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PRESENTATION

Operator

Good day, everyone, and welcome to the First Quarter 2023 Minerals Technologies Earnings Call. Today's call is being recorded. At this time, I would like to turn the call over to Lydia Kopylova, Head of Investor Relations for Minerals Technologies. Please go ahead, Ms. Kopylova.

Lydia Kopylova - *Vice President Investor Relations*

Thank you, Carrie. Good morning, everyone, and welcome to our first quarter 2023 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 know that some of our comments today refer to non-GAAP financial measures. A reconciliation to GAAP financial measures can be found in our earnings release, which is posted on our website. Now I will turn it over to Doug. Doug?

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

Thanks, Lydia. Good morning, everyone, and thank you for joining. Let me give you a quick outline for today's call. I'll start with the first quarter summary. And as you may have noted from the press release, we're reporting this quarter on our 2 new segments: Consumer & Specialties and Engineered Solutions. This is a big change in how we present the company. So I'm going to give a quick refresher on these 2 new segments and how we've organized them from a product, market and technology standpoint. Erik will then take you through the financial details for the quarter and our outlook for the second. And after that, we'll open it up for questions.

Let's go through a quick summary of the first quarter. We delivered what we expected in terms of sales, operating income and earnings per share. After a challenging end to last year, we remain focused on growth, margin recovery and improved cash flows, and we delivered on all 3. We posted record first quarter sales for MTI with growth across both segments and in all 4 product lines. Revenues increased 8% sequentially and 8% year-over-year on a constant currency basis. It was achieved amidst the backdrop of mix market and economic conditions.

Despite these mix conditions, we continued our growth trajectory, which points to the stability that our portfolio can provide. Sales in Household & Personal Care increased 7% driven by strong demand in all regions for pet litter, edible oil purification and animal health products. The Specialty Additives product line, we benefited from higher volumes of Paper PCC in Asia from our newest satellites and from improved market conditions.

This was offset partially by the continued weakness we are seeing in residential construction markets, which has impacted demand for ground calcium carbonate and Specialty PCC compared to last year. Demand in the Engineered Solutions segment was driven mainly by the varied economic conditions we're seeing across our regions. For high-temperature technologies, market conditions remained relatively strong in North America, and sales for foundry and refractory products remained robust.

This was offset by continued weak conditions in European steel and China foundry markets. We expected some modest improvement in the China foundry market as we moved through the quarter, and we did see some improvement in March. However, conditions remained well below the levels we saw last year. In the environmental and infrastructure product line, demand remained relatively stable in all regions for our water remediation technologies and infrastructure drilling products. We also benefited from 2 large sediment capping projects in the United States.

Sequential operating income increased 43% to $63 million and margins expanded 290 basis points. We implemented additional pricing actions, drove productivity gains and operating conditions improved in the areas that were impacted last quarter. Margin growth is a key focus area this year. We expect margins to continue to expand throughout 2023, as our pricing actions catch up with the cost inflation we experienced in the second half of last year. Cash flow and maintaining a strong balance sheet are always priorities for us.

First quarter cash flow returned to historically normal levels, and our balance sheet remains solid from a liquidity and net leverage standpoint. An additional highlight for the quarter is that we completed the resegmentation and reorganization of our businesses. The significant change, and I want to take you through a couple of slides to review the new structure.

If you followed us over the past few years, you've seen how we've targeted acquisitions in pet litter, invested in new higher-margin products and moved into adjacent faster-growing markets. We've transformed from a company which historically served industrial markets in North America and Europe to one with greater involvement in less cyclical and growing consumer, environmental and agriculture markets, together with an increased presence in higher-growth regions.

The word technology has always been part of our company's name. Going forward, you'll hear more about what we call our core technologies and capabilities. They are a foundational part of what our company does and a central part of how we have established and how we maintain our leading market positions. Our innovation pipeline draws on these core technologies and the advancements we've made in new product development over the past few years have been another dramatic transformation at MTI.

Today, we're generating almost 3x more revenue from new products than we did 5 years ago and we have a new product pipeline currently in place to drive this higher. Our company culture is based on continuous improvement. And in keeping with that culture, we saw that moving our organization to one that was structured around our core technologies, similar market types and customer dynamics was a more powerful way to run our business. This new organization has more clarity of purpose, will foster faster decision-making, improve execution and drive closer collaboration on innovation and technology together, fueling higher earnings potential. It's also added a spark to the organization and brought new energy to the team.

Let's take a quick dive into these 2 segments and their respective product lines. The first item I'll point out is that these 2 new segments and 4 product lines are well balanced, balanced in terms of size, growth, types of end markets and long-term growth drivers. First, let me take you through the Consumer & Specialty segment and its 2 product lines, Household & Personal Care and Specialty Additives. Products sold in the Household & Personal Care are consumer products or components of consumer products that you would find in your home, like cat litter, edible oils, over-the-counter skin care products and laundry detergent.

Products are developed primarily through the application of one of our core technologies called functional additives, where we specifically design, classify or create a particle to perform a specific function such as absorb odors, remove impurities or act as a delivery system. The consumer markets served in this product line have similar -- have similarities such as common service models, innovation timelines and macro growth trends.

By organizing these products together into one product line, we can better leverage these similarities to drive innovation and growth opportunities. Specialty Additives product line contains our mineral-based products that become functional components of items such as paper and packaging, sealants and adhesives, paints and coatings and food and pharmaceuticals. These products were developed through the application of a core technology called crystal engineering, where we design crystal morphologies for a specific function such as strength, optical brightness, gloss, calcium fortification and CO2 sequestration.

We can also further adapt these crystals to provide enhanced functionality like rheology modification. The markets served in this product line share the common growth strategy of penetrating growing geographies by using our applications expertise to offer customers a higher value solution. As an example, we've been driving penetration of PCC into the Asian market for many years by offering customers production cost savings, recycling options for waste streams and brighter or glossier surfaces.

The region has become our largest for volumes of Paper PCC and there's still room for continued growth. At this point, this week, we announced 3 new long-term supply agreements in Asia for our PCC filler technology, one of them for our newest recycling product called NewYield LO. Similarly, our Specialty PCC products are growing globally, and we see opportunities to penetrate sealant and adhesive markets outside the United States.

Next, let's go through the Engineered Solutions segment, which contains products and solutions designed for our customers' manufacturing processes. In the high-temperature technologies product line, we are leaders in providing consumable materials and process solutions, primarily for the foundry and steelmaking industries. These products are developed through the application of a core technology called engineered blends. We use our deep understanding of our customers' process to formulate products that deliver benefits such as improved dimensional stability and surface finish, increased production efficiency and safety and lower emissions.

Growth in this product line is driven primarily by the substitution of lower-performing products in large and growing markets. For example, we continue to drive penetration of our Greensand Bond Systems in China and India and deploy our new Scantrol measurement and application system in North America and Europe. The fourth product line is Environmental & Infrastructure, which is home to many of our unique innovative products and solutions for infrastructure, water remediation and environmental waste containment.

Here, we apply a core technology called particle surface modification where we physically alter or adapt the surface of a substrate particle to perform a specific function. These modified particles are used in bulk to create waste barriers, scavenge impurities from water, waterproof large construction projects and enhance drilling fluids. Our products support important projects in communities around the world like wastewater and drinking water cleanup, sediment capping, industrial landfill containment and infrastructure projects.

Growth in this product line is driven by the increased demand for environmental remediation solutions, commercial construction and infrastructure spending and the global need for clean water. Lastly, it's important to mention that each of these product lines is supported and supplied by our own world-class mineral reserves. The quality, quantity and strategic locations of our mineral reserves, combined with our leading technologies and applications expertise, provides long-term supply stability and tremendous value for our customers.

It's the reason we're the leader in many of the markets we serve and what makes MTI truly unique. With that, I hope you have a better understanding of the segments and product lines and can see how they fit together and how they better reflect the MTI of today. I'll certainly take you through more details on these segments and product lines, technologies, and our strategies at our Investor Day in May, and we look forward to doing so.

Now I'll hand it over to Erik to provide more financial details. Over to you, Erik.

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

Thanks, Doug, and good morning, everyone. I'll review our first quarter financial results and I'll also provide an outlook for the second quarter. Following my remarks, I'll turn the call over to Q&A. Now let's turn to our financial results. I'll start with the sequential quarter bridges on the left side of this slide. Sales increased 8% sequentially to $546 million, driven by higher volumes, incremental pricing adjustments and favorable foreign exchange.

Operating income improved 43% to $63 million, an increase of $19 million from the fourth quarter. The biggest driver of the improvement came from pricing adjustments related to the significant inflationary costs we absorbed late last year. We also experienced some moderation of cost pressures on a sequential basis, primarily driven by lower energy costs and more typical sea freight rates.

Moving to the year-over-year bridges on the right side of the slide. Sales increased 5% over the prior year and were 8% higher on a constant currency basis. Our sales growth was primarily driven by higher pricing, which helped offset unfavorable foreign exchange and slightly lower volumes overall compared to the prior year. Demand remains healthy across most of our end markets with a few exceptions. Residential construction markets are softer than last year in the U.S., and foundry products demand in China started to improve late in the quarter as expected, after a slow start to the year.

In addition, while the majority of our consumer-oriented end markets remain strong, we have experienced some customer destocking in Personal Care, primarily associated with our functional skin care products. Operating income was 7% lower than the prior year quarter, primarily driven by the lower volumes.

Our pricing actions offset the year-over-year cost increases in the period, and we expect to recover additional margins through the year with continued price increases and as the pace of inflation continues to moderate. First quarter earnings per share, excluding special items, was $1.14. Note that higher interest rates versus last year impacted EPS by $0.11 in the quarter, and our effective tax rate was 22% versus 20% in the prior year quarter.

Going forward, we expect our effective tax rate to remain at approximately 22%.

Now let's review the segments in more detail, beginning with Consumer & Specialties. First quarter sales for Consumer & Specialties were $297 million, 5% above the prior year and 7% higher on a constant currency basis. Sales in Household & Personal Care increased 7% driven by strong market conditions and higher pricing. For example, global pet litter sales grew 18% driven by continued strong demand, the acquisition of Concept Pet and higher selling prices.

And our edible oil purification sales grew 16% as we continue to penetrate the market with our highly effective bleaching earth products. Meanwhile, Personal Care volumes were lower than the prior year due to customer destocking of certain skin care products. Specialty Additives sales were 3% higher than last year, primarily driven by higher selling prices. Overall market conditions for this product line were in line with our expectations.

Demand for food, pharmaceutical and automotive applications remained strong throughout the quarter, but we experienced lower demand in U.S. residential construction and from paper mills in the U.S. and Europe. In the paper end market, demand in Europe has remained low with paper mill operating rates currently in the 70% range, and we saw some softness in North America as we moved through the quarter with operating rates in the low 80% range.

We did, however, see higher paper volumes in Asia, driven by our newest satellite operations in China and India and we expect operating rates in the U.S. to improve as we move through the year. First quarter operating income for the segment was $32 million, the same level as last year. Our pricing actions are beginning to catch up with the accumulated inflation we've absorbed over the last several quarters.

And going forward, we expect the benefit from price versus cost to expand margins further as additional price increases take effect. Looking to the second quarter, we expect to see improved demand in both the Household & Personal Care and Specialty Additives product lines. In Household & Personal Care, we expect demand for pet litter to remain strong and demand for Personal Care products to improve.

Additional selling price increases will take effect across pet litter as we continue to recover the significant inflationary costs we've absorbed in that business. In Specialty Additives, we expect to see similar demand conditions across the food, pharmaceutical and automotive end markets. Residential construction activity should improve sequentially based on typical seasonality but we expect demand to remain below prior year levels. Demand in paper markets will be similar sequentially, apart from typical customer maintenance outages in North America.

Finally, we expect to see continued recovery of previously absorbed inflationary costs through our contractual and negotiated selling price increases. Altogether, we see operating income for the segment increasing by 10% sequentially to approximately $35 million. Now let's turn to Engineered Solutions.

First quarter sales in the Engineered Solutions segment were $249 million, 6% higher than last year and 9% higher on a constant currency basis. Sales in high-temperature technologies grew 5%, driven by selling price increases and higher volumes in North America. Overall market conditions for this product line were in line with our expectations going into the quarter. Demand in North America for refractory and foundry products remained strong and demand in China began to recover late in the quarter. Sales in Environmental & Infrastructure grew 7%, driven by large remediation projects and higher sales of infrastructure drilling products into tunneling and horizontal directional drilling applications.

Operating income for the segment was $35 million, 5% lower than prior year, primarily driven by the slower start to the year in China. We also experienced higher logistics costs in the U.S. due to ongoing rail service issues, which are causing us to use more expensive modes of transportation. Looking ahead to the second quarter, we expect continued strong demand in North America for refractory and foundry products, and we expect continued improvement in China foundry demand. In addition, we have solid order books heading into what should be a stronger period for environmental, infrastructure and commercial construction projects.

In total, we expect operating income for this segment to increase 10% sequentially to approximately $39 million. Now let's review our balance sheet and cash flow highlights.

Total liquidity at the end of the first quarter was $437 million, up slightly from the fourth quarter and net leverage improved to 2.3x EBITDA. Cash from operations increased $33 million versus the prior year quarter as the inflationary impact on our working capital has moderated relative to last year. As a reminder, the first quarter is typically our lowest cash flow quarter of the year. We deployed $24 million toward capital expenditures in the first quarter, bringing free cash flow to $9 million which is $28 million above last year.

And we expect our free cash flow to continue to improve as we move through the year. Our CapEx in the first quarter included incrementally higher spending on a few discrete projects, including our newest PCC satellites in Asia. For the full year, we continue to expect CapEx in the $80 million to $90 million range, which includesour normal amount of sustaining capital to maintain our operations and selective prudent investment in high-return, short payback opportunities. Depending on the timing of the spend on the new satellites we just announced, we could end up at the high end of that range, and we'll continue to update you as we move through the year.

At this point, we continue to expect free cash flow of approximately $150 million for the full year. The balance sheet remains in a strong position, and we are maintaining our balanced approach to capital deployment. Our near-term priority is to continue to move toward our target net leverage of around 2x EBITDA through debt repayments.

Now I'll summarize our outlook for the second quarter. Overall, for MTI, we expect another strong quarter ahead. In our Consumer & Specialties segment, we expect to see continued strong demand for pet litter globally, and we expect sequentially higher volumes in Personal Care and edible oil purification. Residential construction demand will likely remain below last year, but we should see an increase sequentially as we enter the peak construction season in North America. And we expect paper market demand to be similar to the first quarter with the usual second quarter customer maintenance outages occurring in North America.

In Engineered Solutions, we expect continued strength in North American steel and foundry markets, and China foundry volume should continue to recover on a sequential basis. In addition, the second quarter should be a stronger period for Environmental & Infrastructure project activity. We expect our margins will expand further from continued pricing adjustments and as the pace of inflation moderates, which will help us catch up on the price versus cost lag we've experienced for the last several quarters. And we expect our cash flow to improve as we move through the year.

Overall, our outlook for the second quarter assumes that end market conditions remain similar to the first quarter and that we'll experience typical seasonal improvements as well as continued sequential improvement in China. As of today, we have not heard anything to the contrary from our customers. In total, for MTI, we expect operating income to increase 10% sequentially to around $70 million in the second quarter, which equates to earnings per share between $1.25 and $1.30.

Before we go to Q&A, I'd like to remind everyone that MTI will be hosting an Investor Day on the morning of May 24th at the New York Stock Exchange. We hope you'll be able to join us in person, so please reach out to Lydia if you'd like us to save you a seat. More details will be posted on our website. But if you can't make it in person, the event will also be webcast. We're excited to share how MTI's portfolio of businesses and growth opportunities have evolved over the last several years to position the company for meaningfully higher growth and earnings power.

We'll be providing a deep dive into our current businesses, their leading market positions and their sustainable long-term growth drivers. And we'll also be highlighting what makes MTI unique in terms of technologies, capabilities and our culture of Operational Excellence. Thanks to our recent reorganization, the elements that make MTI unique and valuable are more evident than ever before. And that's why we believe it's a great time to share our story. So we hope you'll join us next month to hear and see more. And with that, let's turn the call over to questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

And we'll take our first question from the line of Daniel Moore with CJS Securities.

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

Start with, obviously, a really good preview of the Investor Day, and congrats on the solid progress in the quarter. You saw a net margin uptick. And obviously, you're pointing to additional margin expansion in coming quarters. I just -- I think there's kind of a wide range of expectations. So previously, you had said 13.5% to 14% margins were kind of a goal by H2. Is that still what you're thinking? And is that on an annualized kind of run rate basis?

There's typically some seasonality where Q4 would be lower, at least pre-pandemic we saw that. So just want to think about kind of the cadence for margins and how we should be thinking about -- how you're thinking about that expansion over the next few quarters.

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

Yes. Thanks, Dan. This is Erik. I can take that one for you. So what I said last quarter was that just based on our price versus cost catch-up alone, we have line of sight to 150 to 200 basis points of margin improvement by the end of the year on a run rate basis. So that's on a full year run rate basis. And like you said, we do have some seasonality in the fourth quarter. But what that means is, we're going to -- we expect to see sequential margin improvement through this year as our pricing continues to catch up with that inflation and as the inflation moderates.

And I will say what we've experienced so far this year has been in line with our plan, our expectations from an inflation perspective. Energy has been down a little bit, and that helps, not quite back to pre-2022 levels, but definitely down from the peaks that we saw last year. As I mentioned, our freight -- our sea freight, in particular, has come back down to more reasonable levels here in the first quarter.

So from an inflation side of things, everything is -- has been happening according to plan. And from a pricing perspective, we're also on our plan for pricing adjustments. And the majority of those have been put in place already in the first quarter and in April. We will have some continuing contractual pricing adjustments happening later in the second quarter and in the third quarter and some additional pricing adjustments taking effect, but the majority of the pricing has already been put in place. And so we still see that margin improvement happening on a sequential basis through the year.

In terms of the year-over-year overall margin improvement - now remember, so 2022, we did 12% operating income margins for the full year. That margin improvement on a year-over-year basis is going to be back-end weighted this year.

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

That is very helpful, Erik. I appreciate that. Shifting gears, really good to see the new paper agreements that you signed. Just talk about NewYield and how that's gaining traction specifically and more generally, what's the pipeline of additional opportunities looks like?

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

Yes, sure. Let me take that one first. We're really excited about these new satellite opportunities and contracts, Dan. Specifically to NewYield, I'm going to let DJ talk about it a bit. But this comes directly from -- but in my comments that crystal engineering, so our ability to be able to, in this case, repurpose a crystal to reshape it or to modify it to become a functional additive, it's kind of core to what we do. It's the same as the technology of growing a crystal for a filler in paper or to grow a different type of crystal to become gloss on a box or another product. This is our ability to take a waste stream and be able to understand that crystal and reapply it. And so one of these contracts is for that new product. So D.J., you want to take us through the timing and a little bit more depth there.

D. J. Monagle - *Minerals Technologies Inc. - Group President of Consumer & Specialties*

Certainly. So Dan, let me unpack kind of the state of new business development and the progress you're going to be seeing. We had already announced expansion into packaging with a GCC satellite. We announced that some time ago, and that will be coming on towards the second half of this year. And that's that provides gloss and a high-end packaging application. We've also already announced, and this is what Erik was referring to with the new PCC satellites, the new opportunities, both in China and in India.

And those were standard PCC applications in printing and writing grades. And those are about 70,000 tons per year, and they're continuing to ramp up. So they've been completed, started in the second half of last year and the first quarter of this year and the they're ramping up. Now with this last announcement that we had, we had 3 PCC agreements. They total about 180-some thousand tons. One of those is a pretty key investment with a company called Nine Dragon. So this particular application is standard PCC and printing and writing grades. But Nine Dragon is a packaging company. So we're going to be able to work with them and expand that crystal, that product into some packaging grades there.

We also announced some 60,000 tons that come online with Zhefeng New Materials. Again, this is a specially tailored PCC that will go into specialty grades. So some printing and writing grades, but the specialty grades will include things like food wrap and those applications. And then the last element that we announced to which you're referring with NewYield LO is a new variant on a platform we had developed some time ago. And that's with -- that's going to be deployed in India with Andhra Paper.

And that's going to be some 40,000 tons in that application. So the right way of looking at the immediate trajectory is that the 70,000 tons of PCC was -- a good part of that was in this growth, and there's still some more to come towards the second half of this year, that PCC -- that GCC will come online. And then also that 185,000 tons of PCC will be second half of this year and early into 2024.

Now I'll tell you just going a little bit further on the NewYield LO. And I do want to link it to what Doug was referring to with the crystal engineering. All of these PCCs have been tailored for these unique applications. What we're excited for about the NewYield LO is we are repurposing this waste stream from the customer. And in this particular application, we're building the satellite around the concept. So that customer would be disposing and landfilling this waste product, and we're able to take a good portion of it now and put it into the paper and provide a high-quality printing and writing grade paper.

So that is allowing for their high performance, but it's also reducing their costs. So in general, we do have some further pull for this. This particular application is mostly in these developing regions where their paper machine is designed and it has some of that waste. They'll no longer landfill it. So we think that this really bolsters our ability to continue to penetrate the market and at the market share that we've enjoyed in the past. I hope that helps.

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

Absolutely does. And from a revenue perspective, I think it used to be like $100 a ton when there wasn't a lot of inflation. And I know these are all different end markets and different applications, but still in that kind of $100, $150 to $200 per ton, is that the right thought process?

D. J. Monagle - *Minerals Technologies Inc. - Group President of Consumer & Specialties*

That's the right thought process. I can't give away any of those specifics, but that's a reasonable process that everything that's been deployed is consistent with our pricing, and I would say consistent with our returns. I would just remind you though that, that GCC opportunity that we had announced earlier, and we had said this in some previous discussions. That one's a little bit different. That's going to be some 320,000 to 350,000 tons of material. That is a different pricing model. That's a tolling arrangement but it's reasonable for you to think that the returns that we put on the capital there are consistent with what our business model is and the sort of income that's generated would be the size of, say, a small satellite.

Operator

(Operator Instructions)

We'll take our next question from the line of David Silver with CL King.

David Cyrus Silver - *CL King & Associates, Inc., Research Division - Senior MD & Director of Equity Research*

I'd also second Dan's comments about thanks for doing that walk through of the new segment setup. It helps just to hear things maybe more than one time. I wanted to ask you maybe about the remediation opportunities. So it was called out in the press release as a source of incremental growth. But I think it was referenced the water remediation and I believe to date the commercialization has been on the ground remediation side of things. So maybe just an update on the pace of commercialization or beta testing in your overall remediation portfolio.

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

Sure, David. Let me take you through just quickly what the types of applications that we provide in remediation space -- environmental remediation. A couple of different types, one is water for remediation. So these are things, groundwater, drinking water and these are areas where our FLUORO-SORB product comes in. So we're able to take impurities out of water. We also apply this in oil and gas in terms of our offshore deepwater flowbacks. We're able to remediate that water right offshore on that platform.

So this is a technology we have as part of the company where we create these media or even the systems to be able to, in some cases, pump and treat. So if you remember last year, we did a project for U.S. government military base, which had some PFAS contamination. That was an area where we actually pumped the water out of the plume underground, treated the water and then put it back in. That's a pump-and-treat application. The one I was referring to another area where we provide remediation services is in sediment capping.

This quarter, I mentioned a couple of sediment capping projects, one of which was here in New York City. It was the Gowanus Canal. We've been continuing to cap and work on that project over several years, but that was really moving forward this past quarter and another sediment capping project here in the United States on Lake George. So we're able to provide products that are able to cap in place and contain chemicals or things that sit on river beds.

The other area I mentioned is drinking water, industrial. We also have an industrial wastewater, so we'll go around to industrial sites, providing the media and, in some cases, the system to be able to clean up water on site. And I mentioned our drinking water where we've had some installations to begin to remove PFAS chemicals from drinking water systems. As you've probably noted, some of the news around that and some of the proposed limitations that the EPA is putting on PFAS on drinking water. We've been working for, as you know, several years with utilities to be able to provide the system and the media.

And we're finding that our product to be extremely effective to be able to remediate down -- by itself down to the levels the EPA is dictating. So that's a new area for us, but it all comes from that capability and technology to provide a particle or a substance that's able to take toxins or impurities out of water. Hopefully, that helps.

David Cyrus Silver - *CL King & Associates, Inc., Research Division - Senior MD & Director of Equity Research*

Yes. No, that's very helpful. I had a question maybe about currency and how it might affect your thinking for the balance of the year. But I think we're coming up on a lengthy period where almost every quarter, currency effects were a detriment to your reported results. And at least if I'm thinking of the dollar, euro and maybe some other relationship -- currency relationships, it looks like that's something that might flip here going forward.

So maybe over a 1- or 2-quarter period, I don't want to ask you to project currency rates too far out. But is that in effect, a factor that's likely to kind of flip from being a detriment to kind of a positive element of some magnitude? And what are the -- maybe the 1 or 2 key currency relationships that you're looking at, which maybe have been the most volatile and maybe we should keep an eye on in terms of the overall effect of currency on your reported results?

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

Yes. Thanks, Dave. This is Erik. So you saw that there was a bit of a reversal in our first quarter results. So on a year-over-year basis, we're still seeing unfavorable currency impacting our revenues. It was about a 3% impact in the first quarter on a year-over-year basis. That's less than it has been in previous quarters. And if you look at the sequential bridges, it was actually favorable moving from the fourth quarter to the first quarter as the euro strengthened a little bit. So just in broad terms, euro, USD matters for us, it's euro and euro-linked currencies that we're operating in, in that region. And so not going to project much further. But yes, on a sequential basis, it did flip to being favorable for us in the first quarter.

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

Yes. The only thing I'll add there, David, is that we have some -- it's not just your dollar. We have some kind of inter-region crosses that are mindful. We have euro lira, which impacts some of that currency and -- but the translation is mostly euro dollar. So we're not going to predict where currencies are, but you've seen the latest set of Europe and the economy seems to be maybe stabilizing or improving some. We'll see where the interest rate cards go. But I would think the tendency would be maybe for a weaker dollar going forward, at least from where it is today.

And given our mix of kind of revenues more heavily weighted to the U.S., that would be a positive for us. But I'm not going to go as far to say when that will happen, but probably later this year into next, I think that could be a positive for us and start to flip the other way.

David Cyrus Silver - *CL King & Associates, Inc., Research Division - Senior MD & Director of Equity Research*

Okay. Great. Last question would be just maybe a general thought about cost inflation here and how it affects your strategies or your plans to fully restore your margins to the desired levels. But in general, I mean, a number of my companies are talking about non-raw material elements in the cost picture. So last year was all raw materials and logistics. This year, it's more like labor, utilities, insurance and other kind of overall elements in the cost picture that are moving ahead even as raw materials have kind of stabilized here.

I'm just wondering if you're seeing the same thing? And secondly, more importantly, how do you anticipate offsetting that? In other words, the companies I talked to would say that it's just a harder negotiation to get reimbursed for cost increases that are not as visible, let's say, as raw material prices might be. So managing the overall cost elements in a still inflationary environment, maybe where the sources of the inflation are shifting.

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

Well, I'd say we're seeing the exact same thing. We have for some time now, at least the past 6 quarters. It's across the board. We're seeing raw material cost inflation. We're seeing energy inflation at least last year. Erik mentioned some of that's moderated. I would say, logistics and transportation. We're seeing labor inflation. But I also think there's another area that will continue to impact, and that is in the capital expenditures. So we're seeing CapEx and things that we buy, the satellites we build. And so therefore, having to make a return on that capital, that will increase potentially, it has the impact of increasing depreciation and being an additional longer-term way on margins.

And so we're across the board looking at that and how that impacts our cost structure in total, fixed and variable and working through pricing with our customers to manage that. Again, we always say we have very constructive conversations with our customers. I think some of the examples we gave you today are that we're not just selling a product necessarily. We're selling a solution. We actually work with them to tailor something to their product in the case of some of our paper and packaging contracts, we tailor something and then it ends up being a 10- or a 15-year contract, right, with the pricing that's negotiated that varies through that contract.

So we're able to find ways to protect ourselves but we also understand the value we provide to our customers in that solution. And so therefore, there is a fair margin and that we should be able to make. And I think they recognize that as well. Now pricing discussions are never easy. They're always challenging. But we're able to have very constructive conversations, and we've protected the company through contractual pricing that will revert to giving those margins back and then the negotiated pricing. But when you're providing a solution and a very valuable solution that's an easier conversation. If these costs continue to inflate, we're going to continue to drive our price to make sure we get the value we deserve and the products we provide.

So that's how we manage it, but we are looking at it, and we're seeing it in labor and transportation and raw materials and energy and in our capital expenditures. It's across the board and companies have had to deal with it. And I think we're dealing with it pretty well, although there's some time associated with how we pass that through. But I think as we've shown over the past year or more, we're very able to deliver pricing, and we'll get our margins back to where they should be.

Operator

And we'll take our next question from the line of Steve Ferazani with Sidoti.

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

On cash flow, I know you had a targeted range, obviously, much improvement over Q1 of the year ago. There was free cash flow even with higher CapEx. Sure, I think of -- I want to know your sense on cash conversion trends now that we're 5 months into the year and whether these sort of targets still hold.

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

You want to take that?

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

Yes, I can take that, Steve. So yes, I mean, as I mentioned, Q1 is -- our typically the lowest quarter of cash flow that we have each year. And so what we saw in the first quarter was back towards more of the normal levels that we expect. It was within our expectations. It doesn't change anything about our outlook for the full year. We're still expecting $150 million of free cash flow.

It's going to improve somewhat in the second quarter, but the majority of the cash flow, which is also typical is going to be in the second half. What is helping our cash flow this year versus last year is that moderation in inflation. Costs don't necessarily have to come down and they haven't that much. But as the pace of inflation slows, the impact on our working capital moderates and that cash flow starts to fall through. And so that's what you're going to see as we move through the year.

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

So still reasonable to think you can get to 2x or even under a year-end net leverage?

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

Yes. So our target is around 2x EBITDA. We're going to be using free cash flow to pay down debt. That's going to happen more towards the end of the year. It's reasonable to think that through debt paydown, building up cash from our cash flow and EBITDA, we're going to get much closer to that target.

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

Yes, Steve, with -- sorry, go ahead, Steve.

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

Please go ahead, Doug.

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

I was going to say, with $150 million of free cash flow, 2x leverage would be around $80 million of net. So within cash build and debt repayment, we see absolutely able to get to 2x or below. Some of that cash, we will maintain -- we generate cash both in the United States and overseas. We will hold that cash overseas. We use that for capital expenditures. So we don't have to move cash offshore. We'll use it for bolt-on acquisitions or we can make the choice to bring it back home, but there's a trade-off with that, as you know, with taxes, et cetera. So we make those trade-offs all the time, but we've got the cash flow to be able to hit that target within reason.

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

How do bolt-on opportunities look now that cash flow could be improving here?

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

I guess I'd say this year, we keep our eye on opportunities, they are out there. I'm going to tell you that, that's -- they're hard to time. We have a strong balance sheet to be able to purchase something and when it becomes actionable. I am going to say our bias this year is continuing to work on. We've got some real good opportunities and some strong profit growth to generate from the ones we've purchased over the past 3 years. So continuing to integrate North America Concept Pet. We've got -- we've worked on some of the, I won't say, easier things. But there's a lot of capacity there and some fixed cost leverage that we can go after as we move and we continue to grow these product lines.

So I think this year, really looking at making sure that we're generating the profitability. We want the maximum profitability of the acquisitions we've made over the past couple of years, paying down debt. But that's our focus. However, if something were to come up, small, we've got the cash in the regions and on the balance sheet to be able to execute on it. So I think we're in a really good spot with our balance sheet, Steve. But I think the focus is really going to be on ourselves this year and that debt -- and some debt paydown.

Operator

And we'll take our next question from the line of Mike Harrison with Seaport Research Partners.

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

Now that you've completed this reorganization, you've definitely indicated that there is some real streamlining that is associated with this new structure. I was hoping that maybe you could just give a little bit more color on what you're seeing now that these changes have been implemented in terms of how these segments are operating. And is there any way to quantify some of the benefits either in margin terms or growth terms or dollar terms, I guess?

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

Mike, you're just going to have to come to the Investor Day to get some of those questions. Look, yes. We're starting to see some -- we're going to quantify a lot of that for you in terms of what we see this -- these segments and these product lines becoming. Look, they are -- I want to stop and say, look, they are the same company that they were last year, but it's a better way to organize them around and what I'm trying to project to you these technologies, similarities and growth drivers.

And so what we are seeing is having those consumer on-the-shelf products, all in 1 group, the conversations that you think could be natural, but they were sitting in separate segments before around the innovation cycles. There are some common customers in there that we supply. And so being able to unify those conversations and being able to kind of present ourselves as a different kind of consumer product type solutions provider to big global consumer products companies is a bit different.

In some of the high-temperature solutions, we just had a couple of meetings with the R&D groups and getting them together to talk about these engineered blends and some of the things that's happening, I think there's a lot of sharing that's going on. There's some direct sales opportunities in terms of -- these foundries use refractory materials, and so there's some small synergies. I'm not going to go too far with that. In terms of being able to have conversations with the sales groups, the R&D groups and being able to look at that industry and there's similar strategies as they move around the world. So we're seeing that happen.

I think this will play out over time. I think the power of these segments will be evident as we go. I think it will yield faster innovation. It's certainly having more conversations in the company. I think that faster, even faster innovation and new products will yield more growth. I also think there's some synergies in thinking around the higher-margin products. And so a lot of the products that we've been developing over the past 3 years are targeted at higher growth, higher-margin type products. And they're growing the fastest. And so they will also be able to help our margin improvement going forward, and that's going to continue to accelerate with these new teams.

So look, sometimes you wonder, well, you're a company, why does it take this reorganization to get these conversations going? And you'd be surprised, once you put things together and once you put incentives in place, you start to drive a different type of dynamic and we're starting to see that. So that's what I meant by it's kind of a spark to the organization and put some energy in there. And I think we're going to see that, and we're going to talk a little bit about how we see that playing out over the next few, 5 years at our Investor Day in May. So hopefully, you'll be able to at least catch up on it if you're not able to make it, but hopefully you will be able to make it.

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

Perfect. Well, I appreciate the preview at least. I wanted to follow up on the NewYield offering. Is that something that you can retrofit with an existing satellite? It sounded to me, D.J., in your explanation that it's something that's integrated into the construction of the satellite. So do you have to start with a new project? Or is that something that can be retrofitted?

D. J. Monagle - *Minerals Technologies Inc. - Group President of Consumer & Specialties*

So Mike, I think the best way to think of NewYield is a capability that is very specific to how we apply that crystal engineering to which Doug referred earlier. And specifically, this particular product can be retrofitted to certain applications. We have a couple of advanced trials and negotiations that are contemplating that specifically.

So it can be built as a new satellite, and it can be retrofitted onto an existing satellite and tailored based on the specific environmental condition in this particular case of each customer. So it's not going to apply to everybody, but it does have a good application. I would also tell you that we're starting to get some pull from some packaging manufacturers that are interested in pursuing this technology as well. So it's retrofit, stand-alone and able to be a little more broadly applied than this particular application in printing and writing papers.

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

All right. Great. And then a question on the consumer business and pet care. You guys have worked to expand your position in private label. Curious if you're starting to see consumers starting to trade down because of inflation. And I guess, just maybe reiterate where private label margins look compared to the products that you're selling into big name litter brands.

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

Yes. Well, as a trend, I think over time, private label has been growing not just in the pet litter market, but in general, it's been growing faster than some of the branded products. Let me give you -- our pet litter business is not just private label, I'll give you kind of an overview.

Not only do we sell private label, we're the largest private label packaged litter manufacturer here in the United States. In Europe, the market is a little bit different, where it's all pretty much store-bought brands or -- and we're the premium in those brands. We're the largest premium cat litter provider in Europe. We also sell 2 branded manufacturers. So we sell bulk litter, a bulk bentonite that goes into clumping cat litter for the branded customers here in the United States.

And we're starting to grow that business in Asia where pet ownership is growing. It's naturally growing. I think pet ownership in China has grown at 15% over the past couple of years. So we've got some initiatives, and we've been there for a while, but continuing to grow in China. Also, we sell online. So we have multichannels. We're in the store. We're selling bulk to the branded and we're into online channels in Europe, North America and which is becoming a prominent channel in Asia and particularly in China.

Demand has been pretty robust. I mean, across -- I mentioned in my comments, across all regions, we've seen pretty solid demand in pet care products -- pet litter products North America, Europe and growing in Asia. I would say that it's a stable growth. We've been growing at between 6% and 8% pretty regularly. I think the category in total is growing a little bit lower than that. So that speaks to private label being a bit higher growth trajectory, especially in North America.

Margins, I can't speak to the branded customer company's margins. I can only speak to ours. Ours are good, and they're growing. And I think the growing margin piece of that is not -- it's driven somewhat by pricing, but I mentioned more of the fixed cost leverage that we're going to get from our system. We've built a system of plants and we have the mines to support it around the world, and we're not done leveraging that system. With

6% to 8% growth in pet litter, we've got plenty of capacity. We think that, that fixed cost leverage is going to drive margins in this pet care business even higher. So more work to do, but the trajectory of the growth and the margin improvement in this business looks pretty positive.

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

I guess just to clarify my question on margins. It is that you guys realized better margins on packaged private label products than you do on bulk bentonite you're selling to customers that use it in their blends.

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

I'm not going to answer that, Mike. We make sure that we have good margins on the -- we have good margins, solid margins in the bulk and across. I would say it really depends on the market. But being vertically integrated and having the resource, as I mentioned, we're in all those channels. I would say there's probably a 60%, 65% chance that in North America using clumping cat litter, you're probably using our bentonite in one shape or form. So that's the kind of position we have being vertically integrated, and we make sure that we get value for that resource.

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

Understood. Last question for me is just hoping that maybe we could get a little bit of a comment on the full year outlook. You guys talked about your expectation of driving sequential margin improvement as the year goes on. But I mean, do you have -- I guess, maybe I'll start here is do you have confidence that you're going to be able to show year-over-year EPS growth for the full year? Any other detail on guidance there for the full year would be appreciated.

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

Yes. So Erik gave a little bit of guidance on the margin. Let me start there, where we do see sequential margin improvement throughout the year. That's going to be -- that margin growth comes from the pricing that we have put in place and continued pricing that will come through some contractual pricing that will happen at specific times throughout the year. We are seeing some tapering of inflation, although transportation costs have been not tapering for us. And we see the net-net of that being margin improvement to the tune of about 150 basis points, 200 basis points on a run rate basis over last year.

So I think last year's margins were 12%. We think on a run rate basis, we can be at 13.5% by the end of the year, if not a little bit higher, like 14%. The EPS is a little bit different though. So that EBIT growth will come through. The EPS is a little bit different. The only -- the change there is interest rates. We're seeing a higher interest. We're about 50% fixed floating on our debt structure. That 50% floating is obviously a little bit more expensive, more expensive than it has been in prior years and that below the line kind of interest charge is costing us.

I think last year alone, over 2021, it was $0.40 of EPS. So EPS can grow, but we're going to have probably another -- I can't project, interest rate is probably another $0.30 drag on our EPS this year just due to interest and some tax changes that are happening around the world. So -- but I think net-net, our EBITDA will grow and how that translates into EPS this year is a little harder to predict based on interest rates.

Operator

At this time, I'd like to turn the call back to Mr. Dietrich for any closing remarks.

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

Thank you, operator. Appreciate that. I very much appreciate everyone joining today for our first quarter call. I do encourage you to join us for either virtually or in person for our Investor Day, love to take you deeper into these segments and their growth trajectories, and we hope to see you there. Anyway, thanks for joining us today. Take care.

Operator

This concludes today's call. Thank you for your participation, and you may now disconnect.
