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- Q2 2013 Momentive Specialty Chemicals Earnings Conference Call

EVENT DATE/TIME: AUGUST 13, 2013 / 1:00PM GMT



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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Q2 2013 Momentive Specialty Chemicals Earnings Conference Call. My name is Glen, and I will 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 Specialty Chemicals. Please proceed.

John Kompa - *Momentive Specialty Chemicals Inc. - Chair, IR*

Good morning, and welcome to Momentive Specialty Chemicals 2013 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 replay 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 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 risks 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 measures 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. 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, CFO*

Thanks, John. Turning to page four, revenues at \$1.34 billion were flat with the prior year, as strong results in our global forest products business and slightly higher overall volumes were offset by continued headwinds in Europe and slower growth in the Asia Pacific region.

Segment EBITDA totaled \$118 million compared to \$145 million in prior year. North American housing and past restructuring initiatives, particularly in Europe, drove record results in our forest products business. Soft market conditions in the epoxy product lines and (inaudible) costs associated with our versatics business, accounted for the year-over-year decrease in EBITDA.

Operating income totaled \$49 million in the second quarter of 2013, compared to \$92 million. The decline was largely drive by \$8 million of idling expense related to planning plant maintenance and margin compression, partly offset by higher volumes. We continue to aggressively focus on cost actions and cash optimization. To date, we have realized \$59 million in cumulative savings from the shared service agreement. We are also pursuing an additional \$11 million in cost savings from both the shared service agreements and additional productivity programs.

Turning to slide five, you can see a brief overview of our financials. As noted, our second quarter 2013 sales slightly decreased while segment EBITDA declined 19%, partially offset by the cost actions I mentioned. Second quarter 2013 operating income reflected lower gross profit from competitive pricing pressures for certain products and idling costs. This is partially offset by lower business realignment costs and the positive impact of savings from the shared service agreement with Momentive Performance Materials Inc.

Turning to slide six, and our combined raw material index. You can see that raw materials generally moderated during the second quarter of 2013, but remain higher on a year-over-year basis. In the first half of 2013, we saw a 9% increase in phenol and a 14% increase in methanol, while urea declined 25%.

Raw material markets remain voluble reflecting the global economy. We continue to remain vigilant on the pricing front to effectively manage that raw material volatility.

Turning to slide seven, you can see the impact of our multiyear initiative to right size our global infrastructure for our forest products Resin business. As I mentioned, second quarter segment EBITDA of \$59 million represented a record quarter for us, and we believe the outlook is strong for the segment for the balance 2013.

North American housing is, by far, the largest end-use market in the forest products division. Despite housing starts remaining 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 a modest recovery in North American demand, on our overall results.

Taking a multiyear view, forest products EBITDA has posted an 18% compounding yield growth rate since 2009. To drive this growth, we've aggressively managed our global network, particularly, in Europe and North America, also (inaudible) price actions to drive margin improvement despite raw material volatility. We've also seen continued growth from aldehyde derivative products of hexamine and tyrosine.

As North American housing improves, we expect to see the significant upside potential as incremental volumes drives operating leverage and the resulting benefits fall through to the bottom line.

Turning to slide eight. I've highlighted one of our newest products within our portfolio Oil Plus, which is continuing to grow quickly in the market. This new resin technology increases through-put for oil and liquid-rich reserves or wet wells. This patent pending technology prevents water and oil from bonding to the surface of the proppants, increasing flow rate. Oil Plus also represents a major growths energy with MPM leveraging



technologies from MPM and then MSC. It is a major contributor to the \$50 million [revenues] energy that we expect to see between the two companies in 2013.

While we've experienced volatility in our profits business during the last 18 to 24 months, on an absolute basis, it continues to be a very strong contributor to MSC profitability. As we've said before, we anticipate energy growth to be a major driver of North American economic growth. We continue to believe that over the next few years the oilfield business unit will deliver record profitability as natural gas drilling inevitably recovers.

Let me now turn to the call over Bill Carter for further discussion on our financials.

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

Thank you, Craig. Turning to our epoxy, phenolic, and coating resins segment, second quarter 2013 revenue totaled \$799 million, flat with the prior year on volume gains of 5% and price mix declines negatively impacting sales by 5%. Quarterly segment EBITDA declined by 28% versus the prior year.

Segment EBITDA reflected pricing headwinds, margin compression and idling costs in certain businesses that resulted in overhead cost being an expense during the idling period, partially offset by quarterly gains and oilfield products and phenolic specialty resins.

Oilfield EBITDA, however, remains well below historical highs, but is showing initial signs of recovery. We continue to strategically invest in key growth regions as we successfully completed the startup of a new acrylic resins plant in Thailand in April, and construction remains on track for a new phenolic resins JV in China to be operational by the end of this year.

Turning to the next slide, in our forest products resin segment, sales decreased slightly to \$451 million with volume gains of 1% and price mix improvements of 3% offset by declines due to portfolio optimization in certain low margin operations and negative currency translation of 1%. Productivity gains and favorable product mix drove our record segment EBITDA performance which included a 120 basis point margin improvement on a year-over-year basis.

We continue to have a favorable outlook for the segment as we anticipate North American and Latin American volumes to continue to grow in 2013, partially offset by slower demand from Europe.

Regarding our balance sheet, we continue to benefit from a substantial liquidity position with cash plus borrowing availability under our credit facility of \$768 million as of the second quarter 2013. Our capital expenditure investments totaled \$33 million in the second quarter. We have lowered our full year CapEx target to \$150 million due to timing of certain projects.

Our net working capital increased slightly to \$576 million at the end of the second quarter, which was still a modest 12% of sales. Working capital reflected an increase in sequential quarter volumes due to seasonality, which drove increases in account receivable in inventory and was partially offset by increases in accounts payable.

Finally, through our January 2013 \$1.1 billion refinancing, we refinanced our credit facility, our second lien notes and funded cash to the balance sheet. Additionally, in late March 2013, we entered into a new \$400 million asset-backed revolving loan facility which is subject a borrowing base. As a result of this activity, we now have no material debt maturities before 2018, and no financial maintenance covenants currently in effect.

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



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

Thanks, Bill. Turning to slide 14. In summary, second quarter revenues were \$1.3 billion, highlighted by record results and our global forest products business. We continue to realize our cost targets as planned and have achieved \$59 million in cumulative savings under the shared service agreement with MPM as of June 30, 2013, since the programs inception.

We're also pursuing an incremental \$11 million in cost savings that we expect to achieve, primarily over the next 12 months. Additionally, our [growth] energies are starting to yield benefits, and we project that revenue between the two entities will exceed \$50 million in 2013.

We demonstrated product manage of our balance sheet and benefit from our substantial liquidity position with \$768 million of cash and available borrowings. As Bill mentioned, we have no material debt maturities until 2018, following our \$1.1 billion refinancing early this year.

The global economy continues to be unpredictable with significant areas of compared weakness; although, we project that our overall volumes will moderately increase in the second half of 2013.

Thank you for your continued interest in the company, and I'll now return the call over to John.

John Kompa - *Momentive Specialty Chemicals Inc. - Chair, IR*

Thanks, Greg. Glen, if you could please open the line for questions and remind callers of those instructions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). And your first question comes from the line of Brian Chavarria, with Credit Suisse. Please proceed.

Brian Chavarria - *Credit Suisse - Analyst*

Good morning, gentleman.

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

Good morning.

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

Hey, Brian.

Brian Chavarria - *Credit Suisse - Analyst*

So just, you know, looking, I guess, at this oilfield sounds like you're starting to see some turning points there. Now, is that from this Oil Plus or more liquids targeted province, or is that just an actual gain on the historical kind of natural gas base?



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

I think a couple things. Oil Plus has definitely been a significant contributor as a new product that was developed and entered into the market and is far exceeding what we had anticipated or projected for a first-year entry. So it's a very significant contributor to that.

Additionally, we're also picking up marketshare in the market as the market leader in technology. I think we have a capability to do that better than any other competitor, and the third thing is, as we see natural gas flow, we start to recover the market to margins and profitability levels that warrant reinvestment. I think you'll see just the number of rig counts in the natural gas segment also recovering. So, we do think we're at the first stages of that recovery and feel extremely well-positioned to benefit from that.

Brian Chavarria - *Credit Suisse - Analyst*

And then I guess, on the forest product side, you know, you guys have kind of talked about some of the leverage on that side of the business and certainly, the gains on the housing starts or what not have been stronger year over year with a little bit of volatility in that. But how should we kind of think about some of that leverage, the \$3 million incremental EBITDA, certainly with some margin improvement there, but you know, versus last year. How should we kind of think about that increased leverage going forward?

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

Yes, I mean, I think we continue to be very well-positioned. It's a lot more than just housing starts in terms of North America. We highlight that because that is our biggest market, but we continue to be very successful in our formaldehyde business and supporting intermediates, MDI and others, that go downstream. We are doing a lot of new product development and optimizing our cost structure and, therefore, improving margins, additionally, we're continuing to push internationally. So I think this business will be very well-positioned.

The basic, you know, wind at your back sort of analogy is, I think, the housing continuing to improve, but there's many other factors. So I think the positive trend we've demonstrated over the last few quarters and year plus now, I think we'll continue for certainly the next 12 months and beyond.

Brian Chavarria - *Credit Suisse - Analyst*

Got you. And then just one last one of kind of CapEx there. I missed exactly what you said on the driver on the reduction and just looking at -- is there any room for that to go down more. It looks like you've spent \$60 or so in the first half with the \$150 budget in the back-half.

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

Yes. The driver is really just around timing of projects, so from a capital expenditures perspective as we've disclosed before, from an MSC perspective, maintenance and environmental is in the \$70 million to \$80 million range. The remainder of that is growth projects and productivity projects and so our guidance, isn't any significant shift in CapEx, it's more around the timing of when we think we'll get projects started.

Brian Chavarria - *Credit Suisse - Analyst*

Okay, perfect. Thank you very much.

Operator

And your next question comes from the line of Tariq Hamid with JPMorgan. Please proceed.



Tariq Hamid - *JPMorgan - Analyst*

Good morning, gentlemen.

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

Hi Tariq.

Tariq Hamid - *JPMorgan - Analyst*

Back on the epoxy business, you know, sort of debate (ph) this law, but is the real challenge ultimately, is it the nat gas rig counts or is it a substitution of uncoated sands or ceramics for the epoxy coated proppant. I mean, how should we think about that, and how do you guys think about?

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

Yes. The actual proppant business, there is some epoxy-type applications. It's more phenolic-based though. There is some diversification into epoxies and now we're diversifying into silanes and others, but I think as you think of that business, there has been some movement to uncoated sand versus resin coated, but we believe that as margins improve, that will reverse itself as we believe there really is a fundamental reason for resin coated proppants and the productivity it drives. So some people may be moving away on a temporary basis, but we believe in the longer term, we're extremely well-positioned.

And additionally, we also continue to develop new applications that, you know, operate very effectively in horizontal wells, deeper wells, things of that nature.

Tariq Hamid - *JPMorgan - Analyst*

Understood. And then, more just a general question. Given your exposure to Europe, we've heard some signs of life coming out of Europe. Are you guys seeing that in some of European businesses. Are the order books looking better now than they were last year?

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

Yes. I mean, we've seen stabilization. We're fortunate that the majority of our business in Europe is in northern Europe, specifically, Germany, Netherlands, some in England, et cetera. So we're not as exposed to southern Europe as some other companies might be. We have some exposure, but not a dramatic amount.

I'd say we've seen stabilizing. We think it's better positioned now than it was a year ago when there was a greater degree of uncertainty. We've seen some modest improvement in orders, but it's difficult to read whether that's people restocking at a certain point in time or the beginning of a significant improvement. At this point, I think it's too early to call a recovery in Europe, but I would say there's been a stabilizing effect and a modest improvement.

Tariq Hamid - *JPMorgan - Analyst*

Thanks. And then just last one for me. On the forest products business, you've done some portfolio rationalization in Europe and Asia, but just wondering given your sort of record EBITDA in North America in that business, do you have the footprint if, you know, starts were up another 20% next year to sort of meet demand, or do you need to sort of reinvest in the North American business?



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

From a resin standpoint, we feel in good shape. From a formaldehyde standpoint, we've seen very strategy growth, and we very well look at other investments to support that growth. I would say it's a very significant payback on those investments, so it's a very attractive investment for us to make, but we have nothing to announce at this time, but it is something that we look at.

One of the benefits of that business is, is it's not a high CapEx business, so investments are relatively low compared to most chemical industries, so it's a fairly quick build and a relatively low investment compared to much of the other forms of the chemical industry that are more capital intensive.

Tariq Hamid - *JPMorgan - Analyst*

All right. Thank you very much.

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

Thank you.

Operator

And your next question comes from the line of Adam Goodwin, with Goldman Sachs. Please proceed.

Adam Goodwin - *Goldman Sachs - Analyst*

Hi, thank you for taking my questions. My first question, could you quantify what the impact of the plant maintenance was during the quarter, and then, I guess, looking towards the back-half of the year, are there any planned turnarounds in the third or fourth quarter that we should be aware of?

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

Yes. I think the total turnaround kind of maintenance in the second quarter was about \$8 million. We do have turnarounds scheduled in the third quarter of about \$4 million, and then generally we don't turn assets around in the fourth quarter, although, if anything gets delayed that may flow into the fourth quarter.

Adam Goodwin - *Goldman Sachs - Analyst*

Got it. And then, some of your competitors in the epoxy resin business have recently talked about potentially looking to exit that business. How do you think that could affect your company, and are there opportunities left for consolidation in the space at this point or not really.

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

Well, I mean, obviously, any time a competitor may or may not sell, there's implications that could happen depending on who the buyer is. I think there are opportunities for different buyers to potentially consolidate the industry, and then the implications of that we'd have to wait and see, but that's really for our competition to discuss as to their plans. We have nothing to announce relative to ourselves at this time.



Adam Goodwin - *Goldman Sachs - Analyst*

Okay. And then I guess looking at the base of epoxy resin business more broadly, what do we need see happen in that market? You guys to see margin improvement and get that business back to where it was in prior years?

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

Yes. I mean, when you look at MSC, we had record profitability in 2010 and 2011, and we find that market can shift very quickly. Go from short to long and long back to short, and margins move accordingly. Specifically when you talk about the [base epoxies]. There's really a number of factors that can drive that. It can be -- if ECH gets tight in China or BPA. It can be if phenol switches.

Right now, there's a significant gap in phenol costs between Asia and Western Europe and North America, which allows for imports to be brought into those regions and, therefore, can potentially impact margins.

So there's a number of different variables, anything from LER capacity going tight to BPA, to ECH, to phenol switching. If one of those occurs, you can start to see a very significant shift, and that's exactly what happened in the second half of 2009, 2010, 2011. And right now, we're more in trough conditions versus that so you definitely feel the margin impact.

Adam Goodwin - *Goldman Sachs - Analyst*

Got it. And then my last question, could you quantify what the expected benefit to sales or EBITDA should be for the new acrylic plant that you just brought online in time?

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

That is not a number -- we typically don't give out information on a plant-by-plant basis.

Adam Goodwin - *Goldman Sachs - Analyst*

Okay, thank you.

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

Thank you.

Operator

And your next question comes from the line of Roger Spitz, with Bank of America, Merrill Lynch. Please proceed.

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

Thanks and good morning.

Can you comment a little more in depth into the base epoxy resin. How the EBITDA moved in Q2 versus Q1, was it flat as you expected the last quarter or down. And if you could further comment how the couple of pieces move like what liquid epoxy resins versus your merchant BPA business?



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

Yes. In the first part of the question, it was pretty flat with the prior quarter. And then I'm sorry, I missed second part about merchant business?

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

Yes, I was just wondering how EBITDA moved or profitability moved out of liquid epoxy resin versus BPA? Was one of them better than the other or are both troughing and flat?

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

Well I mean, I think when you look at what we called the precursors of BPA, ECH, it was -- at a very modest way better than the liquid epoxy resins. On a prior quarter basis both stayed relatively flat. There wasn't major movement. When you look at the prior quarter, when you look at the prior year, both had fallen off significantly as the industry really saw Asia go long and margin compression accelerate.

Additionally, there were plant turnarounds in the quarter that impacted that business significantly, so we would hope to see and plan on seeing an improvement from third to second quarter.

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

From those comments, is it fair to say that ECH, BPA and LER are all more or less troughing. Is that a fair statement right now?

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

Yes, I'd call -- all are definitely feeling the pressures of the larger marketplace, with LER being, by far, the most volatile. LER is a much more significant driver of profitability in terms of volatility. It may not be any particular quarter-over-quarter, but if you looked over a prolonged period of time, it tends to be the greatest driver of volatility in terms of (inaudible) potential and also potential fall-off.

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

Thank you. And I got the feeling, especially epoxy resins and versatic acids that -- it felt like we were rebounding off of lower numbers over the past quarter or two, and it sounds like you're calling them out as being sought. Is that the way to think about it, we were down and then we started coming up for quarter two and then we're back down again?

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

Well, I think when you look at specialty epoxy on a quarter-over-quarter basis, it did improve. So it continued to show modest improvement. It's certainly not back at peak levels, and really that's a major driver there, is wind energy as regulatory changes and subsidies change from country to country as well as I think it's gotten more competitive in China which is a very significant market for us. On versatics, they were adversely impacted by plant turnarounds. Not only ours, but plants that we depend on went down and then were slower to come up than were projected, so that had more of an impact.

And then I would say versatics is more European based. We are diversifying away from Europe, very aggressively, but I would say they've also impacted by the slow-down in Europe, particularly in construction, as well as the Asia slow-down, China not recovering as quickly as many of us would have anticipated. So in the long term, certainly, I think versatics is a very attractive business for us with good margins and significant upside potential in growth for new product development.



Roger Spitz - Bank of America/Merrill Lynch - Analyst

Okay. And regarding working capital, in 2012, Q3 was a small modest user of cash and then Q4 was a major cash outflow, given where volumes and raw material price movement have been going, do you expect to see a similar trend in the second half of '13?

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

Yes, Roger, this is Bill. I think you said outflow in Q4. You probably meant to say inflow? We had a big inflow in Q4 in '12.

Roger Spitz - Bank of America/Merrill Lynch - Analyst

Correct, correct.

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

And I think we expect to see the same trend in '13. It may not be quite as dramatic, but we expect that we will have a significant inflow in the fourth quarter and third quarter will be relatively flat.

Roger Spitz - Bank of America/Merrill Lynch - Analyst

Perfect. And lastly, it sounds like you've put timing of -- in CapEx, timing of projects, have been pushed back. Should we think -- should we should add that extra \$25 to \$35 million to the 2014 CapEx, or will you modify such that 2014 doesn't jump up by that kind of amount.

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

Yes. I think if we delay the projects as we changed our guidance and brought it down, some of that capital will flow into '14, so I think that's a reasonable proposition.

Roger Spitz - Bank of America/Merrill Lynch - Analyst

Great. Thank you very much.

Operator

And your next question comes from the line of James Finnerty with Citi, please proceed.

James Finnerty - Citigroup - Analyst

Hi, good morning. On the epoxy side, coming back to Adam's point, that some people potentially exiting, some of the reasons listed have been over capacity in China. Has there been capacity additions, in general, in China, or is it just the fact that the demand has dropped so much.



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

No, there have been some capacity additions in China, but I would say, you know, the demand in terms of the growth not being there that we historically would expect from China and expect in the longer term, let's face it, both India and China, I think, will be very significantly growth markets.

So the capacity built, I think, will be absorbed in a reasonable period of time. And the other thing you have to remember, again, is you don't need LER necessarily to go tight. Any one of four levers, as I've mentioned, whether it's BPA, ECH, phenol pricing falling in line with Europe or the United States, or LER going tight, allows you to start to move your price.

And when you look at 2010, (inaudible) timeframe, it was actually ECH drive, and it was larger driven by regulations around environmental and water permits -- waste water treatment, excuse me, that the government suddenly cracked down and started shutting down facilities that didn't meet their regulatory guidelines, and that started to drive tightness which create tightness along the entire chain.

So there's many different variables there that can drive that. We monitor all of them very closely.

James Finnerty - *Citigroup - Analyst*

And some of the industries where capacity was a concern, we've a government sort of decide which industry they support and which industries they don't for capacity additions for export, et cetera. Would epoxy be something where China's looking to be self-efficient or be an exporter over the longer term?

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

Yes, I mean, obviously, I can't speak for the Chinese government relative to their strategy around a given product, but I do agree with your comment. First of all, they do support, at times, industry consolidations, and I think many times that's around businesses that originally built that don't have the scale, don't have the environmental capability which is becoming a significant concern in the country and; therefore, companies are consolidated facilities are shuttered and capacity is taken out because it's not economically efficient anymore.

As for longer term strategy around exports, there's many factors that can impact, and phenol pricing is a good example. There are other factors, just on availability and what's required within the country. But I think as you look at the potential consolidation that, at times, their government does drive, as you look at the natural growth that I think will return. I think all of those are positive indicators over the medium to longer term.

James Finnerty - *Citigroup - Analyst*

Okay. And moving to formaldehyde, could you just give us a brief overview of what the -- from an end market perspective what your key products that you flow into are, like just in terms of magnitude, in terms of MBI, (inaudible), et cetera.

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

Yes. As you think of major product lines, as you mentioned, obviously, first of all our largest product line is the internal usage for resin. Externally, MDI we're pipelined connected to the ASF and buyer in the US, as well as several customers overseas, BDO pipeline connected. Agricultural use is fairly significant, and then beyond that, is I would say, both oilfield from a triazines perspective, formaldehyde plays in that market and then kind of general industrial in terms of automotive coatings as well as a number of other industrial uses. So it's a fairly widely used material.

James Finnerty - Citigroup - Analyst

And would the top three -- just for external use, the top three account for what percent of (inaudible) sales?

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

Yes, I don't want to give you a specific percent, but the top three would be a very large percent of the formaldehyde usage.

James Finnerty - Citigroup - Analyst

Great. Thank you very much.

Operator

(Operator Instructions). And your next question comes from the line of [Phil Gabara] with Royal Bank of Scotland. Please proceed.

Phil Gabara - Royal Bank of Scotland - Analyst

Hey, good morning.

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

Hi, Phil.

Phil Gabara - Royal Bank of Scotland - Analyst

Hey. You had mentioned this \$8 million impact due to the maintenance outage in the quarter and, I guess, another \$4 million you expect in the third quarter, is there a comparable -- is that in excess of what you had in the second quarter of 2012 or is there a comparable number that we could look at to compare it to?

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

Yes. I think it is higher than 2012 by a couple million. I want to clarify something. I guess -- you use the word outage, these for us are planned maintenance turnarounds, so for our large facilities, specifically, in our epoxy and intermediates business, as well as our versatic acid business, we go through typically an annual turnaround process for the major plants. They're not all every year. Some of them are on multiyear cycles, but these were planned turnaround activities.

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

Yes, the one addition I'd make to that comment is, as I mentioned earlier, there was an extended turnaround which was not because of our own maintenance, but rather support facilities that are on the same sites that we share or extended by a matter of approximately two weeks. And so that did impact us, but Bill is right, the vast majority of it were things that we had planned and, you know, were just part of our normal maintenance cycle.

Phil Gabara - *Royal Bank of Scotland - Analyst*

Okay, but if I'm just trying to comp it versus a year ago, probably like an incremental \$2 million or something like that?

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

That would probably be a fair assessment.

Phil Gabara - *Royal Bank of Scotland - Analyst*

And then, when you think about the third quarter, and you'd mentioned this \$4 million, I mean, is that going -- is there another number that I can use to comp against the third quarter of last year?

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

That's about the same as the prior year.

Phil Gabara - *Royal Bank of Scotland - Analyst*

Okay, okay, fine. And just, and I know you've talked a lot about epoxy but in terms of the near term outlook third quarter, what are you seeing in terms of volumes and margins in the epoxy business?

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

Yes, we're still seeing that it's under, you know, a significant amount of pressure. We would anticipate a slight improvement in the third quarter, more based on costs from outages not being duplicated, but we're not seeing a significant upturn at this time.

Phil Gabara - *Royal Bank of Scotland - Analyst*

Okay. And volume kind of like still at the similar levels type of --

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

Yes. It's -- I think that would be a fair assessment.

Phil Gabara - *Royal Bank of Scotland - Analyst*

Okay. All right. That's all for me. Thanks.

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

Thank you.



Operator

And your next question comes from the line of Brian Lelli with Barclays. Please proceed.

Brian Lelli - *Barclays Capital - Analyst*

Hi, good morning, guys.

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

Good morning, Brian.

Brian Lelli - *Barclays Capital - Analyst*

Thanks for your time. Just a lot of questions have been asked on the business. Maybe just quickly on the balance sheet. I guess, how are you guys thinking about, you know, things like target leverage and then secondly, you know, the 8 7/8, the one and a half liens are callable in just under six months.

You know, obviously, a relatively high coupon versus some of the other senior layers of your structure. I guess, how do you think about that as we get, you know, close to 2014 when those bonds are callable in February?

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

Yes, I think maybe for the first part of your question is, I think I've talked about before is, as we looked at leverage over the long term, we're looking, you know, somewhere in the three to three and a half range from a planning perspective. We don't have specifics we want to announce in terms of the second piece of your question at this time.

Brian Lelli - *Barclays Capital - Analyst*

Okay, thanks, guys.

Operator

You have no further questions. At this time, I would like to turn the call over to Craig Morrison for closing remarks.

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

Well I'd like to thank everybody for your continued interest and participation today, and we'll look forward to updating you next quarter, so thank you very much.

Operator

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



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