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PRESENTATION

Operator

Good day, everyone, and welcome to the Second Quarter 2020 Minerals Technologies Earnings Call. Today's call is being recorded. And now at this time, I'd like to turn the call over to Erik Aldag, Head of Investor Relations for Minerals Technologies. Please go ahead.

Erik Aldag - *Minerals Technologies Inc. - Head of Investor Relations*

Thanks, April. Good morning, everyone, and welcome to our second quarter 2020 earnings conference call. Today's call will be led by Chief Executive Officer, Doug Dietrich; and Chief Financial Officer, Matt Garth. Following our prepared remarks, we will open it up to questions.

I'd like to remind you that beginning on Page 14 of our 2019 10-K, we list the various risk factors and conditions that may affect our future results. And I'll also point out the safe harbor disclaimer on this slide. Statements related to future performance by members of our team are subject to these limitations, cautionary remarks and conditions.

I'll now turn the call over to Doug. Doug?

Douglas T. Dietrich - *Minerals Technologies Inc. - CEO & Director*

Thanks for the introduction, Erik, and good morning, everyone. We appreciate you taking the time to join our call this morning, and I hope that you and your families have remained healthy and safe. Similar to last quarter's call, we'll be conducting this one from different locations, and we have all of our business leaders on and ready to answer your questions at the end.

I'd like to start by thanking our employees for their continued efforts during very difficult circumstances. Our second quarter results reflect our team's agility to quickly adapt to a changing work environment and dedication to continue to operate safely, both of which underscore the power of our culture and the resiliency of our company.

Let me outline the structure of today's call. First, I'll give an update on the measures we've taken to protect our employees and to safely operate our facilities. I'll then provide a high-level overview of our second quarter performance. Matt will follow with more detail on our financial results, and our July sales trends by business unit. I'll conclude with commentary on our end market conditions and how we're positioning MTI to not only navigate through current dynamics but also to capitalize on opportunities to make our company even stronger.

Consistent with our core values, the health and safety of our employees is and continues to be our top priority as we confront the near-term challenges presented by COVID-19. On our previous earnings call, I outlined a series of rigorous protocols we implemented early on at all of our global facilities. These procedures have helped to mitigate the risks associated with the pandemic and ensure safe and stable operations. We also continue to implement a remote working environment wherever possible, and I couldn't be more pleased with our global business services, IT and technical service teams who continue to perform at a very high level. In addition, we've seen minimal disruptions to our supply chain and ability to serve our customers. We recognize that the risks related to the virus are still ongoing and present in many of the regions in which we operate. As of today, all of our manufacturing facilities are operational. As these conditions persist, I'm confident that we have the right measures in place to continue to protect our employees, safely operate our facilities and meet the needs of our customers.

With that, let me take you through how our second quarter unfolded. As we previewed on our call on May 1, we faced a significant amount of uncertainty through the quarter. We had limited visibility to customer orders and demand levels, which were constantly changing. We managed through temporary government restrictions and customer shutdowns, and we are quickly making changes and maneuvering through the issues we faced during the quarter. Our results reflect our ability to navigate through these dynamics, while remaining focused on the safety of our employees and operations. Specifically, we delivered a solid operating performance characterized by double-digit operating margins and strong cash flow generation. We also took steps to better position MTI as we move forward, including capturing efficiencies in our fixed cost structure, strengthening our balance sheet to improve liquidity and support our strategic initiatives and taking advantage of new market opportunities with customers.

From a financial perspective, total sales in the quarter were $357 million, down about 14% sequentially. In April, sales were down about 10% sequentially, and they weakened further in May before starting to improve modestly in June as government restrictions eased and customer order patterns strengthened. We generated $42 million of operating income and earnings per share were $0.85. In addition, we delivered $64 million in cash from operations, which was a similar amount to the prior year.

Results from our diverse portfolio of consumer and industrial-related businesses mirrored the current macroeconomic environment. Our consumer-oriented businesses, including Household and Personal Care in Performance Materials and food and pharmaceutical applications in Specialty Minerals remained strong and delivered healthy year-over-year sales growth. We saw a sharp uptick in demand for many of these products at the end of the first quarter, and our strong sales momentum extended through the second quarter as order books remained full in both North America and Europe.

Our overall consumer-oriented portfolio, which represents approximately 25% of MTI's total sales, are businesses in which we've been investing in over the past few years. And this past quarter demonstrated the benefit of our strategy to grow these less cyclical businesses.

As we anticipated, our businesses that serve industrial markets, including transportation, steel, construction and paper were more impacted by COVID-19-related production curtailments and shutdowns. Customer demand in these markets dropped quickly in the first 2 months of the quarter. We then experienced a slight upward trend in order patterns as we moved through June. These customer slowdowns were most prominent in our end markets in North America and Europe. Our strong positions in China enabled us to capitalize on the economic recovery there. We delivered year-over-year sales growth of 9% in China, led by the continued penetration of our greensand bond and Paper PCC products.

As I touched on briefly, we mitigated the impact of volume challenges in several businesses with variable cost adjustments and structural overhead savings. We also maintained the pricing improvements that we've implemented over the past several quarters, and we're taking advantage of more favorable raw material costs. These actions helped us to deliver relatively strong margins despite significant sales declines in the quarter. The structural nature of these actions positions us to generate strong leverage on increased sales as markets recover and will expand margins further.

We made significant progress on our growth and business development activities with new PCC contracts and the commercialization of several new products. We signed 2 satellite PCC contracts in the quarter. The first was for a 42,000-ton plant in India, which will come online in the second quarter of 2021, and will be our eighth satellite there. The other was an agreement to restart and operate a 35,000-ton plant, which had previously been idled at our Wickliffe, Kentucky location, and we've already begun to supply this customer from an off-site location.

We also continue to focus on improving the pace and impact of our new product development with 24 new products commercialized so far in 2020. Despite the current market environment, this pace is similar to the prior year. Many of these products, such as variations of our greensand bond formulations for foundry customers and new building and construction and waterproofing systems are enhancements to existing products that generate more value to customers' current applications. Other solutions, including several personal care formulations and PCC for packaging applications have helped us enter into adjacencies with customers.

In an economic environment such as this, generating continued strong operating cash flow and improving our liquidity profile is a top priority. Our experienced management team has acted quickly through disciplined execution and tight control of our cash generation cycle. In addition, we capitalized on attractive credit market conditions by completing a $400 million offering of senior unsecured notes. This strengthened our balance sheet by extending our debt maturities and increasing our total available liquidity to over $675 million. While the economic backdrop continues to evolve, the results we achieved this past quarter under challenging conditions underscore the agility of our team, the resiliency of our combined market-leading positions and the strength of our financial foundation.

Before I turn it over to Matt to discuss our second quarter results in more detail, I'd like to highlight the recent publication of our latest sustainability report. MTI has a long-standing commitment to sustainability in the broadest sense, and we've been focused on continuing to embed sustainability practices into our business strategy and goals. Sustainability is core to who we are, how we operate and drives our actions on a daily basis. This year's report details our progress toward our 2025 environmental targets, along with improvements made around our safety culture, new product development, social impact and employee engagement, diversity and inclusion and community outreach. I encourage you to review the report which is available on our website as it highlights and recognizes the efforts and achievements of our 3,600 employees.

Now I'll turn it over to Matt. Matt?

Matthew E. Garth - *Minerals Technologies Inc. - Senior VP of Finance & Treasury and CFO*

Thank you, Doug. I'll review our second quarter results, the performance of our 4 segments as well as our liquidity and debt position. I'll then turn the call back over to Doug for some additional perspective on our current operating environment and the visibility we have going forward.

Now let's review the second quarter results. Similar to the first quarter, we are presenting year-over-year comparisons of sales and operating income on the left side and the sequential quarter comparisons on the right side of this slide. Given the rapidly changing market conditions, we believe the sequential view highlights the market challenges we faced and our ability to rapidly mobilize to capture improvements.

Second quarter sales were $357.2 million, 21% lower than the prior year on a constant currency basis. The slowdown in economic activity brought on by the COVID-19 pandemic impacted our volume significantly in the quarter. The year-over-year operating income bridge on the bottom left shows we were able to offset the impact of lower sales with favorable pricing and cost performance, driven by the actions we have taken over the last year. Moving to the right side of the slide, sales were lower by 13% sequentially on a constant currency basis as we experienced the impact of COVID-19-related customer shutdowns in several product lines.

On our last call, we told you that sales in April were trending approximately 10% lower than the first quarter. As we progress through the second quarter, we saw further deterioration of volumes in May across several of our end markets and geographies, with China being the notable exception.

In June, our markets started to turn around and our overall sales rates reflected an increase from May. Operating income decreased sequentially, primarily due to the lower volumes. We were able to maintain our pricing levels and our team acted quickly to effectively manage cost and expenses to offset the decline.

Operating margin was 11.8% in the quarter versus 13.2% in the prior year and 14% in the first quarter.

So now let's take a closer look at the changes in operating margin on the next slide. On this slide, we are showing year-over-year and sequential operating margin bridges for the second quarter. Starting with the prior year comparison, the lower volumes contributed to a 410 basis point reduction in margin versus the prior year. I want to highlight, though, that our pricing and cost actions have contributed to 280 basis points of favorability, partially offsetting the impact of lower volumes.

On a sequential basis, we offset 320 basis points from unfavorable volume mix with 110 basis points from our ongoing pricing and cost actions. We believe these actions have positioned us well to take advantage of incremental volumes going forward. While a portion of the lower discretionary spend will come back as activity levels increase from where they are today, we do believe the majority of this improvement is permanent.

It's worth noting that our margin improvement actions have resulted in slightly higher EBITDA margins versus the prior year for both the second quarter and the first half of 2020 despite the lower sales levels we are seeing.

Now let's take a look at reconciliation of reported EPS to adjusted EPS. Second quarter earnings per share, excluding special items, were $0.85. We incurred special charges of $14.6 million after tax in the second quarter or $0.43 per share. The charges included a noncash pension settlement charge and a noncash impairment of assets charge and severance-related costs for the Paper PCC satellite facilities at 2 U.S. paper mills that were idled indefinitely in June. In addition, we recorded a litigation settlement at the conclusion of the Novinda arbitration proceedings. Our effective tax rate for the quarter was 16% versus 17.3% in the prior year due to favorable discrete tax items in the quarter. And we expect our effective tax rate to be approximately 19% in the second half of the year. Lastly, our EPS benefited from lower interest expense and other nonoperating deductions. Note that going forward, our interest expense will be slightly higher due to the incremental interest on the notes offering. Now let's review the segments in more detail, starting with Performance Materials. Performance Materials sales were 19% lower than the prior year and 7% lower sequentially. Of our 4 segments, Performance Materials is the largest, and it was the most resilient to market challenges in the second quarter. Within Household, Personal Care & Specialty Products, we saw continued strong performance from our consumer-oriented businesses. Pet Care, Fabric Care and Personal Care all grew sales versus the prior year. The growth in these businesses was offset by weakness in specialty drilling products. Environmental Products and Building Materials sales were both lower due to COVID-19-related project delays.

Metalcasting sales were impacted primarily by automotive shutdowns in North America and parts of Asia. Our Metalcasting sales in China versus the prior year grew as economic activity rebounded following the first quarter shutdowns, and we continued to penetrate the market with our pre-blended greensand bond formulations.

Operating income for the segment was $21 million and represented 12.1% of sales. The impact of lower sales on operating income was partially mitigated by lower expenses, cost control and continued pricing actions, as shown through the relatively stable margins versus the prior year and sequential quarters.

In the chart on the bottom right, we are showing the daily sales rates for each month of the year as well as comparison to the prior year. May was a clear low point over this period, followed by an uptick in June and further acceleration in July, where we narrowed the gap to prior year sales levels. We expect this trend to continue through the third quarter.

And now let's turn to Specialty Minerals. Sales for this segment were 24% lower versus the prior year and 20% lower sequentially. Paper PCC sales were lower than we expected, primarily due to extended outages in the United States, Europe and India. Our PCC facilities in China continue to run at relatively normal demand levels, up 4% versus the prior year and sequential. However, our locations in India were shut down for much of April and into May. And in North America, 9 of our 16 facilities were either idled or took extended downtime in the second quarter. And in Europe, 3 paper machines took extended downtime in the second quarter.

Specialty PCC sales were lower as demand slowed in the first quarter, and remained at lower levels through the second quarter, primarily driven by lower demand for automotive and construction applications. Process Minerals sales were also lower due to the slowdown in construction and automotive activity.

Segment operating income, excluding special items, was $15.3 million and represented 13.9% of sales. The impact from the reduction in sales versus the prior year was partially offset by continued expense control, input cost reductions, and continued pricing actions.

In the daily sales rates chart, you can see May was also a low point for this segment and the gradual improvement in June was followed by continued improvement in July. In North America, 7 out of 9 paper mills that were down in the second quarter are coming back online in the third quarter and the 3 machines that took down time in Europe are also ramping back up. We remain on track to bring online 250,000 tons of new Paper PCC capacity this year. However, the announcement by Verso to idle 2 paper mills in the United States, will reduce our volumes by approximately 75,000 tons on an annualized basis beginning in the third quarter.

And in addition, our business development efforts continued during the quarter, and we signed 2 new paper PCC contracts, 1 in the United States and 1 in India, totaling 77,000 tons.

Now let's turn to the Refractories segment. Refractories segment sales decreased 28% versus the prior year and 19% sequentially as steel mills reduced production in response to weaker demands in construction and automotive markets. Segment operating income was $5.9 million and represented 10.6% of sales. Note that we continue to maintain double-digit margins in this business despite significantly lower sales levels.

We have seen a slight improvement in daily sales rates in July. To give some perspective, we started 2020 with North American utilization rates in the low 80s. And after declining to the low 50s, they're currently running around 60%.

And now let's turn to Energy Services. Energy Services sales were 31% lower than the prior year and 30% lower sequentially, driven by the decrease in activity due to COVID-19-related customer project delays. North American well testing activity remained strong. However, this was primarily offset by lower global filtration activity. Operating income was $1.4 million versus $3.2 million in the first quarter and represented 7.9% of sales. The daily sales rates chart show the solid start to the year, followed by lower levels of activity due to COVID-related delays. Several projects scheduled for July were delayed to August and September. And from where we stand today, we are starting to see some improvement in international markets, and the pipeline of projects for this business remains very strong.

Now let's turn to our cash flow and liquidity highlights. We continue to generate strong cash flow and maintain ample liquidity. We generated $64 million of cash from operations in the second quarter and $49 million of free cash flow. We used a portion of our free cash flow to pay down $30 million of debt, and our net leverage ratio stands at 2.2x EBITDA. We also took action at the end of the quarter to further improve the liquidity position of the company.

On June 30, after the close of the second quarter, we completed a $400 million offering of 5% notes due in 2028. We used the proceeds to repay $148 million of fixed rate term loans, $100 million of borrowings under our revolving credit facility and the remainder for general corporate purposes. As a result of the offering, the company now has more than $675 million of available liquidity, including cash on hand, as well as availability under the revolving credit facility.

In these uncertain times, we prudently took advantage of the favorable interest rate environment and our strong credit position to extend our maturities at a fixed rate. We extended our weighted average maturity to 5.5 years, an increase of 2.5 years, and this added liquidity provides us with additional flexibility to be opportunistic and to navigate what lies ahead.

With that, let me turn it back over to Doug to discuss our current and market conditions. Doug?

Douglas T. Dietrich - *Minerals Technologies Inc. - CEO & Director*

Thanks, Matt. Before opening the call to questions, I thought it would be helpful to provide commentary on what we're seeing across our businesses and end markets as we move into the third quarter based on sales trends over the past couple of months. I've organized this discussion similarly to what we presented last quarter for clarity and to give you a broad understanding of the various puts and takes and changing conditions.

I'll start by saying that compared to where we sat at the beginning of May, we are more optimistic about the trends in our markets, and we feel that the second quarter had the most acute impacts from COVID-19. With this comes some caution as our view forward is looking into an environment that continues to be uncertain. Specifically, in our project-oriented product lines, we are still experiencing volatility in order patterns and timing.

Let me now take you through what we're seeing by business segment, touching on some end market dynamics. Starting with Performance Materials, our largest segment, our Household and Personal Care product line, which primarily serves consumer-oriented markets has continued to run at strong demand levels, with growth rates similar to what we've been delivering in recent quarters. We see the sales trajectory remaining steady through the third quarter.

Our Metalcasting business experienced a rebound in demand levels at the end of June, which has sustained through July. Volume improvement for this business depends on the transportation sector in North America, primarily in the automotive and heavy truck sectors and how foundries will ramp up and reach more normal capacity levels to support that demand. In July, our Metalcasting facilities in North America operated at about 85% of last year's levels. Based on the latest indications from our foundry customers in North America, we expect these rates to improve to around 95% by the end of the quarter. As noted earlier, Metalcasting sales in China grew 9% over last year during the second quarter, and we expect this strong trend to continue through the third.

I'll discuss Environmental Products and Building Materials together as they are both project-related businesses. Given the nature of these businesses, order patterns have been volatile and several work site shutdowns have pushed projects into future quarters. We started to see some of these projects come back towards the end of the second quarter and into July, but the demand and timing for completing these projects is dependent upon loosening of regional restrictions. Both of these businesses maintain a robust project pipeline with solid customer pull for our latest technologies, and we expect to complete these projects once they commence.

Now let me turn to our Specialty Minerals segment, starting with Paper PCC, where I'll provide color by region. Our PCC facilities in China continue to run at relatively normal demand levels, and our locations in India have been ramping back up since the government shutdowns in April and May. In North America and Europe, 10 of the 12 facilities that took extended downtime during the second quarter are projected to resume production in the third quarter. In total, with the restarts in India, combined with the demand environment in North America and Europe, July volumes have been trending at a rate that is approximately 15% higher compared to June.

On the new capacity front, the construction of our satellites in India and China are on track. Our 45,000-ton facility in India will come online in September and our 150,000-ton satellite in China, which will be our largest when completed, is scheduled to be operational by December.

In our Specialty PCC, GCC and Talc businesses, sales for our pharmaceutical and consumer products have been strong and should remain that way. Demand for our sealant and plastic products that go into the automotive market will be dependent on build rates improving in North America and Europe. And sales for these products that are used in residential and commercial construction applications have steadily improved since June, and this trend should continue in the third quarter.

For the Refractories segment, current steel utilization rates in North America and Europe are around 58% and 62%, respectively, and these rates have increased from the low 50s in the second quarter. Several integrated mills have resumed production in North America and we expect commensurate volume improvements in line with these restarts. We have a strong order book for laser measurement equipment. However, this year, most of these sales will be completed in the fourth quarter.

I'll finish up with Energy Services. While COVID-19 led to some early demobilizations from our larger offshore projects, these projects are being rescheduled to resume in the third and fourth quarter. In addition, we've recently been awarded several new projects, which we expect to commence over the next 2 quarters. It's notable that our order book in this segment remains intact. However, we're with -- dealing more with the exact timing of projects as customers reschedule.

As you can see, we're managing through a number of evolving market dynamics, including changing customer demand patterns. Importantly, though, activity has modestly picked up across our businesses in July, leading to an overall sales trend that is about 5% higher compared to June. However, it's still only 1% above our full second quarter run rate.

We remain focused on navigating these evolving dynamics, and our team's agility positions us to continue to do so. Our key priorities remain keeping our employees and their families safe, serving our customers with value-added products and strengthening our foundation. We've taken thoughtful, decisive actions to adapt to the current market environment and to position our businesses to extend our momentum as market conditions improve.

Looking ahead, we continue to see distinct opportunities that we can capitalize on to further drive our operational and financial performance. With our improved cost profile, we are well positioned to expand margins as volumes strengthen.

Our broad product portfolio, which delivers cost savings and significant value to our customers, has enabled us to realize new opportunities with customers in several markets, and we expect this trend to drive additional revenue growth. And by taking steps to strengthen our balance sheet and increase liquidity, we are well situated to navigate through existing conditions as well as pursue a wide range of attractive growth opportunities, both organic and inorganic.

In closing, I want to thank everyone for joining today's call and recognize our employees for their tremendous efforts during challenging times, and their continued commitment to MTI's ongoing success.

With that, let's turn the call over to questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And we'll first hear from Daniel Moore of CJS Securities.

Daniel Joseph Moore - *CJS Securities, Inc. - MD of Research*

A lot of -- obviously, a lot of ground and a lot of moving parts, so forgive me here for jumping around. But June, I think I heard you say at the end there was about 1% above full Q2 run rate, is that correct? And do you have a sense for what -- sorry, July, rather. And what June kind of looks like on a year-over-year basis as well as July? Just trying to get a sense for the trajectory from that perspective.

Douglas T. Dietrich - *Minerals Technologies Inc. - CEO & Director*

Yes. Let -- well, that's correct. July, right now, we saw about 5% higher than June. So to give you a kind of perspective of the trajectory as we go into the third. That rate, however, you can see -- I didn't go back to the chart, but you saw that chart where April was still higher than July. So I think what we see is -- we saw at the end of April and May, we were looking kind of into that downward trend. I wasn't too optimistic then. But now as we sit in May and we saw that go by, we see the optimism that says, "Look, what we have from our customers going forward, what we saw in July, we see that, that trend is much more positive than we were 3 months ago." That said, the July rate is still below the average for Q2. It's still not up to that April rate.

The year-over-year, Matt, I don't know if you have the year-over-year June rates. I think they're down -- they're probably down 10%, 11%, maybe 12%. They're a little bit higher than May. We were down 10% in April, 14% for the quarter.

Matthew E. Garth - *Minerals Technologies Inc. - Senior VP of Finance & Treasury and CFO*

You're spot on Doug.

Douglas T. Dietrich - *Minerals Technologies Inc. - CEO & Director*

That help, Dan?

Daniel Joseph Moore - *CJS Securities, Inc. - MD of Research*

Got it. Yes, it does. And then specifically on PCC, some puts and takes there. Obviously, you've got a lot of those facilities coming back online. And then you've got the 2 facilities that will -- 75,000 tons, I think you referenced -- come offline in the third quarter. So is the baseline from where we stand today, do we take another step back in Q3 before we start to rebuild and grow again? Or just putting that all together, just trying to get a sense for how we should think about growth from either Q2 or June levels from a jumping off perspective.

Douglas T. Dietrich - *Minerals Technologies Inc. - CEO & Director*

Sure. I'm taking a shot at this and maybe I'd pass over to D.J. to give you some more color on what's coming kind of in the future. Yes, it's unfortunate we saw the Verso, those 2 machines, those are mechanical-grade papers, not uncoated freesheet. They're going to be shutting down, at least what we understand, indefinitely is what's been said, starting in September. That said, we started to supply that 35,000-ton contract we have at Wickliffe, Kentucky. We've already started to supply that from an off-site location. And we'll probably resume on-site manufacturing there at that location in November. So that will be ramping up as we go through from today.

In addition to that our satellite -- 45,000-ton satellite -- in India will be coming online in the third quarter. So I think, yes, the third quarter is going to be though much, much better than the second quarter, we're already seeing 15% growth in volumes in our Paper PCC business. We're going to see probably a little blip there in the end of the quarter before that India satellite comes online. But then, as you know, we have 150,000 tons coming online in December in China. And we have another 75,000 to 80,000 tons -- I'm sorry, an additional 45,000 tons that we'll be building probably in the first half of next year in India. The net-net of all that is still a positive trend. I think it might be a little bit negative quarter-over-quarter in the third, that's due to some of the demand levels, but the capacity additions versus the 75,000 that just came out in North America, the net-net of that is still positive by about 50,000 tons -- by 150,000 tons.

Daniel Joseph Moore - *CJS Securities, Inc. - MD of Research*

By about 150,000, yes, that's the amount. Okay. Just wanted to confirm that math based on the announcements that we sit -- that we have as of this moment at least.

Douglas T. Dietrich - *Minerals Technologies Inc. - CEO & Director*

Let me clarify that. That's about 150,000-ton positive getting back to normal paper demand levels, right? So one of the questions we have going forward is what is normal? And so we can talk about that a little bit. But right now, the net-net of all of that on the kind of 2019 base volume, that would be a positive 150,000, approximately.

Daniel Joseph Moore - *CJS Securities, Inc. - MD of Research*

Perfect. Helpful. Yes. And then I think in the prepared remarks, you've mentioned on the cost reduction front, to the 280 basis points offset to volume declines based on cost reduction -- efficiencies, cost reductions, pricing actions and those being permanent. Did I hear that correctly? Just trying to get a sense for some of the restructuring actions you've taken and how that might flow through as volumes return.

Matthew E. Garth - *Minerals Technologies Inc. - Senior VP of Finance & Treasury and CFO*

Yes. What you saw there, Dan, was about $4 million of pricing and $7 million of cost actions. And those cost actions, you have the carryover from the restructuring we did last year that we are benefiting from. You have a number of positions that will not be replaced based on the efficiencies that we've been able to drive. As a matter of fact, just speaking to that, I mean, the amount of work and effort and engagement that has been done by the team to establish new ways of working, again, just reinforces the culture we have here that we do talk about each quarter and the strong engagement that we continue to have through this pandemic. And that's what's allowing us to say that the majority of that $7 million would be permanent. So the majority could be 2/3, if I'm giving you direct guidance, but give us some play there as we look at the items that really make up the difference where we could have some coming back. It will be in those travel and expense and product testing categories when those types of volumes tick up for us to spend commensurately with that.

Daniel Joseph Moore - *CJS Securities, Inc. - MD of Research*

Okay. And last for me, just Metalcasting... yes. Go ahead, Doug. I apologize. Go ahead.

Douglas T. Dietrich - *Minerals Technologies Inc. - CEO & Director*

I was just going to add a little bit of -- no, no, my fault. I was going to add a little color to that. Just through the quarter, I think you know as we're constantly looking at ways to do things differently and better... continuous improvement. And yes, we have done that. I think we've maintained quite an efficient set of business systems, even working remotely. We're looking at opportunities to continue to move work around the world. We've had some retirements, and we found ways to capture and do things differently and organize. And we've also added some talent, which is in those numbers. So we've been pretty busy on kind of understanding what we can do differently, making sure that we've added talent to the company to make sure that we're advancing things and improving -- continuous improvement on the organizational front. And the net-net of that, we feel is, like Matt said, 60% to 70% of this, we think, is permanent. I will say that we'll also see other opportunities. We are continuously looking at things that we're doing differently today and what can be captured to be permanent and changing the way we do things. And that's why we think that there's margin improvement and kind of how we're running the company today, we can capture, and that's permanent. We think that the majority of that cost improvement is permanent. And so when volumes improve, we see good leverage on that volume.

Daniel Joseph Moore - *CJS Securities, Inc. - MD of Research*

That's helpful. Lastly, Metalcasting. You gave some color around North America as we get into Q3. And if I missed it, forgive me, but just in China. All these foundries, customers back up and running, what capacity and what are you hearing in terms of the trajectory of growth rates from here going forward?

Douglas T. Dietrich - *Minerals Technologies Inc. - CEO & Director*

Sure, Jon Hastings, do you want to take that one? Give a little more color on specific markets?

Jonathan J. Hastings - *Minerals Technologies Inc. - Group President of Performance Materials*

Appreciate the question. Let me talk about China first and then I'll bridge to the U.S., if you don't mind. First, regarding China, as you know, very strong growth. We have a couple of different sectors that continue to rebound. And in fact, we are doing quite well. For example, the auto market in China, in Q2, it was 14% greater than prior year. As a result, a lot of the foundries are continuing to operate at a fairly high clip. Especially the Tier 1 and Tier 2 who recognize the value of our value proposition. We also see strong market with the heavy equipment and excavators and also the ag and the municipal. So very steady in those segments. The only weak spot that we see is there's a little bit of uncertainty regarding some of the exports and mainly around parts that are going into Europe and some into North America, but overall, very strong.

In the U.S., a little bit different story. As you know, we are heavily concentrated with auto and heavy truck, so the transportation segment. We do sell into the ag and municipal markets, but let me talk about the auto first. We've basically been -- our sales basically followed the course of the auto industry. So the reductions and the closures that we saw in the quarter, and then the rebound in recovery as we've come out of that. And in fact, after the 4th of July holiday, almost all the foundries were running pretty close to full out. So we're expecting, as we look forward, for the second half to be very similar to the second half of 2019 regarding our automotive sales. Heavy truck remains strong throughout. Originally, we saw the OEMs continue to produce pretty strong and then the parts came onboard, so that's been going fairly well. And then when we bridge to ag and municipal, the ag market, of course, you know is tractors and combines, and those have been in the low single-digits decline versus last year in the market. And as a result, our sales continue to be pretty flat and almost consistent with last year. And then the bright spot is municipal. I mean that remains strong as the municipal dollars are being spent. And so manhole covers and grates and things of that nature, and it continues to increase low single digits year-on-year. So a couple of different segments there, and hopefully, that gives you some color on what we're seeing.

Operator

Next we'll hear from Silke Kueck of JPMorgan.

Silke Kueck-Valdes - *JPMorgan Chase & Co, Research Division - VP*

If you look at global auto builds, it looks like the build rates that are forecast for the third quarter are pretty similar to what was forecast for the first quarter. So do you think your Metalcasting sales -- I understand it's not all auto, but do you think it's too optimistic to think your Metalcasting sales in the third quarter should look somewhat similar to what you saw in the first quarter?

Douglas T. Dietrich - *Minerals Technologies Inc. - CEO & Director*

Well, it could. I think, right now, we're seeing 2 things. I think we're seeing foundries reopen. We saw a lot of sporadic kind of on's and off's. And we're seeing right now a little bit of restocking, which is very positive. So the levels that we're seeing, and Jon said, foundries starting to run kind of full time, which we didn't see through the second quarter, some of that restocking. Should those build rates continue and that restocking continue, we could see those type of build rates through the third. That said, there's other -- automotive, I think it's about 50% of our North America kind of exposure is foundry. There's also heavy truck, which is not back to what the automotive build rates are. And then there's also some industrial. So there's some other factors there, Silke, but at least for 50% to 60% of the foundries we serve, yes, it's a possibility they could get back to those type of build rates.

Silke Kueck-Valdes - *JPMorgan Chase & Co, Research Division - VP*

And in your Household and Personal Care category, which is probably the largest within Performance Materials business, what slowed sequentially from the first to the second quarter because the sales were -- I was just wondering what slowed. And again, do you think that for household care products, the third quarter could look somewhat similar to the first quarter given like the rates you saw in July?

Matthew E. Garth - *Minerals Technologies Inc. - Senior VP of Finance & Treasury and CFO*

Yes. The -- it is our largest segment, and that does contain more of the consumer-oriented products in this business unit. There are a couple of product lines in there that are basic. We call them our basic mineral products, which service drilling products. And so there are some drilling fluid additives, and that was the one that, from the first to the second quarter, it was -- it supplied some onshore drilling and third-party customers onshore. That did decline. But -- it offset the strong growth we saw in the Fabric Care, Bleaching Earth, Personal Care and Pet Care business.

In the third quarter, a couple of things happened. Probably the largest business in that Household and Personal Care is our Pet Care business. And yes, we see that, that's continuing through its 3% to 4% growth rate. I mean we give you kind of the average pet care market that we serve, which is primarily in North America and Europe, grows at about 2% to 3%. We grow at 3% to 4%, sometimes 5%, so we grow above the market as we continue the premium -- the premiumization of the market, especially in Europe. So we still see those growth trends continuing through the third. Albeit in the summer months, to be honest, cats are outside a little bit more. And so there's a little bit of seasonality in our summer months at our Pet Care business. The higher season comes when things get a little bit colder. So -- but we do expect strong growth rates in the Pet Care business going into the third and then probably strengthening further in the fourth.

Silke Kueck-Valdes - *JPMorgan Chase & Co, Research Division - VP*

That's helpful. And then I have like 2 more questions, if I may. So when I look at your litigation expenses, like I think you spent like $9 million this year on the Novinda litigation. Maybe you spent like $11 million last year. So like maybe you spent like $20 million on it? I mean what did you recover from that? Or what do you hope to get from Novinda?

Douglas T. Dietrich - *Minerals Technologies Inc. - CEO & Director*

Well, Novinda is something that we -- so recall, when we purchased AMCOL, Novinda was a joint venture that was entered into that we inherited through that acquisition. It was for mercury sorbent products. And that business filed for bankruptcy in 2015, I believe, 2016, I can't -- forgive me if I'm not exactly right. Anyway, we were involved in that bankruptcy litigation and defending ourselves. And so yes, for the past 4 years, we've been working through that arbitration. What I will say is that the amounts reflected this quarter are the final arbitration amounts. There might be some legal expenses, small, that will continue as things just finalize. But that is the binding arbitration settlement. So that's done. So I'm not hoping to get really anything out of it other than to be done with it, and that's concluded this quarter.

Silke Kueck-Valdes - *JPMorgan Chase & Co, Research Division - VP*

Okay. And lastly for Matt, I was wondering whether you had like a cash flow target for the year, either specific or in general terms that you want to discuss?

Matthew E. Garth - *Minerals Technologies Inc. - Senior VP of Finance & Treasury and CFO*

Yes. Thanks, Silke. I think if you look through the first half of this year, it's been a pretty comparable year to what we saw in 2019 from an overall cash flow and free cash flow perspective. And so as we look at the second half of the year, we are expecting a continued good operating performance to drive to operating cash flow and to ultimately free cash flow with good control over capital expense.

What does that necessarily mean? As you look at it, there will be some changes in working capital as we move into the third and fourth quarters. Typically, we see those quarters being our strongest kind of cash flow generating quarters. That's changed a little bit this year based on the impacts from the economic impact from COVID. And so the third quarter actually will be a little bit weaker, but then we are expecting the fourth quarter to continue to be a pretty good cash flow quarter. So all in all, for the year, we're looking at something in the area of $100 million to $120 million in free cash flow. Embedded in that is CapEx between $55 million and $65 million. And we're going to continue to work hard on pulling on working capital levers to help us achieve that level.

Matthew E. Garth - *Minerals Technologies Inc. - Senior VP of Finance & Treasury and CFO*

Let me also add. I just got to make a quick correction on something from Dan. I think we were actually looking at the change from sequential quarter sales, Dan, and that you were looking at the June rate. The June rate on a year-over-year basis was down 25%.

Operator

Next we'll hear from Rosemarie Morbelli of G. Research.

Rosemarie Jeanne Morbelli - *G. Research, LLC - Research Analyst*

I was wondering if you could give us a little more detail. I know you touched on it, but in terms of the market opportunities that you are pursuing and the speed of when you are going to get into those markets, and if you look out 2 or 3 years, what type of revenues can be generated and the profitability of those new businesses -- or new pieces of business?

Douglas T. Dietrich - *Minerals Technologies Inc. - CEO & Director*

Sure. Well, let me -- if I can frame some of this. When I was speaking about opportunities, I think that was -- it's kind of across our business. I think we've seen, in the short-term here, opportunities to gain new business with customers, new customers and further extend our business with existing customers kind of across the segment.

A couple of examples. John mentioned some Metalcasting in U.S. and China where we've gained new customers and extended our volumes with existing ones in China. That's been more of around the premiumization, I guess, we call it, of penetration of our blended products. But also, we've seen some really nice inroads in our Bleaching Earth products in Europe. Our new sealant products in -- our new rheology modification Specialty PCC products for sealants, both automotive and construction. We've also seen some really good traction and that's new business there. So we're finding -- and then with our existing products, we have a very reliable, vertically integrated kind of cost structure and our ability to demonstrate the value in times like this seems to be heightened. So being able to show cost savings where folks or the customers may have been on the fence, that's a real premium now. And so our premium products and our cost savings products have really resonated, and we've taken advantage of that activity here in the second quarter. And we think that that's going to lead to kind of continued revenue growth. Those will be permanent adds, and that's going to help our growth going forward in the near quarters.

That said, longer term, we are looking to continue to grow our less cyclical kind of consumer-oriented businesses. We have steered our capital toward, as you know, an acquisition in Sivomatic. We feel that over the next -- that global Pet Care is about a $200-million business. And we think over the next 4 years-or-so, we could double that, both organically and inorganically. And so that's an area where we think we have unique capability around the world with our bentonite positions and mines to serve. And so that's one area.

We also -- there's other consumer-oriented businesses that we continue to invest in that will grow. We look at our Environmental Products business, which is not direct-to-consumer, but it's kind of -- its activity is based on consumer activity in terms of waste disposal and electricity generation, and also into wastewater treatment remediation. And we're looking at technologies and developing them ourselves to expand that business into very high-margin water treatments. And we've talked a lot about our FLUORO-SORB, our PFAS, and we're gaining a lot of traction. We've had a number of trials and sales, small sales and trials for that PFAS product. So I think we see quite a bit of opportunity, not only just extending our value proposition in markets like we have today, but also continuing to steer our capital and grow what's currently 25% of the company's revenue into a larger portion of less cyclical. And I think in the past quarter, you saw kind of the benefit to the company, the more balance that, that brings the company sales aligned in times like this. Does that help?

Rosemarie Jeanne Morbelli - *G. Research, LLC - Research Analyst*

Yes. That is very helpful. And that 25% contribution from the consumer side, what do you think -- what are you aiming to get it up to as you are growing all of those businesses and investing in them? Can it become, I don't know, 40% of total in 4 years, for example?

Douglas T. Dietrich - *Minerals Technologies Inc. - CEO & Director*

I think I'm going to refrain from giving you an exact percentage, but I think that's absolutely a possibility. I think there's some, over the next several years, as we see taking our positions in that Pet Care business, to what I just gave you where we think we might be able to double the size of it and that's $200 million and then the incremental growth in the others. As a $300 million increase in our Pet Care business, we'll take that business probably to almost 35% to 40% of the company.

So I think that's possible. I'm not going to tell you right now that I'll give you an exact timing of that. But yes, we are looking at those product lines that we feel we've got a unique position to serve and to grow. And we've got the technologies and the value proposition, and we think we can make them much more significant and profitable with the kind of consumer specialties. We can make that a much more profitable piece of the company. We think that will help drive our margins. We think it's a -- we see good returns on our capital deployment in those areas. And I think we've kind of demonstrated that with the acquisition of Sivomatic as a first leg to further items that we see as opportunities out there.

Rosemarie Jeanne Morbelli - *G. Research, LLC - Research Analyst*

That is very helpful. And since we are talking about the Sivomatic acquisition, what are you seeing on the M&A front -- in this environment? New properties becoming available out of the multiples that are coming down. Are you getting closer? I mean you have obviously increased your liquidity. So I was wondering if there is something out there that you are maybe getting closer to being able to announce?

Douglas T. Dietrich - *Minerals Technologies Inc. - CEO & Director*

Well, what I can tell you is that we've always mentioned it too on calls and that we have a nice portfolio of things that we've looked at, we've been looking at for some time. And we think that it fits squarely in our portfolio and would add value and advance our strategies that I've kind of laid out. So I will say, though, that we're still -- look at those curves, we're still down there in the kind of trough. We're more optimistic where we are now in terms of looking ahead in terms of what we see from markets. There's still a bit of uncertainty out there, Rosemarie. And so I want to manage the risk of what's out there in the markets and making sure that the company today is well positioned with where we are. Yes, we have a strong liquidity position. I think, we'd be well able to navigate that. But I also do think it positions us to take advantage of things. As we see that kind of market risk and starting to see through that, I think this presents some opportunities.

Do I see multiples coming down? Honestly, I haven't seen very many transactions, to tell you that. I think that, yes, there's probably some assets out there that could probably be willing to transact to more reasonable multiples than I've seen over the past few years. But again, I think we're going to navigate through and make sure that we're managing the risk that we see today. But I do think we have the balance sheet in really good shape to be able to act on both, like I said, organic and inorganic opportunities very quickly.

Rosemarie Jeanne Morbelli - *G. Research, LLC - Research Analyst*

Okay. And looking at that doubling in size, is that something that you can achieve just organically? Do you have enough capacity, both in the U.S. and in Turkey with our Sivomatic friends? Or do you need to actually add some minerals in order to be able to achieve that kind of growth?

Douglas T. Dietrich - *Minerals Technologies Inc. - CEO & Director*

I think we have. And then certainly, in the near term, we have the resources available to support that type of business activity. I think we are constantly looking at reserve positions around the world. Those are things that we're looking at, as I mentioned, in our portfolio, to make sure that we have strong reserve positions out 30, 40, 50 years. I think more around -- instead of the reserve position support, I think we would need to add the equipment manufacturing. I think we're already there with our current growth rates in our Pet Care business. And as they've been picking up, we're going to be looking at some expansions to make sure over the next couple of years we can support all that packaged and processing growth. So we're going to be doing that. I think we've got a good reserve position. But certainly, we're going to be looking to add to that to make sure that we've got long-term line of sight to support that type of growth.

Rosemarie Jeanne Morbelli - *G. Research, LLC - Research Analyst*

And then lastly, if I may. What is -- do you see a large increase in the bad debt? And are you concerned about some of your customers not being able to pay?

Douglas T. Dietrich - *Minerals Technologies Inc. - CEO & Director*

I'm sorry, did you say -- bad debt.

Rosemarie Jeanne Morbelli - *G. Research, LLC - Research Analyst*

Bad debt security.

Douglas T. Dietrich - *Minerals Technologies Inc. - CEO & Director*

Matt, do want to take that one or...

Matthew E. Garth - *Minerals Technologies Inc. - Senior VP of Finance & Treasury and CFO*

Yes. Just to clarify, the question was, are we seeing changes in our customer payment capability and is that increasing our bad debt provisions, and the answer is no. We're actually seeing good payment performance from our customers. Our teams are communicating on a very frequent basis with our customers in terms of -- and how -- in terms of collectibility, how their payment schedules are looking. And overall, they're healthy cash flows. And so you haven't seen a change in our bad debt provision related to customers' payments today.

Operator

And our final question for today will come from David Silver of CL King.

David Cyrus Silver - *CL King & Associates, Inc., Research Division - Senior VP & Senior Analyst*

Okay. And I'll just say this in advance, I had to step away a couple of times, so if my questions have been addressed already, just mention that, and I'll listen to it on replay. So I guess I just wanted to ask a couple of questions on your PCC business. And the first one would kind of just be a little naive, but I look at the revenue number this quarter, and it's very low, much lower than the last several years each quarter. When was the last time that, that business was running at that kind of level during the second quarter? And then more to the point, is there -- was there anything especially different or unusual? I mean was this just the garden variety, but severe downturn in paper production? Or in your opinion, are the customers taking an especially cautious tone? Or is there a shift in the papermaking technology that encourages the shutdown of a mill as opposed to moderating the operating rate? So just maybe some color on the severity, I guess, of the sequential falloff in Paper PCC demand over the last quarter or so.

Douglas T. Dietrich - *Minerals Technologies Inc. - CEO & Director*

Sure. Well, let me just kind of parse this out by region again. I think in Asia, we really didn't see a drop off. We continue to operate. We saw a slight decline, but we saw a drop-off in the first quarter, and our PCC facilities in China continue to run pretty much at normal demand levels, and we saw a 4% increase in the second quarter. That kind of continues with our trend. In India, we saw the closures, but they're now back ramping up. And so we see that market demand picking up in the third.

I think what you're talking about, though, is North America and Europe, but North America, much more severe. To answer your question, I can't tell you, honestly. I'd have to go back and look when our PCC business ran at this level in North America, I don't think it's ever -- and I mean, maybe in the early 1990s as we're ramping up the satellite model through North America. But I also don't think the market in North America has seen a 30% decline in paper demand in 1-month time frame. And so what we saw in the second quarter certainly wasn't -- it was completely unique. And certainly was a result of kind of the complete shutdown of office and school and university kind of consumption activity, which is starting to ramp back up. That said, universities, what happens with universities, what happens with going back into the office and schools, elementary schools, et cetera, high schools, still kind of remains to be seen. So I don't -- a little bit of unprecedented drop in paper production in North America. But we do see that starting to come back. The question is how soon and when that will happen. Kind of looking at -- it's hard to really predict and really to see right now when that will come back. We expect that it will. It may not come back to levels we saw last year, but we do see that, at least in July, that activity level has picked up in North America with -- I mean, we had 9 of 16 of our facilities down. We see 7 of those probably ramping back up in North America. D.J., do you want to give us a little -- you've been part of the business since -- well, you've been in the paper business for most of your career, you want to give us a little more color on kind of North America?

D. J. Monagle - *Minerals Technologies Inc. - Group President of Specialty Minerals & Refractories*

Yes. As best I can. So David, I would echo with Doug. I can't give you an exact time where our volumes were this low and certainly not as a percentage of installed capacity. I've never seen a drop like this in uncoated wood-free demand. But I guess I would tell you this, all of our customers are comfortable that sequentially things are going to be getting better and then everyone is trying to see what the long-term outlook is for demand in uncoated wood-free. But let me, I guess, bring in a couple of other aspects of this. Doug had highlighted earlier that we were able to bring in 2 new contracts for PCC. And I would say that even in this, let's -- for lack of a better term, let me call it a tumultuous market environment, I still got, let's say, 10 to 12, pretty active business development programs going on that have all moved forward in the last couple of months. I can't tell you how many of those we will bring in for sure, but most of that growth is relying on displacement. So -- and it's mostly in Asia where we haven't seen nearly the drop-off and the long-term outlook for the Asia papermaking environment is stable. So we still feel that there's this unsettling period right now, but business development is active. A lot of that in printing and writing papers in [Asia] is active, and I'm quite optimistic about.

And then on top of that, in North America -- so of that 10 or 12 active business development opportunities, there's 3 or 4 that are in -- are targeted for packaging grades, and we are greatly affected by the demise in putting in writing paper, but we're trying to grow in packaging and that fiber-based packaging seems to be a sustainable market. So we're early in that. The transition from international papers, printing and writing grade to a packaging grade that will be coming here in the third quarter is something that we're participating in. We'll help them make that premium paper. Doug had mentioned other expansions coming online. We've got one of our expansions in Europe coming online is in a packaging application. And then we've got these other new development items in the pipeline. So your read on the dramatic shift in paper consumption is right. To me, it's unprecedented, and it should be getting better. But we're -- I think we're going to be able to grow despite that.

Douglas T. Dietrich - *Minerals Technologies Inc. - CEO & Director*

Yes. I was going to add to that. I think, David, the last piece is the market in North America, uncoated freesheet in North America isn't -- it used to be the largest piece of the business and everything it relied on. Today, there's different parallels and tentacles out there in the paper industry. And like I said, we've -- into our New Yield products, our Environmental Products, such as Envirofil that has just started up in Europe and we see opportunities to expand that further in Europe. D.J. mentioned packaging, but other technologies that are on there.

So yes, we still have a lot of base pigment volume opportunities out there. And the net-net of that will still be regardless if the market doesn't come all the way back, a growth in volume for the company over the next 18 months. Add to that, the New Yield, add to that the Envirofil, our new filler technologies, our environmental solutions for customers, and we branch this out into something different than just based on coated freesheet.

David Cyrus Silver - *CL King & Associates, Inc., Research Division - Senior VP & Senior Analyst*

Well, that's -- not only did you pre-answer my first follow up, you also pre-answered my second follow-up, but I'll kind of phrase it a little differently. But I think last quarter or maybe a quarter before that, I think Doug or maybe D.J. did highlight that the -- it must have been 3 months ago, that the pandemic was kind of causing a little bit of problems in terms of getting your technical people on site where you're doing demonstrations and test runs and things like that. And I'm just wondering if those disruptions or those kind of bottlenecks have persisted or maybe just a characterization of the development or the demonstration capabilities within this kind of restricted travel, pandemic-related environment. And that's also for PCC, by the way, yes.

Douglas T. Dietrich - *Minerals Technologies Inc. - CEO & Director*

Yes. Got it. So look, we've had some really good business development success, albeit some in-person, some virtually. D.J., how about some color. I mean you're right in the thick of these contract negotiations and new product development.

D. J. Monagle - *Minerals Technologies Inc. - Group President of Specialty Minerals & Refractories*

Yes. I would say, David, for our standard PCC offering, we've seen no impact because we've got market data that is able to support our value equation and what we're offering. For these new products, it has impeded our ability to trial. But as I speak right now, we've got trials planned for week after next and a couple of weeks after that, even assuming this current pandemic environment. So yes, it has affected us. Yes, it has slowed us down for the new technologies but the teams have been able to work their way through some of these things and develop ways of safely sharing with the customer what these technologies can do. It's taken us a while to come up with some alternate means. And a lot of discussions are happening on video and a lot of translations going on as English speakers speak with folks in other tongues. But we're able to do it, albeit slower.

Operator

And now at this time, I'll turn the call over to Mr. Dietrich for any closing remarks.

Douglas T. Dietrich - *Minerals Technologies Inc. - CEO & Director*

Thanks, April. I appreciate it. Look, again, I appreciate everyone taking the time to join the call today. I do hope everyone remains safe and healthy and your families as well. We'll talk to you again in 3 months. Thanks again for attending.

Operator

That does conclude today's conference. Thank you all for your participation. You may now disconnect.