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Orion Engineered Carbons SA (OEC)

Q1 2019 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Greetings, and welcome to the Orion Engineered Carbons' First Quarter 2019 Earnings Conference Call. At this time, all participants are in a listen-only mode. A question-and-answer session will follow the formal presentation. [Operator Instructions] As a reminder, this conference is being recorded.

It is now my pleasure to introduce your host, Diana Downey, Vice President-Investor Relations. Please go ahead.

Diana Downey

Vice President Finance and Investor Relations, Americas, Orion Engineered Carbons SA

Thank you, operator. Good morning, everyone, and welcome to Orion Engineered Carbons' conference call to discuss first quarter 2019 financial results.

I'm Diana Downey, Vice President, Investor Relations. With us today are Corning Painter, Chief Executive Officer; and Charles Herlinger, Chief Financial Officer. We issued our earnings press release after the market closed yesterday and have posted a slide presentation to the Investor Relations portion of our website. We will be referencing this presentation during this call.

Before we begin, I'll remind you that some of the comments made on today's call, including our financial guidance, are forward-looking statements. These statements are subject to the risk and uncertainties as described in the company's filings with the SEC. Actual results may differ materially from those described during the call.

In addition, all forward-looking statements are made as of today, May 3, 2019. And the company does not undertake to update any forward-looking statements based on new circumstances or revised expectations. Also, non-GAAP financial measures discussed during this call are reconciled to the most directly comparable GAAP measures in the table attached to our press release.

I will now turn the call over to Corning Painter.

Corning F. Painter

Chief Executive Officer & Director, Orion Engineered Carbons SA

Thank you, Diana. Good morning, everyone, and thank you for joining us for our first quarter 2019 earnings conference call. I will start today's call by providing some general comments on our performance and the industry backdrop. Our CFO, Charles Herlinger, will then provide detail on our financial results and related matters for 2019. Then, I'll come back and share some closing comments. We will then be happy to take your questions.

Turning to slide 3, as expected, Q1 was a challenging quarter with first quarter performance in at fourth quarter 2018 levels, reflecting challenging market conditions for us and the chemical industry as a whole. Despite the market conditions in Q1, we progressed key marketing programs and de-stocking appears to have run most of its course, and we feel we are now on more stable footing heading into the rest of the year. Specialty volumes in Asia were weak in January and especially February even considering Chinese New Year with premium products for the fiber and automotive markets particularly weak.

In EMEA, infrastructure and coating markets were soft in the quarter, and the Americas infrastructure was the weakness. Our customers tell us that adverse weather impact was a factor for the pipe industry. However, we are encouraged by the volume trends in March and now in April as well, as these volumes have started to recover and we believe the strengthening trend will continue. Rubber volumes in Asia were also down beyond the impact of the plant consolidation, in part due to the MRG channel management issues we discussed last quarter. We're making progress in recovering from those issues, somewhat helped by an improving Chinese market and fueled by an announced stimulus plans in China. Americas pricing and demand remains strong and we have recently gained some modest tire business based on our superior reliability. In Europe, the market is stable, albeit not robust. Despite this, we've made some gains recently in MRG in the broader EMEA area and reliability is a strength for us here too. Another positive income – indication, excuse me, is that we are already starting 2020 pricing negotiations with some tire customers. Collectively, rubber volumes strengthened in March and April to a level that is consistent with our guidance range. Of course, I'm in the business of always pushing us for us to do more, but I am pleased with – to see these volumes returning and at the current level. We remain keenly focused on ensuring that we are delivering improved results as we move forward in 2019. The trends I just described combined with various self-help initiatives give us confidence that we will deliver improving mix and margin performance as we move through 2019.

Please turn to slide 4. Capital allocation remains a top priority. After paying our dividend and executing must do safety, maintenance and compliance projects to strengthen the foundation of our business, we are focused on balancing opportunities across growth, productivity and share buybacks while maintaining our target debt ratio.

During this time of moderate economic volatility, our capital allocation will be closely managed process with the flexibility to adjust to new opportunities and new challenges when necessary. In practice, this means that during the course of the year we will periodically review our opportunities and pace our spending accordingly. While we have a project slate of \$180 million including some very attractive opportunities, we are currently set our pace for approximately \$150 million in cash spending and we can shift this appropriately up or down as the year plays out.

In practical terms, this means that there are some good value enhancement opportunities that we will put on hold for the time being. For example, every carbon black plant generates waste heat and that heat energy can be recovered through cogeneration of electricity. So, by adding or increasing cogeneration in our facilities, it's an attractive economic opportunity for us. Investments like this enhance value, but we can pace the timing. Also, keep in mind that EPA capital spending while high this year, next is not part of our normal run rate. As I mentioned in our last earnings call, my first few months at Orion have reinforced my view that we have ample opportunity and runway in our core business of carbon black. We see a healthy backlog of value enhancement opportunities including the development and launch of new products, the ability to enter new applications, improving product quality, debottlenecking in-demand plans, and improving our efficiency and agility. All that being said, our capital spending will still be up from 2018 levels due to EPA-related mandated spending. We believe this spend will ultimately help our strategic position in the industry as the incremental spend helps widen our competitive moats. We continue to engage with Evonik, but we'll likely initiate arbitration soon, although this would not preclude continued settlement negotiations.

For reasons of conservatism only, our financial planning is based on receiving zero reimbursement. To further emphasize the importance of getting our capital allocation right, we modified our long-term incentive plan metrics to now be based on ROCE as well as TSR. The annual bonus in large part is now based on plant or regional EBITDA, so our people have a clear link between their work results and their bonus.

As slide 5 shows, with this agile capital allocation process, we have a roadmap to be cash flow positive in our guidance range without any settlement from Evonik this year. While \$13 million to \$17 million is not an extraordinary sum compared to prior years and there are variables such as CapEx timing and the impact of oil prices on our working capital, we expect to grow off this base in the future. As we mentioned on our last call, our mandatory U.S. environmental spending in 2019 includes compliance with established EPA-related project deadline, which is about \$80 million. As we noted in our last update, we now expect the total CapEx investment associated with the EPA work to be up to \$190 million as compared to our initial estimate of \$110 million to \$140 million. Drivers of this increase include higher construction costs anticipated in the U.S. Gulf Coast region. These incremental CapEx investments will not be reimbursed by Evonik under the terms of the agreement we have with them.

Please turn to slide 6. This year-on-year EBITDA will provide some insights to the underlying drivers in our business. Most importantly, you can see the significance of the volume decline. This decline drives higher fixed cost per ton and, hence, contributes to lower GP per ton figures, which will be discussed later. It's noteworthy that price mix is positive despite a negative mix impact. Pricing includes realized prices beyond indexed energy pass through where we have pass-through contracts. I believe it demonstrates that the underlying quality of our business is healthy despite the swing in demand and unfavorable FX translation impact.

Slide 7, we know it's been – it's what we're doing going forward that matters, but I just want to stress that Orion has a capable team that has delivered shareholder value over an extended period of time, and you can see that in this slide.

On slide 8, you'll see that Orion made many significant achievements over the past four years as a public company. We rationalize our production footprint while growing volumes on the remaining plants by 10%, ensuring that our plants were well-loaded with an improving mix. Adjusted EBITDA grew every year despite volatile oil prices and large swings in foreign exchange. We de-leveraged significantly and we expanded our product portfolios organically and through the acquisition of an unsettling carbon black plant. Further, we successfully went through the dollar and U.S. GAAP conversions.

Please turn to slide 9. Aided by these achievements, we have a strong financial position. Debt levels are comfortable and no significant loan repayments are due for five years. We just renewed our RCF at a higher level and a lower rate. We're working on an improved rubber business model that will give buyers and sellers more stability with the conversion to the U.S. dollar and U.S. GAAP reporting. We believe we have now taken all the necessary steps to be eligible for inclusion into the Russell Indexes effective in Q2 of 2019, a year ahead of our original timetable.

I'll now pass the call to Charles Herlinger to discuss our financial results.

Charles E. N. Herlinger

Chief Financial Officer, Orion Engineered Carbons SA

Thank you, Corning. Now, turning to slide 10. Year-on-year volumes were down by 4% adjusted for the plant consolidation in Korea; however, they were stable on a sequential basis. Our Q1 adjusted EBITDA was \$64.6 million for the quarter with EPS and adjusted EPS at \$0.32 and \$0.40, respectively, down from the strong quarter a year ago. Although we achieved our targeted rubber price increases for 2019, lower Specialty volumes and lower MRG volumes in the Rubber segment, as well as FX translation impacts mainly drove this change.

On slide 11 on the top left-hand side, the main drivers of the change in contribution margin from Q1 of last year were positive price mix mostly from our Rubber segment, which were more than offset by reduced volumes and FX translation impacts in both segments. The change in contribution margin was the main driver of the change in adjusted EBITDA, although some favorable FX impacts on fixed cost translation as well as fixed cost reductions partly associated with the plant closure in Korea offset the change in contribution margin.

The waterfall chart along the bottom of this slide shows that the change in net income is principally as a result of the decline in adjusted EBITDA of \$11.4 million, mainly offset by a \$1.9 million reduction in quarterly finance costs due to successful refinancing of our debt. The change in basic EPS versus the first quarter of last year is essentially in line with the change in net income, whereas the change in adjusted EPS reflects declining add back items.

Summing up this slide, the principal drivers of the changes were positive price mix offset by negative volume and FX with these impacts cascading fairly cleanly through our P&L. Now, turning to slide 12, showing our cash flow and our key balance sheet metrics as of March 31, 2019. For the quarter, our cash flow from operations of \$26.2 million, as well as an increase in cash due to net financing activities supported our cash CapEx investment program at a level consistent with our expectations for this first quarter of 2019. Other uses of cash over the same period included dividend payments of \$11.9 million. As a result, our cash position at the end of Q1 2019 was \$60.9 million. The company's non-current indebtedness as of the first quarter end was \$635.3 million with net debt at \$636.2 million, taking our Term Loan B debt and local debt into account, which represents a leverage ratio of 2.25 times LTM adjusted EBITDA.

As Corning touched on earlier, we completed a successful prolongation of our revolving credit facility and took the opportunity on offer to upsize our RCF from €175 million to €250 million, while at the same time being able to reduce our already very attractive interest rate on this instrument by some 60 basis points. As a result, both our main Term Loan B debt and RCF do not mature until July and April 2024, respectively, with minimal mandatory repayment provisions until then.

Due to our refinancing activities in recent years, our interest costs, which are largely kept on the Term Loan B instrument, are very competitive. We are led to believe that our new financing structure, the temporary nature of our current EPA spending levels, together with our business model with significant factors, and S&P recently

confirming our rating at BB with positive outlook, which incorporates their assessment of our liquidity position as strong.

We will now pass the call back to Corning.

Corning F. Painter

Chief Executive Officer & Director, Orion Engineered Carbons SA

Moving to slide 13, with our key quarterly Specialty metrics. Although volumes and gross profit per ton showed some sequential improvement, they were at levels well below the strong quarter a year ago. On slide 14, we take a deeper look at the main drivers in the Specialty business. Lower volumes including a destocking of higher margin premium grade are the largest single factor in the quarter. This, combined with higher fixed feedstock and other costs, as well as the translational FX impacts, more than overcame the positive price mix. And within that, pricing was positive for us, but mix was negative.

Slide 14 also provides insight into the changes we expect during the remaining quarters, which are incorporated into our guidance range for 2019. In summary, we are not expecting to see a radical recovery in the trading environment back to the levels a year ago. Rather, we expect to see more gradual recovery in our key markets, particularly China, resulting in the following quarters in 2019 running at about 5% above the March and April levels, at least partially offsetting the destocking experience this quarter.

This gradual restocking of customer supply chain is expected to improve Specialty volumes and, hence, Specialty product mix and fixed cost absorption, together boosting overall gross profit per ton margin in the remaining quarters of 2019 towards the \$700 per metric ton level. Other key assumptions are the FX translation rates, oil prices remain as seen in Q1 2019 and you can see some of the rules of thumb for these impacts on slide 28.

Please turn to slide 15. Rubber volumes were up 1.7% sequentially, but down by 2.8% year-on-year when adjusted for the plant consolidation. This performance is compared against a stronger trading environment a year ago, particularly with MRG sales in China. Gross profit per ton was up \$15 per ton, reflecting the pricing gains for 2019 and fixed cost savings with the plant closure more than offsetting the impact of lower volumes, including lower MRG volumes.

On slide 16, we provide more detail on these changes versus a year ago, as well as on our insights into the remaining quarters for 2019, which underpin our guidance range for Orion as a whole. In the year-on-year comparison, the major impacts are the positive impact of pricing overcoming both mix impact of lower MRG sales and the impact of lower volumes. Excluding the impact of the plant closure, lower volumes were mainly driven by weakness in China and, to a lesser extent, Korea. Looking forward, we expect our contractual base price increases for 2019 to be supported by the recovery we saw in March and April volumes including MRG volumes. We're going to need to manage MARPOL and work hard to recover feedstock differential. We look to the remainder of 2019 with a good degree of confidence underpinned by healthy demand and supply balance in most of our key markets.

On slide 17, you can see the forward raise for the U.S. oil market. The graph for Europe looks pretty much the same. The trend for low sulfur fuel oil is more muted than some had anticipated. The trend for high sulfur is about what was anticipated. While these curves are benign for us, the greater challenge is the impact on the differentials. That is the difference between the index and what we pay for our raw material. Differentials have widened considerably as a side effect of this and the lightning crude slate.

Slide 18, I have been through many business cycles and whatever the economic season, there are always things to do and improve upon. During a softer economic cycle, you need to get your costs right and drive near-term profits. We have an executive profit improvement team focused just on this. We have an emphasis on cost savings that will remain with us during an economic rebound. Renewing our product portfolio is always a good thing and during a time of economic uncertainty it's sometimes easier to get new product qualifications accomplished. We're pursuing new product qualifications for products ranging from a new carbon black we introduced at the European coating show in March to acetylene carbon black for the lithium ion battery market. This is a good time to catch up on supply chain challenges as well and prepare for the future. We're doing just that by debottlenecking one of our key product lines used in the coatings and ink business. It's also an important time to help your team remain focused and our incentive plan does just that.

Effective incentives and employee engagement are an essential part of any high performing company. The switch from global to plant regional EBITDA is key and gives employees a much clearer link between their efforts and their bonus. We also added a component on safety and sustainability to keep these important issues front of mind.

Turning to slide 19, we are reaffirming our 2019 adjusted EBITDA guidance range of \$280 million to \$300 million. This outlook is based on assumptions provided on slide 28. When we announced our guidance last quarter, we expected a challenging Q1 that would be impacted by volumes, particularly in Specialty, which was borne out in our results. Going forward, we expect to improve volumes in the sequential quarters with a normal seasonal dip in December. Our read on volume trends is that destocking has largely run its course. Beyond that, we anticipate a modest rebalance of mix in Specialty and a modest improvement in trading conditions. We are not expecting a return to robust conditions in the first half of 2018 this year.

For Specialty, in summary, we're expecting the current trend in improved volumes and mix together to continue along with improvement in feedstock and other costs. Beyond that, we're taking concrete steps to set this business up for future success. For Rubber, we have an inherently more stable demand situation with a large tire replacement market and contract pricing for 2019 in our key markets. Indeed, we have already started discussing 2020 pricing with some customers. Recall that we have a large customer on a three-year pricing cycle that comes up in 2020. Higher margin MRG volumes have been a challenge. Through a mix of self-help and trading conditions, this is improving. Across both businesses, we expect subsequent quarters to run roughly 15% above Q1 performance, although this is likely to vary quarter-by-quarter.

FX impacts are soon to remain at Q1 levels. In terms of cash flow and capital allocation, we're managing our spending dynamically. We are currently pacing ourselves for \$150 million in 2019 and then kind of adjust this up or down. We have a backlog of attractive projects, our debt levels are comfortable and our liquidity is strong. We remain very much committed to our dividend policy and are focusing on delivering value to our investors. We have a lot of positive developments on the horizon heading into 2020 as we anticipate the Ravenna plant will come on stream and begin qualifications. We'll take a huge step forward with the EPA work, completing the upgrades at one plant and begin commissioning the kit at our first plant with full scrubbing. We also expect rubber pricing to continue to increase. We will have the Specialty debottlenecking project behind us and expect to advance acetylene carbon black customer qualifications. The Orion team is looking forward to the path ahead.

Thank you. Now, we will be delighted to take your questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. We'll now be conducting a question-and-answer session. [Operator Instructions] Our first question today is coming from Mike Leithead with Barclays. Your line is now live.

Michael Leithead

Analyst, Barclays Capital, Inc.

Hey, good morning, fellows.

Q

Corning F. Painter

Chief Executive Officer & Director, Orion Engineered Carbons SA

Good morning, Mike.

A

Charles E. N. Herlinger

Chief Financial Officer, Orion Engineered Carbons SA

Hi, Mike.

A

Michael Leithead

Analyst, Barclays Capital, Inc.

Hi. I guess first on the Specialty business. Corning, I think in the release you talked about a volume recovery that should improve the mix and profitability of the segment. So, is it fair to assume that a good portion of the profitability hit we've seen in this business has been due to the fall off in higher margin products within the segment? Or I guess a better way to ask it is can you talk about what the mix impact has been to the business's profitability versus, say, underlying unit margin compression for your products?

Q

Corning F. Painter

Chief Executive Officer & Director, Orion Engineered Carbons SA

Right. So, I think a guideline to the unit margin will be to look at if you're looking at that major factor walk, just looking at the price, and that actually has held up well for us in the different segments. What's been the challenge has been the mix in terms of which segments were more adversely hurt. And then, when you look at GP per ton, you're also just seeing also increased levels of fixed cost absorption on the lower volume.

A

Michael Leithead

Analyst, Barclays Capital, Inc.

Got it. Okay. And then, two questions on cash flow. One, the \$30 million reduction in CapEx, can you maybe talk about what you – how you identified the projects you chose to pace out versus others that are moving forward like Ravenna? And second, it looks like working capital held pretty much flat sequentially despite the big run up in crude so far this year. So, maybe parse apart how you're able to do that in the quarter as well?

Q

Corning F. Painter

Chief Executive Officer & Director, Orion Engineered Carbons SA

Okay. So, I'll speak to the capital and Charles will speak to the working capital issue. In terms of projects, we simply prioritize across strategic near-term impact. We also had some benefits of driving for cost reduction across them and just keeping a focus on what's most important to us.

A

Charles E. N. Herlinger

Chief Financial Officer, Orion Engineered Carbons SA

A

Yeah. On the working capital, Mike, the variables are the amount of inventory we have, both raw material and finished goods. We met – we've managed that and we'll need to manage it as the effect of rising crude works its way through our inventory levels. We've got in the back up to the slides our typical rule of thumb and we give a metric, it's on page 28, of the impact on working capital through changes in oil prices. So, it's managing the quantity side of inventories particularly and we've got some latitude on the accounts payable side to manage that more tightly. Those are the two factors we'll keep focusing on to manage working capital through the year.

Michael Leithead

Analyst, Barclays Capital, Inc.

Q

Thanks, guys.

Operator: Thank you. Our next question is coming from John Roberts from UBS. Your line is now live.

John Roberts

Analyst, UBS Securities LLC

Q

Thank you. I'm looking at slide 29 in the appendix where you gave some longer term supply demand outlook commentary and it looks like – is the new Carbon Black capacity coming online in Korea, Japan, Southeast Asia and Indonesia or are those tire capacity increases that you've got in your commentary there?

Corning F. Painter

Chief Executive Officer & Director, Orion Engineered Carbons SA

A

Yeah. So, what we're referring to there is in – actually supply of Carbon Black and there are announcements in places like Indonesia for increases and the expansions in there. And in Korea, really, there is a existing company that's looking at an expansion as well, so that's what you're seeing there.

John Roberts

Analyst, UBS Securities LLC

Q

And then, I don't know if we can pin you down a little bit more on the Evonik indemnification, but I assume that's in euros and is it equivalent to \$110 million or \$140 million or what's the number that's being debated or negotiated?

Corning F. Painter

Chief Executive Officer & Director, Orion Engineered Carbons SA

A

So, we're under a non-disclosure on what's exactly in the contract and I don't think we could go to that degree. For what it's worth, it's a year of denominated sum. But the point is, is that there is at some point a limit to what we can recover and that's what we are trying to [indiscernible] (00:29:23) today.

John Roberts

Analyst, UBS Securities LLC

Q

Okay. Thank you.

Operator: Thank you. Our next question is coming from Craig Bibb from CJS Securities. Your line is now live.

Craig Bibb

Analyst, CJS Securities, Inc.

Q

Hi. Hoping you could give us more detail around the MRG issues you're having in China. So, kind of what are the specific issues and what is the fix and how long does that take?

Corning F. Painter

Chief Executive Officer & Director, Orion Engineered Carbons SA

A

Yeah, great question. So, the challenge for us was just on channel management, which means the distributors that you use and do you think you are getting good performance from them and occasionally you need to shake up that mix. So, we've done that and I think we've made some changes and gotten the attention of some other players. So, where you see ourselves is on the way to recovering that. We've made a partial recovery and we think we're well underway to get that behind us.

Craig Bibb

Analyst, CJS Securities, Inc.

Q

Okay. And then, it sounds your tire producers want to negotiate price now for 2020. Is RCB sold out in the U.S. for next year or likely to be?

Corning F. Painter

Chief Executive Officer & Director, Orion Engineered Carbons SA

A

I'm sorry, I didn't quite hear that. Is what sold out for next year?

Craig Bibb

Analyst, CJS Securities, Inc.

Q

Is the industry RCB production likely to be sold out in the United States next year?

Corning F. Painter

Chief Executive Officer & Director, Orion Engineered Carbons SA

A

So, I mean, you have the question of the nth degree of capacity and does some of us want to hold it back and play the spot market. But I think it will be another year of very high loading. We're, let's say, in the high-80s right now in our loading. So, strictly speaking, we can go a little further, but there's ultimately a limit for all of us.

Craig Bibb

Analyst, CJS Securities, Inc.

Q

Okay. And then, could you give us a little color around your efforts to kind of restructuring the way the industry prices?

Corning F. Painter

Chief Executive Officer & Director, Orion Engineered Carbons SA

A

So, we're in those discussions and this is the time the right market conditions to drive them home. We really don't have a lot to announce until it's done and we've got something to announce and we're committed to making sure we have a good contract that works well for both players.

Craig Bibb

Analyst, CJS Securities, Inc.

Q

Okay. And the last one, Acetylene Black, a tiny acquisition, but you guys sold out a capacity there really quickly. How long do you need to learn about production before you're ready to roll that to other facilities?

Corning F. Painter

Chief Executive Officer & Director, Orion Engineered Carbons SA

A

Well, so, it's a different production technology and it requires being near an acetylene source. So, if we are expanding that, we're going to be near – it's going to need to be a new facility near an acetylene source. But in terms of understanding it and all of that, we're well into the qualification process right now.

Craig Bibb

Analyst, CJS Securities, Inc.

Q

Okay. Great. Thanks a lot.

Corning F. Painter

Chief Executive Officer & Director, Orion Engineered Carbons SA

A

You're welcome.

Operator: Thank you. Our next question is coming from Kevin Hocevar from Northcoast Research. Your line is now live.

Kevin Hocevar

Analyst, Northcoast Research Partners LLC

Q

Hey, good morning, everybody.

Charles E. N. Herlinger

Chief Financial Officer, Orion Engineered Carbons SA

A

Hi, Kevin.

Kevin Hocevar

Analyst, Northcoast Research Partners LLC

Q

Wondered if – so, Corning you mentioned that some of our contracts started get negotiated for 2020 at this point. Is that U.S. specific? Is it across many different regions like Europe as well? And how broad-based is it because I remember at this time last year, negotiations also started. So, is it kind of just a couple people at this point? Is it more broad-based? Wondered if you could just give a little more color where you can.

Corning F. Painter

Chief Executive Officer & Director, Orion Engineered Carbons SA

A

Right. So, there's some competitive sensitivity to say exactly how many you're working with. I would say it's several customers and it's across multiple regions.

Kevin Hocevar

Analyst, Northcoast Research Partners LLC

Q

Okay. And you mentioned differentials being an issue in the period. How – is that in the U.S. – again, is that in the U.S. only? Is that also a global effect? And – so, how big is that headwind? How broad-based is it geographically?

And I know you had surcharges that in the U.S. at least take in effect in April. So, wondering if you have that more in the other region too, if it's happening in other regions and how effective do you expect those surcharges to be?

Corning F. Painter

Chief Executive Officer & Director, Orion Engineered Carbons SA

A

Yeah. So, for those of us who maybe aren't as familiar, what we're referring to here is we have various indexes that link our pricing to how indexes move for heavy heating oil. But that's not actually what we want. What we want is a very heavy grade of carbon black oil like a negative EPA, heavily aromatic and so forth. So, there's sometimes a difference between the cost for that and how these indices move. And effectively, this then means any plant that's using, let's say, FCC bottoms is potentially impacted by that. There's other kinds of feedstock we can use such as coal tar and that sort of thing. So, the biggest impact for us is the U.S., some in Europe and a bit in Korea as well.

Kevin Hocevar

Analyst, Northcoast Research Partners LLC

Q

Got you. Okay. And then, maybe last question. So guidance, if I take the midpoint of guidance, the \$290 million, that implies \$75 million of EBITDA per quarter, the balance of the year and kind of – it sounds like in your comments you expect a gradual – bit of a gradual recovery, but that seems to be more of a snap back to me in something that has to be sustained. And I know you mentioned too that December tends to dip off due to seasonality. So, how – I guess help me understand the pacing of how you expect the rest of the year to go. Do you expect earnings to move up meaningfully in 2Q versus 1Q and then further in 3Q? Just wondering if you can help me understand kind of the pacing of the recovery the balance of the year.

Corning F. Painter

Chief Executive Officer & Director, Orion Engineered Carbons SA

A

Yeah. So, that's why we put some comments in there about how we saw March and April. And that those were strong months for us and an improving trend in those months. So, I think we'll see an improved really beginning with Q2.

Kevin Hocevar

Analyst, Northcoast Research Partners LLC

Q

Got you. Okay. Thank you very much.

Operator: Thank you. [Operator Instructions] Our next question is coming from Chris Kapsch from Loop Capital Markets. Your line is now live.

Chris Kapsch

Analyst, Loop Capital Markets LLC

Q

Yeah, good morning. I was wondering if you could just follow up on the comments and the observations around the destocking having run its course and just provide some more granularity if you could. Is it in any particular region that you notice this inflection? Is it tied to any particular end market? And assuming you're talking about MRG and/or Specialty, if you could delineate if there's any trends that have shown up for those businesses in your – I guess in your order demand patterns in – it sounds like in March and certainly through April.

Corning F. Painter

Chief Executive Officer & Director, Orion Engineered Carbons SA

A

Well, good morning, Chris. You're absolutely right, first of all, that that's much less of a factor ever in the tire area just because of the volumes involved. So, we've seen an increase. If we were going to look at, let's say, January – even January times two because we all know February is going to be a weak month, and then we can compare that to March and April, a really – a quite a substantial improvement there. I think that reflects just sort of broad based across a number of different specialty markets, but primarily in the higher margin ones a stabilization, let's say, in terms of customer stocking level. MRG is probably a little bit less pronounced and I think we're seeing there also just simply end demand.

Chris Kapsch

Analyst, Loop Capital Markets LLC

Q

Okay. And then, if I could follow up on the comments around differentials, so if I – this is something that became an issue of – fairly pronounced issue, jeez, I guess, four years ago or so and then with MARPOL coming on the horizon, there is more discussion about the potential dislocation associated with differentials, but I thought that this was addressed in clauses that were incorporated into your supply agreements to protect you and really the industry more generally from adverse differentials. So, if you could just address that, why is this suddenly seemingly a little bit of a headwind that has reared up?

Corning F. Painter

Chief Executive Officer & Director, Orion Engineered Carbons SA

A

Yeah, so first of all, you're absolutely right. It is our expectation that our customers should compensate us for differentials that our sales team should go get that and we are absolutely committed to it. It obviously doesn't fill in right into an index in that sense of it and so it takes some work to go get it. But we're absolutely positively committed to go get these differentials.

Chris Kapsch

Analyst, Loop Capital Markets LLC

Q

And hey – and Corning, if I could just follow up on one other point...

Corning F. Painter

Chief Executive Officer & Director, Orion Engineered Carbons SA

A

Yeah.

Chris Kapsch

Analyst, Loop Capital Markets LLC

Q

...on the – so, just on the increased CapEx spend in North America tied to the EPA and is this Orion specific or do you sense that other players are having to spend more money on – tied to the agreement with the EPA. And I guess it was on page 29 it looks like if I can make out that arrow, looks like you have an expectation that North American supply would be down. I'm just wondering if there's some expectation that because of these extra capital expenditures that the supply [indiscernible] (00:38:45) I'm just rationalize – is that some capacity that's already been taken out? Thank you.

Corning F. Painter

Chief Executive Officer & Director, Orion Engineered Carbons SA

A

Thanks, Chris. So, first off, you're playing to our competitive spirit, Chris, and I certainly hope our competitors are finding their own little challenges, but I can't speak to that. In terms of the trend of that arrow, it's intending to

show just a slightly down trend saying that people are going to have to take outages to make the modifications to implement the EPA work.

Chris Kapsch

Analyst, Loop Capital Markets LLC

Makes sense. Thank you very much.

Q

Operator: Thank you. Our next question is coming from Laurence Alexander from Jefferies. Your line is now live.

Nicholas Cecero

Analyst, Jefferies LLC

Yes, hi. This is Nick Cecero on for Laurence. So, on the Specialty side of things, it looks like you said you are expecting gross profit per ton to increase and you mentioned toward a \$700 per ton level, but I guess as we are moving throughout the rest of the year, is there a way maybe we see mid-\$700 per ton and what would it take to get there?

Q

Corning F. Painter

Chief Executive Officer & Director, Orion Engineered Carbons SA

So, first of all, we're talking about where it's going to average and I think there's going to be quarters where it's above and below that kind of range that I've gotten. Effectively, what it really turns on is mix and overall volume loading because that plays into fixed cost.

A

Nicholas Cecero

Analyst, Jefferies LLC

Understood. And then, maybe just a second question. So, there's been some commentary around China about them looking to reduce the number of approved chemical parks. And I was just wondering if it's come up in conversations already with customers either on products you sell or maybe some of the raw materials that you procure if you're already starting to see some impacts from that – from commentary around that.

Q

Corning F. Painter

Chief Executive Officer & Director, Orion Engineered Carbons SA

Yeah, Nick, that we have not really seen much impact from that.

A

Nicholas Cecero

Analyst, Jefferies LLC

Great. Thank you very much.

Q

Corning F. Painter

Chief Executive Officer & Director, Orion Engineered Carbons SA

You're welcome.

A

Operator: Thank you. Our next question is coming from Dan Carroll from Inherent Group. Your line is now live.

Dan Carroll

Analyst, Inherent Group

Q

Hey, guys. Good morning. Two quick questions. Charles, can you just give me a sense of the going forward impact of the Korean consolidation as that starts to lap over the rest of the year? And then, now that you guys have had a couple quarters of living with SN2A and you guys have talked about electric vehicle batteries being a kind of a long-term opportunity for that. Can you give us some sense of if you kind of quantify that in any way and kind of how big of an opportunity for the company that could be? Thanks.

Charles E. N. Herlinger

Chief Financial Officer, Orion Engineered Carbons SA

A

Sure, I'll talk to Korean consolidation and calling or pick up on SN2A. We've got one more quarter, Dan, that 10,000 tons lapping. In other words, we closed – consolidated the two plants in Korea at the end of June of last year. And so, be roughly 10,000 tons of volume that is rubber volume, low-end rubber volume, that's missing as a result of that consolidation. And then in terms of the previous quarters, we'll have lapped it and it won't long – any longer be a subject of discussion.

Corning F. Painter

Chief Executive Officer & Director, Orion Engineered Carbons SA

A

And to acetylene carbon black and electronic vehicles, so this is something it could be really quite a positive for us. I'd rather not put a sort of pump a happy story out there on how big this can be until it becomes more real. But you see many countries heavily incentivizing right now and making pledges about changing their automotive fleet. There's obviously a lot of challenges in doing that. But to the extent that happens, that certainly creates a very large market opportunity. And as I said, we've bought our plant, we've fixed it up, we've got products [ph] in quall (00:42:22). It's not real until we're [ph] qualled (00:42:25) and customers are taking it and we're moving it and that's why I'm kind of don't want to make statements here. But we see that as something we're on the path to get done and we're looking forward to it.

Dan Carroll

Analyst, Inherent Group

Q

Great. Thanks.

Operator: Thank you. [Operator Instructions] We reached the end of our question-and-answer session. I'd like to turn the floor back over to management for any further or closing comments.

Corning F. Painter

Chief Executive Officer & Director, Orion Engineered Carbons SA

Thank you all for your time today. We appreciate it, and we wish you all a good weekend. Thank you.

Charles E. N. Herlinger

Chief Financial Officer, Orion Engineered Carbons SA

Thank you.

Operator: Thank you. That does conclude today's teleconference. You may disconnect your line at this time and have a wonderful day. We thank you for your participation today.

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