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PRESENTATION

Operator

Good day, and thank you for standing by. Welcome to the Ashland Inc. Second Quarter 2024 Earnings Conference Call.

(Operator Instructions)

Please be advised that today's conference is being recorded. I would now like to hand the conference over to your speaker today. William Whitaker, Vice President of Finance and Director of Investor Relations. Please go ahead.

William C. Whitaker ***Ashland Inc. - Director of IR***

Thank you, Daniel. Hello, everyone, and welcome to Ashland's Second Quarter Fiscal Year 2024 Earnings Conference Call and Webcast. My name is William Whitaker, Vice President of Finance and Director of Investor Relations. Joining me on the call today are Guillermo Novo, Ashland Chair and Chief Executive Officer; and Kevin Willis, Senior Vice President and Chief Financial Officer.

Ashland released results for the quarter ended March 31, 2024, at approximately 5:00 p.m. Eastern time yesterday, April 30. The news release issued last night was furnished to the SEC in a Form 8-K. During today's call, we will reference slides that are currently being webcast on our website, ashland.com, under the Investor Relations section. We encourage you to follow along with the webcast during the call.

Please turn to Slide 2. As a reminder, during today's call, we will be making forward-looking statements on several matters, including our financial outlook for our third quarter and full year fiscal 2024. These forward-looking statements are subject to risks and uncertainties that could cause future results or events to differ materially from today's projections. We believe any such statements are based on reasonable assumptions, but cannot assure that such expectations will be achieved.

Please refer to Slide 2 of the presentation for an explanation of those risks and uncertainties and the limits applicable to forward-looking statements. You can also review our most recent Form 10-K under Item 1A for a comprehensive discussion of the risk factors impacting our business. Please also note that we will be referring to certain actual and projected financial metrics of Ashland on an adjusted basis, which are non-GAAP financial measures.

We will refer to these measures as adjusted and present them to supplement your understanding and assessment of the financial performance of our ongoing business. Non-GAAP measures should not be considered as a substitute for or superior to financial measures calculated in accordance with GAAP. The most directly comparable GAAP measures, as well as reconciliations of the non-GAAP measures to those GAAP measures are available on our website and in the appendix of today's slide presentation.

Please turn to Slide 3. Guillermo will begin the call this morning with an overview of Ashland's performance and results in the second quarter. Next, Kevin will provide a detailed review of financial results for the quarter, followed by commentary related to Ashland's outlook for our third quarter and full year fiscal 2024. Guillermo will then provide an update related to Ashland's strategic priorities, and then we will open your line for questions.

Please turn to Slide 5. I will now turn the call over to Guillermo for his opening comments. Guillermo?

Guillermo Novo ***Ashland Inc. - Chairman & CEO***

Thank you, William, and hello, everyone. Thank you for your interest in Ashland and for your participation today. Financial results for the March quarter exceeded our adjusted EBITDA outlook range issued on January 30, 2024, with revenues at the midpoint.

Overall sales declined 5% from the prior quarter to $575 million (corrected by company after the call). Improving sales trends noted in our last conference call continued for the balance of the second quarter, delivering year-over-year volume growth for the first time since June of 2022 quarter.

While still early from a trending perspective, the breadth of our ongoing recovery, as well as the constructive external data reinforces our belief that demand normalization is underway within Personal Care and Specialty Additives segments. Looking ahead, April sales are reflective of continued Personal Care and Specialty Additives momentum.

Within Life Science, stable demand in pharma cellulosics was more than offset by the normalization of competitive dynamics in pharma PVP. Pharma PVP volumes were stable sequentially, and we expect overall pharma year-over-year comparisons to improve in the second half as we lap our strong prior year cost. Pricing was down primarily within intermediates, as the Ashland team worked to strike an appropriate balance with moderating costs and increasing competitive activities.

Excluding intermediates, lower prices was largely consistent with favorable raw material costs. The largest impact in our second quarter profitability versus prior year quarter were intermediate pricing and the reset of variable compensation. Production volumes were down 5%, primarily related to Specialty Additives and Intermediates, while overall sales were up 3% versus the prior year.

Based on current inventory levels and demand forecast, we expect to produce at or slightly above the sales volume for the balance of the fiscal year. Overall, while adjusted EBITDA for the quarter decreased 13% to $126 million, it was above expectations for the quarter. Reduced income, partly offset with share repurchase activity over the last year, yielded an 11% decrease in adjusted EPS to $1.27.

Please turn to Slide 6. Overall sales declined due to the factors that I referenced earlier with the largest relative impact in our Intermediates and Life Science business units. Notably, Personal Care sales turned positive for the first time since Q4 fiscal year '22 with momentum in several end markets and regions.

Sequentially, overall sales volume increased 30% with a proportional increase in production. This was the key driver of the 710 basis points quarter-over-quarter adjusted EBITDA margin improvement for the company.

Life Science, Personal Care and Intermediates delivered high-quality margins for the quarter. Specialty Additives was able to improve adjusted EBITDA margins by over 1,200 basis points quarter-over-quarter with an opportunity to further expand going forward. While this is a return to a more typical overall adjusted EBITDA margin for Ashland, we believe there's opportunity to improve to the mid-20s in the second half.

Please turn to Slide 7. Take a step back, the broad themes impacting our performance going forward are the normalization of demand, the quality and resiliency of our core markets and building organic growth catalysts. Normalization is simply the return to customer trend demand following last year's unprecedented and extended destocking. This is about the convergence of our demand with our customers' demand.

Even under a flat to low market growth scenario, our volume demand should increase, driving both improved sales and production volumes, which will improve financial performance. From our perspective, demand is normalizing. Kevin will further explain these dynamics impact and the impact on our outlook in the presentation.

Once demand has normalized, the fundamentals of the core business will drive underlying performance. Our core businesses are focused on high-value and resilient consumer-based industries, Pharma, Personal Care and Coatings. For most of our customers or the customers we serve, end market demand has been resilient and is expected to remain resilient. All these markets have strong underlying megatrends that will continue to provide profitable growth opportunities.

Lastly, we will continue to improve our underlying business mix. Our portfolio improvement actions will improve our portfolio and the quality and resilience of our business mix. Kevin will provide a detailed update later, but our portfolio optimization activities remain on track. Longer term, it's about having strong catalysts to drive our company's future profitable growth.

Our strategic priorities of execute, globalize, innovate and acquire, will provide us unique profitable growth catalysts over the coming decade. Many of these opportunities are not factored in or reflected in our current valuation. If we look at execute, we have the opportunity to further strengthen our core businesses through productivity, commercial excellence and innovation.

On globalize, we have 4 strong businesses that represent 10% of our sales and are well positioned to grow and improve our profitability. We are actively investing on these businesses. Lastly, our Innovate strategic priority presents us with the most powerful growth catalyst opportunity. New differentiated technologies, mostly with a high sustainability profile can expand our available target markets.

I've been personally involved in many meetings with our major customers across our core industries. Customer interest and excitement about these technologies is high. Overall, we're encouraged by our second quarter results, which increased our confidence in achieving our full year outlook.

While there still is uncertainty regarding the pace of a complete normalization, stable customer demand, consumer demand, lower inventories in the value chain and our own order patterns suggest the early stages of demand normalization is underway. We continue to position the company for more resilient operations, with our planning and portfolio shaping actions.

And last but certainly not least, we are excited about our potential or the potential of our growth catalysts. We recognize that the success drivers and capabilities in the past may not be the ones we need to drive the growth catalysts of the future. We are taking action to strengthen our capabilities. We have been refining our organization, hiring new talent with different experiences and investing in our people, processes and technologies to reflect a growth mindset.

With that, let me now turn the call over to Kevin to review our Q2 results in more detail. Kevin?

John Kevin Willis ***Ashland Inc. - Senior VP & CFO***

Thank you, Guillermo, and good morning, everyone. Please turn to Slide 9. Total Ashland sales in the quarter were $575 million, down 5% compared to prior year. Year-over-year quarterly volumes modestly increased for the first time since June 2022, as demand normalizes within the Personal Care and Specialty Additives segments.

These volume gains were partially offset by unfavorable Life Sciences volumes. Pricing was softer in a moderately deflationary raw material environment, primarily within the Intermediates and Specialty Additives segments.

Gross profit margin increased 20 basis points to 32.9% in the quarter. This improvement was largely due to overall production costs that were favorable in the quarter and product mix. This was partially offset by unfavorable Intermediates pricing versus raw materials.

Favorable production costs were a result of generally lower spend across the segments, partially offset by lower absorption. When excluding key items, SG&A, R&D and intangible amortization costs were $117 million, up from $110 million in the prior year, mainly reflecting variable compensation reset and merit increases.

In total, Ashland's adjusted EBITDA for the quarter was $126 million, down 13% from the prior year. Ashland's adjusted EBITDA margin for the quarter was 21.9%, down from 24% in the prior year. Adjusted EPS, excluding acquisition amortization for the quarter was $1.27

per share, down from $1.43 in the prior year quarter.

Now let's review the results of each of our 4 operating segments. Please turn to Slide 11. Within Life Sciences, sustained demand in pharma cellulosics was more than offset by normalized competitive dynamics of pharma PVP, when compared to a strong prior year period.

Nutrition volumes demonstrated moderate sequential improvement but continue to be challenged, when compared to the prior year period due to lower demand, while nutraceutical sales remained strong. Overall pricing for Life Sciences was modestly lower. Life Sciences sales declined by 8% to $222 million. Adjusted EBITDA decreased by 12% to $66 million, primarily reflecting the lower PVP sales volumes and unfavorable product mix, partially offset with favorable pricing versus raw materials. Adjusted EBITDA margin decreased 160 basis points to 29.7%.

Please turn to Slide 12. Stronger demand positively impacted Personal Care volumes within most end markets. Revenue growth was most pronounced in the APAC region and Europe. Oral Care sales were also positively impacted by order timing with a key customer, which is expected to result in lower buying in Q4, before normalizing again in Q1 of next year.

While sequentially improving in the quarter, our Avoca business remains challenged, as customers moved from plant-based to lower-cost bio-based materials. We continue to assess opportunities to improve the underperformance of this business line. Overall pricing for Personal Care was moderately lower.

Personal Care sales increased by 1% to $169 million Personal Care sales for the quarter, excluding Avoca were up high single digits year-over-year. Adjusted EBITDA increased 29% to $45 million, primarily reflecting increased sales volumes, favorable product mix and production costs, partially offset with variable compensation reset.

Favorable production costs were a result of lower spend and higher absorption. Adjusted EBITDA margin increased 560 basis points to 26.6%.

Please turn to Slide 13. Stronger demand positively impacted Specialty Additives volumes within coatings and Performance Specialties partially offset by lower energy end market volumes. Sales growth versus the prior year was most pronounced in the APAC region and Europe.

Overall pricing for Specialty Additives was lower, primarily reflecting increased competition in APAC, but was mostly offset by favorable raw materials. For the quarter, Specialty Additives sales declined by 2% to $157 million. Adjusted EBITDA declined by 21% to $27 million, primarily reflecting unfavorable production costs moderately unfavorable pricing versus raw material and variable compensation reset. Unfavorable production costs were a result of lower spend more than offset by lower absorption. Adjusted EBITDA margin declined by 390 basis points to 17.2%.

Please turn to Slide 14. Intermediates reported sales of $40 million, down 22% compared to the prior year, driven by broadly lower pricing and captive volumes. Intermediates reported adjusted EBITDA of $12 million, a 30% EBITDA margin compared to $20 million in the prior year, primarily reflecting lower pricing.

Please turn to Slide 15. Ashland continues to have a very strong financial position. As of the end of March, we had cash on hand of $439 million with total available liquidity of roughly $1 billion. Our net debt was $889 million, which is about 2.2 turns of leverage. We have no floating rate debt outstanding, no long-term debt maturities for the next 3 years and all of our outstanding debt is subject to investment-grade style credit terms.

We have $900 million remaining under the current Evergreen share repurchase authorization. Our balanced and disciplined capital allocation approach has deployed $1.05 billion to share repurchases and retired 11.1 million shares since June 2021. We are continuing to invest in our existing businesses and technology platforms to grow organically, while pursuing our strategy of targeted bolt-on M&A opportunities focused on Pharma, Personal Care and Coatings.

Please turn to Slide 16. Ashland prudently managed production and inventory levels as we monitored the normalization of demand. Inventory levels have decreased $180 million, when compared to the prior year quarter and $38 million sequentially. Our actions should better position us for more resilient performance and profit momentum across demand scenarios as the year progresses.

Overall, ongoing free cash flow for the quarter was $4 million and $70 million fiscal year-to-date. For the fiscal year, we expect to generate a free cash flow conversion of approximately 50%. Our progressive dividend policy remains an important part of our capital allocation strategy and reflects our confidence in the company's long-term profitable growth outlook.

Ashland has grown its annual dividend every year since 2009, compounding at 18% per year during that time. We target an annual dividend payout ratio of approximately 30% of adjusted income from continuing operations over the long term and are committed to increase the dividend annually as we've demonstrated.

With that, I will now provide an update on the execute pillar of our strategic priorities in addition to an updated outlook.

Please turn to Slide 18. We continue to have 4 primary portfolio actions underway. The nutraceutical sales process is ongoing and we continue to expect a signing and closing within this fiscal year.

CMC production has been shut down at Hopewell and inventory levels are being drawn down while we migrate select production volumes into our Alizay France, manufacturing facility. We have also optimized industrial MC by consolidating production capacity in Doel, Belgium.

As a result, Ashland will be reducing its volume exposure to several lower value, more cyclical industrial segments, including the construction end market. Ashland will continue to operate its remaining MC production unit at Doel to grow in higher-value segments.

Our CMC and MC actions led to $27 million of accelerated depreciation and $20 million in restructuring and separation costs for the quarter. Ashland continues to advance its work to improve the productivity of its HEC business and specific actions will be communicated in due course. We are committed to act with appropriate urgency to deliver on our commitments, including the reduction of all stranded costs to drive an EBITDA neutral outcome and improve overall margins for the company.

In summary, all portfolio actions are on track to deliver a more resilient portfolio with stronger performance by the end of calendar year 2024.

Please turn to Slide 19. As we look ahead, the ongoing question is the timing and magnitude of demand normalization. We recognize that our 2023 baseline was subdued on the heels of supply constraints and overstocking followed by a significant destocking. Understanding end market trends is critical to forecasting the recovery.

End market demand has remained stable and resilient. As Guillermo mentioned, our current demand patterns and market intelligence suggests demand normalization is continuing. Even under a flattish end market demand outlook, we expect to grow from our 2023 baseline, as highlighted on the right side of the chart.

Of course, demand evolution in the coming months will further narrow the range of recovery scenarios for the full year. In the near term, we've had a good start to the quarter and we're expecting this trend to continue with second half year-over-year revenue growth to be high single digits to low double digits, excluding portfolio optimization actions. Our current full year forecast reflects demand normalization throughout the remainder of our fiscal year and does not contemplate customer restocking.

Please turn to Slide 20. Personal Care and Specialty Additives are expected to benefit from demand normalization with favorable second half comps. Difficult Life Sciences comps are expected to improve as the year progresses. We are expecting softer overall pricing, mostly offset with raw material deflation, excluding Intermediates.

We expect significant year-over-year absorption favorability as production is forecasted to normalize, and we compare against last year's inventory corrective actions. Sequentially, Specialty Additives is expected to demonstrate continued margin growth as production increases to align with improved seasonal demand.

Lastly, the portfolio optimization activities are expected to generate 200 to 250 basis points of adjusted EBITDA margin expansion at full realization in fiscal '25 and '26. For the fiscal third quarter, the company expects sales in the range of $560 million to $580 million and adjusted EBITDA in the range of $138 million to $148 million. For the full year, we now expect sales in the range of $2.150 billion to $2.225 billion and adjusted EBITDA in the range of $470 million to $500 million.

Key risks and opportunities are listed on the slide. Demand recovery, variability in plant loading and price versus raw materials continue to be most critical for the full year financial results.

And now let me turn the call back to Guillermo to provide an update on our strategic priorities. Guillermo?

Guillermo Novo ***Ashland Inc. - Chairman & CEO***

Thank you, Kevin. Please turn to Slide 22. Our strategic priorities remain unchanged and continue to guide our actions, investments and profitable growth expectations. As we have discussed before, the priorities include: execute, globalize, innovate and acquire.

As Kevin shared, we're making good progress on our execute priorities and the resulting impact will further strengthen Ashland's financial resilience. Our globalize and innovate priorities are expected to serve as a growth catalyst, extending and expanding improved results from demand normalization and the portfolio optimization actions.

We are pleased to report that the Ashland team is making progress in both areas.

Please turn to Slide 23. Activities underway to globalize four of our extremely attractive business lines, which currently represent 10% of our sales. They are injectables, OSD tablet film coatings, biofunctionals and preservatives; two in Pharma, two in Personal Care. We continue to make progress in our globalization efforts for these profitable growth businesses. In Pharma, the injectable business continues to make progress, expanding the innovation project pipeline across early-, mid- and commercial-stage projects.

During the last year, we have grown our pipeline of injectable projects by 50%. Although starting from a small base, our Injectable business performance is nearly 100% ahead of our first half expectations for this year and 180% above prior year.

We continue to invest in both technical and manufacturing capabilities and expect to inaugurate our new Ireland facility this year in Q4. The OSD film coatings business continues to globalize its manufacturing and technical footprint to enhance its ability to address local needs. During the quarter, we successfully acquired land in India to build out our OSD film coatings business, infrastructure in a key region.

We're also starting the process of converting an existing nutrition site in Brazil to support OSD coatings and in addition to support our biofunctionals business. This conversion is a great example of repurposing assets to be more efficient with capital and speed to market to enable growth. And we're innovating with an exciting pipeline of technologies that will provide increased productivity to our customers.

Shifting to Personal Care, biofunctionals continues to innovate well, leading the Personal Care segment and new product introduction revenue this year. We have also experienced the recovery of sales into China, an important market and the location of our newly commissioned production facility. We will now be able to innovate and produce locally for our customers. We expect this business to maintain strong growth momentum.

The Preservatives business is advancing several projects to optimize our manufacturing and supply chain to reduce overall costs, enabling local supply and further support continued share gains. We're also continuing to innovate, expanding our natural actives portfolio, as well as advancing new process technology to improve productivity.

All four business lines took steps to accelerate globalization activities and remain hyper focused on implementing their respective business plans to deliver highly accretive margins and growth for the company.

Please turn to Slide 24. Innovation is a fundamental component of our growth strategy. Underscored in the video on the onset of the webcast, Ashland's new leading scalable technology platforms, paired with market leadership is at the core of our business model. We are hyper-focused on executing our innovation strategy, launching new products and engaging customers.

As we indicated in the last call, we have launched our first super wetters targeting coatings, and we will be launching new variants targeting other markets. We have launched several liquid cellulose+ products and are now developing new products targeting Asia and Latin America as well as exploring the value of this technology in Personal Care applications.

In bioresorbable polymers, we currently have a pipeline of over 160 customer projects and we expect the pipeline to continue to grow, as we establish commercial traction on sales from recently launched products, such as Viatel and Vialose. Our transformed vegetable oil or TVO technology has probably received the highest level of interest across our customer base given its performance, functional tunability, and sustainability profile.

I've personally been involved in many of the customer meetings, and it's truly exciting to see the enthusiasm about the technology and the interest in collaborating with us to develop this technology across multiple markets and applications.

Based on additional developments we've made on TVO, I'm also very excited about the opportunities TVO may open for Ashland in existing high-volume, high-value application. We recognize that innovation can be more long term in nature, but as we launch more products, we expect to gain commercial momentum, as well as validate the value of these exciting new technology platforms. Our current focus is on developing several joint development agreements or JDAs with key industry leaders.

Please turn to Slide 25. In closing, we will stay on strategy, maintain operating and capital allocation discipline and take appropriate actions to drive fiscal year 2024 performance. We are investing in our innovate and globalized strategy while increasing customer innovation engagement to advance our growth capabilities. We are leveraging the opportunity to refine the portfolio and improve our overall quality and focus on the big three businesses.

We're encouraged by the second quarter momentum, and we believe we are poised to capitalize on continued improvement in demand trends, demonstrating continued progress in our normalizations, resiliency in our business portfolio and the value of our growth catalyst themes will be key going forward. We are confident in the quality and resilience of our strategy and business.

I want to thank the Ashland team once again for their leadership and proactive ownership of the businesses in a dynamic environment. Thank you for your time. And Daniel, let's move to Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Our first question comes from Michael Sison with Wells Fargo.

Michael Joseph Sison ***Wells Fargo Securities, LLC, Research Division - MD & Senior Equity Analyst***

Nice start to the year. When you think about the second half run rate and how you grow that into 2025. Is that the best way to think about sort of the growth or where your EBITDA margin should be as we head into '25?

Guillermo Novo ***Ashland Inc. - Chairman & CEO***

If you just look the 3 points that we made on normalized quality of our portfolio and then the growth catalyst. The rest of the year, normalization is going to be the biggest driver of our performance. So we are seeing this as the higher seasonal part of the year. So the demand is working out as expected. So we should be seeing that increase in revenue and proportional gross profit.

But the bigger issue is going to be obviously our loading of our plants as that volume comes in, that's sort of the projection. So most of the year, it's about normalization and about managing price versus raw materials to balance out any adjustments in the industry. As we move forward, then the other catalysts really take a forward look.

Most of our customers, if you look at our end markets, are expecting more resilience. You have a few customers that were impacted a little bit more that are actually coming out with more positive results in their specific businesses.

Michael Joseph Sison ***Wells Fargo Securities, LLC, Research Division - MD & Senior Equity Analyst***

Right. And then just a quick follow-up on Avoca and the challenges there. What do you think the strategic plan for that will be going forward?

Guillermo Novo ***Ashland Inc. - Chairman & CEO***

That's a good question, Mike. I mean we've talked about this for a long time now. This business has been challenged since 2018, '19. I think the issue is some of our customers have moved to bio-based technology. We had a big impact a few years ago when that process was taking place.

The last few years with the shortages, I think we were able to stabilize the business. I think now as things normalize in terms of everybody's capacity and where they're going. I think that we expect that trend to continue on moving to lower-cost bio-based production. So we're working through what we want to do with that part of the portfolio, as we said in the last call. We don't have any more specific details to share at this point in time, but it's something that's on our radar screen.

Operator

And our next question comes from Laurence Alexander with Jefferies.

Laurence Alexander ***Jefferies LLC, Research Division - VP & Equity Research Analyst***

First, just on the inventory cycle at the customers, to what degree are you getting feedback that customers feel they will need to rebuild or adjust inventory levels? Are there any end market channels that you see kind of more chance of a restock cycle in 2025?

Guillermo Novo ***Ashland Inc. - Chairman & CEO***

No, on that question, I think it's more of the normalization, as we said in our call. The destocking is over. I mean, there might be a customer here or there. But in the big picture, it's about getting now to their demand and they sell a unit, they got to buy a unit, just to maintain the current appropriate inventory levels.

I think what will change is as their sales change, right now, most of the projections are more flattish, but as there a sales change, their days of inventory, I think that's when we'll see a little bit more restocking. But I assume that, that will be more of a 2025 issue. So the focus should be more on normalization. That convergence of our demand to their demand is the big impact at this point in time.

Laurence Alexander ***Jefferies LLC, Research Division - VP & Equity Research Analyst***

And then related to that, are you seeing kind of a shift by customers towards pulling forward R&D cycles because now they have more flex time available as demand trends and inventory levels kind of that volatility settles out? Or can you just characterize like how much demand pull you have for just reformulation adaptation, innovation, not just in the new growth platform just across the portfolio.

Guillermo Novo ***Ashland Inc. - Chairman & CEO***

Yes. I would split it up demand pull of things mean people moving forward on the normal business. I don't think that's going to change so much. I do think your point on the innovation, that's what excites us, and I think we've advanced pretty well. So as people start to reformulate.

If you look at the last few years, most of our customers' labs. If you look at 2021, '22, they were trying to find alternative raw materials, managing costs, reformulating so labs weren't necessarily in their peak innovation. Momentum. I think now as things normalize for them to, there's more stability in supply. We will get more into that cadence.

And I do think there is some more built-up interest in accelerating the innovation. I can say we've been visiting all our major customers, introducing in all the industries, Pharma, Personal Care and Coatings, introducing the new technology platforms, very high level of interest, not just in the technology, but you can see that interest in, hey, getting back to innovation, they want to grow, they want to launch their new products. So it's a great timing for us to be introducing new products.

And I do think that we'll see a wave in 2025 of more new products, new formulated products. and that whole theme of sustainability. Now I would say performance with sustainability, not just sustainability on its own is going to be the big driver. Can the industry move to more equal or better performing, more sustainable products. And I think we're very well positioned for that.

Operator

Our next question comes from David Begleiter with Deutsche Bank.

David L. Begleiter ***Deutsche Bank AG, Research Division - MD and Senior Research Analyst***

Just in Specialty Additives, what are you seeing on pricing trends in this business and potentially going forward?

Guillermo Novo ***Ashland Inc. - Chairman & CEO***

I think as we saw in the inflationary time, just as a reminder, when inflation came up, we moved on pricing, but we didn't really expand margins. We sort of kept them whole. Most of the improvement in 2021, '22 was mix actions that we took.

I think as we look at the slowdown in the economy and now just competitive pressures, probably near term, a little bit of pressure, especially in Asia, Latin America, where you see a little bit more aggressiveness in different players trying to gain share in this environment. But I think the normalization trends longer term, we expect them to go to trend, which is we'll move maintain margins and keep the pricing.

So it's really going to be just a timing. So far, we've been able to offset the two pretty well. But I think as demand starts picking up, we'll see how raw material trends because I think the issue now is a lot of our, and I look at our own suppliers running slower raw materials, when will they start going up again, as volumes come back.

So I think this normalization period is going to be a little bit more choppy in terms of the timing of pricing versus raw material shifts favorable and favorable. But the longer term, we don't expect any big change in the long-term dynamics on the pricing side.

David L. Begleiter ***Deutsche Bank AG, Research Division - MD and Senior Research Analyst***

Very good. And just on volumes, what do you expect volumes to be up year-over-year in Q3?

Guillermo Novo ***Ashland Inc. - Chairman & CEO***

We expect volumes to be up across the board in all the businesses. Per Kevin's comments, the PVP and we're lapping some of the key comps from last year. So sales volumes will be increasing. But the bigger thing is not about the demand side, it's about our production side.

There are significant volumes. We haven't given specific numbers and all that, but it is a significant increase. And especially when you compare to last year. If you remember last year, first half, we overproduced. Second half, we took bigger actions to control inventories. You're going to see this is going to be more of a pickup versus the last year that we were in control mode. So it's going to be a quite significant improvement in production volumes. So I think as you look forward, look at both what we're saying in terms of sales volumes, but also production volumes. But Kevin, I don't know if you have any other thoughts on that balance?

John Kevin Willis ***Ashland Inc. - Senior VP & CFO***

Yes. The outlook would imply mid-single-digit volume growth in Q3 year-over-year. And sales, pretty much across the board -- volume growth, the sales growth numbers will be that or maybe a bit better than that on an overall basis for the second half in total.

Q3 There's a little noise in Q3 and Q4 because the restructuring actions around CMC and MCso top line is a little bit muted. But if you look at it on an overall volume basis for the core business, it should be up about mid-single digits.

Operator

Our next question comes from Chris Parkinson with Wolfe Research.

Christopher S. Parkinson ***Wolfe Research, LLC - MD & Senior Research Analyst***

I just want to turn back to the Pharma business. It seems like you're lapping some comps in PVP based on, I guess, a competitor outage a while back. But can you just take a step back and remind us of what you view the normalized growth rate is of that business? It seems like you've had a lot of solid initiatives over the past few years that have been muted by a little bit of noise in Central Asia, even a little bit in Latin America.

So, can you just remind us of in terms of how we should be thinking about this business, normalized volumes and then potential areas of upside optionality?

Guillermo Novo ***Ashland Inc. - Chairman & CEO***

Thanks, Chris. If you look at PVP in several dynamics that I would highlight. One, as you said, the last year, some players had outages. So as we said last year, the business was doing great, but the PVP business was a little bit higher and that we expected it to normalize once everybody came back on stream, and this is not a surprise and happening as we speak.

What's changed, I guess, a little bit is more the China dynamics on exports and pricing, especially in Asia and Latin America. And I think this is not a Pharma necessarily driven issue only. It's more the whole dynamic of the BDO chain, BDO prices being very down, the nonintegrated players being able to buy very cheaply because costs are down and obviously, a lot more pressure on loading their plants and all that.

I think as other markets that we're not even in, but polyurethanes, fibers, all this go up and the core BDO demand and costs go up which is probably going to start happening towards back end of this year and more into next year. When that part of the demand and the cycle starts normalizing, I think you're also going to see some normalization of competitive activity.

I think the next few months, we're monitoring this normalization period anytime when there's changes, when you have the most choppiness, volumes coming up, people reacting to trying to load their plants and all that, that's when we're going to see a little bit of the noise. But the longer-term trend line should normalize as the entire value chain cost structure normalizes and volumes normalize.

John Kevin Willis ***Ashland Inc. - Senior VP & CFO***

Chris, if you look at that business historically, it's been low to mid-single-digit growth very consistently. If you eliminate some of the noise over the past couple of years, and we would expect that to be the case going forward, ex any kind of platform innovation technologies in that business that take hold. That would be an accelerator over and above what we would normally see.

Christopher S. Parkinson ***Wolfe Research, LLC - MD & Senior Research Analyst***

We can look forward to that. And then just very quickly, once again, you've gone through a couple of choppy quarters based on the destocking on Personal Care. But Guillermo, behind the scenes for years, you've been working on a lot of new product portfolios. It seems like things are beginning to inflect.

I understand we don't get ahead of ourselves. But what as a CEO are you the most enthusiastic about? I mean is it biodegradable, biofunctionals, bioactives, like just when we take a step back, by end market or products, like are there things behind the scenes that you were kind of just thinking about, wow, I'm really optimistic on this, but destockings hold me back a little bit. As I say today, what is your current thought process?

Guillermo Novo ***Ashland Inc. - Chairman & CEO***

So let me take you business by business on that response. I think it is a very important one because a lot of normalization, we're in good core markets, but these catalysts. What I feel good at for our company, the catalysts that we have are significant, especially given our size.

So they're not just good growth opportunities relative to our size of company to the size of the market opportunities that we have, it's significant. It really can change our future. So if you go through each of the segments, Life Science, we have a very strong portfolio of core technologies, which is stabilizing the PVP.

But if you look at all our cellulosics, our Benecel or Klucel, there's great growth opportunities there for the foreseeable future. Our issue there was really making sure that the pipeline for the longer term, that we have that next wave of things that we can start growing. And that's what excites me.

If you look at Injectables, we've been working on our bioresorbable polymers, the pipeline. We'll start sharing more when we have our next innovation update, but really exciting pipeline growing higher purity products, new market applications, a lot of great things that just expand our market portfolio.

Our solubilizers are super wetters for them. They're not looking at super wetters or solubilizers opens up opportunities in the injectable area, opens up opportunities in the consumable areas. In bioprocessing and other areas, they use a lot of these things.

Same thing with the PH Neutralizer. The TVO really exciting opportunity. If you look at film coatings, some really great development that really can transform our position in the market, and that's a very large segment. It's bigger than the PVP segment, as an example, and we're a small player thereo huge growth opportunity for them.

And in the Ag business, we have done trials now with both the super wetter for leaf coatings and the oil, the TVO as a binder for seed coatings, great results. We expect to launch both of those because the regulatory reasons will probably start in Brazil in 2025.

So all of these are scalable, very significant for the size of our Life Science business, very, very significant, and that's where we're putting our energy and effort.

Personal Care, the shift to sustainability. What we've learned and what we've really looked at is, look, it's not a shift to sustainability. It's about performance. The products our customers want sustainability, but it's got to perform and have a cost profile that is competitive with the current technology.

It's almost too difficult to make the transition if you're going to double your costs, consumer will not be able to pay this. So we're very excited now with a lot of the new developments, be it the TVO, look at the novel cellulosic starch space, cellulosic-based EO free. The feedback from customers has been incredibly exciting and these technologies because they're tunable, we're going into new skin applications, new hair applications and even new oral care applications, which is a very sizable market for us and we want to rejuvenate it in terms of the technologies. It even opens up opportunities in the household area, just given the performance of these products.

And in coatings, actually, I will tell you the coatings is probably the one that's transformed the most. We have been concentrated on rheology, that's been sort of our core business. We're one of the largest, if not the largest rheology player in coatings, but we're narrow. -Our Coatings business is not like our Life Science and Personal Care that we have a big portfolio. These new platforms actually open the door of a lot of new technologies, the super wetters, sizable markets, the very sizable market. The TVOs, we're taking them into totally different directions. Their dispersions, their film formers. These are things that can enhance TiO2 efficiency. They can be co-binders. I mean, there's a lot of things.

And as you know, in Coatings, there's nothing small. It's a concentrated market of customers. We're well positioned with them. They're very excited about these technologiesso again, we see great growth opportunities. As you've seen, we've made changes in our organization, we're investing. What I was saying in the call, this recognition that the future road for us is not the same as the past road.

It's different. We need to bring in new skills. It's about innovation growth, it's about engaging our customers differently to really develop. And this is going to be a long-term road. The good news for us is we have the globalize, which can generate near-term growth. And then as we launch some of these new products, I think we'll go over the introduction cycle with our customers.

I think getting a few big JDAs with customers is going to be important because some of these products, we don't want to invent it for them. We want them to be part of designing the products that they want for their applications and the interest has been very high. So as you can tell, I'm very excited about this. This is where we're putting our energy, our resources.

And frankly, this isn't valued in our valuation. This isn't recognized at all at this point in time. And I think that's a great opportunity and a great catalyst for not just the company's growth but for the valuation growth of Ashland.

Operator

Our next question comes from Josh Spector with UBS.

Joshua David Spector ***UBS Investment Bank, Research Division - Equity Research Associate - Chemicals***

I wanted to come back to the volume discussion a little bit. And if I just put some numbers out there, you're kind of presenting 2021, as maybe the right baseline, your volumes in the second quarter, you're about 10% below. You have a lot of moving parts in the second half. I guess my math is your exit maybe your 5% volumes going away with essentially 0 to very low profit dollars.

Does that mean your volumes sequentially improve something like 5%? And where I'm trying to go is if you're saying your end market demand is flat to maybe up versus 2021, is that 5% gap in volumes, basically the amount of reconnection that's left to go versus your guidance? Or would you describe it differently?

Guillermo Novo ***Ashland Inc. - Chairman & CEO***

Let me make some comments and Kevin, maybe you want to talk. I think that the issue in responding to that, it's hard to respond at a total level, given just volumes in these businesses where they're additives. You can't compare preservatives or biofunctional volumes to HEC or other areas. So we look at it more segment by segment on what's happening to the volumes because then you can get some distortions.

As you said, clearly, the reduction in our portfolio actions will reduce volume, but we're taking out costs, and it wasn't at a significant profit. So I do think sales volume versus production volumes. Sales volumes you're going to see, as Kevin said, some continued increase. And if you look at the high-volume areas for us, PVP, high volume significant from a loading perspective. PVP, HEC, our Benecel and our Klucel lines, all of those were expected to see continued momentum.

We got to get to the normalization, which I would say it's more somewhere in between 2021 type volumes in those areas. 2020, 2021, that we'll start getting that momentum back in and it should be in the mid-single digits once we normalize. So that's the biggest driver. In the other areas, it's volume, but you can't compare the total numbers because the volumes are significantly higher value, lower volume.

Biofunctionals as an example, you don't see it on the volume side, but it's a high price per kilo. That one was significantly down. Some of the major customers were down because of travel and things like that. And China was down significantly, a very important market. So the recovery there will be very important for our volumes.

Equally, the Preservative business was also impacted similarly, a lot of the growth that we have in Asia and all that, and that's starting to pick up. You won't see it so much on the total volume lines. But on the revenue line, we expect that to be higher than mid-single, more relative to the performance in the last year, those will pick up much, much more.

And we can go out segment by segment, but it's very hard to give you just an overall number just given the dynamics and the differences between our business. But Kevin, do you have any other comments you would give?

John Kevin Willis ***Ashland Inc. - Senior VP & CFO***

Yes, sure. Of the restructuring work that we're doing around CMC, MC and obviously, just kind of off to the side the nutraceutical sale. Very little of that has actually had any kind of impact on the volume line, at this point, on an annualized basis, volume going away is probably around 5% of kind of the volumes we've been doing. So we'll see that negative impact. And as that becomes more pronounced, we can certainly call that out so you'll understand what's happening kind of on an ongoing basis, and we'll work to do that.

But again, very little of that has happened yet. We'll start seeing that in Q3. And then obviously, presumably we get the nutraceutical sale closed, which we're confident we will do. Then there will be a more pronounced impact from that. But again, we can call those things out.

I think another important point is we use the word convergence. And that's truly what it is. Our customers' volumes to the outside world that they sell to have been kind of flat. And obviously, we saw a big, big decline last year with destocking. While that convergence has started and is ongoing we're not there yet, and we're going to continue our expectation anyway is that we will continue to see that ramp throughout the fiscal year.

The absolute timing of when we can put a stake in the ground and call that done remains to be seen. I mean, timing is what it is. Pace has been pretty much what we expected so far, and we're staying really close to our customers. But again, as Guillermo said, things are a little choppy still. And so we expect to continue to see those lines get closer and closer together. Our volumes, matching what our customers have been selling to their customers.

And then as that happens, to the extent, regular we should grow with them. But that's a timing thing. And it's continuing to happen, and we expect that to continue. And hopefully, by the end of the fiscal year, we'll be pretty much at convergence. But the timing is still a question.

Joshua David Spector ***UBS Investment Bank, Research Division - Equity Research Associate - Chemicals***

That's helpful. I appreciate that. I guess if I kind of build on that more simply, so if we're getting near convergence by the end of the year, it seems like you think things should be normalish than looking at '24. Slide 11, again, 2021, you're presenting as normal, would you expect EBITDA dollars to be above 2021 levels when you normalize thinking about growth, some of the actions you're taking, et cetera?

Guillermo Novo ***Ashland Inc. - Chairman & CEO***

Yes. Once we normalize and that normalization, not just in demand, it normalizes our production volumes, we should see that revenue and EBITDA normalization happened, obviously, with taking out some of the portfolio actions that we're doing, which impact the revenue side more than the EBITDA.

John Kevin Willis ***Ashland Inc. - Senior VP & CFO***

Fiscal '21 EBITDA was $495 million. The midpoint of our outlook is $485 million. So assuming we have the outlook for the full year, things continue as they have been. And as we expect, then yes, for sure, I would expect fiscal '25 EBITDA to be accretive to both '24 and '21.

Operator

Our next question comes from John Roberts with Mizuho.

John Ezekiel E. Roberts ***Mizuho Americas LLC - MD & Senior Equity Research Analyst***

I'll ask just one here. Thanks for the update on the new products, Guillermo, are you ready to give us a vitality index or something to track new products as a percent of sales as a baseline and kind of how we can watch that ramp over the next couple of years?

Guillermo Novo ***Ashland Inc. - Chairman & CEO***

Yes. We are working, John. Thanks for the question. We're working on doing an updated date for our innovation update. And at that event, the intent would be to start setting up a tracking mechanism that's clear.

So for Pharma, what's our pipeline and more of the traditional pharma-type presentation of where we are in the different areas. And probably what we're going to do is look at technologies that we're launching, where are they versus technologies that we're developing because to be honest, some of the newer things.

So over launching, we know the markets, like we're saying AG or in Personal Care, it's pretty clear where we're going, we can do that. I think there's some other areas - it's really moving fast in our ability to develop new things and it's opening up a lot of new markets. So those will give you probably more updates on the technology where we're looking, why we're excited on the performance.

So you're going to see probably different types of metrics that we're going to show so that you can gauge commercial momentum versus long-term opportunity and how you want to gauge some of these things. So an example for me would be things we launched a super wetter, we should be able to give you more of the momentum that we're getting there. In TVO, we're developing things for coatings, as an example, that are more multifunctional binder dispersants and things of that nature, those are big markets.

So we're very excited about what we're seeing, but those are going to be a little bit longer. We're going to work with our customers in a little bit more detail there. We'll present where we are because I do think those are important perspectives to keep, but it's going to be a little bit longer term slightly. So we'll present that spectrum probably by the end of this fiscal year, we'll do that.

Operator

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

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

Guillermo, I was wondering if you could talk a little bit about the recent changes in segment leadership. It seems like maybe it's kind of a tricky time for both an external as well as internal standpoint. You guys have a lot going on. So what are you doing to help reduce the distraction that might come from a leadership change, again, basically in every segment right now?

Guillermo Novo ***Ashland Inc. - Chairman & CEO***

Right. So thanks for the question, Mike, because I do have gotten some notes on that asking what's happening. So, two different things. The prior changes were purposeful. We were looking, as I said, we're moving in a very different direction. If you look at everything I'm talking is about new technologies, new areas, the company has been focused with certain profiles, certain segments. As an example, beyond rheology, we need experience in other technologies that go into coatings, as an example. It is about growth, and it's just a realization, hey, where we're going, we need to bring in different experience and talent. That's what we're doing. We've been purposeful about that.

You've seen the higher level leadership changes that have been public, but we've been bringing in two new R&D heads for two of our businesses. We're bringing a lot of scientists. We're bringing in new marketing people. There's a lot of other changes behind the scenes that are going, and this is really about the future and where we're going.

I'll be very direct on the recent announcement, with our Life Science, that wasn't planned. Ashok got an offer to become CEO of a private equity company. They probably will announce soon wherever he's going to go. It's a good opportunity for him, and we wish him all the best. That was not planned. We're already in the process of hiring. This kind of stuff we hired people. This happens.

I've been involved in these kinds of changes. So this is just part of life, and we need to roll with these changes. The Life Science business is very well positioned. They have a clear strategy. If you could hear from my comments, they know where they're going, they're expanding into a lot of new areas. The business is very well positioned, and it's really about bringing in the new leader, and that's already in progress.

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

All right. And then the other thing I wanted to ask about is the biofunctionals business. You talked a little bit about some of the opportunities for geographic expansion, but it sounds like at least in this quarter, that business was relatively weak. Can you talk about what was driving that weakness and whether you expect improvement in the second half of the year?

Guillermo Novo ***Ashland Inc. - Chairman & CEO***

So biofunctionals was significantly up, improving sequentially in Q2. We're starting to see that recovery. Some of our major customers are picking up momentum.

Recent announcement, people seeing greater Asia travel. These are going into more high-end cosmetics. So definitely, we're seeing that with our core customers. China, we have a very good position in China. We're starting to see the recovery there, which comes at a perfect time when we just inaugurated our biofunctionals plant in our Nanjing plant.

So that business is very well positioned. Our new leader, Jim Minicucci, he's already working with his team. We have very focused teams now in both biofunctionals and the preservative business that we want to drive in that globalization. So we have some new resources that we're adding in terms of leadership, in terms of sales and marketing capabilities that we're augmenting and regionalizing.

So a lot of investment, and I think this is a new part of the recovery, like all the other segments. I think the issue there is the volumes are not the driver, the dollars given the value per kilo in these areas are much different from some of the other businesses that we have.

Operator

(Operator Instructions)

Our next question comes from John McNulty with BMO.

John Patrick McNulty ***BMO Capital Markets Equity Research - MD & Senior United States Chemicals Analyst***

Maybe one for Kevin. So on the cash flow side, you started out the year at a pretty solid level. And yet it sounds like the cash conversion, I think you were calling for 50%, which you're clearly starting at a better rate than that.

So I guess what may be different this time in '24 in terms of how cash runs through the year? Is it something about the restructuring? Or is it just the early harvesting in the first half, as you kind of dialed back production or you're just being conservative? I guess how should we be thinking about free cash flow and cash conversion?

John Kevin Willis ***Ashland Inc. - Senior VP & CFO***

Yes. For the first half of the year in total. So the March quarter was weaker than prior year. First half of the year, we were at about a 36% conversion rate. We expect full year to be 50%. So on a weighted average basis. So the second half should be stronger, relatively speaking, than the first half, for cash conversion.

Cash taxes are a little higher this year than prior year. That's part of the number. But by and large, we're pretty comfortable with the cash conversion. And again, second half tends to be the stronger part of the year, normally anyway. I think the first quarter was somewhat stronger because of the very, very poor incentive payout that we had for fiscal '23 results. We pay those incentives out in the December quarter. And that number was probably $25 million lower than target, let's say. I mean that's what the reset was around $25 million. So that's part of the driver for that as well.

John Patrick McNulty ***BMO Capital Markets Equity Research - MD & Senior United States Chemicals Analyst***

Got it. Okay. That's helpful. And then just one last one. On the raw material front, I mean, it sounds like at least at this point, things are benign, but you've got your eye on a couple of things. BDO, obviously, you're fully integrated through, so it shouldn't be a concern there.

I guess what are the other raw materials that you're looking at where maybe there is some risk of inflation because it still seems like it's a relatively benign environment. So I think how should we be thinking about that?

Guillermo Novo ***Ashland Inc. - Chairman & CEO***

So let me comment and Kevin, you can add some color. BDO, we're not tracking it. I mean, for us, it's butane is more the issue for the back integration that we have. But we do track it because it affects a lot of other players in the market, especially in the PVP and other downstream NMP and other areas.

So I think picking up, we expect those costs, market cost expectations is that we'll start to trend up, which is, for us, a good thing overall, especially in our Intermediates business. So that's where we've seen the biggest impact.

For other areas, obviously, cellulose, cotton and wood pulp is the other big raw materials. They've been sort of stable. Expectations that they'll soften up a little bit more over time, but these products go into hygiene, although it's not our business is and the only user of these materials.

But that one, it hasn't been the biggest driver yet, a little bit of improvement year-on-year, in terms of costs. The rest you really start getting down into the process chemicals that we use the [OPO], solvents, things of that nature. None of them is a significant cost per se, so it will vary by business, but we're monitoring those type of products that we use in our production, for the high-volume products.

John Kevin Willis ***Ashland Inc. - Senior VP & CFO***

Yes, on an overall basis, our raw material forecast has remained pretty stable in terms of raw material cost forecast, it has remained pretty stable throughout the year. I mean first half of the year, we have seen declines in some areas. But again, generally, it's been a pretty stable environment on an overall basis.

Operator

I'm showing no further questions at this time. I would now like to turn it back to Guillermo Novo for closing remarks.

Guillermo Novo ***Ashland Inc. - Chairman & CEO***

Thank you, Daniel. Thank you, everyone, for your time today. As you heard, I think things are normalizing. We're focusing, we're going to manage. We still have work to do during 2024 to make sure we optimize as the normalization dynamics play out, and we'll stay on point on that.

But really, the issue now is also to focus on the future. And the future is refining our portfolio, honing in on those high-value markets that we want to participate in and that we want to lead in and driving our innovation portfolio that really can transform the company in the coming decade. So thank you for your time and look forward to connecting with all of you in the coming weeks.

Operator

This concludes today's conference call. Thank you for participating. You may now disconnect.