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ASH - Q1 2014 Ashland Earnings Conference Call

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OVERVIEW:

ASH reported 1Q14 sales of $1.9b and EPS from continuing operations of $1.42.

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Ashland, Incorporated, first-quarter earnings conference call.

(Operator Instructions)

As a reminder, this conference call is being recorded. I would now like to introduce your host for today's conference, Jason Thompson, Director of Investor Relations. You may begin.

Jason Thompson *- Ashland Incorporated - Director, IR*

Thank you, Nicole. Good morning, and welcome to Ashland's first-quarter FY14 conference call and webcast.

We released preliminary results for the quarter ended December 31, 2013, at approximately 5:00 PM Eastern time yesterday, January 27, and this presentation should be viewed in conjunction with the earnings release. Additionally, we posted slides and the prepared remarks to our website under the Investor Relations section, and have furnished each of these documents to the SEC in a Form 8-K.

On the call today are Ashland's Chairman and Chief Executive Officer, Jim O'Brien; Kevin Willis, Senior Vice President and Chief Financial Officer; and Luis Fernandez-Moreno, Senior Vice President and President of Ashland Specialty Ingredients.

As shown on slide 2, our remarks today may 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 referring to adjusted results in the year-ago period. We believe this will enhance understanding of our performance by more accurately reflecting our ongoing business.

I will now hand the presentation over to Kevin for a summary of the first-quarter results.

Kevin Willis - *Ashland Incorporated - SVP and CFO*

Thanks, Jason, and good morning. As Jason indicated, we released our first-quarter preliminary financial results yesterday, so we'll begin with a brief review before I hand it over to Luis.

We reported earnings of $1.42 per share from continuing operations. We had no key items during the quarter. This compares to adjusted EPS of $1.12 in the year-ago period.

Ashland's overall sales were flat with the prior year at $1.9 billion. These results were negatively affected by guar, intermediates and solvents, and elastomers. Combined sales for these more commoditized products declined $45 million. Excluding this effect, Ashland's overall sales would have been up 2% versus prior year.

Overall, volumes were up 3% from prior year, with each of the commercial units posting gains. Specialty ingredients was led by solid performances from coatings and personal care.

Within water technologies, the industrial water business successfully closed several new accounts in the refining and chemical processing markets. This business has turned the corner, posting the first year-over-year improvement in sales and profitability in several years.

Performance materials turned in a solid quarter. Excluding elastomers, which remains hampered by a challenging replacement tire market, volumes in the core business grew 6%. Valvoline showed particular strength from two key growth platforms, Valvoline Instant Oil Change, and the international business. Combined, these two businesses posted volume growth of 8%.

Now for a few corporate items. Capital spending was $52 million for the quarter. Our full-year 2014 expectation remains unchanged at $275 million.

Working capital investments led to a $15-million use of cash in the first quarter. This was driven by customary year-end payments, and investments in inventory. In the March quarter, we expect to generate free cash of approximately $100 million.

I will now hand the presentation over to Luis for an overview of ASI's strategy.

Luis Fernandez-Moreno - *Ashland Incorporated - SVP and President, Ashland Specialty Ingredients*

Thank you, Kevin, and good morning. Before we get to some of the strategic initiates we are launching, I would like to take a moment to highlight the quality of the portfolio within specialty ingredients.

We have a unique position within the specialty chemicals markets, as we are a leader in both cellulosic and synthetic polymers such as vinyl pyrrolidone. These two key platforms are supported by a strong position in adjacent chemistries such as vinyl ethers, preservatives, and guar-based derivatives. This competitive advantage gives us access to a wide range of customer applications, and provides an opportunity to increase our market share over the long term.

Today, roughly half of our business serves highly regulated, more consumer-facing markets such as pharmaceutical, nutrition, and oral, hair, and skin care. These markets require significant technical expertise, investments in research and development, and high-touch technical and customer service.

The other half of our customer business -- of our business -- serves industrial markets such as coatings, construction, and energy. Although customers in these markets require innovation and technology strength from our products, they do not require the same level of regulatory and service support as our consumer-oriented customers.

Regardless of where we compete, one thing remains pervasive: We build, sell, and support highly technical, tailor-made functional ingredients, specifically designed to address critical concerns and needs of the marketplace.

As you see in the slide, we are making several structural changes to how we operate the Business. All of this is focused on aligning our organization to address opportunities within each market in which we participate.

In order to accomplish this, we are taking four primary steps. First, we are increasing focus on our specialty businesses. We are moving intermediates and solvents business over to Ashland performance materials, and moving the adhesives business from performance materials to specialty ingredients.

The intermediates and solvents business serves a primary role of supplying reliable and low-cost components to our vinyl pyrrolidone franchise. However, it also serves emerging market, supplying BDO and specialty solvents. It operates with a focus on cost effectiveness and asset management. The APM model is consistent with this approach, and the APM team is well-equipped to run this business.

The adhesives business shares many of the same characteristics of our existing specialty ingredients business, including technological innovation, high levels of customer and technical service, and tailor-made application development. By combining the adhesives business with ASI's existing adhesives platforms, both will benefit from mutually shared application development and technical expertise.

Today, the adhesives business generates 90% of sales in North America. Leveraging ASI's global sales channels should enable both geographic and new end-market growth.

The second primary step we are taking is a broad reorganization of ASI into two business units, from six today. This will be aligned along customer needs -- a consumer specialties business and an industrial specialties business. This will not only reduce cost, but will increase our capability to more effectively serve customers with similar needs.

Third, we are moving to a regional management instruction, and reducing the existing matrix structure. This gets us geographically closer to our customers, and improves alignment of our technical and customer-service representatives to capture geographic-specific opportunities. In addition, this will reduce cost and enhance growth in key emerging markets.

Lastly, we are right-sizing the existing support structure to drive efficiency and effectiveness. Today, we dedicate too many resources to support lines of business and their customers where a high-touch model is not valued.

We're also rationalizing our physical footprint of offices. This will consist of reducing the number of rooftops currently employed, and maximizing utilization of the most cost-effective units within the system. The net result of these efforts is a smaller, more customer-centric nimble organization with higher levels of customer service at a reduced cost, while still being well-positioned for growth.

Let's go to the next slide. I have identified three specific areas of focus to optimize business performance: growth, pricing, and competitiveness. The fundamental market trends supporting strong volume growth have not changed.

Emerging markets continue to grow, and so does the middle-class consumer base within them. This is a key demographic for our technologies, particularly for our consumer specialties business, where we provide functional additives for hair, oral, and skin-care products.

Within the developed world, particularly North America, western Europe, and Japan, an aging demographic should continue to generate higher demand for our products sold into various health-care-related end markets, such as pharmaceuticals. Through our regional model fostering increased customer intimacy, we can leverage these mega-trends to develop tailor-made products designed to meet distinct economic and cultural requirements, ultimately driving top-line growth.

The second area of focus is pricing. By increasing collaboration to develop new products and applications, we increase our differentiation in the marketplace. We expect this to result in improved product mix for us, and enhanced value for our customers. At the same time, increased levels of product availability and higher levels of technical service, combined with a disciplined approach, should allow us to command a price that fully reflects the value our products and services offer.

Finally, the restructuring will deliver a better cost model. By leveraging our recent investments in information technology, we enable efficient and effective global processes that can be managed on a regional basis, ensuring tailored customer experiences around the world. This will be achieved with less management, fewer layers in the Organization, and a simpler operational model.

In summary, the structural redesign increases our regional customer focus and competitiveness leads to volume growth and higher margins. I will now turn the presentation over to Jim, who will provide his closing thoughts.

Jim O'Brien - *Ashland Incorporated - Chairman and CEO*

We were encouraged by the strong performances from several areas of the Business in the first quarter. Specialty ingredients posted volume gains in five of the six segments; only performance specialties posted a decline.

Personal care had exceptional performance out of Europe, where volumes grew 18%. This volume growth was primarily concentrated within our skin and oral-care lines. The inventory challenges we faced in Europe last Fall were resolved in the first quarter, and inventory levels are now balanced to meet customer needs.

Water technologies continues to improve. This was the third consecutive quarter of year-over-year sales and profit growth. Industrial water's performance improvement, coupled with pulp and paper's consistently strong performance, highlight the quality of the business.

Performance materials had a strong quarter. The adhesives business experienced a significant increase in both volume and profitability, driven by growth in automotive, housing and packaging, and converting markets. Successful diversification efforts in Asia led to a 5% year-over-year increase in composite sales.

Ashland consumer markets' international business had another solid quarter. Overseas markets are particularly important for growth in Valvoline. The team had another strong quarter, executing on our international strategy, growing volume by 10% versus prior year.

Another key area for growth in the Valvoline business is within Quick Lubes, especially our Valvoline Instant Oil Change network of roughly 900 Company-owned and franchise stores. Year over year, Company-owned same-store sales growth was 4.7%, which led to a $2-million increase in earnings.

When considering Ashland's overall performance, I am encouraged. While sales were flat due to weakness at some of our more commoditized businesses, each of our four commercial units reported volume gains over the prior year. As we look to the second quarter, we expect sales to increase, leading to a slight improvement in EBITDA margin.

Let's turn to slide 7 for final thoughts. As we move into the new calendar year, we will maintain our focus on executing initiatives to create shareholder value. We have several initiatives under way, and I am pleased with our progress on each of these.

I am encouraged by the level of interest in the water technologies business, and continue to expect we will have a formal announcement on the sale of the business during the March quarter. We expect the primary use of the net proceeds from the sale to be a return of capital to shareholders in the form of a share repurchase.

We provided a substantial amount of information on the global restructuring program in yesterday's release, so I will not elaborate in great detail here. I will say, however, that I am pleased with the progress. Once fully executed, Ashland will be better equipped to serve our customers' needs in a more efficient manner. We will be a smaller, more nimble organization, managed on a more regional basis, getting us much closer to the customer.

Pushing the supply chain out into the businesses will improve customer and market focus, and increase operational accountability. Ultimately, this streamlined Ashland will operate at a lower-cost position, while also being better positioned for growth.

With respect to our overall corporate strategy, management and the board will continue to review our portfolio, in order to best position the Company for long-term value creation for our shareholders. Our goal is to create the world's best specialty chemicals company, and we are committed to taking the necessary steps to make this happen.

With that, I'll hand it over to Jason for Q&A.

Jason Thompson - *Ashland Incorporated - Director, IR*

Thanks, Jim. Nicole, before we begin, let me note that we'd like to limit each participant to one question and one follow-up. Nicole, I will hand it over to you.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Our first question comes from John McNulty of Credit Suisse. Your line is now open.

John McNulty - *Credit Suisse - Analyst*

Good morning, and thanks for taking my questions. I guess for the first question with regard to the restructuring, and in particular around the Performance Materials segment, it looks like you've migrated up what I would have viewed as maybe the crown jewel of that business and you've put maybe one of the more difficult businesses, your BDO platform, into that.

I'm wondering what kind of potential you may have in terms of maybe separating yourself from the Performance Materials entity, and if that may be something that you would consider or can consider even structurally going down, looking out over the next few years or so?

Jim O'Brien - *Ashland Incorporated - Chairman and CEO*

As we look at the reasons behind the reorganization we are taking today, we are focused primarily on how do we operate these businesses. When you look at the skill set that Performance Materials has, they can take your business like BDO and put into a low-cost model, and operate it in a manner that we believe will optimize its results, and give us the best chance to run in a good strong manner for our shareholders.

The focus that we've had is that business created a lot of uncertainty around ASI. It's more volatile, its margins are going up and down based upon the price of BDO. We think by putting it into that segment, it won't change necessarily the volatility, but it will isolate it into a business that is used to having that type of volatility. I think it will enhance the ability of our shareholder base to understand how ASI truly is growing and operating, and it won't be masked by the changes in the BDO.

Concerning the second part of your question, of will it make it either easier or more difficult to look at alternative values for that. As I stated in my summary, the board continues to look at all aspects of the portfolio to find the right mix of assets, and the right form of the assets as we go forward. We don't rule anything out, but we're also very focused on getting things done in this particular time frame.

Our primary focuses today are getting the cost take-out and the restructuring done so we can become a better competitor in the market place at a lower cost. That's going to take a lot of effort and a lot of focus by the management team.

We want to get that right, because we think for this year going into 2015 that's going to be critical to our success. That's going to be our primary focus, as well as, as we sell the water business, turning that into a different ownership and extracting from the Company will take a lot of effort and focus, as well.

So our plate is pretty full. As we look at the strategy going forward, we're not ruling anything out, but we have a pretty important set of assets and initiatives under way today that we've got to get right.

John McNulty - *Credit Suisse - Analyst*

Okay. No, thanks very much for the color, and that's definitely helpful. Just one as the follow-up.

On Valvoline, it looks like the raw materials are starting to become a decent tailwind for you. I know there's a bit of a lag benefit that you should be getting. I think in your comments or in part of the release yesterday, it indicated that FX was going to largely eat a lot of that up.

Looking at your geographic mix, I'm not exactly sure why that would be the case. Can you help us to understand what may be kind of driving that in terms of some of the FX challenges -- if there's kind of a one-off around Argentina or something like that, that maybe we are not considering?

Jim O'Brien - *Ashland Incorporated - Chairman and CEO*

Really, a big part of that is driven by the Australian dollar and the weakness that we've seen there, plus continued expected weakness. Obviously if the Aussie dollar stabilizes, then I believe you are right, we would see a tailwind in the Valvoline business.

I think we are just trying to be cautious about world currencies, given the level of volatility that we've seen there. But that's the biggest impact.

John McNulty - *Credit Suisse - Analyst*

Great. Thanks very much for the color.

Operator

Thank you. Our next question comes from the line of David Begleiter of Deutsche Bank. Your line is now open.

Tremaine Brown - *Deutsche Bank - Analyst*

Hi, good morning. This is Tremaine Brown filling in for David Begleiter. Regarding -- relating to ASI on a pro forma basis, how would this segment have performed if you included Adhesives and excluded I&S?

Jim O'Brien - *Ashland Incorporated - Chairman and CEO*

That's actually not something that we are prepared to disclose at this point. We don't intend to get into the individual components of our operating segments. That's not really an area we can go with you.

Tremaine Brown - *Deutsche Bank - Analyst*

Okay. Regarding the restructuring benefits, how do you see if flowing on a segment-by-segment basis?

Jim O'Brien - *Ashland Incorporated - Chairman and CEO*

Well, as you heard Luis talk through the restructuring around ASI, I think what you should assume is that a large portion -- the majority of the restructuring benefit would accrue to ASI. You'll see the largest change from a commercial perspective in the ASI business, as ASI also uses a large portion of what's currently our global integrated supply chain. You will see benefit flow-through from that as the supply chain organization is integrated into ASI.

Likewise, from an overall support perspective, ASI currently picks up an outsized share of the overall support structure. I think as we execute on the restructuring and see the benefits of that start to roll through the P&L, ASI will be the beneficiary of a good portion of that.

Looking at the other units, obviously Performance Materials runs pretty lean today, so you would see them as probably being the least beneficiary of that. Then Valvoline somewhere in the middle.

The other part that I will bring up is part of the point, part of the impetus for this structuring is the fact that we are exiting our water business. As we've indicated, we would expect to see about $70 million of stranded cost once that business is executed.

For a period of time that will be offset to some degree, as we offer a support structure to the ultimate buyer of that business for a period of time. There will be something of an offset in the mix.

But we do have to cover all of those stranded costs, plus significantly more to arrive at the $150 million to $200 million. But we have good solid plans in place to do that, and I'm confident we will achieve the objective.

Tremaine Brown - *Deutsche Bank - Analyst*

Thank you. I will hop back in the queue.

Operator

Thank you. Our next question comes from the line of Lawrence Alexander of Jefferies. Your line is now open.

Rob Walker - *Jefferies & Co. - Analyst*

Good morning, this is Rob Walker on for Lawrence. First, given the slow start to ASI and your outlook comments on Q2, can you give us an update on your full-year outlook for profits for that segment?

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Luis Fernandez-Moreno - *Ashland Incorporated - SVP and President, Ashland Specialty Ingredients*

Well, obviously we expect to see continuous improvement on the business. Both -- as you know, Q4 is our seasonally lowest, so we expect to see continuous improvement, especially starting with the next quarter, where we expect our margins to get back into the 20% range. As we start seeing the benefits of the redesign, not only from a cost perspective but from an operational model perspective, we expect to see improvements on a quarterly basis.

Now we will still see the headwinds on the I&S business. So net-net, we still expect the combination of those two, the improvements on ASI together with the I&S headwinds to put the total business roughly flat with prior year.

Kevin Willis - *Ashland Incorporated - SVP and CFO*

As a follow-on to that, as Jim indicated we do expect to be able to announce a water transaction in the March quarter. As part of that, it would be our expectation that we would move all of the water business into discontinued ops.

As a result of the work and effort required to do that -- it's the same team that actually re-casts our segment reporting -- so we would expect to continue to report I&S, the Intermediates and Solvents business, within ASI for the March quarter, and Adhesives with Materials for the March quarter, and then flip those in the June quarter as we move down the path of restructuring, and have the resources to get that done in an appropriate way, as we do have to re-cast prior results as part of that effort.

Rob Walker - *Jefferies & Co. - Analyst*

Okay, thanks. Then just on the restructuring, how much of the relocated personnel will be in sales or R&D?

Jim O'Brien - *Ashland Incorporated - Chairman and CEO*

Very little. The vast majority of the role relocation will be more support-related. In fact, if you look at the restructuring on an overall basis, they will be a pretty minimal impact on an overall basis to customer-facing roles. As Luis indicated, this is about how we support the business. It's about getting closer to the customer, and the importance of that. Then ultimately the way we support the business, we have to get streamlined and much more efficient about that.

Rob Walker - *Jefferies & Co. - Analyst*

Thank you.

Operator

Thank you. Our next question comes from Brian Maguire of Goldman Sachs. Your line is now open.

Brian Maguire - *Goldman Sachs - Analyst*

Hey, good morning. Maybe just a follow-up to that last question, just the absolute numbers of head count you are talking about are pretty large as a percentage of the Company -- I think a little bit more than 10%. I'm guessing some of that has to do with water.

But a level of sense of your comfort that that is the right number to be taking out of the system, and that won't have an impact on customer service levels? Are you expecting any negative impact from sales on it at all, or do you think you're comfortable that this will go through without any real disruption to the customer orders?

Jim O'Brien - *Ashland Incorporated - Chairman and CEO*

When you take a look at the effort that we put into this and the thought that's already gone into it and the planning, the primary focus has been how can we improve our relationship with our customers and our service to our customers, and get our products and services that they demand at the right position.

Where we started with was how can we improve that relationship. The focus then is on how do we get the sales person more engaged, how do we get the supply chain more engaged, so that these needs are being communicated down to the plant level, so that we can produce the right level of inventory, and get orders on time, and get the right products delivered on time, and have the right products in inventory.

All of this is about improving service levels and improving the sales person's ability to walk into a customer and say not only have I serviced you well in the past, I intend to service you even better in the future. Frankly, that's been an issue for us. During the reorganization that we took of putting ASI and the old Hercules businesses together, and using the same processes and procedures that we had encumbered the business.

We are going to unchain that, so to speak, from the businesses, and then the outcome is fewer layers. We are going to have fewer -- a much smaller matrix, if any matrix, on certain parts of the business. The biggest impact's going to be on the Supply Chain.

By taking water out of the processes and not having this big service component with water, changes our whole approach about how we can now interface with our customers, and the whole business model changes. This is an opportunity for Ashland to actually set together a business design that truly is for a singular business model, primarily for ASI.

How can we run ASI the best way? That's how we thought about it. The outcome of that is the job eliminations that you saw. We didn't take the job eliminations and then try to do a design. We did the design first, and the outcome is the job eliminations.

As I sit here as the CEO, I'm less worried about our ability to service the customers. The whole purpose of this is to make it better and more streamlined, and have the customers actually feel a difference of how they are being served.

Brian Maguire - *Goldman Sachs - Analyst*

Great, thanks for that explanation. Just a follow-up maybe for Kevin, if I could.

I think a big portion of your BDO sales are internal to ASI. Just curious as that shifts to a different segment how the transfer pricing will flow between segments at cost or market? Thanks.

Kevin Willis - *Ashland Incorporated - SVP and CFO*

Typically, the way we do transfer pricing on a US-to-US transfer within the segments is typically a cost-plus arrangement. Frankly, we're still discussing exactly how we will do that, but at the end of the day, any inter-Company profit gets eliminated anyway.

What we want to be is fair and transparent about that as possible internally. I don't expect that to be an issue is the short answer.

Brian Maguire - *Goldman Sachs - Analyst*

Great, thanks very much.

Operator

Thank you. Our next question comes from the line of Summit Roshan of KeyBanc. Your line is now open.

Summit Roshan - *KeyBanc Capital Markets - Analyst*

Good morning. Taking a flip side to the restructuring and the cost savings, are there any opportunities that you might see for investment, whether it's to bolster innovation and the R&D pipeline, or increase touch points for collaboration with customers?

Luis Fernandez-Moreno - *Ashland Incorporated - SVP and President, Ashland Specialty Ingredients*

Yes, absolutely. This is Luis.

One of the things that we are doing with the redesign is by focusing the organization more in a regional fashion, and having the technical service teams dealing with the customers on a regional basis, even global customers. They have unique formulations that are tailored to both cultural, as well as ethnic needs, especially in the care markets.

That focus of being able to work with a customer on location and then driving them to the centers of excellence in R&D will allow us to innovate closer to our customer, and as I mentioned in my remarks, generate more value for them and with us improving our mix. There is no question that through the redesign and by having that focus of our technical service teams in a regional fashion, will enable us to do further innovation.

ASI as a whole has really a tremendous capability to innovate from a technical perspective. That part is there, so what this enables us to do is to get an existing capability on our understanding of the polymer science and formulation science to the very specific needs of a customer in a region in a location and driving -- driven by the consumer needs in that specific market. So tremendous potential there, absolutely.

Summit Roshan - *KeyBanc Capital Markets - Analyst*

Great, thanks. Just to follow-up. The Adhesives business posted a solid quarter, and you pointed out some business wins there. Any commentary on what you are seeing currently in the underlying markets there?

Jim O'Brien - *Ashland Incorporated - Chairman and CEO*

When you look at our broader markets, we were encouraged by what we saw coming out of China. All the news that you read, everything is under some sort of threat or a down-turn that may be imminent. But as far as some of our key markets over there, we've not seen a lot of change.

Even in Europe, as we went into Eastern Europe and parts of Western Europe with our care products and skin care and oral care, we had increased penetration in these markets. Going to the question you had with Luis as far as are we having success with our innovation and with our relationship with our customers, the answer to that's yes.

As we see that being achieved, as we look at the redesign, we are trying to make that even better, so that as we go into some of these emerging markets and growing markets overseas, such as Brazil or Asia and Eastern Europe, we will be more effective there.

We are seeing results. We want to enhance those results and make them go faster. The redesign is to encourage that, and hopefully we will see that with additional penetration where we saw in this past quarter.

Summit Roshan - *KeyBanc Capital Markets - Analyst*

Fantastic. Thanks, guys.

Jim O'Brien - *Ashland Incorporated - Chairman and CEO*

Thanks.

Operator

Thank you. Our next question comes from the line of Mike Harrison of First Analysis. Your line is open.

Mike Harrison - *First Analysis Securities - Analyst*

Just looking at the SG&A cost, you called those out as a headwind year over year, and it does look like SG&A ticked up in all segments. Is that just normal salary increases that we are seeing kick in there, or were there some different issues across the segment?

Just trying to get a better sense of is the Q1 run rate a good number to use for the rest of the year, or should we see those move kind of higher or lower?

Kevin Willis - *Ashland Incorporated - SVP and CFO*

Well, as we execute on the restructuring, which we have a bias to do as quickly as practical, ultimately we should see those numbers tick down for each business. That would be certainly my expectation as we do what's necessary to right-size our cost structure.

Looking at year over year, what you really see there -- it does vary by business. Same thing as Valvoline business, what you see is some marketing spend, advertising spend, et cetera. I think if you look in ASI, it is more of a full-year impact of head count, salary-type numbers.

But again, to be clear, my expectation is as we execute on our restructuring, we will see SG&A in each business come down. That should and will be ultimately a tailwind for us as the year progresses.

Jim O'Brien - *Ashland Incorporated - Chairman and CEO*

One other thing Mike, just to build on Kevin's statements. We announced yesterday to our organization that there is going to be a voluntary severance. That was announced yesterday. As I see the first phase of reducing head count, that will be a very active program, one that will start almost immediately. That's already underway, so it's starting already.

As you look at our cost, we would expect as we get quarter by quarter that our redesign will start taking effect in traction. We want to be complete by this by the end of year so as we get into 2015 it's behind us. This is something we want to do quickly, thoroughly, and get it done, so that we can get the people refocused on the business at hand get the cost structure.

Also in the first quarter, you are starting to get effective salary increases, as well as a reset of the incentives. Last year incentives were not that strong. They were less than half of what we paid out in past years.

The incentives are reset, so the accruals you take quarter to quarter are under the assumption that you are going to hit 100% payouts. That may or may not happen, and you adjust those as you see results quarter to quarter. But right now we anticipate that we are going to hit our plan, and that would require 100% payouts. That's also a change that you saw from the results from last year.

Mike Harrison - *First Analysis Securities - Analyst*

Okay, then a couple questions for Luis. Just in terms of the strength on the industrial side, the volumes being up I think 13%, can you give us some color on how that looked between coatings, construction, and energy. I'm specifically interested in the energy piece.

Were you still selling some straight guar in Q1, or is this primarily derivatives -- guar derivatives that we're seeing growth in?

Luis Fernandez-Moreno - *Ashland Incorporated - SVP and President, Ashland Specialty Ingredients*

Let me answer the three questions. On the construction side, we are seeing benefits from penetration of our new products, especially in places like China. But we're also seeing the benefits of the slight improvement in the rural industry. But it's really a combination of both. What we've been doing in the market place in terms of our ability to penetrate the space, as well as improving end markets.

When it comes to coatings, a very similar situation. Definitely our customers like our products, both on the cellulosic side as well as the synthetic side, and that has led to increased penetration in certain geographies. But it is also combined with an industry that although not growing as fast as people would like, still growing on a year-on-year basis. We are benefiting from our own actions, as well as the market situation.

In terms of energy, when it comes to our straight guar -- that business is much smaller than what we had last year. It's really managed in a way that we minimize the volatility of the business.

We are selling derivatized guar, and that business actually, from a volume perspective, is actually doing better than it was doing in the previous quarters. But compared to last year, it is a very different level of profitability, as last year the derivatized guar business was still benefiting from very high both selling price and raw material prices, something that obviously we didn't see this quarter.

The volumes are healthy, but when it comes to year-on-year comparison, the profitability of the derivatized guar business is very different than last year.

Mike Harrison - *First Analysis Securities - Analyst*

All right, thanks very much.

Operator

Thank you. Our next question comes from the line of Dmitry Silversteyn of Longbow Research. Your line is now open.

Dmitry Silversteyn - *Longbow Research - Analyst*

Good morning, guys. Just a couple of questions, if I may. The first and a follow-up then.

On the first question, looking at the ISI business and the decline in profitability we saw versus two years ago when the guar issue started, and then you had the I&S issue. I'm just trying to understand the $50 million or so negative delta year-over-year on the profit line. How much of that was guar-related, how much of it was I&S related?

Was there any other culprits, so to speak, on year-over-year basis, or was there a strong improvement in other businesses that are just being hid by these two issues?

Luis Fernandez-Moreno - *Ashland Incorporated - SVP and President, Ashland Specialty Ingredients*

Sure, let me take on the question. The way I see it is we reported $116 million of EBITDA in the quarter.

If you add back the guar price-to-market adjustment last year, that was $31 million. We reported this year $110 million of EBITDA, so that's really a difference of about $37 million versus last-year quarter.

About $12 million of those was related to this lower profitability on derivatives that I just mentioned. Again the volumes are strong, but last year we were still benefiting from significant high prices on the derivatives. That is -- makes a difference of about $12 million.

Those comparisons as the year evolved would become less relevant, because as you know, the prices of the guar derivatives and guar products were coming down rapidly. Those comparisons will improve as the year goes along.

In the reports, we already discussed that Intermediates and Solvents provided a headwind of about $11 million. It was both a combination of price, which actually was better than expected, but it was also combined with the plant shutdowns that we had scheduled for this quarter. Those shutdowns took a little longer. Net-net, the impact of Intermediates and Solvents was $11 million.

On a non-currency-adjusted basis, SG&A had a negative impact of $4 million. Then we already talked about the one-time impact of air freight that we had to deal with as we improved our inventories in Europe, so that was $3 million.

With that, it remains then to explain about $7 million of the rest of the core business. The impact there was both a combination of mix and price-cost balance, or margin if you look at it that way. As I mentioned before during my remarks, a lot of the actions that we're taking will enhance our mix moving forward, and our capability to capture price.

Hopefully, that explains the difference between Q1 last year and Q1 this year in terms of what were the headwinds that we faced in the guar I&S space, as well as the Specialty divisional (inaudible) we had, and then how the actions that we are taking in SG&A mix and pricing will minimize this into the future as we move forward.

Dmitry Silversteyn - *Longbow Research - Analyst*

Got it. That's actually very helpful, thank you.

Just as a follow-up question for bookkeeping purposes, you had about a $4-million after-tax gain on a divestiture of assets that it looks like you just ran through your regular P&L. Why was that not called out as a special item? Do you expect that to be repeated going forward?

Kevin Willis - *Ashland Incorporated - SVP and CFO*

These do roll through periodically, based upon an agreement that we have with Marathon. That's a recycling tax credit. It varies in terms of amount by year, but we don't typically call that out.

Dmitry Silversteyn - *Longbow Research - Analyst*

Okay, so that's an ongoing thing, the relationship with Marathon, that will periodically recur, so there's no reason to call out as a special item, got it.

Kevin Willis - *Ashland Incorporated - SVP and CFO*

Right.

Dmitry Silversteyn - *Longbow Research - Analyst*

That's all the questions I had, thank you.

Kevin Willis - *Ashland Incorporated - SVP and CFO*

Thanks, Dmitry.

Operator

James Sheehan of SunTrust, your line is now open.

James Sheehan - *SunTrust Robinson Humphrey - Analyst*

Thanks for taking my question. I'm just wondering if you could talk about some of the capital investments you are making in ASI this year, the timing of them, and what your expectations are for growth that comes about as a result?

Luis Fernandez-Moreno - *Ashland Incorporated - SVP and President, Ashland Specialty Ingredients*

Sure. There's a combination of factors. Obviously, we need to do the maintenance of the facilities. These are very large and important facilities that require significant -- certain amount of work. Specifically this year, we had as we mentioned a couple of turn-arounds. Whenever that happens, that capital is used for maintenance.

Having said that, we are also using very specific investments for certain specific growth. A variety of our lines actually are operating at a very high levels of capacity utilization. We are investing certain product lines to make sure that we have the available capacity as we see growth coming into the market place.

Some of them are in the synthetic side, some of them are in the cellulosic side, so depending on the technologies in the specific geographies. I wouldn't want to specify each one of them, but it's -- we're still seeing the market growth, and we're still investing in it -- at a slower pace than we have done in the past, but we're definitely bringing new capacity on line as we see the market growth accommodating for those increases.

James Sheehan - *SunTrust Robinson Humphrey - Analyst*

On the cellulosics and also on the PVP, just to follow up, do you still see most of those coming on line in 2015, or do you have any that will be on line in 2014?

Luis Fernandez-Moreno - *Ashland Incorporated - SVP and President, Ashland Specialty Ingredients*

We actually have some of them that are coming at the end of our fiscal year. Yes, definitely will come in by our 2014 fiscal year.

James Sheehan - *SunTrust Robinson Humphrey - Analyst*

Okay, thank you very much.

Jim O'Brien - *Ashland Incorporated - Chairman and CEO*

Thanks, Jim. We will take one my more question, Nicole.

Operator

Thank you. Our last question come from the line of Chris Shaw of Monness Crespi. Your line is now open.

Chris Shaw - *Monness, Crespi, Hardt & Co. - Analyst*

Good morning, every one. Thanks for taking my call. I was actually just curious.

Maybe you could talk a little bit more about that 18% growth in Europe in Personal Care. That's a big number, and I was just curious if there was some sort of make-up, or was that all new products introduced into the market, or what's maybe underlying growth in the European market?

Then could you also just remind me how big Personal Care is to the whole global ASI business, like what percent?

Luis Fernandez-Moreno - *Ashland Incorporated - SVP and President, Ashland Specialty Ingredients*

Yes, let me talk about first Europe. Yes, we had two things going on at the same time. Number one, we did have a little bit of a tailwind based on the fact that in the first quarter -- on fourth quarter last year, we couldn't ship everything that was needed. We actually had some of that growth related to catching up versus Q4. But that was not the vast majority of it.

Really, it's a lot of self-help in terms of growing our market share and penetrating specifically the eastern European markets, sometimes with new products, or sometimes making sure that our products are in specified applications that are growing in those markets.

I would agree that this is somewhat unique to the work that we've been doing to be successful in penetrating the markets more so than the growth of the European market, per se. That's very good for us as we can show that we can grow in an overall difficult economic environment. That mostly is in Personal Care. I don't think we -- do we disclose the specifics on how big is --?

Kevin Willis - *Ashland Incorporated - SVP and CFO*

We do. If you look at a on a trailing 12 basis, care specialties represents about 23% of ASI in total from a top-line perspective.

Chris Shaw - *Monness, Crespi, Hardt & Co. - Analyst*

Thanks. I have a quick follow-up. If you guys are targeting top-quartile specialty chemical margins, have you guys ever said what that top-quartile represents, what sort of percent margin?

Kevin Willis - *Ashland Incorporated - SVP and CFO*

Yes, if you look at it, I think from an ASI perspective, what we've said in the past is in the 25% to 27% range. If you look across the spectrum of high-quality, top-quartile specialty chemical companies, I think that's what you'd expect to find and see. With a growth profile that also goes along with that. That's exactly what we are creating here.

Chris Shaw - *Monness, Crespi, Hardt & Co. - Analyst*

Great, thank you.

Jim O'Brien - *Ashland Incorporated - Chairman and CEO*

Thinks, Chris.

Operator

I'm showing no further questions in the queue. I would now like to turn the call back over to Jim O'Brien for any further remarks.

Jim O'Brien - *Ashland Incorporated - Chairman and CEO*

I want to thank everybody for joining us today. As I said in my remarks, I'm encouraged with the quarter. I'm excited about how we're going to redesign this Company to be a very strong specialty chemical Company. Thank you for joining us today.

Jason Thompson - *Ashland Incorporated - Director, IR*

Thanks, everybody.

Operator

Ladies and gentlemen, thank you for participating in today's conference. This does conclude today's program. You may all disconnect. Have a great day everyone.
