

Q1 Conference Call 2007

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April 20, 2007 10:00 a.m., CST

Operator: Good day and welcome to the AMCOL International First Quarter 2007 Earnings Conference Call. Today's call is being recorded. A replay of this call will be available starting at 12:30 p.m. Central Time today. You may access the replay by dialing 888-203-1112 and referencing pass code 3363334. Speakers today will be Mr. Larry Washow, President and Chief Executive Officer and Mr. Gary Castagna, Senior Vice President and Chief Financial Officer.

At this time, I'd like to turn the call over to Mr. Larry Washow. Please go ahead, sir.

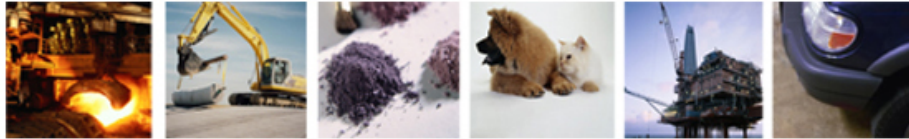
Larry Washow: Thank you and welcome, everybody. Hopefully you've had a chance to take a look at the press release that went out this morning. We described this sort of interesting quarter. The headline numbers here, 15 percent; operating profit up 22 percent, so we definitely had another quarter of solid growth, although as you note throughout the press release, much more of that came from our acquisitions than in the past quarters.

Looking at some of the details, minerals, we did have some sales growth there. Modest, though it was, but we did see improvement in the gross margin, which was encouraging. Issues there primarily related to the U.S. metal casting market and there's no question that we are seeing a slowdown in the U.S. market automotive related as well as the heavy truck and that's something we don't really see a dramatic change for the balance of the year anyway. So we expect that to continue.

Some of the slowdown there has been offset, though, by strength in our products, in our detergent market places and international markets continue to be strong albeit growing at nice levels, but certainly not having significant magnitude impact that will offset the entire metal casting slowdown in the U.S.

So the mineral side, the encouraging thing, margin growth continued sales growth but obviously not at the kind of levels that we would like to see.

Environmental ((inaudible)) environmental and I think it's important to keep in mind before the environmental segment that this is the most cyclical of our businesses. Q1 is typically very unpredictable and there actually was a lot of weather impacting Q1 both in the U.S. and Europe. In spite of that, a good quarter, but certainly our expectations internally were actually going to be stronger than we delivered here.



But good solid growth pretty much around the board. And again, we expect them to have another very good year.

The disappointing part of Q1 undoubtedly, oilfield services, certainly good sales growth. Virtually all of it coming from acquisitions – acquisitions delivering nice margins as well, which is exactly what we would expect. A couple of issues here, one of them is the comparison actually to Q1 2006. Our base business in 2006 was very strong in part because of the cleanup efforts going on as a result of Katrina. There's a tremendous amount of work in the Gulf of Mexico and the pipelines that have been damaged and destroyed throughout that process, and we were extremely busy in that whole project for most of the first quarter and well on into the second quarter. That business obviously was completed and that's been replaced by smaller projects and many more of them, so it takes a little bit more business level in terms of activity to achieve the same type of result.

So the ongoing business was pretty flat for oilfield services. The plus side there, again, the acquisitions do provide the benefit we though. Right along with the acquisitions sales revenue does come the overhead, and you can certainly see the impact again on the oilfield services group in the overhead line.

The transportation sector, certainly soft all the way around. A little bit of our own business soft as well as external business. Saw a couple of articles recently in the financial press about the transportation business, and there's no question that the freight movement total volume is down quite a bit this year first quarter over last year. So not a surprise there.

So that's the quick summary. I'll ask Gary to provide some of the financial highlights and then we'll open up for questions.

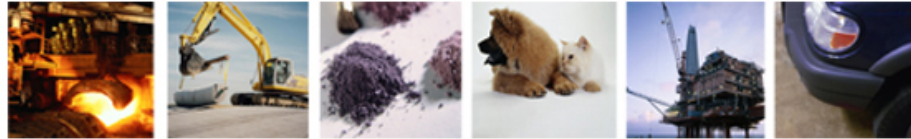
Gary Castagna:

Good morning, everyone. I'll focus my comments around the financial overview section of the earnings release.

The release includes – starts with the overview of our businesses, and sales growth components over the – and this is a consolidated sales growth components by base business, acquisitions and foreign exchange, and those impact points relative to each of our operating segments. And as I think, again as Larry mentioned, going into this part of the presentation, base business levels certainly the growth in aggregate quite modest at 2.7 percent increase overall over last year's \$143.8 million revenues. Acquisitions actually did quite well overall, really meeting our expectations in the quarter especially from the oilfield services area, and also in the mineral segment area for the acquired businesses.

And foreign exchange, a benefit principally with European currencies, the British pound, which is about 10 percent, stronger against the U.S dollar at this point in the year verses last year as well as the euro and Poland's (zloty) since we've got pretty substantial operations in Poland. But in general as you well know, foreign base currencies, generally stronger against the dollar than they were this time last year.

Another positive development in the quarter is gross margin, which improved to 26.6 percent verses 25 percent last year. All three segments, the operating segments improved over the prior year quarter, particularly with minerals, an area that we focused improving gross margin. Despite the reduction in the domestic metal casting business, improvements especially in both (pet) products as well as the specialty minerals areas, improve that margin line. So hopefully that is a signal hereafter of a continued improvement.



General, selling, administrative expenses increased 22 percent, \$5.1 million over the prior year. Again, we mentioned here that that is an increase commensurate with the growth, the rapid growth we're seeing in the oilfield services area as well as in total amortization expenses associated with the intangible assets that we report recorded with these acquisitions. I did not have a chance to include it in the release, but the overall impact of amortization expense in the quarter for intangible assets such as customer relationships, trademarks, et cetera, that we have is about a million dollars. So almost 20 percent of the increase over last year's GS&A had to do with amortization charges.

Operating margin improvement by 60 basis points over the prior year, again, following the improvement in gross margin. And in general, the movement as well as the mix of our businesses this year again because of the more rapid growth of the environmental segment, rapid growth in the oilfield services segment. Those businesses tend to have a higher both gross margin and operating margin levels than the traditional minerals based businesses.

Obviously another pronounced element of operating results and also our financial position is the interest expense. A \$1.5 million increase commensurate with the borrowings to fund the acquisitions towards the second half of last year. Effective tax rate pretty well is in line with our expectations here. Very slightly adjustment in the quarter for tax positions, but in general, no impacts outside of the normal tax basis of the company. Joint ventures and affiliates again, strong supporting us with five percent share of earnings. Again, India continued to look pretty strong especially in commodity based businesses there in ((inaudible)).

And just kind of quickly in to our financial position overview, you could see again with the interest expense commensurate with higher debt levels, you kind of see this really getting toward a peak level as the first quarter of the year tends to be a quarter where we're not generating as much free cash flow basis. And you can see obviously from the statement of cash flows, \$27 million of acquisitions plus a little over a 11 million, excuse me, close to \$11 million of capital expenditures all requiring funding levels that brought the debt to \$155 million at the end of the quarter, and also, working capital, an increase from the end of the prior year.

The one other element on working capital, as we are growing the environmental, the oilfield service, and international base businesses, and we've commented on this in the past and it continues to show here, they tend to have a higher working capital demand than most of our domestic base businesses.

Another positive element during the quarter, cash flow from operating activities actually was a positive 6.3 million, as opposed to actually a deficit of 4.1 the prior year. And again, that also points to the relative impact of non-cash charges in our income such as the higher depreciation and amortization charges.

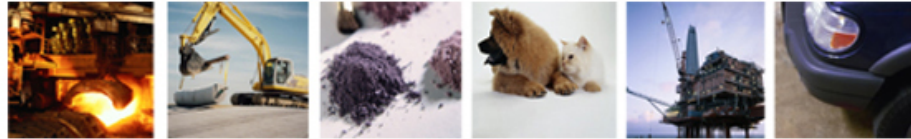
With that, I think we've hit the high notes and I look forward to your questions.

Larry Washow:

All right. Shelly, let's open the call for questions if we could.

Operator:

Thank you. If you'd like to ask a question today, the question-and-answer session will be conducted electronically. Simply press the star key, followed by the digit one on your touch-tone telephone. Please make sure your mute function is turned off to allow your signal to reach our equipment. Once again, it's star, one to ask a question. /p>



We'll take our first question from Jay Harris. Please go ahead.

Jay Harris: Good morning, gentlemen.

Larry Washow: Good morning.

Gary Castagna: Good morning.

Jay Harris: Very thorough press release and comments.

If we characterize the first quarter as having very little organic growth, when do you think organic growth will resume?

Larry Washow: That's a good question, Jay, and it's a difficult one to answer because U.S. metal casting markets that I mentioned, we don't really anticipate that rebounding any time soon, and that's a large chunk of business. The organic growth outside of the U.S. and in Asia is continuing very well, but on a relative basis, it's obviously not at the same magnitude.

The environmental, I think we'll see continued organic growth there. They should be very much on track with a historical. Oilfield services, a lot of the acquisitions provide more benefit to the overall business obviously than some of the original businesses. But we continue to focus and try to develop the original businesses not just in the Gulf of Mexico but around the rest of the world.

So, I guess the long and short answer would be, we're definitely going to see I think a little better organic growth in the quarters ahead. But to get back to the sort of double-digit rates that we've had for a few years, I think that's going to be several quarters out there.

Jay Harris: You've now leveraged the balance sheet to about one-third debt to capitalization. Does this mean you'll slow down looking for acquisitions?

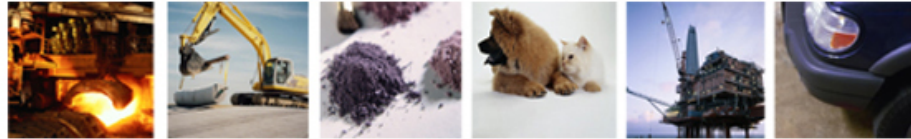
Male: Well, I think we'll – I mean, obviously, the acquisitions process is an ongoing one. As I mentioned on past calls, we ended up (finding) a few all at one time over the last six to nine months. I think that was a fairly unusual situation where we had three or four come together at the same time. But there are still some out there that are sort of interesting that may develop over the course of this year, so I certainly wouldn't say we're stopping. But obviously we do recognize the impact on the balance sheet and the need to really generate cash and begin to work down the debt.

Jay Harris: And one other question coming back to the answer to the first question, what percentage of metal castings is U.S. on a world wide basis?

Male: About over 80 percent, Jay. Probably ...

Jay Harris: So the vulnerability there would exceed any expectation of growth outside of the U.S.?

Larry Washow: In that specific market segment, that's correct. We really have very good growth, you know, certainly in places like China and throughout Asia. But on a relative basis, you're right, it would be very difficult to pick up the overall growth rate as it were without the U.S. kind of coming back.



Jay Harris: All right. Thank you.

Larry Washow: You bet.

Operator: We'll now move on to our next question, from Richard Wesolowski. Please go ahead.

Richard Wesolowski: Thanks, good morning.

Gary Castagna: Good morning, Rich.

Larry Washow: Good morning.

Richard Wesolowski: Gary, what was the geographic breakdown of sales?

Gary Castagna: I didn't get a chance to (finalize) it. It was about 70 percent for North America, with the oilfield service particularly. That's what (slants) that part of the equation. So it was about 70 percent North America, about 22 in Europe, the (e-mail) area and the rest in Asia Pacific, about eight percent; a slight uptake in Asia Pacific and Europe in comparison the first quarter of last year. Maybe one percentage point moved in the favorable direction in both of those geographical markets.

Richard Wesolowski: OK. And when as the real meat of the Katrina work you did in 2006?

Larry Washow: The real bulk of it was in Q1 2006. There were something carried into Q2, but it really sort of finished up at the end of 2005 and then into Q1 2006.

Richard Wesolowski: OK. You mentioned that in the press release that you were disappointed in the oilfield profitability. Does that just signify the overhead that you mentioned or are you implying that the segment can or should generate a gross margin above the level we saw in Q1.

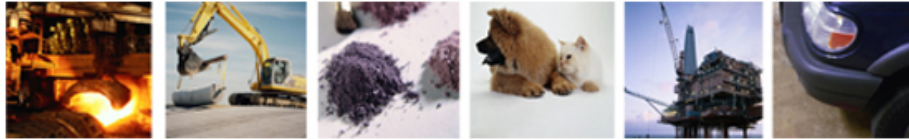
Larry Washow: Well, the gross margin is pretty solid where it is. But I think certainly to generate enough sales to get an operating profit at a better level is what I was disappointed in. And I do believe the (process) is out there to do that, but we certainly have to improve the top line to get there.

Gary Castagna: Yes, and there is a bit of a fixed cost element in oilfield. It's not nearly to what we would we have in a traditional manufacturing business. But if you look at it at a sequential basis indeed the gross margin's down. But if you get the sales levels looking to where we believe they can resume to, then the gross margin will go up accordingly.

Richard Wesolowski: OK. The margins actually look good even though the sales growth wasn't as strong maybe as in prior quarters. I know the acquisition had a higher operating margin, but is there also pricing strength in some of your products?

Larry Washow: There is, certainly there is, Rich. You know, you look at some of the equipment requirements in the oilfield, the lead time to equipment built is stretching all the time. So, the fact that we now have unique rentals, for example, provides an opportunity where we can step in and have that equipment available to ourselves or to other customers are value to both of us internally and externally to have that. So, very nice margins from that business.

The nitrogen business, very similar, there's high demand for that product and as a result, we're



able to deliver very good margins.

Richard Wesolowski: Are these the type of quarterly dollar SG&A increases that we should expect in '07?

Larry Washow: There's a fair bit of oilfield services that's somewhat fixed in that category as far as amortizations and some that obviously came with the acquisitions. So, in terms of a numbers, orders of magnitude. I think the dollars are probably, you know, in the right range. It'll – the increase changes as we get towards the latter part of the year where we had some of the business already incorporated.

Gary Castagna: Yes, you do get a bit of an income comparisons with the GS&A side that one prior year period might have had some benefit to another. I'd say \$5.1 million and extrapolating that to 20 million for the whole year, that would be a bit above our expectations I think by the time we get to the end of the year.

Richard Wesolowski: OK, and finally, with all that in mind and all the recent business integrations, what sort of operating margin do you hope to generate out past '07, you know, in '08 and in '09?

Larry Washow: Well, the good news from our perspective, and there's quite a bit of it actually, is the acquisitions are providing a higher margin in most cases than some of the traditional businesses, and that's not to say we don't expect or have aspirations to improve even on the traditional businesses. But I think we can, you know, the first quarter, pretty good operating margins and I would expect that to continue and hopefully trend up as we get through the year and into 2008.

Richard Wesolowski: Great, thank you.

Operator: And once again, if you'd like to ask a question, it's star, one on your touch-tone telephone. We'll now go to Al Kaschalk, please go ahead.

Al Kaschalk: Good morning.

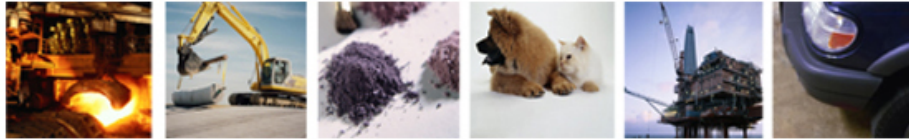
Larry Washow: Good morning, Al.

Gary Castagna: Good morning, Al.

Al Kaschalk: Just to follow up on the acquisitions and in particular, oilfield services. If you looked at what you disclosed in the press release and the revenue and the operating profit that was contributed there, it looks like around 16-and-a-half, 17 percent, yet the segment for oilfield services was in the 14 percent on an operating basis or 17 last year. So my question is, is there some one-time charges that occurred in the quarter or are – was there some business that was sort of weaker on the margin front in the quarter that you don't expect going forward?

Gary Castagna: Yes, I think the – yes, you're citing it in aggregate, the acquisitions – the margin on the acquisitions, right, Al?

Al Kaschalk: Sixteen to 17 percent. And if you break it down, I mean, a majority of that really is obviously in the oilfield services. That's what – that's why we stay there. And I think what it's implying, especially when you look at the GS&A in the oilfield, which is up quite a bit, that there is going to be a part of that that's attributable to the acquisitions, principally the amortization that I



just mentioned. But it also because you have higher base level GS&A expenses.

So I'd say the answer there is that you probably have a fairly, actually know then I think across these acquired businesses in terms of operating margin improvement, you know, those in the minerals and environmental. Actually the environmental probably was the lowest in terms of contribution from the acquisition standpoint. It obviously is from the revenue and also from an operating income level.

And I think that the, in aggregate, the oilfield services operating margin acquisition is not very far off of that aggregate amount.

Al Kaschalk: OK, so ...

Gary Castagna: Even (a bit above).

Al Kaschalk: Right. So, I guess what we should be thinking about, 15 percent of operating margin is not what you have internal targets for oilfield services?

Gary Castagna: That's correct.

Al Kaschalk: All right. In terms of the Katrina questions that were asked earlier, can you quantify how much of the revenue in Q2 in '06 you received from Katrina?

Gary Castagna: We actually don't have that exactly available. In aggregate for the entire year, we have an estimate of between five to \$6 million, and probably betting on that, Al. And I think even some of that might have been in '05, too.

So if you look at just the '06 effect, you're probably looking between four to five million. I think a good chunk of that was the first quarter and a bit less for the second quarter.

Larry Washow: But the majority of that ...

Gary Castagna: ((inaudible)) third quarter, too. I mean, it was quite a bit of a recovery after ((inaudible)) through the year.

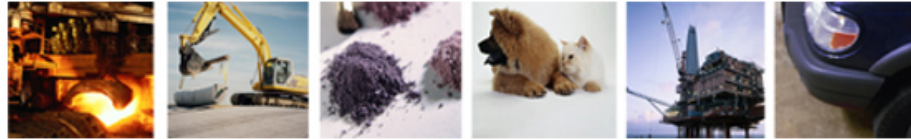
Larry Washow: The majority was in the first quarter and then tail end into Q2 and a little bit into Q3.

Al Kaschalk: Sort of a two-prong question, but with the increase of some of the overhead cost of the business, how should we think Q1 represents the full year contribution from an ESP perspective? Because I think some of us, including myself here may have missed a little seasonality in the business that I think is getting a little bit more pronounced based on some of your acquisitions.

So I was wondering if you could comment more, I guess, from a macro level.

Larry Washow: OK. You know, ((inaudible)) overall certainly, the first quarter as long as I've been here, which is a very long time, has been the most difficult to predict because the weather impacts obviously on the environment sector are significant. Now that Asia's becoming a bigger part, you've got the Chinese New Year thing, which has an impact on us.

And so traditionally if you look back at our history, the first quarter is usually the lowest.



Sometimes the fourth quarter if it's really bad weather will match it. But we do expect to see the second and the third quarters continue their traditional very strong results and we do expect a good solid fourth quarter as well.

So from the standpoint of looking ahead, internally, you know, we're very comfortable that this is going to be another very good year. In the first quarter was not a big shock or surprise in terms of kind of where we had surmise we might be. So, we're still looking for a good solid year.

Al Kaschalk: And then on the gross margin from the minerals, you certainly eluded to the positive impact that the non-metal casting businesses contributed. Are we at a spot now where, at least on the detergents and HPS, that that should continue?

Larry Washow: I think on the specialty minerals and those two in particular, yes, I think that's going to be a very nice contribution throughout the year and beyond.

Al Kaschalk: All right. And then finally, in terms of discretionary cash flow or free cash flow, it sounded like you didn't rule out any more MNA activities, but how do you look to cap ex for the full year? I think we've talked in the high-30 million number for the full year, but what about the rest of the balance of cash flow?

Larry Washow: With cap ex in particular, I think last year was about 42 million and 10 million in the first quarter. That's kind of a spending rate I think per quarter, Al. But you ought to be looking at is that \$10 million range in terms of the cash flow.

Gary Castagna: Well, I think, an extrapolating from there, what we will also anticipate throughout the year, Al, will be some more investments perhaps in our JV efforts to not as great amount in there, but there are opportunities both for India in particular and perhaps some other areas, where we'll have some other investment spending.

But we do see, and I think it was a positive start to the year, that operating cash flow is at pretty good pace. And obviously, we factor in the accretive benefits and I think the cash flow's attributable to the acquisitions and the accretive benefits in particular should be pretty good.

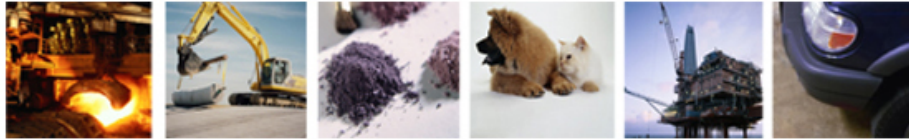
So we had a good start from that perspective, and I think the operating cash flow line is going to be a pretty important line for us to be focusing on this year because that obviously is going to drive more of our investing activities as the year goes along. And I think the outlook is reasonable there.

So we're not going to rule out MNA at this point, because we think the funding – excuse me, the cash flow with these acquired businesses plus our base businesses, should be more ample to support more activity out there.

Al Kaschalk: And then finally, this is much more macro here, in terms of cost or expenses, can you talk about the environment that you're seeing, and particularly relatively to your expectations, are you seeing cost settle or a little bit higher than maybe you thought going into the year?

Larry Washow: In my dream world, I guess I'd hope that oil prices had peaked somewhere along the way, but obviously with the spike over the last few weeks, although it is coming down a bit today, that remains kind of a wild card. We anticipate and expect it to be a fairly high level all year, and that certainly has an impact on our operations and transport of our material. A lot of that does get passed along to customers, but there's some internal costs obviously that don't.

So that is about the only area that I would say we're now pretty comfortable. We've got a good handle on the cost side and we certainly continue to look for ways to improve productivity and be



more efficient as well.

Al Kaschalk: Thank you.

Operator: We'll now take a question from Richard Wesolowski. Please go ahead.

Richard Wesolowski: Hi, thanks again. Gary, could you just go into a little detail about the plans to (stem) the extension of the cash cycle as you generate more and more income from foreign markets?

Gary Castagna: Well, yes. That's a diligent and in fact ((inaudible)) in terms of the working capital use is really what it's getting down to. And I think you've got a couple of different areas there.

One, in the Asia Pacific area, a lot more focusing in on, you know, just really trying to make sure that we are not over extending on the areas that we can control, that being with customer base and I think that's OK. And the other part of it is inventory levels, and I think we're in better shape there although, you know, shipping markets sometimes have to dictate our inventory level whether we're moving and bringing inventories to these overseas locations. We do export a lot of our base material here in the U.S. to support our international operations, and the bulk shipping rates have actually been trending up. That also has an effect on these inventory levels by the way, that you see year-over-year. The (landed) cost, the bulk materials in some of these markets is going up and it doesn't look like it's actually subsiding. Part of that is because of the dollar weakness. Everything is just being pegged to a dollar base rate.

So the bottom line is that we've got some plans in place certainly to do a better job on the working ((inaudible)) so my goal had actually been more of a – into the 160-ish type of range. And it I still see that that's a decent goal over a period of time here.

Again, I still think that operating cash flow levels will fall through commensurately with that.

Richard Wesolowski: Have you seen any relief in the last quarter or two in the domestic rail shipping rates?

Larry Washow: Not at all. Most of our contracts though are annual contracts, so a lot of them come up in the summer and fall. But I would still be very surprised if we had any relief there, Richard. We're going to work hard to try to do that, but even though there is a bit of softness out there compared to last year, I think the rail ((inaudible)) still ((inaudible)) got a pretty strong (virtually) monopolistic position in many of these operations.

Richard Wesolowski: OK. And it looks like between 2006 and 2007, about \$90 million in the payments for acquisitions and ((inaudible)) that's about it, right?

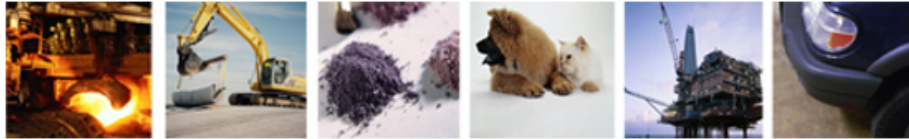
Gary Castagna: Yes, I think in aggregate that's about the number, Rich.

Richard Wesolowski: OK, great. Thank you again.

Larry Washow: Thank you.

Operator: As a final reminder, it's star, one if you'd like to ask a question. We'll go to Jay Harris. Please go ahead.

Jay Harris: If we could come back to metal castings, could you share with us some of the



thoughts you might have on range of revenue declines that you might anticipate in your U.S. operations this year?

Larry Washow: The metal casting, the sort of business levels anyway are probably down sort of five-ish percent from what the year ended up last year, and it varies quite a bit by customer. There are some customers that are quite busy and others that are slow. Lots of speculation when the heavy truck market will pick up again. The slow down there was actually predicted in that the change in the engine requirements ended up that lots and lots of people added new equipment last year, so the expectation was that would slow down this year. It doesn't fundamentally change the recycle requirement for heavy trucks. So the expectation is that that market will start to pickup from where it is now sometimes towards the end of the year, certainly into early 2008.

It's hard to know. I mean, if the automotive market stays where it is, we would expect it to be kind of stabilizing at this level. If it continues to drop, then we don't track percentage for percentage but it certainly is a pretty good indicator of what our business is doing.

Jay Harris: So in the first quarter, you're down about five percent domestically?

Larry Washow: In terms of the metal casting ...

Jay Harris: Yes.

Larry Washow: Yes, something like that, right.

Gary Castagna: Yes.

Jay Harris: OK, thank you.

Gary Castagna: Business-wise, that would probably be right.

Operator: Once again, if you'd like to ask a question, it's star, one on your touch-tone telephone. Star, one to ask a question and we'll pause for just a moment.

There appears to be no further questions at this time.

Larry Washow: OK, (Shelley), thank you very much. That'll wrap up the call today. I look forward to talking to you again next quarter. Thank you.

Operator: That does conclude today's teleconference. Thank you for your participation and have a lovely day.

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