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ASH - Q2 2014 Ashland Earnings Conference Call

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OVERVIEW:

ASH reported 2Q14 sales of $1.5b, loss per share from continuing operations of $0.78 and adjusted EPS of $1.53.

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CORPORATE PARTICIPANTS

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Kevin Willis *Ashland Inc - SVP & CFO*

Jim O'Brien *Ashland Inc - Chairman & CEO*

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Laurence Alexander *Jefferies & Company - Analyst*

Jeffrey Zekauskas *JPMorgan Securities Inc. - Analyst*

Brian Maquire *Goldman Sachs - Analyst*

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Ashland second-quarter earnings conference call. At this time, all participants are in a listening-only mode. Later, we will conduct a question-and-answer session and instructions will follow at that time.

(Operator Instructions)

As a reminder, this conference is being recorded.

I would now like to introduce your host for today's conference, Director of Investment Relations, Jason Thompson. Sir, you may now begin the conference.

Jason Thompson *- Ashland Inc - Director of IR*

Thank you, Marcus.

Good morning, and welcome to Ashland's second-quarter FY14 conference call and webcast. We released preliminary results for the quarter ended March 31, 2014, at approximately 5:00 PM Eastern time yesterday April 30, and this presentation should be viewed in conjunction with the earnings release.

Additionally, we posted slides and prepared remarks to our website under the Investor Relations section and have furnished each of these documents to the SEC and a Form 8-K. On the call today are Ashland's Chairman and Chief Executive Officer, Jim O'Brien, and Kevin Willis, Senior Vice President and Chief Financial Officer.

As shown on slide 2, our remarks today may include forward-looking statements as that term is defined in securities laws. We believe any such statements based on reasonable assumptions, but cannot assure that such expectations will be achieved.

Please also note that during this presentation we will be referring to adjusted results in the year-ago period. We believe this will enhance understanding of our performance by more accurately reflecting our ongoing business.

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

Kevin Willis - *Ashland Inc - SVP & CFO*

Thanks, Jason, and good morning.

As Jason indicated, we released our second-quarter preliminary financial results yesterday. Before we review the second-quarter financial highlights, I'd like to quickly talk about the Ashland Water Technologies divestiture.

We announced during the quarter that we had reached an agreement with private equity firm CD&R to sell the business for $1.8 billion in cash. Net of taxes, we expect proceeds to be roughly $1.4 billion, which will primarily be used to repurchase shares.

In keeping with this intent, Ashland's Board authorized a $1.35 billion common stock repurchase program during the quarter. Overall, we are very pleased with the outcome as we focus on our core specialty chemicals business, and accelerate a return of capital to shareholders.

Yesterday, we reported a loss of $0.78 per share from continuing operations. When adjusted for key items, earnings per share were $1.53, flat with prior year. This excludes $0.21 per share of earnings from discontinued operations.

Ashland's overall sales were flat with the prior year at $1.5 billion. These results were negatively affected by lower selling prices in guar, intermediates and solvents, and elastomers, which combined for a $30 million decline.

Sequentially, we saw sales increase 8%, higher than our prior expectations. Adjusted EBITDA was $272 million, a 15% increase from the December quarter. Specialty ingredients was led by solid performances from personal care, pharmaceutical, and nutrition.

Performance Materials had another good quarter with volume and profitability growth in each of the divisions. Valvoline showed particular strength from Valvoline Instant Oil Change, where company-owned, same-store sales increased 5% versus prior year. This was driven by increased oil changes per day, average ticket price, and total number of oil changes.

Now, for a few corporate items. Capital spending was $51 million for the quarter and free cash flow amounted to $124 million. In light of the Water Technologies divestiture, our full-year 2014 CapEx expectation is now $245 million, and our free cash flow from continuing operations estimate is $275 million to $300 million.

This excludes $40 million to $50 million of restructuring related cash costs, but includes $75 million of AWT stranded cost. When accounting for cash provided by AWT, our full-year free cash flow estimate is $450 million to $475 million.

Turn to the next slide. I wanted to take a moment to update you on our global restructuring program. We provided a few slides on the program in yesterday's release, but I want to share some additional perspective.

First, I want to emphasize how important this program is to our operating model and ultimately to our financial success. This global restructuring is touching every part of our company in every part of the world. We are literally redefining how we go to market and how we support our commercial units in customers.

This is not simply an exercise in cost cutting. Our focus is on improving our operating performance and efficiency, which we expect will lead to enhanced volume gains and improved margins.

Secondly, I want to emphasize our commitment to achieving these targets and sustaining the cost savings to maximize the leverage we will gain with top-line growth. We intend to hold our managers accountable for hitting their cost saving targets, we will track the cost that have been removed, and I will closely monitor our operating expenses to ensure these savings are sustained.

We've made a lot of progress over the past several months, and I'm pleased with the results to date. However, there's still a lot of work to be done. These changes are significant, but they are absolutely critical to position Ashland among the top quartile of specialty chemical companies.

I'll now hand the presentation over to Jim for his closing thoughts.

Jim O'Brien - *Ashland Inc - Chairman & CEO*

Thanks, Kevin. Year over year, two of our three commercial units posted solid results with both top line in earnings growth. Sequentially, we saw better than expected performance from across all of our businesses.

Within ASI, we saw top line improvement from the December quarter, with sales growing 11% and EBITDA margin returning to the 20% level. With our global restructuring in full swing, we expect ASI to begin reaping the benefits of cost savings in the third quarter of approximately $5 million. At the same time, we also expect continued volume growth and pricing improvement resulting from the strategic actions that Luis and his team are taking.

Within Performance Materials, adhesives and composites posted another solid quarter and elastomers performance improved considerably over the prior year. As indicated in the release yesterday, we are restarting the process to sell the elastomers business.

We also announced in early April an agreement to sell our ASK Chemicals joint venture. We expect our half of the cash proceeds to be roughly $100 million.

Valvoline had a record second quarter for operating income led by a strong performance in Valvoline's oil change. International volumes grew 9%, continuing our pattern of strong growth over the past several quarters. We also saw another quarter of improved mix, with sales from premium products increasing to over 37% of total sales.

When considering Ashland's overall performance, I am encouraged by the strength I have seen in our business. I am optimistic about the balance of the year as we build on this momentum and begin to see the benefits from our global restructuring program. We still have work to do on driving growth and removing cost from the business, but we are moving in the right direction.

Please turn to slide 6. I'd like to take a moment and highlight the investment pieces for Ashland. We have launched and executed a number of value creating initiatives over the past several quarters, and I don't believe they are fully appreciated by the investment community.

The first is the cost savings associated with the global restructuring program. We have identified $200 million in cost savings. On a run-rate basis, we expect to achieve more than half by the end of this fiscal year. As you just heard from Kevin, we are committed to not only achieving the target but also to holding onto these savings.

The second initiative is the restructuring of our businesses to be more competitive, agile, and efficient. ASI will be a much more streamlined business, with increased regional focus ultimately getting us closer to our customers. Fewer layers in the organization will improve accountability and speed of decision making, particularly at the regional level.

In addition, the realignment of I&S into Performance Materials and adhesives into ASI will provide a better look at the inherit stability of ASI's core product lines. Based on the proactive changes we are taking, we expect ASI EBITDA margins to return to the targeted 25% to 27% range by the end of FY15. Two-thirds of Ashland's margin expansion will come from initiatives well within our control, like our global restructuring program.

Lastly, we expect the $1.4 billion in proceeds from the Water Technologies transition, as well as the cash flow we generate in 2014, and the cash currently on the books, we will have more than $25 per share in cash to use toward value creating projects. As indicated before, we have a $1.35 billion share buyback authorization program that we intend to use. Additionally, we will continue to invest in high return capital projects, and to evaluate both on acquisitions, targeted debt reduction opportunities.

Next slide. Going forward, we see significant opportunities for continued share price expansion with our four primary levers.

First is growth. Over the long term, we expect Ashland's revenues to grow in excess of global GDP, with peak growth at roughly 1.5 times global GDP. This growth will be supported by a variety of macro economic tailwinds. These include aging demographics, a growing global middle class, improved construction markets, and a growing global [clear] count.

We intend to leverage Ashland's innovative technology platforms within pharmaceutical excipients, personal care products, composite resins, and high-performance lubricants to capitalize on these opportunities. As we begin to realize the full cost savings benefit from our global restructuring in FY15, we expect earnings to grow in the high single-digit range.

Second is margins. We believe that proactive steps we are taking to become more competitive should increase Ashland's EBITDA margin to approximately 20%.

With a more efficient operating model in place, we expect to generate higher volumes and command better pricing that should lead to further margin improvement. This improved margin profile should better reflect our specialty chemical focus.

Third is free cash flow. Over the past several years, we have increased our free cash flow generation considerably. We expect to generate roughly $275 million to $300 million this fiscal year. We'll use this cash to optimize our balance sheet, invest in high growth projects, pursue attractive bolt-on acquisitions, and return capital to shareholders.

Fourth is value. Despite the actions we've taken over the past several years to transform Ashland into a more stable, higher margin company, we continue to trade at a discount to the broader chemical group. Furthermore, if you compare us to the higher value specialty chemical names, Ashland trades at a significant discount versus its earnings at EBITDA.

We continue to believe the market does not fully appreciate the value of the portfolio of assets, and we view Ashland's stock as a good investment opportunity. In getting in the June quarter, we intend to purchase shares under our previously authorized $1.35 billion repurchase program.

Before we open it up for your questions, I want to share some thoughts on my decision to retire at the end of December. It was not an easy decision, but I believe the time is right. By the end of this year, Ashland's global redesign will be largely finished and the sale of Ashland Water will be complete.

Although Ashland will be a smaller company, it will be more focused on our core specialty chemicals business, and should be better positioned for sustained sales earnings growth. We'll be more agile and more accountable.

We'll be closer to our customers. We'll be able to make faster decisions. We are not quite there yet, but are moving in the right direction.

The timing is also right on a personal basis. Our transformation into a global specialty chemical company tops the list. Back in 2002, Ashland was an American conglomerate doing business in a variety of industries ranging from oil refining and marketing to highway construction and distribution. Specialty chemicals made up only 16% of Ashland's annual sales.

More than a decade and two dozen deals later, Ashland is truly a global chemical company with a clear focus on specialty chemicals. Our shareholders have reaped the benefits of that transformation, as Ashland's stock has climbed from around $26 per share in October 2002 to $97 today.

I'm incredibly proud of what we have all accomplished, and I feel lucky to have played a role in Ashland's success. At the same time, I am excited by the opportunities that lie ahead, both for the Company and for me personally. My announcement at this particular point in time gives the Board of Directors an appropriate amount of time to conduct a thorough search as part of an orderly succession plan.

Let me be clear, Ashland's strategic focus won't change. Specialty chemicals is a cornerstone of this Company, and the foundation on which our future will be built. I am confident the Board will appoint a new CEO with the vision and experience necessary to lead Ashland into the upper echelon of specialty chemical companies, with EBITDA margins to match.

Until then, we have a lot of work to do. I intend to be fully engaged over the next eight months to make sure we finished what we have started.

Now, I'll hand it over to Jason to begin Q&A.

QUESTIONS AND ANSWERS

Jason Thompson - *Ashland Inc - Director of IR*

Before we open it up, I'd like to remind everyone that we'll limit to each person to one question and one follow up. With that, I'll hand it over to you, Marcus. Please begin.

Operator

(Operator Instructions)

John McNulty, Credit Suisse

John McNulty - *Credit Suisse - Analyst*

Thanks for taking my question. And first, congratulations on the numbers, but also Jim, on the announced retirement. You definitely transformed the Company in a very meaningful way for shareholders and it's been a pleasure to watch it.

With that in mind, can you give us your updated thoughts on how you're thinking about how Valvoline fits in into the overall portfolio? Especially if this may have some consideration on how maybe the Board is going to be thinking about the right candidate for the next CEO role?

Jim O'Brien - *Ashland Inc - Chairman & CEO*

Let's start off with how we believe the search will go. We have both internal and external candidates that are under review, and what I wanted to give the Board is the appropriate amount of time to do a proper evaluation.

And the Board, as far as their perspective on the type of candidate they are looking for, is they are going to hire to the strategy. So the Board has been involved over the last 12 years working with the Company, obviously, developing a strategy, and they have no intention to change the strategy. So they are going to hire to the strategy, I think that's an important point.

The point around Valvoline, how this may or may not impact it, again as I said, the Board is going to hire to the strategy and we intend to execute the strategy. The issue with whether or not the Board makes a decision to continue to run Valvoline in its current state, or to find some other opportunity for Valvoline, is something that continues to be under study. And as we've stated in the past, the Board continues to evaluate all aspects of the corporation and Valvoline is one of the offsets they continue to evaluate.

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But the decision on the Board is resting with Valvoline's future, this is a highly complex one; and one that continues to take an appropriate amount of analysis and investigation. This is a very complex issue and the Board is taking it very seriously.

But our Board and management, we continue to be committed on this evaluation of Valvoline, as I stated, as well as other portions of the portfolio. And the Board's intention is to maximize the value creation and the Board will work at an appropriate pace to achieve that goal.

John McNulty - *Credit Suisse - Analyst*

Great. Thanks very much. And the maybe as a follow up, first of all I appreciate the granularity on the cost-cutting program because it certainly helpful.

Can you give us some color as to where the run rate currently is on cost-cutting? Because it looks like actually for some of your businesses, Valvoline and Performance Materials, at least based on the strength that you saw this quarter, you actually maybe pretty close to your normalized EBITDA targets at least for those business. So an update there might be helpful?

Kevin Willis - *Ashland Inc - SVP & CFO*

Yes, it's a good question. This is Kevin. Where we are right now is, from a run-rate basis, is I would say in the $20 million to $25 million range, give or take.

We have a lot of actions that are occurring, literally as we speak, in terms of cost out work that's being done and actions that are being taken. We do expect quite a ramp between now and the end of the fiscal year to that range of more than half of the announced $200 million of identified cost savings.

As for Valvoline and Performance Materials, what we would expect from Valvoline, as you saw in the prepared remarks, is really an EBITDA margin, and what I would call a sustainable EBITDA margin, in kind of the 18%, 19% range. So there's still work to be done in Valvoline to achieve that, and really for Valvoline and for all of our business, it's about two things.

It's about reaching a sustainable margin, but it's also about the volatility around that margin. Standard deviations of those margins. And that's something that we're also very, very focused on in each of our businesses, and the corporate level as we move forward.

So again, there is still work to be done, as Jim indicated. And I've just been handed a correction, it's $20 million to $25 million by the end of this quarter, not as of the end of the March quarter, so end of the June quarter, just so we're clear on that.

So that's my thoughts. We still have a lot of work to do and we have every intention to get that done.

John McNulty - *Credit Suisse - Analyst*

Great. Thanks very much for the color.

Operator

Laurence Alexander, Jefferies

Laurence Alexander - *Jefferies & Company - Analyst*

Good morning. I guess two questions. First, Jim as you look at the strategic problems that are left for your successors to deal with, are there any outstanding within the ASI portfolio that are being held off or you think are going to be most pressing for a fresh look?

And secondly, as you look at the ASI margin bridge that you've targeted, how much of that is contingent on end-market recovery? And how much of it do you feel is in the bag with the initiatives you already have underway?

Jim O'Brien - *Ashland Inc - Chairman & CEO*

Let me start with the second question first. I think the important aspect of what we're trying to do with ASI is when we changed leadership between John and Luis, I think we have the right people in the right jobs now. And being the CEO, that's one of my primary responsibilities to get people in the right jobs.

So I think that decision was an important one that I wrestled with and I think we're already seeing benefits, both in the water side as well as on the ASA side for that decision. I think Luis is focused on what that business needs and how to grow that business, and bringing it more toward a regional focus because the business is so diverse, as far as where we serve our customers worldwide, is an important one.

He's placing much more emphasis there, and as a consequent, he's reorganizing the cost structure because we kind of staffed it for growth. And not to say that we still won't get growth, but we got way ahead of that curve, and as a consequence, part of this cost out program, the reorganization, is to get refocused on how to really achieve that growth with an appropriate cost structure.

So I think refocusing the business on a regional basis, taking a lot of the cost and organizational structure that's put in place out, and streamlining the business will do a couple of things. It will help us get closer to the customer and bring the objectives, as far as the programs we have in place and the new products that we're doing, specifically for certain customers around the world, we'll get there faster.

And then more importantly, our margins will expand back to where they should be because we're not overburdening them with a huge cost structure that was built over the last 24 months. So that's being corrected, and Luis is correct in doing that and he's doing a fantastic job getting that organization together and then stripping that cost out. So that's important.

And then when you look at the emphasis of what is either going to be held back or grown, I don't think that my departure is going to have any impact on that. Because the plans are in place, the strategy is in place, Luis understands what he has to do, and then what I'm leaving for my successor, whoever that may be, to me the objective is execution. Where my emphasis has been and where I spent most of my time is in the moving around all these assets, trying to figure out what to buy, what to sell; that's taken in inordinate amount of my time, and I think as we move forward a lot of that work is complete.

That work is never finished and I'm sure the things people believe should be done and that will continue to be evaluated. But I believe that the new CEO, along with the executive team that is there, there will be a much heightened focus on execution and operating the business. Because I think the business is designed now and has the proper assets that that's where the emphasis should be placed.

So I think, that that will be one of the issues from the Board's standpoint. They're going to need to look for someone that is I think strong on execution, as well as growing businesses organically, and then finding the right types of tuck-in acquisitions to continue to grow the business on a constant basis.

So it's going to go, I think, more to an operating type CEO than where I have found myself, for I was trying to transform a company. The transformation is primarily complete, so we need to really hunker down and operating better as well as growing faster.

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Laurence Alexander - *Jefferies & Company - Analyst*

Thank you.

Kevin Willis - *Ashland Inc - SVP & CFO*

Lawrence, to also add a little more color to that. As you'll see in the prepared remarks that we released yesterday, our expectation is that the restructuring program should yield about 3 points of margin for ASI once fully implemented. And the delta between, if you have cost only, cost only; And again, better execution. We think without, call it, significant macroeconomic tailwind, would get us to the low end of our range, kind of the 25%, 26% range.

Obviously, macroeconomic growth, and our participation in that for our fair share, would get us firmly in that range, and that would be our expectation for that business. And we expect to be there by, as we said, the end of fiscal 2015.

Laurence Alexander - *Jefferies & Company - Analyst*

Thank you.

Operator

Jeff Zekauskas, JPMorgan

Jeffrey Zekauskas - *JPMorgan Securities Inc. - Analyst*

Hello, good morning.

Kevin Willis - *Ashland Inc - SVP & CFO*

Good morning, Jeff.

Jeffrey Zekauskas - *JPMorgan Securities Inc. - Analyst*

In your consumer markets business, you said your lubricant volumes were up 1%, but you described your international volumes, I think, as being up 9% and at 5% same-store sales growth at instant oil change. Why is the volume number so low relative to those other numbers? Why isn't the volume number higher?

Kevin Willis - *Ashland Inc - SVP & CFO*

It's the DIY side, Jeff. North American ECMO volume still declining.

Jeffrey Zekauskas - *JPMorgan Securities Inc. - Analyst*

Okay.

Jim O'Brien - *Ashland Inc - Chairman & CEO*

That's not something that's strictly a Valvoline issue. That's an industry issue.

Jeffrey Zekauskas - *JPMorgan Securities Inc. - Analyst*

Yes.

Jim O'Brien - *Ashland Inc - Chairman & CEO*

That's just a fact of the demographics people are going more toward, do it for me instead of do it yourself, and that reflects in the growth of the Valvoline Instant Oil Change.

Jeffrey Zekauskas - *JPMorgan Securities Inc. - Analyst*

Right. And then when you move the intermediates and solvents business into Performance Materials, but then you sell material back into specialty ingredients, will that material be transferred at market or at cost in your accounting going forward?

Kevin Willis - *Ashland Inc - SVP & CFO*

It will be transferred at cost.

Jeffrey Zekauskas - *JPMorgan Securities Inc. - Analyst*

So wouldn't that overstate the profits of specialty ingredients and understate the profits of Performance Materials if you did it that way? And if you did it that way, what's the margin change?

Kevin Willis - *Ashland Inc - SVP & CFO*

Well, those materials go into the ASI today at cost, and so there really shouldn't be any margin change. In terms of our overall external financial reporting, even if we didn't transfer them at cost, that inter-Company profit would get eliminated as part of the overall consolidation.

But it should be on apples-to-apples basis as we've done it in the past. Those materials went into what was the heritage ISP business to produce high-value polymers at cost and that's the way it will be handled in the future, so there shouldn't be any change going forward on that.

Jeffrey Zekauskas - *JPMorgan Securities Inc. - Analyst*

But if they're in the same segment today, you capture the profit in the segment. But if you separate the commodity operations off and transfer at cost, wouldn't the additional margin be picked up without the revenues in the specialty ingredients segments? Or have I misunderstood that?

Kevin Willis - *Ashland Inc - SVP & CFO*

Again, it will be handled just as it's handled today. External sales of BDO, keeping in mind we're quite long on BDO compared to what we have internally.

Jeffrey Zekauskas - *JPMorgan Securities Inc. - Analyst*

Yes, certainly.

Kevin Willis - *Ashland Inc - SVP & CFO*

Those external sales will be reported in the Performance Materials segments.

Jeffrey Zekauskas - *JPMorgan Securities Inc. - Analyst*

Yes.

Kevin Willis - *Ashland Inc - SVP & CFO*

And obviously those sales will be handled at whatever the prevailing market price is.

Jeffrey Zekauskas - *JPMorgan Securities Inc. - Analyst*

Okay. Thank you very much.

Jim O'Brien - *Ashland Inc - Chairman & CEO*

Jeff, I think also in line with your question, the reason why we want to move this business into Performance Materials; they've demonstrated an excellence in managing very tough markets, and highly competitive markets, and having a very competitive cost structure to compete.

So as we move that into Performance Materials, I think we'll have a management team under Ted, that is really focused on how to run these businesses in a different manner and not be burdened with a cost structure that ASI has for our specialty side business. So I think we're getting these businesses oriented in the right management structure with the right focus.

And I think as we report these financial numbers out, they should get better. And then you'll gather a much better sense what our specialty businesses are doing; and then a much better sense of what the more commodity oriented businesses are looking like, but they'll have a cost structure that are totally different.

Jeffrey Zekauskas - *JPMorgan Securities Inc. - Analyst*

Okay. Thank you so much.

Operator

Brian Maguire, Goldman Sachs

Brian Maquire - *Goldman Sachs - Analyst*

Hello, good morning.

Kevin Willis - *Ashland Inc - SVP & CFO*

Good morning, Brian.

Brian Maquire - *Goldman Sachs - Analyst*

Just following up on Jeff's question there, looking at slide 16, the components of bridging from the 20% trailing to the 25% to 27%. Just what contribution will the shift the pieces in and some of the BDO out has, including some of the margin benefits of transferring the cost there? Just what component of that is just the optics of that versus the cost savings and the performance improvement?

Kevin Willis - *Ashland Inc - SVP & CFO*

Right. Again, there won't be any benefit from the transferring at cost because that's effectively how that works to date for the sale of those polymers in the ASI business. So there will be no impact from that.

What we would expect, by moving adhesives into ASI would be probably a 25 to 50 basis point impact, positive impact, on ASI's near-term EBITDA margins. Obviously, as the restructuring folds out, that is subject to change as we get it all done. But initially, that's what we'd expect, probably 25 to 50 bps.

Brian Maquire - *Goldman Sachs - Analyst*

Okay, and then within the performance column there, could you explain where the rest of that improvement would come from? Just, is it more macro dependent or what other kind of factor that you need to get there?

Kevin Willis - *Ashland Inc - SVP & CFO*

No. Really, the way we are thinking about the expansion from performance is the things that Jim talked about, around regionally focusing the ASI business; getting much closer to our customers, being able to execute more quickly, make faster decisions, better decisions, and really capturing more share of wallet as a result of doing that.

Again, not dependent on any kind of outsized macroeconomic growth, just really status quo with where we are today but doing a better job. And that is so much of what this restructuring is about. Yes, there's a lot of cost coming out of business, but it's also very, very much about getting closer to the customer, understanding their needs better, and executing a lot better; both from a commercial perspective as well as from a supply chain perspective, and that's really what you see in the performance column.

And to get firmly into that middle or upper end of that expected EBITDA margin for ASI, obviously, we will need some macroeconomic tailwind to do that. But again, we believe that at least two-thirds of getting where we want to get is well within our control. And that's we plan to do.

Brian Maquire - *Goldman Sachs - Analyst*

Okay. One last one if I could for Jim. Jim, I think you articulated very well the bulk case for Ashland shares here, but it didn't look like you repurchased too many shares in the quarter.

I know your executing on the $1.3 billion buyback depends a lot on getting the proceeds from water, but just thinking how quickly you would look to redeploy those proceeds before the market figures out all the points you brought up there? Would you look to do a Dutch auction, or an ASR, or something to try and redeploy that cash as quickly as possible?

Jim O'Brien - *Ashland Inc - Chairman & CEO*

Well, in my prepared remarks, I stated that this quarter we are going to start buying back shares. So up until this point in time, we had too many moving parts which kept us, in the Company, in a position that we couldn't execute with the knowledge that we had.

With this earnings call, we pretty much now cleaned the slate of any knowledge that we would have that the market does not. We also want to put the intent out there that we do intend to buy back shares from the very point that you just stated. We think our stock is undervalued and I think over time, more and more people will appreciate that fact.

So I agree with you. We want to acquire shares in the near-term to try to capture as much of that value as we can. And also return that value to the shareholders as well. So we're not stating how were going to do that, but you can understand that we will be in the market.

Brian Maquire - *Goldman Sachs - Analyst*

Great. Thanks very much.

Operator

David Begleiter, Deutsche Bank

David Begleiter - *Deutsche Bank - Analyst*

Thank you. Jim, on the portfolio on Performance Materials, composites and intermediate solvents, are the issues for separating those businesses more complex or less complex than the issues involved in separating Valvoline?

Jim O'Brien - *Ashland Inc - Chairman & CEO*

When you look at those businesses, the solvents business is one that's a little more complex, because we have to have a fairly sizable position in that, because it's so critical to our PDP business. So we can't rely on our primary competition to supply us. But the question there is, do we have to have as much as we have today? And the answer to that is no.

We need a more eloquent solution on how to do that and we continue to study how we might do that; and we have ideas, but nothing that we think is imminent. But we would prefer not to have as much merchant material, let's say, as we have. So that's a desire that we think we would be better off with less than more. So were continuing to work that problem.

The other question, as far as Performance Materials on the composite side, the issue is, I think, we have the best business in the space. And as a consequence being the best business in the space, we would be the natural consolidator in that space, if we chose to do so. And we do not want more of that style of business, so we're not going to be the consolidator.

So that leaves the question, how do you do that? And we continue to study how that could be done and we think it should be done. So that's, again, on our list of things that we would like to solve, and at this point in time we haven't found, what we believe, is the highest value creating idea for our shareholders.

So we believe it's at this stage, we're better off to run it than to put it in some other form. But it's not to say we don't continue to study new ideas and other ways to get there.

David Begleiter - *Deutsche Bank - Analyst*

And just back on Valvoline, Jim, does your departure, retirement, either accelerate or slow down the process the Board is undertaking to review? And if not, and this is not a new issue for the Board, what's taking the Board so long to be blunt in deciding what to do here?

Because it seems very straightforward about either keeping or not keeping Valvoline. What's really holding up the Board's decision-making process?

Jim O'Brien - *Ashland Inc - Chairman & CEO*

Well, I think there's two things that the Board has to consider, and that's in any decision, whether it be Valvoline or any decision that we take. The first is the strategic question. And to your point, the strategic question is easier to get your head wrapped around. So strategically, the Board has a position on what they would like or not like to do.

The second is the execution of any decision that you make around that strategic decision. And there when you look at Valvoline, as I stated in answering the question the first time it came up, this is a highly complex execution of doing anything different than just running it.

So the Board continues to evaluate all the issues surrounded Valvoline, and trying to find the right decision so that it creates maximum value to our shareholders. So what you need to appreciate from the Board's standpoint, they continue to evaluate all decisions in light of how do we maximize the value for the shareholders.

They do not take that lightly and they want to make sure that any decision that they make is the one that is going to create the highest value. And whether it takes a short period of time or a long period of time, I guess the timeframe is around the complexity of the issue and the problems that need to be solved.

And I think our Board has demonstrated in the past that they are not reticent to make decisions. We've made a lot of decisions over the last, really seven or eight years, so it's not that the Board is reluctant. The Board is very thoughtful and deliberate in how they go about making these decisions.

And as far as my retirement issue, the retirement was really about my own personal desires, than it was to accelerate or decelerate any decisions. So the timing is one of my own, and I was pushing the Board, to say, I would like to retire; not the Board pushing me, to say, please retire.

So this is my decision and that's part of the reason I'm giving the Board eight months to figure out my replacement. Not that I'm impossible to replace, I'm not, but I want to make sure I give them enough time to find the appropriate decision.

David Begleiter - *Deutsche Bank - Analyst*

And I may have one quick thing for Kevin. Kevin, is the new tax rate guidance sustainable for 2015 and beyond at 21%?

Kevin Willis - *Ashland Inc - SVP & CFO*

Yes, we believe that it is. It's primarily driven by mix. More income outside the US, so yes, we believe that is the new sustainable run rate, 21%

David Begleiter - *Deutsche Bank - Analyst*

Thank you very much.

Operator

Michael Sison, KeyBanc

Michael Sison - *KeyBanc Capital Markets - Analyst*

Hey, good morning. Nice quarter there and, Jim, congratulations as well. It's been fun seeing you transition the Company.

When you think about specialty ingredients, I think you noted in the slides that SG&A as a percent of sales should be around 15%. Is that the right level? Or could there be another round that gets you a little bit lower longer term?

Kevin Willis - *Ashland Inc - SVP & CFO*

A couple things, Mike. As we look at it, the 15% is kind of the all-in Ashland rate, and ASI will likely also hover around that rate. Performance Materials is lower, and Valvoline may be a bit higher.

As I think about it, as we've thought about it, what we've tried to solve for is, in looking at our peers, where do they stand? And if you look at it around 15%, maybe it's at the upper end of the middle, in terms of SG&A as a percent of sales.

But particularly with ASI, we've talked about this some before, there's a couple of points of deal amortization running through SG&A due to the transaction we've undertaken over the past few years, and so clearly not much to be done about that. That will amortize out as an amortizes out.

So that's really another part of that delta. If you compared us to the top quartile of specialty chemical companies and the relative SG&A percentage of those.

Michael Sison - *KeyBanc Capital Markets - Analyst*

Okay. Great. And then, Jim, the balance sheet, and obviously going to be in very good shape, and historically when that's the case you tend to go out and find something interesting for the portfolio. In the near term, given the transition, are you on hold in terms of maybe doing a bigger acquisition at this time?

Jim O'Brien - *Ashland Inc - Chairman & CEO*

You know, as we stated in the prepared remarks earlier, we've always had multiple ways to create shareholder value and returning currency back to the shareholder is our near-term idea at the current moment in time. We're committed to, so buying back our stock is number one in our list. We'll continue to constantly be in the marketplace looking for opportunities.

At this stage, we don't see anything that is imminent. So I would say, that not to say we would or would not do something, but I can't see that as being high on our priorities right now. And it has nothing to do with me potentially leaving here in the near term. So our priorities are the same, but our highest priority right now is returning cash to shareholders.

Michael Sison - *KeyBanc Capital Markets - Analyst*

Great. Thank you very much.

Jason Thompson - *Ashland Inc - Director of IR*

We'll just have one more question there, Marcus.

Operator

Mike Harrison, First Analysis

Michael Harrison - *First Analysis Securities - Analyst*

Thanks, and let me add my congratulations to Jim. Wanted to ask about ASI. You mentioned that your cellulosic businesses there are seeing some capacity constraints. What specific products or regions are tight right now?

Kevin Willis - *Ashland Inc - SVP & CFO*

HEC is pretty tight. We do have a fairly significant debottlenecking project in Nanjing that we are executing on. We expect to have approximately 2000 tons more capacity there, let's call it, early fiscal 2015 would be our estimate.

And we also have some other opportunities, particularly in Nanjing, in terms of some work that we did to start a capacity expansion that we then put on hold; and we're also gaining at potential acceleration of some of that work. That's really, I would say, our highest priority within the cellulosic's piece of the business that we're focused on right now.

Michael Harrison - *First Analysis Securities - Analyst*

So it's really just the HEC, there aren't any other areas or product lines?

Kevin Willis - *Ashland Inc - SVP & CFO*

Nothing that's huge at this point. HEC is really the primary focus for us today.

Michael Harrison - *First Analysis Securities - Analyst*

Okay. I think the reason I'm interested is historically, when Hercules owned this business, there were periods they would get capacity constrained. They would have to go out, they'd buy third-party product, they would resell it at low margin or they would have to shift from one region to another, again, at relatively high cost or lower margin than we'd be accustomed to.

In the meantime, while we're dealing with this capacity constraint, is that something that we should expect is that there's some near-term margin compression from HEC? Or is it something your confident you can manage through?

Jim O'Brien - *Ashland Inc - Chairman & CEO*

You know, Mike, your knowledge of the business is very good and we're currently in that process now. So we've been doing that for probably two quarters, so those effects are in the margin today. And as you described, what we do in that business is, we let demand tighten up and then we expand.

Otherwise, you find yourself in the situation we did a couple of years ago where the expansion took place, at the same time, there was a slight deceleration in demand; and competitor put a lot of product in the market and it really impacted us and whipsawed us for about three quarters. And now we're back to a more balanced supply demand, which is good.

And that puts us in the situation that we have to manage our customers demand, and as you said, allocate product, move it around the world, and that's a typical stage where it's now right for us to expand. So we are in the process of taking these projects that we had in place, getting them scheduled to be done, so you should expect us to expand our capacity here in the near term.

But the good news for us is that that will be absorbed fairly quickly and should not have an impact on margins.

Michael Harrison - *First Analysis Securities - Analyst*

All right. And then I wanted to ask about Valvoline. Often, April is a key month or key indicator for what the rest of the year looks like.

Can you comment on the trends that you are seeing? Particularly the strength in VIOC and whether that's sustainable? And in terms of the DIY weakness, if you want to call it that, is that just a continuation of a trend or was there maybe some depression related to the weather in North America?

Jim O'Brien - *Ashland Inc - Chairman & CEO*

In the winter months, obviously, it's a weaker period because people can't get outside and work on their cars. I would say that the severe winter that we had probably had impact, but I think it's probably marginal because the amount of people that go out in the winter to do that type of work or work in their garages that time of the year is less.

So I think the trend for the DIY is continuing to be a decline, and our objective is to continue to fight very hard for our share and to grow share. And we've demonstrated our ability to do that through some very innovative products. And so our challenge for that team is to improve its mix, to get to more premium, as well as increase its total market share at those accounts.

So they work very, very hard. We don't allow them to use that as the excuse for having lower sales quarter to quarter. So they have to continue to improve mix, they have to continue to increase their share, and they been fairly successful in doing that.

VIOC, on the other hand, we expect to have aggressive growth there. There's no reason why, as more people move to that style of service, that we have the best system in the marketplace, we have the best franchisee system as well, and we're growing. I think we're probably one of the best, if not the best, out there.

And that is demonstrating the increase in ticket, increase in car counts, we continue to get franchisees to sign up, and we're also acquiring other systems as they transition from ownership of people that are retiring and want to move on and sell their businesses. So our franchise group, as well as ourselves, we continue to buy stores. So that's a growing part of that business.

We want to grow that business because it successful and I think we have a good operating model that we can make money at this.

Michael Harrison - *First Analysis Securities - Analyst*

And in terms of adding to the VIOC store count, is that something that would probably be more likely to happen organically? Or do you guys see some properties you could acquire, maybe regional guys or some small national chains?

Jim O'Brien - *Ashland Inc - Chairman & CEO*

Yes, we see the opportunity as continuing to open a few number of stores every year organically, so finding a good corner as the suburbs grow or new places where people want to live. We always enter those markets, but those are small.

The real opportunity is to buy those systems that people are retiring from and want to sell their 10, 12, 14 store operations. That's a sweet spot for us. And there, when it's in our primary markets where we have a lot of stores, we will buy those stores.

And where it's a franchise operation, we'll support them for them to buy those stores. And we have several examples of that, just in the last, really three months, that we've done some of those deals. And those deals are quite accretive to our earnings because we can actually take those stores, repurpose them, put them on our system, and we actually increase the car counts and increase the ticket almost every time.

Michael Harrison - *First Analysis Securities - Analyst*

All right. Sounds good. Thanks for a much.

Operator

All right, Mr. Thompson, we are showing no further questions in the queue at this time. Please proceed with any closing remarks.

Jason Thompson - *Ashland Inc - Director of IR*

Okay, thank you, Marcus. Thank you, everybody, for your interest in Ashland. Feel free to give me a call, I'll be around today. Thanks.

Operator

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