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MTX.N - Q4 2022 Minerals Technologies Inc Earnings Call

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PRESENTATION

Operator

Good day, everyone, and welcome to the Fourth Quarter 2022 Minerals Technologies Earnings Call. Today's call is being recorded.

At this time, I'd like to turn the call over to Lydia Kopylova, Head of Investor Relations for Minerals Technologies. Please go ahead, Ms. Kopylova.

Lydia Kopylova - *Minerals Technologies Inc. - Vice President Investor Relations*

Thank you, Anna. Good morning, everyone, and welcome to our fourth quarter 2022 earnings conference call. Today's call will be led by Chairman and Chief Executive Officer, Doug Dietrich; and Chief Financial Officer, Erik Aldag. Following Doug and Erik's prepared remarks, we'll open it up to questions.

As a reminder, some of the statements made during this call may constitute forward-looking statements within the meaning of the federal securities laws. Please note the cautionary language about forward-looking statements contained in our earnings release and on this slide. Our SEC filings disclose certain risks and uncertainties, which may cause our actual results to differ materially from these forward-looking statements. Please also note that some of our comments today refer to non-GAAP financial measures. A reconciliation of GAAP financial measures can be found in our earnings release, which is posted on the website.

Now I'll turn it over to Doug.

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

Thanks, Lydia, and good morning, everyone. Thanks for joining the call. First off, I'd like to welcome and congratulate both Lydia Kopylova and Erik Aldag on their new roles. Lydia is Vice President of Investor Relations; and Erik as Senior Vice President, Finance and our Chief Financial Officer. Many of you met Erik over the past few years, and I know Lydia looks forward to meeting our investors and coverage analysts in the coming months.

Okay. We've got quite a bit to go over today, so let's get started. A quick outline for today's call. I'll begin by giving you some context on the fourth quarter and then review the highlights of our full year. Erik will take you through the details of our financial results by segment and give you a look into the first quarter. As you saw from our press release, we'll be reporting on new segments and product lines starting in the first quarter. I'd like

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to take you through this change and how this structure better defines the minerals technologies of today. After that, I'll give you some perspectives on the year ahead and open it up for questions.

Let's start with the quarter. As you saw in our press release, this was a challenging one with several acute factors that impacted our results. On the positive side, sales levels remained healthy in most of our end markets and compared to last year, sales increased 13% on a constant currency basis. We saw continued strong sales in Metalcasting and PCC driven primarily by strength in North America foundry and paper markets. We also saw continued growth across our consumer-oriented product areas. These areas of strong demand were offset by a few markets that slowed through the quarter.

You recall, we saw signs of weakness at the end of the third quarter in our construction and steel end markets plus generally slow economic conditions in China and Europe. The slowing trend continued through the fourth quarter, and in the case of China, deteriorated further in December. As the quarter progressed, we also began to see orders and a few other businesses begin pushing into January. Our customers' inventory levels are healthier now than they were last year, which gives them more flexibility to manage the timing of their orders to us, and we believe they exercised some of this flexibility in December.

In addition to these market changes and the dynamics taking place in our order book, the most significant impact on our quarter came from 3 other areas. First, the cold weather experienced in the U.S. in December impacted our mining and processing plant operations and shipments leading to increased costs and delayed sales. Our operations managed through these issues and have since recovered, but we still have some catching up to do on mining. The Bottleneck of rail transportation that was created is now beginning to return to normal.

Second was the rapid increase in COVID infections in China in December. COVID swept through our facilities and our customers' operations, which slowed demand and created significant operating and shipment challenges. Thankfully, our employees in China have all recovered persevering through a challenging few weeks. At this point, we've not yet seen volumes recover in China, and our outlook is for market conditions to remain weak for most of Q1 and to see more meaningful recovery to begin late in March or early in the second quarter.

Third, we experienced a significant increase in energy and sea freight costs in Europe. The level of these increases was higher than expected, and we absorbed them in the quarter and are adjusting pricing to recapture them. Despite these challenges, our teams around the world did an amazing job, swiftly navigating these issues to keep our plants operating safely and our customers supplied. This quarter was an unusual one for MTI as we faced some unique challenges. Except for the continued slow conditions in China, these issues were isolated in the quarter.

We've made the necessary adjustments and demand remains relatively healthy across most of our markets. As a result, we see a significantly improved first quarter, which Erik will take you through in a moment. Outside of the fourth quarter, 2022 was an otherwise strong year for MTI. We posted 3 record quarters, and our teams around the world demonstrated their agility, perseverance and focus on our priorities through 2022. We continue to execute on our growth strategy, positioning our businesses in faster-growing markets and geographies, accelerating the development of new products and technologies, acquiring companies that fit our core markets and which position us in higher growth markets.

This year was some of the tale of 2 halves. First half started with extremely robust demand across each of our businesses, customer orders hitting record levels. Second half of the year, demand began to moderate in a few of our end markets and inflation pressures became a bigger weight. It was a robust sales year for MTI with growth of 14% which was 20% on a constant currency basis. We saw continued organic growth in our consumer-driven product lines like cat litter, edible oil purification and health and beauty products, expanded our core positions in growing geographies, securing 2 satellite contracts in China. One is a traditional PCC filler satellite and the other for a GCC packaging application.

The Metalcasting business continued to grow in India, and we've established ourselves as the green sand bond technology leader there. Our Refractories business secured $100 million in sales over the next 5 years to deploy our new Scantrol Refractory application technology. Our Environmental Products business continued to grow through several large sediment capping projects and the continued trial and commercialization of our FLUORO-SORB, our unique PFAS water remediation technology.

New product development continues to have a larger impact on our sales growth. We commercialized 63 new products this year and sales of new products commercialized over the past 5 years increased 42% to over $300 million. We completed the integration of Normerica, establishing

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ourselves as the largest private label cat litter manufacturer in North America. We acquired Concept Pet, establishing ourselves as a leader in Europe. As I mentioned, inflation was a major factor this year, and it will continue to be through the first half of 2023. We absorbed $190 million of inflationary increases in 2022 and worked diligently to offset them with $210 million of price increases.

Margins were impacted as a result, but higher margins will return as inflation flattens and lagging contractual price adjustments kick in. Our ability to change prices reflects the value that we deliver to our customers every day and is a testament to having the right technologies and applications to enhance our customers' products and help them generate higher value in their markets. In addition, as we always do, we continued our focus on maintaining the highest level of productivity and on diligent cost and expense control. As an organization, we gained a lot of speed and agility this past year. Our teams overcame several challenges and reacted decisively to maintain strong momentum. This momentum will serve us well as we go into 2023.

And with that, I'll pass it to Erik to review the financials in more detail. Erik?

Erik C. Aldag - *Minerals Technologies Inc. - Senior VP of Finance & Treasury and CFO*

Thanks, Doug, and good morning, everyone. I'll review our financial results for the fourth quarter and full year 2022, and I'll also provide an outlook for the first quarter. Following my remarks, I'll hand the call back over to Doug to discuss our newly announced reorganization and give some additional perspective on how we're viewing the year ahead.

Now let's turn to our financial results. As Doug mentioned, we had a challenging finish to an otherwise strong year. Fourth quarter sales were $508 million, 6% above last year and 13% higher on a constant currency basis, primarily driven by $63 million of higher pricing. Our sales volumes were relatively flat overall as strength across our consumer-oriented end markets was offset by weakness in Europe and China as well as production and shipping limitations from severe cold weather in the Western U.S. We also experienced some late quarter inventory destocking by our Specialty PCC and Processed Minerals customers in the U.S.

Fourth quarter operating income was lower than our expectation going into the quarter, primarily due to the sales volume pressures I noted as well as higher freight, energy and production costs. The operating income bridge on the bottom left shows we absorbed $60 million of inflation in the quarter, which was the highest level we experienced all year. While we offset the entire inflationary cost increase with $63 million of higher pricing, we expected a more favorable price versus cost benefit this quarter. We have further pricing actions to recover the additional costs that we absorbed in the quarter, and we expect our price versus cost benefit to expand over the coming quarters.

The unfavorable other cost in the bridge is associated with higher mining and production costs due to the severe weather in the U.S. as well as COVID-related production shutdowns in China. As you'll see in the full year operating income bridge, these fourth quarter events had a significant impact on our full year other cost category as well. Continuing on the right side of the slide, full year sales were $2.1 billion, a record level for MTI. Despite $100 million of foreign exchange headwind, total sales grew 14%, driven by continued execution on our strategic growth initiatives and pricing actions totaling $210 million.

Full year operating income grew 5% to $253 million. Our pricing actions exceeded inflationary costs by $20 million for the full year. Recall that in 2021, our pricing was approximately $20 million behind the inflation that we absorbed that year. So while our pricing actions caught up on a dollar margin basis in 2022, this 2-year pass-through of higher costs into our revenue line has resulted in a percentage margin dilution of 150 basis points. We have sufficient pricing actions in place for the first half of the year to catch up on a percentage margin basis by the second half, and that time line could accelerate depending on the pace of inflation.

From an earnings per share perspective, our full year operating income growth was worth approximately $0.28 of EPS improvement. However, full year EPS ended up at $4.88 compared to $5.02 in the prior year due to $0.42 of unfavorable below-the-line items, primarily driven by foreign exchange and higher interest expense.

Now let's review the segments in more detail, beginning with Performance Materials. Fourth quarter sales were $266 million, 4% above prior year. Sales in Household, Personal Care and Specialty Products grew 8%, driven by the acquisition of Concept Pet and growth in Personal Care and Edible

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Oil Purification. Metalcasting sales were 5% lower. We continue to experience strong demand in North America, where sales in our greensand bond business grew 13% compared to last year. This growth was more than offset by lower sales in China, where volumes were impacted by COVID-related restrictions and shutdowns.

Operating income for the segment was $19 million, which was significantly below last year and our expectations for a few discrete reasons. First, severe weather in the Western U.S. forced us to pause mining activities for several weeks and implement cold weather safety protocols at our processing facilities, which reduced production and shipping volumes. The weather also resulted in congestion on the rails, and we incurred significant costs shipping our products via truck instead of rail. Heading into the quarter, we had also expected a slight rebound in China. However, our volumes ended up lower on a sequential basis due to COVID-related restrictions and shutdowns at our facilities as well as some of our customers.

Finally, volatile energy cost in Turkey and bulk sea freight on the Black Sea resulted in significantly higher landed raw material costs for our European pet care business. We are increasing prices to cover these higher costs. However, pricing changes in this business typically have a 90-day contractual lag. The good news is that shipping rates on the Black Sea have moderated, and we have sold through most of this higher cost inventory. Therefore, we do not expect the same magnitude of cost in the first quarter, and margins will further benefit when our pricing actions take effect in the second quarter.

Moving to the full year. Segment sales grew 16% to $1.1 billion. Household, Personal Care and Specialty Product sales were 22% higher driven by acquisitions, higher selling prices and continued strong demand for consumer-oriented products. Metalcasting sales increased 5% as strong demand in North America and higher selling prices offset slow volumes in China. And sales in our Environmental Products business rose 28% on higher levels of project activity. Operating income for the full year was $131 million, 4% higher than the prior year. It's worth noting that this segment offset $84 million of inflationary cost impacts with pricing actions during the year.

Looking ahead to the first quarter, we expect significant improvement given the isolated impacts we experienced in the fourth quarter. We expect similar market conditions overall with improvement for our China Metalcasting business beginning later in the first quarter. And our mining and processing facilities have now returned to normal operations. Meanwhile, new pricing actions will take effect through the first quarter and into the second, and we are seeing moderation in the inflationary cost elements that impacted us in the [fourth]. Overall, we expect operating income for this segment to increase by $8 million sequentially, approximately 40% higher than the fourth quarter.

Next, I'll review the Specialty Minerals segment. Fourth quarter sales for Specialty Minerals increased 10% versus the prior year to $155 million. PCC sales grew 13% on the ramp-up of new satellites and higher selling prices. Operating income grew 17% versus the prior year to $16.9 million as contractual price adjustments in this business are starting to catch up with inflationary cost increases.

Turning to the full year, sales increased 12% to $648 million, primarily driven by new satellites, higher selling prices across all product lines and continued strong demand for our specialty mineral additives across a wide range of consumer and industrial markets in North America. Full year operating income of $72 million was 2% lower than the prior year as this segment incurred significant raw material and energy inflation throughout the year. This is also the segment with most of our contractual price mechanisms, which will further catch up and improve margins as the pace of inflation slows.

Looking to the first quarter, we expect demand in Europe and China as well as residential construction activity in the U.S. to continue at relatively lower levels. Despite similar market conditions, we expect operating income will improve due to price adjustments that went into effect in January. And while there is potential for energy volatility in the winter months, this segment could see additional margin recovery in the first part of the year if natural gas and electricity rates stay around the levels they are today in Europe and the U.S. Overall, we expect operating income for this segment to increase by $3 million sequentially, approximately 20% higher than the fourth quarter.

Now let's turn to the Refractory segment. Fourth quarter sales increased 10% over the prior year to $87 million, driven by higher selling prices and higher laser equipment sales. Operating income was up 1%, reflecting solid execution amid softer steel market conditions and higher raw material and energy costs. Full year sales were $349 million, 15% higher than 2021. Steel market conditions in the first half of the year were strong with utilization rates in North America around 80%. Although market conditions softened in the second half with utilization rates closer to 70%, this

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business delivered a strong performance, driven by execution on new contracts, higher selling prices and increased laser equipment sales. All of the above resulted in operating income increasing 17% to $58 million, a record level for this business.

Turning to the first quarter. We have additional laser equipment sales as well as pricing adjustments that should improve operating income sequentially. And we expect market conditions to remain similar. Overall, we expect operating income for this segment to increase by $2 million sequentially.

Now I'll review balance sheet -- now I'll review our balance sheet and capital deployment highlights. We finished the year with total liquidity of $432 million and net leverage of 2.4x EBITDA. In 2022, our capital deployment priorities were balanced across sustaining our operations, investing in high-return growth and cost savings initiatives and returning cash to shareholders. Looking to 2023, we expect higher cash from operations as the inflationary impact on our working capital begins to release.

Our first and best use of cash flow will continue to be investing in ourselves to maintain and sustain our high-performance operations. We will also use a portion of cash flow to strengthen our balance sheet and return to our target net leverage of around 2x EBITDA. And we will continue to invest in high-return opportunities, both organic and inorganic. We always stress test our market assumptions for growth capital across multiple economic scenarios. And in times of increased economic uncertainty, this stress testing provides a key governor to ensure prudent deployment of capital. Overall, for the full year 2023, we expect free cash flow to return to a more normalized level of approximately $150 million, assuming capital expenditures in the $80 million to $90 million range.

Now let me summarize our outlook for the first quarter. Overall, for MTI, we see a much improved performance in the first quarter as we move beyond some acute issues. Specifically, our mining and processing operations in the U.S. are back to normal operating conditions, and they are catching up on production. And the logistics disruptions on the rails have mostly unwound. We've had several pricing actions and contractual pricing adjustments take effect through January, and we have more to come through the first half of the year. And while we expect inflationary cost pressures to persist, the most severe inflationary costs from the fourth quarter have eased, namely sea freight and energy rates in Europe. In addition, we expect modest improvement from our China business late in the first quarter.

We are entering 2023 facing softer market conditions than we experienced at the beginning of last year, and we expect construction and steel markets to remain soft through the first quarter at least. Nevertheless, our more balanced portfolio is proving its resilience and strength as demand for our consumer-oriented products and specialty additives is holding up well. We see most of our end markets remaining strong through the first quarter with a few areas of uncertainty. As a result, we expect first quarter operating income to increase significantly to a range between USD 55 million and USD 60 million, which would be up 25% to 35% from the fourth quarter.

Now I'll pass it back over to Doug to share how our reorganization provides a better view of who we are today and enables higher levels of performance going forward. Doug?

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

Thanks, Erik. Over the last 18 months, you've heard me speak about how we've transformed MTI's portfolio of businesses. I've been highlighting how we built a larger portion of our portfolio directed toward consumer-oriented products, and how we've been developing new technologies for more specialized, higher margin and sustainable products. As a result, MTI is much different now. We're more balanced, faster-growing, technology-advanced company and our organization and reporting structure should better reflect who we are today. With that in mind, we felt that this was the time to present ourselves differently.

Beginning in the first quarter, we'll be reporting in 2 new segments: one named Consumer and Specialties and the other Engineered Solutions. The Consumer and Specialty segment, which generates 53% of our sales, combines all of our businesses that directly serve consumer-driven end markets and our mineral-based solutions and technologies that become a functional part of our customers' products. The 2 product lines that we will report on within this segment are Household and Personal Care, our mineral to shelf products and Specialty Additives, the products which should become a functional additive in a variety of consumer and industrial goods. This business group is being led by D.J. Monagle.

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The Engineered Solutions segment, 47% of our sales combines all of our engineered systems, mineral blends and technologies that do not become part of our customers' products, but rather are engineered to aid in their manufacturer. The 2 product lines that we'll report on within this segment are High Temperature Technologies, combining all of our mineral-based blends, technologies and systems, serving the foundry, steel, glass, aluminum and other high-temperature processing industries. And Environmental and Infrastructure, which contains all of our environmental and remediation solutions such as geosynthetic clay lining systems, water remediation technologies as well as our drilling, commercial building and infrastructure-related products. This business group is being led by Brett Argirakis.

This new organization moves us away from our past legacy-oriented structure into one where we are organized around common technologies and applications expertise as well as common market and customer characteristics. It will streamline our reporting structure, speed up decision-making in the organization and enable stronger collaboration. It also enables us to drive synergies through the alignment of our technologies with customer needs, accelerate innovation and further drive operational efficiencies. Our first quarter 2023 results will be reported along these new segments and product lines, and we'll be sharing further details over the next couple of months. Following our earnings call in April, we plan to hold an Investor Day, where we can provide an in-depth view of each of these product lines for associated technologies, strategies and resulting synergies. Please stay tuned for more details on that as well.

Before we close the presentation, let's talk about our focus areas for 2023, and what we are seeing in our end markets as we start the year. In general, demand in the U.S. remains relatively healthy. Cat Litter, Metalcasting, Paper, Automotive and Environmental Products remain strong. Residential construction as well as the steel market are slower than last year and similar to the fourth quarter levels. Outside of the U.S., Europe demand remained strong in cat litter and specialty consumer products, but relatively slow in our industrial markets.

We expect China to remain slow for the majority of the first quarter, but indications from our customers are that activity and demand will likely pick up in the second. Further out, the second half of the year is harder to see right now. Our order books typically strengthen in March and April and our more seasonal Construction and Environmental markets, and we are watching automotive build rates. Early spring will be a telling period for these businesses on the strength of market demand going into the second half of the year.

For our consumer-oriented businesses, we expect demand to remain resilient and for them to continue on their growth trend throughout the year. Internally, we have a clear set of priorities for 2023 focused on 3 pillars: financial performance, organization and people and continued execution of our growth strategy. Our focus is on recapturing margins through both cost improvements and pricing actions. Contractual pricing will catch up, and margins will further improve as we make other necessary adjustments and take advantage of lower input costs.

We'll maintain a strong balance sheet and improve cash flows. As inflation plans over, we see the release of the working capital that has built over more than a year. We will continue our balanced approach to capital deployment, funding high-return internal projects with a priority this year on debt repayment. We have a very global organization, which is now better aligned with our customers and markets through common technologies and applications know-how. The reorganization of our businesses and segments improves alignment and creates more speed.

We'll continue to drive growth, expanding our positions in our core markets and geographies, focusing on the development of sustainable solutions for the markets we serve, investing in product development and evaluating inorganic growth opportunities. These initiatives have transformed MTI, and we see more opportunities ahead. MTI is a less cyclical and more resilient company than in the past, regardless of what the markets bring us this year, our balanced and higher-growth portfolio of businesses enables us to deliver more stable sales and earnings growth.

I'd be remiss if I didn't tie all this together and mention the foundation that supports everything we do. Our dedicated employees and the MTI culture built on operational excellence and an unwavering adherence to our values. It's the foundation that sets MTI apart from others. 2022 marked our 30th year as a public company, and 2023 will be a pivotal year as we move into a new era. Looking back, we note the dedication and commitment of all MTI employees over the past 30 years who helped form who we are today. As we now turn and look forward to the next 30, we see many more exciting chapters to write for our company.

Now, let's go to questions.

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QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And we'll now take our first question from Daniel Moore with CJS Securities.

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

Let me start with -- you gave a lot of good -- a lot of color, which is greatly appreciated on the various challenges that impacted margins and the results in Q4. Is the order in which you sort of presented those 3 challenges, whether first, COVID, and China second, energy inflation in Europe, third, is it the right way to think about it from an order of magnitude perspective or are they sort of relatively, relatively even across the 3?

Erik C. Aldag - *Minerals Technologies Inc. - Senior VP of Finance & Treasury and CFO*

Yes. I can take that for you. So I mean, as you know, heading into the quarter, we said we'd do around $60 million of operating income. And so we missed that by about $16 million. And so I can put that into some buckets for you. About 1/3 of that impact was associated with lower volumes, so sales related to sales, so about $5 million or $6 million. And that was really from 3 areas. The China COVID situation impacted our volumes, the production and logistics challenges that we were facing in North America impacted volumes. And we did see some softness in the steel and residential construction markets that we mentioned.

I'll note, we've moved through those production issues in North America. From a China perspective, we do expect improvement there. The timing of that improvement is still a little bit of a question mark, but we expect that to improve. The one aspect we don't see changing at least in the near term, is the softness in the steel and construction markets. So that is the sales side of things. The larger piece of the impact was on the cost side. So both manufacturing costs and inflation costs. So let me give you a little color on the inflation that we experienced, that was more than we were expecting heading into the quarter.

So most of this was specific to our European Pet Care business, as we mentioned. And first of all, so the bentonite that we use in that business comes from Turkey. And we've got mining and processing facilities there. And as an example, energy rates in Turkey have been very volatile. In September, we got hit with a 50% increase on natural gas. Electricity rates have been up over 200%. And then sea freight also on the Black Sea has been very volatile. So we've had to deal with price spikes up to EUR 90 per ton when we're used to dealing with sea freight costs from the EUR 25 to EUR 50 range.

So this all contributed to this wave of inflation that we've described absorbing in the fourth quarter. Now we've adjusted prices. We adjusted pricing in the fourth quarter to pass this through. And as I mentioned, this business has a 90-day lag in terms of pricing adjustments typically. And we're going to be adjusting prices again in the first quarter. The good thing is that these costs have moderated since these spikes in the fourth quarter, and that's going to help our margins going forward as well.

Just one note on the higher manufacturing costs. These are related to the challenges we had in December, mainly related to the weather, the severe cold weather out west and much of that was around the lower fixed cost absorption at our plants. The production challenges in China also had a cost element to them there, but that was the manufacturing side of things.

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

Got it. Sorry, excuse me, that's helpful. Based on the pricing actions you've taken so far in '22 or you took in '22 as well as expected for Q1 '23, what would be kind of incremental revenue look like for full year '23 if volumes were flat year-over-year?

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Erik C. Aldag - *Minerals Technologies Inc. - Senior VP of Finance & Treasury and CFO*

Yes. So I mean what we have line of sight to right now is probably mid-single digit impact on our revenue from pricing in 2023. We expect inflation to persist in 2023, but we do expect it at a much lower rate than we experienced last year. Probably half of the inflation. We're expecting around half of the inflation that we experienced in 2022. And a lot of that is going to be front-end loaded. Some of the things that we've seen moderating are energy and energy derivative raw materials like packaging. We do see inflation -- the types of things we see continuing are around labor, transportation, particularly around rail and certain of our raw material purchases, but it should be at a much lower rate than we experienced in '22. And we have pricing in place. I mentioned the 150 basis points of margin dilution that all of this inflation and pass-through of costs has impacted us by over the last 2 years. We plan to get that back at least in 2023, and we have line of sight to more than that as well.

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

Really helpful, Erik. That just leads to my next question, which is making sure we're working off the right base. So you mentioned 150 bps of margin impact over the last 2 years. So are we looking at 2021 in terms of margins is getting back to those levels? Is that the way to think about it?

Erik C. Aldag - *Minerals Technologies Inc. - Senior VP of Finance & Treasury and CFO*

Yes. So I would just say for the full year 2022, we did just under 12% operating income margin. And so the pricing that we have in place and what we see today from an inflation perspective should get us 150 basis points on that in 2023. So we're looking at 13.5% to 14% margins by the second half on a run rate basis for this company.

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

Perfect. That's exactly the -- just wanted to make sure we were working on the same page. I will jump back in queue with a few follow-ups.

Operator

We'll now take our next question from Mike Harrison with Seaport Research Partners.

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

And I want to pass along my congratulations to Erik and Lydia. In terms of the European sea freight issues, I'm just trying to understand and maybe throw the natural gas in there as well. I'm just trying to understand a little bit more about the timing of when you saw that. Obviously, the China COVID impact was something that happened in December. The winter weather in the U.S. was something that happened in December. But natural gas and power costs in Europe were a pretty well-known quantity and there was a lot of concern. We discussed it on calls. So I'm just trying to understand why that caught you guys by surprise? And maybe a little bit more about the timing of when those became a much bigger issue relative to your expectations?

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

Yes. Let me take that one. I think there's a piece of it that was absolutely known. It's been volatile all year, energy in Europe and Turkey, in particular. It's gone up almost 200% over what we experienced at the beginning of the year and about 3 different government-mandated jumps. That latest one happened kind of late in September. We did have that in our forecast, and we had some pricing adjustments to cover it. I would say the bigger surprise was some of the freight, the shipping costs that were more spot-based for us that kind of increased significantly as a result of that as well. I'm not going to say though that I'd look back in hindsight 2020. We probably could have been a lot faster with our pricing increases, at least in that business. We probably could have been more aggressive.

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And so I think when we look back on this saying, what did we see, what didn't we see? I think part of it was known and we made some pricing adjustments. Part of it was a surprise to us. We probably should have been quicker and more aggressive on our pricing adjustments in the fourth quarter. Those adjustments have been made. We're moving through the first quarter. We have some catch-up to do. But again, as Erik mentioned, we have 90-day kind of notification periods and so being very aggressive and very timely with our going forward pricing is where we are now. So I'd say that's the hindsight 2020 kind of look, we probably could have been a little bit faster on that pricing.

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

All right. And I guess just given the significance of the shortfall relative to the $1.20 in EPS that you guys were guiding in the quarter. Did you consider making a pre-announcement to call out these unexpected headwinds that you were seeing? Or I guess, help us understand the thought process there.

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

Yes. I guess, look, we -- as we evaluated a lot of these things continue through December. And let me start with -- we don't see anything really structural changing in our markets. The business fundamentals that we have, the operations, our cost positions. There's not a lot of [real market] other than, I guess, China, but that's kind of well known. Market positions are relatively stable in what we saw in the third quarter. December was a very challenging time for the company in terms of the things we were dealing with in our plants in the United States and in China. And so -- and a lot of them have been kind of late in the month. We -- I guess we felt that these acute issues that we don't see repeating were in the quarter and isolated that quarter and not something that was of a structural nature or a significant change to our go-forward forecast from a market perspective or kind of our operations perspective. I think that was our thought process, Mike.

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

All right. And then a couple of quick ones on the PCC business. First of all, in terms of the new Asia satellite ramp-ups, it's good to see that flowing in. Can you give us maybe an update on how much additional volume has come on as of the end of the year? And maybe how much additional volume is still to come?

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

Sure. Let me pass that to D.J., he can take you through that.

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

Yes. Mike. So right as we closed the quarter, we brought 2 new satellites on that are roughly 70,000 tons of PCC business. And then going into -- through the course of next year, we've got mostly in the second half, several satellites coming on. Two of those are PCC satellites, a little over 100,000 tons there. And then we had announced some time ago and Doug had highlighted it the penetration in the GCC, and that is a couple of hundred thousand tons as well. So as we come out of next year, you'll see something in the neighborhood of 400,000 tons that sort of a run rate going forward.

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

All right. And then in terms of the pricing in the PCC business, obviously, you've called out that most of that is contractual pass-through. Maybe help us understand what you've seen going on with Lime and other raw material costs? Are they stabilizing? Are they starting to come lower? Maybe just help us understand kind of where we are on that lag in the contracts catching up to your input costs?

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

Certainly, glad to share that with you. So what we are seeing is Lime is mitigating. So it's starting to plateau and our pricing is catching up on that. So we'll see some incremental increases as we go into next year, but they're not nearly the rate that we saw in the prior periods. So I would say that our contractual mechanisms seem to be holding through this process, and it's something that still provides a very collaborative relationship with our customers as we work through these things together. Further, I would say that the value equation of our PCC in these markets stand strong as our customers are experiencing energy increases. For instance, part of the value contribution we bring is reduced energy consumption in their paper making process. So it's getting better. Contracts are working, and we seem to be holding up our value pretty well.

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

I think, Mike, the only thing I'd add to that is just kind of energy. We do -- we are supplied a lot of electricity from our customers -- as we reside in their facilities. So major inputs this year have been lime cost, which is kind of a derivative of energy and the energy that goes into making it. And then also the direct electricity and energy from our customers. As that energy is planed over, as you've seen through the first half of the year, we have that lag. And as that planes over, you'll see us catch up pretty quickly. I think that's what you saw happened in SMI in the fourth quarter. That margin expansion is starting to happen. Again, we have to see energy continue to plane over. And if it starts to decline, you'll see that margin improvement accelerate.

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

All right. Very helpful.

Operator

We'll now take our next question from Steve Ferazani with Sidoti.

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

I just wanted to follow up some of the other questions. In terms of the way you're laying out 2023 and then your guidance for Q1, it sounds like China is certainly -- knowing what we know now, China gets a lot better as 2023 goes along. Inflationary pressures ease. I'm just looking at your market conditions for guidance, inflationary pressures ease. Do you get more of the lagging price effect. All things considered, would you knowing what you know now, say that Q1 would mark the significant low point for the year in terms of EPS?

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

I guess that's a little bit hard to predict. I would say that yes. Yes, Q1 is going to be probably a slow quarter for us. And seasonally, Q2 and Q3 are always our strongest, right? So I see of the next 3, Q1 probably being the lowest. And as you see us continue to catch up on price, as Erik mentioned, driving those margins towards 13% or 14% at a run rate basis. We have a number of new satellites in PCC coming online later in the year, which you're going to add. And in our consumer businesses, as they continue to grow in their upper, mid upper single digit kind of range, we see a top line growth going through the year. Again, a little caution on how these construction and steel markets and what happens in the back half of the year. But we see half the business continuing on its growth trend.

The other half looks very strong for at least the first half, and we'll see in the back half of the year, what happens with the U.S. economy. But as we see inflation, if it planes over and our pricing actions catch up and what we already have implemented, we see that margin improvement. So that top line growth and that margin improvement bodes for a pretty strong year. Now I've given you a lot that says, a lot's got to have to happen to deliver that, right, with inflation and there's some uncertainty in terms of demand in the economies. But as we see at least in the first half of the

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year, I think we have at least a strong look in the first quarter being the lowest. I'm going on a little on a limb there, but I think you're about right there, Steve.

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

Just help me out on that because I'm looking at the Household and Personal Care results for 4Q versus even 3Q. And some of this is tough to sort of pick through. I know you lapped the Normerica acquisition by the end of 2Q. When I look at the growth 4Q versus 3Q annually, it looks lower on both a percentage and dollar terms. If you can help me through that.

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

I think some of that was some of the shipment challenges we had in North America. And so a couple of our facilities in Petcare are in Canada. With the cold weather, we had a very challenging month in December in terms of shipments out of those plants. So I think some of that has just been delayed. Those moved into the first quarter. We haven't lost those orders, so you'll see those pick up. The only other thing I would add is that it's kind of opposite seasonal. It's -- there's a higher seasonal demand sometimes in the fourth quarter and the first than it is in the summer. And so you might see some of that impact as well. But I think more of this quarter was much more some of the shipment delays we saw in North America late in December.

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

[So just your feeling] as we go into 2023 in a slowing economy, a lot of your bigger acquisitions in that area. We're just generally not that cyclical. Your expectation is demand is there. And with new products, you still can get reasonable growth even in this environment. Am I tracking that right?

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

Yes. And so we're going to highlight that to you in that Consumer and Specialty segment. I guess I go back to the last semi or small cycle we had in 2020. On that Petcare business, which was a little bit smaller at that point, grew at almost 8%. Now the dynamics of going through the pandemic were a little bit different. But I will tell you in terms of Cat Litter products, Fabric Care, Edible Oil purification, these products, they're consumer-driven, they're a little less discretionary in some aspects, right? Folks are going to continue to purchase them through economic times. And we're the largest private label cat litter manufacturer globally. And so therefore, that positions us well in a downturn to be the more economical choice.

And so I think the exact level of demand is going to be hard to predict, but the fundamentals of this business that we've built should withstand to be really resilient and continue to grow as we've seen with kind of GDP plus cat litter and pet ownership around the world. Other things that we are working on, we've got some online channels that we're now selling through and some new business developments in Asia as we start to build out our presence in that region. So pretty bullish on that consumer business and its growth. And as we see margins expand, we think it becomes a really big earner for the company.

Operator

We'll now take our next question from David Silver with CL King.

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

Yes. Several questions. I think I'll start with this one. So Doug, you talked about a lot of things regarding the fourth quarter. There was one thing I didn't really hear that I have heard from every other industrial company that's reported to date. And that would be inventory destocking on the

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customer side. So in some of your slides, I could see that the volume change year-over-year 4Q versus 4Q was roughly flat, and I could kind of point to some of the pluses and the minuses within the individual product lines. But just broadly speaking, how much did inventory destocking, typically, your customers impact the fourth quarter? And might we see more of that come through in the first quarter?

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

Yes, we did see some destocking. I think Erik mentioned it in his comments, largely in the Processed Minerals business. And in some in mining., I recall last year where inventory levels for customers were quite low. And orders were just continuing to move through our plants even in low seasonal periods like December and January. This year, a little bit different, customers we see, especially in that construction market, higher levels of inventory. We did see some orders move out of December and placed into January.

So we think some of that destocking or at least managing inventories happened, similar impact in our steel businesses. And so we did see some of that destocking, but we saw those orders move over into January, and we'll see that -- we're going to see that pick up. That was part of -- Erik tried to dimension about 1/3 of our impact in the quarter was some destocking in Processed Minerals, and it was the impact on sales, both in transportation logistics in China was about $6 million in the quarter. So yes, some destocking.

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

Okay. My apologies for missing that. I wanted to follow up with D.J. You laid out the new satellite plant start-up time line very well. I was wondering if you could also just maybe reflect on the new project or the new opportunity funnel that you see. And in the past, you've been very good about not just the number of projects but maybe which innovation or which technology they're relying on. So in the last couple of years, packaging grades have been introduced, the de-inking technologies, and I guess, the PCC, GCC project. But if you could just talk about the outlook for the new project funnel as you see it here. And in particular, is there a particular new or expanding innovation that seems to be gaining more traction with potential customers?

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

Gladly, David. So I mentioned the ones that are starting online and coming online in 2023, but the commercial activity remains very robust, and it's spread around the world, but most of the opportunities remain in Asia. On top of that, the standard PCC still continues to be a pull for us. But as I'm looking at the pipeline now, where before we would be, say, 90% pursuit of growth in printing and writing grades. Now we're closer to 50-50 printing and writing versus packaging. Of note, in the fourth quarter, we made some considerable progress with full-scale trials of 2 new products in brown grades. One of those was with a major brown box manufacturer in the United States. The other one, and that is our new product that I've alluded to that's targeting Brown.

The other product that we are excited about is we began experimenting it with some time ago, but it was New Yield, which is that product that repurposes a paper-making waste stream. We had designed it for printing and writing grades, and we were optimistic that we could modify it for packaging grades, and we've run some good trials in packaging grades in Asia. So both of those hold promise for us for what I would say, some near-term activity. So we're pretty excited about that. And then on top of that, still the -- there's a great pull for the standard PCC products if anyone is considering an upgrade for their quality of their paper. And if anyone's considering putting in a new machine, we are one of the first calls they make and because of the strength of the brand. So that's how I would summarize.

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

Great. Appreciate it. Last question. I did want to ask about the CapEx budget. So I think it was bracketed at $80 million to $90 million as we start the year. And I would ask, Erik, if you could just focus on the discretionary portion of that $80 million to $90 million and whether you could call out what are the top couple of priorities in there? What's getting the most discretionary capital out of your original budget for 2023?

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Erik C. Aldag - *Minerals Technologies Inc. - Senior VP of Finance & Treasury and CFO*

Yes. So I'd say that every year, $30 million to $40 million of our CapEx spend is on sustaining our operations, improving our facilities. And that's the amount that is less or nondiscretionary. So we will likely spend that $30 million to $40 million in 2023 on sustaining and maintaining our operations. The rest of that, that we typically budget for is growth. It's cost savings projects. But as I mentioned, we're going to be taking a really close look at market assumptions that we're using for justifying those projects. And as far as -- if there's a discretionary bucket, that's it. And if economic conditions change, that's where we'll flex.

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

Okay. I'm going to get back in the queue. Appreciate it.

Operator

(Operator Instructions) We'll now take a follow-up from Daniel Moore with CJS Securities.

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

Just thinking about revenue for the next quarter or 2. Obviously, pricing is a bit of a tailwind, but FX continues to be a significant top line headwind. Do you expect similar impact in Q1? Or based on today's kind of exchange rates, how does that taper off over the next couple of quarters?

Erik C. Aldag - *Minerals Technologies Inc. - Senior VP of Finance & Treasury and CFO*

Yes. So Dan, I would say in 2022, FX was a significant headwind for us. We said $100 million on revenue for the full year. If you look at sort of current rates now versus what we had in 2022, it's still, I would say, moderately unfavorable on a full year basis, '23 versus '22, but not to the extent that we experienced in last year.

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

So we see -- yes, our FX is probably going to be a similar impact -- negative impact on us in the first quarter. So, we still see both. Yes. But though we still see there's that pricing lift that will happen, and we see volumes improving from the fourth quarter. So in total, we see our revenue up in the first quarter, and we think that growth, at least in our consumer-oriented businesses continue through the year. The industrial piece -- it's a little bit early to tell how that's going to play out in the back half. But we see a pretty strong first half of the year nonetheless.

Operator

We'll now take a follow-up from David Silver with CL King.

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

Yes. So I have kind of a question that was not covered directly in the comments today. But in doing some reading in related industries, I came across a whole series -- and I'm sorry, the topic here is remediation and in particular, the momentum behind PFAS removal. So in doing some research, I mean, I came across a whole range of articles about efforts to accelerate or to implement new restrictions on PFAS. I mean one in particular, I think the state of California is moving to remove all PFAS from personal care products within a few years.

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There was another one at the federal level, I think, amping up penalties and whatnot for ramping up the responsibilities for the producers of PFAS. Anyway, not exhaustive by any case. But I just wonder -- I'm just wondering if from your particular perspective, whether you think the business case or the long-term growth or customer interest in your remediation strategies has qualitatively or meaningfully improved in recent months in response to some or any of the new legislative and regulatory proposals I've been reading about. Is anything especially relevant to your particular remediation strategies and targets.

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

Sure. Well, let me take that in pieces. I guess PFAS is only one part of our remediation capabilities. So we have an industrial wastewater and slurry wall cleanup, groundwater cleanup systems. We have contaminant removal from -- in the oil and gas industry as well. So we have a wide range of water remediation technologies and systems. PFAS, our FLUORO-SORB is one of the mediums that we have developed targeted at, obviously, PFAS removal.

Look, first, I think it's good to see that the regulations have stemmed the use of it. But I will also say that the amount of it that exists and the fact that it is forever around is going to create a number of opportunities for us that have only just started. I think we have spent -- had some really good trials. We've continued to commercialize it over this year, gaining more traction in terms of efficacy and proof of ours versus other media, ours being a very economical workhorse to remove significant amounts of PFAS from water.

The real catalyst though is not on stemming the flow of PFAS, it will be in the regulation of cleanup and cleanup levels. I think there's a lot of opportunity out there in terms of cleanup of water, groundwater, drinking water systems. But I think until there's a level of cleanup kind of regulation to what level needs to be cleaned up. I think that will be the real catalyst. Once people know where they have to go, they'll know the system they want to employ, and I think that's going to develop a significant amount of opportunity for us.

In the meantime, there are acute areas around the United States and in the world that we're seeing and that we're being pulled into project-related cleanups. But I think long-term, with the amount of the chemical that's there and with it being there forever, our technology being able to bind it forever is going to be a real good system once people start to use it more, I guess, from a regulation standpoint. So hopefully, that helps you. It's one piece of it, David, but it's not everything with remediation -- water remediation for us.

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

Okay. So no landmark legislative or regulatory development in the last few months. No, that's great.

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

Not that's going to change the opportunity for us. Regulation on cleanup levels will accelerate the opportunity for us.

Operator

We will now take a follow-up from Mike Harrison with Seaport Research Partners.

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

Just a couple more for me. Can you hear me okay?

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

Yes.

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

Sorry about that. I was looking for an update on the talc litigation. I know there will be something in your filing, but presumably, that won't be out for a little while. Any update on the number of cases relative to the last time you reported? And do you expect to have to add to the reserve at any point during 2023. I noticed there was not a special charge related to the litigation in the fourth quarter.

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

No, Steve, there hasn't been -- I'm sorry, Mike, there hasn't been any change. The level of cases are stable. There's been no change in terms of the litigation and the reserve that we took it continues to be adequate to cover what we saw back in the third quarter as the liability for that case load. So no change.

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

All right. And then just a quick one on the Refractories business. You mentioned that kind of the second half utilization rates were lower and things were stronger in the first half. But as I look at kind of the year-on-year change, I know this is sales not volume, but the revenue number at least looks pretty consistent first half and second half. So maybe just help us understand, is there something that's changed that your Refractories business is maybe less sensitive to utilization rates than it had been in the past. I think in the past, you should think of 80% of utilization as a number where your business would really be performing well. And if it was lower than that, that would be a headwind, but it doesn't seem like that has been the case more recently.

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

Yes, Mike, thanks for that question. This business is very different than it used to be. And so you referenced having to be at 80% for this to be a profitable business, and we're generating higher profits at even 70%. So directly, the market is down from where it was last year. But this business is able to generate income due to a number of different things. I'm going to turn it over to Brett to let you know, but the technologies that it's been developed, the systems, it's developed, the new refractory formulations, all of that is combined to change the real profile, the profit profile of this business. Brett, you want to give some color on that?

Brett Argirakis - *Minerals Technologies Inc. - SVP & Managing Director Minteq International*

Sure. I appreciate that question, and glad it's noticeable. This is a business that we've been working on for a long time, especially in my 36-year career. We have changed and started the change going back to 2009, when that big market dropped and it really hurt us. We resized the business, we reorganized the business. And every so many years, we just took a look at it and did that even further. It's a combination of our steel mill service groups that are embedded into our steel plants, our customers. But those people, although they've been there for many, many years, we're increasing that technology of what we do and increasing their ability to operate more higher tech equipment. We've also moved into different product lines where we're driving similar cost or in some cases, could be lower cost where we can work with our customers on pricing, but it's all about value. And our value is driving the lowest cost opportunity on an installed basis for our customers so that they can run their steel plants more efficiently and more effectively.

The other thing that we've done is really driving that automation of our application equipment and signing in 5-year deal contracts. We have now, over the last couple of years, about 13 new automated application units. A couple of those are in Europe and the majority right now in North America. We're really happy about that excited. Those are all going to be rolling out. The other thing is you see the utilization rates going down as

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they're coming down, we have 5 new steel plant customers that are expanding in 2023. So we're riding with them, and we're helping them in their expansion. So as Doug said, it truly has evolved to a much different higher tech business than it has been looking back in the past. So we're really proud of that.

Operator

And it appears there are no further telephone questions. I'd like to turn the conference back over to Mr. Dietrich for any additional or closing comments.

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

Thanks, everybody, for joining the call today. Again, please look out for some more information on our new segments that we'll be reporting on, and we look forward to reporting under it in our first quarter and then further to an Investor Day probably scheduled in May. So stay tuned for that as well. Thanks for joining today.

Operator

And once again, that does conclude today's conference. We thank you all for your participation. You may now disconnect.

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