



**Valvoline, Inc.**

**Fourth Quarter and Year-End Earnings Conference Call**

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## CORPORATE PARTICIPANTS

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

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

## CONFERENCE CALL PARTICIPANTS

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

**Simeon Gutman**, *Morgan Stanley*

**Bill Schmitz**, *Deutsche Bank*

**Jeff Zajkowski**, *JPMorgan*

**Stephanie**, *SunTrust*

**Dmitry Silversteyn**, *Longbow Research*

**Mike Harrison**, *Seaport Global*

**Carolina Jolly**, *Gabelli*

**Jason English**, *Goldman Sachs*

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

## PRESENTATION

### Operator:

Good morning. My name is Sean, and I'll be your conference Operator today. At this time, I'd like to welcome everyone to the Valvoline Fourth Quarter Fiscal 2016 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'd like to ask a question during that time, simply press star, followed by one on your telephone keypad. If you'd like to withdraw your question, please press the pound key.

Now, I'd like to turn the conference over to Jason Thompson, Investor Relations Officer. Please go ahead sir.

**Jason Thompson:**

Thank you, Sean. Good morning and welcome to Valvoline's fourth quarter fiscal 2016 conference call and webcast. We released preliminary results for the quarter ended September 30, 2016 at approximately 5:00 pm Eastern Time yesterday November 8, and this presentation should be viewed in conjunction with the earnings release. In addition, we posted slides to our website under the Investor Relations section. 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 as defined under US Securities Law. We believe any such statements are based on reasonable assumptions but cannot assure that such expectations will be achieved. Please also note that we will be discussing adjusted results as well as using non-GAAP measures in this presentation. We believe this enhances understanding of our performance by more accurately reflecting our ongoing business.

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

**Sam Mitchell:**

Thank you, Jason and good morning everyone. I appreciate everyone joining us for this early morning call after what was probably a late night for many. The good news is, is that our consumer-driven business model is built to generate growing and consistent results in any economic environment.

Well, this is certainly a very exciting time at Valvoline. As you are aware on September 22, 2015, Ashland announced its plan to separate into two great independent public companies, each with unique market opportunities and distinct business identities; Ashland Global Holdings, Inc and Valvoline, Inc. The rationale for the separation included realizing different drivers of value creation, a more efficient allocation of capital, enhanced focus and distinct investment identities of the new companies with different shareholder basis.

Teams from all over the world work for 10 months getting us into position to operate separately which we began doing on August 1, and a little more than one year after the initial announcement on September 28, 2016, we completed an initial public offering of 34.5 million shares of Valvoline's common stock taking the first step in the separation from Ashland. We are pleased with the overall separation process and the outcome of the IPO, and we feel Valvoline has achieved its objectives.

In summary, we successfully separated Valvoline from Ashland operationally with no negative impact to our day-to-day business. We raised \$759 million in equity capital through the IPO as well as \$750 million in debt capital. The combination of the two helped enable us to achieve our target BB credit rating.

Lastly, we established a natural shareholder base for a branded consumer products company.

With that, let's turn to the next slide and I'll turn the call over to Mary to briefly discuss our fourth quarter and fiscal 2016 results.

**Mary Meixelsperger:**

Thanks, Sam. Before I discuss our fourth quarter and fiscal 2016 results, I'd like to open with a few comments. I've been with the Company now for almost five months and I've been very impressed with the talent we have across the business. I arrived at a very demanding time for the Company executing an operational separation in an initial public offering is no small feat. But, Valvoline was able to successfully transition to a public company while also reporting strong fourth quarter and record fiscal year results.

As you can see on Slide 4, Valvoline was able to maintain the strong performance needed to position the Company for success. In looking at our fourth quarter results, Valvoline posted strong volumes driven by gains in both the quick loops and international segments, which was partially offset by a slight buying decline in core North America. Premium mix was positive in the quarter in both core North America and quick loops. We saw a modest decline in premium mix within the international segment, which was driven by a strong growth in emerging markets where engine technology lags out of developed economies. Margins in the fourth quarter were strong compared to prior year driven by favorable mix, good volume growth, and lower SG&A expenses. During the quarter, base oil cost increased negatively affecting our results modestly as we work to pass those costs increases to our selling prices. Valvoline subsequent price increases will be fully executed across all of our business segments by the end of Q1.

When looking at our full year results, strong volume and favorable price over cost partially driven by the decline in base oil costs drove a 230 basis point increase to EBITDA margin. Valvoline instant oil change had another solid year posting strong same-store sales growth. The Oil Can Henry's acquisition in February was also a solid contributor to our results adding \$34 million to sales for the year and \$8 million to EBITDA. Currency had a negative effect to sales of \$31 million and Adjusted EBITDA of \$4 million.

Valvoline's balance sheet finished the year with total debt of \$749 million and \$172 million of cash and cash equivalents yielding a net debt position of \$557 million. Our cash position was enhanced by the underwriters' execution of the over allotment option of the initial public offering, which generated \$94 million dollars of net proceeds. The Company generated \$245 million in free cash flow in 2016 while making \$66 million in capital investments.

During the fourth quarter, we completed a retiree annuity purchase program, transferring approximately \$375 million of pension liabilities in a comparable amount of assets from the US qualified pension plan to a third-party insurer. Not only did the project reduce the size of the gross obligation, it was also a strong MPV positive project as we have reduced our administrative costs associated with the plan.

We will continue to evaluate projects such as this one with the aim of reducing planned related costs as well as mitigating potential volatility of the net pension and OPEV obligations. Overall, Valvoline's balance sheet and free cash flow profile remains strong giving the Company flexibility to invest organically, pursue opportunistic bolt on acquisitions, and evaluate additional returns of capital to shareholders.

Before I hand it back to Sam, I want to make sure that you're aware in yesterday's release we inadvertently provided inaccurate EBITDA margin and EPS guidance. We mistakenly stated our EBITDA margin for the full year would be 24% or 25% of sales and EPS of \$1.28 to \$1.38, whereas our internal forecast are for EBITDA margin to be 24.5% to 25.5% and EPS of \$1.31 to a \$1.41.

Our Q1 guidance provided in the release is accurate and remains unchanged. Sam will be discussing additional guidance measures in a few moments.

With that, I'll hand the presentation back to Sam to discuss the fiscal 2016 accomplishments and expectations for 2017.

**Sam Mitchell:**

Thanks, Mary. As you just heard, Valvoline had another outstanding year financially, a record year as a matter of fact. Overall, the Company posted a 4% lubricant volume increase as compared to fiscal 2015, 9% increase to Adjusted EBITDA, an adjusted EPS growth of 6% for fiscal 2016, evidence that the separation from Ashland had no adverse impact on business operations.

Our input costs were down year-over-year leading to a slight benefit to earnings. Our sales declined 2% as we adjusted our selling prices to reflect the lower raw material cost. Each of our business segments reported strong fiscal year results. Core North America posted a 6% increase in operating income driven

by share growth in the do-it-yourself market, higher sales of our premium products, and growth in our heavy duty platform. We also renewed multi-year contracts with two of our largest national installer accounts. Our quick lube segment reported outstanding fiscal year results. Quick lubes contributed the largest Valvoline acquisition ever, Oil Can Henry, and Valvoline Instant Oil Change posted exceptionally strong same-store sales growth in both company and franchise operations. In fact, this was our tenth consecutive year of growing comp store sales with good momentum going into 2017. These successes in the segment led to an impressive year-end numbers, a 16% increase in volume and sales, and a 23% increase in operating income. Valvoline's international business segment reported a 6% increase in volume driven by strength in core emerging markets posting an 8% growth rate. While results in mature markets were softer in Q4, for the full year our team generated volume growth of 4% in these markets which include Europe and Australia. The international team grew with key OEM partners and renewed two key global contracts.

Now, let's take a look at our 2017 objectives outlined on Slide 6. As I just mentioned, 2016 was a strong year for us financially. It was also a year where we made some key investments, particularly when it comes to our teams. We added our own IT function, finance, and HR departments, and have bolstered our commercial and marketing teams with new talent.

In addition, we have a dedicated Board that has a wealth of consumer products, retail, and global industrial experience that we plan to leverage for greater growth. So, while 2016 was a demanding year with respect to the separation, 2017 is the year for us to build the foundation for faster growth. We will be making important investments into the business such as in digital marketing, and infrastructure, and continuing to invest in our teams and their capabilities.

So, while this will lead to increased SG&A in 2017, we are confident the higher spend will generate growth for years to come. We are confident these investments will generate very strong returns. We have four core priorities for 2017. One, drive business results in each segment, growing our market share, premium mix and unit margins. We will do this by investing in our brand through new innovations in product packaging, marketing, and services, and being a value added partner to our customers assisting them in growing their businesses and improving their profitability. We will continue to deliver on our promise of providing a quick, easy, trusted customer experience at all Valvoline Instant Oil Change stores and will be investing in channel development and marketing programs to grow our share in international markets.

Two, we'll grow our retail presence both organically and inorganically and we'll do this by growing our store base across each of our three quick lube platforms. We'll be pursuing high return acquisition opportunities to supplement our growth.

Three, we'll make investments in digital marketing and infrastructure in order to engage directly with the consumer and to strengthen the relationship that we have with our installer customers around the world.

Four, establish a culture of creating value for our shareholders. While Valvoline has a strong culture of bringing hands-on expertise for the benefit of our customers, we now have the added responsibility of delivering value for our Valvoline shareholders. This means embracing a strong focus on managing our cost, ensuring we're investing in high return projects, managing our balance sheet and capital allocation effectively. By executing against these core priorities, we believe we will generate strong financial results and returns for our shareholders.

On this slide, you'll see a list of metrics and our outlook for fiscal 2017. Valvoline anticipates delivering 2% to 3% volume growth in fiscal 2017. At current base oil cost, we expect this level of volume growth would generate—would result in revenues growing in the 3% to 5% range. In our quick lube segment, we anticipate between 25 and 35 new organic units added to our Valvoline Instant Oil Change platform. This comprises 15 to 25 Valvoline Instant Oil Change franchise stores, which is consistent with growth we've seen in the past few years.

For Valvoline Instant Oil Change company-owned stores, we expect to only open a handful of stores in fiscal '17 as we continue to develop our capabilities to increase new store openings at a faster pace. We expect the rate of new store growth for company-owned operations to accelerate beginning in 2018 with approximately 25 new stores opening per year, and of course, we are pursuing acquisitions of regional operators to further grow our store count. Driven by our proven in-store operating model, we expect same-store sales growth of 3% to 5% from 2016. While we anticipate modest ticket growth, we expect an increased number of transactions to be the primary driver to same-store sales growth. Netting all these factors, as Mary noted, we expect diluted adjusted earnings per share to be in the range of \$1.31 to \$1.41. This includes income generated from pension of \$66 million, but excludes \$25 million to \$35 million of anticipated onetime separation related costs.

To fuel our long term growth plans, we are investing in digital marketing and new store development. As a result, we expect to increase cap ex from \$66 million in 2016 to between \$70 million and \$80 in 2017. We expect continued robust free cash flow generation from the business of \$90 million to \$100 million. Keep in mind that this includes an estimated \$30 million of one-time cash costs related to the separation. This free cash flow will afford us the flexibility to invest organically in incremental growth projects such as new stores, to look for opportunistic acquisitions in the quick lube space, and to build out our non-lubricant product portfolio to assess debt reduction opportunities that are value creative and evaluate incremental returns of capital to shareholders above our current dividend.

As you can see, we're expecting another year of strong performances from teams across our business. Two thousand and seventeen is an exciting year for Valvoline as it will be our first year as a standalone public company. Being part of the Ashland portfolio has provided many benefits, but we're excited to move forward as a separate company building and executing our growth strategies and creating lasting value for our shareholders.

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

**Jason Thompson:**

Thanks, Sam. Sean, before we open it up. I just want to ask everybody to keep their line of questioning to just one question and one follow up. With that, Sean, please open it up.

**Operator:**

At this time, I'd like to remind participants, in order to ask a question, please press star, followed by the number one on your telephone keypad. Your first question comes from the line of Olivia Tong, Bank of America Merrill Lynch. Your line is now open.

**Olivia Tong:**

Good morning. Thank you. First question is just sort of around your base oil expectations. What are you embedding into your outlook? If you're looking for volume of 2% to 3% in sales plus 3% to 5%, I'm assuming you do it embedded and that is in expectation for improvement in profit per gallon. So, is that primarily coming from price, or do you think other changes as well?

**Sam Mitchell:**

Yes. First with regard to the base oil markets, yes, we did see increases in base oils that impacted us in our fourth quarter, and as a result Valvoline put in place price increases, executing price increases across all the business segments. So, an example of Valvoline's ability to adjust pricing appropriately to protect our unit margins in a rising base oil environment. As far as the future goes, you know, we're very confident that any subsequent changes in the base oil market, again, we'll be able to make the appropriate moves to manage our margins.

The next question with regard to our growth rates in our premium mix, we had an outstanding year of premium mix improvements in 2016 and we continue to see nice momentum behind our initiatives to drive that premium mix in our different business segments, particularly in core North America and in our quick lube business.

So, this is where we really have opportunities to further our unit margin improvements by that focus on driving market share and growth in our premium product lines.

**Olivia Tong:**

Thanks. That's helpful. Then just on the store count, can you talk to some of the capacity constraints to expand your store count this year, and what you're putting in place to allow for an acceleration starting in fiscal '18.

**Sam Mitchell:**

Yes. You know, the real work of the team this past year has been to put in place market specific plans for store growth for Valvoline Instant Oil Change. We have mapped out the country. We see tremendous opportunity for store growth over the long-term. It is a process where this first year because it's roughly in an 18-month development cycle from start to finish for a new store. That is really the reason why you're not going to see significant ground-up store improvements in 2017. But, our capacity will be greatly improved, and we'll be in position to add closer to that 25 store range in 2018 and beyond. So, building that capacity has been a key component of ours.

We've added to our team. We've also, you know, have engaged with a third party that is helping us with our store growth plans. In addition, to the ground up store growth, as I mentioned in my comments that, you know, we're very focused on looking for solid regional acquisitions that could accelerate our store growth. So, you know, I'm pleased with the progress that the team is making there. We're in discussions with multiple operators. But what we look for, you know, are good quality systems with good real estate that could be a good fit for Valvoline Instant Oil Change.

**Olivia Tong:**

Great. Thanks, Sam.

**Operator:**

Your next question comes from the line of Simeon Gutman with Morgan Stanley. Your line is now open.

**Simeon Gutman:**

Thanks. Good morning guys. I guess a simple question because there's a lot of moving pieces, and I guess the guidance is a little different from what the release is. If we look at the business maybe on an ex-pension basis, ex-pension income, what is the assumption for EBITDA growth, the core assumption for EBITDA growth year-over-year in '17 versus '16?

**Mary Meixelsperger:**

Simeon, excluding pension income, our expectation is for EBITDA to grow – gosh, at the midpoint, the growth is just modestly positive to upward of in the 5% to 6% range at the high end of the guidance.

**Simeon Gutman:**



Okay. Okay. That's kind of what our numbers are getting. Then, if I heard correctly, and hopefully this is not my follow-up yet, the reason, I think Sam discussed some higher SG&A spending as being the reason for why that's maybe not stronger, and if that's right, can you talk about what's changed?

**Sam Mitchell:**

Yes. You're right. The SG&A spend is an important investment that we're making, and so it is—versus, you know, certainly 2016. The new corporate cost is roughly about \$20 million of increased SG&A spend. The results in accounting change, it's effecting us negatively of about \$5 million software as a service to accounting change, and then we've got—basically what's left there is an increase in the \$10 million range of investment in the business through the direct of digital infrastructure initiative and then some of the investments that we made in the team.

So, you know, our baseline SG&A has certainly increased, but the, you know, the way I look at it is, one, is that we've established strong gains in finance, in IT, and we're, you know, very well positioned with this new baseline spend to deliver I think outstanding results over the long-term.

**Mary Meixelsperger:**

The other thing I would tell, Simeon, if I could is that we did have an accounting change from our models perspective where we had approximately \$6 million of SG&A costs that shifted from our cap ex in '17 into operating expense related to how we're accounting for costs associated with the implementation of our digital transformation, which is primarily software as a service and that \$6 million shift is affecting the increase in our SG&A expenses as well.

**Simeon Gutman:**

Right. That's helpful. Okay. Then my follow up, I guess back to I guess the group 2 question, can you give an assessment of just the overall supply and capacity in the group 2 oil world, and then in general how should we think about the relationship between WTI and base oil prices?

**Sam Mitchell:**

Yes. As we've shared before the, you know, the group 2 market it continues to be long. You know, a lot of capacity additions have been made over recent years, you know, that have outstripped demand growths. So, we've got a long market, and that has, you know, benefited Valvoline in our contracts with group 2 suppliers. With regard to, you know, the correlation to crude, group 2, you know, is highly correlated. Base oils are highly correlated to movements in WTI. So, that's something we have to keep an eye on it. Because of the longer market it's not as volatile, so it's typically when crude, you know, makes the sustained move to a new level that we'll start to see adjustments in base oil pricing. But as we've adhered to, you know, our model is strong in terms of how we're able to capture any cost increases through, you know, price adjustments.

**Simeon Gutman:**

Okay. Thank you.

**Operator:**

Your next question comes from the line of Bill Schmitz with Deutsche Bank. Your line is now open.

**Bill Schmitz:**

Hi, good morning. Hey, can you going to can you guys bridge the gross margin expansion, which was much better than our model and I think much better than the consensus was expecting. So, can you



bridge it in the quarter kind of what drove, you know, the year-over-year change, and then what your outlook is for 2017?

**Mary Meixelsperger:**

You're talking about the fourth quarter '16 margin versus '15 margin?

**Bill Schmitz:**

Exactly. Like the 700 basis points plus or minus increase in gross margin, and then, you know, so what drove that, and then, you know, how you see that progressing in 2017.

**Mary Meixelsperger:**

You know, the primary drivers within the fourth quarter margin, we certainly saw some improvements in margin in terms of the underlying volume growth as well the strength that we had in our quick lube business, and we had some modest change as well in terms of the overall business mix impacting margins, and we can get a little bit more detail for you on that later on. But generally, the margin improvement was driven by our core North America business as well as our quick lube business. We did see a little bit of margin contraction from rising base oil prices that we experienced in the fourth quarter where our price increases weren't fully passed through. I mentioned in my comments that we expect to see those pricing get fully passed through and completed in Q1 of '17 in terms of the point increases.

**Bill Schmitz:**

Okay. Can you give us like, you know, the broad strokes and how you think gross margins are going to progress next year?

**Mary Meixelsperger:**

Sure. In terms of gross margin progression last year—next year, we expect to see some modest improvement in gross margin as we see our price increases get fully passed through. Again, we expect to see our premium penetration continue to grow. That will also help us to drive gross margin improvements next year.

**Bill Schmitz:**

Okay, great. Then just a follow-up. On the DIY business, you know, I knew there was some sort of friction with some customers in terms of, you know, pricing, we can do a high-low or everyday low price and the promotional cadence. Is a lot of that stuff blown over, or, you know, are you still seeing some, you know, potential headwinds from that?

**Sam Mitchell:**

No, we're in good shape as we start the new fiscal year and prepare for the 2017 calendar. Got an outstanding merchandising schedule across our key accounts, and so I'm very pleased with, you know, the coordination that we've had with the key retailers, both in terms of executing pricing, but also in establishing a strong promotional calendar for next year.

**Bill Schmitz:**

I got you. So, Sam, do you think the category still stays on high, low at least for, you know, the foreseeable future?

**Sam Mitchell:**

Yes, and if you look at retail auto parts, it's certainly been a high-low approach to the business. Don't see any evidence of that changing. It's a promotion driven category, but, you know, Valvoline's strong market position as a strong premium player, that works well for us because, you know, the Valvoline brand is promoted often and featured prominently in the stores. So, the one significant DIY account that is more of an EDLP approach is Wal-Mart. So, a little bit different strategy there, and it's important for, you know, Valvoline to win at Wal-Mart stores too, but it's just a different promotional strategy at Wal-Mart versus say the retail auto parts stores.

**Bill Schmitz:**

Okay. Great. Thanks. Very helpful.

**Operator:**

Your next question comes from the line of Jeff Zajkowski with J.P. Morgan. Your line is now open.

**Jeff Zajkowski:**

Thanks very much. What was your SG&A before pension income?

**Mary Meixelsperger:**

You know, that's detailed—you can get to that, Jeff. We've added a table within our press release that provides some information that could hopefully help you to arrive at that number. Table 8 in our press release shows all of the different components of pension income, and if you look at the quarter for 2016, pension income in total for the quarter was a net of \$25 million and that's net of the service costs. The breakout for that between the cost of sales and SG&A we'll have to get to you. I don't have the specific break out between COGS and SG&A.

**Jeff Zajkowski:**

Okay. So, did some of the pension income filter into the gross profit margin?

**Mary Meixelsperger:**

In '16 in Q four, yes. In Q4—beginning of 2017, all pension income will be in operate in OPEX in SG&A. But, in Q4 there was some pension income within in the cost of sales.

**Jeff Zajkowski:**

So, okay, maybe I can follow-up on the extent of that. Then lastly, haven't base oil prices come down in October? So, I know that you were trying to push prices up, but is there resistance from customers who are saying that raw materials are going the other way?

**Sam Mitchell:**

There was a modest decrease in base oil from Motiva. So, you know, it's not, you know, substantial enough to make any impact to our pricing plans. Okay, great. Thank you so much.

**Operator:**

Your next question comes from the line of Bill Chappell with SunTrust. Your line is now open.

**Stephanie:**

Hi, this is actually Stephanie on for Bill. I just have quick question on your international performance. Maybe if you just go into more detail on some the weakness you saw in the more mature markets. Is this new, or it's kind of been kind of a sequential trend? Just a little bit more color there would be great, thanks.

**Sam Mitchell:**

I haven't seen anything significant in the international markets. You know, I mention that, you know, Q4 is a little bit softer in the mature market regions of Europe and Australia where we have, you know, good strong brand presence. But, I don't know but I don't think there's anything long-term that we're concerned about. So, I would expect that our, you know, international mature markets can grow, you know, in that low single digit rate whereas our emerging market focus is expected to deliver in the high single digit rate in terms of overall growth.

**Stephanie**

Great. Thanks to the color.

**Operator:**

Your next question comes from the line of Dmitry Silversteyn with Longbow Research. Your line is now open.

**Dmitry Silversteyn:**

Good morning everybody and congratulations on your first conference call and a very exciting day for your company.

**Sam Mitchell:**

Thank you.

**Dmitry Silversteyn:**

A question on international part of the business. Can you talk a little bit about, you know, you just mentioned some of your growth expectations for the developed the part of the world? But, if you can just sort of take a look at what happened in the quarter and what your outlook is for the next, I don't know three to six months or so between kind of Australia and some of the growth of your parts of Asia as well as the, you know, very various parts of Europe.

**Sam Mitchell:**

In terms of the international business, and you know, what we saw in '16 and what we expect to continue to see in '17 is, you know, in markets like China and India, parts of Southeast Asia, we've been making, you know, tremendous progress continuing to develop our brand and develop our distribution network channels to market, adding stronger distributors, more distributors. You know, in each of those markets, we're seeing growth rates in the high single digit to even double digit range. The India business I believe was up 11% in volume in fiscal '16. We've also noted Mexico as an important growth market for us too. We've been able to substantially improve our distribution network in Mexico, and each of these regions were start—beginning to accelerate our consumer marketing efforts too to grow our brand there.

So, I feel very bullish on our opportunity in front of us to see that international business continue to grow and perform as we really become a much more global company in 2017. So, we've invested significantly

over the years in building strong team and capabilities in each one of these regions, and we're well positioned to do so.

As far as the mature regions of Australia and Europe, you know, while we'll have lower growth rates there, they are both well positioned to deliver strong profits in fiscal '17.

**Dmitry Silverstejn:**

Okay. All right. Thanks for that rundown. Then to follow-up your raw material question, you know, we can sort of see what's going on with base oil and we can make our own conclusions about, you know, what that means that going forward for four or profitability in pricing and whatnot. But, can you address sort of the other part of the raw material basket, you know, what's going on with the, you know, I don't know additive packages or, you know, packaging costs that you kind of took a look at the of the raw material basket outside of base oil. Are there any trends that we can project into 2017 that will help us think about kind of margin in the pricing opportunity for Valvoline?

**Sam Mitchell:**

We're projecting it to be pretty steady with regard to the cost in both (inaudible) and packaging.

**Dmitry Silverstejn:**

Okay. So, you're not expecting any price increases in additives given the base oil has moved up, and you've raised your oil pricing, and, you know, the environment for pricing and on plastics and metals that you guys in packaging basically flattish year-over-year. Is that what I'm hearing?

**Sam Mitchell:**

That's right. I mean over time, you know, based oil tend to, you know, base oils will follow crude. The additive package is influenced by crude but it's not as strong a correlation. So, you know, again it's something that we manage very closely, but we're not expecting any significant change in additive pricing.

**Dmitry Silverstejn:**

Okay. Fair enough. Thank you.

**Sam Mitchell:**

Thanks, Dmitry.

**Operator:**

Your next question comes from the line of Mike Harrison with Seaport Global securities. Your line is now open.

**Mike Harrison:**

Hi. Good morning.

**Sam Mitchell:**

Good morning.

**Jason Thompson:**

Good morning.

**Mike Harrison:**

Sam, I was wondering if you could talk a little bit about -- you mentioned your expectation, and in the quick lube space, you would expect increasing number of transactions to be the key driver of same-store sales growth. How much capacity do you have at the store level to handle additional car counts? At some point, one would think that you would see diminishing returns if you have too many cars there in customers have to wait longer.

**Sam Mitchell:**

Yes, that's a good question, Mike, and yet we feel we have plenty of capacity in our stores to handle more cars. So, there are certain times of the day where the stores can get particularly busy, and our biggest challenge there is to make sure that we're making, you know, full presentations to our customers and not missing out on ticket opportunities with other services that the customer may need as those teams feel a bit of pressure. So, we continue to refine our model to make sure that we're, you know, delivering that consistency of service even when the stores get busy. But overall, you know, we've got, you know, stores in the system that do well above you know the average. So, the focus that we have on speed, convenience, trust, is really working well for us and we don't see that changing at all. Instead our teams are just getting better and better at consistently delivering that, but as far as capacity constraints in our stores, we just don't see those.

**Mike Harrison:**

All right. Then you mentioned that you're going to continue to look for acquisitions. I was just hoping that you could kind of walk through Oil Can Henry's and talk a little bit about your criteria for acquisitions and kind of what boxes the OCH acquisition checks and kind of what you're looking for in future acquisitions going forward.

**Sam Mitchell:**

Certainly, you know, the Oil Can Henry's acquisition checked all the boxes. It was a perfect fit for us, and then I want to say our teams have done a phenomenal job integrating that acquisition too. So, with Oil Can Henry's number one, you know, we moved into a new region of the country where we had minimal presence. So, having 89 stores in the Pacific Northwest now has been a great addition to our overall footprint and a great base to grow from as we now have strong operations there.

The Oil Can Henry business was well run. They took care of their customers. The stores were well located, and so that really checked a couple of more boxes too, is that it wasn't a complete turnaround situation, and yet, we were able to model the real estate and know that they had potential for increased car count.

So, what we were able to do is as we implemented the Valvoline model, in other words, we have a proprietary super pro operational model that we trained our teams in that coincides with our custom point of sale system, and as we train the store personnel at Oil Can Henry's, they learned it very quickly and executed it well.

So, we saw no drop-off in customers. In fact, we saw the opposite. That we immediately began to provide greater speed of service and we saw increases in our car counts.

From there, you know, we converted the brand to Valvoline, and then we turned on some of our marketing programs. Digital marketing's to become a key tool for us to attract new customers to the stores. All of those initiatives were put in place through the summer months, and as a result, you know, we've far exceeded even our own lofty expectations for the first year of Oil Can Henry's performance.

So, when we're looking at acquisitions, we'd like to find more Oil Can Henry's. I don't know how many there are out there. I mean certainly, they were one of the bigger well-run regional operators.

Typically, we're going to be looking at some smaller regional chains, but the key for us is to make sure that the real estate is solid. We can model the real estate quite accurately in terms of what its potential is in terms of customer counts and revenue for the store.

Ideally, you know, this store is the best fit for us. There are stores that are fairly well run, and that makes for a much smoother transition. So, you know, a lot of leverage when we make acquisitions, particularly, you know, if the quick lube operator, you know, is not using Valvoline products. There's tremendous energy, you know, in making an acquisition to bring in the Valvoline brand, to drive car counts, our operational system to improve operations and then of course our products that significantly improve the overall returns on an acquisition. So, acquisitions can really make sense for us if again, you know, the real estate's in the right places and fits our model for what—where we're going to be growing.

**Mike Harrison:**

All right. Thank you very much.

**Operator:**

Your next question comes from the line of Carolina Jolly with Gabelli. Your line is now open.

**Carolina Jolly:**

Good morning. Thanks for taking my call. So, can you discuss a little about the seasonality across the different business segments, and if that's one of the reasons that your first quarter 2017 results are looking stronger than full year?

**Sam Mitchell:**

You know, first of all with regard to seasonality, there's some modest seasonality in the business but it's not all that significant. The first quarter actually tends to be our lowest quarter in terms of overall lubricant volume moving into the winter months. So, you know, in core North America for example, you see a little bit of a drop off in D.I.Y. behavior during the winter months, and then that quickly picks up as you approach spring. So, Q2 we typically see a nice rebound as in core North America, a nice pick up. But what we're talking about in terms of seasonality is, you know, roughly, you know, an index of, you know, 95, you know, for the first quarter and then that picking up in Q2 and Q3, and then moderating a bit in Q4.

**Carolina Jolly:**

Okay.

**Sam Mitchell:**

With regard to your question, you were comparing you know, our Q1 forecast guidance versus prior year, and prior year was a bit on the soft side as I recall.

**Carolina Jolly:**

Okay. Then just to—could you kind of outline some of the factors of your cash flow? I have 2016 at around \$245 million in free cash, but it looks like your guidance is \$80 million to \$100 million for 2017. Can you discuss any factors outside of just the slight increase in cap ex and extra separation costs?



**Mary Meixelsperger:**

Sure. The big drivers of the delta, as you mentioned, separation cost is, you know, \$30 million to \$35 million of the change. Our cash interest expense is another \$28 million to \$32 million of the delta, and then that pension funding for the plans that we assumed, this is primarily the other cost retirement benefit obligations as well as our non-US plans will have funding requirements in the \$25 million-range. Then we are assuming some increase in working capital investment as well, which is, you know, in total gets you to the revised—the current guidance for '17 in terms of our cash flow.

**Carolina Jolly:**

All right. Thank you.

**Operator:**

Your next question comes from the line of Jason English with Goldman Sachs. Your line is now open.

**Jason English:**

Hey, good morning folks. Thank you for the question. A couple of quick questions. Sam, one for you. Clearly you really saw momentum on quick lubes overall, yet not a lot of upfront investment plans to accelerate some of that growth. I know you're talking about laying the foundation to really try to invest more heavily for a ramp up of footprint in units into 2018. But why not sooner? Why not faster?

You guys have been preparing for the separation for a while. It seems like you've got momentum on your side. It looks like the opportunity's there. Why not spend more up front to really drive that faster?

**Sam Mitchell:**

Jason, I mean we're going to be looking for all opportunities to drive it faster because the only thing that's holding us back is just our ability to execute on the ground-up strategy. As a shared earlier, it does take some time, so that's frustratingly long, but we have teams in place in multiple markets. Our priority markets will be moving into new regions of the country, new markets where we see significant growth opportunities, where we want to establish strong company operations. So, the teams are working hard to accelerate that work.

It just take—this first year is going to take some time. This past year, you know, a lot of our effort has been focused on the Oil Can Henry acquisition and integration. A tremendous effort and a huge success for us. So, that gives us, you know, great confidences that we find other regional acquisitions to bring in that will be very successful and those transition plans and executing those.

So, you know, '17 the way to think about it is certainly a year where we hope to accelerate store growth as I mentioned. You know, franchisees are in a good position to continue to add stores in 2017, that plus-25-store rate.

Then we're going to be looking for—hopefully be able to close on a couple regional acquisitions in 2017, and then we'll be ramping up as fast as we can on the ground-ups. It's just that's the one that's taken a bit longer than we'd like, but certainly, you know, by the time we start 2018, we should be hitting on all cylinders there. But we've got, you know, three important avenues to grow; acquisition, franchise growth and the ground-ups, and it's, you know, a very high priority focus for us as I laid that out in, you know, our top four priorities.

**Jason English:**

That's helpful. Thank you. Then one quick follow-up, a housekeeping item. Mary, Jason, could you give us your outlook for the corporate expense line as we go into next year? Then also what's the clean number for the fourth quarter, because I know pension income's a big chunk of that. The release is a little bit confusing because there's a footnote saying you've got 28 million of pension income, then you pointed to the table that says 25 million of pension income, but 23 million sort of a one-time gain, so only 2 million underlying, and now, we walk away a little bit confused in terms of what it what exactly is the right underlying number to plug into that. So, maybe you could help shed some light on that.

**Sam Mitchell:**

Yes, Jason, I mean I can quickly—on the first part of your question on just the corporate piece of the SG&A pocket, we expect that to be around 100 million or slightly north of that - kind of 102-ish.

**Jason English:**

Then on the quarter?

**Sam Mitchell:**

Then on the quarter, it's pretty standard. About 25 a quarter.

**Jason English:**

No, but for the fourth quarter. The clean number. Because you're backing out—in the reconciliation you're backing out the 23 million as sort of a one-time gain. So, you know, if we backed it out, we're left with a pretty small corporate number which is what I think sort of drives the headline EBITDA miss. But I'm not sure that's really the right way to be cutting it.

**Sam Mitchell:**

Yes. So, for the fourth quarter we're—for this year, for each of the quarters, it was closer to 20 million, just that (inaudible).

**Jason English:**

Okay. Yes. I'll follow up later to try to cut through some of the details on that one. Thank you.

**Sam Mitchell:**

Sure. You're welcome.

**Operator:**

Your next question comes from the line of Chris Shaw with Monness Crespi Hardt. Your line is now open.

**Chris Shaw:**

Yes. Good morning everyone. How you doing?

**Sam Mitchell:**

Good morning

**Chris Shaw:**

(Inaudible) ask another question on the first quarter guidance, the 4.5% the 6% top line. I assume there's some pricing in there from what you were saying earlier, but have we now lapped, you know, the price--the headwinds—I don't know—it looked like in the fourth quarter pricing was a headwind for the top line. But have we lapped that now?

**Mary Meixelsperger:**

It'll be fully lapped in Q1 of '17. After Q1.

**Chris Shaw:**

Is the 4.5% to 6%, does that have that element. Could you break that between volume and price?

**Mary Meixelsperger:**

It certainly does have an element of price inside of it. I don't have the break out between volume and price.

**Chris Shaw:**

A follow up on another—sorry.

**Sam Mitchell:**

Yes, it's mostly volume. I mean there's a fair amount of volume in there. Like Mary said, we're still implementing some of those price increases. So, there's a touch of price in there, but it's mostly volume.

**Chris Shaw:**

Okay. I just want to follow up, but just curious almost on—you were talking about the Oil Can Henry—how you got the car growth up. But it sounded like—did you get the car growth up even before you switch the brand to Valvoline?

**Sam Mitchell:**

Yes, we did. We saw some early momentum just from implementing our Super Pro operational system and our point of sale. So, that was real encouraging. We inherited a strong store level team at Oil Can Henry's, so they were able to learn our system quickly. So, we sent teams of our operational folks to work side-by-side with them and their ability to execute quickly enabled us to pick up cars from the very beginning.

Then as the brand change was made and the marketing programs started this summer, we saw continued momentum in that car count growth. So, yes, you know, been tremendous.

**Chris Shaw:**

Is that typical when you take over a non-Valvoline branded store and change it to Valvoline, you'll see an uptake in the car counts?

**Sam Mitchell:**

It is, you know, it can be hard to get it to distinguish between, you know, what's brand versus the operational system, versus the marketing program, versus how we develop a very strong culture of customer service at our team. All these things contribute, you know, to improved performance. But, we're confident that we have the best model in the industry and the best execution in the industry, and so,

when we look at an acquisition, you know, we're always looking to say, okay, you know, what can we do with that real estate? How should it perform, you know, with our approach to running that store?

**Chris Shaw:**

Okay great. Thanks.

**Sam Mitchell:**

You bet. Thanks, Chris.

**Operator:**

There are no further questions at this time. I turn the conference back to the presenters.

**Sam Mitchell:**

Yes. Thanks Sean, and thank you everyone for your interest in Valvoline. I will be taking calls later this morning. So, if you have any additional follow-up, please give me a call. Thank you.

**Jason Thompson:**

All right. Thanks everyone. Bye. Bye.

**Operator:**

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