

— MANAGEMENT DISCUSSION SECTION

Operator: Good day everyone and welcome to today's Ashland Incorporated Fourth Quarter Earnings Call. As a reminder, today's call is being recorded.

At this time, it is my pleasure to turn the call over to Mr. Eric Boni. Please go ahead, sir.

Eric N. Boni, Director, Investor Relations

Thanks, Carla. Good morning and welcome to Ashland's fourth quarter fiscal 2009 conference call and webcast. We released our results for quarter ended September 30, 2009 at 6 o'clock Eastern Time today and this presentation should be viewed in conjunction with that earnings release. These results are preliminary until we file our 10-K in November.

With me here today are Jim O'Brien, Ashland's Chairman and Chief Executive Officer; Lamar Chambers, Senior Vice President and Chief Financial Officer; and Sam Mitchell, President of Ashland Consumer Markets.

Before we get started, let me note that as shown on slide two, statements may be made that constitute forward-looking statements as the term is defined in relevant securities laws. We believe our expectations are based on reasonable assumptions, but we cannot assure that those expectations will be achieved.

Please turn to slide three. Please also note that during this presentation, we will be discussing adjusted pro forma results. We believe these adjusted pro forma results enhance understanding of our current and future performance by reflecting the impact of the Hercules acquisition completed last November and the related accounting effects.

Our fourth quarter highlights are on slide four. As compared with the prior year September quarter, our adjusted pro forma EBITDA increased 37% to \$224 million, benefiting from record fourth quarter performances by Ashland Consumer Markets, which our Valvoline business and Ashland Hercules Water Technologies.

We recorded \$1.30 of earnings per share from continuing operations. When adjusted for key items, which I'll discuss in a moment, EPS was \$0.96. We again generated substantial free cash flow totaling \$305 million during the September quarter, including \$128 million from trade working capital.

Additionally, we received net proceeds from the sale of both our Drew Marine business and redundant Shanghai headquarters facility, totaling more than \$140 million. We used our cash to reduce gross debt by \$380 million or 19% of debt outstanding, bringing total debt down to approximately \$1.6 billion.

We are closed to completion of our \$400 million cost reduction initiatives having achieved \$355 million of saving on a run rate basis. We achieved our overall EBITDA increase despite year-versus-year volume declines in all five of our segments with decreases in our non-consumer markets businesses ranging from 11% to 25%.

That said, volumes have increased sequentially in most of our businesses. I'll provide a few details on that shortly.

Now, I'll start our comments on earnings with key items on slide five. Two key items affecting operating income in the fourth quarter; the first of these was severance and accelerated depreciation charges totaling \$23 million or \$0.20 per share after-tax and included \$3 million of

non-cash accelerated depreciation. The severance was largely related to \$100 million of additional cost reductions we announced in our July call.

Operating income was positively affected by significant reduction in our insurance reserves, resulting from lower than expected claims experience.

During the quarter, we retired significant portions of our term loans A and B that were part of the financing package for Hercules. As a result of this early retirement, predominantly non-cash debt issuance cost amortization, which appears in the income statement as interest expense, increased by \$9 million pre-tax and reduced earnings per share by \$0.08.

In addition, the gain on the sale of Drew Marine increased earnings by \$56 million, or \$0.50 per share. The net benefit to reported earnings from all of these key items was \$0.34 per share.

In the year-ago quarter, key items affecting operating income totaled \$0.04 per share.

Please turn to slide six for our adjusted pro forma EBITDA chart. For the September quarter or adjusted pro forma sales declined 25% versus the year ago quarter to \$2.1 billion.

Gross profit as a percent of sales was 680 basis points above prior year, while SG&A expenses decreased by 12%.

Operating income increased by 78% to \$142 million and EBITDA rose 37% to \$224 million, due primarily to price and cost management. Our EBITDA margin increased by 480 basis points to 10.6%.

Please turn to slide seven for our EBITDA bridge. Our EBITDA bridge shows the factors affecting our comparisons for the fourth quarter of fiscal 2008 and 2009. The positive impacts of margin improvements were more than \$30 million greater than the negative effects of volume reductions.

With the exception of Ashland Distribution, all of our businesses were important sources of margin improvement with each contributing significantly more than \$10 million of positive margin impact.

SG&A expenses excluding the effect of currency translation declined by \$36 million versus the prior year quarter due to our cost reduction initiatives. As a reminder, our furlough program was essentially completed by the end of June and the \$18 million benefit that we saw in the June quarter was not repeated in this quarter.

Please turn to our cash flow statement on slide eight. For the fiscal year, Ashland generated more than \$1 billion in cash flows from operating activities; \$378 million of which was generated during the fourth quarter.

During the September quarter, we generated \$254 million of cash from changes in operating assets and liabilities, which includes working capital.

Capital expenditures for fiscal 2009 were \$174 million, and although not shown on this chart, on a pro forma basis which adjusts for the period we did not own Hercules, were \$193 million, slightly below our \$200 million previous guidance.

Please turn to slide nine to see the favorable impact of debt reduction on our credit statistics. With our debt reduction efforts this quarter, our debt-to-EBITDA ratio is now just 1.7 times. As a result of achieving this leverage ratio, our interest rate spread been reduced by 50 basis points on our term loan A and revolver. It is now just 275 basis points, over our LIBOR floor of 3.25%.

Our fixed charge coverage also improved during the quarter and is now three times and our net worth is approximately \$450 million greater than our covenant requirement. In the 10.5 months after closing the Hercules transaction, we have reduced our debt by nearly \$1 billion. Of that nearly \$1 billion reduction, on a little more than \$200 million came from the sale of assets with most of the remainder attributable to cash flow from ongoing operations.

With gross debt now at roughly \$1.6 billion, we have reached our stated debt targets. Now that we have reached our targeted debt level, we will use our excess cash flow to increase liquidity, providing increased financial flexibility.

Please turn to slide 10 to look at the progress on our cost reduction program. We've achieved run rate savings of \$355 million from our cost reduction program. During the fourth quarter, we realized \$84 million of savings in the income statement, including \$51 million in SG&A savings.

As compared with fiscal 2009, we would expect to realize \$100 million of incremental savings in our 2010 income statement from our cost reduction program, primarily resulting from the full year impact of the program.

Please turn to slide 11 for our recent volume trends. As you can see on this chart, our businesses, excluding Consumer Markets experienced dramatic volume reductions during the December 2008 and March 2009 quarters. Since then, the markets appear to have settled and we're seeing improvements in volumes on a sequential basis.

On the whole, sequential volume increases averaged about 5% and ranged anywhere from 2% in Ashland Aqualon Functional Ingredients to 8% in Water Technologies.

I would point out that seasonality for the December quarter, historically, represents a 5 to 10% volume headwind versus September for Ashland as a whole.

I'll now turn the presentation over to Sam Mitchell to discuss Consumer Markets' results and trends starting with slide 12. Sam?

Samuel J. Mitchell Jr., Vice President and President, Ashland Consumer Markets

Thanks, Eric and good morning. Lubricant volume for Consumer Markets, Valvoline, decreased 3% from the prior year quarter, largely driven by a decrease in private label volumes, while Valvoline branded U.S. lubricant volumes increased 3%. Premium brand volumes increased 7% from a year ago. Sequentially, however, volume was up 7% following our very strong June quarter from lower lubricant volumes in the do-it-yourself or DIY market channel.

We had a particularly strong slate of promotions with DIY retailers in June and July behind our Valvoline Engine Guarantee launch, and most of this volume shipped in May and June.

Sales decreased 9% versus the prior year quarter, mostly from the overall volume decrease and weaker foreign currencies. Gross margins improved from 19.2% a year ago to 35.5% in the September 2009 quarter. September quarter margins improved as a result of pricing actions, cost savings initiatives and a continued increase in sales of premium brands.

The gross margin decline from the June quarter was a result of higher raw material costs during most of the quarter. SG&A expenses increased by 6% versus the September 2008 quarter and 9% versus the June quarter, primarily from higher advertising expenses in support of the Engine Guarantee program.

Earnings improved significantly in all of Consumer Markets segments and in all geographies versus the prior year. As a result EBITDA more than tripled to \$79 million. The \$24 million EBITDA reduction from the June quarter is a result of lower volumes, increased raw material costs and higher advertising expenses. That said, consumer markets achieved record EBITDA for the fourth quarter and for the full year.

Slide 13 shows Consumer Markets' EBITDA bridge. It is important to note that the September 2008 quarter suffered from a significant spike in raw material costs and the resulting compression in gross profit margin as offsetting pricing actions did not begin to take effect until the following quarter.

As you can see, by far, margin was a driver of earnings growth versus the prior year September quarter. Margins improved in both lubricant and non-lubricant sales. Valvoline Instant Oil Change continued to show broad-based growth with the number of oil changes per day, up 5% versus the prior year and the average ticket up 3%.

Now, I'll highlight key trends and initiatives in our major business units on slide 14. One of our most improvement achievements in 2009 was growing market share by approximately 2 points in our DIY business. This was accomplished by working closely with key retailers to executive more effective promotion events, increasing our advertising impact through our Engine Guarantee program, and focusing additional marketing efforts on the important Hispanic and Youth segments.

It was also encouraging to see solid category growth in lubricants throughout the summer.

Our Valvoline Instant Oil Change business continued to make impressive progress as our company-owned stores posted same-store sales growth of 8% a year in what has certainly been a difficult retail environment. This is the third consecutive year of same-store sale growth.

Our franchisees representing nearly 600 stores are also critical to our success, and we are pleased to see results consistent with those of our 259 company-owned stores. We are bullish on the future of this business as we continue to make operational improvements, and working closely with our franchisees, win the trust of more cars and small fleet owners.

Our do-it-for-me or DIFM business with independent installers was negatively affected by the economic slow down in 2009 as volumes with many existing customers were down more than 10%.

We were, however, able to mitigate some of the impact by winning new national account customers during the year. And consistent with the DIY market, we have seen positive volume trends in recent months. While this business is highly price competitive, our strategy differs from competitors as we've demonstrated success in working more closely with installers to improve their operations and sell a broader product line.

Our Valvoline international business, which includes a global commercial and industrial market, now represents approximately 20% of consumer market revenue. During the first half of fiscal 2009, volumes in this business were negatively affected by the global recession, but have stabilized during the second half of the year. Despite the soft demand, this business delivered record earnings in fiscal 2009 as a result of good margin management, expense controls and currency translation benefits.

There are many short- and long-term growth opportunities in this business. One particular focus is on developing business with fleet customers and equipment manufacturers, adding a number of new customers in 2009, including Tyson, and Mahindra, an India-based of global manufacturer of tractors, household equipments and SUVs.

Now turn to slide 15 to discuss factors influencing our margins. While raw material costs and competitive dynamics certainly can impact margins, the Consumer Markets team has made significant progress with internal improvements. We continue to focus on identifying and executing product cost savings opportunities, while maintaining the highest standards of product performance. These initiatives have delivered approximately \$30 million of structural cost improvements in 2009.

DIY business growth, particularly with the growth of our premium segment brands, has had a positive effect on margins. And the Valvoline Instant Oil Change business is also contributing to improved margins.

As we began fiscal 2010, we expect to have a continued dynamic cost price environment throughout the year. We are focused on offsetting any current or future raw material increases, with both pricing actions and further cost reduction initiatives. Although there is a lag in recovering these increased costs.

As we mentioned last quarter, base oil cost increases totaling \$0.40 per gallon were announced in July, although we didn't feel the full affects of these increases during the entire quarter. We announced price increases to customers in August that should nearly offset the impact of the base cost increases. These price increases become effective beginning in November.

Consumer Markets has been a long-term private label supplier to the U.S. warehouse distributor segment, while we have strong relationship with warehouse distributor customers, this business is very price competitive and is expected to have a reduced gross profit this year, lowering the overall gross profit percentage for Consumer Markets by approximately 1% of sales.

Please turn to slide 16 for our outlook. Ashland Consumer Markets achieved an all-time record of nearly \$290 million of EBITDA in fiscal 2009. While we do not expect to repeat this performance in fiscal 2010, we are expecting another strong year as we have positioned Consumer Markets to be successful under a variety of economic back drops.

As we noted in our last call, in June we launched a first of its kind Engine Guarantee program across the United States. Motorists who use Valvoline motor oil regularly can have their engine guaranteed up to 300,000 miles. Early results have been very positive.

Our market share is up significantly in retail auto parts since June including strong share growth of Valvoline MaxLife and Valvoline SynPower. Driving premium mix is initially for Valvoline and for retailers and installers. And one reinforcing data point is that to-date consumers enrolling in the program are registering for the 300,000-mile synthetic use guarantee at twice the rate that synthetics are used by the general population. Of course, the program is designed to drive loyalty to the Valvoline brand.

And at Valvoline Instant Oil Change stores, our research shows a 12 point improvement in the customers' likelihood to return. Our job at Consumer Markets is build on the strength of the Valvoline brand.

Great products performance [ph] is the foundation. We build on that foundation by investing in marketing initiatives that drive consumer preference for Valvoline. And we partner with retailers, installers, Valvoline Instant Oil Change franchisees, consumer fleets -- commercial fleets and industrial customers to strengthen our value proposition in ways that drive their success too.

While the markets that we compete in continue to be highly competitive, we plan to build on the momentum that we have across our businesses for long-term success. And with that, I'll turn the presentation over to Lamar Chambers. Lamar?

Lamar M. Chambers, Senior Vice President and Chief Financial Officer

Thank you, Sam and good morning. Please turn to slide 17. You'll note we've added for this quarterly review, sequential comparisons to highlight some of the near-term trends we're seeing in our sales and earnings.

Turning to Functional Ingredients, metric tons sold dropped by 21% versus the year ago quarter and sales declined by 18%. Regulated markets experienced a 10% volume decline as compared with the prior year quarter, largely driven by the Food segment. This was roughly the same decline as was experienced in the last two quarters.

The energy and specialties business increased versus the June quarter, although volume is still down greater than 50% versus the prior year quarter, due to low levels of gas drilling activity. The construction business was down 23% versus the prior September quarter, and compares favorably with the 28% year-versus-year decline experienced in the June quarter. Our coatings business increased 7% over last year, as our new product introductions continue to generate substantial business.

Regionally, Functional Ingredients volumes were strongest in Asia-Pacific with only a 9% decline versus the prior year. Gross profit, as a percent of sales, increased by 310 basis points over the prior year quarter. SG&A expenses were 2% above the year ago quarter. And bridging between reported and pro forma results, please remember that there were \$9 million of severance expense that affected SG&A.

Overall, EBITDA declined by 16% to \$56 million in the September quarter and represented 23.6% of sales, a 40 basis point improvement over the prior year quarter and 210 basis point improvement sequentially.

Let's take a look at Functional Ingredients' EBITDA bridge on slide 18. As this chart shows, volume reductions drove the lower EBITDA versus the prior year. Favorable raw material and energy costs versus the year ago eliminated a significant portion of the impact to lower volumes.

Pricing was negative by \$4 million in the quarter, while raw materials, energy and freight were favorable by \$17 million.

Please turn to slide 19 for Water Technologies' results. Revenue declined 14% versus year ago quarter, while volumes were down 11%. As a reminder, we sold the Drew Marine business on the last day of August this year. Thus results for the September quarter include only two months of marine business, while the same quarter last year, of course, had all three months.

North American volumes were down roughly 5% versus the prior September quarter, while other regions experienced larger declines. Sequentially, however, volumes were up 7% with all regions reporting improvements, particularly Latin America, which increased by more than 20%.

Our growth markets, which include such markets as tissue and towel, packaging and mining, had sales growth of 10% sequentially, with most other markets also having positive trends. StreamLink, our new low touch [ph] business were selling such high volume products as polyacrylamide, sizing additives and wet strength chemicals, delivered 8% sequential sales growth.

At 36.7% of sales, gross profit significantly improved, primarily due to decreases in raw material manufacturing costs, combined with favorable mix. EBITDA increased by \$31 million to a total of \$66 million in the quarter, representing an increase of 780 basis points to 14.2% of sales.

Let's move to the EBITDA bridge on slide 20. The increases in margin significantly more than offset weaker year-versus-year volumes. Reductions in SG&A, primarily due to integration savings and

reduced travel expenses provided \$18 million of additional EBITDA, excluding currency translation. Currency translation resulted in a \$5 million negative impact to earnings.

Please move to slide 21 for Performance Materials results. Pounds per shipping day declined 25% versus the prior year quarter, an improvement over the 36% year-versus-year decline that occurred in the June quarter. Revenue declined 37% as compared with the year ago quarter.

We continue to believe these declines are consistent with the overall composites and castings markets. While volumes in our composites business was down 21% versus the prior quarter, it was up 4% sequentially, driven by some recovery in the transportation and construction markets and despite seasonably weaker sales in Europe. China was nearly flat versus the prior year quarter and much more profitable.

The castings business experienced a significant 63% volume increase in the month of September versus August, as a result of both seasonality and the U.S. "cash for clunkers" and similar foreign programs.

Gross profit as a percent of sales increased 270 basis points versus the year ago September quarter. It was down sequentially by 280 basis points as increased propylene glycol and styrene costs were not fully offset with price increases during the quarter.

SG&A expenses improved by 18% or \$11 million versus year ago quarter, as a direct result of the cost reduction actions taken during the past year. These improvements were not enough to offset the volume declines, and Performance Materials' EBITDA decreased by 40% versus the prior year quarter to \$12 million or 4.5% of sales.

Please turn to slide 22 for Performance Materials' EBITDA bridge. Volume reductions reflecting the continued weak automotive construction and recreational marine markets negatively affected profitability by approximately \$30 million. Improved margins mitigated half the volume decline. SG&A improved by roughly \$9 million, excluding currency translation in the September 2009 quarter, largely affecting head count reductions. Add it together, these improvements were not enough to overcome the weak demand.

Now let's turn to Ashland Distribution on slide 23. Volume per shipping day decreased 18% versus the prior quarter in the distribution business. Volumes in our plastics and chemicals businesses declined less than 15%, when we exclude the eight percentage points of decline reflecting the termination of our aliphatic hydrocarbons distribution arrangement with Marathon in the March quarter.

Overall sales drop by a third to \$771 million as average selling prices were 18% below the same quarter last year.

While gross profit as a percent of sales was up by 70 basis points over the year ago quarter, it declined sequentially as selling price increases averaging 4% during the quarter lagged product cost increases. We reduced SG&A expenses by 23%, partially offsetting the volume declines.

Overall, EBITDA was down 40% versus the prior year quarter.

Now please turn to slide 24 for Distributions' EBITDA bridge. During the quarter, SG&A expense reductions were not enough to offset the impact of the 18% reduction in volumes.

Now please turn to slide 25 and I'll cover a few corporate items you want to know when you're updating your 2010 models. As you might be aware, we announced on October 1st, that we plan to contribute up to \$100 million of Ashland stock to our pension plan in early November. This

contribution reduces both future funding requirements and pension expense. As a result, our pension expense was only expected to increase by approximately \$15 million for fiscal 2010.

If we adjust our September 30, 2009 funding position for this \$100 million contribution, we would be funded at 83% of our ABO and 79% of our PBO. And we anticipate another \$40 million in remaining funding requirements in fiscal 2010, primarily related to various foreign plans.

Our \$1.6 billion of debt carries a blended interest rate of approximately 8.8%, which amounts to roughly \$140 million a year of cash interest expense. Our reported interest expense includes an additional \$35 million or so of debt issuance costs and other amortization.

Our current expectation is that our full year 2010 tax rate will be in the low 30% range, as opposed to the 22% implied tax rate on our adjusted earnings in the September quarter.

Let me caution you that events in any given quarter can cause significant fluctuation in the effective tax rate for that quarter. There is considerable variability due to ongoing developments and negotiations with government tax authorities around the world, as well as, changing forecast of normal taxable income, including the mix between foreign and domestic sources.

We've also made significant progress on our working capital investment over the past two years, particularly in our Ashland Distribution segment, where we've reduced investment in working capital by more than \$275 million during the period.

For Ashland, overall, trade working capital as a percentage of sales has decreased by roughly 3.5 percentage points. For fiscal 2010, we expect to maintain or slightly improve our working capital in relation to sales. Capital expenditures are expected to be \$200 million for 2010.

With that, please turn to slide 26, and Jim O'Brien will conclude.

James J. O'Brien, Chairman and Chief Executive Officer

Thank you, Lamar. This year has been extraordinary year, both for Ashland and the global economy. Like most businesses, Ashland has taken unprecedented action to cut costs and resize itself to fit, which amounted to be a step wise reduction in global demand.

I'm proud of the work that we've accomplished to position the company to perform well, in what may be an uneven and bumpy recovery and through this period, we have demonstrated our ability to generate cash even in a difficult economic environment.

Our businesses generated over \$1 billion of cash flow from its operations this year. This was primarily a combination of cash earnings of well over \$400 million from the businesses and driving nearly \$500 million out of our investments and operating assets and liabilities, mainly working capital.

We took the cash generated and paid down debt, and we now have \$1 billion less in debt than we did less than a year ago. We have been very focused on aggressively taking costs out of the business, and we have now completed more than \$350 million of our \$400 million cost reduction program.

When this work is finished in fiscal 2010, I don't anticipate introducing any new corporate wide initiatives, although we will continue to maintain our focus on cost efficiency. An important accomplishment in 2009 has been the successful integration of Hercules, in particular the Water Technologies business.

We had historically suffered from lack of scale in the Ashland water treatment business, which resulted in poor profitability. The combination of Ashland and Hercules's water treatment businesses and the shifting of resources and improvement of process have delivered quick improvement throughout this year, despite the economic environment.

We were able to increase EBITDA margins to the mid-teens by the fourth quarter and we expect our progress to continue. And overall, we have achieved \$130 million in synergies from the combination of Ashland and Hercules. As a company, Ashland has also been focused on pricing processes and margin management. You can see the results of this in a business like consumer markets.

Valvoline achieved record results, due to a combination of strong gross margin management, focused marketing and excellent operational performance that increased both market share and same-store sales.

So why invest in Ashland? Let's look at the next slide. Through the acquisition of Hercules last November, we created a global specialty chemicals company with number one or strong number two positions in most of the markets in which we participate. There was sufficient scale to compete successfully.

We continue to be highly focused on cash generation and believe this is important to drive value for our shareholders. Instead of using cash generation for further debt reduction, however, we will use our excess cash flow to increase liquidity, providing increased financial flexibility moving forward.

The work that we have done over the last year has enabled what I believe to be a tremendous value-creating opportunity for Ashland shareholders, and that value creation will come from operating leverage. We have cut nearly \$400 million out of our cost structure, two-thirds of which is permanent. Aggressively managed the other third as volumes recover, it should drive increased margins and profitability over and above historical levels.

While our positions in [ph] less cyclical with growing markets, such as a personal care, pharmaceuticals and water treatment, provides stability through the economic downturns. It is our position in some of the more cyclical industries such as transportation and construction, which may provide disproportionate top-line growth opportunities as these industries recover.

As synergies continue to make their way to the income statement and volumes improve, that is when we will see the real benefits of the operating leverage achieved in this resizing.

I believe that our operating leverage coupled with our strong cash flow generation creates a compelling investment opportunity. With that, we'll take your questions.

Eric N. Boni, Director, Investor Relations

Do we have any questions?

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions]. And we'll take our first question from David Begleiter with Deutsche Bank.

<Q – David Begleiter>: Thank you. Good morning.

<A – James O'Brien>: Good morning, David.

<Q – David Begleiter>: Jim, in the Valvoline, we've begun to see some grade, the base almost higher this week. What's the ability of you guys to offset future base oil price increases for Valvoline?

<A – James O'Brien>: I'll let Sam answer that. Go ahead, Sam.

<A – Samuel Mitchell>: Yes. Just this week we did see one announcement made by Valero on Group I base stock pricing, while we're not a heavy Group I user. There is always potential that Group II stocks could move up in the future, and we certainly are confident that we can implement price increases appropriately in the marketplace to recover our costs. We've shown that over the last number of years in an inflationary environment and we continue to be confident of that.

<Q – David Begleiter>: Sam, what do you think normalized earnings are in Valvoline going forward?

<A – Samuel Mitchell>: Well, certainly we had an impressive year in fiscal 2009. And as we look forward and as I covered in the presentation, we feel very good about the fundamentals on our business. We have good momentum across a lot of our -- a number of our business segments. As we look forward to 2010, we don't expect to have another record year in 2010. But we do expect continued performance at a very high level.

<Q – David Begleiter>: And Jim, lastly, of the non-permanent cost reductions, how much come back in 2010?

<A – James O'Brien>: I think a lot of it is tied to growth of sales. So as sales grow, that's going to potentially drive travel, entertainment, those type of costs as we get more and more engaged with growth orientation with our customers. And we are, I think, changed our perspective of how we view a lot of these costs. I think we've learned how to operate differently, and I think we have a much better highlight, let's say, of cost control because of our SAP implementation. We can now have really strong visibility of what's going on.

So as we look at people's habits and where cost is actually being applied, I think we can manage it more proactively than we have in the past because we have that visibility. So I'm encouraged that we'll do a much better job as we cycle through the next part of the economic growth that we have in the past.

<Q – David Begleiter>: Thank you.

Operator: Now we'll open the floor up to Jeff Zekauskas with JPMorgan.

<Q – Jeff Zekauskas>: Hi, good morning.

<A>: Hi.

<Q – Jeff Zekauskas>: Jim, in old days you used to talk about Valvoline as a non-strategic business, but Valvoline's characteristics have changed over time. Do you still view it as non-strategic to Ashland or has your view changed?

<A – James O'Brien>: Well, as I talked about the businesses of Ashland, the strategy has been to create a unified core around specialty chemicals and we accomplished that when we brought the Hercules and the Ashland specialty side of the company together. So I believe we define the company. So it's more around definition of what the company is, because as you well know, Jeff, as we've transformed the company going from the last three or four years, I think we're getting a much more defined view of what the company is.

So as you look at Valvoline and Distribution, I've described them as close adjacencies. And by that it has to do with their performance around the metrics that are required for us to see them as being a value creating concept to Ashland. For Valvoline, that metric is free cash flow generation as well as a double digit return on sales of EBIT. And where Valvoline is performing today and where I think the business has shifted over the last couple of years through the run up of crude, I think Valvoline has an excellent position in the market and can demonstrate excellent returns for our shareholders.

Distribution is the same sort of idea, where they generate a lot of cash through management of their assets. It's more of an asset turnover business and they need a 3% return on EBIT for us to see a true value creation for our shareholders in that area. As we look at moving forward though, I have made it clear that as we continue to transform into a specialty chemical company, I fully expect that we would over time bring assets into the corporation that more to reflect a specialty chemical type design. And I fully expect over time that assets may leave the corporation. But it really has to come to the alternative investment pieces versus just to say something fits or doesn't fit. It all comes down to the contribution to cash flow and the returns that -- as it provides opportunities for us to serve the shareholders.

<Q – Jeff Zekauskas>: So if I understand what you just said to me. Valvoline is -- is more strategic than it used to be; is that right?

<A – James O'Brien>: I would say everything is strategic if it's meeting its return requirements.

<Q – Jeff Zekauskas>: Okay. And then lastly, in the \$100 million of costs you're going to take out next year, that we'll see in the -- we'll see past through the income statement. How would you allocate the \$100 million across your five divisions?

<A – James O'Brien>: When you take a look at where most of it will come out, a lot of it will come out of distribution. And we've already seen some of it really take place in the fourth quarter a little bit, but they have taken a lot of actions that are required. They'll share a big part of it. Performance Materials will be the next big one. And then, Water will be the third and then Aqualon will have some, and Valvoline will have some.

<Q – Jeff Zekauskas>: Okay. Thank you very much.

<A – James O'Brien>: Sure.

Operator: And now we'll go to First Analysis, Mike Harrison.

<Q – Michael Harrison>: Hi, good morning.

<A>: Good morning, Mike.

<Q – Michael Harrison>: A couple questions on Valvoline. Was curious if you can quantify the additional marketing costs that you incurred during this quarter and how long those costs are going to stick around?

<A – James O'Brien>: Well, we don't disclose the marketing cost per se, but Sam can give you some insight on the new program we had -- on the Engine Guarantee program, may be, incrementally what that might have cost us.

<A – Samuel Mitchell>: Yeah. We have increased our investment behind the Engine Guarantee program. The way we look at that investment, though is, one in which we expect to payout in relatively a short time period. So the additional investment based on the strength of that advertising proposition, and its communication and effect with our consumers is one that we expect to payoff with a solid return on that investment, not in the long-term as you might traditionally look at advertising, but even contributing to our bottom-line performance in 2010.

It is a program that we're very confident in. It reinforces the Valvoline brand proposition with customers. It's timely and that consumers are looking to take care of their cars longer, and therefore, it's something that we want to continue to remind our consumers that Valvoline helps them with their car's performance, and keeping their car on the road, running appropriately, and the advertising campaign does a great job in getting that message across. So it's one that we'll continue to invest in for the foreseeable future.

<Q – Michael Harrison>: All right. May be, let me ask it a different way. Your SG&A costs went up \$7 million sequentially on 27ish million decline in revenue. Can I assume that increase, the delta there, call it close to \$10 million was the cost of the marketing?

<A>: Not the full cost, but definitely the majority of that. SG&A increase was tied to incremental advertising investment.

<Q – Michael Harrison>: All right, got it. And then I was also hoping that you could comment on specifically in September what was going on with respect to volumes and pricing in Valvoline? And if you could provide any comment on what's happening so far in October. It sounds like your pricing increase isn't going to take effect until November 1st, is that correct?

<A>: That's right. So there weren't any price changes to speak of in September or October.

<Q – Michael Harrison>: Right. A question on Aqualon, can you talk about where operating rates are in that business and how those have changed over the past few months?

<A>: Aqualon has, has had a fairly stable quarter as far as pricing. They've done a really good job taking cost out of their system on their fixed cost absorption. They've worked very hard on running their plants and then shutting them down as they build inventory. And then bringing that inventory down and then restarting the plants. We find that much more effective than just throttling back the production rate.

The other aspect is they have been able to get pricing through the last, call it 4 or 5 months. So, when you look at the last two quarters, their margins have increased sequentially. And that's because of the ability to get price as well as control costs through the fixed cost absorption. Jimmy [ph] I think you agree [ph] on that.

<A>: And, Mike, volume sequentially are up a couple of percent. A lot that has been driven by some improvements in the construction market. So we are seeing capacity utilization a little bit better there. We still -- we do have a number of product lines where we are -- we're fully sold out as well. So -- but the big gap, if you will, on utilization was primarily in the construction area. We are starting to see those come back sort of a few percent or so from last quarter.

<Q – Michael Harrison>: When you say you have some product lines that are fully sold out, does that mean -- is that based on your lower production rate or does that mean that you're actually capacity constrained again?

<A>: Well on certain product lines we're actually -- we are capacity constrained.

<Q – Michael Harrison>: All right. And then last question I had is, just a question for Lamar, around this research and development line that's on the P&L. Is that something that was previously included in cost of goods sold and are those R&D costs exclusively related to Aqualon or rather pieces that you would find that come out of other businesses?

<A – Lamar Chambers>: It was previously included in our P&L and the SG&A line as opposed to cost of sales, Mike. It is found in all of our businesses. The Aqualon piece would be a larger share, probably than the average for the rest of our businesses for sure, but that's really across the board from all of our businesses. And we'll be reporting that as we did this quarter as a separate line item in our P&L going forward.

<Q – Michael Harrison>: All right. Thank very much.

<A>: Very good.

Operator: And now we'll hear from Laurence Alexander with Jefferies.

<Q – Laurence Alexander>: Good morning.

<A>: Good morning, Lawrence.

<Q – Laurence Alexander>: I guess a couple of things. First, can you give a little bit more detail in Performance Materials, which businesses were most negative in the quarter or contributed to the loss?

<A>: As we look at the businesses and their performance, the composite area is still pretty weak. We are seeing some sequential improvements in that business. Volumes were up sequentially, call it, to 4% or so on the composite side of the business. So, we're seeing some improvements there. Of course, the castings business, which is pretty heavily tied into the automotive area had pretty difficult July and August as we mentioned in the prepared remarks. Septembers was much better from a volume perspective. But those are the two primary areas of that business.

<A>: The area, Lawrence, that seems to be performing for this business is Asia. Asia is up sequentially compared to quarter three. And we continue to expand our customer base there and that business is still robust and growing. So, Asia is the bright spot in this business.

<Q – Laurence Alexander>: And given the progress you've made on deleveraging, are you still going to be pushing to sell those smaller underperforming businesses or is that off the table for now?

<A>: We still have several negotiations taking place on pieces of business that we think long-term may fit better someplace else. Those discussions are still ongoing. Obviously, the pressure on doing something quickly is no longer paramount. So valuation is critical in these businesses. So as we get the proper valuation for the business and we can agree to a definitive agreement, we would complete.

<Q – Laurence Alexander>: And finally just on the cash flow statement. Are there any other large drains on cash, the outstanding environmental payments or any other items that we should be thinking about for 2010?

<A – Lamar Chambers>: We do, of course, have ongoing requirements for environmental and asbestos would be the two main areas that perhaps we didn't highlight in this call as we've talked about in the past. And we would expect those cash outflows probably to be in the 50 to \$70 million per year range on a net-net of recovery basis going forward.

<Q – Laurence Alexander>: Okay. Thank you.

Operator: And now we'll hear from Stephen Velgot with Susquehanna

<Q – Stephen Velgot>: All right. Yes, a question on the improvement you've seen in Water Technologies margins. I was wondering if you could talk about whether or not you feel that there's further room there for margin improvement, I suppose. We had seen gross margins up in 36% range back in the spring only to kind of come under some pressure in the summer, but the September margin that you reported was quite good, and I wonder what extent you think it's sustainable or you're looking for perhaps even better margins within Water Technologies?

<A – James O'Brien>: I think the -- the story that we have around our water team is probably one of the outstanding stories along with Valvoline this year as far as what they've been able to accomplish. They've pulled together these two companies, Hercules and Ashland and made the right decisions around who the management team is going to be taking the cost out and did that very quickly, which enabled them over the last four months to really get focused on the marketplace. And we probably got there, I'd say six or seven months sooner than we -- our original plans would have dictated.

So as they got more engaged with the marketplace, the decisions we're making now is around which mix are they going to sell, which product lines, how they're going to build the story about support of the customer. And they're doing a much better job I think of providing a real value creation opportunity for their customers through the offering and how they service that and the methodologies they're using about going about that. I think we're much more competitive than we ever have been.

So as a consequence we've been able to, I think bring a better product mix to bear. As you look at the whole sales mix, it has improved. And I think that as we have gone and serviced the customer, we've got a larger share of wallet, which has helped us through our service costs and that service leverage, which was really the biggest detriment we had in the model previously.

So, I think there's a lot of different changes, and this is one of the primary reasons we did the Hercules deal, is to bring these businesses together to give us a much better foothold in this very important marketplace. And I'm convinced that we have a competitive model now, that's going to deliver double-digit EBITs, which is one of our primary objectives and create the cash flow out of this business that I think you can -- it can deliver. So, our water team, I think, is just beginning to show performance. So I'm very encouraged with what I saw in the last quarter and I think '10 should continue to improve from there.

<Q – Stephen Velgot>: And just a follow-up on your answer to the question about the strategic rationale for Valvoline. I suppose I'm a little -- still a little confused as to, now that some of the other businesses are showing some traction, whether or not long-term you think Valvoline belongs as part of Ashland even if it's generating the kind of returns that you think help shareholders. Why it doesn't behoove Ashland's shareholder to potentially have that as a separate security?

<A>: Well, I think that that's always something that we review and certainly understand your question. And it really comes down to alternative value and the value creation idea. I think what Ashland has demonstrated over the last seven, eight years we are very active with and analyzing how we can create value for our shareholders and we are not reluctant to make change when it truly does create value. I think the environment that we're in today with alternatives for assets, the value creation just isn't there in today's market.

<Q – Stephen Velgot>: Thank you

Operator: And now, we'll open the floor up to KeyBanc's Mike Sison.

<Q – Mike Sison>: Hey, good morning, guys.

<A>: Good morning, Mike.

<Q – Mike Sison>: Hey Sam, if I did the math for gross margins for Valvoline, did you end up in September somewhere in that 32, 33, given that you were running at 37 through August, and if you get the price increases in November that offset that \$0.40 increase, wouldn't gross margins go back to that 36, 37% range?

<A – Samuel Mitchell>: Well as I noted in my comments earlier we do have other factors that put pressure on margins and certainly the private label business is one significant factor that the business that we have with a number of warehouse distributor customers, because -- where we don't have the leverage of the Valvoline brand certainly the competitive pricing environment puts more pressure on those margins, and so the margin strength that Valvoline has does vary somewhat from one part of the business to another, and so that's reflected in our outlook for fiscal 2010.

<Q – Mike Sison>: Right. All else being equal, it would have went back to 37, though, assuming you got the price increases?

<A – Samuel Mitchell>: Yeah, over time, yes. The issue with cost increases hitting the business, we tend to have a bit of a price lag and fully recovering those margins.

<Q – Mike Sison>: Your assumption for gross margins for 2010, given that you have a very easy comp in the first quarter obviously --

<A – Samuel Mitchell>: Correct.

<Q – Mike Sison>: ...would be what somewhere in the low 30s at this point to get to that sort of down from 2009 type of outlook?

<A – Samuel Mitchell>: I think you're -- I think you're in the right range. We certainly do have a favorable comp versus the first quarter. Our margins improved last year in the second and third quarters, particularly spiking due to some timing in the third quarter. So, third quarter will be a pretty tough comp, but I think in general you're in the right range.

<Q – Mike Sison>: So if the base -- if you actually catch up with pricing throughout the year, given, some of the offsets you talked about, the good odds if oil -- base oil doesn't incrementally go up every quarter, you would actually probably could do a little bit better than that type of outlook.

<A – James O'Brien>: Well, Mike, this is Jim. I think that as you all can think of Valvoline for '010, we think that with what they produced last year was just a phenomenal performance and we think it's going to be very, very good. But we don't think it's as good as last year.

<Q – Mike Sison>: Got you. Then could you give us a little bit of insight on water treatment and Aqualon for [indiscernible] in terms of sort of – and given that there should be hopefully some recovery in economic demand over the next 12 months given cost savings, would you expect -- maybe some color on whether earnings would improve versus '09 and maybe to what -- to some degree?

<A>: I'd say that the way we've managed the company where it's positioned right now, we will make a profit that would be reasonable given a flat demand curve. So if demand is totally flat, you can kind of look at last year's results and give you some perspective of what you think the business can perform.

Now if there is any, any growth in the economy, what we've been trying to do is have some leverage inside of Ashland, so that as that growth occurs we think that we have a cost structure and margins now that as we put more top line growth on it, it should be very dynamic to the performance of the bottom line. So as you look at the metrics that we have in the business today, as you put growth on that, it should have a very, very strong down draft on earnings. It should produce some pretty decent earnings.

<Q – Mike Sison>: Right. Thank you.

<A>: Thanks, Mike.

Operator: And now we'll hear from Dmitry Silversteyn with Longbow Research.

<Q – Dmitry Silversteyn>: Good morning. A couple of questions that I want to follow up on. When you announced your price increases for Valvoline to offset the increase in base oil price, are you -- is your magnitude of price increase basically designed to offset what's already been announced? Or are you trying to anticipate where base oil prices are going to over the next quarter? I'm just interested in the pricing mechanism.

<A – Lamar Chambers>: The market is typically moving after base stocks have increased or additive costs, raw material costs have increased. So that tends to create that lag effect.

<Q – Dmitry Silversteyn>: Okay. So you're playing catch up, in other words, rather than trying to anticipate where the pricing will go and adjust your price accordingly?

<A – Lamar Chambers>: Exactly.

<Q – Dmitry Silversteyn>: Okay. All right, thanks. And then I just want to clarify what you meant by getting debt down to the level that you were targeting and now using your cash generation to improve liquidity, are you talking about building cash in the balance sheet for some strategic actions down the line? Or will you still be paying down debt from these levels?

<A>: I believe that where we have achieved our debt pay down, we met our objective. So what we would do with the free cash flow in the future, we will accumulate that on the balance sheet as cash, and then evaluate our alternatives from there. Do we look at, tuck-in acquisitions that may come our way? Do we increase dividend? Do we buy back stock? I think that we would look at all kinds of alternative ways to increase value for our shareholders, but the first objective is to create some capacity to make those decisions.

<Q – Dmitry Silversteyn>: Okay. I understand. What do we need to see -- you talked about economic recovery obviously, it definitely has to be broader, it can be specific sectors that are recovering or specific regions. So, what do we need to see in terms of economic recovery in 2010 in markets or geographies to improve the performance of the Performance Technologies and the Aqualon businesses?

<A>: I think Aqualon the dramatic growth will come out if there's any improvement in the construction market in Europe or Asia. Any strength there would translate very well into a marked improvement in that business. As you look at Performance Materials, it's automotive and construction and mainly the United States, some in Europe, but they already have some decent growth in Asia. So for those two businesses inside of Performance Materials is more of a U.S. story. If U.S. improves, it will improve more dramatically. Aqualon is more of a European-Asian story. If that improves, it will get better.

<Q – Dmitry Silversteyn>: Okay. That's very helpful. And then final question, you talked about the foreign exchange impact on earnings in profits in the quarter. Can you give us understanding of the sensitivity of foreign exchange rates to profitability. In other words, when the dollar changes by whatever pick a number a penny, what impact that it has on the basket of currencies and the profitability of the operations?

<A – Lamar Chambers>: As you can see from the bridges that we went through, we had a little over a \$10 million impact on the quarter from the currency exchanges. About five net, I guess all together; 1% change, roughly in the exchange rate of the dollar against our foreign currency, it gives us about a \$2 million effect on our P&L when it's all netted together.

<Q – Dmitry Silversteyn>: Okay. Lamar. That's very helpful. Thank you very much. That's all the questions I have.

<A>: Very good.

<A>: We have time for probably one more question.

Operator: Okay. We'll take our final question from John McNulty with Credit Suisse.

<Q>: Hi. This is actually Obin Heikenen [ph] for John.

<A>: Good morning.

<Q>: I was just wondering how long it would take you guys to recover the raw material increase in Performance Materials. So, basically can you implement price increases in the first quarter that will largely offset that or will it take longer?

<A>: Normally the -- these price increases have lagged about two to three months by the time you announce them and you work it through the system, so -- and with the demand there being so weak, I would say at least two to three months to get those prices through.

<Q>: Okay, that's helpful. Thank you.

<A>: Okay.

Operator: And I'll turn it back over to Mr. Boni for closing remarks.

Eric N. Boni, Director, Investor Relations

Thank you for your participation in the call and we look forward to speaking to you in the future. Thank you.

Operator: Ladies and gentlemen, that does conclude our conference for today. Again, thank you for your participation.

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