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Corporate Participants

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John E. Panichella – Senior Vice President and Group Operating Officer, and President, Ashland Specialty Ingredients
Lamar M. Chambers – Chief Financial Officer & Senior Vice President
James J. O'Brien – Chairman & Chief Executive Officer

Other Participants

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MANAGEMENT DISCUSSION SECTION

Operator: Good day, ladies and gentlemen, and welcome to the Ashland Incorporated Fourth Quarter Earnings Call. [Operator Instructions] As a reminder, today's conference is being recorded.

I would now like to turn the call over to David Neuberger.

David A. Neuberger, Director-Investor Relations

Thank you, Jamie. Good morning, and welcome to Ashland's fourth quarter fiscal 2012 conference call and webcast. We released results for the quarter ended September 30, 2012 at approximately 6:00 a.m. Eastern time today and this presentation should be viewed in conjunction with the earnings release. These results are preliminary until we file our 10-K.

On the call today are Ashland's Chairman and Chief Executive Officer, Jim O'Brien; Lamar Chambers, Senior Vice President and Chief Financial Officer; and John Panichella, Senior Vice President and Group Operating Officer responsible for Ashland Specialty Ingredients and Ashland Water Technologies.

As shown on Slide 2, our remarks today will include forward-looking statements as that term is defined in securities laws. We believe any such statements are based on reasonable assumptions but cannot assure that such expectations will be achieved.

Please also note that during this presentation, we will be discussing adjusted and pro forma results. We believe this will enhance understanding of our performance by more accurately reflecting our ongoing business.

In addition, we are providing ISP's historical financial contribution, representing Ashland's best estimate of the appropriate cost allocation and shared resource costs. Reporting results in this manner has inherent limitations, and we do not represent that these financial results were calculated using the same methodology used by ISP.

Please turn to Slide 3 for our fourth quarter highlights. In the September 2012 quarter we reported a loss of $3.47 per share from continuing operations. This reported loss included a $3.88 unfavorable expense related to pension which I will describe shortly. When adjusted for pension and other key items, EPS was $1.87 as compared with $1.01 in the year ago quarter.

We acquired ISP on August 23, 2011 and the prior year only includes a partial quarter of the ISP results and related financing. For the rest of the presentation and to aid in your analysis. We will generally present results on a pro forma basis, which includes the results of ISP in prior periods.

On a pro forma basis, sales were $2.1 billion. When we normalize for currency and adjust for divestitures and joint ventures, pro forma sales would have increased 3% over the prior year quarter. While sales growth has been tempered due to the macroeconomic environment, Ashland achieved a roughly 30% increase in pro forma EBITDA with EBITDA margin of 17% during the quarter. These improved margins were driven by strong pricing and cost discipline with Specialty Ingredients, Ashland Performance Materials and Ashland Consumer Markets all generating year-over-year increases in profitability.

Another highlight was the recent refinancing of roughly 90% of our 9-1/8% notes. We also implemented an accounts receivable securitization program. These combined actions should save Ashland roughly $40 million of annualized interest expense. Last, we generated $154 million of free cash flow during the quarter due to a combination of good business performance and improvements in trade working capital.

Slide 4 details our key items. In total, five key items had a net unfavorable EPS impact on continuing operations of $5.34 in the September 2012 quarter. The first key item is an $8 million after-tax charge or a negative $0.10 per share related to an impairment of the in-process research and development originally being worked on by ISP. As part of the initial purchase accounting, values were assigned to a number of R&D projects then in the pipeline. During the quarter we discontinued some projects in order to increase focus on higher return opportunities. If the discontinued projects had a value assigned an impairment charge was taken shown here.

The second key item is an $18 million after-tax charge or a negative $0.23 per share related to various restructuring activities and the integration of ISP. Roughly half of this charge stemmed from plant rationalization projects which when completed should lead to better utilization rates and improved fixed cost absorption. The remaining half is primarily related to the integration of ISP.

The third key item is a $307 million after-tax charge or a negative $3.88 per share related to our now annual pension adjustment. As described in the past, Ashland recognizes pension gains and losses in the year in which they occur. This non-cash book loss was primarily due to an approximately 100 basis point reduction in our discount rate since our last actuarial revaluation.

Our fourth key item is a $63 million after-tax charge or a negative $0.80 per share associated with the various debt refinancing actions taken during the quarter. These actions ultimately led to the interest rate savings I mentioned on the previous slide.

Last, we incurred a net $26 million tax expense or a negative $0.33 per share. This was due to certain deferred tax adjustments related state valuation allowances and our international restructuring activities.

In the year ago quarter, six key items combined for a net unfavorable impact on earnings of $4.51 per share.

To aid in your analysis versus the peer group Ashland's results included $29 million of intangible amortization expense during the September 2012 quarter. We carry higher than average amortization due to our corporate transformation and prior acquisitions. Without this amortization, earnings would be roughly $0.25 higher or $2.12 per share.

Please turn to Slide 5 for Ashland's adjusted pro forma results. As a reminder, results are presented on a pro forma basis, including a full quarter of ISP in the September 2011 quarter. As such, Ashland's September quarter sales decreased 3% over the prior year to $2.1 billion. This decrease was more than accounted for by currency translation, which had a roughly $80 million negative effect. Normalizing for currency and also adjusting for joint ventures and business divestitures, sales would have grown 3% over the prior year quarter. Sales declined 4% sequentially. This decline was due to reductions in our more commoditized products which includes guar, solvents and elastomers. More on this later.

Gross profit as a percent of sales was 29.5%, a 420 basis point improvement over the prior year. This increase was driven by improved pricing and lower raw material cost as compared to the prior year quarter.

Selling, general, administrative, and research and development expenses, collectively referred to as SG&A, fell somewhat to $376 million. SG&A benefited from Ashland's overall corporate cost reduction program as well as the effects of currency translation. EBITDA of $349 million grew an impressive 32% over the prior year, but was down 8% sequentially. EBITDA as a percent of sales was 17%.

Now turn to Slide 6 to review our volume trends. This chart shows underlying volume trends on a normalized and rolling four quarters basis. By totaling the trailing four quarters for each period we are eliminating seasonality and showing yearly growth. The data have been normalized for acquisitions, divestitures and joint ventures.

As shown, each of the commercial units has seen some evidence of a diminished macroeconomic environment. Specialty Ingredients, our largest and most profitable business, as well as our strongest growth vehicle is proving to be quite resilient. Volumes in this business are holding up well, although we have seen a flattening out in recent quarters. John will discuss this later. Performance Materials had been trending downward primarily due to reduced demand in Europe and the emerging regions. This trend has recently reversed largely due to a strengthening North American environment.

Water Technologies continued to remain soft, particularly in the mature economies. Ashland Consumer Markets has also declined partially due to the previously described loss of a low margin tolling account as well as market softness in North America. This situation is beginning to improve and you can see a recent leveling in Consumer Markets volume.

Despite the volume softness, Ashland's consolidated EBITDA increased considerably as shown on Slide 7. This chart shows what led to the September quarter's performance as compared with the year ago period on a pro forma basis. Improvements in margin drove the year-over-year increase in EBITDA. While Ashland's raw material cost declined versus the prior year quarter, we were generally able to hold on to previous pricing gains. Improved mix more than offset small volume declines, leading to the $17 million positive effect shown here. Mix effects were greatest within Specialty Ingredients which had a very strong performance in pharmaceutical this quarter.

Currency translation represented a $16 million negative to EBITDA. Nearly half of our business comes from outside the U.S. and the dollar strengthened roughly 11% versus the euro and almost 25% versus the Brazilian real. All together, EBITDA increased by $85 million compared to a year ago.

Now let's turn to Slide 8. We made a number of changes to our debt structure during the quarter. First, we completed the tender offer for nearly 90% of our 9-1/8% notes. This was financed with approximately $160 million of cash and the proceeds from a $500 million bond offering. The new bonds are 10-year non-callable unsecured notes with a coupon of 4.75%. We also put in place a $350 million AR securitization program which was used to partially pay down the relatively higher interest term loan B. These combined actions should save Ashland roughly $40 million, reducing fiscal 2013 book interest to approximately $180 million.

Total liquidity of $1.5 billion, which is cash plus available revolver and AR capacity, was consistent with the June quarter. This is due in part to the strong free cash flow generation in the quarter. Our gross debt was down to $3.6 billion and our net debt was $3.1 billion. I'll remind everyone that we have a long-term targeted gross debt to EBITDA ratio of two times. Given the reduction in debt and the company's growth over the last year, we have made significant progress toward this goal, and now stand at a leverage ratio of 2.6. This is down from the year ago ratio of 3.3 times.

I'll now turn the presentation over to John Panichella and will ask you to turn to Slide 9.

John E. Panichella, Senior Vice President and Group Operating Officer, and President, Ashland Specialty Ingredients

Thank you, David. Good morning, everyone. Specialty Ingredients pro forma volumes were down 1% from the prior year quarter. Over this comparison, most of our business held up well with a few exceptions. Our pharmaceutical and nutrition business did very well with volumes up 10% over the prior year quarter.

In contrast, our coatings and energy businesses were both down about 6%. In coatings, we had reduced demand in Europe and Asia due to the broader economic climate. In energy, we had a sizable decline in guar-based products, which were off by nearly a third. Pro forma sales increased 9% to $734 million with good mix and solid pricing versus the prior year.

Gross profit as a percent of sales was 34%. This was up 330 basis points over the prior year, but down 70 basis points sequentially. The vast majority of sequential decline is due to a shutdown at one of our major production facilities in the U.S. This type of shutdown is taken once every three years and it cost us roughly $6 million during the quarter. The plant is now back online. SG&A was $127 million in the quarter. While up versus the prior year, we view this as a good run rate going forward. Overall, EBITDA grew 25% over the prior year to $193 million. EBITDA as a percent of sales was 26.3%.

Slide 10 shows Specialty Ingredients' EBITDA bridge. Improved margin and mix were the primary drivers of the year-over-year increase in EBITDA. While overall volumes were down slightly, we had a very strong business mix during the quarter, leading to the $22 million EBITDA contribution shown here. Our higher margin pharmaceutical and personal care businesses did well and we saw a compression in our low margin intermediates and solvent product lines. Within solvents, volumes were up slightly over the prior year. However sales were off more than 10%. Solvents pricing has been declining the last few quarters due to reduced global demand and recent capacity expansion from our competitors. This later trend was described in detail at our November 2011 Analyst Day and is playing out generally as expected.

Margin contributed $38 million of EBITDA with price more than covering roughly $25 million of increased raw material cost, SG&A was up over the prior year to help support our strong sales growth leading to be effect shown here. In addition, currency translation amounted to an $11 million negative. Other effects led to $5 million of additional EBITDA. This is primarily due to higher income from a guar joint venture based out of Pakistan. In total, EBITDA was up $38 million over the year ago September quarter.

Please turn to Slide 11. Looking out through December, we expect guar to remain soft. Energy customers are destocking the positions they built up during the June quarter and we expect that to continue until January when the new crop becomes more widely available. I should mention that the guar dynamic differs by end market and product. We sell two main types of guar. Derivatized guars are highly differentiated, more technically advanced products that can help improve oil field yields and can also perform well under more extreme operating conditions. In these products, we continue to be in a sold-out position and are taking proactive steps in 2013 to expand capacity.

In our straight guar product lines, we have a more commoditized product which is experiencing large decrease in volume and sales. While margins held up reasonably well during the September quarter, prices declined significantly in recent weeks. Today, the implied price on straight guar products appears to be below our inventory values. If the implied price remains at these rough levels, we could have a potential $15 million to $25 million loss on these products during the December quarter. The likelihood of this occurring is impossible to predict and it could get better or worse. This is due to a pricing environment which remains highly volatile and can swing by up to 10% a day. Our current strategy is to largely hold onto materials now in inventory and wait for the market to stabilize before reinitiating sales or buying new material. Because of this strategy, the inventory risk is associated with material now on hand and should not be an ongoing issue.

Please turn to Slide 12, and I'll give you an outlook on the other parts of our business. Outside of straight guar, the rest of the business should perform very well. We expect solid year-over-year growth in our three primary areas of focus which includes pharmaceutical, personal care and coatings. We also expect good growth in energy products other than straight guar.

While we are always looking for ways to improve our cost structure, the primary strategy is to grow the top line. This growth will come from a combination of the overall market and our internal product development efforts. New products are critical to our long-term success and for fiscal 2012, they represented 21% of overall sales.

A great recent example is our new Natrosol Performax technology sold into the coatings industry. This product enables a faster, more flexible paint production process, while preserving critical performance characteristics, such as efficient thickening, stability and sag resistance. Initial customer response has been strong, and we expect this to become a flagship product for the future. We will share more details on this and other new technologies at our Analyst Day in December.

To support overall demand growth, we see great opportunities to expand capacity. These are high return projects with good underlying margins. For fiscal 2013 this should result in a $220 million capital expenditure for Specialty Ingredients, which includes roughly $100 million of growth investment.

Now let's go to the Water Technologies business on Slide 13. While still weak versus the prior year, Water Technologies' performance was generally consistent with the June quarter. The only material exception was increased SG&A expense, which I'll discuss shortly. Water Technologies' sales were $431 million, down 12% from the year ago quarter. Approximately $28 million or almost half of this decline was attributable to the strong dollar. Divestitures also played a role. Normalizing for these effects sales were off about 4%. Paper and industrial markets have both remained weak with currency-adjusted sales down approximately 4%. Sales were up 1% sequentially with paper and industrial showing small gains.

Gross profit was up 90 basis points from the prior year to 32.3%, a roughly equivalent performance sequentially. SG&A of $126 million was up $7 million versus the June quarter. This increase was due to a number of miscellaneous items such as bad debt and small write offs, none of which made up a majority of the increase. A number of these items should be non-recurring and we expect our run rate of SG&A expense to be more centered between the June and September quarters. At $33 million, EBITDA declined 34% versus the prior year quarter and EBITDA as a percent of sales was 7.7%.

Now let's turn to the bridge on Slide 14. When normalized for currency, the higher SG&A expense I mentioned earlier accounted for nearly half of the year-over-year decline in EBITDA. Lower volumes also played a role, accounting for an additional $7 million headwind. Excluding divestitures volumes were down approximately 4%. While we've begun to see some improvement in Latin America, all other regions have remained soft. In addition, given that one-third of Water Technologies' sales come from Europe, currency negatively affected EBITDA by $4 million. In total, EBITDA decreased $17 million from the year ago quarter.

Please turn to Slide 15. It has been a challenging year for Water Technologies, markets such as printing and writing have been weak and our performance within industrial markets has not met our expectations. While the business has stabilized at the sales and gross profit line, the loss of volume has continued to eat into profits. We can fix these issues. We have a number one position in the growing tissue and towel and packaging markets and see significant opportunities to expand our business in emerging regions. We've also increased our focus on industrial markets with limited results to date. The market potential here is significant, but we must improve our sales efficiency and overall execution to meet our financial targets.

Jim has asked that I step in to manage this business, and I expect to be involved for the foreseeable future. Keep in mind that I came up in through the water treatment industry, spending over 20 years within the Betz organization. Today I am directly involved in day-to-day leadership while still managing Specialty Ingredients. My day-to-day involvement will continue as we search for a new President and the search has already begun. I expect this period of direct involvement to be relatively short and plan to have the position filled in the near term.

Let's go to Slide 16. The problems within Water Technologies come down to two related issues. We've been unable to grow the top line and because of this, our SG&A spend is too large as a percent of sales. We need to address both issues. To grow volume, we need to improve execution and overall accountability. We want to make the organization more nimble and more capable of meeting customer needs. As a part of this objective, we're implementing a more disciplined approach to SG&A to better control our cost relative to sales growth. This should also lead to improved sales efficiency over time.

We also plan to implement tighter controls over pricing and the contract management process. This is an area where I am proud of what we achieved within Specialty Ingredients and I would like to replicate some of that success here. Obviously there is a lot of work to do. The actions being taken will require a few quarters for full implementation. However, I am confident that these steps will improve Water Technologies over the longer term.

With that, I'll turn the presentation over to Lamar Chambers, beginning on Slide 17.

Lamar M. Chambers, Chief Financial Officer & Senior Vice President

Thank you, John. Performance Materials had another good quarter in adhesives and composites and the elastomers business returned to more normalized margin levels. Performance Materials' reported volume and sales were down 11% and 15% respectively from the year ago quarter. When we exclude the effects of the Casting Solutions and the divested PVAc business, the normalized volumes were up 4%. This is largely due to continued strength in North America. Overall sales were $369 million and we achieved gross profit as a percent of sales of 16.3%, a 300 basis point improvement over the prior year.

Profitability gains were driven by adhesives and composites where we continue to benefit from the strategic actions we have taken over the last few years. These actions include capacity reductions and cost outs, which have raised utilization rates to around 90%. We're also benefiting from an improving North American construction market where we have seen good growth in both the residential and industrial areas. This has led to a significant improvement in profitability with adhesives and composite margins up over 400 basis points from the prior year quarter.

As expected, margins returned to normal levels within elastomers. This was due to a more stable raw material cost environment which was described in some detail during our June quarter call. For Performance Materials in total, we view normalized gross profit at current demand levels as being roughly in line with the September quarter. This level will vary to some degree based on normal seasonality and I will remind you that the December quarter is our seasonally weakest.

While not explicitly shown on the slide, we had a roughly $5 million sequential decline in equity income from our Casting Solutions joint venture. This shows up within Performance Materials' operating income. Part of this decline is due to normal seasonality, but we have also seen significantly reduced demand in the European transportation market. In total, Performance Materials' EBITDA was $31 million during the September quarter, with EBITDA margin of 8.4%.

Now let's turn to Slide 18. The effects of ASK Chemicals joint venture and a divested PVAc business are captured in the other category on this chart. Excluding those effects, increased margins were essentially offset by higher SG&A expenses. Margin alone contributed $9 million to EBITDA primarily due to the improvements in the adhesives and composites that I just described. SG&A, adjusted for currency was up $7 million. The prior year quarter had lower than usual employee expenses, leading to the increase shown here. The current level of SG&A has been very consistent throughout 2012 and we view it as a good run rate going into 2013. In total, EBITDA was consistent with the prior year quarter.

Now let's go to Consumer Markets on Slide 19. Consumer Markets achieved a significant expansion in earnings with volumes beginning to return, and margins increasing to more normalized levels. Lubricant volumes were down only 2% as compared to the prior year and volumes were roughly flat sequentially, significantly better than the normal 4% to 5% seasonal declines. This is due to continued strength outside the U.S. and better performance within the do-it-yourself market. DIY has been soft throughout 2012 due to a combination of high gas prices, customer destocking and consumers' delay of routine vehicle maintenance. Based on the latest market data, the DIY categories are beginning to stabilize, but they're still down somewhat versus the prior year.

Sales of $522 million were up 1% versus the prior year. Gross profit as a percent of sales was up 670 basis points to 29.7%. Gross profit improved due to the two recent base oil cost decreases that we described last quarter. These decreases have restored margins to more typical levels and we expect to hold price barring additional movements in our raw material cost. SG&A was down $7 million or 7% from the prior year primarily due to reduced advertising spend. Overall, Consumer Markets generated EBITDA of $83 million, more than double the prior year quarter and a 22% increase sequentially. We achieved EBITDA margins of approximately 16%.

Now please turn to Slide 20 for Consumer Markets' EBITDA bridge. Higher margins were the number one contributor to the year-over-year increase in EBITDA, accounting for $34 million of growth. Volume mix also played a small role with a stronger business mix offsetting slight volume declines. The better mix was due to relatively stronger performance from our higher margin do-it-yourself categories.

SG&A continued to benefit year-over-year comparisons. We have tightly managed SG&A spend throughout 2012 to keep it in line with the current reduced demand environment. With volumes now beginning to return, we will expand SG&A as a percent of sales to better position the business for growth. This should result in a Q1 SG&A spend roughly in line with the September quarter. Depending on the level of growth, we will then adjust SG&A in subsequent quarters as necessary. In total, it was a good end to the year for Consumer Markets and EBITDA, increased by $44 million from the September 2011 quarter.

Please turn to Slide 21. As Dave mentioned earlier, Ashland recognizes pension actuarial gains and losses in the year they occur. For fiscal 2012, U.S. asset returns were fairly strong, returning approximately 12%, exceeding our long-term expected return on assets by nearly 400 basis points. Unfortunately discount rates have declined further, falling by more than 100 basis points from our last actuarial revaluation. This negative valuation effect more than offset the strong asset returns leading to the roughly $500 million increase in our unfunded position.

The cost difference between the discount rate and our expected return on assets has now grown. We expect $35 million to $40 million of additional pension and OPEB income in 2013 versus 2012. This year-over-year benefit will be primarily captured in the unallocated and other caption of our segment reporting. We expect fiscal 2013 cash funding for pension to be $110 million, roughly $60 million below 2012. This reduction in funding is attributable to the 2011 pension catch up contribution that we incurred last quarter and the recently passed pension legislation.

Let's go to the next slide. Capital expenditures were $134 million for the September 2012 quarter. This brings our total year spending to approximately $300 million, in line with our previous guidance. After adjusting for key items, net interest expense came in a little higher than expected and was $54 million in the quarter. This line item includes the net effect of our interest expense and our interest income and interest income was approximately $3 million lower than usual during the quarter. This should return to more normalized levels going forward.

Our effective tax rate for the quarter was 21% excluding the effects of key items. This brings our full fiscal year effective rate to approximately 26%. This is better than our previous estimation by roughly 200 basis points. Ashland has done a significant amount of work to align our tax position with our business transformation. Two major actions include the integration and restructuring of our global business groups and the pay down of our higher interest rate debt, which leads to lower U.S. cash needs. Given these and other activities. We expect our fiscal 2013 tax rate to be in the range of 26% to 28%.

We generated $154 million of free cash flow during the quarter. As typically happens this time of year, our trade working capital declined during the quarter becoming a source of cash. This takes our free cash flow generation for the year to $183 million.

Now I'll turn the presentation over to Jim O'Brien for his closing comments starting on Slide 23.

James J. O'Brien, Chairman & Chief Executive Officer

Thanks, Lamar. Good morning, everyone. Ashland had solid performance versus the prior year but mixed performance on a sequential basis. As compared to the June quarter, our Specialty product categories continued to perform. The reduction in sales and earnings were in the more commoditized product lines, including straight guar, solvents and elastomers. Together, these more economically sensitive products declined $80 million in sales.

Excluding the effects of straight guar and solvents, Specialty Ingredients' sales would have been consistent with the June quarter. Guar declined due to inventory destocking by our customers. Solvents had lower pricing and significantly reduced demand in Europe, due to the broader macroeconomic environment. In our primary areas of focus, which includes pharmaceutical and personal care, we achieved solid performance during the quarter.

Water Technologies had a difficult quarter primarily due to increased SG&A expenses. These SG&A increases should be largely non-recurring. Performance Materials performed generally as expected, although we did see a roughly $5 million decline in income from our Casting Solutions joint venture due to Europe. Consumer Markets did well with the recent reduction in base oil cost restoring us to more normalized margins. We also had a decent quarter for volumes with better execution in the DIY categories. When compared to the prior year quarter. Ashland's overall volumes were down about 1% when we normalize for the effects of divestitures and joint ventures.

Although pro forma sales declined roughly and slightly to $2.1 billion on a normalized basis, sales would have been up 3% over the prior year. This primarily reflects the pricing actions taken by our commercial units. We achieved EBITDA of $349 million, a 32% increase over the prior year on a pro forma basis. It was a strong quarter for free cash, and as you heard from Lamar, we generated $154 million.

Let's turn to Slide 24. 2012 has been an exciting year. We made great progress on our longer-term goals with a number of major accomplishments. First, we significantly expanded earnings. We achieved adjusted gross earnings per share of $6.62, putting us well on track to achieve our longer-term expectations. This is a roughly 70% increase from fiscal 2011, which did not include ISP until late August. When we include ISP and look at it on a pro forma basis. EBITDA still increased 17% to $1.4 billion. This was driven by good earnings growth in Specialty Ingredients, Performance Materials and Consumer Markets.

Second, we cut costs, we achieved roughly $75 million in savings through our corporate cost reduction program. We captured these savings more quickly than expected, contributing to EBITDA growth for the year.

Third, we integrated ISP. Commercial integration is complete and we have a unified channel to market. Back office integration continues and will be completed next summer when we roll out Ashland's global ERP platform.

Fourth, we improved our capital structure. We paid down nearly $250 million worth of debt, we improved our gross leverage ratio to 2.6 times and we took action in the fourth quarter to lower our interest expense by $40 million.

Let's turn to Slide 25, and I'll give you a near-term outlook for our business. Through October, our business is generally following normal seasonal trends, one exception is guar. Guar was in tight supply in 2012 due to strong energy demand. While fracking activity and underlying demand should grow, the supply-demand balance is resetting as the new guar crop becomes available. Today customers are destocking and we are seeing large swings in price. This causes some uncertainty for the December quarter. For Ashland overall, our regional expectations have not changed, North America and Latin America should continue to improve, Asia and Europe remain weak.

In total, we're looking out over the next few quarters with cautious optimism. While the macro remains somewhat uncertain, we continue to take the necessary steps to expand earnings. But if we do incur a significant loss on guar as John described, that effect will be tough to overcome through strength elsewhere.

Now let's conclude on Slide 26. We have three primary objectives going into 2013. First, we must grow the top line and contain costs. Specialty Ingredients' demand is generally holding up well, and we are allocating roughly 80% of Ashland's growth capital to expand capacity. Water Technologies must improve and John and his team are taking actions to better position this business. Performance Materials is in good shape with their cost structure but we must now grow volumes and sales. Consumer Markets is taking steps to gain share. These actions include a more targeted sales and marketing effort within North America and an increased focus internationally.

Second, we will complete our corporate cost reduction program. As I mentioned, we will expect to roll out the overall Ashland ERP platform next summer. When complete, we should capture the remaining $15 million of ISP cost synergies.

And third, we will maintain our focus on free cash and build on our momentum from the quarter. While we typically consume free cash during the December quarter. I expect the overall year to result in a near doubling over fiscal 2012. Cash will go to pay down debt and we will continue to analyze other value creating opportunities. This could include bolt-on acquisitions, expansion of our dividend and share repurchases. Completion of these objectives will continue to strengthen the company. We are making steady progress and remain committed to our 2014 goals and I expect our history of long-term success to continue. With that, we'll take your questions.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] The first question comes from David Begleiter from Deutsche Bank.

<Q – David Begleiter – Deutsche Bank Securities, Inc.>: Good morning.

<A – David Neuberger – Ashland, Inc.>: Good morning, David.

<Q – David Begleiter – Deutsche Bank Securities, Inc.>: Jim and Lamar, just on the 2014 reaffirmation of the target, could you bridge us from 2012 to 2014 to get to that midpoint $10 EPS number?

<A – James O'Brien – Ashland, Inc.>: When you take a look at what we described in our last meeting, we said that the mix is going to be a little bit different. I think the Specialty Ingredients to meet those goals will be higher than we described. Obviously, with Water having the difficult – really last two years and with the reset this year, I would expect it to fall short of its objectives. I think Valvoline will come close to what they've outlined and their segments that they're trying to grow are still doing very well. So I fully expect Valvoline to get close to their objectives. And in Performance Materials, I think we'll require a better European market and a reset in China. So if we don't get China and Europe reset, I think, they'll have a difficult time meeting theirs. So I think that all hinges on that performance. But overall, I think that within the range that we provided, we're still very much committed to get there, but obviously, the external environment will have a big impact on our ability to achieve.

<Q – David Begleiter – Deutsche Bank Securities, Inc.>: You mentioned that Water Tech must improve in 2013. What if it doesn't improve in 2013? Is there – will it still be part of the portfolio in 2014?

<A – James O'Brien – Ashland, Inc.>: I can't predict what we'll do, but obviously, we're running out of plays, and I think that with John's involvement, with – as he described his experience, being in the water industry for over 20 years, that's going to be very helpful. We're very focused on getting new external leadership and the people we've interviewed already are very, very talented, very experienced. So in that part I'm encouraged. So as we put the new leadership in I would say that by this summer, we should be able to tell if this is making a difference or not. If it's not making a difference then obviously that limits our alternatives and what we can do, and we'll certainly take a hard look of what the outcome will be.

<Q – David Begleiter – Deutsche Bank Securities, Inc.>: And lastly, Jim, in guar, how much is – of your business is derivatized guar versus the commoditized portion or straight guar?

<A – James O'Brien – Ashland, Inc.>: John is probably best suited to answer that question, I'll let John Panichella answer that one. John?

<A – John Panichella – Ashland, Inc.>: It's about 50%-50%. So it's pretty close to half.

<Q – David Begleiter – Deutsche Bank Securities, Inc.>: Thank you, very much.

<A – David Neuberger – Ashland, Inc.>: Thanks, David.

Operator: The next question comes from John McNulty from Credit Suisse.

<Q – Abhiram Rajendran – Credit Suisse Securities (USA) LLC (Broker)>: Hi, this is Abhi Rajendran calling in for John. Good morning.

<A – James O'Brien – Ashland, Inc.>: Good morning, Abhi.

<Q – Abhiram Rajendran – Credit Suisse Securities (USA) LLC (Broker)>: So a couple of quick questions. So in Valvoline it appears the base oil market has been relatively steady recently. I guess how are you thinking about that market as we head into year-end and into 2013 and how should we be thinking about maybe cost per gallon being relatively stable or maybe down a bit in the near term?

<A – James O'Brien – Ashland, Inc.>: When you take a look at the base oil market, that has historically followed crude. With crude softening and playing within a smaller range, I think that base oil has caught up with crude at that $90 plus. So I think that in the near term if crude stays in the range that it's been trading, I would fully expect that the base oil would be fairly stable as well. As I look in the next year, the things that worry me most are more of some sort of political economic activity in the Middle East. I think that's our biggest risk. If something happens there and drives crude up, that could bring base oil with it. But with the economy being soft and all the things that are forcing crude down, I think that in near term at least, there is more headwinds against crude than bullishness. So I would fully expect that Valvoline should experience a more stable environment here in the near term. Now for the full year, I can't predict, but I think in the next quarter at least, we're anticipating it's going to be somewhat stable.

<A – David Neuberger – Ashland, Inc.>: And then, Abhi, this is Dave Neuberger. One other thing that I'd add to that, when you're looking out over the longer term, bear in mind, we do expect significant capacity expansions in both the group two and the group three space. So from our view, at a minimum that should limit some of the volatility that we've seen in that input over the course over the last year, year and a half.

<Q – Abhiram Rajendran – Credit Suisse Securities (USA) LLC (Broker)>: Okay, great. And then just a quick follow-up. How should we be thinking about the current raw material environment in Performance Materials and Water Tech with regards to propylene and some of its derivatives and are there potential further tailwinds to margin and also how is the pricing environment kind of shaping up in this more benign raw material environment?

<A – James O'Brien – Ashland, Inc.>: I would say that really over the last several months, the material markets have somewhat stabilized and flattened. So in some respects that's good news because the margins that we've been able to achieve look like they'll be able to be held and there is no pressure up or down on that to create a disruption. So from that standpoint, stability is probably a good thing for us and I'm hopeful that'll continue for some time, so we can get our markets reset to go out and try to achieve some top line growth. So our focus now is more on top line growth because that's where the toughest issues are for, I think, all companies. The economies are not – they're not strong obviously and to go out and find new business and has to be done through innovation and new products and John described one of those in the coatings market, with work that they've done. So I think we have some good things coming out next year which gives me encouragement that we'll be able to achieve some top line growth in many of our products.

<Q – Abhiram Rajendran – Credit Suisse Securities (USA) LLC (Broker)>: Okay. Great. Thanks very much.

<A – David Neuberger – Ashland, Inc.>: Thanks, Abhi.

Operator: The next question comes from Mike Sison from KeyBanc.

<Q – Mike Sison – KeyBanc Capital Markets>: Hey, good morning, guys.

<A – David Neuberger – Ashland, Inc.>: Good morning, Mike.

<Q – Mike Sison – KeyBanc Capital Markets>: If the – if guar stays at these levels, I suppose, when you look in for the full year, do we sort of take that potential loss in the first quarter and multiply by it by four, is that sort of the [ph] size? (46:04)

<A – James O'Brien – Ashland, Inc.>: No. Mike, I think in the description, maybe we weren't clear, but the potential loss, number one, isn't certain -

<Q – Mike Sison – KeyBanc Capital Markets>: Right.

<A – James O'Brien – Ashland, Inc.>: – but it's likely and it just depends on how the market plays out and resets. So we don't – we really don't know. So we wanted to make sure that the market was aware that that potentiality was out there. So that's the primary reason for it. But as you take a look at the inventory that we have in hand, it's all isolated to that. So if you take the inventory in hand and you take a look at the pricing that is bouncing around now that's where the range of loss possibly could be. Once that's taken, whatever it is, if it's taken at all, it's done. And then, as the market resets in January, we'll go back in the market and purchase and we'll have a much better sense of the spread of what the selling prices will be versus the cost of purchase. So this is an isolated issue that should play out in the first quarter.

<Q – Mike Sison – KeyBanc Capital Markets>: Got it.

<A – Lamar Chambers – Ashland, Inc.>: And Mike, this is Lamar. Let me just add that on that range of potential loss that John described, $15 million to $25 million, that is really almost a mathematical computation just based on what we think we can observe in the market currently. The challenge is there is not a very robust market right now. So it's hard to get a fix on what clearing prices would be even be. So it's – we're trying to give you a sense of where we think the values will be relative to our inventories if we were executing transactions today. So it's a highly uncertain range of numbers, but still give you some sense of order of magnitude.

<A – John Panichella – Ashland, Inc.>: Just to add – this is John. Just to add a little color to that, this is an annual crop and so the reason there is uncertainty right now is the crop is just being harvested. It'll come to market in the November, December timeframe and we'll start purchasing then. So there is no really current transactions happening because the 2012 crop, if you will, is done and gone and sold and now we're anticipating the 2013 crop.

<Q – Mike Sison – KeyBanc Capital Markets>: Got it. Okay. And then you've outlined some CapEx for Specialty Ingredients. I think you've spent a good amount this year in terms of growth prospects. How much of that will be a positive for you in 2013 and then the plans that you just laid out in terms of spending, John, a little bit in 2013, when do those projects come on and how much could that contribute?

<A – John Panichella – Ashland, Inc.>: Yeah so as you know, we invest in really high growth, high margin product lines and only consider projects that are pretty well in excess of our cost of capital. So when you look at – that's the kind of project we invest in, it generally takes us 18 to 24 months to execute on projects and then they produce those kind of returns as I explained to you, well in excess of our cost of capital. So that's kind of the way to think about it. These aren't generally projects that return in the fiscal year, they are more or like 18 to 24 months and they're pretty high return kind of projects.

<Q – Mike Sison – KeyBanc Capital Markets>: Okay and then, Jim, if you could sort of give us a little bit of help, your interest expense is going to be lower next year, pension income better, cost savings, that's a plus. How much growth in earnings do you see in your operating business now when you go through each of the segments next year to help us maybe given this economic outlook that we see?

<A – James O'Brien – Ashland, Inc.>: Yeah. I would say that the 2014 guidance we gave you, directionally gives you the endpoint. So we've got two points now. You can draw a curve, so depending upon how that curve plays out we'll know, but directionally, you kind of have a sense of that. So I would use that. And then also when you look at the environment Specialty Ingredients is probably best suited to perform in the current environment because the types of products and markets they sell into are less economically sensitive. We talked about guar, so you have a sense of that. And then when you get into Performance Materials, as I said, it's highly sensitive to the macroeconomic environment of China and Europe. So we're going to need some recovery for that business to perform. Valvoline is less sensitive, broadly both internationally and domestically. It's more of a consumer-style product. So it's going to perform in spite of the macroeconomic environment. And that leaves you with Water, and Water isn't so much it's being held back by the market where it's held back our own execution. So that is all going to be around our ability to execute better. And in that one – and in some respects it's an easier one to fix since it's all under our control. So that's kind of how I see the year playing out, and as you think about it, those would be some of the inputs that I would consider.

<A – David Neuberger – Ashland, Inc.>: And then, Mike, this is Dave Neuberger. Just two below the line items to mention when you're modeling it out. One is the tax rate. So we've given you the – our estimation of the range for 2013, somewhere in the 26% to 28%. By 2014 that will probably come down a bit more, closer to the mid 20% range. And then on the interest income, we gave you the current run rate of interest expense for the year. Right now, that's around $180 million. When we call the remaining 9 and 1/8% notes that are out there and make the required debt payments, that might pick up another $10 million or so as we go into 2014. So I think when you add in all those elements, you'll see how we come up with those targets.

<Q – Mike Sison – KeyBanc Capital Markets>: Got it. Thank you.

<A – David Neuberger – Ashland, Inc.>: Thanks, Mike.

Operator: The next question comes from Jeff Zekauskas from JPMorgan.

<Q – Jeff Zekauskas – JPMorgan Securities LLC>: Good morning. In terms of your pension expense and your – or your pension income for 2013 versus 2014, do the funding requirements step up again in 2014 and does your pension income change very much for 2014, assuming that interest rates stay the same?

<A – Lamar Chambers – Ashland, Inc.>: If we assume consistent interest rates and achieve our long-term asset returns across that period, we'd expect the book expense for pension to be pretty steady across that period between now and 2014. On a funding basis, the federal legislation that was passed back in the summer under MAP-21 does gravitate toward the more traditional funding rules by the time you get to 2016. So there's a phase back in of more normal funding, but we'll be able to enjoy this deferral of funding for between now and 2016 on a declining basis. We get the full effect of that of course first in 2013, and we're actually pleased to have that opportunity.

<Q – Jeff Zekauskas – JPMorgan Securities LLC>: And then if you can just describe sort of guar related products generally, that is in fiscal 2012 on some kind of rough operating income basis, how much did you benefit year-over-year in guar and in 2013, what do you see the penalty as being or the adverse comparison assuming prices stay more or less where they are?

<A – David Neuberger – Ashland, Inc.>: This is Dave Neuberger. I'll share with you the public disclosures that are already out there. In terms of the overall guar sales for 2011, and this is something that we report out every quarter on a trailing 12 month basis, within what we call our business profile slides, it would have been somewhere around $120 million, $130 million of sales. And again, that would include both the straight guar and the derivatized guars. In terms of 2012 that would have grown to somewhere around the $340 million to $350 million sales range. So huge increase in volumes, huge increase in price over that period as we covered the large inflation in the raw material cost.

In terms of disclosures around profitability, we don't get into that level from a product perspective mainly for competitive concerns. What we have shared though to give you some idea, maybe to remind you, back in the June quarter, we had pointed to some of the unusual profitability in guar as being the primary contributor to the sequential increase in profitability. And I think it's safe to say that when you look from the June to the September quarter for Specialty Ingredients, some of the softness that we saw in guar, particularly in the straight guar product lines, was the primary reason for the sequential decline in profitability from the June to the September quarter. Now looking out into 2013 and, John, you'll probably want to elaborate on this, but it's probably too early to say considering where the crop is.

<Q – Jeff Zekauskas – JPMorgan Securities LLC>: Okay. Thank you very much.

<A – James O'Brien – Ashland, Inc.>: But I think also as John described, just so we don't lose this point, that guar has derivative guar, which is a very high margin, highly sought after product, which is short in supply and we actually have to process that and create a value-added product; that's 50% of the sales. So the part that's probably more volatile and it causes us ups and downs is the straight guar, the powdered guar. And the part that we're most interested in is the derivatized guar. That's why we're in this business. We're not in the business just to trade guar. We're in it to create a derivative, which is highly processed, high value-added, in short supply and we're actually looking at ways to expand that. So that's really the opportunity long-term.

<A – Lamar Chambers – Ashland, Inc.>: Just one clarification on that, to be sure you're getting it right for your attempts to model this, the guar split between derivatives and straight 50%-50% is at the gross profit level. So the sales mix is actually a little different because you get a higher gross profit percentage on the more derivatized.

<Q – Jeff Zekauskas – JPMorgan Securities LLC>: Thank you.

<A – David Neuberger – Ashland, Inc.>: Thanks, Jeff.

Operator: [Operator Instructions]

<A – David Neuberger – Ashland, Inc.>: And I think we have time for one more question, Jamie.

Operator: Okay. The final question comes from Mike Harrison with First Analysis.

<Q – Mike Harrison – First Analysis Securities Corp.>: Hi, Good morning.

<A – James O'Brien – Ashland, Inc.>: Good morning, Mike.

<A – Lamar Chambers – Ashland, Inc.>: Mike.

<Q – Mike Harrison – First Analysis Securities Corp.>: I had a couple questions on Valvoline. First you kind of talked a little bit about the SG&A outlook and suggested that this year you would pull back on SG&A spend and maybe anticipate spending a little bit more next year. And I know you guys don't like to talk too much about marketing spend, et cetera. But I guess just help me understand, my expectations there were that you were going to try to kind of keep SG&A costs flat while you were growing the business. And now, it sounds like we should expect SG&A up next year?

<A – James O'Brien – Ashland, Inc.>: Valvoline?

<A – David Neuberger – Ashland, Inc.>: This is Dave Neuberger, I'll give the data and then maybe Jim will elaborate. In terms of the overall SG&A dollars, the way that I'd model that in today and as we said on the prepared comments, from the September to the December quarter. We think the SG&A dollars will remain relatively flat. And so what we've done this year that we actually take a fair bit of pride in is we did ratchet down SG&A to be more reflective of the current reduced demand environment. That market has started to stabilize, we started to see some signs of it coming back. So we're resetting that SG&A expense as we go into 2013 at this type of higher level. And then from there we'll take a look at what the results of that spend are and adjust as necessary going forward. But right now I'd say going into the December quarter, you're flat and then that sets the new baseline that we'll adjust from.

<A – James O'Brien – Ashland, Inc.>: And what also drives that marketing spend is the ability of the team on how many promotional activities they achieve from the various retail accounts and Walmart, et cetera. And inside of that, there's a certain amount of pull marketing that stays fairly stable, which is the advertising you see on television and whatnot, then there's also a push, which is more of incentive style marketing on markdowns and incentives for the retail community to push volume through the system and that's very variable, based upon the number of events you get and the size and the success of the pull-through. So that's why you get some variability. And in the last quarter we were fairly successful. And I think as we look into the next several quarters, I think we have some pretty decent programs coming in.

<Q – Mike Harrison – First Analysis Securities Corp.>: And then also on Valvoline any – can you give us some details on the NextGen product, what kind of volume growth you saw this year and maybe in the fourth quarter, just what kind of run rate we're looking at into next year?

<A – James O'Brien – Ashland, Inc.>: Yeah. When you think of NextGen, we're looking at this more as a retention tool. What we found with the buyer of NextGen, they are highly attached to it from the standpoint they're environmentally-minded and it's an emotional buy and these people are coming back on a more regular basis which is the primary purpose. So as we look at the success of NextGen, it isn't necessarily the number of gallons, though that's always part of it. It's really the market share that we're getting in certain segments of the market. And that's how we're looking at it. And from the standpoint of where the market share gains we're getting, we think they're sustainable and especially at our VOC business, we've had some very good success on return business there, getting an extra car with people on return business. So it's doing what we had hoped it to do and the way we're going to measure it is on share gains. So that's how we're going to measure its success.

<Q – Mike Harrison – First Analysis Securities Corp.>: Okay. Last question I had is for John on the Water Technologies business. You noted you wanted to replicate the pricing and contract management success that you had in ASI. But I also think of Water as being a pretty different business from Specialty Ingredients. What specifically do you see as some of the problems that might be fixed with some of the changes in pricing contract management that you made in ASI?

<A – John Panichella – Ashland, Inc.>: Yeah. So this is a highly complex business, Water where a large percentage of the business is tied up in contracts we have with customers. And those contracts can be items like cost per ton billing, consignment contracts, all sorts of different contracts. And we need to do a better job in executing against those contracts we have in customers and the visibility and the complexity of the data and the information. We've done a much better job here recently of understanding that, so that we can get the price that we deserve. So getting that information in a way that we can manage it better will allow us to take the appropriate marketplace actions that we need to take around both pricing and contract, and it's highly complex in a business like AWT. And we're leveraging some of the things that we learned around standard pricing in ASI because we don't have contracts in ASI. So we're leveraging some of the best practices that we had from standard pricing in ASI to drive standard pricing improvements in AWT. And we think there can be some pretty nice improvements there that can develop in the short-term.

<Q – Mike Harrison – First Analysis Securities Corp.>: Thanks very much.

<A – David Neuberger – Ashland, Inc.>: Thanks, Mike.

David A. Neuberger, Director-Investor Relations

This is David Neuberger again. Thank you for your time this morning and for your interest in Ashland. If you have any additional questions, please give me a call at 859-815-3527. Thank you.

Operator: Ladies and gentlemen, that does conclude the conference for today. Again, thank you for your participation. You may all disconnect. Have a good day.