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PRESENTATION

Operator

Good day, everyone, and welcome to the Second Quarter 2022 Minerals Technologies Earnings Call. Today's call is being recorded. At this time, I'd like to turn the call over to Erik Aldag, Head of Investor Relations for Minerals Technologies. Please go ahead, Mr. Aldag.

Erik Aldag - *Minerals Technologies Inc. - Head of IR*

Thanks, Jennifer. Good morning, everyone, and welcome to our second quarter 2022 earnings conference call. Today's call will be led by Chairman and Chief Executive Officer, Doug Dietrich; and Chief Financial Officer, Matt Garth. Following Doug and Matt's prepared remarks, we'll open it up to questions.

I'd like to remind you that beginning on Page 15 of our 2021 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.

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

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

Thanks, Eric. Good morning, everyone, and thanks for joining the call today. We've got quite a bit to go over, so let's get started. I'll walk you through the highlights of our results and what contributed to this record quarter. Then Matt will give you details on our financial results and share our outlook for the third quarter. To conclude, I'll provide some highlights from our 14th Annual Corporate Responsibility and Sustainability Report, which was published Wednesday.

Let's get started with a recap of the quarter. This was a remarkable quarter for MTI with record sales of $557 million, record second quarter operating income of $74 million and record earnings per share of $1.50. This performance is the result of our team's execution over the past several years on some key fronts: delivering on our strategic growth initiatives, driving continuous operating improvements and disciplined capital deployments.

To begin, MTI sales were up 22% versus the prior year and up 27% on a constant currency basis. Every product line grew and contributed to double-digit growth in all 3 of our segments. We saw growth in every region, in North and South America, in EMEA and in Asia despite lower sales in China due to the COVID situation there. This performance was the result of our broad-based approach over the past several years to grow the company both organically and inorganically. It's also the result of our pricing actions and value selling efforts to offset the significant inflation we've experienced over the past 12 months.

Our operations performed well, and our team coordinated seamlessly to overcome persistent challenges and meet market demands, address consumer needs as well as identify and create efficiencies to drive profitability. Supply chain and labor challenges persisted. However, our teams navigated these issues and continued to demonstrate their agility in dealing with the evolving market landscape.

We saw higher-than-expected inflationary cost pressures in the quarter of $43 million compared to last year, and our pricing actions accounted to $47 million. I'd like to note that we absorbed $4 million of this cost inflation without pricing adjustments because we couldn't begin to pass through this cost contractually until July 1.

Our culture of disciplined cost control and continuous process improvement was on full display this quarter, maintaining efficient overhead spending and integrating 2 acquisitions, driving our SG&A as a percentage of sales down 160 basis points. The result was operating income of $74 million, a record for the quarter. And despite the significant cost pressures, our margins ticked slightly higher.

From an investment standpoint, we maintained our discipline and balance with capital deployment. We acquired Concept Pet, returned $26 million to shareholders through share repurchases and dividends and invested $21 million in capital expenditures to support our facilities and organic growth. All in all, we had a very productive quarter. We're executing well on numerous fronts, and we're well positioned to sustain our strong performance.

Now I'll take you deeper into some of the underlying drivers of our record performance this quarter. As I alluded to earlier, our growth strategy is multifaceted. It consists of positioning ourselves in faster-growing markets and geographies and accelerating the development of new products and technologies. It also includes the disciplined acquisition of companies that help accelerate these efforts, further balance our portfolio and expand our technologies and capabilities.

For the past several years, we've been executing on each of these fronts, and the second quarter is in part a representation of the results. This quarter, our sales increased 27% over last year, a robust figure that was broad-based and driven by 4 areas: 7% revenue growth -- base revenue growth, 2% from new product sales, 8% from acquisitions and the remainder from price increases implemented across our product lines.

Let me take you through each of these components in more detail, starting with the base organic growth. Over the past several years, we've been positioning ourselves in faster-growing markets and geographies, expanded into consumer-oriented markets, which are characterized by favorable secular trends. These trends such as growing pet ownership, consumer preference for over-the-counter functional cosmetics and increased demand for high purity edible oils are driving higher levels of sustained revenue growth. Demand for these products is also more resilient and will lessen the impact of cyclicality on our total sales, balancing the industrial side of our business.

We've been benefiting from these macro trends and market positions. Our household and personal care product line, which includes many of our consumer-oriented products, has grown at a 17% compound rate over the past 5 years. Including acquisitions in this product line, it's grown organically at a 6% compound rate, illustrating the stability and growth potential of these products.

In addition, we continue to penetrate growing regions with our high-value products. Our sales of pre-blended greensand bond products in the 2 largest foundry markets, China and India, have grown at 9% and 20% annually over the past 5 years. For many years, we've been penetrating growing regions with our latest PCC technology, and this month, we signed an agreement to construct a 43,000 ton PCC satellite plant in India, which will feature our first deployment of MTI's sustainable NewYield® LO PCC technology. This technology is a combination of our traditional PCC technologies, while at the same time, repurposing a paper mill waste stream, saving the customer's money and alleviating a waste disposal challenge.

The acceleration of product development and commercialization to meet new customer demands and the transition of our portfolio to more sustainable solutions is having a noticeable impact on the top line. Sales of new products are on track to increase 38% over last year. And as I mentioned, our newest products drove 2% of the overall organic growth that we saw this quarter.

Some examples of these new solutions are our latest edible oil purification products, which grew 29% versus last year. These products create higher purity, longer shelf life edible oils. And we're developing new products targeted at the rapidly evolving market for biodiesel.

In pet care, we commercialized new fragrance and dust control formulations for customers in our North American market, and introduced new product offerings tailored for Asian markets, where sales grew 15% over last year. Personal Care, our Health and Beauty Solutions business, has been supporting several new active skin care products over the past few years with our delayed-release retinol technology. Our capabilities to support customer formulations and provide them packaging solutions has driven continued growth in this product line, and sales this quarter grew 13% versus last year.

We're also benefiting from the general market appetite for sustainable product and process solutions. We've invested in R&D to expand our portfolio of sustainable solutions. And as a result, the majority of our new products in development, 65%, in fact, feature aspects that benefit our customers' sustainability goals.

We're also moving into higher tech value-added solutions for our industrial customers. For example, our Refractories business is offering a higher tech solution to improve the safety and productivity of steelmaking. Our solution uses laser-guided systems to measure and collect data on steel furnaces, and automates the application of the refractory material.

These systems yield more accurate measurements of furnace wear and lining degradation than conventional methods, while also collecting data to enable predictive maintenance through analytics. Not only is this valuable information, but it keeps furnaces running longer without the need for remedial repairs, saving our customers money. Most important, it removes people from proximity to a high temperature environment.

Our PCC business is also developing new technologies to scale into the growing packaging market. Last year, we signed a contract with Asia Symbol in China to deploy GCC technology in the whiteboard packaging market. And we have new technologies currently in trial with our customers that target additional white and brown packaging applications.

We also bolstered our growth in the second quarter by 8% from acquisitions, including Normerica, Concept Pet and the Specialty PCC facility in the Midwest. These acquisitions accelerated our movement into growing markets and geographies. They are progressing well. And through them, we see avenues for additional growth and value creation. We have an active pipeline of other M&A opportunities that will support our growth objectives, and importantly, we have the balance sheet strength to execute on them.

The ability to adjust prices given the inflationary environment has been a key topic for many companies lately, and as you can see, a significant portion of our sales growth this quarter came from our pricing actions. We price our products on the value they provide, and we are uniquely positioned in the marketplace through a combination of our technologies, our applications expertise and our global mineral reserves to provide supply stability and continued value to our customers. We have deep long-term relationships with our customers and we engage and partner with them to ensure we deliver the solutions they need.

In summary, this quarter represents many aspects of the execution of our growth strategy, but it still doesn't show our company's full potential. We are a higher growth, more resilient company with more opportunity ahead. This, combined with our demonstrated ability to navigate challenges gives us conviction that we'll continue on this strong trajectory.

With that, I'll hand it over to Matt to discuss the financial results and our outlook for the third quarter. Matt?

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

Thanks, Doug. I'll review the second quarter results, the performance of our segments and our outlook for the third quarter. Following my remarks, I'll turn the call back over to Doug to provide some highlights from our recently released sustainability report. And now let's review the second quarter results.

Total sales in the second quarter grew by 22% year-over-year to $557 million. And excluding $21 million of unfavorable foreign exchange impact, sales growth was 27% above the prior year. Sales increased by double digits across all 3 segments. And as Doug detailed, the increases in sales were balanced across contributions from our acquisitions, improved volume and mix and higher selling prices.

Second quarter operating income, excluding special items, improved by 15% compared to the prior year to $73.5 million. The year-over-year operating income bridge, on the lower left side of the slide, shows that we continued to implement selling price actions to offset the impact of inflation. In total, we delivered $46.6 million of selling price increases compared with $43.1 million of inflationary cost impacts. The inflation consisted of approximately 60% raw materials, 30% energy and 10% logistics.

Contributions from our acquisitions, continued strength in our Refractory segment and higher activity in our project-oriented businesses drove a favorable volume and mix impact of $9.6 million.

Now shifting to the right side of the slide. The sequential sales bridge shows that sales improved by 7% and were 8% higher when excluding the impact of foreign exchange. The sequential operating income bridge shows an improvement of 8% driven by stronger volume and mix.

We experienced higher-than-expected inflation, primarily due to energy and logistics costs, which resulted in a temporary lag between price and cost on a sequential basis. And we expect to fully make up this gap in the third quarter with pricing actions and contractual adjustments that began on July 1.

Reported earnings per share were $1.36. We incurred special items of $4.3 million after tax, consisting of acquisition-related transaction and integration costs, a noncash pension settlement charge and litigation costs. Excluding special items, earnings per share for the company were $1.50 in the second quarter, a record EPS performance amidst a significant inflationary environment that underscores the team's agility and the earnings power of the company.

And now let's review the segments in more detail, beginning with Performance Materials. Second quarter sales for the Performance Materials segment were $300 million, a 26% increase compared to the prior year and 10% higher sequentially. Sales in household, personal care and specialty products increased by 37% year-over-year, driven by our pet care acquisitions and continued strong performance from our portfolio of consumer-oriented products.

Our fabric care, personal care and edible oil purification businesses each delivered double-digit growth versus last year. Increased project activity helped to grow sales in environmental products and building materials by 36% and 6%, respectively, compared to last year, and Metalcasting sales were 10% higher than the prior year and were 11% higher sequentially.

Our North America greensand bonds business experienced strong demand in the second quarter, more than offsetting lower sales in China, where we saw reduced volumes amid local COVID restrictions. Segment operating income increased by 12%, both sequentially and versus prior year to $38.9 million and operating margin improved by 20 basis points sequentially to 13% of sales.

As we look ahead to the third quarter, we anticipate demand for household, personal care and specialty products to remain strong, albeit with typical seasonality in our pet care business. In Metalcasting, we expect seasonal foundry outages in North America to be offset by recovering volumes in China. We see a similar strong performance from our project-oriented businesses as the strong order book for environmental products should offset slowing activity levels in Europe for our building materials business.

In addition, we expect to continue to adjust our selling prices to offset the impact of inflationary costs. Altogether, we see a similar level of operating income sequentially for the segment.

And now let's move to Specialty Minerals. Specialty Minerals sales were $164 million in the second quarter, an increase of 15% year-over-year and 1% sequentially. Global PCC sales increased by 15% versus last year, driven by higher selling prices as well as volume growth in our Specialty PCC business. Processed Minerals sales increased by 16% year-over-year and were 5% higher sequentially on higher selling prices as well as continued strong demand in the construction and consumer markets.

Operating income for the segment improved by 10% sequentially to $20.2 million, and operating margin improved by 100 basis points as the impacts from our selling price actions offset the impact from inflationary cost increases. Recall that this segment has been the most impacted by energy inflation, largely as a result of rising European energy costs. This segment also has the largest proportion of price lag, so we'll see a recovery of these costs in the third quarter given contractual time and adjustments.

As we look to other third quarter factors, we expect a moderate recovery in China that will offset seasonal maintenance outages in PCC. In addition, demand in Specialty PCC and Processed Minerals is expected to remain strong. In total, we expect a similar level of operating income sequentially.

And now let's continue on to the Refractory segment. Refractory segment continued to perform well in the second quarter. Sales were $93 million, an increase of 25% year-over-year and 11% sequentially, driven by higher volumes and selling price increases. Operating income was $16.2 million as the sequential benefit from higher volumes was offset by energy and raw material-related cost increases, most notably in Europe and Turkey. And operating margin remained strong at 17.4% of sales.

As we look to the third quarter, we see another strong overall performance for the segment. However, we anticipate some moderation in steel market conditions in Europe, and we expect raw material and energy inflation to continue. As a result, we expect operating income will be lower sequentially by approximately $2 million.

Now let's take a look at our cash flow and liquidity. Second quarter cash from operations was $33 million and free cash flow totaled $12 million. Cash flow was higher compared to the first quarter. However, it was lower than last year due to increases in working capital. In the first half of 2022, our working capital has increased $92 million due to the significant growth we are realizing as well as the inflationary impact on our inventories and accounts receivable. As we've discussed previously, we also have some strategic inventory positions, which we put in place this year, and we expect to draw down these inventories by the end of the year.

Our strong growth and the persistence of the inflationary environment is resulting in a longer working capital build, which means a portion of our expected 2022 cash flow will likely move into the next calendar year. As a result, we now expect free cash flow this year to be in the range of $100 million to $125 million. Importantly, our working capital efficiency measured in days of working capital has remained the same as last year, and the company's cash flow generation capability remains strong.

Capital expenditures during the second quarter were $21.2 million, and we repurchased an additional $24 million of shares under our $75 million repurchase authorization, bringing the program to date total to $52.5 million. At the end of the second quarter, total liquidity was approximately $426 million and our net leverage ratio was 2.3x EBITDA. We continue to maintain a strong balance sheet, providing ourselves with the flexibility to continue to invest in high-value growth opportunities both organically and through M&A.

Now let me summarize our outlook for the third quarter. On balance, we see similar conditions to the second quarter with order book strong, consumer-oriented demand continuing solid and higher sales in China compared to the prior quarter. However, we are monitoring a few risks to this outlook. First, the China recovery may take longer than expected. Second, the inflationary environment may continue at a higher rate than expected. And third, general demand in Europe may be impacted by higher costs for energy and raw materials.

Overall, and depending on how these factors play out, we expect operating income in the third quarter to be $2 million to $3 million lower sequentially and earnings per share in the range of $1.40 to $1.45.

We remain confident in the team's ability to remain agile in the face of challenges, and we continue to see full year earnings per share in the range of $5.60 to $5.70.

I'll now turn the call back over to Doug to review some of the highlights from our 2021 sustainability report. Doug?

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

Thanks, Matt. Before we end the call today, I'd like to take a moment to highlight the publication of our 14th Annual Corporate Responsibility and Sustainability Report. This report provides a comprehensive overview of our wide-ranging ESG efforts for all stakeholders. Equally as important, it describes who we are as a company, our values and how sustainability is embedded into our strategy, our thinking, our product development and our people.

One highlight you'll see in the report is that we've not only met but exceeded 5 of the 6 2025 environmental goals we set for ourselves back in 2018. Because we've surpassed those initial goals 4 years early, we've reset them to more aggressive reduction targets. I encourage you to read the report to understand our safety-first culture, the acceleration of our sustainable product portfolio and our numerous initiatives around employee engagement, diversity inclusion as well as community outreach.

I'm extremely proud of all of our employees and their commitment to these efforts. Their contributions and teamwork have driven the progress we've made advancing these objectives. Again, I encourage you to review the report, which is available for download on our website.

Now let's open the call to questions.

QUESTIONS AND ANSWERS

Operator

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

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

Maybe start with Metalcasting, drilling in a little bit. Just to contrast what you're seeing in Asia and China specifically in terms of the pace of recovery there versus North America. Whether you're seeing any signs of softer demand in real time? And your kind of outlook beyond the next quarter, in general? That would be really helpful.

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

Sure. Lots of strong demand so far in North America. Asia, obviously, slow in the second quarter, but rebounding. Jonathan Hastings, you want to take us through what you're seeing in more detail?

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

Sure. Dan, on -- I'll start with North America and then get to the heart of your question over in China. North America, as Doug said, we've got really strong demand. We're seeing a rebound in auto. We also know that inventories are very low across most of the segments. We see heavy truck, the industry of the municipal markets, all continuing to execute extremely well. And we see that continuing into Q3 and Q4 as well. So as we talk with our foundries, we don't see anything on the horizon that really should impact that.

As we moved into the quarter in China, of course, you saw all the COVID shutdowns, and that impacted demand. Meanwhile, what we've been doing is we've been working with our customer portfolio. We've been working with the preeminent foundries. They have been testing new products. And at the same time, we've continued to expand our market share.

We have seen the start of a rebound, especially in the past couple of weeks, that took a little bit longer than I was expecting based on the lifting of some of the COVID outages. However, as you've seen, they've continued to roll through different parts of their economy.

So we've seen it start to rebound, and we expect over the course of the next couple of months, we'll see the ramp-up in demand. And certainly, by the end of the year -- I know global estimates of auto production, for example, continue to be 6% year-on-year. And that's a combination of what we see in North America and also in Asia as well.

So anyway. So rebounding in China, very strong in North America. We saw other Southeast Asia, Indian markets running very strong. So if we can see the rebound in demand, we'll be in really good stead versus 2021 and going into the future. I hope that helps, Dan.

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

Very much so. And maybe switching over to Environmental Products and Construction Technologies. Obviously, seen nice recovery there. Demand has been building. Any pause to that? Or are things still picking up nicely despite some of the kind of inflationary and global macro dislocations?

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

Yes. Dan, you've hit it right on the head. We've seen strong demand. Our order books for Q3, for example, in environmental in North America are above 100%. So full order books. That is expected to continue. We see that with municipal landfills. We see with some coal ash products and mining projects. We've got the waterproofing for building, and infrastructure projects continuing to roll as well.

In Europe, because of the economic pressures, we have seen some projects starting to slide. That may be the willingness to spend in the economic environment that they're in right now. That has mostly affected our building products markets. However, if you would go further around the world, Australia, for example, very strong with building products. So we've kind of got a mix when you look at it in EPBM (Environmental Products and Building Materials). But overall, the strong North America markets seem to be offsetting what we're seeing elsewhere, especially in Europe, et cetera.

So that's kind of the status of the EPBM (Environmental Products, Building Materials) right now. Of course, we're taking the time to invest in our technologies. We're working with the customers. Like I said, the order book is good. So we've built a business over the past couple of years. We've been trying to lay in the foundations of new technologies and new manufacturing processes, and that seems to be shaping up real well as demand continues.

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

Excellent. Last for me, and I'll jump back. Just in general, inflation, it's been remarkable and your ability to respond to it, it's been pretty remarkable. But is there any area where you're seeing it taper a bit or even signs where you could see a little bit of favorability and all those pricing actions turn to maybe higher margins in a couple of quarters? Still early to tell, but any signs of relief?

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

No, inflation has continued. Matt outlined that a lot of the inflation we're seeing is energy-related or a derivative of energy, and we don't see that abating right now. There are a couple of areas, but I'm not sure that they're permanent areas -- that we buy in China some of the raw materials there have planed over. That may have been more due to supply-demand issues through the second quarter. So we'll see how that continues in the third. But for right now, we've seen continued increases at least through the third quarter.

As we sat here in the beginning of the second quarter, we had an assumption for the second, and I think our costs were $10 million higher than that. We're sitting here today with some long positions on things, some that we can't get long positions on. It may be even higher than that. But some areas that might plane over -- but to your point, when they do and as we catch up, as Matt mentioned in Specialty Minerals on our pricing, which is contractual, that will plane over and we will catch up on that pricing and those margins will expand.

The price we go into right now has our margins, targeted margins and recapture that margins. But as this bubble of cost keeps coming in, it's a delay to pass that through. And when that planes over, those targeted margins will come back.

We also have more to go with some of our acquisitions. We have margin that -- and I kind of alluded to this in my comments, that we're still integrating. We have some cost catch-up -- or some price catch-up through some costs that we've seen over this year. I think we mentioned it last quarter, where kind of those synergies from Normerica are a quarter or so delayed because we've been catching up on price there. That's largely finished, and we see that value dropping through in the back half of the year as well.

So I think you're going to start to see the margins expand. Again, like I said, if we continue to take on $10 million every quarter and have to wait to pass it through, that's going to be that quarter delay. But you'll see that happen, Dan.

Operator

And our next question comes from Mike Harrison with Seaport Research Partners.

Michael Joseph Harrison - *Seaport Research Partners - MD & Senior Chemicals Analyst*

Congratulations on a nice quarter. And I appreciate this breakout that you provided of the base volumes and the pricing and acquisitions and all of that. I think it does a great job to illustrate what you guys are doing. I wanted to ask about -- more specifically about the household and pet care business. The 37% growth that you saw there, I'm assuming that the vast majority of that was from acquisitions. But can you help break that down between organic volume, price and acquisition? I also assume there was some FX in there as well. So any details on that HPC (Household Personal Care) business.

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

Yes. I think the majority of that -- 2/3 of that growth was acquisitions. Again, you're seeing still Normerica that we didn't have in the second quarter of last year, and then we've added the Concept Pet acquisition in. So 2/3 of that is the acquisitions, but -- and yes, there has been some negative foreign exchange in that business as part of it is -- the Concept Pet and Sivomatic are in Europe.

That said, I tried to allude to a longer-term kind of trajectory of this business in the household and personal care. And like I said, even with the acquisitions we've done over the past 3 years, it's grown compound at 17%. But if you strip that out -- and I didn't adjust my numbers for foreign exchange -- it's grown at 6%. But that's 6% through a couple of different cycles, right? It's averaging the 6%. And we think that, that -- with our new positions and growth in Asia that, that 6% is going to go north. So on a base rate, we think through a cycle growth rate of high single digits -- mid- to high single digits in this business. And we think there's other opportunities that we can bolt-on some positions to accelerate that.

But I tried to give you a flavor for our strategy to move into growing markets with secular trends, favorable secular trends like pet ownership, more stable growth. Growing pet ownership in Asia, moving into that direction. Our growth there was 15% this year -- this quarter. So these are the parts of our strategy that we've been executing on that will continue to deliver that kind of stable growth through the cycle going forward.

I know you didn't ask about it, but I'm going to jump into bleaching earth and Specialty Products and household -- or our health and beauty systems. It's the same thesis. It's been moving into these markets that have higher stable growth rates, higher demand levels due to secular consumer preference. And we've been positioning ourselves there. And I think that's -- like I said, this quarter didn't just happen. We've manufactured this kind of growth rate that you're seeing, and we wanted to break that out for you. So anyway. A little more than you asked for, but I wanted to take the time to lay that out for you.

Michael Joseph Harrison - *Seaport Research Partners - MD & Senior Chemicals Analyst*

No. And that's all fair because I think it's easy to think of that segment as being pet care, but there's a lot of other exciting applications for bentonite in there that you guys are expanding. So I appreciate that.

I was hoping that you could give us some sense -- in Europe, there's a lot of talk and concern about energy rationing. As you think about some of your key facilities in Europe, whether it's production facilities, mines, PCC satellites, can you walk through your exposure to natural gas or to countries that are dependent on natural gas for electricity? And maybe talk about what kind of contingency plans you're considering if that situation gets worse as we head towards the winter in Europe?

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

Yes, certainly a challenging situation that could unfold in Europe. Let me just kind of mention our sales in the market. Europe is about 23% -- 25% of our total sales as a company. I'll break down: 1/3 of that -- a little less than 1/3, like 27% of that is paper. About the same amount -- maybe 1/3 is pet care. 1/3 refractories, and I know that's 100%, but there's other things like animal health in there. But the 3 majority -- the 3 big ones are paper, pet care and refractories.

Our paper business, I would say -- our energy is provided by the host mill. So we're going to flex and operate as that host mill does. So large paper mills, if they take extended outages due to curtailments, we're going to go along with that. So that's the one area that we don't necessarily control, but it will cycle with those plants if they do that.

Our pet care business, we do have some energy consumption, largely in Turkey and in the Netherlands. We'll probably -- we'll be able to campaign that business through energy cycles if we need to, the same with our Construction Technologies business and the same with our Refractories business. A lot of our consumption of energy sits in 2 areas. It's in Poland and in Turkey. And right now, those have been relatively stable from a supply standpoint --not from a price standpoint, I will tell you that. But from a supply standpoint they have been. But if we do have curtailments, we'll be able to navigate through kind of campaigning those plants to adjust to those downtimes.

So that's how we're looking at it right now. The piece of paper is one that we're not going to be able to control. It will be dependent on what the host mill does.

Michael Joseph Harrison - *Seaport Research Partners - MD & Senior Chemicals Analyst*

All right. And then the last question I had is just on the litigation cost special item. It says in your press release, "this is related to a number of cases seeking damages for exposures related to your talc products and operations." What is the number of cases? And can you characterize a little bit better what kind of exposures and what kind of damages these plaintiffs are seeking? And I guess is there something that you've already recorded as a reserve liability? Or I guess how should we think about the potential liability here?

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

Yes. So let me take you through with the charge, was related -- charge is related to 2 things. One, as you mentioned, some higher litigation costs associated with the increased number of cases that we're seeing. But it's also due to kind of a onetime cost of preparing for a potential trial, but also setting us up for a more efficient way to deal with the cases from an information standpoint. So we did some things to set ourselves up for being able to deal with the case load.

A little bit of history. We've always had a small number of talc cases in the company over the past decade. We've never had any settlements or verdicts against us or payments. And so most of them have been meritless -- they have been meritless claims. And I think what's happening now is with what's going on with the talc industry with Johnson & Johnson and others. We've never supplied Johnson & Johnson. We're not part of that. However, I think talc companies have -- it's been a light has been shined on them, and so we're seeing an increased number of cases.

These are all -- our talc business is relatively small. It's a $50 million business. It's isolated in a sub called Barretts Minerals. But we're going to expect some ongoing litigation. Right now, we look at them all as meritless. We don't see any liability associated with them as we sit today. But we are going to have some increased costs as we deal with them, and that's a function of being on a list of being a talc producer.

A number of cases right now. We have about 420. But that's -- that compares to what others have seen, over 33,000 cases. So a very small number. We don't see the liability as we sit today as anything meaningful or financially material to the company.

Operator

(Operator Instructions) And we'll hear next from Steve Ferazani with Sidoti.

Stephen Michael Ferazani - *Sidoti & Company, LLC - Research Analyst*

I did want to ask a little bit about working capital and cash conversion and just -- so obviously, inventories are growing. That's dollar -- higher dollar value, inflation pressures and volume is growing. So you're building that up. But I'm trying to think of when -- you're expecting a drawdown on inventory as supply chain issues ease. You're expecting a stronger cash conversion to the back half of the year.

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

Yes, Steve, I think you got the inventory component right. And the drivers around that: higher volumes requiring a higher level of inventory to feed those volumes. Also, the inflationary factors that we've been talking about and some of the costs have been going into inventory, obviously.

Second component of that is the strong pricing that we've been talking about and the higher volume also driving the accounts receivable dollars up.

Again, our efficiency is very, very consistent over the last several quarters, exactly where they were here in the second quarter to where they were last year. So I feel good about that. The cash conversion component of that, though, like I said, really just gets pushed out a little bit. We do have a normal seasonal build in working capital that happens in the first half. Second half of the year, we do see some release of that as we have some seasonality in those as project-oriented businesses come off. And so there's typically a working capital release on the third and fourth quarters.

This year, any year really, we come into it expecting about $150 million. That working capital that we've absorbed, just pushing out a bit of that in terms of timing. So as you see inflationary factors start to plane over, as we talked about earlier, that's going to release some of that working capital. The strategic inventories we talked about, we should be releasing those as we move further through the year.

And then also from the strong growth that you're seeing on the top line that is driving that AR (Accounts Receivable) side, as you see some of that moderation take place versus a year-over-year consistency, that will also release some of that inventory. So that's why we're saying pushed out to the next calendar year. And so that means that kind of $30-plus million of free cash flow that we would expect here this year, all things being equal, we would expect that next year.

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

Steve, if I can add. I think -- if you look back in the history of our cash flow kind of cycle and generation -- I think you've seen this a couple of times before, where the cycle is a little bit off from the earnings. In 2018, we had a -- it kind of went through a high-growth period, and cash flow that year was $120 million. The following year, that released to $180 million. And I think when you saw through the 2020 downturn, we released quite a bit of cash, up to almost $175 million.

So we go through these periods. We don't think there's anything changed for the cash conversion rate of the company, cash capability of the company. Like Matt said, that cash -- again, with inflation plaining over, that cash is going to set us up for probably a larger than average 2023.

Stephen Michael Ferazani - *Sidoti & Company, LLC - Research Analyst*

Makes sense. So when I think about that -- and obviously, cash in your balance sheet is still quite significant. And then you expect to build next year. Does that -- does the timing of that affect your capital allocation priorities and how you think about spends in the different buckets?

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

No, it doesn't. I mean, we look at -- I'll give you one piece where we do look at it, but it's not because of the cash conversion. We have confidence in the cash generation of the company. Right now, we're under a $75 million share repurchase program. I believe we have about $22 million, $23 million left. Likely, we will finish that program.

As we look at capital expenditures, of the $80 million, $35 million of that on average every year goes into maintenance capital, maintaining our facilities, et cetera, safety. We'll continue with that. The piece that we always look at is our growth -- is our CapEx that goes into growth. And as we look ahead, we may adjust some of those assumptions. Many of them are based on markets and growth. And what we can do with it and how quickly we can fill up that expansion or -- as an example.

And yes, we always take a look at that, but some of that deployment might change going forward. But the balanced approach in terms of -- the share repurchases, we'll finish that, to mergers and acquisitions if we see them become actionable. We have a nice portfolio of opportunities. And then into investing in ourselves. We're going to continue that. And we see that cash conversion of the company stable and being able to support all 3.

Operator

(Operator Instructions) and there are no further questions at this time. I'd like to turn the call back to Mr. Dietrich for any additional or closing remarks.

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

Thanks, Jennifer. I appreciate that. Listen, thanks to everyone for joining today. Again, I encourage you to check out our website and take a look at our sustainability report. It really is a comprehensive view of all that we do as a company and a testament to our employee base and all that they're doing to help with our sustainability efforts. Please check it out, happy to answer any questions you have after you review -- thanks a lot. Appreciate the time today.

Operator

And this concludes today's conference. Thank you all for your participation. You may now disconnect.
