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MTX.N - Q3 2022 Minerals Technologies Inc Earnings Call

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## PRESENTATION

**Operator**

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

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

Thank you, Jenny. Good morning, everyone, and welcome to our Third 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?

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

Thanks, Erik. Good morning, everyone, and thank you for joining our call. We've got quite a bit to go over today so let's get started. First, I want to quickly mention that MTI celebrated its 30th anniversary this week. We debuted as a public company in 1992 with revenue of $400 million. Over the past 30 years, the company has grown and transformed into a global specialty minerals leader with operations in 38 countries and revenues of over $2 billion. I want to congratulate all employees of MTI, past and current, for their dedication and contributions to this journey.

Now a quick outline for today's call. I'll begin by walking you through our financial results for the Third Quarter and provide some context to put our results into perspective. I also want to walk you through the execution of our growth strategy and give some examples of how we're positioned to continue to drive higher levels of growth and performance. Finally, I'll share some perspectives on what's happening around our end markets and our near-term outlook.

Then Matt will share details of our financial results and our outlook for the fourth quarter.

Let's start with a recap of the quarter. Our track record of growth continued in the Third Quarter with sales up 22% on a constant currency basis to $542 million. Each of our segments realized double-digit sales growth, reflective of our efforts to position the company on a higher growth trajectory. In general, this is one of the more challenging quarters from a market and cost perspective and the risks to our guidance that we highlighted during our second quarter call came to pass. We saw softer-than-expected demand in Europe, higher energy costs and a sluggish rebound in China. Foreign exchange rates were also a more significant drag on sales and earnings. Going into the quarter, we expected some moderation of inflationary pressures, but we ended up experiencing the highest inflationary period of the year.

Despite these challenges, the majority of our product lines performed well. Our pricing actions more than offset the higher inflation and our acquisitions delivered, all of which offset the market weakness we experienced and resulted in operating income of $67 million, 6% higher than last year.

I'll also note that we recorded special items in the quarter. One was a reserve established to cover ongoing talc-related litigation. Given the current environment of talc-product litigation, we felt it was prudent at this point to reserve for potential additional costs. Matt will outline this and the other charges in more detail later. Excluding these special charge items, earnings per share was $1.35, continuing our trend of year-over-year earnings growth. We also moved quickly in the quarter and took steps to strengthen and enhance the flexibility of our balance sheet by refinancing our debt and extending maturities out through 2027.

Overall, this is a strong quarter for MTI, although it played out a bit differently than we expected when we last spoke to you. The team continues to take advantage of the opportunities presented to us as well as navigate the challenges we face around the globe. Focus, discipline and agility are the characteristics that describe our team. Same characteristics are what make MTI well positioned to continue on our strong track.

Now I'll go to the next slide where I'll take you through the sources of the broad-based growth we realized in the third quarter. MTI's growth strategy focuses on 3 key areas: positioning our businesses in faster-growing markets and geographies, accelerating the development of new products and technologies and the acquisition of companies that help advance these efforts. Through the execution of this strategy over the past several years, we've built a portfolio of businesses which is more resilient with a greater mix of sales to noncyclical and growing markets that is positioned for continued growth.

Once again, in this quarter, we saw the impact of this strategy. Sales increased 22% over last year, with broad-based growth driven by the 3 pillars of this strategy. Let me take you through each in more detail.

Our success in market positioning is highlighted by the build-out of our consumer-oriented product lines and the positioning of our more industrial businesses in faster-growing regions. Sales from base volumes and mix improved by 6% this quarter. Our less cyclical consumer-oriented markets led the way with our household and personal care product line, growing 16% over last year, driven by growth in pet care and our edible oil purification business.

We continue to position our industrial product lines in faster-growing geographies and utilize our applications expertise to drive the penetration of our core technologies in these markets. We've steadily grown sales in the Asia foundry and paper and packaging markets, and sales there this quarter, excluding China, increased by 7%, driven by a 13% growth in India as our PCC and Metalcasting business continued to strengthen positions in their respective markets.

We maintained our focus on offsetting the inflation we're experiencing, pricing actions added 13% to our overall sales this quarter. Our ability to price is derived from the value we provide to customers every day. Our base technologies, applications expertise and pricing structure work in tandem to ensure we continue to deliver sustainable value for our customers.

The second pillar of our strategy, which is delivering results, is accelerating the development of new products and technologies. Innovation is alive and well at MTI, creating new solutions for our customers. Solutions that save them money, enhance the performance of their products, reduce their environmental footprint and eliminate or recycle waste streams. Our newest products continue to contribute more meaningfully to our top line, adding 3 percentage points to our organic growth in the third quarter. In fact, sales of new products are up 48% year-to-date versus last year and now make up 14% of MTI's total sales, up from 11% last year. Our newest innovations address a variety of needs in markets that touch millions of lives every day.

A few examples include, in Fabric Care, our newest hueing particle additive is the application of a technology that makes whites whiter and colors brighter in dry laundry detergent. Our Pet Care business has developed new low dusting cat litter, which keeps households cleaner, and we recently introduced new cat litter box fragrance boosters. Our Specialties product line has commercialized more efficient bleaching earth products that further extend the shelf life of edible oil.

We also have several new innovations for our industrial markets. In Metalcasting, we've secured new sales for our low-emission greensand bond blends, which reduce emissions in the casting process. We've deployed new high-durability refractory materials in Europe and are currently commissioning our first Scantrol (TM) automated refractory application and laser measurement system here in the United States. We commercialized 2 new coated ultrafine specialty PCCs, which are specialty additives that provide critical viscosity control to our customers' products.

These are just a few examples of the breadth of new product development occurring across the company.

The third pillar of our strategy is acquisitions. The addition of mineral-based companies with value-added technologies has been a key contributor to our success. Over the last 4 years, we've acquired 4 companies that support our strategy, representing nearly $300 million in sales. 3 of them were aimed at building out our pet care business, which as a result, is now the largest product line in the company. We maintain a pipeline of attractive consumer and industrial-based opportunities that we feel fit our strategy, and we have the financial strength to execute on them if they become actionable.

Before I move on, I want to point out the bottom of this slide, what is graphically and literally our foundation. The ability to innovate, develop leading technology platforms and the expertise and know-how to apply our technologies and our customers' products and processes. The strength and longevity of our vertically integrated and unique mineral reserve positions around the world and the engagement and support of our employees who support our values and culture of operational excellence. We build on this foundation every day to drive value for our customers and shareholders.

Now I'll take you through some dynamics that are playing out across our end markets. As I mentioned earlier, the economic environment continues to evolve, and we saw several market shifts in the third quarter. I want to take a few minutes to share our current view of our end markets and the near-term outlook for our major product line.

Like most, our company is not immune to macroeconomic factors. The decisions we've made over the past several years have placed our company in a stronger position than it's ever been to weather economic challenges and continue to deliver consistent growth and performance.

This slide shows our market outlook by product line. I noted a couple of additional items on the slide. The blue section in each circle represents the amount of each segment sales that are consumer-oriented and more directly driven by consumer behaviors. Also next to each product line, we've listed the percentage of MTI sales that each product line represents.

Let's start with our Performance Materials segment. This is our largest segment, and you can see that approximately half of its sales are consumer-oriented. Starting from the top, Household and Personal Care, our largest product line, has a solidly positive market outlook which continues to benefit from favorable consumer trends and strong sales from our newest products.

This product line includes Pet Care, Fabric Care, Health and Beauty and our Oil Purification products, along with other nonindustrial specialties. In general, this product line serves end markets that are more closely tied to consumer staples, enabling it to better sustain sales levels through economic cycles. Furthermore, we're strongly positioned on the private label side of both the pet care and personal care markets. Private label brands are a growing category across consumer packaged goods, and they also tend to perform well when customers are looking for ways to save at the store shelf and make more economical choices.

Demand for household items like pet litter, over-the-counter active skin care products, fabric care additives and edible oils are poised to grow over the longer term, driven by increases in population and the general rise in global income.

Next is Metalcasting. This business also has a solid market outlook through the fourth quarter and is benefiting from strong automotive, heavy equipment and infrastructure casting demand in North America. The China foundry market has been much slower this year. However, we saw an increased demand late in the third quarter and expect this improvement to continue. Further out, we're well positioned to continue to penetrate foundry markets around the world with our leading technologies and see ample runway to continue our growth trajectory.

Our Environmental Products business, which has historically been driven by industrial landfill lining systems has a growing focus on consumer drinking water and municipal cleanup efforts. We have a balanced view of this business into the fourth quarter. We see strong markets for our water remediation products like Fluoro-sorb (R), which targets PFAS contamination and ground and drinking water and continued solid demand for our offshore water filtration and well testing. The other factor giving more balance to our outlook is that we will experience the typical seasonal reduction in the number of landfill lining projects as we move into colder months.

Our Building Materials product line primarily serves commercial construction and infrastructure end markets. We have a cautious outlook here, but we have seen a general slowdown in the European construction market that will likely extend into next year. Our project pipeline for North America, however, remains relatively strong at least through the fourth quarter.

Now let's move to Specialty Minerals. We have a balanced outlook for our Paper PCC business. Volumes will continue to grow in India from our latest satellites, and North American volumes will remain strong, driven by high paper machine utilization rates. We also see a modest near-term recovery in China, which will likely extend into next year. Offsetting this, we see continued softer conditions in Europe due to generally weaker economic conditions and higher energy prices.

Our Specialty PCC and Processed Minerals product lines serve construction, auto and consumer markets. We see continued favorable trends in the consumer segment, solid demand for antacid and food and beverage calcium fortification applications. Additionally, both Specialty PCC and Processed Minerals products continue to benefit from strengthening auto production, which should keep demand relatively solid through the fourth quarter and into next year. This, however, is balanced against a less favorable outlook for sales into residential construction materials.

In Refractories, we have a balanced but perhaps cautious outlook going into the fourth quarter. We did see some softening in this business in the third quarter, with North American steel utilization rates moving from 79 to around 76%, which is where we expect them to remain through the fourth quarter. European steel market also slowed through the third quarter, and we could see further softening into the fourth. We secured several contracts for our new Scantrol (TM) devices, our latest innovation that is delivering higher value for our customers, which will add incremental sales and profits next year. These devices are representative of the innovation happening in this business that has fundamentally transformed it for higher levels of profitability.

In summary, the business environment has certainly changed from where we began the year, shifting economic and market conditions, persistent inflation, supply chain and labor market challenges and foreign exchange movements have combined for, shall I say, an interesting business environment. Despite all of this, we have a positive or balanced outlook for 80% of the company's markets through the fourth quarter, and we remain on track for another record year of earnings. We do recognize that the environment can change rapidly, but our focus, discipline and agility are characteristics of our team that enable us to continue to successfully navigate what lies ahead. Our portfolio of businesses is much different today, more balanced and it's structured to deliver consistent, solid relative growth and performance through economic cycles. With that, I'll pass it over to Matt to review the financials in more detail. Matt?

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

Thanks, Doug, and hello, everyone. I'll take you through the third quarter results, the performance of our segments, and I'll also share our outlook for the fourth quarter. And then following my remarks, we will turn the call over for questions.

And now let's review the third quarter results. Third quarter sales were $542 million, 15% above the prior year and 22% higher on a constant currency basis. Starting with the sales bridge on the top left, you can see that foreign exchange impacted growth unfavorably by 7 percentage points or $33 million. Acquisitions contributed 3% to the overall growth in sales driven by Concept Pet, our new SPCC assets and approximately 1 month of incremental sales from Normerica. Our continued selling price actions drove sales higher by 13% over last year and improved volume and mix added 6% to sales driven by higher Metalcasting volumes, continued growth from new contract wins in Refractories, higher levels of activity in our project-oriented businesses as well as an increase in sales from new products.

Operating income in the third quarter, excluding special items, increased by $4 million over the prior year to $67.2 million. We continued to implement selling price increases during the quarter amid the persistent inflationary environment. As Doug mentioned, the $51 million of inflationary cost increases was the highest level we have experienced in any quarter this year. You can see in the operating income bridge on the lower left-hand side that our selling price actions exceeded the inflationary cost increases by $8 million. Offsetting this was $2.6 million of unfavorable foreign exchange and another $2.6 million of other costs, including SG&A wage inflation and other operational costs.

Now turning to the right side of the slide. The sequential sales bridge shows that sales were lower by 1% on a constant currency basis. Continued selling price actions were offset by slower demand in Europe, softer steel market conditions and typical seasonal foundry maintenance outages.

Adjusted operating income was lower by 9% sequentially, driven by volume and unfavorable foreign exchange of $2 million. We experienced inflation of approximately $4 million higher than we expected at the start of the quarter due to significant energy cost increases in Europe. And as you can see, we were able to fully offset the additional inflation with price adjustments.

Relative to the guidance we provided at the start of the quarter, our operating income was impacted by softer demand than expected in Europe and China and unfavorable foreign exchange.

Now let me share a reconciliation of reported EPS to adjusted EPS. Third quarter reported earnings per share were $0.41. During the quarter, the company recorded special items of $38.7 million, primarily consisting of $31.1 million for litigation costs and $6.9 million for debt extinguishment costs related to the refinance.

The litigation costs were incurred to defend against, opportunistically settle, and establish a reserve for claims associated with certain talc products from the Barrett's Minerals Inc. subsidiary. The company's position is that all talc-products sold by Barrett Minerals are safe and these claims are without merit. We have a relatively limited number of cases, but they do require legal preparation and the proper response, hence our decision to prudently set aside a legal reserve to resolve them.

And now let's review the segments in more detail, starting with Performance Materials. Sales for the Performance Materials segment were $290 million in the third quarter, an increase of 16% versus the prior year and 24% higher on a constant currency basis. This sales growth was driven by strong demand for consumer-oriented products, continued selling price actions as well as strength in Metalcasting, particularly in North America.

Sales in Household, Personal Care and Specialty Products increased by 16% compared to prior year and were 1% higher sequentially. Pet Care acquisitions and higher sales in our Personal Care and Edible Oil Purification businesses drove the growth compared to prior year.

Sales in our Metalcasting business were 17% higher than Europe year-over-year as a result of strong volumes in North America. Sales were 4% lower sequentially on the previously mentioned maintenance outages at our North America foundry customers. We did see a modest improvement in China volumes. However, the improvement lagged our expectations and volumes remain below prior year levels.

Environmental Product sales grew 20% versus the prior year on strength in remediation, wastewater and filtration activities, but were 12% lower sequentially due to the timing of projects and Building Material sales were slightly lower year-over-year and sequentially, as higher levels of project activity in North America were more than offset by slower activity levels in Europe.

Operating income, excluding special items, was $38.2 million and represented 13.2% of sales, 20 basis points above the prior year and sequential quarter as pricing actions offset inflationary cost pressures. The segment largely met our expectations for operating income in the quarter, as strength in the Household and Personal Care product line and North America Metalcasting offset the slower-than-expected rebound in Metalcasting demand in China.

Now looking ahead to the fourth quarter. We are entering a seasonally stronger period for Pet Care in both North America and Europe. In Metalcasting, we see continued strong demand in North America and improvement in China with the rest of the Asia region remaining strong.

Meanwhile, we are entering a seasonally slower period for our environmental, commercial construction and drilling products businesses. Given the typical seasonality, we expect segment operating income to be lower by approximately $4 million sequentially. In addition, there continues to be uncertainty in Europe, and we could see continued slowing industrial markets and additional inflationary cost increases.

And now let's take a look at Specialty Minerals. Third quarter sales in the Specialty Minerals segment were $166 million, an increase of 13% compared to prior year and 18% higher on a constant currency basis.

Global PCC sales were higher by 14% versus last year, with Paper PCC up 9%, driven primarily by contractual selling price increases. Sales in Asia were lower than prior year on soft conditions in China and weaker-than-expected demand in Europe due to increasing economic challenges in the region related to energy costs.

Specialty PCC sales were 40% higher year-over-year, driven by continued strong demand in North America, higher pricing and the asset acquisition in the fourth quarter of last year. Processed Minerals sales also grew year-over-year, rising by 9%.

Operating income in this segment, excluding special items, was $16.9 million and represented 10.2% of sales. Softer demand in Europe, higher energy costs and higher operational costs impacted results by $3 million against our expectations. In addition, the segment absorbed $21 million of raw material and energy inflation in the quarter, and we've been passing this cost through to our customers in price adjustments. As you are aware, some of these costs are passed through on a contractual basis, and there is a lag as to when these adjustments will take effect and improve margin.

Now looking to the fourth quarter. In Processed Minerals and SPCC, we are entering a seasonally lower period for our construction end markets, but we are seeing volumes to the automotive market remaining strong. We also expect our Paper PCC business to have a similar quarter sequentially. And overall for this segment, we expect operating income to be similar to the third quarter.

And now let's move to Refractories. Refractory sales increased 13% versus the prior year and sales grew 20% on a constant currency basis on the continued ramp-up of new business volumes and higher pricing to cover inflationary cost increases. Sales were 8% lower sequentially due to softer global steel market conditions and resulting lower utilization rates.

Operating income was $12.4 million, roughly $1 million lower than anticipated and margin remained strong at 14.5% of sales. Performance was impacted by higher energy costs in our manufacturing location in Turkey, unfavorable foreign exchange and softer-than-expected steel market conditions.

Now looking ahead, we expect a strong fourth quarter for laser equipment sales. We see North America steel market conditions remaining at similar levels for the third quarter however, we anticipate some softening in Europe. In addition, we see continued higher energy costs for our Turkish operations. The net effect of this will result in operating income of approximately one to $2 million lower sequentially.

Now let's take a look at our debt and liquidity. We completed the refinancing of our revolving credit facility and term loan B during the quarter, which extended maturities from 2023 and 2024 out to 2027. As a result of the refinancing, our overall interest rate was reduced by 50 basis points and our fixed to floating ratio remained roughly 50%.

Cash from operations for the quarter was $30 million, and we deployed $19 million of capital expenditures. While we expect a strong fourth quarter free cash flow of around $70 million, inflationary factors have increased our working capital. As the inflationary pressures abate, we see working capital releasing and a return to more normal levels of cash flow. Overall, our liquidity remains very strong at over $400 million.

And now let me summarize our outlook for the fourth quarter. Demand remains strong in our consumer-oriented product lines and solid across most of our end markets in North America, although note that we do see the typical seasonality in our construction end markets.

In Asia, we see continued modest improvement in China with stable conditions elsewhere in the region, which should benefit our Metalcasting and PCC businesses. In Europe, we expect industrial market conditions to remain soft, and we could see higher energy and related input costs as we move into the winter months. Overall, we expect operating income to be around $60 million, which would be 10% above last year and EPS of $1.20. From where we sit today, the fourth quarter reflects continued year-over-year growth, driven by ongoing execution of our strategic growth initiatives and solid operating performance. Today's guidance equates to full year EPS of around $5.40. This is 8% growth versus 2021 and a testament to the resilience of our portfolio and the perseverance of our team. With that, let's move to Q&A.

## QUESTIONS AND ANSWERS

**Operator**

Thank you. (Operator Instructions) and our first question comes from Daniel Moore from CJS Securities

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

Thank you Doug and Matt, thanks for taking my questions.

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

Hi Dan.

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

Good morning. Let me start with Performance Materials. If we just maybe talk about volume versus pricing for both household personal pet care and this kind of same question for Metalcasting, what you saw in Q3.

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

Sure, Matt, do you want to take that or?

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

Yes, absolutely. So I think, Dan, when you take a look, the team did a really good job in continuing to drive price. If we break it down for the segment, we're still net kind of $5 million ahead of the inflationary factors that they saw. But you are seeing very good year-over-year volume growth across Metalcasting, the Pet Care business that's helping to drive that and also other components of HPC and that specialty business, where the team has been making advances. It might be good, Jon if you want to give some color on some of those components?

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

Sure. You wanted me to highlight Specialty Matt.

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

Sure.

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

Hi, Dan, especially, we've got a nice balance of unique product positions. Certainly, we've got our Personal Care, which we talk about embedded in that business. We also have talked at length about edible oil. Both of those are growing, we look for opportunities to continue debottlenecking our plants to push more capacity through. So as demand continues to grow, we have the ability to serve. We've got other Specialty segments as well. So we're in human health. We're in ag. We're in - we have a segment called Advanced Performance Additives. We're also in Drilling Products for both oil and gas and water well drilling. So it's a wide variety. And certainly, we've got growth across the entire portfolio. This is predicated on our strategy. Our strategy is very consistent across the company, but it's really playing out in Specialties. It's geographic growth, it's growth through innovation. We have about 50% of our new products in this segment going through that Specialty business. So a lot of factors all coming together with great demand and well positioned with high-value products.

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

Yes. And one other thing, Dan, you know, as far as Metalcasting goes, if you take a look, what we talked about was on a regional basis, really good performance in North America. Again, Jon has talked about the mix of end markets that we serve there with automotive continuing to trend well, but those other markets performing very well amongst our customers. And then China, what we talked about is, yes, it wasn't as strong as we expected, but we did see a nice uptick in the third month of the quarter, so in September, with really nice demand coming back into place. So that helped to really set some of the trajectory that we were looking at for the fourth quarter of continued improvement in metal casting.

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

And if I could add to that, Matt, we do see we track our daily sales and what we've seen in Metalcasting, daily sales in Asia ever since May every month has increased. We had a nice increase, like you highlighted in September. Going into Q4, again, we see that demand continue to increase. A little slower than what we expected, but still very well positioned. And we're not sleeping there, you know, as the markets have been slow, that team, and we've got a great leader, a great team and their positioning with customers, and we've won some new customers. So our share positions are continuing to increase with our blended products and our positions with those customers.

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

You kind of read my mind, I was going to just dig into Metalcasting given the strength of the outlook that you described, maybe try to get a sense of how much is increased penetration or set assume the way share gains versus positive market outlook.

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

Yes. So we're seeing, Dan this is Doug, as Matt and Jon kind of mentioned, volumes are still remaining very strong in North America. We see that automotive demand, heavy equipment is going to continue to drive volumes through the fourth quarter, and we see into next year. I think China is the weakest spot of the year so far. However, the uptick that we saw in September is going to, we think, continue at a moderate pace. It's not going to rebound. We don't see that drastically, but it's going to continue to grow through the fourth quarter and into next year. A lot of that is coming from our positioning, and you mentioned price before. Our ability to price is coming some from our ability and our applications of these greensand bond products, our blended products in China. And as they become much more of a staple to more modern casting processes, our ability to drive more value and therefore, continue to drive more price is behind that. So we're positive on that, both the Pet Care and the Metalcasting as we showed from that slide going into the fourth and into next year.

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

Perfect. Maybe one more, just digging down into the edible and purification oils. Any sense for kind of what run rate revenue we're at and just who are your primary customers? Is it larger CPGs? Is it smaller niche companies? Where are you gaining the most traction and is it mostly North America or pretty well balanced in North America and Europe since we're hearing more about that quarter in, quarter out, thank you.

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

Yes, these are so our business is largely in Europe right now. Our production and sales are in the Europe region for edible oils. You know that's grown from 0 a couple of years ago as we've entered into this market. We're growing -- we'll discover probably in the $20 million, $25 million range growing very quickly, as I mentioned this quarter. Customers are large ag oil producers were talking the Bunges, others of the world like that. So big ag customers that are into soybean and oil production. And so we've seen our business grow along with them.

As I mentioned, we've developed some new products, very high efficient purification products, which helps them in their processes, process speed, their capacity utilizations and therefore, also, and I guess, I'll call it, purifying or cleaning up the oil to levels that extend shelf life. So real value for them and efficiency value for them and a nice premium product for us. We continue to look to expand that business. Jon mentioned debottlenecking. We've done a number of investments to continue to maximize the asset utilization for what we've invested in. And we're also looking to continue to invest in that business so that we can grow at this pace along with our customers.

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

That's helpful, Doug. Yes, it does. I will jump back within it maybe 1 or 2 follow-ups, thanks

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

Thanks Dan.

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**Operator**

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

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

Hi, Good morning.

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

Hi Mike.

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

I was hoping that we could dig in a little bit on the margin performance, particularly in Specialty Minerals and Refractories. I guess, first of all, on Specialty Minerals. It seems like you've kind of taken a step back in terms of that price/cost recovery trajectory. Maybe just flesh out in a little bit more detail what you guys were seeing in terms of cost and maybe how we should see margin track over the next couple of quarters as those higher costs are passed through in some cases, contractually.

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

Yes, absolutely. I'm going to start off and then I'll give it to Matt to give you some more details. This is definitely and has been all year, the segment and the product lines that have been impacted the most from currency, from energy inflation, raw material inflation, #1. #2 it's as we talk about all the time, this business has the most contractual nature to its sales. And in that, in those contracts, the timing of our ability to pass through pricing. So what you saw you've seen this year as we've seen persistent inflation, persistent energy, we absorbed that in our income statement until we can pass that through and that lag can be 3 months, to 6 months. And so, years past, that happened both up and down, and we'd absorb in the kind of hundreds of thousands of dollars of kind of range. What you're seeing this quarter is in the millions. Matt will describe those types, but I want you to know that they do get passed through contractually. So there is this delay. It weighs on our current quarter. We see that in our margins, but then in about 3 months, probably January, a lot of this gets moved through into our customers. Now those margins will rebound and they'll rebound as inflation starts to plan over, our pricing catches up contractually and you'll see those margins rebound significantly. Matt, do you want to give some details of the...

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

And that's exactly what we spoke to. I mean take, for instance, again, we talked about it in the prepared remarks. We saw about $21 million of inflation in that segment alone, a net of which I said was probably 2 to $3 million that will come with a lag on it. So we will capture that. And if all else stays equal, Mike, that goes back to sort of recovering and establishing the margin.

I think the broader point, and I know you talked about Refractories as well, but let's just step back for a minute and talk about the company's journey over the past 2 years. So coming out of 2020, we've absorbed $75 million of inflation in 2021. So far in 2022, we've absorbed about $135 million in inflation. So that's $210 million inflation in 2 years. And although we've captured most of that in pricing, that in itself is dilutive to margin by about 200 basis points. So the company generating about 14.5% back in that early 2020 time frame and now this quarter, around 12.5%, 12.4%, 200 basis points of that difference is the dilution in the margin from passing through these inflationary costs. So that speaks to, one, the great work by the team to capture those costs, pass them through. Two, if you recall, we came into this year expecting about $40 million of pricing. That $40 million was to catch up on inflationary costs from '21 but also $20 million to reestablish our margin. We'll continue to work on that as we go forward. Again, capturing those inflationary costs, yes, but then reestablishing our margin based on all the things that you heard Doug talk about; the great position of our products, the great position and technical capability we have with our customers and also introducing new products. So that's what gives us the confidence that as those inflationary factors start to plan over, about 35% of the company has contractual lags in that pricing. That will come, and the teams are working on the other 65% to reestablish that margin as we move forward.

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

All right. And then over on the Refractories segment, you mentioned a couple of times the higher costs that you're seeing in Turkey. Maybe give a little bit more color on what you're seeing there. And then also curious on the MgO market in terms of the raw materials that you're using in Refractories. I believe that you stocked up on some of that material before we saw big price run-ups. And I'm just curious kind of where you're seeing the, how you're seeing, the cost structure for Refractories raw materials play out as we get into 2023. Sure.

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

So the cost increases that you saw in refractories this quarter was, as you mentioned in Turkey, it's energy related. And so we do produce our own magnesium oxide. We buy magnesite ore and center ourselves in Turkey, and it supplies roughly 35 to 50% at times of our base raw material production for Europe, our refractory production in Europe. And so that cost came in, in energy as we center and we're moving that through in pricing to customers, but that was a large increase that we saw through the quarter. Magnesium oxide prices in general, we do source from around the world. We source from China. We source from other regions. Last year, you're right, we did take advantage of some dislocations, not dislocations, but some lower pricing in the market, and we stocked up. And that was done for 2 reasons. One, we found some good opportunities for pricing and also we wanted to buy ahead of, if you remember, the Olympics that were in China to make sure that we loaded everything out of the country before that potential disruption. We've largely used through that. But again, we're in a position now where, given the conditions in China, we're starting to see some good pricing, taking advantage of things, not just in magnesium oxide, but in other raw materials. And so therefore, we're looking at making some opportunistic purchases this year to extend us into next year. So there are some areas that we are seeing some planning over of inflation. We're taking advantage of them, but I think the vast majority of what we saw in the quarter and what we think we're going to probably see in the fourth quarter is energy-related and energy-related here in the United States and in Europe. Does that help, Mike?

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

Yes, very helpful, thank you. And then my last question is on the talc litigation. I'm curious if you can let us know how many cases were settled and how many cases are still pending. And I'm also curious of the $31 million charge, how much of that is a cash impact? And how much of that is a reserve that is a noncash expense for now?

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

Yes. Sure, let me take you first through the charge, so to clarify that. As Matt mentioned, there's 3 components to that, it's both defense costs in the quarter, some settlement costs and then a reserve to establish. Let me outline a little bit for you in talc. I think I mentioned on the last call that talc it's about a $50 million business for us. And the cases that we have against the talc business right now are against our legacy cosmetic talc and cosmetic talc has been 2 to $3 million, is a tiny piece of that business, a very small piece of the company. We discontinued those products in 2016. And so because of that, we have a relatively limited number of cases. But when we've been defending ourselves over the past several years, actually, I mentioned that on the last call that we've been incurring more litigation costs. And as we went into the quarter, we made the decision to settle several of them.

But also looking at the litigation environment in general, we said, well, look, we have about 450 remaining cases against the company. We wanted to take a look at that and make sure that we assess any potential future liability that, that holds given our litigation strategy. And so we felt it was prudent to take the reserve this quarter. So it's a portion of that 31. Now I don't want to break out for you the components. I want to, you know, a portion of that 31 is that reserve for these potential future liabilities. But I don't want to give you that, that's part of our litigation strategy. As far as cash flows, a portion of the cash flows in the third quarter within our cash flows will be a bit more in the fourth quarter, but the bulk of it is noncash that will be set aside for resolving these cases as going forward, as Matt mentioned. Does that help dimension it for you?

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

That's very helpful. Thank you very much.

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**Operator**

And our next question comes from David Silver at CL King.

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

Yes, hi, thank you. I think I just if you wouldn't mind, I'd like to just go back to the talc question for just a moment. But maybe just to clarify, but of the cases at issue here, are the parties all focused on, I guess, the cosmetic use of talc or is there some litigation that might be related to industrial or non-cosmetic use of the product? Just what is the range of the parties who are filing the suits, just what parts of the talc business are at issue Okay. I'll stop there.

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

Hi, David, these are cosmetic talc applications, as I mentioned, a very small portion of the talc business, not the industrial application. And they're all associated with lung issues, and that's right, I'll stop there.

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

Okay. Great.

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

Does that help?

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

Okay, thank you for that. So next question, I think I'd like to ask you is about the PCC businesses. So they showed a very nice revenue gain sequentially and whatnot and year-over-year double digit. And I was just wondering if you could characterize a little more detail, the source of the increase. So in particular, I'm wondering if there are some new project, or new satellite plant start-ups in there or if it's just higher utilization from your existing network? In other words, what it seems like there's a lagging price effect. So maybe if you could just talk about the source of the double-digit year-over-year increase

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

Yes, sure. I'll start, and then I'll pass to DJ to give you some more details. Look, we've seen as you know, we've built a number of PCC satellites in India. We've got a new one ramping up in China over the past several years. And what we saw in the quarter is really just the stronger volumes from those new satellites. And you also see strong demand in Europe. I will tell you, utilization rates, paper machine utilization rates are very high in the United States. We are selling just about every ton of PCC we can make here in the United States that's behind that. A little bit slower in China but we still see a really strong pipeline of opportunities. I'll let D.J. kind of highlight more of those and some of the business development activities.

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

Glad to, Doug. So David, a couple of things. Regarding new satellites, nothing really significant yet, but you're going to start seeing in this quarter and really ramping up in the early part of 2023 is the new satellite that we had previously mentioned. Baiyun's about a 50,000 ton satellite. In January, we're going to have another satellite turn on in India. And then just a reminder, we had announced last year a major new product for us in packaging, white packaging, and that is a GCC satellite in China, and that is still on track to kick in on the second half of next year. So those are all things in building, in commissioning of things to come.

On top of that, I look at the pipeline, there's pretty significant pipeline that's still underway. It's reasonable for you to think it's about 15 to 20 sort of discussions that are going on split between Asia and Americas and Europe pretty evenly. In Asia, it's traditional PCC plus some penetration in the packaging. And in the Americas and Europe, it tends to be these newer products, these environmentally focused products and packaging so that's kind of where the pipeline is evolving to. But in terms of what you're seeing now, the big part of it, as Matt mentioned, is price with still more to come to recover on that energy and then the volumes on those projects will start kicking in really early part of next year. I hope that gives you the color.

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

And yes, no thank you for that. And if I could just follow up quickly. But from your experience, DJ, does the prospect of like a slowing global economy, let's say, impact the capture rate for these new project opportunities. How do customers typically respond to a slowing economy when they're considering a new satellite project or a packaging conversion?

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

So in general, it creates more opportunity for us, certainly, the urgency of the conversations cranks up during these periods. There's 2 things driving that. The first thing is most of the customers look at it as a chance to reposition and upgrade on their quality. The second thing, especially when you're dealing with these energy prices, we've had big price increases, but it's against the increases that they're seeing in their pulp. It's against the increases that they're seeing in drying their paper and our products help with both of those parts of the value equation. So I would say that what I've been experiencing most recently is an increase in interest on the traditional products and our newer products. So that's what's still holding out now.

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

Okay. Great. And then I did have one more question within Performance Materials on Environmental Products in particular. So second quarter and third quarter together, that's over $100 million of revenue from that product line. And I mean that historically, that's a very strong trend. So just a couple of questions about that. But first, could you just kind of speak to, let's say, the backlog or the order book for new environmental products-based project work? And then secondly, if you could just give us an update on Fluoro-sorb(R) sales and beta testing and development like that? That would be helpful.

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

Sure. Let me start and then I'll give it to Jon. We have seen some really good growth in this business. As I mentioned, several years or for several years, this is our Environmental Products business has been based on lining systems. So geosynthetic liners for municipal and industrial landfill use. Over the past couple of years, we've spent a lot of time and innovation in more water applications, remediation applications. And our PFAS product, our Fluoro-sorb(R) products is one of those outcomes. And so we are moving this business and we've seen a tremendous amount of growth on the water side of things and even more so looking at drinking water applications. And so a lot of our newest technologies are on that remediation. We think that it's obviously a growing market. There's a number of factors there. One, obviously, the consumer side of it in terms of protection of drinking water, but also the municipal side of it, which though there isn't a regulation necessarily to a level of remediation cleanup by the government there is municipal interest and local interest in cleanup efforts, and we've been taking part in that. So a real shift toward more of the water side of things and remediation side of things. And Jon, you want to give more detail on some of the Fluoro-sorb(R) and the projects that we have in the backlog.

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

Sure. I appreciate the question. I guess think about the magnitude of what we're doing and who we're working with. First, put it in terms of pilots. We've had about 100 successful pilots demonstrating the activity of the product and the success of the product. And that certainly sets the stage for commercialization. We've been talking about that for quite some time. we have started to see the ramp-up of commercialization.

So it's broken into a couple of different segments. If you think about in-situ soil stabilization, this is what we've been doing with some of the defense department. And we've got a major installation with the DoD site. We've had 2 industrial sites. We've got 2 mobile filtration units that were moving around, all generating sales and revenue. The second segment is drinking water, like Doug described. This has the potential to just be continuous business as they use the media and we replenish the media. And right now, we've got 2 orders for full-scale water purification systems and that will be, we suspect, a great entry into the utility segment. Once we demonstrate full-scale commercial success, we believe others will be watching that, and we have the potential to continue to grow that.

And then the last segment is landfills. And during the quarter, we had 2 systems go in. We've got another order for another system. We've had one in place for over a year now so again, that's kind of our bed and butter as well. So 3 segments all have significant potential. We believe that what's really going to drive this is regulation and once regulations get in place with the technology being fully demonstrated, we'll have the ability to grow that exponentially. I hope that provides some color

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

I like the word exponential. Okay. Thank you very much. I appreciate all the color.

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

Thanks, David.

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

I almost had to hold Jon back there on the exponential number, but yes, no, good growth.

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**Operator**

(Operator Instructions) And we'll take our next question from Daniel Moore at CJS Securities.

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

Hi Dan, are you there? Operator, did we lose Dan?

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**Operator**

No. We still have Dan connected, Dan your line is open. Would you like to go ahead and ask a question or maybe we did lose him. Would you like to go to the next question and possibly have Dan recue.

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

That would be fine.

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

Okay. Our next question comes from David Silver at CL King.

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

I'm not going to say I had anything to do with that, but anyway when I have to get a follow-up and I'll go to any extreme Anyway, sorry about that. I just wanted to touch base real quickly. Thanks for laughing that's all I could come up with on short notice, but okay. So cash flow and in particular working capital. So I would just say, over the last several quarters, there has been a pretty significant buildup in the use of working capital. And certainly, there's been some buffer inventories and some accommodations to supply chain issues and whatnot. But I'm just wondering, if I look over the last 4 to 6 quarters, I mean, the net increase in working capital build has been pretty substantial. And I'm just wondering if you could, you know, 2 things, I mean, could you cite maybe the strategic rationale behind that? And then secondly, how do you anticipate that level of working capital progressing, let's say, over the next quarter or 2, thank you.

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

Sure. Yes. Thanks, David. A few things. One, we look at it on a multitude of factors. And like you said, as we move through the course of the period you just laid out, we did have strategic inventories that we put in place. We've managed through some of the higher revenue periods in the second and third quarters. And then we have strategic inventories that go back in place ahead of the winter months on the mining businesses. But in all of that, you need to take a look at the efficiencies.

And from a days on hand perspective, we're essentially flat year-over-year. And so what does that tell you? It tells you that we are inventorying as we need for the revenues that we are generating. Now the inflationary inputs that we've been experiencing have been driving that, yes, both on the revenue side and on the inventory side. But the net efficiencies, so the actual units of what we're holding are pretty much in line with where they needed to be and where they've been over the past several quarters. So as those inflationary factors, that's what we said in the prepared remarks and what we've said over the past couple of quarters is as those inflationary factors abate, that working capital will release. And remember, we kind of have sort of 60, 70-day terms. And so you would see that take place in that type of time lag. And so a few factors there for you to consider. One, inflationary impact has been in that 70 to 90 million range depending on if you're going year-over-year or 6 quarters back. And then that will work itself out on a 60-day basis once you start to see those inflationary factors stabilize.

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

And Dan, I'll just add, we don't see there's no change to the characteristics of the company in terms of its cash flow generation potential. As a matter of fact, as we continue to add product lines that we feel less cyclical, higher margin, we should enhance that going forward. I think like you're saying, and I think many companies are seeing this inflation being parked on the balance sheet. And as it starts to plan over, we will revert to normal kind of cash flow yield type characteristics. So it is as I mentioned, we thought that, that would probably be a little bit more in the second half of this year. But as we continue to experience inflation and we continue to buy our higher lows and put them in that balance sheet, that's going to take a little bit of time to a little more another quarter or 2 to release, but that's the dynamic. I don't see there is anything in the characteristics of the company and our historical cash generation that's changed at all.

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

That's kind of where I was so that's kind of what I was wondering so thank very much. I appreciate, again, I appreciate the detail.

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

Thanks, Dan.

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**Operator**

It appears there's no further questions at this time. I'd like to turn the conference back over to Doug Dietrich for additional or closing remarks.

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

Thanks, Jenny. Thanks, everyone, for joining the call. We do appreciate the questions and the attention today. We'll talk to you in another 3 months. Thanks.

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