municipal treatment facilities are up and running, we expect to reactivate as much as 10 or more million pounds of activated carbon each year.

The 10-year contract requires that Calgon Carbon build a reactivation facility in Maricopa County, and we expect that facility will be completed before the end of the second quarter of 2013. Until that time, reactivation will occur at existing Calgon Carbon reactivation plants. We expect Phoenix reactivation to begin no later than Q2 of this year, and perhaps even March.

Scottsdale, Arizona. Scottsdale is also a large user of granular activated carbon for disinfection byproduct treatment. Their volume is lower than Phoenix's, but still on the order of 6 million to 7 million pounds per year. Although we do not yet have a contract from Scottsdale, we have already begun to reactivate their carbon, and we have begun negotiations on a contract. We believe that the potential multi-year contract will be very similar to the one that we have with Phoenix.

Earlier this year, we reached tentative agreement with a US customer for potentially several years, to provide customer reactivation for all of their treatment plants that utilize carbon. This involves 39 plants, only a couple of which have disinfection byproduct issues. But the potential contract value is approximately $2 million to $3 million per year. Reactivation for that customer will be handled primarily at Columbus, Ohio.

The new furnace at Feluy is operational and has been running well for a few weeks. The large new customer that I talked about in previous quarters has completely shifted their reactivation to Feluy.

China react. During Q1 in Suzhou, we will be extracting the original refractory and replacing it. As I said previously, this long, tedious, manual work will require several more weeks to complete. At this time, we hope that feed will be on the first kiln in April. Until that time, we will continue the practice of 2011, which is total reactivation. The plant workers who have been trained and on board since the beginning of the fourth quarter of last year, will provide help where possible, but their costs will hit SG&A until the plant is running.

Mercury removal. On December 21, the Utility MACT Rule, now referred to as the MACT Rule, was finalized and announced by the EPA. On February 16, the Rule was entered into the Federal Register. The contents of the regulation is what was expected, and should provide the market growth that we had anticipated previously. In other words, another 300 million to 500 million pounds per year over what is currently being consumed. From a timing standpoint, the EPA was a little more flexible, which means that for some power plants, they may not need to convert until after 2015. Legal challenges are being reported, so we will have to watch how those develop during this election year and beyond.

Regarding our products, we did a substantial amount of testing in Q4, testing our new, high performance products. The results of the test have been very successful, proving that these powdered activated carbons, while more expensive, definitely cut the customer's volumetric consumption by one-half or more. The interest level by potential customers for testing is obviously very high. In Q1, we only expect a small number of tests that will cost about $200,000. However, when we are notified by potential customers that a testing window is open, we will seize each of those opportunities. We are hopeful that these products will benefit us in 2012 and 2013 as contract renewals begin to occur.

Calgon Carbon Japan. There are a couple of additional comments that I would like to make about CCJ. The news in the fourth quarter was negative. However, we still very much believe in the potential of this business. We are convinced that we can grow revenue and reduce costs and improve margin. By year end 2011, despite all of the problems of Q4, the annual margin in 2011 improved by 300 basis points over 2010; and revenue grew in 2011 to $81 million. I expect margins to improve in 2012, hopefully as much again or perhaps more than they improved in 2011. However, we still have some heavy lifting to do. One of the things that we have definitely learned is that the progress in making change in Japan is slower than we would like.

Hyde & UV. In November, the US Coast Guard submitted their proposed regulation for Ballast water treatment to the OMB. Normally, regulations are finalized roughly 90 days after submittal. That has not occurred in this case. The OMB has classified this rule as, quote, review extended. We are not aware of the specific reasons for the delay.

Regarding the IMO, more countries have now subscribed; we are up to 33. However, global tonnage remains under 27% versus the target of 35%. Rumors of additional countries continue. For us, there has been a continuous stream of new orders. The growth in our equipment backlog is primarily attributable to our success in the Ballast water treatment market. This is especially noteworthy, because in 2011 we experienced a very slow year in liquid phase carbon equipment sales, which I believe was primarily due to the lack of capital available to municipalities.

For Ballast water treatment, the proposal activity continues to be very heavy. As an example, in one week alone in January, we issued preliminary bids for $54 million. In one week. My confidence in this business continues to run very high. Two of the new ships made in Korea as part of the $20 million order we announced in October of 2010 have now undergone successful tests. During 2011, we added more than 60 people to our UV and Hyde business, nearly doubling our headcount. Our revenue grew by more than 50%.

In general, as the equipment business has a relatively long life cycle from customer inquiry to project completion, we have not yet realized a lot of net income in this part of the Company. What I am saying is that costs thus far are outpacing our revenue at this stage. But this will eventually reverse, and the position that we are in now is very necessary. The volume of activity and the pace continues to be frenetic, and I believe that we will have to add more people as 2012 progresses. Remember, just 25 months ago this business had $0 backlog. And also remember that the regulations, especially for retrofits, are not even in place. I believe we have established ourselves as a technology leader, and getting more ships on the water will only help confirm that position.

Regarding traditional UV, we received California Title 22 approval for our patented Delta Wing design unit. The significance of Title 22 is that it strengthens our position in this significant global market opportunity for water reuse. The design is new and patented, as I mentioned. We have already been notified that an American municipality wants to begin final negotiations for a $2 million contract for a wastewater unit incorporating this new design.

We'll now take your questions. Thank you.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Rosemarie Morbelli, Gabelli & Co.

Rosemarie Morbelli - *Gabelli & Co. - Analyst*

John, could you talk a little bit about the $5 million contract that was postponed? In which categories or which markets are we talking about?

John Stanik - *Calgon Carbon Corp - CEO*

Sure. They -- really two areas. The first is our specialty carbon market, primarily in respirators. And the second is the mercury removal market, for a take or pay customer that we expect will fulfill those requirements a little later on in the year.

Rosemarie Morbelli - *Gabelli & Co. - Analyst*

Okay. And, if your FLUEPAC is successful, then this -- let's say that -- well, obviously not all customers or potential customers are going to get it, but -- it could certainly imply that the need for additional carbon is going to be a heck of a lot less then the 300 million to 500 million pounds anticipated at the moment. First of all, is that correct? And if so, does that change your plans in terms of capacity addition? And with your competitor adding capacity by leaps and bounds, are we going to find ourselves in a totally oversupply situation and no one can make money on that activated carbon? I know this is kind of long winded, but it gives you --?

John Stanik - *Calgon Carbon Corp - CEO*

No, that's okay. I think I got it all.

Yes. I will start here. Yes, I believe that, if there is widespread consumption or selection in our new performance products, the volume will go down. I believe that places us in a stronger position, because, as far as we know, the testing results for our products have far surpassed anyone else's. So I think it puts us in a better position from a dollar standpoint. I can't really estimate what the difference might be. Obviously, it should be somewhat lower.

Regarding the second part of the question -- based on what we would expect would occur, we would still need to build capacity, as would others. I would say, if people react rationally, which hasn't really occurred thus far, we would not be in an over-supplied situation, even with some of these developments. And I am pretty confident that, that will be the case. We are still talking about a market that will add at least a few hundred million pounds.

Rosemarie Morbelli - *Gabelli & Co. - Analyst*

Okay, thanks. That is helpful. I'll get back in queue.

Operator

Kevin Maczka, BB&T Capital.

Kevin Maczka - *BB&T Capital Markets - Analyst*

John, I was wondering if you could just circle back to the capacity, and describe in terms of virgin and react, where we ended the year? And of course you're planning to make pretty significant additions throughout 2012. We've had some delays on the react side. Can you talk a little bit more about where you expect to end 2012? Has that changed at all? And exactly how we should think about this ramping throughout the year?

John Stanik - *Calgon Carbon Corp - CEO*

Well, let's begin with the easier part of the equation, which is virgin. We will hopefully be complete with Pearl River by the beginning of the third quarter. So, from a virgin capacity perspective, we will increase by -- let's say -- anywhere between 5 million and 10 million pounds this year. Datong has been idle through the winter; I believe we mentioned that during the last call so, that will come up whenever it comes up. But I would still say, net, we should be in that 5 million to 10 million. And then, when we experience a full year of Pearl River growth, it will probably, from a granular standpoint, be somewhere around 15 million pounds. For the reactivation, Feluy is actually producing at a rate greater than designed. So I think that will probably make up the time that we lost in January; so I'll say that we will still increase Feluy's capacity by about 30 million pounds.

Suzhou -- we will lose probably a quarter and a half, for the two furnaces combined. So I don't know what that works out to be -- 75% for one, and maybe 60% for the other, of the 15 million pounds capacity. Phoenix -- we'll use at existing plants, be they -- because we won't have the new facility built. So, for Phoenix and Scottsdale and Glendale -- the other community that we are working with there -- I would expect that we'll reactivate all of that material, first in Blue Lake, due to its proximity, which is in California; secondly, in Columbus, which is the next closest; and then any spillover will go to North Tonawanda, which should start sometime in the second quarter. So, that's -- and North Tonawanda, if it starts in the second quarter, will be somewhere around 8 million or 9 million. Does that sound right Steve?

Steve Schott - *Calgon Carbon Corp - CFO*

Yes, maybe less for the --.

John Stanik - *Calgon Carbon Corp - CEO*

8 million, we'll say. Okay, so 8 million; say, 10.5 million for China. So it would be 18.5 million and 30 million. About 50 million pounds will increase for reactivation in 2012, and that should be in actual pounds.

Kevin Maczka - *BB&T Capital Markets - Analyst*

Okay. So we're going to take react from about 160 million to about 210 million, with the additional 50 million. And if I understood on virgin right, we're going to go from -- we're going to add about 15 million or so to about 160 million currently?

John Stanik - *Calgon Carbon Corp - CEO*

Well, we won't get all of that 15 million in '12. We will get maybe half of it.

Kevin Maczka - *BB&T Capital Markets - Analyst*

Okay, and is that also true of the 50 million on react -- we only get about half?

John Stanik - *Calgon Carbon Corp - CEO*

No, I think what I told you is the way it will play out. I think we will get all of the 30 million in Feluy, and then we will get the pieces, as I mentioned, let's see in -- yes, I think I did that right. Yes, I think that's it, Kevin. I'm sorry.

Kevin Maczka - *BB&T Capital Markets - Analyst*

Okay. Thanks for that.

Operator

Ben Kallo, Robert W. Baird.

Ben Kallo - *Robert W. Baird & Company, Inc. - Analyst*

Can we talk a little bit about pricing overall, and then specifically in the mercury market? Because it sounds like there is some delays in contracts there, and there's a little bit of moving parts there? So, could we start there?

John Stanik - *Calgon Carbon Corp - CEO*

Starting in mercury -- yes, there really hasn't been a whole lot of activity that's been going on in the recent months. There was one bid that I think went at reverse auction in the fourth quarter for a ridiculously low pricing. So that part is disappointing. Not unexpected, but disappointing. I expect that, that may continue; not sure, though, what people will do. But pricing has definitely been soft in the mercury market. It's a temporary situation, I believe, I believe that as time goes on and as we get closer to MACT's implementation, then we will be in a sellers' market, where capacity will be limited for some period of time, and we'll see that pricing increase.

In general, I think that pricing has still been firm in the US. We're satisfied -- pleased, actually -- with where our pricing increase went in the Americas in 2011. And as the year proceeds, we will get the full year effect of the anniversary dates for price increases that occurred in 2011. Asia -- we were successful in getting some price increases there. Some of the index pricing that we have for reactivation services will also get price increases this year as the PPI has gone up.

Europe has been soft in pricing. Our new organization is evaluating that situation to determine the best approach for how we can improve margins for the Company in total. I know that's kind of a weird thing to say, but if you go back to my prepared comments, when I said we've got to sell the right products in the right place for the right price, that's what I am referring to. So, we have a global marketing effort, led, of course, by Bob O'Brien, that is evaluating the pricing for each customer in each region and determining where we can get the most margin for every furnace unit hour of assets that we have.

And that process will continue through 2012; and I expect that our margins will improve as time goes on. But I would say, from a regional standpoint, to answer your question, I'd say Europe is the softest, and we expect benefits in Japan; we expect benefits to continue in the Americas and in the rest of Asia.

Ben Kallo - *Robert W. Baird & Company, Inc. - Analyst*

Okay, and then you mentioned a pretty successful switch from virgin to react out of water utility. I think you said 39 plants. Can you update us where you stand on the switching that would cover that capacity increase for your virgin as part of the 2012 initiative?

John Stanik - *Calgon Carbon Corp - CEO*

Yes, Ben. Gail, why don't you handle that? That's in the annual -- in the letter, in the annual report.

Gail Gerono - *Calgon Carbon Corp - VP of IR*

We have 4;, the customers currently that are --

John Stanik - *Calgon Carbon Corp - CEO*

Converting

Gail Gerono - *Calgon Carbon Corp - VP of IR*

Converting or have converted. So, we're making very good headway there.

John Stanik - *Calgon Carbon Corp - CEO*

And how many are in the possibility?

Steve Schott - *Calgon Carbon Corp - CFO*

20.

John Stanik - *Calgon Carbon Corp - CEO*

20?

Gail Gerono - *Calgon Carbon Corp - VP of IR*

Yes.

John Stanik - *Calgon Carbon Corp - CEO*

So that, hopefully within a reasonable period of time, we will make a little more than 60.

Ben Kallo - *Robert W. Baird & Company, Inc. - Analyst*

And what does that get you as far as tons? Or pounds, I mean?

John Stanik - *Calgon Carbon Corp - CEO*

I don't think we have that number.

Ben Kallo - *Robert W. Baird & Company, Inc. - Analyst*

Okay.

Steve Schott - *Calgon Carbon Corp - CFO*

We can probably do that in the future.

John Stanik - *Calgon Carbon Corp - CEO*

Yes we will try to get you that in the future meeting. I'm sure our people have it, but the three of us don't.

Ben Kallo - *Robert W. Baird & Company, Inc. - Analyst*

Okay, great. Thank you very much.

Operator

JinMing Liu, Ardour Capital.

John Stanik - *Calgon Carbon Corp - CEO*

JinMing, before you start, please let me say something to finish off Ben's question, and hopefully do a little better.

I would obviously count Phoenix and Scottsdale; so that would be -- let's say, 16 million, 17 million, maybe 18 million. And then all of the others, of course, are considerably smaller. But I would say we're probably well above 20 million, and perhaps even well above 25 million. But don't hold me to the 25 million, Ben. We will try to get you a future number, but considering that those two communities alone are probably -- when you throw in Glendale -- at 18 million; maybe even more than 18 million. I think that the other 20 million-some have to get us to above 25 million. But we will get you a better number.

Excuse me, JinMing. Please ask your question.

JinMing Liu - *Ardour Capital Investments - Analyst*

Yes. Can you comment on the municipal market? It has been slow for a while. What is your expectation for the municipal market for this year?

John Stanik - *Calgon Carbon Corp - CEO*

First of all, for 2011, I think it was a pretty normal year. It wasn't down or up. If anything it was a little more positive for us because of the success we had in the conversions to custom. So far, our people tell us that it looks like a normal year, or maybe even a little stronger than a normal year in 2012. A few jobs have been awarded; we've done fairly well so far. None of the business has been shipped, of course, because that happens in the warmer months, typically. But, there have been a normal level of bidding; and that pace will pick up as March comes, when the majority of the bidding is done in the end of March, April and May.

JinMing Liu - *Ardour Capital Investments - Analyst*

Shifting to your equipment segment -- the cost has been increasing. Can you give us some idea as to what kind of revenue run rate you will reach the breakeven point on the operating level for that segment?

John Stanik - *Calgon Carbon Corp - CEO*

The problem that we have had in the equipment segment makes it difficult to predict what you're asking. If you look at how well our UV and Ballast water sub-segment did in equipment, we should have had a much, much better year. But carbon equipment was just horrible in 2011. So, trying to predict what will happen next year is difficult because of that outcome. I expect significant growth in both UV and Ballast water. In fact, if we didn't increase by another 50%, I would be somewhat disappointed.

But the part of the business that makes your question difficult to answer is, what is going to happen with the carbon equipment? We had a pretty good year in 2010; we are in the disinfection byproduct big years, '12 and '13; where '12, '13 and '14, all of the municipalities have to have their systems basically in place. So logic would say that the carbon equipment would go up. But, having said that, I am not aware of any large bids that have occurred thus far in January and February. There have been a number of smaller ones, and we've done pretty well, but there haven't been the really big ones like we saw in 2010.

JinMing Liu - *Ardour Capital Investments - Analyst*

Thanks. I will get back in queue.

Operator

David Rose, Wedbush securities.

David Rose - *Wedbush Securities - Analyst*

I have one question, with a kind of tail on.

The first is the reactivation -- as we continue to model some of these nice contracts that you're picking up for Scottsdale as well as Phoenix, the assumption is long-term, that you will build on that. In the near term there is cannibalization of virgin, right?

John Stanik - *Calgon Carbon Corp - CEO*

Yes.

David Rose - *Wedbush Securities - Analyst*

How much should we start to think about that? I guess the pounds that we discussed earlier at a lower rate early on, we were looking at roughly $0.50, $0.55 per pound. So is that how I should look at the delta between your virgin and your reactivated? When you add Scottsdale and Scottsdale/Glendale, and Phoenix on, that you'll probably have a $0.70 differential per pound? Is that how I need to think about it, at least initially?

John Stanik - *Calgon Carbon Corp - CEO*

I think I understand the question, and based on my understanding, I think your numbers are too high. I would say that, typically, we would expect a differential price of -- it could be anywhere from $0.30 to $0.50. That's point number one. There is cannibalization; you're absolutely right about that.

David Rose - *Wedbush Securities - Analyst*

I'm sorry, John. But your initial order for reactivation is at a much lower price.

John Stanik - *Calgon Carbon Corp - CEO*

Phoenix -- yes, the Phoenix order is in -- I can't remember -- $0.61 or $0.62, $0.595. So, yes, that was something that we felt we had to do to get the major contract for the base load so that we could build the system.

David Rose - *Wedbush Securities - Analyst*

Did you do the same thing in Scottsdale?

John Stanik - *Calgon Carbon Corp - CEO*

I am sorry; I didn't hear your question?

David Rose - *Wedbush Securities - Analyst*

I am sorry. Was the price the same on Scottsdale?

John Stanik - *Calgon Carbon Corp - CEO*

That's not done yet; but being that Scottsdale was involved in the selection process, my expectation is it is going to be pretty close, if not identical.

David Rose - *Wedbush Securities - Analyst*

Okay. So then, the cannibalization of that range for those two? The rest, no?

John Stanik - *Calgon Carbon Corp - CEO*

Yes. For customers beyond that, depending on the size of their order, then we will come up with different prices there. And then, of course, in other areas of the country, depending again on the size of the order and how easy it is for us to transport the material, that will depend on the price there. But, I would say, other than the two big ones that you mentioned -- rightfully so -- I would say we're probably in that $0.30 to $0.50 range.

David Rose - *Wedbush Securities - Analyst*

Okay. And then, with that, the B question is -- how does that roll into your thought process on return on invested capital? And maybe you can shed some light on return on invested capital incorporating your reactivation strategy?

Steve Schott - *Calgon Carbon Corp - CFO*

David, it should fit very well into our return on invested capital model, from the standpoint that we had capacity in our reactivation facilities that we'll now use more fully. Going so far as to hoping to have to start up North Tonawanda that is not running yet. So, it works very well. We would continue to expect that our margins in that business would be essentially as attractive, if not more attractive, than in our virgin carbon business.

David Rose - *Wedbush Securities - Analyst*

Can you quantify the delta? I'm sorry, John.

Can you quantify the increase in return on invested capital which you've planned? Is it 100 basis, 200 basis points on your cost to capital?

John Stanik - *Calgon Carbon Corp - CEO*

Well, hopefully it will be ever-increasing. Our goals, if you remember our strategic planning presentation of a couple of years ago, are to be in the high teens. So, last year, as we brought a lot of new capital online, we experienced a decline; you'll see in the annual report. And being that we are continuing to spend and bring on new plants, Phoenix, of course will be the big new one, and Pearl River will hit next year. Those are almost $40 million when you include just those two and their finishing of the warehouse and Feluy. That's going to be another light year; but following that, except for when we bring on a new virgin plant, we expect to increase our ROIC quickly.

David Rose - *Wedbush Securities - Analyst*

Okay, great. Thank you.

Operator

Dan Mannes, Avondale.

Dan Mannes - *Avondale Partners - Analyst*

A couple quick ones.

First, on Japan -- can you help me get our arms around a little bit what happened in terms of the commercial side? And how this was able to happen, whereby such a large -- what appears to be a large amount of low margin sales are done? Was there some strategic rationale? Can you walk us through what happened there, and aside from change in leadership, anything else that's being done to remedy that?

John Stanik - *Calgon Carbon Corp - CEO*

I think that what we lacked there that would have really helped the situation is the ERP system that we have everywhere else, like SAP. Our Company -- we have a daily sales report, and I know how much we have sold every day; and somebody in the Company knows what the product was and what the price was. I don't go to that level of detail every day.

We didn't have that at CCJ until SAP was implemented on January 31. So, that was the first issue. For the remainder of the problem, I think the best explanation I can give you is, there was no strategic basis for any of the crazy decisions that were made. They were disappointing, and we did what we felt we had to do as immediately as we could, once we found out what the situation was in January. It won't continue, I guarantee that.

Dan Mannes - *Avondale Partners - Analyst*

Why did this crop up in the fourth quarter, but it didn't seem like this was nearly as much of an issue over the prior quarters under which you have on CCJ?

John Stanik - *Calgon Carbon Corp - CEO*

That's right.

Dan Mannes - *Avondale Partners - Analyst*

Well, I'm wondering -- did something specific happen in the fourth quarter that would drive this?

John Stanik - *Calgon Carbon Corp - CEO*

No. As I said, Dan, it's -- I don't see any reason to get into the details of it. It was poor decision making; it occurred in the fourth quarter. It brought our margins down, we were on a pace to increase margins even better than the 300 bps that I talked about. We gave up a lot in the fourth quarter. So it was a big step backwards that couldn't be tolerated.

Dan Mannes - *Avondale Partners - Analyst*

Right. And then one quick one on another topic.

You talked a little about the mercury market and timing. With the new products you're rolling out, and with your current contracts, how do you view the next year, year and a half? And what risks do you see potentially to repricing contracts you have, versus your ability to gain share off some other people who locked up more in the earlier periods and are subject to re-contracting?

John Stanik - *Calgon Carbon Corp - CEO*

That's the balance, Dan. I think that -- can we gain share, or will we lose share in the short term? Because I would say that, in most cases, unless we can leverage these new products, prices are going to go down and therefore margins are going to go down. So it's very important to see how well these new products do; otherwise we could have a negative in 2013. I don't think there will be any effect in 2012, but there could be a negative that we'll have to overcome next year with some of our other growth initiatives and cost reduction programs and all the other things we are trying to do to improve the financial performance of the Company.

Dan Mannes - *Avondale Partners - Analyst*

Okay, thanks.

Operator

Rosemary Morbelli, Gabelli & Co.

Rosemarie Morbelli - *Gabelli & Co. - Analyst*

John, I was wondering if you could elaborate a little more on the reactivation versus the virgin carbon? You talked about the impact on invested capital. Is it automatically improving the operating margin for those particular businesses when you reactivate instead of selling granular virgin?

John Stanik - *Calgon Carbon Corp - CEO*

It got closer Rosemary. Historically, the answer to that question has been a very strong yes.

Rosemarie Morbelli - *Gabelli & Co. - Analyst*

Right.

John Stanik - *Calgon Carbon Corp - CEO*

And I would say it is still a yes. But, with the benefit of the tariff and fair pricing around the world, and the fact that costs of increased so significantly in China, the difference between virgin and reactivation margins has lessened. But we still prefer the service business to the one-time sale of virgin carbon. I think the only other point that I would like to make about that question -- the previous question; I think it was David's -- was that the other, as we cannibalize, to use that word, the virgin business, what that does for us in addition to providing more granular carbon for us to sell or more capacity to convert into powder if we need it, is the fact that we will be able to take our products, which are lower costs than, say, outsourced products, and sell them as opposed to selling outsourced products.

Now there will be competitive reactions to that situation, depending on how much carbon, and how much volume we can shift that way. But that will have two benefits. One, we should be able to increase our margins on the virgin side by selling less outsourced; and then on the service side, we have the general improved margins from more, from a higher proportion of total sales being service versus virgin. So that's a part of our strategy.

Rosemarie Morbelli - *Gabelli & Co. - Analyst*

Okay. And then, if I may -- you are comparing the margins in Japan to those, I think, in the fourth quarter of 2010. But I am not too sure I got all of the numbers right. So, if you could talk about or remind me at least of what the high level of margin was, and how low it came down this quarter?

John Stanik - *Calgon Carbon Corp - CEO*

No. I haven't said that, Rosemary. It was very poor in the fourth quarter, but I don't want to mention numbers. There's too much public bidding out there for us to mention margin numbers.

Rosemarie Morbelli - *Gabelli & Co. - Analyst*

Okay; no, I understand.

And you said that Management in Japan made crazy decisions, to quote you. Can you give us an example of what a crazy decision would be?

John Stanik - *Calgon Carbon Corp - CEO*

No. I'd prefer not. I think what is being inferred is selling products for the wrong price.

Rosemarie Morbelli - *Gabelli & Co. - Analyst*

Okay. So, that will not happen once you actually understand, with the SAP or whatever other system that you use, what is the cost of each products there, selling price; and then I am assuming you will do that on a customer basis as well?

John Stanik - *Calgon Carbon Corp - CEO*

Yes. And Dan, I'm sorry if that is the question you were asking, I didn't understand it well enough. So, maybe, hopefully, that answers your question, too.

Rosemarie Morbelli - *Gabelli & Co. - Analyst*

And if I may ask one last quick question -- could you update us on the pension cost? What is the size of your pension? How much is underfunded? What did you spend in 2011 and what are you expecting to spend in 2012?

John Stanik - *Calgon Carbon Corp - CEO*

Steve is looking for the data. I know that we are expecting to spend considerably less cash than we did from a funding standpoint in 2011. But I think what he was referring to in his comments was pension expense in addition to funding. But he can tell you how much the under funding us.

Steve Schott - *Calgon Carbon Corp - CFO*

Sure, Rosemary.

Our underfunding grew year-over-year. Our assets obviously didn't perform as we had hoped they would in 2011, and the discount rate dropped. We are currently underfunded when we compare the PBO to our assets by about $33 million. And when we look at the effects that will occur in 2012 compared to 2011, we expect to see an overall expense increase of about $2.5 million. That will be split between SG&A and effects on product margins.

Rosemarie Morbelli - *Gabelli & Co. - Analyst*

About half and half?

Steve Schott - *Calgon Carbon Corp - CFO*

Probably more. I don't have an exact breakdown of that. But more up in margin than in SG&A.

John Stanik - *Calgon Carbon Corp - CEO*

More for the unions, Rosemary.

Rosemarie Morbelli - *Gabelli & Co. - Analyst*

Oh, right. Okay. So we add $2.5 million to what amount?

Steve Schott - *Calgon Carbon Corp - CFO*

It was just over $2 million in 2011, so we're looking at about $4.5 million for 2012.

John Stanik - *Calgon Carbon Corp - CEO*

More than double.

Rosemarie Morbelli - *Gabelli & Co. - Analyst*

All right, thanks.

Operator

Ben Kallo, Robert W. Baird.

Ben Kallo - *Robert W. Baird & Company, Inc. - Analyst*

One, could you go into a little more detail about the coal situation? Where you're seeing benefits there, and what your strategy is around locking up longer term -- three, five year-type contracts? And then, also give us an update on any type of Greenfield decisions. Because I was expecting to hear something by the end of last year. I don't know if you have delayed considering the market, or where you stand there?

John Stanik - *Calgon Carbon Corp - CEO*

Yes, two good questions, Ben.

To give you more color on coal. We have more suppliers now. I think I said that in my comments. We have two multi-year contracts; I believe one or both of them -- they are both at three year as a minimum, and I think one or both of them has an option to make it five. We have a number of other suppliers that we are buying, either from a spot basis or from an annual basis, depending upon our need. The market right now is moving in our favor. In other words, the spot prices in this country are going down. I expect that's going to change, because more coal companies are looking to export now.

But when I spoke about reducing cost -- so our cost increase is small -- $1 million, $1.2 million, something like that, from 2012 to 2011. But more exciting is, we've got a couple more trials that we have planned for full-scale operation that tested very well so far in less than full scale. And if those are successful, then we expect to cut our costs by $2 million at least in 2012 versus 2011. We'll know those results definitely -- well, I shouldn't say definitely by the next call; maybe we won't -- we will probably know them by May. Because some of the trials are in April, and our next call will be, I think, last week in April. So it's one of the best accomplishments that we had in 2011.

And I should mention, we haven't talked about this, but not all the coals that we tested were tested favorably, and our manufacturing operations have to eat the costs of failed trials. So, we haven't talked about that, but we probably ran dozens and dozens of tests in manufacturing this year, and that had a negative effect on us. Hopefully our trials will be over in April, and if we are doing any beyond April, they will be minimal numbers.

Regarding the Greenfield site -- we have moved that forward. We are working with some people in certain states; meaning that our preliminary decision will be that it will be in North America. So we have continued to move that project forward. I decided not to take it to the board in February. We looked at the project schedule, and we believe that we have at least three more months to make the decision, and perhaps six; and with the people who are making a lot of noise in an election year, that's one of the reasons that I am holding back. But we are still, from a Management standpoint, absolutely convinced that we need to build that plant when the market arrives. Which, if it's the end of 2014 or the beginning of 2015, which is when most of it should hit if things don't change, we'll be there and we will be ready.

Ben Kallo - *Robert W. Baird & Company, Inc. - Analyst*

Great; thank you very much.

Operator

David Rose, Wedbush Securities.

David Rose - *Wedbush Securities - Analyst*

Sorry -- one last housekeeping question. Can you provide us some expectation on FX headwinds or tailwinds for 2012?

Steve Schott - *Calgon Carbon Corp - CFO*

David, I imagine that we will -- obviously, first it's hard to predict those things. But I would say particularly in Japan, we may see adverse results there compared to 2011. And I hate to venture a guess as to Europe at this point. Could be somewhat worse than 2011's results; but we'll see.

John Stanik - *Calgon Carbon Corp - CEO*

Our experts are having trouble being experts about this. But, obviously Europe didn't start out very well. Depending on where your reference point is, at one time we were being led to believe that it was going to improve in Europe as the year went on; meaning the dollar would be weaker. But, with all the uncertainty over there right now I don't know how to make the call.

David Rose - *Wedbush Securities - Analyst*

Right. That's helpful. Then I guess you get over the biggest hump in the third quarter, right? That's where you had the most tailwind?

John Stanik - *Calgon Carbon Corp - CEO*

I think that's right. I think I remember it that way.

David Rose - *Wedbush Securities - Analyst*

At least with CCJ?

John Stanik - *Calgon Carbon Corp - CEO*

Yes.

David Rose - *Wedbush Securities - Analyst*

Okay, great. Thank you very much.

Operator

At this time, there are no further questions. I would now like to turn the floor back over to Mr. John Stanik for any closing remarks.

John Stanik - *Calgon Carbon Corp - CEO*

I do have a closing.

Q4, I'll reiterate was disappointing for us. I want to assure everyone that we are working very hard at our strategic initiatives -- expanding our asset base, penetrating new markets and new areas, and bringing improvement to our bottom line. Including Phoenix, we are in the process of adding three new reactivation facilities, and we've increased the capacity of Feluy by 50%. We're finalizing the integration of three acquisitions that we made in 2010. And in some cases, such as our Ballast water treatment system Business, we feel that it is most prudent to allow our costs to get a little ahead of our income. In other words, we are trying to manage a balance of growing earnings while still preparing for our longer term, very large, exciting opportunities.

In Q4 we had to address issues which we will resolve or have already been resolved. New plant startups usually experience problems. Our goal is to continue to manage this balance and deliver more earnings each year, while preserving that longer-term outlook and getting it to our grasp. We expect 2012 to be a better year than 2011; how much better will depend upon our ability to run the Business and be proactive and reactive to negative, external forces such as the economy and potentially regulatory changes. We appreciate the patience that our shareholders have shown, and I'm pleased to understand that our goal continues to be to exceed your expectations. Thank you.

Operator

Thank you. This concludes your conference, you may now disconnect.