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ASH - Q2 2005 Ashland Earnings Conference Call

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OVERVIEW

The Co. reported net income of $33m or $0.44 per share for 2Q05. For the six months ended March 31, ASH reported net income of $126m or $1.72 a share vs. $17m or $0.25 a share a year ago. Q&A Focus: Hedging, MAP, and APAC.

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PRESENTATION

Operator

Good day, ladies and gentlemen. Welcome to the second quarter 2005 Ashland earnings conference call. (OPERATOR INSTRUCTIONS). As a reminder, this conference is being recorded for replay purposes. I would now like to turn the presentation over to your host for today's call, Mr. Bill Henderson, Director of Investor Relations. Please proceed, sir.

Bill Henderson - *Ashland - Director of IR*

Good morning everyone. We released results for our second fiscal quarter at 8 AM Eastern Time today, and I hope you have had an opportunity to review the release. Our second quarter was highlighted by the strength of our Chemical sector, where Distribution and Specialty reported record earnings for the quarter, and Valvoline essentially equaled its record March 2004 quarterly results.

APAC's performance reflected adverse winter weather, while MAP results were up significantly versus a year ago due to increased crude oil throughput and stronger refining margins, which were aided by wider sweet/sour crude differentials.

During our conference call we will be referring to a number of slides which can be found on our website at www.Ashland.com. Participating into a conference call, which is also being webcast, are Marvin Quin, Ashland's Chief Financial Officer, and Bill Thompson (ph), Ashland's Assistant Controller. In addition, we are pleased to have two of our colleagues from the Marathon Ashland Petroleum joint venture with us today. Gary Heminger is MAP's President and Gary Peiffer is Senior Vice President of Finance and Information Technology.

Before proceeding, allow me to review our cautionary language regarding forward-looking statements, and this is seen on slide number 2. Statements may be made during the course of the call which constitute forward-looking statements as that term is defined in relevant securities laws. Such statements, if made, will be based on a number of assumptions such as price, supply and demand, market conditions, and operating efficiencies. Ashland believes that its expectations regarding operating performance are based on reasonable assumptions, but it cannot assure that those expectations will be achieved. Therefore, any forward-looking statements made may prove to be inaccurate, and actual results may differ from those anticipated.

Ashland Inc. reported today net income of $33 million or $0.44 per share for the March quarter, the second quarter of the Company's fiscal year. And this is seen on slide number 3. These results compared to net loss of $16 million or $0.23 a share a year ago. The prior year loss from continuing operations was $11 million or $0.16 a share.

For the 6 months ended March 31, Ashland reported net income of $126 billion or $1.72 a share compared to $17 million or $0.25 a share a year ago. Income from continuing operations for the prior year was $27 million or $0.39 a share.

Now for a more in-depth discussion of our businesses, let's begin with our 38% ownership in MAP. Our Refined and Marketing segment reported operating income of $61 million for the quarter, which is after an Ashland level deduction of $9 million for amortization and other R&M-related activities. The $61 million compares to income of $2 million for the quarter a year ago.

Our colleagues at MAP, Gary Heminger and Gary Garry Peiffer, will now provide a little more insight into the results for the quarter. Gary?

Gary Heminger - *MAP - President*

I would like to describe the factors that contributed to MAP's operating income results last quarter, which improved from $49 million in the March 2004 quarter to $204 million in the March 2005 quarter. This was MAP's second-best March quarter operating income performance.

As indicated on slide number 4, crude oil prices increased from $43.45 at the end of December to $55.40 at the end of March, or an increase of almost 30%. Even more significant was the increase in U.S. Gulf Coast spot gasoline prices noted on slide number 5, which increased from $1.09 at the end of December to $1.62 at the end of March, or increase of almost 50%.

All petroleum markets continued to reach new highs last quarter on a combination of speculative fund buying, widespread refinery problems, and declining, though still ample, U.S. product inventories. The sharp increase in product prices in the last half of March was especially significant, since neither the market fundamentals nor the widening contango for crude oil futures suggested a bullish case at that time.

The most significant factor that contributed to MAP's quarter to quarter improvement in operating income was the steep sweet/sour crude oil discount experienced during the quarter. As noted on slide number 6, average sweet/sour differentials continued to widen to $12.09 a barrel in the March 2005 quarter, versus $5.80 per barrel in the March 2004 quarter. Consequently MAP's crude oil and other feedstock acquisition costs were significantly lower relative to the change in WTI this quarter compared to the same quarter last year.

In addition, primarily due to the relatively light maintenance activities we had planned at our refineries, we ran 8.8 million barrels more of crude and other feedstocks last quarter than we did in the same quarter last year.

And finally, the futures market structure was in contango, on average $0.33 per barrel last quarter versus being $0.64 in backward (ph) (technical difficulty) in the same quarter last year. This improved our crude oil acquisition costs relative to the WTI price used in the traditional 3-2-1 crack spread calculation last quarter versus the same quarter last year.

Partially offsetting these positive factors are the following major items. Slide number 7 shows that even though we had relatively large crack spreads at the end of the March 2005 quarter, the Chicago 3-2-1 crack spread average for the quarter was only slightly higher than the average for the same quarter last year. On a two-thirds Chicago, one-third U.S. Gulf Coast basis, the 3-2-1 crack spread was essentially flat quarter to quarter.

However, the other products we produce and sell, such as asphalts and heavy fuel oils, were priced at a significantly greater discount to WTI prices in the March 2005 quarter than during the March 2004 quarter. For example, as noted on slide number 8, the difference between 3% residual fuel oil prices and WTI prices continued to widen last quarter to $21.65 per barrel, compared to $12.45 per barrel in the same quarter last year.

Also, due to the steep increase in refined product prices during last quarter, we cannot pass along these price increases at the wholesale level as quickly as they occurred in the spot market. Both these factors obviously negatively affected our overall product realizations last quarter, compared to the change in spot gasoline and distillate prices used in the WTI 3-2-1 crack spread quarter to quarter.

Next, due to the significant increase in crude oil prices in the March 2005 quarter, we reported a negative crude oil in-transit effect of $73 million last quarter, compared to essentially a zero effect in the same quarter last year.

Also during the quarter, MAP reported a loss on crack spreads we sold forward of about $73 million versus recording a loss of about 41 million in the same quarter last year. Approximately 61 million of this 73 million charge was related to the sale of crack spreads that will expire over the remainder of 2005. This primarily involved number 2 fuel oil crack spread collars that we sold forward to lock in the extremely high cracks noted on slide number 9, and at the same time participate in some upward market improvement.

MAP marks to market all this derivative activity, and the actual gain or loss we will record on these derivatives that will expire in the future will not be finalized until these contracts expire or are otherwise closed out.

Now I will turn to a few operating statistics. First of all, on the sales side, MAP's overall consolidated refined product sales excluding buy/sell volumes totaled 4.9 billion gallons, or up about 3.9% from the same quarter last year.

Speedway SuperAmerica same-store gasoline sales were up about 1.2% quarter-to-quarter, in spite of the fact that SSA's retail gasoline price averaged $1.89 per gallon in the March quarter compared to $1.61 per gallon in the March 2004 quarter.

Also, we find this increase in same-store gasoline volume important, as we are comparing against a very robust first quarter of 2004. Speedway SuperAmerica gasoline and distillate sales were down about 18 million gallons quarter-to-quarter, or about 2.4%, primarily due to the fact that SSA only operated 1659 stores at the end of March 2005 quarter compared to 1773 stores at the end of the March 2004 quarter.

SSA's merchandise sales on a same-store basis increased about 11.5% last quarter. Even though SSA operated fewer stores last quarter compared to the same quarter last year, SSA's total merchandise sales increased by $39 million or 7.5% quarter-to-quarter to $560 million, primarily due to these strong same-store sales.

Our refining and wholesale marketing margin increased from $0.0344 a gallon in the March 2004 quarter to $0.0685 a gallon last quarter. This improvement was primarily due to the improvement in the sweet/sour differentials that I just described.

SSA gasoline and distillate gross margins decreased from $0.1145 per gallon in the March 2004 quarter to $0.1058 per gallon in the March 2005 quarter. This reduction primarily reflected the fact that SSA had to increase retail prices significantly last quarter in an attempt to keep up with the increase in wholesale prices.

Now let me give you a few other operational updates. Within refining operations our refineries ran very well last quarter, primarily due to our recent emphasis on reliability, investments we had made in our plants over the last few years, as well as the relatively low planned maintenance scheduled for the March 2005 quarter. Because of the condition of our plants and the very attractive refining margins last quarter, we set a March quarter crude oil throughput record averaging 922,000 barrels per day compared to 789,000 barrels per day last quarter -- last year in the same quarter.

Last year we completed a significant amount of planned maintenance activity at our Canton, Ohio, Garyville, Louisiana and Catlettsburg, Kentucky refineries in the March quarter. Our other charge and blend stocks' throughputs, decreased from 196,000 barrels per day in the March 4 -- or March 2004 quarter to 171,000 barrels per day last quarter, primarily because of our ability to process more crude oil this year rather than supplement the lack of crude oil capacity in the same quarter last year without side feedstock purchases.

However, we still set a total throughput record for the March quarter averaging 1,093,600 barrels per day. Assuming refining margins continue to remain strong in 2005, we expect to exceed the crude oil throughput record we set in 2004 and 2005.

Turning to crack spreads, as you know Q4 the forward crack spread, especially for high sulfur number 2 fuel oil, were exceptionally strong during the March 2005 quarter, but have dropped back somewhat after the end of the quarter. The major unknown at the present time is what crude oil prices will be the rest of this year and the impact these prices will have on refined products demand.

While we are currently in uncharted waters, we don't expect crack spreads and sweet/sour differentials to be as strong during the rest of 2005 as they have been in the March 2005 quarter. But we do expect, because of the relative tightness of refining capacity in the U.S. and still strong worldwide demand, that we will continue to enjoy above cycle crack spreads the remainder of 2005.

Moving to demand, and finally gasoline demand as of late has been showing some weakness because of the high retail prices. We project that total refined product demand will increase about 1.2% in the U.S., that gasoline demand will increase about 0.6% and distillate demands to increase about 2%. These forecasts are down considerably from our previous forecasts, and actual demand will obviously be heavily influenced by the absolute price of refined products at that time. And with that, Bill, I will turn it back to you.

Bill Henderson - *Ashland - Director of IR*

Turning to Ashland's wholly-owned businesses, Ashland Distribution reported operating income of $34 million, an all-time record quarter, far exceeding last year's record performance of $19 million and December's previous all-time record quarter of $24 million.

Sales per shipping day, as seen on slide number 10, were up 25% for the quarter, increasing to $15.4 million per day versus $12.3 million per a day year ago, reflecting the strength in the economy and rising hydrocarbon prices. Adjusting for the sales from the adjustables business, which by the way was sold in January of 2005, unit volumes were up 2.5%. Also contributing to Distribution's record performance was a slight increase in gross profit to 9.8%, as seen on slide number 11, from 9.7% year ago and 9.6% in the December quarter of 2004. Lastly, adding to Distribution's performance was its ability to maintain its low cost structure.

Turning to Specialty Chemical, they reported operating income of $39 million, more than doubling last year's record quarter of $19 million. Included in the results was a pre-tax gain of $7 million from the sale of an idle plant in Louisiana. Especially strong performance reflected a 32% increase in sales revenues.

Now as seen on slide number 12, sales per shipping day increased to $7 million per day from $4.8 million per day a year ago. In particular, we saw strength from our composite polymers, our casting solutions, and drew (ph) marine businesses.

For the quarter, thermoset volumes were up 8% versus a year ago. Specialty's gross profit, as seen on slide number 13, grew to 26.7% from 24.2% in the December 2004 quarter, reflecting the Company's focus to improve upon our ability to pass along escalating raw material costs. However, this is below last year's gross profit of 29.5%.

Raw material prices remained elevated as evidenced by our key raw material cost for styrene, as seen on slide number 14, which is used in the manufacture of (indiscernible) polyester resins; butane, as seen on slide number 15; and maleic anhydride and acrylate, as seen on slide number 16; and adhesives.

Turning to Valvoline, they reported operating income of $24.2 million versus last year's record of $24.5 million. Our blended lubricant volumes declined 7% versus a year ago on weaker demand. Relative to the market data that we have, our volume decreases are slightly below the market.

Now in contrast, premium volumes increased 5%, which somewhat offset the decline in overall volumes and now comprise 24.1% of Valvoline (indiscernible) to lubricant volumes, and that is as seen on slide 17, up from 21.4% a year ago. Valvoline Instant Oil Change results were down somewhat relative to a year ago on reduced car count.

Somewhat offsetting the decline was an increase in ticket price for services such as transmission and antifreeze flushes, windshield wiper replacement, tire service, cabin air filters, and belt replacement. Valvoline Instant Oil Change into the quarter was 763 units, an increase of 13 units versus a year ago. Valvoline international income was up slightly versus a year ago, predominantly due to strengthening foreign currencies.

And lastly, Valvoline introduced its AroMetrics line of fragrance car care products during the quarter, and with a lot of interest from customers. In fact, Wal-Mart plans to feature AroMetrics in its checkout lanes and its automotive products department during the month of May. This is another example of Valvoline's commitment to new product introduction and organic growth.

Looking at APAC, our Paving and Construction segment, they reported an operating loss of $46 million versus an operating loss of $33 million a year ago. Results were disappointing despite the seasonality in this business.

Unfortunately, this is an outside business and the month of March incurred persistent wet weather conditions, as seen on slide 18, which hindered work activity. And in particular, some of the key southern states such as Florida, Georgia, Alabama and South

Carolina normally experience moderate climate in the month of March. This allows us to complete existing work or initiate new work earlier than some of the cooler states in which we operate. And this was not the case this year.

Due to the poor conditions in March asphalt production and revenues were adversely affected. Hot mix asphalt production for the quarter, as seen on slide number 19, fell 16% to 3.7 million tons versus 4.4 million tons a year ago. And just for the month of March alone, production fell 40% versus a year ago.

Now as seen on slide number 20, hot mix asphalt production must reach approximately 2500 tons per month, as depicted by the blue or middle line on the graph. The difference between the lines for the previous two years is the difference in our margins. We believe that the primary difference in the margins by the higher hydrocarbon costs and trucking fees related to these higher hydrocarbon costs.

So essentially, during this year's March quarter we generated less revenue to spread over our fixed costs resulting in a wider loss. And despite our efforts to improve our cost structure and inefficiencies, it is apparent that we now need to grow the revenue line to improve our performance during this slow period.

Lastly, APAC's backlog increased 13% to $2.1 billion, versus $1.9 billion a year ago, and this is an all-time record as seen on slide 21. Our inability to complete work during the March quarter was a major contributor to the backlog increase.

In addition, we now have a approximately $210 million of major project in the backlog, which includes two recently awarded $80 million projects in the Miami/Fort Lauderdale area and a $50 million project in the Memphis, Tennessee area. Major projects totaling $135 million were added during the quarter. Marvin Quin will now discuss asbestos.

Marvin Quin - *Ashland - CFO*

Thank you, Bill, and good morning everyone. If you will turn to slide 22, it provides the quarterly asbestos update. As you'll note, new claims during the quarter were 3600. Our average quarterly claim year-to-date is less than half of those of 2004, and only one-fifth of those received in 2003.

We paid about 800 claims during the quarter, which is below our historical rate. The dismissal rate during the quarter was a favorable 81% and the cost per claim disposed was $1992. This figure is higher than we experienced in fiscal 2004, or fiscal 2003, primarily because we processed fewer claims during the quarter. Legal defense costs tend to be somewhat fixed in nature, and during the quarter represent 44% of our asbestos comps.

We had -- if we had processed 7800 claims during the quarter, as we did on average in 2004, rather than the 4200 claims that we did process, the average cost per claim we have been similar to 2004.

The next slide shows the quarterly new claims filed for the last several years, and the final slide shows the quarterly cost per claim disposed. I should note that the high cost of claims disposed in fiscal 2001 and early 2002 was primarily due to few claims being settled, and therefore are legal defense cost were -- or our total costs were abnormally high due to legal defense costs.

I would like to caution everyone the number of claims received, or the cost per claim disposed of etc., can be quite volatile from quarter to quarter. So future activity may well differ from recent experience. Now let new turn the program back to Bill.

Bill Henderson - *Ashland - Director of IR*

Allow me now to review corporate developments. During the quarter our debt increased by $150 million, due in part to a $148 million income tax payment and approximate $40 million increase in normal working capital items, and no cash distribution from MAP.

Cash investments decreased by $34 million during the quarter, and at the end of the March quarter MAP had $560 million in distributable cash due Ashland. Lastly, our effective tax rate is currently estimated at 38.5% for the remainder of the year. At this time, Marvin Quin will make a few comments.

Marvin Quin - *Ashland - CFO*

Let me give you an update on how we see the rest of the year on unfolding, starting with APAC. As we demonstrated on slide 20, the breakeven graph, APAC's profitability is highly correlated to hot mix asphalt production. As we enter the spring and summer, we would expect hot mix production to rise sharply and for profitability to likewise recover.

As a reminder, over the past five years 106% of APAC's total annual profitability has come in our third and fourth fiscal quarters. We do have a strong backlog; however, we are also experiencing hydrocarbon price pressures.

APAC consumes the equivalent of about 12 million barrels per year of crude oil through diesel fuel and asphalt. Additionally, the independent truckers are frequently adding fuel surcharges on now, due to the higher cost of diesel fuel. So we're facing some headwind there.

The results of Ashland Distribution and Ashland Specialty Chemical should be driven by economic activity in the manufacturing sector of the economy. We expect the earnings for these two divisions to remain strong, but their ultimate performance will be driven by three factors -- economic activity, our ability to pass on higher hydrocarbon prices, our ability to maintain a low-cost structure and of course our ability to serve customers well.

Turning to Refining and Marketing, the June quarter has been MAP's best quarter in 5 of 7 years in which MAP has existed. Given that the 3-2-1 crack spreads were over $12 per barrel on Friday afternoon and the seasonality of MAP's business, we are expecting robust earnings in the June quarter.

The September quarter has traditionally been our second most profitable quarter, and we see nothing on the horizon which would suggest otherwise for this fiscal year.

Valvoline is a somewhat seasonal business. In the past five years, 61% of our operating income has been recorded in the last half of the year. We are concerned about our decline in unit sales, and this is receiving considerable attention.

In order to pass on loop stock cost increases, we're raising our prices, and this is temporarily costing us marketshare in some markets, particularly some auto dealers and some big-box retailers. We expect our marketshare to return to more normal levels as prices stabilize.

Our confidence in this business has also been enhanced by one additional factor. This will be Bill Henderson's last conference call as Director of Investor Relations. In coming weeks, he will transition to Valvoline and become part of their sales management. Those of you know Bill will realize how qualified he is for this new assignment, and we wish him well in this new opportunity. I personally want to thank him for his tireless and successful efforts as the head of the function. So thanks very much, Bill. Now let me turn it back over to you.

Bill Henderson - *Ashland - Director of IR*

Thanks, Marvin. This concludes the presentation segment of our conference call. We will now open the phone lines for any questions that you may have.

QUESTIONS AND ANSWERS

Operator

(OPERATOR INSTRUCTIONS). Doug Terreson of Morgan Stanley.

Doug Terreson - *Morgan Stanley - Analyst*

First, congratulations to Bill on the fine job that he has done over the years. Secondly, I have a question for Gary which regards his comments on the effects of hedging and also crude oil and transit charges. Specifically, and I apologize if I missed this, but you have the amount and type of production that you have hedged during the remainder of this year, and any spread information on those volumes would be helpful as well. And then secondly, you also mentioned that there was a $73 million crude in-transit charge in the period, and then on this point I wanted to see if you have the comparable figure from the fiscal first quarter of 2005?

Gary Heminger - *MAP - President*

Let me go over the hedges and then Garry Peiffer can review the market -- the in-transit number. Here are the hedges. As I said, primarily distillate, the high sulfur distillate, and I will break it down into spreads for you.

April 2005 through June 2005, we have 5 million barrels at a floor of 4.55 to a ceiling of $7. Then we have again April 2005 to June 2005, 1.3 million barrels and that is at $5.98. Then we have some more collars from July 2005 to September 2005, 3.3 million barrels at a floor 4.17 to an $8.31 fall. And then again July 2005 to September 2005, 3 million barrels at $4.15.

On the gasoline side, and that averages on the -- I believe we have about 16% is what that number comes out to be on the distillate side, and only about 4% on gasoline. Let me give you the gasoline. April 2005 to June 2005, 3.4 million barrels. These are collars again -- 9.27 to 15.62. We have another collar July 2005 to September of 2005, $8.50 to $15. Did I give you 2 million barrels there?

Doug Terreson - *Morgan Stanley - Analyst*

You did now.

Gary Heminger - *MAP - President*

And then lastly, April 2005 to June 2005, 1.1 million barrels at 8.82, and that is primarily to hedge some ethanol or butane that we purchased. And that takes care of that. And Garry, you want to cover the in-transit?

Garry Peiffer - *MAP - SVP of Finance and Information Technology*

Sure. This is Gary Peiffer. In the first quarter of '04 it was basically zero with 100,000 negative, so basically the 73 million or so is all variance quarter-to-quarter.

Doug Terreson - *Morgan Stanley - Analyst*

What about the first quarter of '05?

Garry Peiffer - *MAP - SVP of Finance and Information Technology*

The first quarter of '05 was 73 million. And the first quarter of '04 was essentially zero.

Operator

Michael Judd of Greenwich Consultants.

Michael Judd - *Greenwich Consultants - Analyst*

Yes, on the specialty chemicals side and also on the distribution side, can you talked about your inventory levels and also inventory levels at your customer. That is the first question. And then the second question is in terms of CapEx, what are the expectations for the year? And I noticed that the numbers for the second quarter were a little higher than I had anticipated, especially in APAC, if you could comment on that please.

Marvin Quin - *Ashland - CFO*

This is Marvin Quin. As far as the inventories, as you see on page 2 of the attachment to the press release, in dollar terms they are up. If you look at them in terms of days sales outstanding, they're basically flat. Taking the percentage -- that number as a percentage of revenues, it would be about 23 days either way. So our inventories really haven't changed. Most of our inventories are on LIFO. Some are on FIFO, those being within drew (ph) -- those within APAC and those that are international.

As far as a question on capital expenditures, our capital expenditures are a little higher than last year. And the primary reason is we have ceased leasing within APAC. So we're basically buying equipment that we may have leased in prior years. I think that is the primary factor. Let me ask Bill Thompson if he has anything he might want to add to that.

Bill Thompson - *Ashland - Assistant Controller*

No, I think that's correct Marvin. And the 29 million of capital expenditures in the March '05 quarter for APAC. That is up considerably from what it was in the quarter last year.

Michael Judd - *Greenwich Consultants - Analyst*

Do you have an estimate for the full year for all of CapEx for the entire Company?

Marvin Quin - *Ashland - CFO*

I think we were projecting about $200 million in CapEx, as I recall. You have to remember that much of the capital expenditure for APAC occurs right before the construction season begins. So obviously if you're going to buy a road paver, you wouldn't be doing that in June and July. You would be doing that in February before the season starts.

Michael Judd - *Greenwich Consultants - Analyst*

Thank you very much and congratulations.

Operator

Jeff Zekauskas of JP Morgan.

Jeff Zekauskas - *JP Morgan - Analyst*

There was a transaction announced between Valero and Premcor. All things being equal, should an Ashland shareholder be encouraged by that transaction, or discouraged or should it be in different?

Marvin Quin - *Ashland - CFO*

Looking at the screen this morning, it appears that shareholders were encouraged.

Jeff Zekauskas - *JP Morgan - Analyst*

I mean the rational shareholder.

Bill Henderson - *Ashland - Director of IR*

I guess we look at this as a data point. It is a very interesting transaction and it is something that we will study. We certainly have not completed our analysis of it. But I think it is obviously a relevant transaction.

Jeff Zekauskas - *JP Morgan - Analyst*

Can you give us an update on what is happening with the MAP transaction?

Marvin Quin - *Ashland - CFO*

As I think we disclosed recently, we are in discussions with both Marathon and the IRS, and at this point in time we have nothing to announce.

Jeff Zekauskas - *JP Morgan - Analyst*

I remember that there was a hope that the deal would close by the end of June. What relevance does that date have, and is it now likely that the deal won't close at the end of June?

Marvin Quin - *Ashland - CFO*

Clearly, closing by the end of June would be a challenge at this point in time. Not impossible, but it's a challenge. I think the relevance of that date may be less than a lot of investors place on it. From our perspective, if we are able to negotiate a transaction that we think is favorable to our shareholders, we would be inclined to extend that date. If we are unable to, we would be -- it would just terminate.

It is not terribly relevant in the sense other than the sense that it is in the existing document, the original document. It is once again, what can we negotiate? If it is attractive we would be willing to extend it.

Bill Henderson - *Ashland - Director of IR*

And we would expect it to take approximately 60 days after some announcement to close the deal, approximately.

Jeff Zekauskas - *JP Morgan - Analyst*

60 days. Again, can you remind me as to the meaning of a tax efficient transaction?

Marvin Quin - *Ashland - CFO*

Yes, what we're talking about there is using the structure that was announced in March of 2004 in the Morris Trust. And we say tax efficient as opposed to nontaxable because I think we have disclosed that we were not able to get one of the tax rulings. And as a result, there would be a certain amount of taxes due related to contingent liabilities. And in addition, there would be taxes due related to our stock price now exceeding our basis of new Ashland.

Jeff Zekauskas - *JP Morgan - Analyst*

Lastly, has the -- what is the IRS is feeling about the tax efficient transaction?

Marvin Quin - *Ashland - CFO*

I really cannot talk about the IRS' views on matters. That is a confidential discussion between the IRS and ourselves and Marathon at this point.

Jeff Zekauskas - *JP Morgan - Analyst*

Did it have any view in the past that you have already said?

Marvin Quin - *Ashland - CFO*

I'm sorry?

Jeff Zekauskas - *JP Morgan - Analyst*

What was your previous public view on the tax -- on the IRS' view of the tax efficient transaction?

Marvin Quin - *Ashland - CFO*

As you may recall, there were a number of rulings which we requested, and we received all but one of those rulings. And that was the one related to contingent liabilities. And the IRS has stated that they will not provide that ruling.

Operator

Paul Cheng of Lehman Brothers.

Paul Cheng - *Lehman Brothers - Analyst*

First just want to say thank you for Bill for all the help that you gave us over the past couple of years. It is really appreciated. I have two questions. One is for Gary and one is probably for Marvin. Let's ask the simple one for Marvin. Marvin, any kind of quick guidance that you can give related to the corporate expense and the interest expense over the next several quarters?

Marvin Quin - *Ashland - CFO*

We would not anticipate a major change in interest expense over the next few quarters. As far as corporate expense, our corporate expenses were a little bit higher than normal past quarter for certain reasons. The -- I think they were $26 million. That is a little higher than we would have expected, but it is a function of a lot of other -- and a lot of activities and what is going on at that particular time.

Paul Cheng - *Lehman Brothers - Analyst*

Marvin, I think at one point after some restructuring that you were speaking on a going forward basis, company expense (indiscernible) being less than 20 million. Is that -- now that assumption is too aggressive, or we should assume more like in the 23 to 25 million going forward?

Marvin Quin - *Ashland - CFO*

It is hard to tell. What actually shows up in that account is some non-recurring or unusual type items frequently show up there. But if you are looking at steady-state type numbers, I think the 20 million is certainly reasonable. But it will vary from that as it certainly has this past quarter.

Paul Cheng - *Lehman Brothers - Analyst*

The next question is for Gary. Gary, we know that from time to time you engage in the hedging, but hedges arguably that no one really can predict the price in the future and in any position. And up to a point it is a zero sum game or that is a net loss game because you are more (indiscernible) management time and also costs associated with that.

So from your view, is hedging going to be a part of an ongoing strategy for the Company's, or that you may revisit saying that you may not want to, say after you finished with whatever hedges you have, you're not going to engage it in the future? (multiple speakers) if you talk about on the key (ph) one impact I think you mentioned something. Can you quantify that on the sequential to the fourth quarter, what is the positive or negative of the key one impact?

Gary Heminger - *MAP - President*

On the fourth quarter?

Paul Cheng - *Lehman Brothers - Analyst*

I'm sorry, from the March -- from the December to March quarter what is the (indiscernible) one, the way that you applied (ph) your domestic crew, what is that impact? Is it a negative or positive, if you can quantify that?

Gary Heminger - *MAP - President*

Let me have Garry Peiffer -- do you have that number Gary?

Garry Peiffer - *MAP - SVP of Finance and Information Technology*

Hold on, just a minute. I will see if I can get it.

Gary Heminger - *MAP - President*

While he is working on that, let me go over your other question, which is a very fair question. To say are we going to pull back or are we going to do any hedging into the future, we constantly look at that within our management and within both parents to determine what is the best position forward.

Obviously, we certainly would have liked to have done better here in the first quarter. When I step back and look at the end of December, when we made a decision to put a small piece of our high sulfur distillate on, we were looking at negative gasoline cracks on the NYMEX at that time. So negative gasoline cracks and high sulfur distillate cracks higher than we had ever seen in time. So we sold some of that forward and did it on a collar basis for the most part.

So when I look at it, I said today and look at it -- we were looking at numbers then kind of four times historical averages and felt pretty good about it. I will never say that we're trying to outsmart the market, it just seemed common sense when we were looking at a negative position on gasoline. And knowing the history of all the years of being in this business and how volatile margins can go up or down, that was the decision we made at the time.

We've certainly not put anymore hedges on for the most part for the balance of the year, just because of how the markets -- where the supply has come on and the strength in the demand side of the equation. At this time, we really like the strip going forward and we don't see the need to do that. But that is why we did it at that time. And we'll constantly review this with our management team to see what makes most sense for us and our shareholders.

Paul Cheng - *Lehman Brothers - Analyst*

So in other words, that hedging will continue to be part of your overall strategy going forward?

Gary Heminger - *MAP - President*

I would say -- what I want to say is that I'm not saying it won't be part, I am saying it will be a very small piece. But I just don't want to be incorrect and say emphatically we won't hedge going forward. It just depends on where the forward markets are and where we see supply/demand and what is going on with our two parent companies. I don't want to say no, but as we look forward into the balance of 2005, more than likely a diminished look at hedging.

Garry Peiffer - *MAP - SVP of Finance and Information Technology*

This is Garry Peiffer. In fourth quarter of '04 or the December quarter of '04, the markets were backward-dated about $0.37 versus being contango about 33 in the March quarter. That had about a $26 million beneficial effect for us.

Paul Cheng - *Lehman Brothers - Analyst*

26 million beneficial. Thank you.

Operator

Jack Pasterchak (ph) of BB&T.

Jack Pasterchak - *BB&T - Analyst*

I would also like to thank Bill for his efforts. I have only been covering the Company about 9 months, but he has been tireless in supporting that effort. So thanks. With regard to APAC, just want to get a picture of the underlying business environment there.

The weather effect aside, and that pushed some backlog into the June quarter, but if we look at highway construction spending, it is running up over 20% right now. Maybe on the verge of getting a highway bill from Congress pretty soon. How would you describe the overall environment, not just with regard to large projects, but bidding opportunities in general? Are you seeing your states put more money to work, and how would you compare it to the previous couple of years?

Gary Heminger - *MAP - President*

Certainly the highway bill would be beneficial from a couple points of view and providing additional funding going forward. And also I think from the states' point of view of issuing large contracts, they will have more confidence in doing so once they know that the bill is in place and what is coming down the stream later.

I would say if you look at the history of APAC over a number of years, a 10-year, 15-year period, the environment we're in today, and really been for the last few years, has been one that is certainly more competitive than in prior years. I think it is due to the fact that there is plenty of capacity in the industry, and you have -- that capacity is competing for either a stagnant or diminished number of jobs depending upon the state. And it really is a local business.

In some states, like Texas, or parts of Texas, Florida, there is very strong growth in the highway programs. There are other states that are having financial challenges, Tennessee or Mississippi, where a lot of projects have been put on hold. But overall I would say it is kind of the demand for services is flat to down in general. Certainly in some states, though, it is up.

Jack Pasterchak - *BB&T - Analyst*

Second question, with regard to the Marathon and MAP transaction, given that the IRS did not give you the initial rulings on the transaction in its initial contemplation, and given that today's announcement between Valero and Premcor sets some sort of valuation bar mark-to-market, if you will, for these types of assets anyway, why -- in a sense, couldn't you guys just move on with sort of a newer negotiation, given that changed environment that has occurred in the industry in terms of performance and now valuation over the last year since this transaction was done? Since it was initially announced it kind of seems like we are a little stuck in the mud. It is that not a fair assessment?

Gary Heminger - *MAP - President*

I think it is a fair assessment. And I think as we disclosed earlier, we are looking at -- are discussing alternate transaction structures. So it is not just the original Morris Trust structured that has received our attention.

Operator

Fred Leuffer of Bear Stearns.

Gary Heminger - *MAP - President*

That was a key part of that answer.

Fred Leuffer - *Bear Stearns - Analyst*

First, Bill, congratulations and thank you for all your help. You have done a fantastic job. I had two questions. First, Marvin, just a clarification. It sounds like regarding the MAP transaction, you are still in discussions with the IRS, meaning that you are still looking for some kind of tax-favored structured? Is that correct?

Marvin Quin - *Ashland - CFO*

That has been one of the options we have been pursuing.

Fred Leuffer - *Bear Stearns - Analyst*

Secondly, Gary, I think you mentioned in your remarks that same-store gasoline sales were up 1.2% in the quarter.

Gary Heminger - *MAP - President*

Yes, that's correct.

Fred Leuffer - *Bear Stearns - Analyst*

What is going on here? In the past when we have seen pump prices near $2 a gallon, there has usually been a fall off in demand. But your numbers are consistent with what we see out of the DoE and the API for gasoline demand in the first quarter. What do you think is happening? And can you give us some idea of the trend, if there was one, on same-store sales as we went through the quarter?

Gary Heminger - *MAP - President*

Yes, I would -- and it is really a reflection of how many times you have to what we call restore the price, or raise the price at the retail level. When we look at the quarter, 1.2% -- and this was on top of the same quarter last year, we were up 2.3%. So we feel very robust in the demand side to our predominately Midwest/Upper Southeast stores.

If I were to look at it on kind of state data, where our sales are per state and where it is trending, I would say we're probably looking somewhere to between zero to 0.5% increase on a going forward basis. January was about 0.5% up and February was up big on same-store basis, and that is because we didn't have to raise prices many times -- as many times this February as we did last February. And then March has been down a little bit in comparison to last year.

So when you look at the number of stores we have and the density in the markets and kind of being the leader on the price restoration, that costs us volume. So I would say it is more of a reflection of that.

But we continue to be pleasantly surprised at these prices and at the close of the week -- this is public information -- the retail price across the Midwest was about $2.15. So we continue to be pleasantly surprised at the demand versus that retail price, because last year when we hit $1.80 to $1.85, we started to see a big deceleration in demand. And it has continued to be strong.

However, we have seen the fleet -- so that the fuel efficiency of the total fleet seems to have stabilized, which means SUV sales have reduced significantly and some of the higher performing mpg type cars is what is being sold into the marketplace. So we have seen the miles per gallon seem to stabilize in the marketplace.

Fred Leuffer - *Bear Stearns - Analyst*

I think you said something about you are estimating gasoline demand at 1.2% for the year now? Is that right or no?

Gary Heminger - *MAP - President*

We're looking at gasoline demand for the year now to be approximately 0.6. We're looking at overall U.S. demand to be at 1.2 for refined products. And we're looking at 0.6% on gasoline demand.

Operator

John Roberts of Buckingham Research.

John Roberts - *Buckingham Research - Analyst*

Sorry, Marvin, to keep asking you this differently. But is it fair to say that Ashland would not be inclined to extend the end of June deadline for the original price deal?

Marvin Quin - *Ashland - CFO*

I don't want to go into price. Let me put it in this way. Ashland has several alternatives. One is to continue its ownership. Two, if we don't reach agreement Marathon could call our interest. In the third scenario, we could enter into some type of an agreement. We are obviously not going to enter into an agreement that we think is less favorable than the other two options.

John Roberts - *Buckingham Research - Analyst*

You're not obligated to extend the June 30 deadline if you're unhappy with the deal?

Marvin Quin - *Ashland - CFO*

Yes.

John Roberts - *Buckingham Research - Analyst*

And then secondly, and again thanks, Bill, you have been very helpful. Did you announce a replacement in the IR?

Bill Henderson - *Ashland - Director of IR*

Not yet.

John Roberts - *Buckingham Research - Analyst*

Again, Bill has done a great job but this seems to be made a peculiarly odd time to make that change, given all of the help everybody needs with the MAP transaction.

Gary Heminger - *MAP - President*

I have had the same feeling myself.

John Roberts - *Buckingham Research - Analyst*

It is just the opportunity was too good --?

Gary Heminger - *MAP - President*

Yes, Valvoline had been talking to Bill for some time and it is a great opportunity for Bill and his career. And Bill will probably -- we're going to have sort of a soft transition, so he is not going to disappear right away. But we did not want Bill to miss this opportunity.

John Roberts - *Buckingham Research - Analyst*

On Valvoline I guess I'm a little bit confused, but I thought you had said that the volumes were down a little less than the industry volumes. But you also said you had lost some share because you led the price increases. Did you lose share or were you down more than the industry volumes? The two statements don't seem consistent.

Gary Heminger - *MAP - President*

Bill is our Valvoline guy now, let's --.

Bill Henderson - *Ashland - Director of IR*

What we said is that our volumes were slightly below -- with the data that we have, it is slightly below what we think the market downtrend was.

John Roberts - *Buckingham Research - Analyst*

(multiple speakers) while (ph) you gained some share.

Bill Henderson - *Ashland - Director of IR*

No, it wasn't share. What we were saying is our volumes were below what the market downward trend was.

Gary Heminger - *MAP - President*

I think we feel that we've lost some share.

John Roberts - *Buckingham Research - Analyst*

It was down more then. I thought you were --

Gary Heminger - *MAP - President*

And we -- it was basically two classes of very price-sensitive buyers. We don't feel that this is a permanent situation. We feel that this is it in response to our aggressiveness in raising prices. And I think one of the themes you'll see throughout Ashland, whether it is in Distribution, Specialty Chemical, APAC or Valvoline, is we have expanded great efforts to pass through rising hydrocarbon prices. And obviously sometimes that has a negative impact.

John Roberts - *Buckingham Research - Analyst*

I'm sorry. I was just a little confused on the semantics and on the decline, but if base lube prices were to rise substantially further, you would expect this to being a more lasting effect. It goes on at least until base lube is stable.

Bill Henderson - *Ashland - Director of IR*

I would say that is right. And it is a function of course of how other competitors react as well.

Operator

Ike Bethune (ph) of Key McDonald.

Ike Bethune - *Keybanc McDonald - Analyst*

Congrats to you Bill. I just wanted to get a better feel for the underlying growth or drivers for revenue for Specialty Chemical; sales were up 22%. You did comment about 8% in thermoset resins, but just give us a better feel what actual volume was, and maybe pricing and foreign currency if there is a breakdown?

Bill Henderson - *Ashland - Director of IR*

I don't think foreign currency was a material item. Basically what it is is thermoset volumes were up nicely. We seem to be doing well in the marketplace. And then we are also seeing the impact of the price increases that we have announced in recent months, they are rolling through and of course that drives higher dollar revenue.

Ike Bethune - *Keybanc McDonald - Analyst*

Pricing was up maybe in the 24, 25% range year-over-year?

Gary Heminger - *MAP - President*

You can basically take the difference in the percentage growth in revenue and that 8%, and essentially all of that is due to pricing, and maybe some currency and there's probably some mix change. I should also add we did the DERAKANE acquisition earlier in the year. And that is in the dollars. The 8% I think we have adjusted that out so it reflects an apples-to-apples. But the total dollar sales does include some DERAKANE revenues, which would have been maybe in order to what --(multiple speakers)

Ike Bethune - *Keybanc McDonald - Analyst*

Maybe 7% for DERAKANE, right?

Marvin Quin - *Ashland - CFO*

It is probably $15 or $20 million. It is not a huge number.

Ike Bethune - *Keybanc McDonald - Analyst*

Pricing was strong. In distribution, did you see underlying growth in volumes as well?

Marvin Quin - *Ashland - CFO*

Yes, we did. As Bill stated, the volume went up 2.5% excluding -- we sold during the quarter a food ingredients business. If you exclude that from both periods, we were up 2.5%.

Ike Bethune - *Keybanc McDonald - Analyst*

And going into the second quarter, we did hear last week from some of the other specialty chemical companies, weak volumes in March or maybe sluggish in April. Are you seeing something different, or is it something more indicative to what you're doing internally that is showing better volume growth?

Marvin Quin - *Ashland - CFO*

It is difficult to tell just on the results of one or two weeks. We are not seeing any particular weakness. I am not sure we're seeing any acceleration of growth, but it seems to be kind of a steady growth is what it feels like.

Operator

Chi Chow of Petrie Parkman.

Chi Chow - *Petrie Parkman - Analyst*

Bill, best of luck in the new position, I know you'll do well. And thanks for all your help and going to miss your visits every time you swing through Denver here. Gary, got a couple of questions for you. The 1.2% total product demand, that was for total U.S., is that correct?

Gary Heminger - *MAP - President*

The 1.2% -- yes.

Chi Chow - *Petrie Parkman - Analyst*

And you mentioned gasoline is 0.6% growth this year is what you're expecting?

Gary Heminger - *MAP - President*

Yes.

Chi Chow - *Petrie Parkman - Analyst*

That is down quite a bit. I recall I think last quarter you said your estimate is 1.7%.

Gary Heminger - *MAP - President*

That's correct. That is what we said. We have just -- I believe that is a very conservative forecast going forward. But as I said in my speech, we are in uncharted waters. And at above $2, none of us have any knowledge, evidence of what happens to demand. And when I look at the first quarter last year, up 2.3%, and then the second and third quarter fell off significantly, again kind of a bell curve on demand but it fell off significantly -- so that is our forecast. While it might be a little conservative, the run rate over the last month has been about 0.5%. We'll see. But we think that is fairly close to what is going to happen.

Chi Chow - *Petrie Parkman - Analyst*

It seems a little bit on the pessimistic side, but okay. Any thoughts going forward on creating an MLP type of structure with your midstream assets?

Gary Heminger - *MAP - President*

Yes, we have studied that and both parents have studied that. I really would say that is more of refinancing decision the way we look at how an MLP structure woodwork with us. But we are not looking at anything in the near future on that. We have a very, very strong logistics system that -- we are shipping a large volume from the Gulf Coast to the Midwest every day and over to the Southeast. So the way we are set up really fits our assets and our structure at this time going forward. So I would say we don't see anything in the near future.

Chi Chow - *Petrie Parkman - Analyst*

It seems like you're still acquiring terminal type of assets.

Gary Heminger - *MAP - President*

Yes, we just announced and we hope to close by the end of June an acquisition of say former Motiva terminal in Fort Lauderdale, 388,000 barrel facility. We are, we believe, the largest supplier of gasoline distillates into the Florida market. So it really fits very well with us, and also fits very well for some imported volume that we find from time to time makes sense to bring into the eastern side of Florida. And we have made some other pipeline and smaller pipeline type deals in and around the Midwest. But we are still able to do that.

Chi Chow - *Petrie Parkman - Analyst*

Were the terms disclosed on that Florida terminal acquisition?

Gary Heminger - *MAP - President*

No, they were not.

Bill Henderson - *Ashland - Director of IR*

We have time for one more call.

Operator

Matt Warburton of UBS.

Matt Warburton - *UBS - Analyst*

Bill, all the best for the future. Two quick questions, if I may. The tax burden that you said, 148 million, was that in relation to your taxable income that obviously hasn't been distributed on MAP? So I see you also borrowed some money from MAP during the quarter. And then I have a follow-on on MAP after that.

Marvin Quin - *Ashland - CFO*

The answer is yes. As an MLP -- LLP -- MAP is paying -- repaying (ph) income taxes on that income as it is recorded, not as paid.

Matt Warburton - *UBS - Analyst*

Secondly, Marvin, you mentioned that you continue to talk to the IRS and they're looking for a tax favored structure. And it seems to me, given the duration and given what the IRS has said to you in the past, that a tax restructure is virtually impossible, from looking at it on the outside. To what degree if the IRS come back and say we are prepared to accept a partially taxed transaction, will Ashland then return -- stick to the guns of no restrictions on use of proceeds?

Marvin Quin - *Ashland - CFO*

We can't make a judgment without having specific facts available to make that judgment. The factors that are important to us are after-tax value, and it is certainly the most important. But also factors like financial flexibility and certainty of transaction would be important in that (technical difficulty) deliberation.

Matt Warburton - *UBS - Analyst*

So essentially you could potentially see a case where the after-tax value was preserved or even increased, given what the commentators were saying in terms of the benchmark stage -- Premcor, Valero deal, that you would accept some sort of limitations on use of proceeds?

Marvin Quin - *Ashland - CFO*

Yes. It would depend on the overall -- what we thought the value of each alternative was.

Bill Henderson - *Ashland - Director of IR*

This concludes our conference call. If you all have any more questions, just give me a call in the office. And have a great day.

Operator

Thank you for your participation in today's conference. This concludes the presentation. You may now disconnect. Good day.
