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PRESENTATION

Operator

Good day, everyone, and welcome to the Second Quarter 2023 Minerals Technologies Earnings Call. Today's call is being recorded.

At this time, I would like to turn the call over Lydia Kopylova, Head of Investor Relations from Mineral Technologies. Please go ahead, Ms. Kopylova.

Lydia Kopylova - *Minerals Technologies Inc. - VP Investor Relations*

Thank you, Rachel. Good morning, everyone, and welcome to the second 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 the slides. 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 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. Thanks for joining. Let me give you a quick outline for today's call. I'll begin with the highlights that drove our results for the second quarter and provide some comments and context around our recent announcement on the talc business and details on the $10 million cost savings program we just initiated. Then I'll take you through our view of general business conditions, the trends that we're seeing across our end markets and the positive outlook we have for the second half of the year. Erik will then take you through the financial details for the quarter and our outlook for the third.

We published our latest sustainability report this past Monday and we're extremely proud of this year's report and the progress that it shows we're making on all fronts. I'm going to cover some highlights for you later in our presentation.

Let's go through a quick summary of the second quarter. We had a solid performance and delivered on what we committed to in terms of operating income, earnings per share and cash flow. Our teams remain focused on margin improvement and we expanded margins sequentially in both segments.

Let's start with our sales. In the Consumer & Specialties segment, sales grew 3% over last year despite facing some mixed market conditions. Our Household & Personal Care product line led the way with Pet Care sales up 15%, Edible Oil and Renewable Oil filtration up 13% and Animal Health with 29% growth. The Paper and Packaging market in Asia was healthier this year and our PCC volumes there were up 24% driven by strong pull from our newest satellites.

These positive sales areas were offset by lower sales in North America Paper and Packaging, which were down 18% due to paper customer destocking actions. Slower residential construction markets and lower demand for specialty food additives impacted sales in Specialty PCC, which was down 10%.

On the Engineered Solutions side, sales were slightly down compared to last year. We benefited from strong Metalcasting and Refractory sales in North America as well as higher Metalcasting volumes in China. We also saw significant growth in our Remediation and Wastewater business with sales up 86% driven by the continuation of 2 large sediment capping projects. These areas of strength were offset by continued slow conditions in commercial construction and the European steel market.

Sequential operating income grew by 12% and operating margin improved by 120 basis points driven by favorable price cost dynamics. The pricing actions that we have put in place are beginning to meaningfully offset the raw material inflation we experienced for the past 6 quarters.

Additionally, cash from operations doubled compared to last year. The higher working capital level we experienced due to inflation is beginning to release and convert to cash flow. As mentioned in previous presentations and at our recent Investor Day, we completed the business re-segmentation to focus MTI's energy and capital on our core markets, product lines and technologies.

An outcome of this realignment is an opportunity to streamline our organizational structure and reduce overhead costs. We expect to save $10 million from this program, which will be implemented over the next 3 to 4 months. And Erik will discuss the details in his financial section.

We also made an announcement that our subsidiary, Barretts Minerals Inc., is exiting the talc business. As was outlined in the release, we took a very careful look at all the circumstances concerning the Barretts subsidiary and made the decision to exit the talc market. A relatively small size of the business within MTI needed to be balanced against the outside costs and distraction from the escalating litigation environment that primarily involves other large companies, but has nonetheless impacted Barretts.

I want to reiterate that our talc is safe and we're proud of Barretts' track record of meeting its customer needs with the highest quality products and service. However, we're taking the step to divest its talc business and are now working to determine the transaction structure that best provides value to all stakeholders. Part of this process includes taking the prudent steps required to ensure that any liabilities associated with talc are dealt with both effectively and efficiently.

As you can imagine, a number of activities are ongoing while we move this process forward. Our intent is to move quickly so that all our energy can be focused on achieving our core long-term strategic objectives. We'll certainly provide further updates as the process moves forward.

So overall for the quarter, I'm pleased with our performance and the progress we're making with margin expansion and cash flow improvement. I'm also pleased with how our consumer-oriented businesses continue to perform well through mixed economic conditions, providing the balance that we expected to our portfolio.

Now that you're more familiar with our new segments and product lines, I'd like to share how we see the market playing out for them over the balance of the year. Overall, we have a positive view of our positions, market conditions and momentum going into the second half.

Let's start with the Consumer & Specialties segment. In Household & Personal Care, we expect demand to remain strong across the majority of our consumer-oriented product portfolio. Our Pet Care business is experiencing significant growth across all regions and for the remainder of the year, we see this demand continuing.

In other consumer businesses like Animal Health and Bleaching Earth for edible oil and renewable fuel purification, our customers are expanding production capacity and have new facilities coming online. This is creating new supply opportunities for us, and as a result, we're projecting to remain on our current strong growth trajectory.

Our Personal Care business has been experiencing lower volumes for most of the first half of the year due to customer destocking actions. Indications are that this will continue through the third quarter, but that we'll begin to see an increase in order volume in the fourth.

In the Specialty Additives product line, we expect North America -- the North American paper market to improve from a rather lackluster first half as our paper customer destocking activity concludes, and for the European paper market to remain stable for the balance of the year. We started up one new paper PCC satellite in India earlier this year and we'll start up 3 additional satellites, 1 in India and 2 in China over the next 3 to 4 months, which will support continued volume growth in Asia.

Additionally, we just announced a new agreement with one of our customers in Brazil for our new NewYield LO product. This technology leverages our crystal engineering platform to recycle a paper mill waste stream and offer our customers a more sustainable filler particle for manufacturing paper. We expect this facility to be operational by this time next year. Elsewhere in Specialty Additives, markets are mixed.

In North America, we see strong pull for pharmaceutical and automotive sealant additives for the remainder of the year, though demand for our specialty food additives is expected to remain soft through the third quarter, but pick up in the fourth.

Let's talk about the market trends in Engineered Solutions. In high temperature technologies, we expect the North America and European steel markets to remain at similar levels for the second half. Refractory sales will improve in the second half versus last year as we begin to benefit from the new Scantrol laser and application systems we've been deploying.

Speaking of which, this quarter, we signed another contract for this technology worth $10 million over 5 years. This is our 11th contract like this, demonstrating that this technology is truly unique and valuable to the electric steel furnace market.

The North America, foundry market was strong for the first half driven by relatively robust auto, heavy truck and agricultural equipment demand. We expect these conditions to remain through the second half and translate into continued strong Metalcasting volumes for the remainder of the year.

In China, our Metalcasting volumes have steadily improved each month this year, albeit at a slower pace than what we expected at the beginning of the year. In the second quarter, volumes grew 10% over last year despite the slower rebound. This is largely due to the growth and penetration of our latest blended technologies. Current signals from our foundry customers in China are that volumes will continue to increase through the remainder of this year.

In Environmental & Infrastructure, our outlook is mixed. We see stable demand for Wastewater and Water Remediation as well as for our Drilling Products throughout the balance of the year. Project activity for both our environmental lining and commercial construction waterproofing systems is expected to remain soft.

Before we move on, I'd like to make a couple of comments on the China market. There's been a lot of commentary recently on China and how their potential transition to a lower growth economic phase will impact companies who do business there. I've already made a few comments on our second half outlook in China for specific product lines, but I thought I'd give you a longer-term perspective on our business position.

China represents about 8% of our overall global sales. We primarily participate in 3 markets in China, Foundry, Paper and Packaging and Pet Litter. Changes in economic growth rates there will have an impact on our Metalcasting and PCC sales. But growth in these 2 product lines is driven more by the introduction and penetration of our new technologies and the substitution of existing products in the market.

For Pet Litter, the market is in the early stages of development and given its current size compared to the more mature Pet Litter markets in the U.S. and Europe, we see a long growth path ahead of us. China is still a relatively small region for us, but given our current market positions, we see being able to continue to grow sales at our historic rates despite potentially slower economic growth conditions there moving forward.

To sum up our market outlook, I have a positive outlook for the second half of the year and I'm pleased with the momentum we have going into it. We're making a great deal of progress leveraging our core technologies and expertise to enhance our positions in key areas. We see continued margin and cash flow growth in the second half and feel we're well positioned to deliver on the targets we recently laid out for you.

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

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

Thanks, Doug, and good morning, everyone. I'll review our second quarter results and I'll also provide our outlook for the third quarter. Following my remarks, I'll turn the call back over to Doug to cover some highlights from our latest sustainability report.

Now let's review our financial results. Before I get into the details, let me summarize by saying we had a solid quarter and our earnings performance was a reflection of our team's ability to execute despite near-term variations in a few end markets. We remain positive on our end market outlook and we are solidly on track for our target margin expansion.

Now, let's begin with the sequential quarter bridges on the left-hand side. Sales were $552 million in the quarter, up 1% from the first quarter, primarily driven by higher pricing. Volumes were relatively flat sequentially as destocking activity in a few of our end markets offset growth in other areas.

Operating income increased 12% sequentially to $71 million and operating margin improved 120 basis points. Our negotiated and contractual price increases are taking effect as planned, which, along with stabilizing input costs, are helping us recapture margin from the inflationary cost increases we absorbed last year. Operating margins improved in both segments sequentially as expected.

Turning to the year-over-year bridges on the right side, sales were 1% lower than last year. Foreign exchange had an $8 million unfavorable impact on sales. And on a constant-currency basis, sales were slightly higher than last year. As Doug mentioned, we continue to see growth in several of our end products, end markets such as Pet Litter and Bleaching Earth, and demand remains strong in other key end markets such as steel and foundry in North America.

However, volumes were impacted by weaker conditions in our project-based businesses within Environmental and Infrastructure as well as inventory destocking in the Paper market and in some of our consumer end markets such as Personal Care and Food Additives.

Second quarter operating income was 4% lower than prior year, primarily driven by the impact of lower volumes in the markets I mentioned. In total, we delivered $43 million of price increases compared with $29 million of cost increases. It's worth noting that this was the largest favorable net impact from price versus cost we've delivered in any quarter since the beginning of this inflationary cycle.

Now, before we get into the results for each of our segments, I'll review our second quarter EPS and the special items in the quarter. Reported earnings per share of $0.82 in the second quarter included special items of $0.49, including $0.16 of severance-related costs associated with our cost savings program and $0.33 of litigation costs.

As Doug mentioned, we initiated a cost savings program in the second quarter. Following our reorganization and re-segmentation earlier this year, we identified opportunities to further streamline the company's cost structure. We recorded $6.6 million of severance costs in the second quarter associated with this program and we expect to deliver $10 million of annualized savings starting late in the third quarter and ramping up to full run rate by the first half of 2024.

This cost savings program solidifies our margin improvement trajectory and gives us further confidence that we will remain on track to deliver our target margins. The litigation costs we incurred were to defend against claims associated with certain talc products from the Barretts Minerals Inc. subsidiary and to restore our reserve back to the level that is appropriate for the existing claim. Excluding these special items, earnings per share was $1.31 in the second quarter.

Now, I'll review the performance of our 2 segments, beginning with Consumer & Specialties. Second quarter sales in the Consumer & Specialties segment were $290 million, an increase of 3% compared with last year. Sales in the Household & Personal Care product line were 6% above last year. Our Pet Litter business remained on a strong growth trend with sales increasing 15% year-over-year.

We also saw significant growth over last year in Bleaching Earth, up 13%, and in Animal Health, which grew 29%. Partially offsetting this growth was the impact of inventory destocking we are seeing in Personal Care and Food Additives. While these markets are currently a small part of the portfolio from a sales perspective, we're highlighting the impact because of the higher margins they carry and because the company's margins will benefit when the current destocking cycle ends.

Specialty Additive sales were flat compared to last year due to several offsetting market dynamics in this product line. Sales are benefiting from higher prices, the ramp up of new PCC satellites and continued solid demand from automotive and pharmaceutical end markets. Residential construction has been more of a mixed picture with resilient demand for our products going into home improvement mostly offsetting softness in the products with more exposure to new housing starts.

Meanwhile, we experienced customer inventory destocking in the North American paper market as well as ongoing general market softness in Europe. Segment operating income improved 1% over the prior year and was 5% higher sequentially. This segment continued to make progress in recovering the inflationary costs incurred throughout the prior year and operating margin improved 90 basis points sequentially as a result.

Looking ahead to the third quarter, we expect to see similar market conditions overall in the Household & Personal Care product line with Pet Litter and Bleaching Earth remaining strong. And we don't expect a significant pick up in personal care order patterns until the fourth quarter.

In Specialty Additives, we expect North America paper production to increase in the third quarter to be more in balance with paper consumption. Demand conditions across other geographies and end markets should be similar sequentially. Altogether for the segment, we expect to see continued improvement in operating income and margin in the third quarter driven by modest demand improvement, additional price increases and stabilizing costs.

Operating income should be approximately 5% higher sequentially on continued margin improvement. I'll note that the Consumer & Specialties segment is the biggest driver of the company's overall margin improvement toward our target level and is on track to deliver that improvement.

Now let's review the Engineered Solutions segment. Second quarter sales in the Engineered Solutions segment were 5% lower than last year, but 5% higher sequentially. In our High-Temperature Technologies product line sales were 2% below last year and 2% higher than the first quarter.

Demand for Foundry and Refractory products in North America remained strong and overall sales were similar to prior year levels. Market conditions in Europe have remained soft through the first half. However, we are seeing sequential improvement in Asia and Foundry volumes in China are now above the levels we experienced last year.

In our Environmental & Infrastructure product line, growth continued for Wastewater and Remediation applications as well as for our Drilling Products. However, we experienced lower activity levels in commercial construction and for environmental lining systems. Overall, sales were 10% lower than the prior year, but improved 12% sequentially as the business entered its peak seasonal period.

Operating income for the segment was 8% below the prior year as resilient sales and solid execution in High-Temperature Technologies was offset by slower project activity in the Environmental & Infrastructure product line. Operating income grew 9% from the first quarter and operating margin improved 50 basis points to 14.7% of sales.

In the third quarter, we expect demand for High-Temperature Technologies will remain strong in North America and continued modest improvement in China, with Europe remaining slower. In Environmental & Infrastructure, we expect commercial construction and large-scale environmental project activity to remain similar to what we experienced in the second quarter. In total, we expect segment operating income to be similar sequentially.

Now, let's move to our balance sheet and cash flow highlights. Cash from operations in the first half was $79 million, more than double the prior year. Our working capital at the end of the quarter was $20 million higher than the same period last year. While the inflationary impact on our working capital has moderated significantly, it is still having an impact on cash flow and our businesses are still working through higher cost inventory.

We expect working capital levels to normalize further in the second half and we expect significantly higher operating cash flow as a result. Capital expenditures have totaled $46 million so far this year, bringing free cash flow to $33 million.

Our CapEx this year includes the construction of new PCC satellites as well as the completion of several new Scantrol automated refractory maintenance systems. For the full year, we expect capital spending to be approximately $90 million and free cash flow to be in the range of $100 million to $125 million.

Our balance sheet remains very strong. Total liquidity at the end of the second quarter was $437 million and net leverage was 2.4x EBITDA. So far this year, we used free cash flow to pay down $20 million of debt. I'll note here that approximately 50% of our debt has a fixed interest rate, which we achieved through our fixed-rate notes and by fixing a portion of our variable rate debt with a hedge instrument. And we've had that 50% fixed variable ratio for the last several years.

In the second quarter, our average interest rate was approximately 6%, which was 160 basis points higher than the same period last year. And this translated to more than $4 million of higher interest expense in the quarter or approximately $0.10 of EPS. Year-to-date that figure is $8.5 million or approximately $0.20 of EPS.

Our near-term priority for capital deployment continues to be debt repayments to move toward our target net leverage of 2x EBITDA as well as mitigate the higher cost of interest. Our fixed floating debt ratio also positions the company well should the interest environment change.

Now I'll summarize our outlook for the third quarter. Overall for MTI, we expect another solid performance in the third quarter. We are forecasting market conditions to remain relatively stable from the second quarter. Demand for Pet Litter, Bleaching Earth and Animal Health products should remain strong and we should see modest sequential improvement in North American paper volume.

We expect residential construction and automotive will be similar sequentially and that other consumer end markets will remain mixed with Personal Care destocking likely to continue until later in the year. We expect North American steel and foundry markets to remain stable and we're are assuming modest sequential improvement in China foundry volumes.

However, commercial construction activity and environmental lining systems will likely remain slower. We have incremental pricing actions taking effect in the third quarter, which will help to keep us on track for continued margin improvement.

Our cost savings program will support continued margin improvement later in the year as well the expected rebound of orders for our Personal Care and Food Additive products. Overall, for MTI, we expect operating income for the third quarter to be in the range of $70 million to $73 million or approximately 4% to 9% above last year and earnings per share between $1.30 and $1.35. The company is on track for continued margin improvement and higher levels of cash flow and we are taking action to ensure we stay on track.

With that, I'll pass it back to Doug for a quick preview of our latest sustainability report. Doug?

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

Thanks, Erik. Before we conclude, I just want to make a brief mention of the publication of our latest sustainability report. This is the 15th year we've published the report, demonstrating that sustainability is not new at MTI. For us, it's always been part of how we do business. Sustainability has been a central tenet of our values and an essential part of our business strategy innovation pipeline and employee engagement.

Leading with our values, our entire organization is passionate about reducing our environmental impact, protecting natural resources, ensuring the safety of our employees, creating an open, welcoming and transparent work environment, being accountable, being humble and always winning with integrity.

A couple of highlights from this year's report. You'll see that we've already exceeded our 2025 environmental targets in 4 of 6 categories. We made progress on moving to sustainable energy sources. Our largest processing site recently converted to 100% renewable diesel for their heavy equipment fleet and we've significantly increased the amount of power we're sourcing from renewable sources.

Our core technologies are being leveraged to provide sustainable products to the market and the report outlines how we see further development of more sustainable solutions as a significant growth driver for us. There are several other highlights shared in the report along with extensive data on our progress.

I want to thank everyone at MTI for their hard work and dedication to these efforts and particularly those who participate in our Sustainability Lead Team. I encourage you to take a read through the report, which is available on our website.

Okay, let's open it up for some questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Daniel Moore with CJS Securities.

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

Let me start with the cost reduction initiatives that you described. Just from a high-level view, would you describe them as kind of being more offensive rather than a reaction to any softness in any particular end markets? And how much of those do you expect to fall to the bottom line versus perhaps being reinvested?

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

No, I do think its offensive. Look, as we went through our restructuring -- we highlighted at the Investor Day a couple of areas where we thought there'd be some efficiencies. And though I didn't highlight a lot of cost efficiencies, once we got into it, we started to see that the organization was operating in different ways. There is a lot of focus that was put around our 4 new product lines, the technologies that were in there and -- more of the support of those. And finding that some of the silos that perhaps we didn't see were broken down and there are some areas of efficiency.

So I think it's -- as we do all the time in the company, we're constantly looking for ways of being more efficient. And so, I think this is little bit more offensive. I do think, though, that it's prudent that we make sure that our cost structure is in solid shape and is efficient as possible.

Given the forward look, it's been a little bit murky at least going through the beginning of the year. So we think it's prudent to do so. But I think it's coming more from an offensive standpoint, Dan. We think the majority of it will fall to the bottom line. We're projecting $10 million of cost savings run rate by the beginning of the year next year, and they will be implemented over the next 3 to 4 months. So you will see some savings in the fourth.

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

Very helpful. And then just kind of a cadence question. Doug, you described a few markets where you could see orders picking up in Q4, plus you start to get a little bit of the benefit of the cost reductions on the margin for -- on the margins. Having said that, Q4 is -- Q3 is typically a fair bit stronger than Q4 seasonally. So just how do we think about putting that altogether from a seasonal perspective? Do you still expect Q3 to be kind of the peak quarter from a profitability perspective?

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

Yes. This is Erik. I can take that. So that's true in terms of seasonality that we typically see a little bit of a drop off in our sales mainly around residential -- mainly around construction in the fourth quarter. But I will say that we're still on track from a margin perspective. In terms of what we said last quarter and at the Investor Day, we plan to be at 13.5% on a full year run rate basis by the end of the year, moving to 14% next year and 15% by 2025.

I would point out -- you saw in the bridges for the second quarter volumes have been unfavorable, and that's been impacting -- that impacted margins in the second quarter. But we have a lot of activities going on to offset that. I would say the price versus cost catch up alone is enough to get us to where we would expect to be by the end of the year. And we -- the pricing actions are still resulting in favorable pricing impact to our revenue on a year-over-year basis.

So that's going to continue. We should also benefit from some of the higher margin products coming back in the fourth quarter. On top of all that, we've got the cost savings to kind of bolster that improvement. So yes, we're still confident in getting to the 13.5% run rate. On a full year basis, margins should be at or above where we are in the second quarter, in the third quarter, and looking to hold that into the fourth despite some of the normal seasonality that we have.

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

Yes, Dan, I'll just -- I'll add to that. My comments were a positive second half to the year. And the reason we have that view is because going into the third quarter, we see a lot of the destocking actions that we saw in the first and second ending, right. So we see a positive third quarter.

And then even further out, some of -- the areas like in Personal Care and some of the other areas that are very profitable for the company, we see those order books are -- we expect to see those order books turning north. So we've got a number of positive items coming at us in the second half, and that's what gives us the confidence to kind of make the statements we did.

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

Very helpful. It sounds like if there is a little bit of a seasonal dip, it would be lighter than what we've seen previously given all those factors that you just described. Maybe the last question from me would be from a capital allocation perspective, what you laid out at the Investor Day was an EBITDA above $500 million, free cash flow conversion of 7% of revenue. By our estimates that could be $700 million, $750 million plus cash flow over the kind of planning period. Talk about -- I guess near term is the focus to maybe pay down a little bit of debt. But how far would you want to push your leverage down before maybe thinking about being more aggressive be it M&A or even wrapping up on buybacks?

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

Yes. I think in the near term given what we see as savings in terms of interest and making sure our balance sheet is in good shape around that 2x leverage, that's where our focus is going to be. Like Erik said, we think just with the cash flow generation in the back half of the year, we should be able to hit that target.

As we go forward, we'll look at the environment, we'll look at where interest rates are, but we're always looking for growth and potential acquisitions that fit the company. And short of those, we will allocate that capital to shareholders and we usually do that through share repurchases, although we're looking at all different ways to make sure that our allocation to shareholders is appropriate.

So right now, I think for the rest of the year we're going to be looking at debt pay down, getting the balance sheet to our target levels, see how things pan out next year with acquisitions. If not, that excess cash flow that we -- that you've noted that we'll be generating, we will be steering that to shareholders.

We do tend to keep some on the balance sheet opportunistically, so we'll do that. But usually at least 50% of our excess free cash flow goes to shareholders, 50% on the balance sheet, so that we make sure that we have some money for small acquisitions here and there that may pop up.

Operator

Our next question comes from the line of Mike Harrison with Seaport Research Partners.

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

Looking at the PC&H sub-segment and that up 6% year-on-year number, I believe you said that Pet Care was up 15%. It would kind of imply that the other piece -- I believe Pet Care is 75% of that business or so. So it would imply that the other non-pet care piece was down like 20%. And it sounded like Edible Oil was up, Animal Health was up. So maybe just help me understand kind of how pronounced that destocking impact was as you look at some of those other pieces of consumer, particularly the Personal Care piece?

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

Yes, it's largely that Personal Care piece. I think Personal Care is a smaller piece of that segment, but I think was down 40% -- 42% in the quarter. So it's pretty pronounced. And as Erik mentioned, that's some high margin products for us. And we think that's probably going to continue through the third, Mike. But then like I mentioned, we think some of the order book will uptick in the fourth.

I think you've seen that in the marketplace with kind of consumer products have been going through a destocking phase. This portion of that product line faced that as well. But we do have a number of good trials going on for our new retinol delivery device -- retinol delivery systems with some major healthcare providers. So we think that that bodes well probably for the fourth and into next year.

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

Got it. And then I guess maybe just a couple more on Pet Care. In terms of that 15% year-on-year number, I'm curious how much of that was pricing. I think you guys were still trying to catch up on pricing there. And also curious if you're seeing a pickup in the private label side of that business. I would assume that there is some trading down that is happening in this inflationary environment. So are you seeing some faster growth on the private label portion of your Pet Care business?

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

So first question, I'd say of that 15%, probably 50% pricing, 50% volume. I'm going to say it's pretty balanced around the world. I'd say North America has seen some good strength in the order book, and all of that is private label. So I think the private label in general, as we highlighted, has been growing probably the fastest as a category and I think we're participating in that.

So I'd say probably more of that was North America, but we also saw some good demand pick up in Europe as well. China, high growth small portion of the business, so I won't call that out. But I'd say to the first question, 50-50 price, volume; strong private label; the majority of that was in North America.

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

Perfect. And then on the PCC business, I'm just kind of curious if you can talk about price cost dynamics and whether you saw sequential increases in pricing for PCC as your contractual pass-throughs are kind of catching up there? And what does that mean for the pace of margin recovery in the second half in that PCC business?

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

Yes. This is what I've been highlighting for I guess several quarters. And last year when inflation was coming through -- the way these contracts are setup is with the delay mechanism -- we have to absorb a lot of this cost. I remember last year a couple of quarters, we were absorbing $2 million, $2.5 million worth of costs before we could pass that through. Well, now we're at that point where, as inflation starts to taper,it hasn't gone back down -- we're catching up on all that. All of that pricing is being pushed through.

In some areas, we're starting to see some of the energy, some of the input costs deflate. And that is what's driving some of that expanded margin. So it's really a function of those contracts and how they protect us in that business. And so, yes, we are seeing some of that. As long as energy prices continue to decline in certain areas, we will see that margin continue to expand through the back half of the year.

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

All right. Last one for me is on the free cash flow guidance. I think I missed that. Did you say $100 million to $125 million or $125 million to $150 million?

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

$100 million to $125 million, Mike.

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

Okay. Historically, you guys have been kind of closer to that $150 million to $175 million range. Is that kind of where you could potentially get to as we think about next year and beyond?

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

Yes, absolutely. I'd say we're sticking to that 7% of sales kind of ratio. This year, the biggest impact has been -- in the first half, we still had significant year-over-year inflation to contend with. And so, that continued to kind of push out the normal working capital cycle. But the second half should be very strong. We're expecting $115 million to $135 million of cash from ops in the second half, $70 million to $90 million of free cash flow in the second half. So that's turning around in the short term here.

Operator

Our next question comes from the line of David Silver with CL King.

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

So a few topics, and this will be a little scattered. The first topic I wanted to ask you about, Doug, maybe would be your outlook or your take, your perception of the Chinese market, maybe Asia in general, but really China in particular. So I'm about halfway through my earning season and every company that has exposure there has called that out as kind of a negative comparison year-over-year. However, I think your company -- if anything, you were a little more positive and I think it was a positive factor you called out on PCC and maybe one other area.

So from your perspective as someone producing in the country, could you give us a sense of how they're reopening or their economic recovery has gone year-to-date?

And then secondly, maybe just a sense of overall demand for their products, I guess, the export-based products or things that move out -- are made in region, but move out. Just your sense of the activity levels in Asia and -- for you in Asia in general and China in particular, please.

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

So yes, I'll go back to the comments I just made in my remarks. We operate -- I think every company is little bit different in China, right, and it depends on what you're doing there. I guess we are largely -- we're largely localized. And what I'd say about that is we kind of source, produce and sell in the region. So we're not a large export -- we're not reliant on exporting or importing into the region. It's largely localized. That's the first piece.

Second piece, it's still a relatively small region for us, it's about 8% of our revenues. And I'm speaking about China, not Asia. The dynamics for us are a little bit different. They always have been. Yes, demand levels do affect us. Economic activity, whether it's 6%, 8% or 2% will have an effect on that 8% of our sales. But our growth and how we've been growing in that market over the past 10, 15, actually 20 years now is driven more by substitution and technology, new technology introduction.

So to give you example. In the Metalcasting business, bentonite is always consumed as a base in the binding systems that every foundry uses. But the technology that we deploy which creates a custom blend is still bentonite based, but it is a higher -- it is a more efficient way of making a cast product. It saves the foundry money in terms of throughput, productivity, scrap rates, quality, et cetera.

And so, we are able to -- and that's also -- we sell it at a higher price point than a base ton of bentonite. So we're able to,through this technology, increase our sales within a given amount of economic activity. The foundry is still producing the same amount of brake rotors or agricultural equipment or housing -- yet we're able to help them with yield. So our revenue can continue to go up higher because we're selling a more sophisticated product under a certain base load of economic demand, right? Now, the demand affects it, but we can continue the growth rate.

The same is for our Paper and Packaging. We're substituting other pigments for use as a filler or coating in paper with higher value ones with higher quality pigments or higher performing pigments. We're recycling waste streams, right? So we have low input costs and we're able to give -- generate revenue from taking recycled waste stream. So we have different revenue streams but again on the same load of paper because we're displacing an existing product that's being consumed.

The Pet Litter business is the third main. -- -- The market is small, it's developing, it's developing around bentonite. We're driving that development. Relative to mature markets that we just talked about earlier in North America and Europe, we see that it's going to continue to grow despite some of the economic slowdown that could occur, potentially transition to a lower growth economy.

So for us -- every other company has different positions in China whether they're exporting or what their positions are. But for us, we see that regardless of it moving to maybe a lower growth economy, we have new technologies, products and our positioning in markets where we can continue our high growth rate going forward. And that's what I was trying to portray or describe in my comments. Hopefully that helps.

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

Yes. No, I think it was maybe just in my view just kind of understanding maybe near term, not discounting the long-term potential, which is how it played into your most recent quarter or 2 of results?

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

Got you. My view on -- I got you. I probably didn't answer your question. My view on China, is just like everybody else. We thought it would rebound much quicker than it did. But I will tell you that it has continued to improve at least in our markets. And I'd say the foundry market is probably the best bellwether for how -- economic activity because it's based on industrial activity like automotive, heavy equipment.

Very slow first quarter. We saw improvements in the second and indications from our customers that it's going to continue to improve in the third and into the fourth. And we're seeing that order book go that way. So slower than we all expected going into the year, but absolutely I'm seeing it improved at least in our business. And the Metalcasting business, I think, is probably a good gauge for economic activity.

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

Okay. Great. I wanted to switch over to the NewYield project announcement in Brazil. And in particular, I'm just curious about how the economics and the capacity change surrounding the implementation of NewYield works. So I reread the release a few times and I just wanted to clarify that it seems like this is not a fundamental capacity increase, but it's maybe a case where what normally would go to a waste disposal unit is now going to be effectively recycled in the existing hardware, let's say.

So is it the case that when you implement NewYield, there is not necessarily any appreciable increase in plant output, I guess, without further investment? And if that's the case, how do the economics of that installation and whatnot, how does that work in practice? How do you get a return on your investment if the NewYield product effectively displaces some virgin PCC material?

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

Sure. How about -- D.J., you want to answer that?

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

Sure. So David, let me try and put this in context. We've got several satellites coming online in the second half. Doug and Erik have referred to them during the presentation. One of those is in India that is a NewYield LO satellite. So an element of NewYield that you're going to see is that it going to contribute to our geographic growth projections that we discussed during the Analyst Call. So NewYield supplements our ability to do further penetration, especially in those emerging markets. That would be one application.

When we were together for the Investor Day, I'd also indicated that one of the things that we're excited about in this application of our crystal engineering is that we have an opportunity to retrofit our existing PCC plants when applicable. This case in Brazil is the first example of that in use. Now what happens in terms of the economics is that we're able to take a material that would typically be a waste material and require some landfill. And so, the customer benefits by eliminating or reducing a disposal cost and we benefit by having a much lower input cost.

So in those applications, if you see an upgrade, you can assume that it would be neutral to volumes, but it would be part of that margin improvement program that Erik is referring to. It will be contributing to the margin improvement of that business. But on other announcements, you will see it being part of our geographic expansion because it supplements that whole portfolio.

The last part as it relates to the NewYield platform is that we've got several packaging producers that are talking to us about how NewYield can apply into that space. And so, it would be a part of the offering that provides us an opportunity to penetrate the packaging market. So the particular announcement which you picked up on was right. But the broader impact of the platform is supplementing the growth and improving our operating income margin.

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

Okay. One last one and I think this would also be for D.J. But I would really like your opinion about the trajectory, I think, of paper and especially packaging growth, I think, from a secular perspective. So pre-pandemic -- sorry, pre-pandemic everyone was talking about reducing packaging in all manner of ways of accomplishing that. And if you read a consultant's report, as I did, I mean everyone would point to maybe a negative demand trend in paper use in particular. But since the pandemic -- and I see this every week when I take out my paper and cardboard for recycling, I mean it's just been a real turnaround in the way people view that particular waste stream and usage.

So from your perspective, as you think out maybe 3 to 5 years, I mean is this the case where apart from your technologies, I mean, that you see like a growing demand for packaging? Will the pandemic era boost in delivered goods in the packaging that accompanies that? Is that going to be sustained in your opinion? Or is that somewhat negative annual rate of consumption decline, I guess, is that going to reassert itself? What is your view from maybe a 3- to 5-year perspective starting now?

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

So David, I'm processing and figuring out the best way to answer it. And it's -- let me try to distill it down. If I look at the printing and writing grades, we still see some of the secular decline. But what we're seeing in that short term and it probably continues in that 3-year look is that we saw a spike in North America. But that recently we just saw the destocking that went on. But in North America some capacity has just recently come out of the market.

And in North America, that industry goes back to probably 85% plus operating rates, which seems pretty sustainable for the next 3 plus years or so. Hard to tell for sure, but that's what it looks like. Europe, we see that being -- that has been on a decline, but it has not been in the grades in which we participate. So Europe seems to be going through a rationalization period. That is augmented or offset by continued growth in Asia, particularly China, where, although their growth has slowed down over recent years, it's still a growing region. India as well.

So on balance in that look, printing and writing grades still come down a little bit, but not a lot. It seems to be a gradual decline. On the packaging, we've seen a shift that's going on as people have converted some of that old capacity into making some packaging. So the packaging overall consumption, it kind of depends on the type of packaging. The way we look at it is there these high-end boxes that hold the iPhone or a crate, a box of golf balls, that seem to be pretty steady or growing at a slight rate.

The recent shift has been -- brown boxes have come down slightly since the pandemic era and there's people taking a pause and seeing how that goes, but long term that will probably grow at GDP plus sort of rate. And then what's been supplementing that or growing at a greater rate than that is this kind of in between box. It's a white top box. That's where we've had recent applications both in Europe and North America, where that Amazon box that you're getting is no longer just a brown box, it's well printed. So that will be growing as well.

So it's, overall, packaging's still growing, the overall printing and writing probably flat. But that flat is deterioration especially in Europe, growth in Asia. Does that balance out the thought.

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

I asked you an impossible question to answer. So I really appreciate you handling that on the fly. That's all from me.

Operator

Our next question comes from the line of Steve Ferazani with Sidoti.

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

I wanted to ask about the updated free cash flow target. Anecdotally, we're certainly hearing cases where -- I know traditionally your second half you benefit from receivables conversion. But we're hearing anecdotally that maybe those conversion cycles are stretching out a bit, everyone's trying to hang on to cash a little bit longer. Is that -- are you seeing that? Is that playing at all into your cash flow guidance?

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

Yes. The answer is, no, we're not seeing that. I mean, we look at our receivables balances very closely and our DSOs. They're staying around 60, 61 days. And that's been consistent over the last several years. So we're not seeing those stretch out.

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

Okay. Perfect. And then in terms of your margin targets for at least for end of year, what are the variables that may affect that? It sounds like you've gotten the pricing in Pet Care. Certainly, we've heard that it's getting harder to get more pricing on the consumer side. And I know you have some contractual resets. What's the variables that will -- could affect you? If get exceeding or missing the year-end targets at this point, what are the most likely variables?

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

Well, I would say in terms of the things that are with our -- within our control, we feel confident. We've got everything in place to get there. I would say that -- again, if you look at our bridges for the second quarter, the volume impact, the variations we saw in some of the end market volumes in the second quarter, if you just do the math on that, that's 190 basis points of margin that we offset in the second quarter. So once those end markets that we spoke about start to come back, that's the biggest upside I would say to our margins, is getting that volume leverage back on some of the softness that we saw in the second quarter.

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

Yes. I'd say some of that -- like our assumptions around the fourth quarter are some of our higher margin products, that destocking does not end. But even then I think -- I do think that we're on track to hit those targets, Steve. It's little hard to predict what will happen. If the economy does fall off or something happens, that could be a challenge. But right now, we think we've got it in place. We've got a cost savings program. And so, we've got some levers that we've pulled to make sure we get there.

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

Perfect. And then just last one in terms of your expectations on timing on paying down the revolver. Obviously this quarter, you could see the year-over-year impact from interest expense. We had another rate hike. How quickly do you want to get that revolver down to get interest expense lower?

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

As quickly as possible, Steve. The higher free cash flow in the second half is certainly going to help.

Operator

Our next question comes from the line of Mike Harrison with Seaport Research Partners.

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

Just one more for me. I didn't want to let you off the hook on the talc announcement. Just curious, it looks like as of the end of last quarter you had 460 open cases. I know the new number will be in the Q when it comes out. But where is that number today. And I guess as you think about -- you're looking at divestiture, but I believe your press release also used the term structural alternatives. So is it your intention to exit or dispose of that business in such a way that you do not end up with legal liabilities or any exposure to further litigation related to that business.

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

Yes, that's correct, Mike. So I'll give you the number. Right now, the number you'll see in the Q is 501 cases. And I think that reflects kind of what we're talking about in terms of the increased kind of litigation environment that we're facing. But yes, we're looking at a comprehensive solution for both assets and ensuring that the liabilities are dealt with efficiently and effectively.

So right now, we've started that process. We've made the announcement. We've looked at this. The business, again, is relatively small, under 3% of the company's sales. We're weighing that against kind of the ongoing cost to defend ourselves against what we see are meritless claims, the ongoing litigation environment and have made the decision to exit the business.

Putting the business up for sale, we're looking at various alternatives. But yes, it will be dealt with -- or we're looking at structural solutions to deal with both assets and the liabilities of the business. So more to come on that, and we'll certainly give you an update as the program develops.

Operator

(Operator Instructions)

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

Okay. Thank you, operator. Thank you everyone for joining today's call. We'll see you and talk to you again in 3 months. Thanks a lot.