Q2 2009 Conference Call

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Operator: Good day and welcome to the AMCOL International's second quarter 2009 earnings 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 6095554.

The speakers today will be Mr. Larry Washow, President and Chief Executive Officer, and Mr. Don Pearson, Vice President and Chief Financial Officer.

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

Larry Washow: Thank you, and welcome, everybody. By now I hope you've had a chance to take a look at the press release that went out this morning. Obviously, a very interesting quarter from many different perspectives.

So we're going to change our format just a little bit today, and I will start here in just a minute reviewing the segment information as I usually do. We'll have John talk about -- or Don rather, talk about the important metrics in the financial side. And then I'll come back and just talk a little about some of the macro indicators and some of the things that we look at in trying to figure out where these markets are going.

But for now, obviously, a difficult market from a revenue side all the way around. But if you look at minerals in particular, we saw our biggest drop in sales of any of the segments across the Company, primarily related, as you would expect, to the metalcasting market, but also the petroleum products. Oil drilling, very, very soft given the price of oil and the gas activity these days. Additionally, the pet products market was pretty good. Now, it does show on our segment reporting that the sales were down 19% in pet products, but actually the vast majority of that is freight as we switched customers from prepaid freight to FOB plans. So the business is pretty steady as she goes and doing well. So that's one of the good points I think overall for the mineral side.

The other good point is the margins, certainly not where we want to be on a long-term basis but with margins given the volume declines and the revenue declines still hanging around that 20% range, I'm pretty pleased that we're able to do that, so that is the good news I think, and we'll talk about that for the other segments, as well.

Environmental, a similar quarter-over-quarter decline on a percentage basis. In that case when you look at the different components, building materials is a smaller part of the Environmental segment but an important one in that it tends to be higher margins, and not surprisingly with the decline in commercial construction, as we've talked about, that is dropping quickly, and recovery time there undoubtedly will be quite some time.

Lining Tech is also down, and in the past we've talked about the different markets that we serve with our Lining Tech products. Certainly, landfill continues to be a very important one, and as we've talked about in the past on a consumer basis the landfill waste, the waste that goes into a landfill, I should say, during a recession does decline slightly on the consumer side. The bigger impact and the reason we're seeing a slow-down in some of the landfill activity is construction products represent a substantial amount of waste, as well, and industrial products, too.

So what we've found is that with the residential construction down as much as it is and commercial construction, municipal operators who had expected themselves to be full by now based on the activity the last couple of years, are seeing that the rate of increase and the amount of material going into the cells is lower and so they don't really need to build a new one as quick as they thought. Plans are still there, projects are still there, but the timing obviously in some of these cases has been pushed out quite awhile.

The good news there (Environmental), as well, gross margins hanging in there, 35% for the quarter, and with the Environmental business getting into their stronger quarters, we expect to see some pretty good results there in Q3. The challenging area for Environmental is operating profit, and we're definitely working on that.

Oilfield Services has a very difficult comparison with Q2 of 2008. That was their all-time best quarter. In fact, if I recall correctly, I think at one point we had virtually every piece of equipment and every person we had out on a job. At the same time in mid quarter (Q2 2008) had purchased the coil tubing business. That business came in from day one, it was a nice contributor, as well.

Obviously, the world has changed and the markets are much, much softer. The activity level is down dramatically, although we still see good positive results from our filtration group and the deepwater, to the degree that the projects are out there we're certainly getting our share, but obviously activity even in that area is slowing down.

The Transportation Group I look at as sort of a reflection of overall market activity. You'll see the sales down 31%. A portion of that, though, really relates to fuel surcharges which are down a lot from last year. The market is more competitive with less freight, but we're still maintaining even in that case gross margins about in line with what we would expect.

So overall revenues down, margins generally hanging in there, which I think is a good thing, but also it's very important that we had a real focus and I think some pretty good results on the balance sheet. So I'll let Don hit some of the other financial highlights.

Don Pearson: Thanks, Larry.

I want to start off with the sales line, and just put some color to the 27% drop. If you look at the combination of the FX impact and the freight revenue reduction and the fuel surcharge reduction about 40% of that $62 million reduction is due to those factors, just to point that out to you.

On the other net line item, that is principally foreign exchange losses on transactions. Similar to Q1 where we had a lot of foreign exchange volatility, that continued into Q2. If we look at some of our larger currency pairings, the volatility in the quarter can be anywhere from 5% to 10%, up to 15% volatility.

So, as an example, this is where we would -- in Poland, sell in Euros and collect in Euros. So in this environment if volatility continues I'd expect to see some type of negative activity on that line item.

Income tax, we had a relatively low effective tax rate of 17% in the quarter compared to 26% last year. That's a function of the dispersion of the income, and we've had lower income in the U.S. where tax rates tend to be higher. Therefore, a higher mix internationally, where the tax rates are lower. So for 2009 for the balance of the year we'd probably look to about a 20% effective tax rate. Looking out further into 2010 as we would expect to normalize, expect that tax rate to get back into our range of mid 20% to upper 20% range.

The loss in the joint ventures and affiliates, I want to point out that we record those losses one quarter in arrears, so the numbers we're seeing here relate to the period January through March and the companies that had poor performance, were Russia, Japan, and the Netherlands.

Now, because we see these in arrears we have some visibility into Q2, so we will report what they experience in Q2. In Q3 we would expect a substantial improvement in that line item, and expect that going forward.

Moving over to the balance sheet, nothing too exciting other than I want to point out the great progress we've continued to make on the inventory and receivables, reducing those. We still want to continue to improve the performance of that in Q3 and into Q4.

I do point out the other line item there for current assets, that reduction of about $7 million is the Chrome Corp. receivable that we had from the company we bought the South African mine from. A year ago we gave them a loan holding a $6 million receivable, so that's simply the pay-off of that receivable.

Going down the balance sheet, the debt line item, again, we paid down about $27 million in debt. You'll see a slight difference on the cash flow. That's really just $1 million or $2 million in some noncash items from an accounting perspective related to capital leases.

And then moving over to the cash flow statement, again, strong operating cash flow generated in the six months of $65.5 million compared to the prior six months of a cash outflow of $2 million. So, again, reflective of the efforts that we're putting on working capital and continue to have for the second half of the year.

Capital expenditures, $32.4 million, about $15 million of that was South Africa, the remaining was other CapEx in our businesses of $17 million, so $17 million is really kind of the comparable number to the prior year of $23 million if you exclude South Africa.

Corporate building we've talked about in the past, that's just an in and out on the sales leaseback, and then we see again the net change reduction in the debt. I'll also point out that our trailing 12 months EBITDA calculates out to about $95.6 million, and hopefully you've seen that we have posted that calculation on our website, that should be posted today.

So, with that, Larry, I'll turn it back to you.

Larry Washow: Okay, thanks, Don.

I just want to spend a couple minutes on some of the macro indicators we look at and then open it up for questions. When we look at metalcasting, obviously, the biggest business for all of AMCOL, the biggest single segment we serve is the auto market, and there's no question that the U.S. market is in relative chaos.

But there's some interesting parameters there, too. The current run rates are 9 million, 9.5 million units; depending on which survey you believe there's something like 250 million cars on the road. So at that sort of replacement rate clearly most of the cars built these days don't last 25 years, but they may last 10 or 12 or 15 if people need to run them that long.

So one would expect as time goes on that that run rate will increase from the current level back up into the 12, 13 million range. When that is likely to happen, hard to say, and I think that's -- in listening to the auto reports this week there's some positive news certainly coming internationally.

In fact, we saw positive news in China, as well. The automobile sales in China are very strong due to incentives and positive activity there, but not any real increase yet in the U.S. So that's not a bad measure, though, to keep an eye on. It'll give you some idea as to the activity level that we would expect to see as that goes forward.

If there's a bright spot in there, the heavy equipment guys, a couple of them have reported, as well, and a similar story. They're seeing a pick-up in activity overseas, as are we, and hopefully that bodes well ultimately for some of the U.S. production that gets exported. So have we hit a bottom? I'm always reluctant to say yes or no, but it would certainly seem like we're much closer to that than we have been in a long time.

Other Mineral business, oil and gas drilling, as you know, the price of oil is well down from a year ago. The natural gas price though is really down, last July it was around $12, it's now down under $4. And the good news from one perspective is that it's clear we have a lot more natural gas in the U.S. than we thought, but the bad news is that suggests that we might not need to do anywhere near as much drilling.

So we're going to have to see how that plays out, but that's an important measure of the whole rig count for not only the drilling side of our Minerals business but the Oilfield Service, as well. And the rig count today is down to less than half of what it was a year ago.

Environmental, I mentioned the commercial construction, that tends to be a very long lead-time, so you can sort of look at architectural reporting, their activity levels which is down and everything we see on the commercial construction puts it out for quite some time before there's a recovery, at least in the U.S. and the western European countries.

There are some things we're doing, though, that I think are important to recognize, as well. One is we have had very little activity historically in the Middle East, but over the last year we've established a presence there, we've got a nice product portfolio, and we're really seeing some very positive activity.

So I think for a new market we're really generating some very nice sales and revenue. It's not going to move the needle this year, but I think in the years ahead that's going to be a very important area, and it does seem like that's one area in spite of the oil price decline that the building does, indeed, go on.

Oilfield services, price of oil, price of gas, pretty good measure of activity. Drilling activity a pretty good measure. The oilfield service companies have announced their earnings so far, almost uniformly have reported that activity outside the U.S. is stronger than inside. And we see the same thing.

Unfortunately, for us, our activity outside of the U.S. is fairly small, but is growing. Two years ago we had nothing going in Brazil, today we've got some very nice projects. Two years ago we had a small presence in Asia. Today we've got a good-sized team and a lot of activity in Malaysia, so we are definitely focused in on expanding the service range that we have to the rest of the world, and I think that's going to be a benefit as we go forward.

The other point I'd like to make on environmental, and I'll cover that and then we'll open for questions, was the environmental business is the only one of our segments where more half of the revenue is generated outside the U.S. And I think as the economies recover it does appear that Asia is moving at a faster pace.

Eastern Europe, we've got a lot of very good activity going on, especially in our Lining Tech area, but also somewhat in the building. So we're seeing some very positive things happen in developing areas faster and on a more interesting basis than the U.S., and the segment most likely to benefit from that is our Environmental Group.

So, with that, Andrea, let's open it up for questions.

Operator: Thank you so much. (OPERATOR INSTRUCTIONS.)

And we will take our first question from Rich Wesolowski with Sidoti & Company.

Rich Wesolowski: Good morning, Larry and Don. How is it going?

Larry Washow: Good morning. Good.

Rich Wesolowski: Can you talk in more detail about the changes you've made in the U.S. minerals business, both the production capacity and the personnel? And specifically whether those moves are girding for maybe a temporary loan business or a more lasting downturn?

Larry Washow: There's a couple of things going on, Rich, in our U.S. minerals business. We don't see the oil drilling, for example, oil and gas drilling we don't see recovery anytime soon. Another segment that's part of that group is related to the production of steel, iron ore pelletizing uses bentonite. Everything we read and hear from the customers there we don't see much activity increasing there, at all.

What we've done with our Minerals Group in the U.S., however, over the last couple of years is really focus on improving the throughputs and efficiencies. So we have closed or idled one of our major western operations. We've idled three of our blending plants serving the metalcasting industry. But the big western operations are really positioned at this juncture that if the business came back we can add a lot of business and not have to open up the plant that we've idled.

Similarly, with the blending plants for the metalcasting industry, we can service the industry as it is run today, anyway, in the big pockets with the plants that are running now, and we can take a good bit of growth before we need to do anything else.

So we're positioned for almost anything. If it stays down a long time we're in good shape. If it comes back tomorrow we're in very good shape without adding a lot of people or starting up the plants.

Rich Wesolowski: Okay, so you did take some permanent costs out, but that does not necessarily say that you're girding for a lasting downturn in the business?

Larry Washow: That's correct. No, I think at some stage the metalcasting market will definitely rebound in the U.S. It may be the heavy equipment guys that lead the way, but at some juncture and I think the real driver for auto sales ultimately has got to be jobs. And when people are comfortable that the job is secure, they're more comfortable going out and buying a house or buying a car, and when that's going to happen, of course, you guys are better than I on the guessing so I won't even try.

Rich Wesolowski: Can you give us an idea of what percentage of the Oilfield segment comes from the offshore filtration today, maybe what that was a year ago, and how far down the remainder of the business, the onshore business was from its peak?

Don Pearson: Yes, Rich, it's Don. Generally it's -- the offshore is about two-thirds of the business.

Larry Washow: And that's the more profitable or interesting business and relatively speaking more steady. But obviously the land based is down dramatically.

Rich Wesolowski: Is the offshore down, as well?

Larry Washow: It is down a little bit, but certainly not anything like the onshore.

Rich Wesolowski: Has that remained strong, the offshore? Because your products are being used on platforms that have remained active, or are you continually needing to see new bidding opportunities that offset jobs that are completed?

Larry Washow: It's a little bit of both. There's certainly some ongoing projects, and some of these offshore projects are huge, multiyear, multibillion dollar deepwater projects. And those are just ongoing, but there is activity obviously in bidding new projects and trying to get on different rigs or new rigs that are coming or rigs that are being refurbished, so it's a combination of both, but it tends to be because of the long-term nature of the deepwater it tends to be a little steadier business and goes on for a longer time.

Rich Wesolowski: Okay, that's helpful. And then, lastly, I was surprised by the drop in the landfill lining or the Lining Tech sales, excuse me, even recognizing that up to half of that was currency. Usually when you study these businesses now, your biggest revenue category, it seemed like you had a little bit more optimistic tone in the first quarter. What gives you the sense and the confidence that some of those projects are going to come back in the second half or even in the first half of 2010?

Larry Washow: The European side is where we're really more confident. And in talking with our team over there just in the last couple days the level of activity and projects committed and, more importantly, the money behind them is really strong for the second half. Now, this is all relative, and so I mean it's not going to -- we're not going to see a boom in Lining Tech by any means, but I think in terms of the volume and the opportunities for growth year-over-year, if anywhere, we do have a little bit of opportunity in Europe.

So based on everything we're seeing and hearing and projects committed we think that the balance of the year is going to be strong in Europe. The potential negative is obviously the weather, and August just tends to slow-down dramatically as vacations happen in Europe. So both of those could impact how quickly some of these get installed, but I think over the third and fourth quarters and into Q1 2010 we've got some pretty good visibility and some pretty good confidence that on the European side business is good.

Rich Wesolowski: Thanks a lot.

Larry Washow: Thank you.

Operator: And we will move to our next question from Al Kaschalk with Wedbush Morgan.

Al Kaschalk: Morning, guys.

Larry Washow: Good morning, Al.

Don Pearson: Good morning.

Al Kaschalk: Larry, I wanted to see if we could talk about maybe, first of all, the additional color on the macro side was helpful and I appreciate that. Which leads me kind of to the first question. On the margin front it seems like you got quite a bit of positive results from pricing and historical discipline on pricing coming through, but didn't get the operating leverage. And I just wanted to see if you could share, maybe it's by segment or maybe it's by certain larger businesses, the variable cost nature of those businesses on a whole?

Larry Washow: Yes, I think, again, the margin side combination, as you point out, good pricing which seems to be stable and continuing cost efforts. We have made some improvements on the overheads there for general, selling, administrative, but we haven't really got the full benefit there that we need to get the operating margins back to where we'd like them to be.

Obviously, on the Mineral side, you know, last year we were about an 8% operating margin. It really on a sustainable long-term basis we need to be in double digits. It'll take some time to get back there, but certainly that's the goal.

The Environmental Group, typically the mid teens is where they run. Obviously, a little stronger in the middle two quarters, a little softer in the first and fourth, but we would expect to see that improve. We need to get it back up into the mid teens at this kind of business level.

And similarly the Oilfield Services, you know, the mid to upper teens is really where their operating line should be, and it's a little more difficult in that area, quite frankly, just because of the nature of the talent that you need to really be successful in a lot of the markets that we serve there.

So that one is probably, if I had to point to one that's going to be a little more difficult to get where we want, it's probably going to be Oilfield Services. But I do think we will see progress on Environmental and Minerals in getting a big more operating leverage from the, not great, but pretty respectable gross margins that they're delivering now.

Al Kaschalk: Is that a function, though, of the seasonal strong Q3 forthcoming or do you still, are you still in the spot where you maybe need to look further or more critically at the cost structure of some of these?

Larry Washow: We're definitely looking at the cost structure, Al. I mean we've -- over the first several months across AMCOL probably 220 people have been laid-off, and we're continuing to look to try to make sure we've got the right balance of people and skills, recognizing that we clearly can't predict when these markets are going to come back. So let's assume it's going to be awhile and make sure that we get our total cost structure from the top through the operating line in good position for sustainability and proper profits going forward, no matter what the markets do.

Al Kaschalk: Is it fair to translate that to say that in terms of the book of business and your forward calendar, perhaps even what you're seeing in Q3, that you're dependent on some recoveries out there? And I won't say the indirect impact or benefit of stimulus money, but overall the book of business is still soft across the board and you just need to hunker down here in the short term and continue to drive leverage through probably cost reductions as opposed to volume improvement?

Larry Washow: Yes, I think generally that's an accurate statement. There are pockets, I mentioned the European Lining Tech business is strong. The Asian metalcasting business is strong, albeit it's a relatively small percentage of our business. But really across Asia we're starting to see things pick-up, so there are areas we're seeing some pretty good improvement, but in our biggest market which happens to be the U.S. that definitely has not shown really any significant signs that things are getting better.

Al Kaschalk: Okay, and then just on the metric side, on the covenants, and we've chatted a little bit about this, but how do you manage the business forward and the financial calculations that you have to meet for your debt level, even as you've made a nice repayment here in the quarter. But as you get -- as this book of business is a little bit light on volume, I imagine we still have not reached the trough on say EBITDA levels which would start to pressure probably covenants in the back half of this year more than you've seen recently. So can you talk about how you're thinking about cash flow and how we or how investors should think about what we should see going forward in light of the tough economic conditions you're experiencing?

Larry Washow: Yes, I think it's a critical question obviously for us and the outside world, as well, but I think the performance relative to the balance sheet in Q2 provides a pretty visible demonstration as to where our focus is. There's definitely more leverage on inventory.

Receivables will be a little more difficult in Q3 because we tend to see the business pick-up for the Environmental Group, but I think there's room even there to improve. We're looking at any spending that goes on across the Company to make sure that it's only the necessary activities that we go ahead with.

But in our models going forward we do expect given kind of Q3, looking at Q3 2008 and it's a rolling 12 months even on multiple, definitely see some decline there, but based on everything that we know and the progress we think we can make we think we're going to be in good shape with our debt covenants right throughout the cycle.

Al Kaschalk: Thank you.

Larry Washow: Thank you.

Operator: And we'll move to our next question from [Tod Vensil] with Davenport.

Todd Vensil: Hi, good morning.

Larry Washow: Good morning, Todd.

Todd Vensil: Just a couple things. On the JV in your comment or the JV line and your comments said that you're looking for substantial improvement going forward. I mean does that, you know, given the business, well, first of all, given what you obviously have already seen in terms of results from I guess April through June but given the business trends there, I mean when you say substantial improvement are you looking for a smaller loss or are you looking for some kind of actual increase there, but can you give us some color on that?

Larry Washow: Yes, Todd, I think we're -- we'll probably just have a loss in Q3, but it'll be less than half of what we saw this quarter, maybe even down as much as a third.

Todd Vensil: Okay. And what's the outlook for those businesses? I mean are they going to continue to improve a little bit do you think going forward?

Larry Washow: I think they will, and I think it's very driven again by sort of the macroeconomic environment. The business in Russia, for example, a lot of that's related to steel production, and especially in the first quarter, the first real quarter of this year, the steel plants were virtually shut-down across Russia. They're definitely coming back now in Q2. They've got some activity over there that's pretty positive, and we think that's going to continue.

Japan, their first quarter, I mean the businesses were really, really soft across the board in Japan in Q1, calendar Q1. And while the economy is still in tough shape in Japan, they're benefitting obviously with the increased activity in the rest of Asia for their exports, and we definitely see improvement there going forward.

The operations in Antwerp, you know, much more positive activity. There's a couple of consumer related businesses there that we're involved in, and those are getting some traction now over the last couple of quarters, so we'll definitely see improvement in Q3 in our JV performance.

Todd Vensil: Okay, that's great. Anything to -- anything of note going on in India, South Africa, things like that?

Larry Washow: South Africa, we're going ahead obviously with the plant, and final contracts are being negotiated for the plant construction. We still plan a Q2 2010 startup of that plant, so that is a very exciting for us. We still think that's a great opportunity, and look forward to that really making a difference in the second half of next year.

India, nothing terribly new there. The basic bentonite business is okay. The bauxite shipments have not resumed. So it's pretty much status quo in India.

Todd Vensil: Okay, pardon me, just writing -- on the South African plant, you guys, how are the construction contracts shaping up? I mean what do -- at this point what are you looking at for CapEx there?

Larry Washow: We're pretty comfortable that we're going to be in the $15 million range plus and minus, and obviously there's currencies that play into there but that's going to be a pretty good number I think.

Todd Vensil: Is that basically -- when does that start to kick-in?

Larry Washow: We will start that spending later this quarter and probably more than half of that will happen this year.

Todd Vensil: Okay, got it. And then just some comments that you had. I mean we noticed and it's not a huge deal, but we noticed sort of a sequential pick-up in SG&A in Minerals despite the fact that revs were down. You know, the only -- the thing that you mentioned on a year-over-year basis I guess in the commentary in the release was that there was some higher bad debt expense going on in there. I mean is that the driver, the sequential increase from 1Q or was there something else going on?

Larry Washow: Bad debt is a bigger factor in there for sure.

Todd Vensil: Okay, what -- can you kind of talk a little bit about what's going on, who you're seeing that from, and how much of an impact that had?

Larry Washow: Yes, we -- I mean the big impact, obviously, is in the metalcasting area, and there have been some reorganizations already and some bankruptcies. We did not have any big impact from General Motors, for example, or Chrysler, but there's other foundry groups that have been struggling a bit and we did have some issues there.

We also obviously have accrued an anticipation of ongoing potential problems, but I think we're -- we think anyway we're getting closer to the bottom of those guys that are a little bit more vulnerable financially, and hopefully in the quarters ahead we won't have the same magnitude of bad debt accrual.

Todd Vensil: Okay, thanks a lot.

Larry Washow: Thank you.

Operator: (OPERATOR INSTRUCTIONS.)

We'll take our next question from Jay Harris with Goldsmith & Harris

Jay Harris: Good morning, gentlemen.

Larry Washow: Good morning, Jay.

Jay Harris: I have several questions. One, where do you think your debt levels will be by the end of the year?

Larry Washow: We look for the debt level to continue to decline. I think the second quarter decline was impressive. Going forward we'll probably see, again, it's hard to say exactly, Jay, but percentage wise certainly 5% to 10% decline again by the end of the year for sure.

Jay Harris: Well, as I looked at the June quarter, a substantial portion of your cash flow came out of reduction of working capital.

Larry Washow: Correct.

Jay Harris: What -- have we learned anything about working capital management that will require -- enable us to use less working capital when our revenues go back to $425 million a quarter?

Larry Washow: Definitely, yes, and I think part of that is --

Jay Harris: Could you talk a little about that?

Larry Washow: Sure. Part of it is and a big part of it, quite frankly, is in the Minerals business, is the lead-times and cycle times to ramp it up and ramp it down can actually take several months. And we put together mining plans and mining sequences and activity that can be slowed down to a degree, but it's very difficult just to stop. And typically, especially for our international business, where we're exporting, the pipeline and the shipping lines are fairly long, so we often have a lot of material in the queue, going to the ports, on the water, in inventory in foreign locations.

So those areas are a little bit difficult to bring down, but I think with the relatively lower level of activity in shipping, overall, there's a far greater confidence level that the reliability is greater now. So if we're going to ship something today through the Port of Seattle to Taiwan it will get there in X weeks and X is now a better defined number that's more reliable. Whereas before with the level of activity being so strong we would be booked on a container ship and they'd say, "No, sorry, we're overbooked, you guys don't go." So assuming that that sort of keeps in line with what we see today, we will be able to much more closely manage our whole demand, supply line chain.

Jay Harris: All right, so you had regional warehousing because you weren't sure that you'd be able to ship, last year you weren't sure you'd be able to ship and get there on a timely basis, is that --

Larry Washow: Exactly.

Jay Harris: Okay.

Larry Washow: And so we'd have a lot of material --

Jay Harris: What's going to happen as you ramp-up your [chromes sands] business? Is that a higher working capital demanding business than businesses outside of the minerals area?

Larry Washow: It's probably similar. There's definitely working capital demands. Obviously, we only have one producing and shipping location, so clearly we'll have inventory in the different regions. But again the demand side of that and the shipping side is pretty predictable, it should be pretty reliable, and once we get our arms around that we'll certainly manage that. But it definitely will lead to an increase in working capital.

Jay Harris: Oh, okay, I'm not sure this is a valid methodology, but if you took the $120 million of working capital that's on your balance sheet at June 30th which is inventories plus receivables less payables, on an annualized $1.2 billion of revenues, where do you think that ratio goes as you re-ramp the business?

Larry Washow: The working capital ratio today is running sort of 20, mid 20s, 23, 24%. I think as a metric if we're better at it and we can be and should be, it should be much closer to the upper teens than around 20%.

Jay Harris: Okay, are there rules of thumb that you could possibly share with us? I'm going over to metalcasting now. Per million vehicle increase in automobile production, what kind of impact would that have on the demand for what you sell foundries?

Larry Washow: I haven't got a good, hard ratio for you. Obviously, it certainly helps. Part of that, part of the difficulty is, and this is something we see in China, they're selling over a million cars a month in China, but the vast majority are very small cars. They all use castings, brake drums, and things like that, but the relative weight of casting that's used per car is much less than the historical rate in the U.S., where you've got SUVs which use a lot of big castings and things. So it's -- I haven't got a good answer for you. We certainly will see a significant improvement in our business if the units built goes up by a million on an annualized basis.

The other factor, automotive is 60%, 70% of the business, but the other factor is that heavy equipment side and that's an important one, as well, and it could be, as I mentioned, that we see some benefit and some recovery there even before we get to meaningful improvement in the automobile side. So both of those are positives when they finally happen.

Jay Harris: Yes, is there a variable margin that you could share with us for a ramp in metalcasting revenues?

Larry Washow: You mean the margin--?

Jay Harris: On the incremental revenues? In other words, if we say you're at a low point today and you're going to go back to some higher level at some future time, that incremental revenue, what kind of variable operating margin does that carry?

Larry Washow: I would expect, and we were well on the way to this prior to the economic decline, that additional volume going through these operations should be in that sort of mid 20%, 25% gross margin range, and as the volume really does pick-up the whole business will get there. But certainly incrementally even today we should be close to that.

Jay Harris: All right. Thank you very much.

Larry Washow: Thank you.

Operator: And we'll take our next question from Andrew Nelson with Nelson & Associates.

Andrew Nelson: Good morning, Larry and Don, how are you?

Larry Washow: Good morning, Andrew. Very good.

Don Pearson: Good.

Andrew Nelson: Good. Just wanted to have you address your dividend policy, how secure it is, and what might change it in the future?

Larry Washow: Good question, and obviously it's one that the Board of Directors considers very seriously every quarter. By way of background, as you know, Andrew, we've paid dividends I think now for 70 plus years, so I think the prospect of a dividend, a dividend payment is very secure. Obviously, the scale and the size and the quantity is up to the Board of Directors, and that'll certainly be an interesting discussion point for our August meeting, but I can tell you for sure the Board recognizes, as do I, how important a dividend is and when you're looking at a difficult economic environment lots of folks say well, it's a reliable return to investors certainly more than waiting for capital gains. But we certainly counter that by looking at the balance sheet and making sure that we're very well positioned as a Company long term to continue to be successful. So that's kind of a long answer that's no answer because it's really up to the Board of Directors, but there will be a dividend. How much we'll know in a couple weeks.

Andrew Nelson: Thank you.

Larry Washow: Thank you.

Operator: And we'll take our next question from Nat Kellogg with Next Generation Equity Research.

Nat Kellogg: Good morning, guys. Just a couple of quick questions for you. On the metalcastings side, I mean I would assume in the short term that you guys are really more tied to automobile production versus sales. And my understanding is that production was cut way back in the first half of the year to try and work down some of the inventory, and that we've heard that you guys are starting to ramp-up production again the second half.

And so, but it sounds like from what you guys are saying that you're not seeing that as much as I would have maybe expected. So I'm just wondering if you could maybe talk a little bit about that disconnect and maybe where I've got things wrong?

Larry Washow: Right, your analysis is exactly right, Nat. It's clearly the build rate that drives our business and obviously the sales that drive the build, but no question between Chrysler and GM they were both shut-down for big chunks of the first half. Both of them are starting to ramp-up.

And, yes, we do see a little more activity but on a relative basis it's not big enough yet to get excited about, but there's no question that there's more foundries running automotive related parts today than there was three months ago. So we need to see that on a continuous basis and hopefully the sales come through to continue to drive the need to build the cars. But it's a good ratio. And you're right, the relative build rate today is better, and we do see a little benefit from that.

Nat Kellogg: Okay, that's good, that's helpful. And then also on the -- I know I'm [politizing], and I realize it's not a huge business for you guys, but again my -- the first half of the year the mills are running at below 50%, in the low 40s, really, and it sounds like as you're talking about sort of 60% to 65% for the back half of the year which obviously is down a lot from last year, but it would sound like an improvement over the second half, I would assume that you guys are hearing the same sort of things or is there a little bit of a lag there because of the inventory, with the iron ore versus the actual production?

Larry Washow: Yes, we have a relatively small customer base there, as some of these guys have their own iron ore and things, so the customization we're dealing with is still fairly cautiously pessimistic I must say, and they really -- they don't see a lot of improvement the balance of the year. They're all kind of talking sort of Q1 2010, but a lot of the mills that are shut-down they expect to continue to be shut-down.

The converse is true obviously in China where they're bringing in vast quantities of iron ore, and so the Australians are very busy, the Brazilians are very busy. But in the U.S. it hasn't really clicked in that there's going to be a bigger demand for steel in a hurry. And, again, that goes back to a great degree to automobiles, commercial construction, things where they use a lot of steel. So I would say I'm probably a bit more negative on that than you would be.

Nat Kellogg: Okay, no, that's helpful. And then just wondering if you could talk a little bit about South Africa? And just sort of the chrome sand market, just sort of what you guys are seeing there, how this economic slowdown has been affecting that market, if at all, whether it's pricing or volume or what-not? I mean, maybe we've seen a lot of shutdowns both of mines and of production and how that's affecting the market, at all? I was just sort of curious, just some color on those end markets.

Larry Washow: Yes, the major end market is obviously ferral chrome going into stainless steel, and that's where 80 plus, probably 90% of the chrome goes. That's a market of no interest to us. And the reason we're spending $15 million to build the processing facility is that we would be producing a substantially larger percentage of foundry grade material than mines currently do. And we know the quality is going to be better and the uniformity, it's going to be a great product.

The market for those, for that material, for the foundry grade is very large steel castings, so if there is infrastructure getting built, new generators, for example, and that'd be castings around them; those would be cast in those types of companies. Ships with big castings would be cast in those types of companies.

The relative strength is pretty good. Now, shipbuilding is down, and that has an impact on some of the steel foundries, but these guys tend to have multi month if not yearlong order lists and order logs because there just aren't a lot of them. It's a really specialized skill and there's -- the biggest ones, not surprisingly are in China. There's some outstanding ones in Europe, and a couple in the U.S.

So most of our focus for that business is international, outside the U.S. and we still see that business as solid and strong, a good deal of interest from the customer base. We've got really good contacts and relationships with them, so we're excited. I wish we had the product to sell today because I think it's going to be a big success for us.

Nat Kellogg: Okay, that's great. And then just a last question. I know you guys at the beginning of the year sort of said on the cash flow side you'd like to get about half the working capital that you invested in the business last year back, and just you've done a very nice job here in the first half of the year on the cash flow generation. And I was just curious if that's still the target or whether you think you can do a little bit better than that, so any update there would be great?

Don Pearson: Yes, Nat, I'd say that we're well along the way. As Larry said, as we get into Q3 the receivables will probably inch up a bit in Environmental but we do see a substantial amount, probably $5 million or $10 million minimum on the inventory side with the Minerals Group. So we're expecting to get continued reduction.

Nat Kellogg: Okay, that's great. I appreciate that. Well, guys, thanks very much for taking my questions, and I'll hop back into queue.

Larry Washow: Thank you.

Operator: And we will take a follow-up question from Rich Wesolowski with Sidoti & Company.

Rich Wesolowski: Thanks. Going back to the oilfield business, I look at this quarter versus the second half of 2008, you did much less revenue here in June, but a much higher margin. Could it be that the gap between the margin and the offshore and the onshore businesses is that wide that it would explain why the margins have been so good in '09 despite the poor revenue?

Larry Washow: That's a big part of it. The offshore deepwater business is much more profitable, and the other side is certainly over the last several months we have focused in on getting the costs down there, as well. We have had some pretty significant layoffs and consolidations to make sure that we're running more efficiently, so it's a little bit of a combination, good high margin business in the deepwater, and really focus in on getting the cost right for our other service businesses that are onshore.

Rich Wesolowski: Okay, separately, you held the pricing program in the minerals business that you implemented in the second half of 2008 and you have a stated aim to get that margin up to 25% over some period of years, is there a threat of substitute products coming in or other choices if you press that issue during a period when your customers aren't doing so well?

Larry Washow: We're very comfortable that we're providing a great value to the customers at the pricing that's out there today. And, in fact, there's probably room to move it up. One of the interesting attributes of our material is that it's a very small piece of their total cost. So there can be some substitutes but they tend to be very high priced materials. The bentonite that's been used, especially in the iron foundries for over a hundred years has really proven to be the most cost effective material as a binder that people have come up with.

So I don't think there's any risk of substitution there. We're, as Gary Castagna, who runs that business, likes to say, it's the beauty of being insignificant in the whole process, because we're just a tiny part of the cost -- the sand, the scrap steel, the energy, the people, I mean everything, every other component that goes into making a casting is just a far greater piece of the cost basis than we are.

Rich Wesolowski: Do you have an idea of what the cost of using a substitute product would be? So to give yourself a sense of where the ceiling would be where you could put your pricing?

Larry Washow: Yes, we do, we do, and it's a multiple of our pricing, so there's a lot of room.

Rich Wesolowski: Okay, lastly, as I understand it your building products business is centered in the U.S. and Europe, where the outlook is poor. Do you have the ability to use the distribution network you have for other products that are bigger in Asia or a healthier property market to export building materials? Does that make sense to explore?

Larry Washow: Yes, we produce in China and Korea, building materials, so we are in those markets in a very active way. China is an extremely competitive environment, so we have a nice business there, but it's fought for tooth and nail to get every job. We've had some great projects, the Beijing Subway we've done a lot of work on and we're looking for more. There's subways getting built all over the country, so we're very active in the building materials market in that part of the world, and winning our share, but on a relative basis it is certainly smaller than the U.S. or the European business but it's an important component and one that is growing, there's no question about that.

Rich Wesolowski: Thanks, again.

Larry Washow: Thank you.

Operator: And currently with no other questions in the queue, I would like to provide everyone with a final reminder, that that is star one to ask a question. And we'll wait for just a moment for any final signals.

Mr. Washow, it appears we have no further questions today.

Larry Washow: Very good. Thank you, all, for joining the call and look forward to talking next quarter.

Operator: And, once again, this does conclude today's call. Thank you for your participation.