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- Q3 2012 Momentive Specialty Chemicals Inc. Earnings Conference Call

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CORPORATE PARTICIPANTS

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

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

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

CONFERENCE CALL PARTICIPANTS

Brian Chavarria *Credit Suisse - Analyst*

Bill Hoffman *RBC Capital Markets - Analyst*

Roger Spitz *Bank of America/Merrill Lynch - Analyst*

PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Third Quarter 2012 Momentive Specialty Chemicals Inc. Earnings Conference Call. My name is Tahisha and I'll be your operator for today. At this time, all participants are in listen-only mode. Later, we will conduct a question and answer session.

(Operator Instructions).

As a reminder, this conference is being recorded for replay purposes. I would now like to turn the conference over to your host for today, Mr. John Kompa with Momentive. Please proceed.

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

Thank you, Tahisha. Good morning and welcome to Momentive Specialty Chemicals' Third Quarter 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 Momentive.com website under the Investor Relations section of Momentive Specialty Chemicals. A replay of this call will be available for 3 weeks and the replay dial-in information is contained in Momentive Specialty Chemicals' 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 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 estimates 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 in 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 our website. Our earnings release and our recent SEC filings are also available on the internet at Momentive.com.



With that, I'll now turn the call over to Craig Morrison to discuss our quarterly results.

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

Thanks, John, and welcome to our call. Turning to page 4 in an overview of our third quarter results, we continue to experience weakness in certain key end-use markets and geographies.

In the third quarter of 2012, revenues were \$1.2 billion compared to \$1.3 billion in the prior year as the decline reflected lower volumes and negative product mix. Segment EBITDA totaled \$115 million compared to \$162 million in the prior year, driven by ongoing economic weakness in Europe and Asia and lower volumes in our oil field business.

Our earnings decline was partially offset by improved performance in our North American and Latin American forest products businesses. Our cost and cash actions have achieved \$19 million in savings from the shared service agreement during the first 9 months of 2012. Total cumulative savings for this program totaled \$49 million since its inception.

We generated cash from operations of \$38 million in the third quarter of 2012 versus \$15 million in the third quarter of 2011. And we maintain substantial liquidity of \$591 million in cash and available borrowings as of quarter end. We are in compliance with all financial covenants that govern our senior secured credit facilities and indentures.

Turning to slide 5, you can see an overview of our financials. As noted, our second quarter 2012 sales decreased 11% due to softer volumes while segment EBITDA and operating income reflected lower demand and negative product mix partially offset by the cost actions I mentioned.

Net income totaled \$364 million compared to net income of \$39 million in the prior year as we recognized a tax benefit of \$373 million. This occurred as the result of the release of a significant portion of the evaluation allowance in the US.

As we've said before, the inherent earnings potential in each of these specialty businesses remains intact due to proprietary technology and secular growth trends. We will continue to focus on our cost structure and optimizing our cash position as we close out the fourth quarter and move into 2013.

Turning to slide 6 and our combined raw material index. You can see that raw materials generally moderated through the third quarter of 2012 will remain higher on a year-over-year basis. In the first 9 months of 2012 we saw increases in each of our 3 largest raw materials ranging from 3% to 15%. We remain vigilant on the pricing front to effectively manage raw material volatility. Historically we have demonstrated our ability to drive pricing actions and recover raw materials inflations. That will remain a key focus going forward.

Turning to slide 7, you can see our segment sales and segment EBITDA for the third quarter 2012. In our Epoxy, Phenolic and Coating Resins segment, sales declined by \$119 million or 14%. Volume decreases negatively impacted sales by \$35 million as volumes declined primarily in our base epoxy resins and oil filled businesses, partially offset by our specialty epoxy resins. Pricing has had a negative impact with \$25 million due primarily to the impact of price declines in our base epoxy business. Segment EBITDA decreased by 40%.

In our forest product resins segments, second quarter 2012 sales declined slightly by \$26 million or 6%. Lower volumes negatively impacted sales by \$20 million, reflecting competitive pressures and site closures, partially offset by volume increases in our North American resins and formaldehyde business.

Higher raw material prices passed through the customers and pricing actions led to overall pricing increases of \$18 million. Segment EBITDA increased by 7% supported by our productivity actions and stronger demand in North and South America.

Turning to slide 8, you can see the cumulative impact of a multi-year initiative to right-size our global infrastructure for our forest product resin business. North American housing is by far our largest end-use market in the forest product division. Despite housing starts remaining well below



their 40 year average of approximately 1.5 million starts and the peak exceeding 2 million starts in 2006, you can see the positive impact of just small recovery and demand in our overall results.

On a global basis, our volumes declined by about 10% since 2006, but our segment sales were up 15% and segment EBITDA increased 28%. To drive this EBITDA growth we've aggressively managed our global network with 7 site closures over the last 5 years, aggressively pursued productivity within our other plants, and reduced our overall headcount by 26%.

Additionally, we pursued price and margin improvements despite raw material volatility. As North American housing improves, we expect to see significant upside potential as incremental volumes drive operating leverage the resulting benefits fall through to the bottom line. We've also balanced these cost actions with investments in our world class site in Monte Negro, Brazil and a joint venture in Russia with a strategic partner.

Turning to slide 9, we've highlighted 2 investments that will strengthen our Asia Pacific network. We recently announced plans to build a new plant in Thailand. The new plant will triple our capacity for acrylic based resins in the region. These resins are designed for use primarily in coatings, adhesives and building and construction applications.

In addition to production facilities, the new site will include product development and application laboratories as well as technical service and application support capabilities for our customers. Construction of the plant is underway and completion is expected to occur in the first half of 2013.

We also broke ground on our phenolic specialty resins manufacturing joint venture in China. Its construction represents the first portion of a two-phase project which will create an 80KT/annum facility producing a full range of specialty [novalac and resolve] phenolic resins. These materials are used in applications including refractories, frictions, abrasives and electronics.

Let me now turn the call over to Bill Carter, our CFO, to further discuss our financial results. Bill.

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

Thank you, Craig. Turning to our epoxy, phenolic and coating resin segment, second quarter 2012 revenue totaled \$751 million, decreasing 14% versus prior year with volume, price mix, currency translation declines of 4%, 3% and 7% respectively.

Quarterly segment EBITDA declined by 40% versus the prior year as our results reflected lower volumes and negative product mix in our base epoxy and oil filled resin businesses partially offset by specialty epoxy improvements.

In the prior year period, our based epoxy resins also benefitted from tighter market conditions. Despite the slowdown, we believe our oil filled resin business remains a long-term growth platform for us considering the global macro trend of energy exploration.

Our phenolic specialty resins business also reflected lower results in Europe while our recent investment in our Versatic Acids business continues to ramp up our overall volumes and strengthens Asia Pacific presence.

Turning to the next slide, in our forest products resin segment, sales decreased slightly to \$426 million with price mix gains of 4% offset by negative currency translation of 5% and volume declines of 5%. Volume declines reflected competitive pressures and site rationalizations in Europe and Asia Pacific.

In the second quarter of 2012 we posted a 7% gain in segment EBITDA supported by our formaldehyde business, strong results in our North America and Latin America businesses and our productivity initiatives over the last several years.

Regarding our balance sheet, we continue to benefit from a substantial liquidity position with cash plus borrowing availability under our credit facility's \$591 million as of September 30. Our capital expenditure investments totaled \$34 million in the third quarter of 2012.

We continue to anticipate \$145 million to \$155 million in cap ex for 2012 in support of numerous growth opportunities. Our networking capital increased due to improved volumes and higher raw material costs in the first 9 months of 2012.

Networking capital at the end of the third quarter as a percent of LTM net sales remained a modest 13%. We anticipate working capital to further decline in the fourth quarter as we continued to take aggressive actions to drive this lower as well as the benefit of normal seasonality.

Let me now turn the call over to Craig to wrap up.

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

Thanks, Bill. Turning to page 15, looking at our segment EBITDA, the third quarter of 2012 reflected negative product mix and the economic slowdown in Europe and Asia partially offset by improved results from our forest products division.

We continue to keep a steady focus on our cost reduction activities. We achieved \$19 million in savings for the first 9 months of 2012 under the shared service agreement with MPM. And \$49 million since the program's inception as these programs continue to create long-term value.

We generated cash from operations of \$38 million in the third quarter of 2012 versus \$15 million in the third quarter of 2011 and continued to maintain substantial liquidity, a \$591 million in cash and available borrowings as of quarter end.

Looking ahead we anticipate that the weakness demonstrated in the third quarter will continue throughout the remainder of the year. Our forecasting capability into 2013 is limited at this time as our customer report macroeconomic uncertainty as a primary driver of their own limited visibility. However, we do believe that momentum is well positioned for the eventual economic recovery.

Thank you for your continued interest in the Company and I'll now return the call back to John.

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

Thanks, Craig. Operator we'd now like to open the line for questions, if you could please provide those instructions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions).Your first question comes from the line of Brian Chavarria from Credit Suisse. Please proceed.

Brian Chavarria - *Credit Suisse - Analyst*

Good morning, gentlemen. How are you?

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

Good morning, Brian.



Brian Chavarria - *Credit Suisse - Analyst*

I guess we're looking at a pretty challenging quarter. If you look at the visibility into 2013 is still pretty limited, but any more commentary on what to expect here for the fourth quarter and some of the changes perhaps versus what you were seeing on the second quarter call?

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

Yes, as I kind of indicated at the end, we would anticipate the fourth quarter in terms of obviously this is normal seasonality impact that occurs which varies business by business, but in general the weakness that we saw in the third quarter we project extending into the fourth quarter and that's more driven just by the macroeconomics I think a lot of people are observing.

Brian Chavarria - *Credit Suisse - Analyst*

Okay. Got you. And then could you explain the tax benefit valuation in a little bit more detail, please?

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

Yes. We had, as you know, we have substantial tax assets on our balance sheet and given our prior experience of having tax losses in the US we had a valuation reserve against those assets. As we continue to evaluate that reserve in the last couple years we have had US taxable income and so we made the decision to reverse those valuation reserves against those tax assets, effectively generating the income in the quarter and the increase in equity.

Brian Chavarria - *Credit Suisse - Analyst*

Okay. But we shouldn't expect any cash impacts from that then?

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

No. This is more taxable keeping versus any cash impact.

Brian Chavarria - *Credit Suisse - Analyst*

Okay. And then last one for me, I guess, is oil field chemicals has obviously been weak here for the last couple quarters. Is that getting - - can you describe that on a sequential basis? Is this getting better? Is it getting worse, kind of flat? How do I think about that?

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

Yes, I think as you look at oil field in general it's more in a flat mode in the fact that it's in a generally weakened state versus where it was a year ago, 18 months ago, and I think that's what you would expect as natural gas has fallen off dramatically. In the long-term it continues to be an extremely attractive segment to be in as you look at the demand globally for energy going up that will benefit and I think natural gas in the long-term in the US will be a very attractive play and we'll be a major participant in that as well as we're aggressively diversifying into oil, not only natural gas, but it takes time to do that. So I'd say the trend has been to be flattening at this point, but it is down significantly from prior peak periods as the rigs have declined very dramatically as the gas prices decline.

Brian Chavarria - *Credit Suisse - Analyst*

Okay. Perfect. Thank you very much.

Operator

Your next question comes from the line of Bill Hoffman from RBC Capital Markets. Please proceed.

Bill Hoffman - *RBC Capital Markets - Analyst*

Yes, good morning.

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

Hi, Bill.

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

Hi, Bill.

Bill Hoffman - *RBC Capital Markets - Analyst*

Craig, I just wondered if you'd talk a little bit about what your view of what inventory is like in the chain with your customers as you look here through the fourth quarter. I mean we assume obviously people are going to be very cautious about where they're running inventories and I'm just wondering if that may even further impact your volumes in the fourth quarter.

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

Yes, I would say 2 comments. First of all, in general since the '08, '09 downturn we have found our customers have become much more sophisticated and aggressive about managing their inventories across almost all industries. So the degree of impact has been reduced from a few years ago.

However, having said that, there's no doubt that just like we're going to aggressively move on inventory. Our customers will most likely do the same, so we will probably see some degree of impact, but it won't be of the magnitude you would have seen a few years ago. And I think that's true of most chemical producers nowadays.

Bill Hoffman - *RBC Capital Markets - Analyst*

OK, thanks. And then just in the epoxy business, as you look forward, is there anything you can do with your assets sort of consolidating production, etcetera, just to bring the cost down while you're running at lower rates here?

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

Well, we aggressively manage our assets and we don't comment on whether we're going to be taking incremental assets out of the market or not, but I think we've aggressively managed it over time. We continuously look for opportunities but again unless we have something to announce we won't try and speculate about potential capacity going up or down.



Bill Hoffman - *RBC Capital Markets - Analyst*

Okay. And just as you look into next year with some of these new projects plus some of the prior business, could you just talk a little bit about potential growth that you see in the - - I guess more sort of the Asia Pacific region?

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

Yes, I think we are aggressively looking to grow into the brick regions and we have the joint venture we've announced in China on the phenolic side. We've had two capacity additions, one a joint venture and one a wholly owned in Asia. One went up - - this is on the Versatic side. One went up in Korea. A joint venture went up in China.

On the epoxy side we've announced a holding agreement for incremental capacity from a company we've dealt with over for a long period of time, so that will give us incremental growth. So I think most of us, virtually everybody says in the long-term that China and Korea, for that matter, will be growth market. Same with Southeast Asia. I think some of those are going through a more challenging period right now, but we look at it as temporary adjustments, not permanent declines in any way, so I think we're well positioned to participate there. It will be a very attractive growth area for us and that's really what those capacity additions are aimed at.

Bill Hoffman - *RBC Capital Markets - Analyst*

Is there any way for us investors to think about it like what it might add to growth next year just in the things you've done already, maybe just a top line number?

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

You know I think a few percent incremental on top of that 3%, 4% is one way of thinking about it.

Bill Hoffman - *RBC Capital Markets - Analyst*

Okay. Thank you.

Operator

(Operator Instructions). Your next question comes from the line of Roger Spitz from Bank - - my apologies, Roger Spitz from Bank of America. Please proceed.

Roger Spitz - *Bank of America/Merrill Lynch - Analyst*

Thanks. Good morning, guys.

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

Hi, Roger.



Roger Spitz - Bank of America/Merrill Lynch - Analyst

In terms of base epoxy resins and BPA, do you believe you guys are maintaining growing or losing market share in each of those areas?

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

In BPA specifically? I mean BPA we're probably staying fairly flat on market share. For us, the primary focus on internal sourcing, we sell excess capacity into the marketplace. It's not something we look to be a primary driver of growth. It's not something we're looking to make large capital investments in. As you know they are expensive assets to build. We are more focused on investing downstream and so eventually we'd be perfectly happy to provide internal product at a cost competitive position, which is really our main focus of maintaining those assets.

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

I think on how you mentioned LER, I think on LER we believe we're maintaining share. I mean certainly shares wiggle up and down depending on the part of the world you're in, but I think generally we believe we are maintaining shares the last 18 months.

Roger Spitz - Bank of America/Merrill Lynch - Analyst

Okay. Very good. And just maybe this is asking it in a slightly different way, but thinking about the epoxy and the merchant BPA business, where we are now, you think perhaps other than seasonality these businesses have sort of hit the base level or bottom level after in previous last year where other people had outages and you were benefiting from that. Do you think we're at that kind of steady stage other than seasonality and that sort of thing?

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

Yes, I mean right now I'd say we're at a more or less a steady state and, as we all know, when you talk about the chain and BPA, ECH, LER, et cetera, they can go tight very quickly with outages or other events that could occur in the market. But I don't think that's a bad way to characterize it.

Roger Spitz - Bank of America/Merrill Lynch - Analyst

Okay. In terms of proppants, again here is this - - do you feel you've been maintaining share as the business moves?

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

Yes, we feel extremely well positioned in the proppants business both from a share standpoint and margin profitability. We truly believe we're a market leader. We think we're very adept at tactically moving in that marketplace and so, yes, we feel we are in a very strong position there.

Roger Spitz - Bank of America/Merrill Lynch - Analyst

Okay. And lastly, for proppants, is there a sort of a split you can give us now of your business versus targeting more oil versus natural gas? I know there's some gray area, but give us a sense of how your assets are situated now.

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

Yes, we really don't comment about the split between natural gas and oil. Generally we will say that we're significantly larger on the natural gas side than the oil. We are aggressively moving and we are successfully growing into oil, but we don't give out specific data on that.

Roger Spitz - Bank of America/Merrill Lynch - Analyst

And just so I understand, when you make that shift, is the main cost perhaps a freight cost or a logistics type cost that makes it more difficult to serve that market or how should we think about that?

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

No, it's not really a cost issue because it's a very profitable product line. It really is around a technical sell to the oil producers that there's a benefit and it's not traditionally a product they've used as aggressively as natural gas industry has. But as we further develop our products with new technical formulations, we're able to prove a very clear benefit for them and so more and more are switching to using proppants as a way to improve their own productivity. So it's purely a matter of selling into a market on a technical basis. It's not really a cost driven issue in terms of we can't get there logistically.

Roger Spitz - Bank of America/Merrill Lynch - Analyst

All right. Thank you very much.

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

Thank you.

Operator

Ladies and gentlemen, we have no more questions in queue, so I would now like to turn the conference back over to Mr. Craig Morrison for any closing remarks.

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

I'd like to thank everybody for your participation today and we will look forward to talking with you on future calls. Thank you very much.

Operator

Ladies and gentlemen, that concludes today's conference. Thank you for your participation. You may now disconnect. Have a great day.

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