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Conference Call Transcript

IPHS - Q4 2008 Innophos Earnings Conference Call

Event Date/Time: Feb. 10. 2009 / 10:00AM ET

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PRESENTATION

Operator

Good day, ladies and gentlemen and welcome to the Fourth Quarter and 2008 Innophos Holdings, Inc. Results Conference Call. My name is Erica, and I will be your coordinator for today. At this time, all participants are in a listen only mode. We will be facilitating a question and answer session towards the end of this conference.

(Operator Instructions)

I would now like to turn the presentation over to your host for today, Mr. Bill Farran, Vice President and General Counsel of Innophos. You may proceed.

Bill Farran - ***Innophos Holdings, Inc. - VP, General Counsel***

Thanks for joining us today for the Innophos Holdings, Inc., conference call to discuss 2008 results. Conducting the call today are Randy Gress, Chief Executive Officer; Richard Heyse, Chief Financial Officer; and myself, Bill Farran, General Counsel. During the course of this call, management may reiterate forward-looking statements made in our February 9 press release regarding financial performance and future events.

We will attempt to identify these statements by use of such words such as expect, believe, anticipate, intend and other words that denote future events. These forward-looking statements are subject to material risks and uncertainties that could cause actual results to differ materially from those in the forward-looking statements.

We caution you to consider the important risk factors that could cause actual results to differ from those in the forward-looking statements, as contained in this conference call and in our earnings reports and filings we make with the SEC. We will make a replay of this conference call available for a limited time over the telephone at the number set forth in our press release and via a webcast available on the Company website.

In addition, please note that the date of this conference call is February 10, 2009. Any forward-looking statements we may make today are based on assumptions that we believe to be reasonable as of this date, and we undertake no obligation to update these statements as a result of future events. Now I'd like to turn the call over to Randy Gress, CEO of Innophos. Randy?

Randy Gress - ***Innophos Holdings, Inc. - CEO***

Thanks, Bill, and good morning, everyone. In keeping with the usual approach we use on our conference calls, I will start off with some comments about the full-year results and then what we have seen in the business in the fourth quarter, and finish up discussing our outlook generally. Then Richard Heyse will give us some of the highlights for the quarter and the full year. Next, Bill Farran will give us an update on the outstanding legal issues and then, after a short summary from me, we will take your questions.

Full-year results can only be described as exceptional. We saw substantial increases in 2008 net sales at $935 million versus $579 million in 2007 or a 61% improvement as our 83% selling price increases positively impacted revenue and income by $480 million across all product lines. These changes outweigh the 22% negative volume and mix impacts on revenue, primarily in STPP and other products.

Reflecting the quarter's results, the largest portion of the annual negative volume and mix changes took place in Mexico due to reduced demand for granular triple superphosphate, GTSP, fertilizer co-product, because fertilizer markets have ground to a standstill, and also limited reformulation in detergents using sodium tripolyphosphate or STPP.

Meanwhile, in the US full-year demand for specialty salts and specialty acids was strong, with a positive volume and mix impact. We had strong performance in this area by focusing on growing the business domestically as well as internationally. This is why you see a positive 6% favorable volume variance year-over-year in the specialty salts and specialty acids business. We were very successful in achieving our objectives.

However, purified phosphoric acid had unfavorable volume and mix for 2008 compared to 2007, primarily due to lost production from planned maintenance and an unplanned Hurricane-driven outage at our Geismar, Louisiana, facility, along with the impact of the recession on fourth quarter industrial and agricultural demand.

Benefiting from our raw material supply contracts, which buffered us from much of the 2008 price shocks in sulfur and phosphate rock, and strong product selling price increases, we saw 2008 operating income increased by $248 million, or 520%, and net income improved by $206 million compared to a loss of $5.5 million for 2007. These were unprecedented levels of achievement for our business.

Now in switching to the most recent quarter's performance, Innophos delivered solid results in the fourth quarter despite a selling environment that became significantly more challenging through the quarter. Net sales for the fourth quarter were up 50% over fourth quarter 2007, due to average selling price increases of 98% or $141 million across all product lines. Operating and net income for the quarter at $69 million and $52 million respectively, show that we continued to operate successfully in the dynamic pricing and cost environment despite a lack of demand for fertilizer and the softening of demand for other products at the lower end of our product portfolio.

One can see this softening of demand in the quarterly volume and mix impacts on revenue, which had a negative impact of almost 48% across all product lines, but most notably in the STPP and other products, due to reduced demand for GTSP fertilizer co-product in fertilizer markets that were essentially non-existent in the fourth quarter. Volume was also lower both in US and Mexico in specialty salts and specialty acids, primarily due to reduced demand in some technical applications.

As one would expect, demand for our other products supporting the food, beverage, pharma and oral care business held up well. Demand was also lower in the United States for technical grade purified phosphoric acid. Technical grade products are primarily used in the industrial, detergency, and horticulture markets we serve.

Accordingly, volumes in the US were lower in the fourth quarter particularly in accounts exposed to the agricultural and industrial markets, due to overall economic slowness and likely correction of inventories across the chain all the way to the final customer. In addition, competitive pressure from European and Chinese producers increased as they began to try to enter the US market in response to slowdowns in their home markets.

Going forward as result of these pressures, we expect to see downward pressure on selling prices which are currently at historically high levels. In response, we are taking a more aggressive stance to retain our leading market position and keep profitable business going forward. We are responding to the increased pressures in all segments by maintaining a competitive offering. We are prepared to maintain our share using the best business practices we know from many years in this industry.

We will continue to focus on providing the best service, proprietary technology, and improving our supply chain to help ensure the quality and consistency of our customers' products. Our raw material outlook has changed since the fourth quarter and it's continuing to evolve up to today as demand for phosphate fertilizers fell to nearly zero, and worldwide economic conditions have pushed the market price of sulfur down rapidly.

We are benefiting from declining sulfur, energy and transportation costs in comparison to 2008 levels. Since there has been very little phosphate rock traded recently, there simply isn't much data concerning the market prices, although a few recent trades have occurred that indicate the market price of phosphate rock has also begun to decrease significantly. As a result, we are currently expecting our overall first quarter 2009 US cost structure to remain substantially unchanged from fourth quarter 2008 levels.

In order to calculate our raw material cost in Mexico, we assume sulfur market prices would remain at current levels. And for phosphate rock price, we used the upper end of the range of what we have determined to be reasonably possible outcomes of the arbitration process that we are currently undergoing with OCP.

Due to the recession-driven Latin American market weakness, competitive factors, phosphate rock pricing uncertainty, and weak global demand for fertilizers, we currently anticipate operating our Mexico plant at significantly reduced levels for 2009. Also, we built considerable raw material inventory at the end of 2008, which will delay the impact of phosphate rock cost increases. Therefore, the increases in phosphate rock cost will not begin to affect our financial performance until the middle of the second quarter of 2009.

Considering these assumptions, we expect Innophos' first quarter 2009 cost structure in the United States, Mexico and Canada, to be similar to the fourth quarter of 2008. As most of you already know, we are disputing the interpretation of the pricing clause for our phosphate rock supply deposit focus. Both parties are resolving the dispute with binding arbitration, which is specified in the contract.

The three arbitrator panel has been named and we hope to conclude the process as quickly as possible, but it could take through the end of the year. Both 2008 and 2009 pricing are being disputed. However for 2008, we do not have any material negative downside to what was reported.

For 2009, we are using for our disclosure and outlook for overall performance, assuming phosphate rock cost to be at the upper end of what we deem as reasonably possible from the arbitration. The results could increase our cost for Mexican production by approximately $40 million per quarter in the second half of the year assuming full capacity operations. However, assuming we continue to operate at current reduced levels, this would result in an increase of roughly half the previously reported full capacity amount or $20 million increased cost per quarter.

Last quarter, we mentioned that we were seeing limited amounts of detergent reformulation to replace STPP with alternative chemistries. It appears that this reformulation trend may gain momentum. In addition, we believe Innophos' largest Mexican customer recently lost a significant amount of STPP business for which Innophos historically supplied purified phosphoric acid. This loss of business triggered the closing of one of this customer's three STPP plants, which represented over 50% of its STPP production capacity. This customer is therefore reducing its purified phosphoric acid purchases from Innophos starting in the first quarter of 2009, where we expect to supply roughly a third of historical volume.

We estimate that this loss of business could result in a 2009 revenue loss of between 5% and 10% of historical total company sales and then annual consolidated operating income reduction of between $6 million to $16 million based on pre-2008 historical profitability and management success and mitigation efforts. We are taking a number of actions to address this situation. First, we are continuing to work with this customer to support its reduced operations and, of course, we are focused on increasing Innophos' overall share with the customer, if we can do so in a manner that is mutually beneficial.

Second, because of the reduced operational levels, we are taking actions to reduce manufacturing cost across the whole site. Also, we are considering several options for the longer term, including seeking new customers for Innophos' Mexican purified phosphoric acid capacity. We have accelerated plans to increase Innophos' diversification of end markets and customers in the future.

Additionally, with limited and reasonable investment levels, we are increasing the flexibility to greatly the increase the capacity that can be utilized to supply the US operations and to grow the business. Because we continue to be focused on finding new customers for our higher margin products, we are investing to upgrade the majority of Mexico's technical grade purified phosphoric acid capacity to food-grade capability. We anticipate the investment will be completed by the end of 2009.

Separately, as for our main US and Canadian raw material supply in the first quarter, Innophos purchases some of its purified phosphoric acid needs from a third party US supplier. While that supplier's Aurora, North Carolina, purified acid unit is being curtailed temporarily due to a partial shutdown of their complex due to a lack of phosphate fertilizer demand, Innophos is responding by operating its Geismar, Louisiana acid purification complex at full capacity. And we expect that we will be able to meet our current operating and supply plans without having to supply purified acid from our Mexican operations. In the event that our suppliers' outage is extended, we could supply our Mexican produced purified acid to meet our US and Canadian market commitments.

We are currently projecting that our US specialties businesses will perform well in the first quarter of 2009. While we cannot rule out price pressure throughout our portfolio, this portion of business supplies much of the defensive end markets that we consider our core business -- pharma, food and beverage, which comprises a small percentage of our customers' end product cost.

Our US and Canadian purified acid supply is cost effective in today's marketplace and product selling prices are now at historically high levels. And turning to our Mexican operations, in the first quarter of 2009 we expect to operate at roughly 50% capacity and pursue business with solid margins. Our main goal is to operate Innophos' Mexican facilities profitably. A side benefit of running at reduced levels is that it will reduce any contingent liability due to rock price uncertainty caused by our current arbitration of our phosphate rock supply agreement.

We will focus on reducing cost sufficiently to run profitably at lower capacity utilization and will take every additional opportunity to gain needed efficiencies. We've also looked hard at our plant capital expenditures for 2009 because we want to focus investment on critical projects that maintain the flexibility and efficiency that we need in the current dynamic market environment.

For example, Innophos is continuing with the expansion and upgrade of its Chicago Heights facility, which is critical to the growth of its higher margin pharmaceutical and nutraceutical excipient product line. As a result, we now project 2009 capital expenditures to approximate $20 million to $25 million, in line with historical levels. This amount also includes the investments being made to upgrade the Mexican phosphoric acid purification plant.

In expressing an outlook for Innophos financial performance in 2009, we must consider several issues. We cannot now predict how severe the recession will be, nor the associated impact on industrial and agricultural demand. With the uncertainly around Mexican phosphate rock cost and operating levels, and along with greater competitive intensity, we have to conclude that we cannot offer reliable and specific operating income guidance for the year.

We can give you an idea of first quarter outlook. We expect that first quarter 2009 volumes will be up approximately 15% from fourth quarter 2008 levels. For selling prices, with the usual puts and takes from various customer agreements, we expect to increase prices in some areas, primarily in the US, but this will be offset in our less specialized product areas and should result in overall prices that should remain somewhat similar to those of fourth quarter 2008. Lastly, our cost structure should remain relatively flat as well.

Beyond the first quarter, volume impacts are uncertain and we believe are recession dependent. We do expect to see selling prices trending down, while Mexican cost structure increases also start to kick in mid-second quarter, again, to some extent affected by operating levels. Now Richard will give you some more details about the quarter and the year.

Richard Heyse - ***Innophos Holdings, Inc. - VP, CFO***

Thanks, Randy. Despite the world economy entering into a severe recession in the fourth quarter, Innophos achieved solid fourth quarter net sales and operating income results of $216 million and $69 million respectively compared to $144 million and $6 million in the fourth quarter of 2007. In the fourth quarter, year-over-year selling price increases had a favorable impact on revenue of 98% or $141 million.

Volume mix impacts had an unfavorable impact on revenue of 48% or $69 million in the quarter. So in fourth quarter, our favorable selling price variances offset the unfavorable volume variance caused by lack of fertilizer demand, the softening demand for products at lower end of our portfolio and the year-over-year unfavorable impact of increased raw material cost.

For the US, year-over-year quarterly net sales increased 55% in the fourth quarter due to higher prices across all product lines, most notably in specialty salts and specialty acids, which exceeded lower volumes across the -- the impact from lower volumes across all product lines, most notably in purified phosphoric acid. Our technical grade applications accounted for the majority of the volume decline as our technical grade applications are most exposed to the industrial and agricultural markets which are currently in a severe recession.

In Mexico, net sales increased 46% versus the comparable quarter of 2007 due to significantly higher prices across all product lines, which exceeded lower volume and mix effects on revenue. STPP and other products accounted for most of the volume and mix declines primarily due to reduced demand for GTSP fertilizer and lower sales of STPP due to a number of factors including reformulation. So we are seeing a broader recession-driven trends and are potentially seeing momentum gain in STPP reformulation, that is, further reductions in the use of STPP in detergent application.

Diluted EPS was $2.40 for the quarter and $9.23 for the year. As Randy already commented, full-year EPS was outstanding. Included in our fourth quarter results was a pre-tax charge of $1.9 million related to the write-down of on-hand GTSP fertilizer inventories to net realizable value. Also included in the fourth quarter taxes was a benefit of $14.4 million or $0.66 per share due to the use of NOLs in the partial reversal of certain valuation allowances against US Federal net deferred tax assets.

We have concluded that a full valuation allowance is no longer needed due to anticipated future US profitability. The impact of the above for the full year was a benefit of $24.9 million, or $1.15 per share. Although we did have an unfavorable impact of increasing inventory on fourth quarter working capital levels, Innophos ended the year with a cash balance slightly in excess of $125 million, as anticipated. Our March 2009 mandatory free cash flow sweep payment on our bank debt will be approximately $54 million.

In the fourth quarter, we made estimated income tax payments as planned and there was no need to use the Company's revolving credit line. Finally, we are targeting to maintain an operating cash balance of at least $60 million during 2009 due to the upcoming expiration of our revolving credit facility. Capital expenditures for the full year 2008 were $18.5 million compared to $28.4 million in 2007, when the Company was investing in Coatzacoalcos cogeneration project. This is a bit on the lower side of our targeted $20 million to $25 million range.

In 2009, we expect to invest $20 million to $25 million in CAPEX with a focus on greater production efficiency and growth in our higher margin, more stable businesses. On the other hand, some potential investments in Mexican capacity that we had previous considered important in a higher demand environment will be pushed out until it's demonstrated there is a strong demand side argument to be made for those projects.

As you know, since 2005 Innophos has stayed focused on strengthening its balance sheet. As a result of our exceptional performance in 2008, we've been able to continue to make significant progress and greatly exceed the de-leveraging goals we set for ourselves in 2005. During 2008, we reduced net debt by 30% from $369 million to $257 million, strengthening our balance sheet, putting ourselves in an excellent liquidity position with a $125 million of on-hand cash at year-end.

Our year-end net debt position of $257 million, when compared with our peak net debt position of $493 million in early 2005, speaks of the significant progress we have made in less than four years. In addition, we billed $118 million of working capital during 2008 and anticipate recovering a significant amount of this working capital billed in 2009 and early 2010.

This recovery of working capital cash combined with free cash flow generated from 2009 operations is expected drive additional increases in our cash balances during 2009. This anticipated 2009 cash flow generation, plus current on-hand cash, exceeds our current bank debt balance and so we anticipate no difficulties with paying off our remaining term bank debt from on-hand cash as it begins coming due in the fourth quarter of 2009.

After our bank debt, our next maturity is our $66 million of Innophos Holding, Inc., or holdco notes, placed in 2007 which are not due until 2012. So with our steady multi-year focus on our improving our balance sheet, we've been successful today to navigating Innophos through the current credit crisis. Now I'll turn it over to Bill for a legal update. Bill?

Bill Farran - ***Innophos Holdings, Inc. - VP, General Counsel***

Thanks, Richard. In addition to initiating international arbitration proceedings in order to resolve a dispute with our phosphate rock supplier, OCP, over the interpretation of the pricing provisions of our supply contract which Randy discussed briefly, we've had several developments in the fourth quarter that I'd like to take a minute to highlight.

First, we received confirmation from the United States Department of Justice or DOJ that its investigation into the STPP industry for potential antitrust violations, with which we cooperated fully, was closed as to Innophos. And the documents we provided in response to the DOJ's subpoena will be returned to us. Secondly, remaining claims by the Mexican National Waters Commission, or CNA, for higher water fees sought for the period 1998 to 2002 from our Mexican plant totaling approximately $24 million for which we are fully indemnified by Rhodia, S.A and its affiliates, remains on appeal in the Mexican court system.

During 2008 we received a unanimous favorable ruling from the Mexican Tax Court, most recently on further appeal by the CNA. That ruling was affirmed in part and remanded in part for the stated reason that the written decision below did not adequately explain the Court's rulings on all points raised by the CNA. We understand that a decision on remand should be available soon but we do not have an exact date.

Third, as we explained in the press release, we continue to engage in active discussions with the government parties as to potential civil enforcement with regard to our Geismar, Louisiana, plant's compliance with, or exemption from certain hazardous waste regulations also known as RCRA regulations. In the context of potential settlement, we are working on technical solutions with a neighboring facility which supplies raw materials to our plant and receives a co-product from our plant and have submitted regular updates to the government parties.

We believe it is probable that we will reach agreement on implementation of a technical solution for one of the two significant issues at the site at a cost which would not be material. A viable technical solution has not been identified for the second issue although we are continuing to work with our neighbor in the hope of finding a viable solution.

At this point we cannot determine whether the entire matter will be resolved by settlement with the government parties or whether the issues surrounding our claimed exemptions from RCRA regulations will require litigation. I'll now turn it back over to Randy for the closing.

Randy Gress - ***Innophos Holdings, Inc. - CEO***

Thanks, Bill. 2008 was an excellent year for Innophos. And I want commend and thank our employees for their commitment to the goals that we have reached in the past year. Their work has put us in a position to capture opportunities that arise in the current 2009 environment and handle the challenges. As we face issues in 2009 that we have laid out, we will keep you updated on the routes we take towards resolution.

We are prepared to operate aggressively to preserve market share, as companies do when they have commodity-influenced inputs and are seeing increasing economic and competitive pressures. We will retain profitable business and believe that the historical averages to which we expect the business to return can enable us with continued de-levering and healthy free cash production to continue to offer a stable return to our stakeholders.

We will continue to invest in increasing our capability in specialty salts and acids, as well as increase our food-grade acid capability. Meanwhile, we continue to move toward de-risking the Company as we have done since its formation, by reducing debt, both overall and on a net basis, returning capital through dividends, and by choosing capital investment in higher margin product lines, when the demand situation is stable.

We believe the work we have already done to improve efficiency and to move capacity toward higher margin business in 2008, will serve us well. And we are continuing to execute incremental projects that will move us in this direction over the coming year as well as increase our flexibility to be successful in addressing the challenges the future brings. Thank you for listening. Now we will take your questions. Operator?

QUESTION AND ANSWER

Operator

(Operator Instructions)

And your first question comes from the line of Christopher Butler from Sidoti & Company. You may proceed.

Christopher Butler - ***Sidoti & Company - Analyst***

Hi. Good morning, guys.

Richard Heyse - ***Innophos Holdings, Inc. - VP, CFO***

Good morning, Chris.

Christopher Butler - ***Sidoti & Company - Analyst***

Wanted to direct that the first question towards the STPP business. I know one of the concerns during 2008 with the dramatic pricing that was put in was that there would be demand destruction and concerns about reformulation. It seems that at this point some of those fears are coming to fruition. Could you touch on sort of the -- that as far as Innophos versus the industry down there and you also mentioned that pricing in the US would continue to climb. Any risks of a similar situation in the US business looking forward?

Randy Gress - ***Innophos Holdings, Inc. - CEO***

Yes, thanks, Chris. As far as the STPP impacts from reformulation, we have seen some demand destruction there. I think that comes in two areas; one is some reformulation in some of the products and specifically talking about some of the laundry detergent in the Latin America area, some reduction that we see in the actual formulations and the use of STPP, although they are still used in the formulations, and the other maybe some introduction of some no-P, or no-phosphate, type of products.

So we have seen some of that but what also we see is, some of the export markets from Mexico that are being supplied where there is increased competition and not necessarily the demand destruction, increased competition, primarily from China. As far as the overall demand, we have seen some -- and potentially I think in the US, just to add to that, there has been the pressure from the auto dish-wash regulations, although there hasn't been a significant increase in that activity, the time line for that was 2010.

And basically, in response to any kind of demand destruction, what we are doing is, I think, one, for the US, we have converted some of our capability in Port Maitland to make food grade products, primarily for the baking area. And then in Latin America, we're making some investment here on the acid side to convert to greater food grade product there, and then our offering.

And as far as the US pricing, the second question there or comment, we are seeing some improvements still into the first quarter but over time would see some further pressure on prices. But the -- any further demand destruction that we've seen has been limited.

Christopher Butler - ***Sidoti & Company - Analyst***

And help me out here a little bit. I have looked at detergents as being somewhat less tied to the overall economy and everything that I've heard as far as long-term trends for fertilizer demand, which still seem to be on the up and up, a plant closure as opposed to mothballing from your customers seems to be a fairly dramatic step. Is this a situation where the competition has come in from overseas so hard and have really show no signs of letting up that that becomes necessary?

Randy Gress - ***Innophos Holdings, Inc. - CEO***

As far as the fertilizer, yes. We're in the fertilizer business primarily as a co-product there with our GTSP and we would expect recovery in that market, most likely within the second quarter there. But for the STPP, and the competitor or the customers' decision to reduce the STPP capacity, I believe most of that business was for export outside of Mexico to supply the US as well as Latin America. And with the loss of business, they decided to shut that down. There is no evidence of dismantling at this point.

Christopher Butler - ***Sidoti & Company - Analyst***

And looking at the upgrade that you are talking about to food-grade in Mexico, there doesn't seem to be a significant uptick in capital expenditures expected for 2009. Is this a relatively inexpensive event? And if the business were to pick up, say on the fertilizer side again and becomes profitable, can you move -- ship production back to the lower grade easily or is this a situation where once the migration has taken place it's a done deal?

Randy Gress - ***Innophos Holdings, Inc. - CEO***

I think that, as far as the investment, it is fairly modest. It is included in our capital plan there in the $20 million to $25 million expenditure. Basically, it does give us a great deal more flexibility to support our growth in the food business as well as support our overall acid network. As far as the flexibility, it does allow us to convert back if the need or the opportunity was there.

Christopher Butler - ***Sidoti & Company - Analyst***

Thank you for your time. I'll go back in the queue.

Randy Gress - ***Innophos Holdings, Inc. - CEO***

Thanks, Chris.

Operator

Your next question comes from the line of Jeff Zekauskas from JPMorgan. You may proceed.

Jeff Zekauskas - ***JPMorgan - Analyst***

Hi, good morning.

Richard Heyse - ***Innophos Holdings, Inc. - VP, CFO***

Good morning, Jeff.

Jeff Zekauskas - ***JPMorgan - Analyst***

I guess a couple of general questions and a couple of specific ones. Your operating margin in the quarter was 32% and if you go back to 2007 and 2006, your operating margin was roughly between 6% and 8%. And we have had this very unusual appreciation in raw material costs, having to do with a tightness in the fertilizer industry that's now past. Order of magnitude, what should your normalized margins be? That is, should they go back to that, say, 6% to 8% level, or you think that they will reach a different level because of changing in industry dynamics? Can you talk about that overall?

Richard Heyse - ***Innophos Holdings, Inc. - VP, CFO***

I think as we said, there is lot of moving pieces right now; it's harder to forecast more than a couple of quarters. As far as the operating margins there -- again, we've been trying to shift mix towards the specialty products, which have a higher operating margin. But clearly right now we are benefiting from the price increases we got in excess of raw material cost.

Jeff Zekauskas - ***JPMorgan - Analyst***

Right.

Richard Heyse - ***Innophos Holdings, Inc. - VP, CFO***

As Randy mentioned, there will be some pricing pressure. To try to project out into 2010, 2011, will we return to kind of historical norms, Randy touched on that in the press release, or the script just now. And I think that that's very possible, but we've got, again, a number of moving pieces that I think, most notably would be, what is the intensity of Chinese competition?

They are facing some new pollution control regulations; they are getting the benefit of lower energy prices. Energy dropped pretty dramatically and they use a different route to making specialty phosphate. They use one that is very energy intensive. But to me the biggest single driver probably and what will be our future operating margins is will be dependent upon the intensity of Chinese competition and their cost structure, which is heavily dependent upon energy prices.

And because they are losing, they have been -- if we are what we see now from product prices out of China, you can see the effect of them losing the support, the subsidies they have been getting from the government and we anticipate with the new pollution control regulations, they're going to have some more pressure. So ultimately it's a good answer -- basic answer, it's hard to answer your questions.

Jeff Zekauskas - ***JPMorgan - Analyst***

It's hard to know.

Richard Heyse - ***Innophos Holdings, Inc. - VP, CFO***

If you can tell me where oil prices are going to be in 2010 and '11, I probably could give you a better answer. If oil prices and energy prices are high, I would expect us to have better margins, particularly in specialty businesses. If they stay low, it's going to be pretty competitive for the next couple of years.

Jeff Zekauskas - ***JPMorgan - Analyst***

Okay. So secondly, one of the things that Innophos has really been characterized by over the past two or three years has been the stability in demand. And what's happened is that demand has gotten more volatile. Now part of it is that it seems that you've had some difficulties with your customer base in Mexico.

But even if we exclude that, I think it seems that the demand volatility now is much greater than it has been. So when you look at this down 48% number, is it natural to assume that four quarters from now or three quarters from now, you should be up 20% or is demand not the kind of thing that would spring back that way as inventories are rebuilt?

Randy Gress - ***Innophos Holdings, Inc. - CEO***

Let me just comment on the overall demand. I think if you break it into the different major product categories, first, you look at what we were hit in the fourth quarter and what we are seeing now in fertilizers side, with our co-product that's basically been non-existent in the market demand. I think if you look at the acid side, we've seen some decline there because of the heavier amount that's in the technical applications and impacted with some of what's going on with the global recession and what we are facing there.

And then in the specialty salts and specialty acids, certainly the portion that's in the food, pharma and consumer side and the consumable side, we've always said that we are resistant to any kind of economic downturn. I think in that area, we may be seeing some correction in inventories, because it is a long supply chain from the grocery chain to the manufacturers, even into the home of the consumer.

So I think certainly in that area we would expect some recovery in what we have on the supply side. As far as the overall impact going forward with some of the corrections in the chain, I think we would expect to see some recovery in the fertilizer and in the other products, but just how great that would be is difficult to determine right now with what's going in the economy.

Jeff Zekauskas - ***JPMorgan - Analyst***

That's helpful. Just a couple of small things. How many NOLs do you have remaining or what's the aggregate amount of your tax NOLs remaining?

Richard Heyse - ***Innophos Holdings, Inc. - VP, CFO***

It's very minimal. The little bit we have at the state level, frankly, and yes -- it's about $4 million or $5 million.

Jeff Zekauskas - ***JPMorgan - Analyst***

$4 million to $5 million.

Richard Heyse - ***Innophos Holdings, Inc. - VP, CFO***

But we've pretty well consumed the NOLs plus the balance in essence that we were -- because we could remove the valuation allowance. That value is pulled on the balance sheet in the fourth quarter. We'll give some specific disclosure on that when we file our K, but in essence the tax impact is recognized this year.

Jeff Zekauskas - ***JPMorgan - Analyst***

And then lastly, when you see product substitution because prices have moved up, where is that, in which product lines?

Randy Gress - ***Innophos Holdings, Inc. - CEO***

Where we've seen it, I think we have commented before, it would be we've seen some modest substitution in the STPP and it's -- other than that it's been minimal, but it's just been primarily in the STPP area.

Jeff Zekauskas - ***JPMorgan - Analyst***

Okay. Thank you very much.

Operator

(Operator Instructions)

Your next question comes from the line of Frank Mitsch from BB&T Capital Markets. You may proceed.

Frank Mitsch - ***BB&T Capital Markets - Analyst***

Thank you and good morning.

Richard Heyse - ***Innophos Holdings, Inc. - VP, CFO***

Good morning, Frank.

Frank Mitsch - ***BB&T Capital Markets - Analyst***

I was curious about the assertion that your volumes are going to be off 15% in the first quarter versus the fourth quarter. Can you give a little bit of breakdown as to which end markets you anticipate that 15% drop off sequentially?

Richard Heyse - ***Innophos Holdings, Inc. - VP, CFO***

As we comment in the script, we are seeing more in the, what we would call our technical grade, if you look grades in phosphates it goes agricultural/feed, technical then food, and then finally pharma. The technical grades get used in industrial situations, also for agricultural making various components for agricultural fertilizers.

And those markets are very much being affected by the recession. But we what we are also seeing in the first quarter, and this is similar to what a number of food product companies have commented, is that it appears even there is some a bit of fall off in the food categories as grocery stores and the inventory channels reduce inventories.

And I think part of what we're seeing is similar to what other chemical companies are seeing, in that the GDP is contracting very rapidly. There was an inventory build up in the US in the fourth quarter despite a slowdown in production. And I think across the board, companies were seeing that similar kind of follow up. I've heard quotes today as much – that US GDP may be off anywhere from 6% to 7% in the first quarter, year-over-year, which is a pretty staggering number. So there is definitely a recession out there and I think we're seeing it like most companies are.

Frank Mitsch - ***BB&T Capital Markets - Analyst***

All right. So I am trying to get a handle on the 15% breakdown. It sounds like you would put some in the food and beverage camp, some in the detergents camp, some in the industrials camp and some in the fertilizer camp?

Richard Heyse - ***Innophos Holdings, Inc. - VP, CFO***

Yes, it's probably the -- two-thirds of it are -- two-thirds is probably in the technical applications, which would be detergency, industrial and in fertilizer we said it's just been the market is non-existent. It's still --it's just barely starting to function in the last couple of weeks. So that market that we didn't ship much product in the fourth quarter, so relative to that 15% is more in the detergency and the tech and industrial.

Frank Mitsch - ***BB&T Capital Markets - Analyst***

I see, okay. And then you -- you obviously mentioned about the Mexican client. So that's going to continue to be a volume -- a negative volume impact for as far as you can see. Is that correct?

Richard Heyse - ***Innophos Holdings, Inc. - VP, CFO***

Correct.

Frank Mitsch - ***BB&T Capital Markets - Analyst***

All right, great. And with respect to the environmental litigation that you have currently ongoing, you say pretty much issue one is not material, however issue two -- it sounds like an open-ended liability with an undetermined cost. When might we get clarity on that issue?

Randy Gress - ***Innophos Holdings, Inc. - CEO***

I'm going to ask Bill Farran to answer that.

Bill Farran - ***Innophos Holdings, Inc. - VP, General Counsel***

Yes, thanks for the question. Yes, I think we are sort of working with the technical teams on that end with the government parties. I think we regularly update the government, so they are familiar with this issue. And I know it's hard to predict just when a technical solution to something would be found. I can say that we have some very capable teams of both companies working on this, and I would expect this issue to be better known in the summer.

But the talks with the government are continuing and as I mentioned briefly in the presentation, it's difficult now to determine whether the whole matter will settle or whether we're going to have to get the help of a court on the interpretation of the exemptions for the whole site for both matters that we've been claiming. But we now think it's probable that we are going to reach an agreement with respect to the first issue with the government and won't have the cross swords on that. But the second is both a legal and a technical head-scratcher right now. So if I were to just guess, we will have more insight into it this summer.

Frank Mitsch - ***BB&T Capital Markets - Analyst***

Your engineers' best guess on the amount of funds that might be required for the second, technical solution, I mean is this -- are you just trying as to put this in a breadbox, if you will. I mean, how large could this be?

Bill Farran - ***Innophos Holdings, Inc. - VP, General Counsel***

Well as I said, if it's something that can't be resolved by agreement, we'll litigate the exemption. But I can't put a number on a technical solution, it really hasn't been identified. I mean this site and others have long claimed, we think rightly, a mineral processing exemption from the hazardous waste loss which is the matter that is in dispute across the country.

So we aren't alone in this and it's not sort of a remote sort of claim we're making. It is, in fact, something that-- there is a reason that there is an exemption. We have large volume materials that have to be handled. So, I mean, if we don't have the technical solution to handle it as the government wants us to, I can't put a number on that. I can say that to become something that the companies are not willing to underwrite, we will engage in litigation.

Frank Mitsch - ***BB&T Capital Markets - Analyst***

All right, terrific. And while we're on the topic of litigation and arbitration, if you will, the Moroccan phosphate rock situation. Is one way to think about that is that as every day goes by, it appears that phos rock prices are coming down. Would it not be in the Moroccans' favor to try and to get a ruling sooner rather than later on this that or am I thinking about this wrong?

Bill Farran - ***Innophos Holdings, Inc. - VP, General Counsel***

No, I think you're thinking about it correctly and I think the parties are both in agreement generally that it ought to move forward expeditiously. I don't know whether you're familiar with international arbitration. This is at the ICC in Paris. That will require an agreement and there are some issues that are flying back between the parties right now, if you will, to frame on that. But I am optimistic about the companies both agreeing to do this on an expedited basis.

Now what that means, though, isn't something that will happen tomorrow afternoon, it's litigation. You have to sort of start counting back from, you've got three world-class arbitrators who are going to need some time to make a decision. You've got the presentations of the parties. So when you start to do that on a calendar basis, you're probably at best in the middle of the year. But to answer your question, yes, I think it's in the interest of both parties and we're hammering out what we hope will be an agreement on an expedited basis.

Frank Mitsch - ***BB&T Capital Markets - Analyst***

Terrific, thank you.

Operator

Your next question comes from the line of Bill Hoffmann from UBS. You may proceed.

Bill Hoffmann - ***UBS - Analyst***

Hey, good morning.

Richard Heyse - ***Innophos Holdings, Inc. - VP, CFO***

Good morning, Bill.

Randy Gress - ***Innophos Holdings, Inc. - CEO***

Good morning, Bill.

Bill Hoffmann - ***UBS - Analyst***

I just wanted to -- Richard, I just want to run through the working capital cash release as you go through the period. You talk about, one, having built a lot of inventory in fourth quarter. I am just trying to get a sense on how that starts to flow out in the first half and you also mentioned that your cost structure is pretty well locked in for that first half of the year. So if you can explain a little bit more about the cash release?

Richard Heyse - ***Innophos Holdings, Inc. - VP, CFO***

Well, we -- as we said we increased working capital inventories in particular in some areas that made sense before the annual price resets, in essence some pre-buying occurred. Also, one of the things we did is we paid all of our bills, so unlike most parties in the fourth quarter, we were receiving inventory and paying off bills and so the gist of that was, like I said, $118 million. I think as our unit inventories drop and as we get down to kind of normal levels of on-hand inventory, which should happen in the first and second quarter, we'll see some of that value come out, when working capital gets changed to cash, but the balance will have to wait till 2010 until some of our unit prices drop further.

Likewise, on receivables we're seeing that drop a bit, as sales drop. So we're getting some recovery there. But I think it's reasonable that between now and, say, first quarter 2010 that we should recover maybe about half of that working capital. And again, you throw that in with we expect to have positive operating cash flow in the year and we feel pretty good about our cash position for the year.

Bill Hoffmann - ***UBS - Analyst***

Great, that's helpful. The second question is just, given some of the color that you guys provided, certainly about the Mexican facility, I think the thing that I am still questioning is thinking about the margins in the domestic US business and how that may trend back down towards more normal levels. Just because I guess I -- the one thing I really question is, your costs are up because you got the inventory on hand and will stay at these kind of elevated levels, yet demand seems like it's softening, and I would have expected prices to start to come down. Can you just talk about that dynamic and when you start to see your margins getting compressed?

Richard Heyse - ***Innophos Holdings, Inc. - VP, CFO***

Yes, again I think as we said in the press release that we would expect there is going to be pressure on pricing through the year. In the past, we identify these situations, we respond to competition, we know which customers we serve long term and we're clearly going to maintain overall competitiveness with those customers. So as Randy said in the script, beyond the first quarter, it's very difficult right now to predict the competitive environment besides that we know the intensity is going to be high. But we'll be dynamic in our response and we'll stay competitive at the customers that we have served long-term. And we will just simply as if the year evolves and each quarter we'll just have to get everyone updates. But at this point, we know what the first quarter -- got a good feel for the first quarter, but we don't know what things we will have to respond to in the second quarter as competitors take action. So wish we could give you better clarity of this. As we said in the script, it's a very, very difficult time right now and I don't think many companies are able to pierce through the second, third, fourth quarter and predict what things are going to look like.

Bill Hoffmann - ***UBS - Analyst***

Do you have any sense even in the first quarter here maybe what the cost inventory position is of your competitors, i.e. do they have a lot more flexibility in having lower raw material costs coming into the year than you might?

Richard Heyse - ***Innophos Holdings, Inc. - VP, CFO***

Again, it depends on the competitor. Several of our European competitors are not integrated back to phosphate rock similar to Innophos. So we don't know what their purchasing arrangements are, so we can't guess and say what their cost structure is. We do have one competitor, Israeli Chemicals, that is integrated back to rock, in Israel. And so, they clearly have got a good cost structure. But generally we've had a reasonably good cost structure also with our contracts and have been able to compete profitably.

I think the flipside if you look at the lower end of our portfolio where the competition is more based in what we're seeing particularly for Mexico is based out of China, part of what -- due to some actions by the Chinese government, their phosphate rock cost is somewhat below market levels, global levels. So they have had some advantage due to, effectively regulations in China -- it's a regulated economy. And so, there -- until the cost of phosphate rock in China gets back to normalized with world levels, they do have a somewhat of an advantage right now.

Bill Hoffmann - ***UBS - Analyst***

Great, thanks. That's helpful.

Operator

(Operator Instructions)

Your next question comes from the line Maryana Kushnir from Nomura. You may proceed.

Maryana Kushnir - ***Nomura Asset Management - Analyst***

Hi. I was wondering how much do you think prices would have to fall in order to invite competition and basically return to the competitive environment you've seen early in '08?

Randy Gress - ***Innophos Holdings, Inc. - CEO***

Maryana, can you repeat the question?

Maryana Kushnir - ***Nomura Asset Management - Analyst***

Basically how much do you think prices of the finished products would have to fall in order to put the market back in the position it was early in 2008 where you would describe the market as being super tight and virtually very little foreign competition?

Randy Gress - ***Innophos Holdings, Inc. - CEO***

If I can make some comments, I am not sure if I'll get it directly. I think as far as the -- there was some global tightness in the overall supply demand balance in the beginning of '08, but at that time also there was a significant run up in cost. And throughout the year, we had implemented a series of price increases throughout the year.

I think some of that is capturing some of the value and use of the products, especially on the specialty salts specialty acid side and some of the critical functionality that those products provide. And going into this year, we are still seeing at the high end here, some improvement in the price, in the value we're getting on those products. It's in the lower end on the portfolio where we're seeing some more competition and pressure on prices right now.

Maryana Kushnir - ***Nomura Asset Management - Analyst***

And regarding your raw material costs are going to be up for you and you mentioned that in second quarter you would expect raw materials to be higher by $20 million if the Mexican plant is running at 50% and by $40 million per quarter, if the Mexican plant is running at 100%. Is that -- would that be where they would peak or would we expect to see more increases after that, given your contract position?

Richard Heyse - ***Innophos Holdings, Inc. - VP, CFO***

Let me explain in our disclosure, as Bill touched on. What we've got in our disclosure is the worst possible outcome of the arbitration -- what's the correct language? The high end of what's reasonably possible. So we are trying to box the range of what we think is possible out of the arbitration and in that case, in the event, it would go that way be roughly about $10 million and assuming we stay at roughly 50% operation and the impact on Mexican cost is about $10 million in the second quarter and $20 million each quarter after that.

As we said in the US cost structure, sulfur has dropped pretty dramatically in the last two quarters. So the decrease in the cost related to sulfur prices dropping in marketplace has offset some of the other increases for some of our contracts, and net-net, it's pretty much going to be a wash. So our cost structure we are looking at for the US business for all of 2009, we expect to be pretty similar to the unit cost structure that we had in the fourth quarter of 2008.

But clearly the biggest single issue that we have as far as the cost structure 2009 is the outcome of the arbitration and, as Bill said, we are going to have to be patient and work through that process and drive for the best possible outcome on that front.

Maryana Kushnir - ***Nomura Asset Management - Analyst***

Would you just clarify what do you just said. So you said in Mexico it would up $10 million in second quarter and then $20 million each of the following quarters?

Bill Farran - ***Innophos Holdings, Inc. - VP, General Counsel***

Correct, as we -- basically we're in a FIFO inventory basis --

Maryana Kushnir - ***Nomura Asset Management - Analyst***

Okay.

Richard Heyse - ***Innophos Holdings, Inc. - VP, CFO***

First in, first out. So as that new rock feeds in and start to hit our cost of sales -- that would be sometime in the middle of the second quarter based on -- we ended the year with fairly high inventory levels in 2008 in Mexico. So it is going to take a while to rotate through the on-hand inventory and for that cost to rock to show up in our financials.

Randy Gress - ***Innophos Holdings, Inc. - CEO***

But yes -- just let me clarify again, that's based on the disclosure and that's based on high end of what's reasonably possible in the results on the arbitration where our expectation would be significantly and materially below that on the outcome.

Richard Heyse - ***Innophos Holdings, Inc. - VP, CFO***

But part of the challenge for us, it is essence a legal case, so we can't go in to specifics. We have to respect that process and so from a disclosure point of view, we simply only can disclose that reasonable possible downside option.

Bill Farran - ***Innophos Holdings, Inc. - VP, General Counsel***

Maybe it would help if I just took a quick minute on this. While any kind of litigation, including this arbitration, is confidential, the financial and accounting industry has long ago determined, well how do you begin to box something like this. And we evaluate that under the Financial Accounting Standards Board's Statement Number Five, where management is required to make a determination as to whether contingent liability, that would be the requirement in this case, to pay more than what we're going to be paying for an interim price in 2009 once that agreement is reached.

And figure out whether that probability -- whether that likelihood is either probable, or reasonably possible, or remote. And is there a range with respect to that determination and if so, is there any number that is more probable than another. We could have used in our disclosures, the number that we believe is more probable, which is the number we have calculated under our determination of the interpretation of the contract clause.

But we've done something different than that. We've said, let's look at the reasonably possible range and let's make our disclosures and our outlook on the basis of the high end of what we think is reasonably possible. We think that's fairly conservative. It's not specific numbers because of the confidential nature of it. But our work through of the FAS5 evaluation, that's where we came out and that's sort of how we built our outlook and our disclosures in this situation.

Richard Heyse - ***Innophos Holdings, Inc. - VP, CFO***

We've been doing that since second quarter of last year. This was the consistent approach that we've been following all along.

Bill Farran - ***Innophos Holdings, Inc. - VP, General Counsel***

Okay, an aggressive approach, a more aggressive approach, if we just say, just check our number because our evaluation has that as the most probable, but that's not what we have used.

Maryana Kushnir - ***Nomura Asset Management - Analyst***

And then when you estimate this worst possible outcome for the rock price --

Richard Heyse - ***Innophos Holdings, Inc. - VP, CFO***

Reasonably possible.

Maryana Kushnir - ***Nomura Asset Management - Analyst***

Or reasonably possible, so how does that price compare to the current rock prices for phosphate rock?

Richard Heyse - ***Innophos Holdings, Inc. - VP, CFO***

There isn't -- one, it's just tough to comment on that. It's within the range of market prices from last year. Right now there isn't a phosphate rock market that's functioning. If you look at any trade magazine that reports on that, they're all saying that there is no effective market to quote. So really -- the market hasn't restarted. So we really can't comment to how does that compare to current market because there is no current market.

Maryana Kushnir - ***Nomura Asset Management - Analyst***

Okay, thank you.

Operator

Your next question comes from the line of Richard O'Reilly from Standard & Poor's. You may proceed.

Richard O'Reilly *- Standard & Poor's - Analyst*

Okay, thank you. Good morning, gentlemen. Two questions, the OCP rock price for '09, that is determined by price changes in '08. So what you are looking at is based upon '08, so whatever the today's rock price is, market price is sets for 2010. Am I correct with that thinking?

Bill Farran *- Innophos Holdings, Inc. - VP, General Counsel*

There are actually a number of moving parts on that. One, you take at any point in time, you take the then current contract price. And then you determine what has been the variation between, if we're trying to find out the 2009 price, you would take the variation in the market between first half '08 and first half '07.

So it's not as simple a matter as looking at any current market condition or broad average for a particular period of time. You have to know the starting point and then you have to know the variation. Now I think folks can begin to box this -- We are just constrained on confidentiality -- but folks can begin to box some of this with some publicly available information.

Richard Heyse *- Innophos Holdings, Inc. - VP, CFO*

I think to his question of 2009's market price doesn't feed into our 2009 price for rock and OCP.

Bill Farran *- Innophos Holdings, Inc. - VP, General Counsel*

Right, the 2009 price would begin to feed into the determination for 2010.

Richard O'Reilly *- Standard & Poor's - Analyst*

Right. Okay. Great, that was my broad understanding. Okay, thanks. Second, you give price and volume change for your products and for STPP and other it's a negative 125%, can you explain that?

Richard Heyse *- Innophos Holdings, Inc. - VP, CFO*

That's an accounting artifact. What we report is the price variance and then the combined volume, mix impact upon revenue. And when you, when one's doing the variance calculations, in the end one in three has to be a plug. And we're just getting the numbers that are so large that it's forcing in essence to be not quite meaningful.

I think the way to look at volume is as we said, we have volumes in Mexico are roughly 50% of capacity levels overall when you look all the product lines there. And in the fourth quarter, the US was more normal levels with a little bit of fall off of the technical side. But with the magnitude of our price increases combined with no fertilizer sales and fertilizers are high-volume low-priced item, it drives some very strange calculations, unfortunately, but we have to stick with our methods and report that way.

Richard O'Reilly *- Standard & Poor's - Analyst*

Okay, fine. Is it correct to assume that overall for the specialty salts and acids, that is generally the higher margin product category?

Richard Heyse - ***Innophos Holdings, Inc. - VP, CFO***

Correct, one way we have described it, if you look, say, historically 2006-7 margin percentages between STPP, specialty salts and purified acids might be similar, but the specialty salts sell for much higher prices per pound. So when you look at a profit per pound, it's significantly higher than the other products.

Richard O'Reilly - ***Standard & Poor's - Analyst***

Okay. Fine. Okay, thank you for that.

Operator

This concludes the question and answer portion of the call. I would now like to hand it over to Mr. Randy Gress, CEO. You may proceed.

Bill Farran - ***Innophos Holdings, Inc. - VP, General Counsel***

No, operator this is Bill Farran. I have one additional clarification question. Randy, about the expected impact of reduced sales to the customer that you've mentioned in Mexico in connection with the closure of its Mexican STPP plant, both in the press release and the earnings call presentation, you mentioned a range of annual operating income reduction. Could you go over that one last time, because I may have misheard you?

Randy Gress - ***Innophos Holdings, Inc. - CEO***

Yes. Thanks, Bill. Yes, as far as the impact on the companies based on a historical basis, we're actually looking at an operating income reduction of between $6 million and $16 million based on pre-2008 historical profitability. And also based on management's success that the mitigation efforts -- and again we're focusing on offsetting those sales, continuing sales with the customer, offsetting some additional sales and then also investing to increase our food grade capability within the site to support our other growth initiatives.

Bill Farran - ***Innophos Holdings, Inc. - VP, General Counsel***

Okay, great, sorry for the interruption.

Randy Gress - ***Innophos Holdings, Inc. - CEO***

Thanks. Yes, in closing I want to thank everyone for participating in the call and thank you for your questions and look forward to updating you in the next call. Thank you.