



**Valvoline Inc.**

**First Quarter Fiscal 2017 Earnings Conference Call**

**January 27, 2017**

## C O R P O R A T E P A R T I C I P A N T S

**Jason Thompson**, *Vice President Finance, Treasurer, Investor Relations*

**Sam Mitchell**, *Chief Executive Officer*

**Mary Meixelsperger**, *Chief Financial Officer*

## C O N F E R E N C E C A L L P A R T I C I P A N T S

**Simeon Gutman**, *Morgan Stanley*

**Wendy Nicholson**, *Citi*

**Bill Schmitz**, *Deutsche Bank*

**Olivia Tong**, *Bank of America Merrill Lynch*

**Jason English**, *Goldman Sachs*

**Bill Chappell**, *SunTrust*

**Carolina Jolly**, *Gabelli*

**Mike Harrison**, *Seaport Global Securities*

**Dmitry Silversteyn**, *Longbow Research*

**Chris Shaw**, *Monness Crespi Hardt*

## P R E S E N T A T I O N

### **Operator:**

Good morning and welcome. My name is Carol and I will be your conference Operator today. At this time, I would like to welcome everyone to the Valvoline Inc. First Quarter 2017 Conference Call and Webcast. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question and answer session. If you would like to ask a question over the phone at that time, simply press star, then the number one on your telephone keypad. If you would like to withdraw your question, please press the pound key.

At this time, I would like to turn the call over to Jason Thompson, Vice President, Treasurer, Investor Relations.

**Jason Thompson:**

Thank you, Carol. Good morning and welcome to Valvoline's First Quarter Fiscal 2017 Conference Call and Webcast. Valvoline released results for the quarter ended December 31, 2016; at approximately 5:00 pm Eastern Time yesterday, January 26, and this presentation and remarks should be viewed in conjunction with that earnings release. These results are preliminary, until we file our Form 10-Q with the Securities and Exchange Commission. A copy of the news release has been furnished to the SEC in a Form 8-K.

With me on the call today are Valvoline's Chief Executive Officer, Sam Mitchell, and Mary Meixelsperger, Chief Financial Officer.

As shown on Slide 2, our remarks include forward-looking statements as such term is defined under US securities law. We believe such statements are based on reasonable assumptions, but cannot assure that such expectations will be achieved.

In this presentation and in our remarks, we will be discussing our results on an adjusted basis. Adjusted results exclude key items, which are unusual, non-operational or restructuring in nature. We believe this approach enhances understanding of our ongoing business.

As you can see on Slide 3, Valvoline delivered reported EPS of \$0.35, an increase of \$0.03, versus prior year, operating income grew 25% to \$120 million, and net income of \$72 million grew 11%.

Let me briefly discuss some notes on reporting. Two items related to the separation are driving differences in our year-over-year comparisons. The first is interest expense. This represents the creation of Valvoline's new capital structure that was established in 2016. We did not have interest expense in the prior year first quarter. The second is recurring pension-related income, which is much higher this year than it was in the prior year. The pension and other OPEB plans that we assumed from Ashland did not transfer to Valvoline until September of 2016. Prior to this, we were allocated a portion of the pension and OPEB income based on our participation in the plan.

Next, are key items. Due to the freezing of certain OPEB plans, we were required to do a re-measurement of those plans at the end of Q1, which resulted in a one-time gain of \$8 million. We also incurred separation costs this quarter of \$6 million. Again, our adjusted results for the quarter exclude these two key items. In Q1 of fiscal 2016, there were no key items.

We'll also be discussing EBITDA from operating segments, which is simply the contribution to our total EBITDA from our three operating segments of Core North America, Quick Lubes and International. We believe that both adjusted results and EBITDA from operating segments are meaningful to investors, so we'll be focusing on those for the remainder of the call.

Now, I will hand the presentation over to Sam and Mary. Sam?

**Sam Mitchell:**

Thanks, Jason, and good morning, everyone. Valvoline's first quarter has given us a great start to fiscal 2017, our first full year as a public company. We grew adjusted earnings per share at 9% over the prior year quarter and EBITDA from operating segments grew 8%.

We are making good progress on delivering against our four core priorities for the year.

Our first priority is to drive business results in each segment, growing our market share and unit margins. Valvoline grew volumes 7%, outpacing the market growth rate, with each segment delivering year-over-year gains. Valvoline Instant Oil Change registered a system-wide same-store sales increase of 9%. Unit margins improved sequentially from Q4, as we passed through base oil cost increases that we saw

toward the end of fiscal 2016. As you may have seen recently, posted base oil prices have increased modestly. I continue to remain confident in our ability to pass through cost increases in order to maintain unit margins and, over time, increase unit margins, as we improve our premium mix.

Our second priority is to grow our retail Quick Lubes business, both organically and inorganically. In the first quarter, we added eight stores to our Valvoline Instant Oil Change network. Compared to the end of Q1 last year, we've added 120 stores to our system, including the acquisition of 89 Oil Can Henry's stores in February 2016. We recently announced signing a definitive agreement for the purchase for Time-It Lube, which will add another 28 company-owned stores to the network in Q2. I'll provide a little more detail on this acquisition in a moment. We are on track to add new company-owned stores in 2018, and we continue to work with our franchisees on their store development. Overall, the team continues to deliver on our customer promise of quick, easy, trusted, in every store every day.

Our third priority is to invest in digital marketing and infrastructure. These investments will enable us to directly engage with the consumer and to strengthen the relationship we have with our installer customers around the world, while enhancing operational efficiency. We continue to make good progress on these investments. Most notably, we expect to launch our new CRM tool and customer portal during the second half of fiscal 2017, both of which should begin the process of simplifying our interface with customers and improving customer service levels. This is an important step in our digital transformation that will allow us to drive sales growth, by reaching a broader base of customers, providing them with greater access to our full suite of marketing and training tools, while leveraging our broader product portfolio.

Our fourth priority is to drive a culture of creating value for our shareholders. We believe this means consistently growing volume and profitability in the business. We also believe this means reinvesting into high-return projects and finding ways to return capital to shareholders. We've demonstrated all of these through our strong first quarter results, the announcement of the Time-It Lube acquisition, and the initiation of a cash dividend.

As I mentioned earlier, and as you'll see on this slide, we announced our plan to acquire Time-It Lube in early January.

I'm sorry, I'm going to back up to Slide 6, and we'll focus on the operating segments.

As you can see on Slide 6, each of the three operating segments delivered solid year-over-year volume growth, with Quick Lube and International showing growth in EBITDA, as well.

In Core North America, we had nice volume gains and continued to grow our premium mix. The EBITDA decline in Core North America was largely the result of modestly lower unit margins versus prior year. The first half of fiscal 2016 benefited from a positive price cost lag effect, as a result of declining raw material costs. As we indicated on our Q4 earnings call, we implemented price increases across all channels during the first quarter of this year in order to offset the base oil increases announced in the latter half of fiscal 2016.

In Quick Lubes, our store and franchise teams delivered strong same-store sales growth of 9%, due to effective marketing driving both customer retention and acquisition. To a lesser extent, favorable weather, particularly in December, combined with an extra sales day in the current quarter versus prior year, also contributed to the strong results. EBITDA increased \$7 million, or 26%, as a result of strong operating performance, as well as good results from the former Oil Can Henry's stores.

Turning back to the Time-It Lube acquisition, this acquisition, again, announced in early January, helps us accelerate the growth of our retail model, giving us 28 company-owned stores in East Texas and Louisiana. Like the Oil Can Henry's acquisition, this expands our reach into markets where we previously had little presence, establishing a beachhead for further unit growth. Also, like Oil Can Henry's, Time-It

Lube is well run, with a strong commitment to customer service and efficient operations. We're excited to have Time-It Lube joining Valvoline and look forward to closing the transaction later this quarter.

Finally, our International segment. Our International segment delivered solid volume gains. Coming off the heels of a softer quarter in Q4, we're now back in line with our longer-term volume growth expectation of high single-digits. These volume gains were broad-based, with both mature markets and emerging markets delivering solid growth, which was primarily driven by continued market penetration.

With that, I'll turn it over to Mary for a detailed look at our first quarter results.

**Mary Meixelsperger:**

Thanks, Sam. As Sam described, EBITDA from the operating segments was up 8% year-over-year to \$109 million. The main items affecting the year-over-year change can be seen on the bridge on Slide 7. Volume mix was the largest driver, adding \$10 million to EBITDA. Acquisitions, along with equity and other income, were also favorable, contributing \$7 million. These were partially offset by margins and SG&A. As Sam mentioned a moment ago, the prior year benefited from favorable price cost lag, which is captured in the \$3 million decline in margin. SG&A is up, primarily due to public company costs, and is in line with our expectations. The net of all of these factors lead to an \$8 million increase in EBITDA from operating segments. Valvoline's overall Adjusted EBITDA was \$127 million and includes the impact of non-service pension and OPEB income, which was about \$18 million in the quarter.

Slide 8 shows the adjusted EPS increase by \$0.03, or 9%. Two cents of the increase came from operating segment results and a penny came from the net of pension and OPEB income and interest expense.

Turning to other corporate items, on Slide 9, our effective tax rate in the quarter was 34.5%, in line with our full year guidance. Cap ex totaled \$9 million. Free cash flow was \$79 million for the quarter, an increase of \$44 million from prior year. The increase was primarily driven by the timing of cash settlements of separation-related working capital accounts. We ended the quarter with total debt of \$740 million, which included \$75 million of short-term debt, as part of our new accounts receivable securitization facility, which is used to repay our term loan by an equivalent amount. Key items include re-measurement of certain of the OPEB plans, resulted in a gain of \$8 million, and separation costs totaling \$6 million.

Now, let's turn to Slide 10, where I'll give you an update on our full year outlook. Our performance in Q1 gives us confidence to raise our full year guidance. We are raising our adjusted EPS forecast and narrowing the range to \$1.36 to \$1.43 per share. Our outlook for total volume growth is now at 3% to 5%, and our revenue growth is at 4% to 7%. As we mentioned, VIOC had another great quarter and, combined with that, we have increased full year same-store sales guidance to 5% to 7%, and we are adding the 28 Time-It Lube stores to our company-owned VIOC column. EBITDA from operating segments is now forecast at \$440 million to \$455 million. As a comparison, our previous outlook, adjusted for pension income, was approximately \$435 million, at the midpoint of our guidance. We are also raising full year free cash flow guidance to \$130 million to \$150 million, reflecting approximately \$25 million in lower estimated cash taxes and \$25 million in cash settlements related to the separation.

Now, let me turn things back over to Sam to wrap up. Sam?

**Sam Mitchell:**

Thanks, Mary. We've made great progress over the past several months and laid a strong foundation for continued growth in the future. We have good momentum in the business and we're raising our full year outlook as a result. We will continue to focus on the execution of our core priorities, including continuing to evaluate bolt-on acquisition opportunities, such as Time-It Lube, where we can deploy capital to drive

incremental earnings and cash flow growth. We're excited to move forward in fiscal 2017, as we progress towards the final step in the separation.

With that, I'll hand it over to Jason to open the line for Q&A.

**Jason Thompson:**

Thank you, Sam. Just a quick reminder for everyone, one question, please, and one follow-up. With that, Carol, please open it up.

**Operator:**

Certainly. As a reminder, if you'd like to ask a question, please press star, followed by the number one on your telephone keypad.

Your first question this morning comes from Simeon Gutman from Morgan Stanley. Please go ahead, your line is open.

**Simeon Gutman:**

Thanks. Good morning, everyone. My first question, on the—I guess, thinking about weather for a second, you mentioned in the press release the Quick Lubes business got maybe a little boost from weather. Does the Core North America business also get helped, as well, or does it not work that way, because it's a sell-in? Then, in the same question, do you give anything back in the second quarter from, I don't know, weather normalizing?

**Sam Mitchell:**

Weather is not a huge impact for us, Simeon. It does have some impact on the Quick Lubes business, and, in particular, December, the weather was pretty mild, and so we didn't have any weather disruptions, and we just felt, versus the prior year, when we looked at it, we did pick up some volume. So, I'd probably attribute 100 basis points or so to the 9% sales increase that we had from weather.

When you look the Core North American business, typically, again, not much of a weather impact. We've never had really a chance to see any major impact in previous results; so don't pay too close attention to weather when it comes to Core North America. The only impact it can have, that we've seen, is if we're running a major promotion and you've got exceptionally poor weather that's keeping people from, say, getting into the DIY stores, that can have an impact, but didn't see any major impacts at all on weather during the quarter on Core North America.

**Simeon Gutman:**

Okay, and my follow-up, on Time-It Lube, have you shared, or can you share sales per store, and then, just simply, if they already sell Valvoline products?

**Sam Mitchell:**

Time-It Lube was not selling Valvoline products, so we're excited they'll be picking up Valvoline products, and a good vertical integration. We haven't shared specific results in how the Time-It stores were performing before the acquisition, but they're definitely in our range. They're fairly well run, good, solid locations, but we're very confident that our model will be able to improve those results. We've talked about our oil changes per day, system-wide average being in the low 40s, so they're below that, but I expect that they'll be moving close to that average pretty quickly after we integrate those stores and implement our tools.

**Simeon Gutman:**

Okay. Thanks a lot.

**Sam Mitchell:**

Yes.

**Operator:**

Your next question today comes from Wendy Nicholson from Citi. Please go ahead, your line is open.

**Wendy Nicholson:**

Hi, thanks. Sorry, two questions. But, first, the same-store sales guidance, obviously, awesome that it's gone up for the rest of the year, but my question is still—I mean, based on the same-store sales numbers that you put up in this quarter, it looks like you're looking for a deceleration in sort of as we go into the back half. Is that right, or is there still conservatism sort of built into that 5% to 7% target.

Then, my second question, just generally, you know, the news out of Amazon that you're going to be focused more on auto parts and expanding their business and presence in those channels and with those products, what's your take on that, what do you do to prepare to offset that, you know, how big a deal is it? Thanks.

**Sam Mitchell:**

Yes, first, with Valvoline Instant Oil Change and same-store sales, Wendy, the 9% is obviously outstanding and we just don't expect that to continue at that level. Nonetheless, we expect pretty strong same—mid-single-digit performance from Valvoline Instant Oil Change. We continue to have very good momentum with some of the marketing programs that are driving new customers to our stores and converting those to new loyal customers. So, that's been the real key driver behind our performance. We've had some ticket improvement, too, but the biggest driver has been oil changes per day and bringing more customers to our stores. So, we're going to keep our focus on that and continue to drive very strong customer service across the system, while we're making acquisitions and growing the store base. So, really feel good about it, but 9% is a bit unusual, a bit strong.

Again, I don't like to focus too much on weather, but we saw a little bit of weather in the first half of January and that does have a bit of an impact, but weather, when it has an impact, it's typically—those aren't typically lost oil changes, those customers are going to be coming in as the weather clears. It's really if you have a very long sustained period of difficult weather that keeps people from driving, that's when it can have a negative impact on the performance, say, over a quarter period. But, typically, you're not going to be finding us talking about weather, unless it's a very minor issue.

Turning to the Amazon issue, we do sell products through Amazon, and we've got a team that is working with Amazon in selling our products through that channel. They are pushing into the automotive space. There's some momentum there, so we're going to be taking advantage of that and working with them to grow our products for those consumers that are looking for that outlet, but it's not at the rate right now that we see having any material impact on our business with retail auto parts, or any other part of Core North America at this part.

**Wendy Nicholson:**

Okay, terrific. That's all I had. Thank you.

**Operator:**

Your next question comes from Bill Schmitz from Deutsche Bank. Please go ahead, your line is open.

**Bill Schmitz:**

Hi, guys, good morning.

**Sam Mitchell:**

Good morning.

**Jason Thompson:**

Hey, Bill.

**Bill Schmitz:**

Hey, a couple questions. Can you just give us an outlook for base oils and commodities, broadly, for 2017?

**Sam Mitchell:**

Sure. Well, first of all, base oils do follow the crude market. Over time, there can be a little bit of a lag impact. The base oil market, particularly, given that it's long, tends to move after crude moves to a new level for a more sustained period of time. So, with crude where it is today, because it has moved up, versus where it was last year, we've seen a series of base oil increases and that's resulted in Valvoline moving ahead with price increases, to make sure we're protecting those margins. As far as the future goes, it's hard to project sometimes the direction of crude, but, whereas the last couple of years we were in a declining market, I think there's more upward pressure, so we have to be prepared to move if base oil prices continue to move up.

As I mentioned in the call, and in our comments, we have seen a recent base oil increase, so that's something that we'll have to take action on, too. But, when you think about the connection between base oil and crude, it's relatively tight, but, importantly, in a longer market, it moves in a more systematic fashion and that enables us to make the appropriate moves to protect our margins. In a longer market, too, as we've talked before, it enabled us to put together—put in place pretty strong terms with the base oil suppliers, which has helped mitigate any lag impact.

Does that help you, Bill?

**Bill Schmitz:**

Yes, that's perfect. Then, I know it's just like semantics, but it seems like—and it's very small, but the new store opening guidance came down. Is that just a function of the acquisition and probably the work you have to do to maybe overhaul some of the Time-It stores? Then, with those Time-It stores, it seems like they have a lot of car washes, also. Are you buying all those car washes and do you have broader aspirations in that part of the industry?

**Sam Mitchell:**

No. To address that quickly, is we're not interested in the car wash business. There are some of their locations that are co-located with a car wash operation and we're not purchasing the car wash.

**Bill Schmitz:**



Okay, great.

**Sam Mitchell:**

But, regarding new stores, for the most part, the teams that are working on new store development and the acquisition integration are separate, and so it's really—the guidance and pushing that down this year, in terms of what new stores will open, is a matter of handful of stores that are going to be opening in early fiscal '18, as opposed to the end of fiscal '17.

**Bill Schmitz:**

Okay, great, and I'm going to sneak in one more. I mean, in terms of the regulatory environment and what it takes to permit a store, I mean, do you view it as sort of constructive or onerous, and does anything change with the new administration in terms of finding the land and getting the permitting and getting the store built?

**Sam Mitchell:**

Well, that is a big part of the timeline in putting up a Quick Lube, is the permitting environment and working with the developers and helping them understand the importance of having an Valvoline Instant Oil Change, and what it brings to a development sometimes, but as far as the regulatory environment improving, it's really local issues that we've got to deal with, it's nothing that I think is going to change dramatically. So, the key for us is to develop our approach to getting the permitting in place and to try to take weeks out of the timeline in developing stores. But, the key for us, too, is we really just started this effort and developing our new-build capabilities last year, and so it takes some time just to get that pipeline moving, but once we have the pipeline moving and we're working in a number of the different regions where we want to add new stores, I think that's where we can start to become pretty consistent, but the team is preparing for hitting at you know a much higher level, plus 25 stores a year beginning in fiscal '18. So, that's our first target, is to get to that level of performance in opening up stores, and my expectation is we'll be adding plus 25 new company stores each year, while we will be making acquisitions. We definitely see opportunities over the next couple of years to continue to make some of these regional acquisitions of the higher quality regional operators, so that's very much a focus of ours. Then, finally, we're working with the franchisees to make sure that they're developing their market regions, too.

**Bill Schmitz:**

Great. Thanks so, guys.

**Sam Mitchell:**

You bet.

**Operator:**

Your next question comes from the line of Olivia Tong from Bank of America Merrill Lynch. Please go ahead, your line is open.

**Olivia Tong:**

Thanks. Good morning. I want to talk a little bit about the SG&A margin, because that was a lot better than we thought. So, can you talk through some of the puts and takes there and what you think the opportunities for sustained improvement there are going forward?

**Sam Mitchell:**

Sure. Mary, do you want to take that?

**Mary Meixelsperger:**

Yes, sure. Olivia, good morning. The SG&A increase, overall, we laid out in a table to our press release, and you can see that the underlying business SG&A, excluding the change in pension income and the separation costs, increased by about \$8 million, from \$87 million in Q1 of '16 to \$95 million in Q1 of '17. That \$8 million increase was really driven, in part, by some of the SG&A that chased our acquisition of Oil Can Henry's, that was about \$1 million of the increase, and then we also had kind of general inflationary costs associated with our direct SG&A, which is 2% to 3% a year, so if you think in terms of the core SG&A that was in place within that business, and the balance is really related to new public company expenses, offset by some savings that we had by freezing the pension plan. So, you know, overall, I would say, generally, if you think about inflation being related on the direct costs being about half and the new public company costs being about half, you'd be thinking about it right.

**Olivia Tong:**

Got it, thanks. Then, when we met last month, we talked a fair bit about the opportunities to consolidate the Quick Lubes space, and obviously since then you've executed your first deal post IPO with Time-It. So, can you talk a little bit more about the deal environment? Are the targets you're looking at, typically, do they do less in oil change per day relative to your average? Then, also, have the potential sellers' views or desire to sell or not sell been impacted in any way by the election?

**Sam Mitchell:**

First of all, with regard to the market for continued acquisitions in the Quick Lubes space, we—the systems that we're looking at, we have a team that's in conversation with a number of different regional operators out there, and studying their operations, and, in general, their oil changes per day, their store averages for sales are less than Valvoline. As we've shared before, Valvoline, particularly when you look at oil changes per day, we're in the low 40s and the industry average, according to Oil & Lube News, is in the low 30s, so there's a pretty gap there. What we find is that if a system is in the low 30s or declining, or even in the 20's, typically, there's real estate issues, location's not the best, and those are the ones that we're going to be passing on. We do have an Express Care model that works well for the lower volume stores or non-franchised opportunity stores, but the Valvoline Instant Oil Change model, when we see operators that are more into the mid-30s, that have solid real estate, have decent operations, decent customer base, those are the ones that are going to be most attractive to us. Like I said, we're optimistic about opportunities in the space. Haven't really seen any change in attitude with the people that we've talking to with regard to their interest in selling as a result of the election. I really don't have anything that I can add beyond that.

**Olivia Tong:**

Got it. Thank you.

**Sam Mitchell:**

Sure.

**Operator:**

Your next question comes from Jason English from Goldman Sachs. Please go ahead, your line is open.

**Jason English:**

Hey, good morning, guys.

**Sam Mitchell:**

Good morning.

**Jason English:**

Thank you for taking my question. Congratulations to the strong volume performance this quarter and certainly the bolstered volume outlook for the year. It looks like you've got some solid momentum there, so I'm going to ask elsewhere, and that's at the gross profit line. I think we saw for the first time in a while gross profit per gallon start to tick lower, off of what looked to be kind of a new all-time peak for you last year. So, the question is around the outlook there. As base oil is ticking higher, you mentioned you've taken some pricing, but should we be bracing for some erosion on gross profit per gallon on the forward? If so, how far down could we correct off that peak? Or, are there real components that you see in the business that you think are going allow you to sustain, in a pretty tight range, around the high that you set last year?

**Sam Mitchell:**

That's right, last year, we saw a pretty strong uptick, particularly in the first half of the year in our unit margins in Core North America, and that had something to do with a very positive price lag effect, because in that first half you saw falling raw material costs, and while we pass through price decreases to our customers, we're still getting a positive lag impact the first half of the year. So, while we've had a long-term trend upwards, and moving our unit margins up across our different businesses, you did see a bit of a one-time increase in that first half of the year, the first couple of quarters, that certainly benefited us.

So, in a market now, where we've seen a series of base oil increases, that can have a small negative lag impact on certain parts of the business, and we've described it before. It's really in about half of our Core North American business, particularly in the DIY customers, where we have a bit longer lag impact in implementing price increases, but, nonetheless, we've always been successful in pushing those through. So, that's where you saw a nice sequential improvement in our results this quarter versus Q4 of fiscal '16.

Regarding the cost increases that have been announced more recently, we'll be taking actions to protect our margins there, too. In my opinion, they're very manageable and we'll be able to, again, keep our unit margins very solid. Again, the way we look at is protect those margins as costs are moving up, pass through the appropriate price increases, and working with our trade customers to do that effectively, and then, over time, keep that focus on driving our premium mix, because the mix improvements really help us drive unit margins over time, too.

**Jason English:**

Great, thanks a lot. I'll pass it on.

**Sam Mitchell:**

Okay.

**Operator:**

Your next question comes from Bill Chappell from SunTrust. Please go ahead, your line is open.

**Bill Chappell:**

Thanks. Good morning.

**Sam Mitchell:**

Good morning, Bill.

**Bill Chappell:**

Just one kind of tax question, I'm just trying to understand. I can't remember, on the International business, how much of the business is manufactured in the US and shipped to distributors outside, especially if you look to, like, Mexico, Canada and other places?

**Sam Mitchell:**

Latin America does get support out of our Deer Park facility. As far as the percent goes, I don't have that handy to share.

**Mary Meixelsperger:**

It's relatively modest, Bill, compared to our overall business. For the most part, our businesses serve locally. For example, in Europe, we have a blending facility in Dordrecht, Netherlands, that serves our volume that we deliver in Europe. In India, we have a blending plant in India, and in the US; of course, most of the volume is served by our multiple blending plants here in the US. We do have some export volume out of our Texas facility into Mexico, but I would call it relatively modest.

**Sam Mitchell:**

Yes, truly, just the Latin American business.

**Bill Chappell:**

Gotcha, that helps. Then, just to follow up on pricing, I want to understand, kind of the pricing you put in place, it didn't really happen towards the end of the quarter, is that correct, and you're now comfortable that there's no real issues or no real gaps where you need to push further pricing through?

**Sam Mitchell:**

The impact of the last price increase benefited us throughout the quarter. There were a small part of the business where it took place towards the end of the quarter, but, for the most part, the first quarter benefited from the price increases that we put in place and that we announced the end of last summer. Moving forward, as we talked about the new base oil increases that will be impacting the business later in Q2, and primarily in Q3, that's where we're going to have to take additional actions to protect the margins.

**Bill Chappell:**

Got it, but you're comfortable that that goes through everywhere?

**Sam Mitchell:**

Definitely.

**Bill Chappell:**

Perfect. Thanks so much.

**Sam Mitchell:**

You bet.

**Operator:**

Your next question comes from Carolina Jolly from Gabelli. Please go ahead, your line is open.

**Carolina Jolly:**

Good morning and thanks for taking my question. I'm sure that we've spoken about—or you're spoken about this before, but can you help me better understand the puts and takes to the Core North America revenue? It seems like volumes are up, and then you said you took some price increases, the revenue is down slightly. If you could help me out on that?

**Mary Meixelsperger:**

The corner of the America revenue bridge, Carolina, is really—we saw—really, it's a push from the volume side, because, while we saw a volume increase, there was a mix difference between private label and branded products that made the actual volume impact be relatively modest on overall revenues, and then we did see some pricing reduction year-over-year, compared to first quarter of 2016, versus '17, that's about \$10 million of the impact, and that was offset by the premiumization benefit of about \$5 million. So, the overall revenue delta in Core North America was about \$5 million. It was really those two drivers.

**Sam Mitchell:**

Yes, I'd just add a little bit of color on Core North America in the first quarter. When it comes to the volume growth, the majority of the volume growth was coming from an incremental very strong performance out of a private label promotion. Private label does represent an important part of the business and Core North America is about 25% of our volume. We've got some long-term strategic customers that we do private label with, and of course that margin is lower on private label than it would be for branded. But, on the branded side, while the volume growth was, to a lesser extent, on shipments, I was really encouraged by taking a look at our share performance during the quarter, too. So, when we look at performance through the DIY sales channel, we saw excellent execution of our marketing plans and, as a result, picked up market share there, too. So, very much encouraged by the work that the teams are doing in growing our important DIY business, too.

**Carolina Jolly:**

Perfect. Thank you.

**Operator:**

Your next question comes from Mike Harrison from Seaport Global Securities. Please go ahead, your line is open.

**Mike Harrison:**

Hey, good morning.

**Sam Mitchell:**

Good morning.

**Mike Harrison:**

Sam, I was wondering if we can just kind of continue on this Core North America theme here. I was wondering—you mentioned the private label promotion. That was an unusual promotion and probably something that is not going to be repeated through the rest of the year?

**Sam Mitchell:**

The private label business, you can see spikes in the volume from time to time that are driven by promotions from one or two of our key private label customers. When we look at it over the course of the year, we have a pretty good insight into each one of our major retail accounts and what their promotional schedule looks like, and over the course of the year it looks like—with this strong start, we're probably picking up about one major promotion versus prior year, versus what we had last year. So, that bodes well for just overall private label volumes being up this year.

**Mike Harrison:**

All right. Then, in terms of the share gains that you saw in Core North America, and maybe the DIY channel, are you increasing the number of outlets that you're selling through, or should we think of it more as addition shelf space at existing outlets, or how should we think about that?

**Sam Mitchell:**

Most of it is driven by our performance with existing outlets. The big retail auto part stores and Walmart are the key customers that drive the DIY sales channel. So, it's working closely with them on their promotions, with promotion execution, the representation of our products, picking up incremental SKUs from time to time. That's important to winning with the trade, is having those strong trade relationships and working closely with them on the promotion support. The other way we win and drive market share is our marketing programs that are targeted directly to DIY consumers, and that's where I'm seeing really good progress from our teams, in terms of how we target different segments in the DIY community. With our digital marketing efforts, we've seen some excellent progress in our numbers on social media. Our Team Valvoline online program that talks directly and educates DIYers on DIY activity, and helps build the brand directly with the different segments, the Hispanic segment, is really key for us, too. We've picked up market share there. So, winning in DIY is a combination of working closely with the trade and then improving the brand marketing efforts directly with the consumer, and then putting the two together. The thing that we're doing that I think is beginning to help us, as I look forward in this business, is how some of our digital content can be leveraged with our key customers, too, with their digital efforts. So, it's important to have these close working relationships with the Marketing Teams, Merchandising Teams at each of the major retail accounts.

**Mike Harrison:**

All right. Then, on the International side of the business, the emerging market strength you saw there, can you give us some color on some of the actions that you're taking to penetrate those markets, and is 16% a high water mark or is that something that you can sustain through the rest of the year? Thank you.

**Sam Mitchell:**

Sure. First, regarding overall growth rates in the International business, we are expecting high-single growth rates to be—single-digit growth rates to be sustainable, and that means the emerging markets will be growing at a faster rate than some of the mature markets, like Europe and Australia. So, 16% was really strong. I don't know that we'll be able to sustain 16%, but we do expect double-digit performance out of the emerging markets. It's a combination of different initiatives. A lot of it still is channel building. We've got some excellent initiatives in Southeast Asia, India, that have continued to improve our market

penetration. In China, our business through distributors—in other words, reaching small installers, garages—has really been strong, so we've had some really good success there, both in adding the number of distributors, but also increasing our sales through our existing distributors with some of our programs, to reach the mechanics and the smaller garages. In addition, our joint venture with Cummins had a particularly strong quarter, too, and we've had a recent breakthrough with a custom heavy-duty product for one of the Cummins engine joint ventures in China, and so we're seeing some nice pickup in volume there. That OEM strategy is important for us in emerging markets, too, as we work directly with key OEMs, from Cummins to Mahindra to TADA. These are important ways for us to grow the business on the heavy-duty side, too.

**Mike Harrison:**

All right. Thanks very much.

**Sam Mitchell:**

You bet.

**Operator:**

Your next question comes from Dmitry Silversteyn from Longbow Research. Please go ahead, your line is open.

**Dmitry Silversteyn:**

Good morning. Thanks for taking my call. A couple of questions, if I may. First of all, on the Quick Lubes growth, I mean, obviously, you guys had a very good quarter this quarter, you raised your guidance for the year, but as we sort of look beyond the impact of the first quarter and what it does to your annual growth, should we still be thinking about this business as a sort of 3% to 5% grower, or is the 5% to 7% guidance you gave for the year something that you think you can sustain beyond 2017?

**Sam Mitchell:**

Yes, I'm, frankly, very bullish on the Quick Lubes business and being able to sustain really strong comps there, and I'm comfortable guiding to the mid-single-digit comp level. We're still learning in this business, we're still getting better with some of our marketing programs that are allowing us to attract more customers to our stores, and we still have opportunities, too, on the execution in the stores. I'm impressed with the talent in our stores and the commitment that they have to very strong customer service. So, we're doing a good job broadly, but there's opportunities on the ticket front, too, as we can better penetrate some of the services that we currently offer. So, it's not a matter of adding more services. It's opportunity to just execute better in the stores, to make sure that we're appropriately selling and presenting the other services that Valvoline offers that bring real value to our customers. So, that's an area of opportunity for us. So, the combination of the continued momentum in oil changes per day, with the opportunity on ticket, gives me confidence that our same-store sales improvements should continue out into the future. So, it's a pretty exciting time for us with this business, given the momentum and what we're learning, and the excellent execution from our team, as we give them the tools to execute across all our company stores, and great to see our franchisees performing like they are, too.

**Dmitry Silversteyn:**

Okay. As a follow-up, in terms of the premium growth that you guys are seeing—you keep putting up these, you know, percentage of your sales that are coming from premium products—I was just wondering if these premium products also sort of become non-premium over time. In other words, what was premium five years ago may now be sort of run-of-the-mill. So, are you moving your target on what you consider premium or is it everything premium to 10W-40, or something like that?

**Sam Mitchell:**

Well, first, commenting on the shift towards premium products, it's really accelerated over the last couple of years, and as newer products require synthetic oils, lighter grade oils, we see it improving for years to come. The growth in premium products is happening on a couple of different fronts. Synthetics, as I mentioned, the high-mileage segment is also growing at a very strong rate, and then opportunities in the heavy-duty oils, too. As new technology comes online, premium products and the use of more synthetics benefits us there, too. The premium products do carry a higher margin for us. Frankly, what we see is that there's more and stronger brand preference as the market moves towards premium. So, for example, in the high-mileage segment, Valvoline has a much stronger market share in the high-mileage segment, say, than we do overall. So, that preference for MaxLife is very strong. We've been making some very good progress with our synthetic lubricant marketing programs, too. There's just stronger opportunity for product differentiation with the premium products. So, I'm really encouraged by the shift towards premiums. That doesn't mean longer term that there won't be more price competition, but that's an issue that we deal with all the time, particularly with the installers sales channel within Core North America, and that's where we've got to work closely with the installers to make them understand the benefits of selling a premium product line, like Valvoline.

**Dmitry Silversteyn:**

Okay. All right, thank you.

**Sam Mitchell:**

You bet.

**Jason Thompson:**

Thanks, Dmitry.

**Operator:**

Your final question today comes from Chris Shaw from Monness Crespi Hardt. Please go ahead, your line is open.

**Chris Shaw:**

Hi, good morning, everyone.

**Sam Mitchell:**

Good morning.

**Chris Shaw:**

Your outlook for free cash flow was increased by about \$40-to-\$50 million. There was no change in the cap ex, and obviously the EBITDA went up a bit, but that wouldn't explain all of it. I'm not sure if you talked about it, but went up there other than the EBITDA?

**Mary Meixelsperger:**

Sure, Chris. About half of the increase came from an update in our view of the final separation-related working capital accounts, and about half of it came from our update and better understanding of what our cash taxes will be for the full year, and then, as you mentioned, EBITDA improvement will also benefit the



free cash flow for the full year. I would say that we did have some timing in Q1. Q1, we didn't have any cash tax payments, but we will have two cash tax payments in Q2. So, Q1, in particular, benefited from just some timing-related issues that'll work its way through in terms of the second quarter.

**Chris Shaw:**

Okay, thanks. Then, the increase in the outlook for pension income, talked a little about (inaudible), is it a function of interest rates, or is it that you guys were changing the plans or your valuations of the plans?

**Mary Meixelsperger:**

No, the pension income move from \$66 million to \$70 million was just a small adjustment related a refinement based on our final actuarial reports, so it was nothing changing there in relationship to underlying assumptions related to the plans themselves.

**Chris Shaw:**

Great, got it. Thank you.

**Jason Thompson:**

Thanks, Chris.

**Operator:**

We have no one else in queue at this time, so I'll turn the call back over for closing remarks.

**Sam Mitchell:**

All right. Well, thanks, everyone, appreciate the interest and the questions. Obviously, it was a very strong quarter for us, and while 7% volume growth might be on the high side for what we can sustain longer term, we do expect that we're going to be able to continue that volume growth across each of our businesses. We've got some very good momentum in the business. We did talk about a little bit of pressure with rising raw material costs, but we're also confident in our ability to take the appropriate actions to protect our unit margins and keep this business moving forward. So, we think we're in great shape as we enter the second quarter and prepare for the final distribution of the shares of Valvoline stock, and the team is really excited about the future of this business. So, again, thank you, and look forward to continuing the discussion as we continue to progress.

**Jason Thompson:**

Thanks, everybody. Have a good day.

**Operator:**

This concludes today's conference. You may now disconnect.