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# EDITED TRANSCRIPT

- Q4 2012 Momentive Specialty Chemicals Earnings Conference Call

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**Adam Goodwin** *Goldman Sachs - Analyst*

**Roger Spitz** *Bank of America - Analyst*

**Brian Chavarria** *Credit Suisse - Analyst*

**Bill Hoffmann** *RBC Capital Markets - Analyst*

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## PRESENTATION

### Operator

Good day, ladies and gentlemen, and welcome to the Q4 2012 Momentive Specialty Chemicals earnings conference call. My name is Gary, and I will be your coordinator for today. At this time all participants are in listen-only mode. We will conduct a question and answer session towards the end of the conference.

(Operator Instructions)

As a reminder, this call is being recorded for replay purposes. I would now like to turn the call over to John Kompa. Over to you.

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**John Kompa** - *Momentive Specialty Chemicals Inc. - VP IR*

Thank you, Gary. Good morning, and welcome to Momentive Specialty Chemicals fourth quarter and fiscal year 2012 earnings conference call. Leading today's call will be Craig Morrison, Chairman, President, and CEO, Bill Carter, Executive Vice President and Chief Financial Officer, and George Knight, Senior Vice President -- Finance and Treasurer.

As a reminder, this call is also being webcast, and the slides referenced in today's conference call are available through the momentum.com website under the investor relations section of Momentive Specialty Chemicals. A replay of this call will be available for three weeks, and the reply dial-in information is contained in our latest earnings release.

Before we start, I'd like to review information about forward-looking statements and the use of non-GAAP information as part of this call. As you know, some of our comments today may include statements about our expectations for the future. Those expectations are subject to known and unknown risks, uncertainties, and other factors that may cause the Company's actual results and performance to be materially different from any future results or performance suggested by these expectations.



The slide you now see gives you more information on the assumptions and factors we consider in making those forward-looking statements. We can't guarantee the accuracy of any forecast or estimate, and we undertake no obligation to update any forward-looking statements during the quarter, except as otherwise required by law. For more information on our risk factors, please see our earnings press release and our SEC filings.

In addition, some of our comments may reference non-GAAP financial measures. A reconciliation of the most directly comparable GAAP financial measure and other associated disclosures are contained in our earnings release and on our website. Our earnings release and our recent SEC filings are also available on the internet at [momentum.com](http://momentum.com). With that, I'll now turn the call over to Craig Morrison to discuss our quarterly and year ended results.

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**Craig Morrison** - *Momentive Specialty Chemicals Inc. - Chairman, President, CEO*

Thanks, John. Turning to page four and an overview of our fourth quarter results, revenues were \$1.1 billion compared to \$1.2 billion in the prior year, as strong results in our global forest products business were offset by weakness in certain key end use markets and geographies.

Segment EBITDA totaled \$84 million compared to \$106 million in the prior year, as we experienced continued economic volatility in Europe and Asia and a shift in product mix, primarily due to lower volumes in our oilfield business. Segment EBITDA was also negatively impacted by \$8 million, due to a temporary production outage at one of our epoxy facilities. The impact was contained to only the fourth quarter as normal operations have since resumed.

Operating income of \$15 million in the fourth quarter trailed prior year slightly, but there were some positive trends in our results. For example, we posted quarterly segment gains in each region of our forest products business as an offset to the overall macroeconomic headwinds.

In response to sluggish demand in certain end use markets, we continue to aggressively focus on cost actions and cash optimization. We have realized \$58 million in savings on a run rate basis from the shared service agreement as of yearend 2012. We have identified an incremental \$25 million in cost savings from both the shared service agreement and additional productivity programs that we expect to achieve over the next 12 to 15 months.

Turning to slide five and a full year -- and full year 2012 highlights, we were pleased to post strong cash flow from operations of \$177 million in 2012 compared to \$171 million in 2011, as we continue to carefully manage our balance sheet. Net working capital totaled \$476 million, or 10% of sales, in 2012 versus \$568 million, or 11% of sales, in 2011. Our working capital trend is the result of structural initiatives in demand planning and inventory management.

We improved our long-dated maturity profile following the successful refinancing of portions of the capital structure in 2012 and early 2013, which resulted in no material debt maturities prior to 2018.

We continue to position the Company for long-term success through a number of important growth projects, such as our phenolic specialty resins facility in China, our new acrylic resins plant in Thailand, and our recently announced forest products joint venture in Australia.

Regarding our liquidity position, at yearend, we had \$666 million in cash and available borrowings, despite working capital increases from the raw material inflation we experienced during the year. Finally, at December 31, 2011, (sic -- see press release -- 2012) we were in compliance with all financial covenants that govern our senior secured credit facilities and indentures.

Turning to slide six, you can see an overview of our financials. As noted, our fourth quarter 2012 sales decreased 6%, due to softer volumes, while segment EBITDA declined 21%, due to lower demand and negative product mix, partially offset by the cost actions I've mentioned. Operating income declined by 21%, driven by similar factors in segment EBITDA. As we've said before, despite the lower volumes, the inherent earnings potential of our specialty businesses remains intact, due to the proprietary technology and secular growth trends.



Turning to slide seven, you can see an overview of our yearend financials. In 2012, net sales decreased by \$451 million, or 9%, compared to 2011. Volume decreases negatively impacted net sales by \$260 million and were primarily driven by our epoxy specialty, phenolic specialty resins, oilfield, and European forest products businesses.

Pricing had a positive impact of \$2 million on net sales, as pricing decreases in certain businesses, due to competitive pressures, were offset by the pass through of raw materials price increases in several other businesses. In addition, foreign currency translation negatively impacted sales by \$193 million. Segment EBITDA and operating income reflected the volume and pricing challenges experienced in 2012 and declined by 23% and 45%, respectively.

Turning to slide eight and our combined raw material index, you can see that raw materials moderated briefly in midyear 2012, but have steadily increased through yearend. In 2012, we saw increases in each of the three major raw materials, ranging from 5% to 10%. We anticipate continued raw material volatility in 2013, as global markets remain mixed. Despite this volatility, we've demonstrated our long-term ability to drive pricing actions.

Turning to slide nine. Taking a longer view, we've highlighted how our business continues to become increasingly global. We continue to invest in the high growth regions of the world, with sales into the BRIC countries and rest of world reaching 24% in 2012. Medium term, we are targeting greater than 40% of our sales to come from BRIC/rest of world.

These recent investments have proven successful, including our Montenegro, Brazil, forest products site, which has been a major contributor to growth in that region since 2010. Since 2005, we've posted a compound annual growth rate of 18% in Brazil. We believe strategic expansion projects and a robust R&D pipeline position us for long-term growth.

Turning to slide ten, we were pleased to announce in January the formation of a new joint venture in Australia that is owned 50% by Momentive Specialty Chemicals and 50% by Laminex. The JV provides formaldehyde and urea formaldehyde resins to Laminex, as well as other products to industrial customers in Western Australia. MSC will manage the day-to-day operations of the JV, as well as provide industry leading technology.

Laminex is the leading marketer and manufacturer of premium decorative surfaces in Australia and New Zealand. The JV generated approximately \$30 million in sales in 2011.

The JV further strengthens our relationship with a key customer, and we have aggressive plans to scale that business. This joint venture, along with our five existing manufacturing locations in Australia and New Zealand, puts us in a strong position to serve the growing forest products market in that region.

I'll now turn the call over to Bill Carter to further discuss our segment results. Bill?

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**Bill Carter** - *Momentive Specialty Chemicals Inc. - EVP, CFO*

Thank you, Craig. Turning to our epoxy, phenolic, and coating resins segment, fourth quarter 2012 revenue totaled \$681 million, decreasing 7% versus prior year, with volume, price mix, and currency translation declines of 4%, 1%, and 2%, respectively.

Quarterly segment EBITDA declined by 37% versus the prior year, as our results reflected lower volumes and negative product mix in our base epoxy and oilfield resins businesses, partially offset by specialty epoxy improvements. Our results were also negatively impacted by \$8 million, due to a temporary production outage, as Craig mentioned.

We continue to strategically invest in our oilfield business through the opening of another transload facility, as this remains a long-term growth business for us. The new transload site is located in Fort Collins, Colorado, and is part of our commitment to maintaining a significant footprint in every major basin in the US and Canada.



Turning to the next slide, in our forest products resins segment, sales decreased slightly to \$403 million, with price mix gains of 2%, offset by volume declines of 4% and negative currency translation of 1%. Volume declines reflected site rationalizations in Europe and Asia Pacific. The positive impact of our multiyear productivity initiatives can be seen in our segment EBITDA results, with a 28% year over year increase, as we posted strong performances in our formaldehyde business and broad gains in all geographies.

Regarding our balance sheet, we continue to benefit from a substantial liquidity position, with cash plus borrowing availability under our credit facilities of \$666 million at yearend 2012. This does not reflect incremental liquidity from the January 2013 refinancing or the new ABL facility.

Our capital expenditure investments totaled \$133 million in 2012, below our previous guidance of \$145 million to \$155 million, due to timing related to certain capital projects. We anticipate a slight increase in 2013 CapEx and expect to invest between \$175 million to \$185 million.

Our net working capital decreased to \$476 million at yearend and was 10% of sales, as we took aggressive actions to drive this lower, in addition to the benefit of normal seasonality in the fourth quarter of 2012. Net working capital compared favorably to 2011 levels of \$568 million. In 2013, we anticipate net working capital to increase slightly, due to moderate volume increases and raw material volatility, partially offsetting continued actions to improve efficiency.

Turning to slide 15, you can see the various parts of our January 2013 \$1.1 billion refinancing, with the proceeds used to refinance our credit facility, second lien notes, and fund cash to the balance sheet. Additionally, in January 2013, we issued \$200 million aggregate principal amount of senior secured notes due in 2018. The new senior secured notes were issued to lenders in exchange for loans of MSC Holdings, which were retired in full.

In late March 2013, we also entered into a new \$400 million asset-based revolving loan, which is subject to a borrowing base. The ABL facility replaced the existing senior secured credit facilities. As a result of these refinancings, we have no material maturities before 2018 and no financial maintenance covenants in our capital structure.

Now, let me turn it -- the call back to Craig to wrap up.

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**Craig Morrison** - *Momentive Specialty Chemicals Inc. - Chairman, President, CEO*

Thanks, Bill. Turning to slide 17, in summary, fourth quarter 2012 segment EBITDA reflected negative product mix, cyclicality, and slowdown in certain end use markets in Europe and Asia, partially offset by improved results from our forest products business. We have maintained a steady focus on our cost reduction activities. We achieved \$58 million in savings under a shared service agreement with MPM since the program's inception. We have also identified an incremental \$25 million in cost savings that we expect to achieve over the next 12 to 15 months.

We continue to demonstrate prudent management of our balance sheet and generated cash from operations of \$177 million in 2012, a slight increase versus 2011. You've heard from Bill who discussed the positive impact of our recent refinancing, as we now have no material debt maturities until 2018.

Looking ahead, overall volumes are expected to moderately increase in 2013 versus the second half of 2012. Our broad product portfolio, diversified customer base, and international footprint positions us well for the future growth and a return to historical profit levels. Thank you for your continued interest in the Company, and I'll now return the call to John.

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**John Kompa** - *Momentive Specialty Chemicals Inc. - VP IR*

Thank you, Craig, and Gary, if you could please open the line for questions and remind callers of those instructions.

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## QUESTIONS AND ANSWERS

### Operator

Certainly. So, ladies and gentlemen, your question and answer session will now begin. (Operator Instructions) Tarek Hamid, JPMorgan.

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**Tarek Hamid** - *JPMorgan - Analyst*

Good morning.

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**Bill Carter** - *Momentive Specialty Chemicals Inc. - EVP, CFO*

Morning, Tarek.

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**Craig Morrison** - *Momentive Specialty Chemicals Inc. - Chairman, President, CEO*

Hi, Tarek.

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**Tarek Hamid** - *JPMorgan - Analyst*

On the proppants business, obviously, the sort of -- the comps have been very tough for the last few quarters. Is that -- should we start to comp a little bit easier on a year over year basis, at least, in the next couple of quarters? If, maybe, just some broader comments, if you could, on just where volumes are trending in that segment.

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**Craig Morrison** - *Momentive Specialty Chemicals Inc. - Chairman, President, CEO*

Yes, I think, naturally, as you saw weakness enter the year in the second half of last year, the comps will improve on a year over year basis. We are not, however, seeing a real recovery in that market yet, again, driven by the natural gas pricing, which, therefore, really doesn't incentivize the oil companies to drill.

But, in the long-term and medium-term, this is an extremely attractive segment. It's still a very profitable segment for us. It's just, on a comparative basis, it doesn't comp well when you're at record levels 12 months, 18 months ago, and again, in the medium to long-term, we think this'll be a very attractive segment to continue to play in, as natural gas prices will inevitably rise as demand rises and people will start to drill again.

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**Tarek Hamid** - *JPMorgan - Analyst*

Sure. And then, maybe just shifting over to some of your epoxy resin businesses, on the -- obviously, you guys announced a number of price increases, year-to-date. Is that sort of more in response to industry conditions -- sort of a better China, or is it just a little bit of a cost push, given some of the raw material movements?

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**Craig Morrison** - *Momentive Specialty Chemicals Inc. - Chairman, President, CEO*

Well, it's a -- it's always a combination of factors, and it -- both of those factors certainly enter into the equation. First quarter continues to be a challenging environment, but we are seeing signs as we enter the second that we think that market will be improving somewhat and, again, driven by the factors you've highlighted.

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**Tarek Hamid** - *JPMorgan - Analyst*

And just, finally, on the forest product resin business, results obviously improved a lot. Do you feel sort of that you have adequate capacity to meet demand in North America, as, sort of, housing starts go over 1 million?

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**Craig Morrison** - *Momentive Specialty Chemicals Inc. - Chairman, President, CEO*

Yes. I mean, if you remember, this is an industry that was at 2.1 million at its peak towards the end of 2006, and we certainly have rationalized capacity, from a plant footprint standpoint, but we've also increased incremental capacity at the existing plants through efforts like Six Sigma projects and things of that nature. So, we are generally not limited by our resin capacity. We have adequate capacity, and we believe that, as the market recovers, we'll really be positioned as the key competitor out there to really benefit from that.

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**Tarek Hamid** - *JPMorgan - Analyst*

Right. Thank you very much.

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**Craig Morrison** - *Momentive Specialty Chemicals Inc. - Chairman, President, CEO*

Thank you.

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**Operator**

Thank you. Adam Goodwin, Goldman Sachs.

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**Adam Goodwin** - *Goldman Sachs - Analyst*

Hi. Thank you for taking my questions.

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**Craig Morrison** - *Momentive Specialty Chemicals Inc. - Chairman, President, CEO*

Hi, Adam. Sure.

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**Adam Goodwin** - *Goldman Sachs - Analyst*

Hi. So, in the epoxy resin part of the business, we've heard from some of your competitors that they have or are considering rationalizing some capacity. Is that something that you guys have also been looking at?

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**Craig Morrison** - *Momentive Specialty Chemicals Inc. - Chairman, President, CEO*

Well, we always assess good demand capacity. It's not something we'll talk about publicly, specifically, and we have nothing to announce at this time, so, really, don't have anything further to say about that, other than it's a natural process competitors go through in different economic cycles.

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**Adam Goodwin** - *Goldman Sachs - Analyst*

Sure. Okay. I guess, turning to the forest products resin segment, your volumes were down, year over year, but it looked like that was due to some of the portfolio rationalizations that the Company's been doing. What's the thought process there? What products have you been rationalizing? And would you expect this to continue to dampen overall volumes in that business going forward?

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**Craig Morrison** - *Momentive Specialty Chemicals Inc. - Chairman, President, CEO*

No, we really had two major moves. One, we divested the Malaysia business in the Pacific, and then, we rationalized, in quite a significant way, our European capacity, focusing on our more profitable regions and product lines. And so, what you saw was a falloff in volumes, because they were fairly significant high volumes, specifically in Europe, but we took out a disproportional amount of cost related to that. So, net net, it was very beneficial.

We don't see major incremental volume reductions through rationalization. It doesn't mean small actions won't be taken of that nature again in 2013. That was a one-off set of circumstances and, I think, one that was very beneficial to us, overall, from a profitability standpoint, and now, we think we're well positioned to benefit as North America and South America continue to rebound very nicely.

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**Adam Goodwin** - *Goldman Sachs - Analyst*

Got it. And then, my last question is the Company is sitting on quite a bit of cash right now, and it looks as though you should continue to generate cash throughout the course of this year. Can you talk about the priorities for cash, going forward?

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**Bill Carter** - *Momentive Specialty Chemicals Inc. - EVP, CFO*

Yes, Adam, I think -- certainly, I think, priority number one is to fund operations and continue to fund our growth plans. So, as we've talked about, either CapEx investments, or Craig mentioned the JV we recently entered in Australia. I think that will be our first focus. We've also talked, in prior calls, that we ultimately would like to delever the Company, and that will certainly be our second focus.

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**Adam Goodwin** - *Goldman Sachs - Analyst*

Great. Thanks a lot, guys.

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**Operator**

Thank you. Roger Spitz, Bank of America.

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**Roger Spitz** - *Bank of America - Analyst*

Yes, thank you. Good morning, guys.

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**Craig Morrison** - *Momentive Specialty Chemicals Inc. - Chairman, President, CEO*

Hey, Roger.

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**Bill Carter** - *Momentive Specialty Chemicals Inc. - EVP, CFO*

Hi, Roger.

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**Roger Spitz** - *Bank of America - Analyst*

Hey, on -- think you can provide a sense of the year over year decline between the epoxy -- liquid epoxy resins and the proppants, in terms of how much of it -- can you give -- I know you don't want to give any details of EBITDA, but can you say -- is it like two-thirds, one, one-third, the other, or some insight?

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**Craig Morrison** - *Momentive Specialty Chemicals Inc. - Chairman, President, CEO*

Well, I think, as -- again, we don't give details, but more of it was on the oilfield side of the business versus -- this is in the fourth quarter on the oilfield side of the business versus the base epoxy resin side of the business, and your estimate was not far out of line.

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**Roger Spitz** - *Bank of America - Analyst*

Okay, great. And in terms of the base epoxy, was it, in fact, in the LER, or was BPA also impacted?

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**Craig Morrison** - *Momentive Specialty Chemicals Inc. - Chairman, President, CEO*

It was a mixture of both the precursors, which we have the BPA, ECH, as well the LER, relatively balanced between the two on a quarter year over year basis.

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**Roger Spitz** - *Bank of America - Analyst*

Okay. And do you feel you're losing share on either the LER, the precursors, and/or the proppants? How do you think you're faring in all those businesses?

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**Craig Morrison** - *Momentive Specialty Chemicals Inc. - Chairman, President, CEO*

No, we don't think this is primarily share driven. Proppants -- we consider ourselves an industry leader, and we don't think that's share driven. It really is margin driven, and just the overall market has been down significantly. Same with the base epoxy resins. We don't see ourselves losing significant share there either.

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**Roger Spitz** - *Bank of America - Analyst*

Got it. And lastly, can you provide a sense or break down a sense of versatics -- each of your versatics and specialty epoxy resins? I know you spoke about, perhaps, the whole area doing better, but are they -- I felt last quarter, too, they had finally started to bounce off some of the earlier weakness. Are both versatics and specialty epoxy resins up year over year, or sequentially, can you give some insight?

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**Craig Morrison** - *Momentive Specialty Chemicals Inc. - Chairman, President, CEO*

Yes. On a year over year basis, both are up. Versatics up significantly and specialty epoxies also up quite a bit, as some of those markets recover, in both cases.



**Roger Spitz** - *Bank of America - Analyst*

Thank you very much.

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**Operator**

Thank you. Brian Chavarria, Credit Suisse.

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**Brian Chavarria** - *Credit Suisse - Analyst*

Morning, gentlemen.

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**Bill Carter** - *Momentive Specialty Chemicals Inc. - EVP, CFO*

Hi, Brian.

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**Craig Morrison** - *Momentive Specialty Chemicals Inc. - Chairman, President, CEO*

Morning.

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**Brian Chavarria** - *Credit Suisse - Analyst*

Just a couple quick questions here. One, can you give us a sense of what the borrowing base currently is on that ABL. Just trying to figure out what kind of pro forma liquidity looks like here.

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**George Knight** - *Momentive Specialty Chemicals Inc. - SVP -- Finance*

This is George Knight. Our initial borrowing base -- we've got \$400 million of commitments. We're in the process of finalizing some of the security in some of the foreign receivables. So, the borrowing base, initially, was \$350 million, approximately.

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**Brian Chavarria** - *Credit Suisse - Analyst*

Got you. But then, you would expect that to get closer to that \$400 million as you work through the process then?

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**George Knight** - *Momentive Specialty Chemicals Inc. - SVP -- Finance*

Yes. Yes, we do.

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**Brian Chavarria** - *Credit Suisse - Analyst*

Okay. Got you. And then, could you potentially just bridge us a little bit more on the building products -- or the forest product resin, in terms of year over year EBITDA? How much of that's kind of coming from price or cost reductions with some of the shutdown capacity?

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**George Knight** - *Momentive Specialty Chemicals Inc. - SVP -- Finance*

Yes. I mean, it really is -- this is a business that has been extremely well managed, and when you dissect the financials, which, obviously, we don't go in the kind of detail on this call, but we do go, in fact, on the detail when we do our monthly reviews. There is no one major factor. Everything from new product development to reengineering products to pricing through on raw materials, incremental volume growth, et cetera -- it's a lot of little singles, if you would, in terms of baseball analogy, that add up versus one major driver, and [they've done], including the cost out initiatives that you referred to.

So, it'd be very difficult to categorize it in even one or two or three. It really is a series of five, six, and seven initiatives -- everything from cost out on product formulations to cost out on plants, like we talked about in Europe, to price increases, selectively, new product development, et cetera. It's very much across the board.

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**Brian Chavarria** - *Credit Suisse - Analyst*

Got you. Thank you. And then, just one last question, I guess, is within the CapEx, how much flexibility is there if things don't materialize as you see. This year is zero; I think, past year, flux that down or not.

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**Bill Carter** - *Momentive Specialty Chemicals Inc. - EVP, CFO*

Yes. I mean, we certainly have the capacity to flux CapEx, as you say. As we've talked about, maintenance and environmental capital is in the \$60 million to \$70 million number, with growth on top of that, and, as we've shown in prior years, we do have a fairly good ability to flux up and down, depending on economic situations.

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**Brian Chavarria** - *Credit Suisse - Analyst*

Okay, great. Thank you very much.

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**Operator**

Thank you. Bill Hoffmann, RBC Capital Markets.

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**Bill Hoffmann** - *RBC Capital Markets - Analyst*

Thanks. Good morning, guys.

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**Craig Morrison** - *Momentive Specialty Chemicals Inc. - Chairman, President, CEO*

Hi, Bill.

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**Bill Hoffmann** - *RBC Capital Markets - Analyst*

Can you guys talk a little bit about the BRIC country/rest of world growth -- sort of, your thought process for 2013? What your -- you think you'll be able to achieve.

And then, the second question is what would be the, sort of, North American forest products segment? I mean, I think we're looking at housing starts up probably 20%-ish range, and it looks like it definitely started to flow through in your numbers in the -- really, in the back half of last year, and just wondering if you could give us some thoughts on '13.

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**Craig Morrison** - *Momentive Specialty Chemicals Inc. - Chairman, President, CEO*

Yes, when you look at BRIC, Latin America, specifically, in MSC, is very sizeable because of forest products, and that continues to be a very attractive segment for us. Probably the bigger unknown area is China, and that's because government policies can have a sizeable impact on things like wind energy, where we're the market leader there. But overall, we tend to see the BRIC regions growing at two to three times the more mature Western markets and really don't see any reason to see that abate anytime soon. So, we continue to be very bullish.

We are continuing to invest, like we had mentioned, in Thailand. Australia, New Zealand, obviously, is not BRIC, but it's part of rest of world, and its products do ship, actually, into Asia, and Latin America is obviously significant for us at MSC. So -- well, we continue to think of it as being an attractive region and, again, two to three times the growth rate of the more mature regions of North America and Europe.

On the second half of your question, again, which was about --?

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**Bill Carter** - *Momentive Specialty Chemicals Inc. - EVP, CFO*

The -- I think, our view -- housing.

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**Craig Morrison** - *Momentive Specialty Chemicals Inc. - Chairman, President, CEO*

The housing. Yes, we're very bullish on what we're seeing right now. The market is continuing to rebound. We are very well positioned to take advantage of that and are seeing that growth in the first quarter, in line with that. So, we're very optimistic about [forth] -- going forward and think it's very well positioned for the reasons I mentioned on the previous question.

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**Bill Hoffmann** - *RBC Capital Markets - Analyst*

All right. Thanks. And then, Bill, this is a question for you. Obviously, a huge amount of release of cash and working capital in the fourth quarter. What are your thoughts here, as you get into the beginning of this year? And I'm wondering, just as, like, if -- in the inventory build side of the equation, and obviously, [issues] will follow, but --.

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**Bill Carter** - *Momentive Specialty Chemicals Inc. - EVP, CFO*

Yes. I mean, certainly, as you probably remember from prior years, we will see an inventory build as we get into the second quarter -- really, the end of the first quarter into the second quarter, and that is partly around seasonalities, such as, the forest products business we were just talking about. So, from a cyclical perspective, we would expect working capital to increase in Q2 and Q3, and then, moderate again in Q4 of 2013.

As we've said, I think we expect to see an overall increase in working capital, even as we get in the fourth quarter of next year versus this year, '13 versus '12, just in terms of we are anticipating improvement in many of our businesses, especially as we get into the second half of '13. We continue to work on a number of productivity projects related to working capital, and that will abate some of the increase, but we would expect it to be higher.

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**Bill Hoffmann** - *RBC Capital Markets - Analyst*

Right. Thanks. And then, you also mentioned, I guess, in Q4, obviously, you've seen the raw material index coming up -- any thoughts on further negative timing impact that might have had in the fourth quarter?

**Bill Carter** - *Momentive Specialty Chemicals Inc. - EVP, CFO*

Yes, I don't want to give out a specific number. We think it did have a slightly negative impact in the fourth quarter. I think what -- our bigger concern is we're probably going to see some impact in the first quarter, in terms of carrying over some of the purchases of raws we made in the fourth quarter into the first quarter, so we'll see a little bit of impact in the first quarter as well.

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**Bill Hoffmann** - *RBC Capital Markets - Analyst*

Okay. Thank you.

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**Operator**

Thank you for your question. Brian Lalli, Barclays.

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**Brian Lalli** - *Barclays Capital - Analyst*

Yes, thanks. Good morning, guys.

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**Craig Morrison** - *Momentive Specialty Chemicals Inc. - Chairman, President, CEO*

Hi, Brian.

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**Brian Lalli** - *Barclays Capital - Analyst*

Just really quick out of me. How are you? I think, it's slide seven -- yes, you mentioned that \$365 million tax benefit as it related to release of Company valuation allowance. Can you maybe just walk through that? And then, I guess, on the back of that, does that impact your restricted payment basket and maybe you could update us on sort of what room you would have to dividend money.

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**Bill Carter** - *Momentive Specialty Chemicals Inc. - EVP, CFO*

Okay, Brian. Yes, the tax benefit that we recognized in the third quarter -- we had set up valuation reserves, historically, in the United States for tax benefits that were generated there with the losses. Because it was not set that we were going to be able to utilize these things before they expired, we had to set up valuation reserves.

We've made money in the United States the last few years, so, because of that, we can demonstrate that now that we are going to be using these tax benefits before they expire. So, in the third quarter, we did reverse the valuation allowances, and that's what gave rise to the \$365 million benefit.

And as far as the second part of your question, the impact on restricted payment basket, it really had no impact, because the deferred tax aspect of it was never deducted in previous years.

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**Brian Lalli** - *Barclays Capital - Analyst*

Would you mind just maybe walk -- I mean, how does that work, if your net income is moving up? Is that just (multiple speakers)



**Bill Carter** - *Momentive Specialty Chemicals Inc. - EVP, CFO*

Well, we had a -- we didn't recognize the loss in prior years. We set up the valuation allowances, and the valuation allowances were always add backs to the restricted payment basket, so when it reversed, it never had an impact on the calculation.

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**Brian Lalli** - *Barclays Capital - Analyst*

Understood. Okay. And then, maybe just one second follow-up from me. Would you mind maybe just walking us through, given, obviously, there's a lot of different indentures in baskets, what is maybe your room to issue additional secured debt, if necessary, down the line for liquidity purposes at this point? Thank you.

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**Bill Carter** - *Momentive Specialty Chemicals Inc. - EVP, CFO*

Yes. I mean, as you said, there is a lot of different baskets there. I think, when we went through the process before, there was approximately about \$100 million of baskets left.

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**Brian Lalli** - *Barclays Capital - Analyst*

And that would be on a first lien basis, if I could just confirm that?

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**Bill Carter** - *Momentive Specialty Chemicals Inc. - EVP, CFO*

Yes.

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**Brian Lalli** - *Barclays Capital - Analyst*

Okay. All right, great. Thank you, guys.

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**Operator**

Thank you. [David Trow], [Citi].

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**David Trow** - *Citi - Analyst*

Good morning.

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**Craig Morrison** - *Momentive Specialty Chemicals Inc. - Chairman, President, CEO*

Hi, David.

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**Bill Carter** - *Momentive Specialty Chemicals Inc. - EVP, CFO*

Hi, David.

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**David Trow** - Citi - Analyst

I just wanted to follow up on the CapEx, with \$175 million, \$185 million for full year '13 and environmental maintenance, \$60 million or so -- that -- \$60 million or \$70 million. That leaves quite a bit of -- for growth capital in 2013. Just wondering if you could highlight some of the major projects and timing that expectation.

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**George Knight** - Momentive Specialty Chemicals Inc. - SVP -- Finance

Yes, I had a little trouble hearing you, but I think you were asking about major projects. Yes, we are in a valuation phase on several different things. I don't want to get too specific, because we haven't made final decisions, but I would say, certainly, part one, they're around several of our specialty businesses, in terms of potentially putting more capacity in place, given the growth we have seen. So, I think one part of it would be continuing to invest in specialty businesses, where we have -- we've seen growth.

I think piece two is, to Craig's point, just as we've demonstrated in our forest products division, we continue to look at productivity projects at many of our plants, in terms of, again, driving down costs, and so, we have, I would say, a second category where we're looking at several projects that we think could be significant cost reducers for us, from a production perspective.

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**David Trow** - Citi - Analyst

Okay. Can you hear me better?

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**Craig Morrison** - Momentive Specialty Chemicals Inc. - Chairman, President, CEO

Yes.

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**George Knight** - Momentive Specialty Chemicals Inc. - SVP -- Finance

Yes, yes. You're louder.

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**David Trow** - Citi - Analyst

Okay. Then, I had -- I'm just trying to keep track. When you announced the \$25 million of incremental cost savings -- I think it was on slide four. Is this, in fact, new cost savings that you have identified, or are you just discussing things that have previously been announced and you've previously been working on?

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**Bill Carter** - Momentive Specialty Chemicals Inc. - EVP, CFO

Yes, these are things we've been working on.

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**David Trow** - Citi - Analyst

Okay.

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**Bill Carter** - *Momentive Specialty Chemicals Inc. - EVP, CFO*

So, what that represents are the last round of cost savings from our shared services agreement, where we've -- we talked about what we'd gotten from a run rate perspective, but we still have about \$11 million that is still to come from shared services; and then, the remainder of the \$25 million -- \$14 million is from a number of different cost reduction programs that we worked on in 2013, and we'll be executing in -- or, excuse me, worked on in 2012; we'll be executing in 2013.

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**David Trow** - *Citi - Analyst*

Okay. And then, finally, you've made some general comments about 2013 full year outlook. I guess the first quarter is done yesterday or sometime last week. Is there any comments you can make about the first quarter, specifically, or at least, say, whether your broader, full year expectations held in the first quarter?

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**Craig Morrison** - *Momentive Specialty Chemicals Inc. - Chairman, President, CEO*

Well, we had -- from an internal basis, we had thought that the first quarter would not be the strongest quarter anyway, because we had felt that the economy would pick up as the year progressed. And, as you look at it, it really varies by region of the world. North America has held up well and continues to be a strong area for us, as is Latin America.

Europe is mixed, obviously, with Germany doing fairly well, but much else of Europe is still under a rather significant cloud. And China is probably the most difficult to project, where we do see some pickup in some markets, and other markets continue to be rather weak.

So, we had not projected, in our own internal basis, a strong first quarter, and it's pretty much what we had thought. It's not that it's weaker, per se. It's just not our -- most of our pickup for the year was projected -- as you progress through the year, and we thought the economy would start to have a modest increase in growth.

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**David Trow** - *Citi - Analyst*

Okay. That's all I had. Thank you.

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**Craig Morrison** - *Momentive Specialty Chemicals Inc. - Chairman, President, CEO*

Thank you.

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**Operator**

Thank you. I'd now like to turn the call back over to Craig Morrison for any closing comments. Over to you, Craig.

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**Craig Morrison** - *Momentive Specialty Chemicals Inc. - Chairman, President, CEO*

Thank you very much, and I'd like to thank everybody for their participation today, and we'll look forward to continuing to update you in future quarters. Thank you.

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**Operator**

Thank you very much, ladies and gentlemen. That now concludes your conference call for today, and you may now disconnect. Thank you.





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