



## Conference Call Transcript

\*\*MPM - Q4 2009 Momentive Performance Materials Earnings Conference Call

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**Tariq Hamed**

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**Bill Hoffmann**

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*Brownstone Asset Management - Analyst*

**Kristin McDuffy**

*Goldman Sachs - Analyst*

**Aaron Weitman**

*Appaloosa Management - Analyst*

## PRESENTATION

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### Operator

Good day, ladies and gentlemen, and welcome to the Q4 2009 Momentive Performance Materials Earnings Conference Call. My name is Modesta and I will be your operator for today. At this time, all participants are in listen-only mode. Later, we will conduct a question-and-answer session.

(Operator Instructions).

I would now like to turn the conference over to your host for today, Peter Cholakis. Please proceed.

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### **Peter Cholakis - Momentive Performance Materials - IR**

Thank you. Good morning, and welcome to the Fiscal Year-end 2009 Earnings Call for Momentive Performance Materials. Before getting started, let me remind everyone that any redistribution, retransmission or rebroadcast of this call in any form without Momentive's express written consent is strictly prohibited.

As you know, some of our comments today may contain forward-looking statements. These statements are subject to known and unknown risks, uncertainties, and other factors that may cause Momentive's actual results and performance in future periods to be materially different from any future results or performance suggested by these statements.



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Such factors include, but are not limited to, our substantial leverage and limitations in operating our business contained in the documents governing our indebtedness, including the restrictive covenants contained therein. Other potential factors that could affect our results are included in our reports filed with the SEC. All information discussed on this call is as of today, March 9th, and we undertake no obligation to update this information to reflect future events or circumstances.

On today's call, we will utilize certain non-GAAP financial measures in discussing the Company's performance. Reconciliations of those non-GAAP measures to the GAAP measures we consider most comparable can be found in our earnings release.

Yesterday evening, we issued our earnings release and our 10-K for the year ended December 31, 2009, both of which are posted on the Investor Relations financial results page of Momentive's website at [www.momentive.com](http://www.momentive.com). We will post a transcript of this call on our website tomorrow. And now, I'd like to introduce our President and CEO, Jonathan Rich. Jon?

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**Jonathan Rich - Momentive Performance Materials - President, CEO**

Thank you, Pete, and good morning, everyone, and thank you for joining our call. On the call this morning, I'll briefly review some highlights from 2009 and update you on what we're seeing in the marketplace. Tony Colatrella, our CFO, will then take you through our annual and fourth quarter results in detail. After that, I'll make a few closing comments and then we'll move on to the Q&A session.

2009 will certainly go down as one of the most challenging years in our history. The global recession significantly affected our full year results, with sales and adjusted EBITDA off 21% and 25%, respectively. The majority of the contraction in our business occurred in the first half of 2009, and as economic conditions stabilized and picked up during the year, our sales rebounded. We are pleased to report another quarter of improved results with fourth quarter sales and adjusted EBITDA coming in higher on both a sequential and year-over-year basis, in line with our prior guidance.

Sales and adjusted EBITDA in the period were \$607 million and \$106.5 million, respectively. This performance represents an increase in sales and adjusted EBITDA of approximately 7% and 14%, respectively, compared to the third quarter, and 11% and 172%, respectively, compared to the fourth quarter of 2008. Although our results have improved considerably since the beginning of the year, our sales and adjusted EBITDA in the fourth quarter still remained below normalized pre-recessionary levels.

In the quarter, demand continued to improve moderately. Order rates came in above the third quarter tally, which marks the third consecutive quarter of increases. Backlog also improved in the quarter on a sequential and year-over-year basis.

As we outlined in our Q3 call, our quartz business grew sequentially more rapidly in Q4 than the silicones business. This is consistent with the recovery of the semi-conductor equipment segment, which lagged the upturn in silicone sales by roughly a quarter. We believe that the quartz business reached a bottom in its business cycle in early Q3 2009 and should benefit from improving conditions throughout 2010.

We also continued to benefit from our reduced cost structure from lowered raw material costs. SG&A and the fixed portion of cost of goods sold were down significantly from the prior year, reflecting the actions we took to streamline our operations during 2009. For initiatives implemented in 2009, we expect total annual cost savings on a run rate basis of approximately \$65 million, with total cost savings of about \$43 million realized.

In 2009, our silicones business experienced improving demand on a quarter-over-quarter basis throughout the year. The rebound was more robust in Asia, followed by the Americas, and then Europe. We are optimistic that the global economic recovery will continue to gain traction. One good sign is the recent recovery in longer-term blanket orders in both our silicones and quartz businesses. In the depths of the recession, virtually all blanket orders from customers disappeared.

So far during the first quarter of 2010, we've continued to see average daily order rates and backlog improve on a sequential basis, offsetting the normal 3% to 5% seasonal decline that we typically see in our business from the fourth quarter to the first quarter. We note, however, that the fiscal calendar in the first quarter of 2010 has eight less days than Q4 2009, which will impact comparisons.

For the entire year 2010, we're now forecasting improving demand from economic recovery, but stubborn weakness in some segments such as automotive, construction, and furniture, especially in Europe, will continue to hold sales below the levels achieved in the first half of 2008. As I said earlier, we remain quite optimistic about sequential improvements in our quartz business.



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As we look throughout 2010, our focus will continue to be on growing our specialties business. As we've discussed in the past, Momentive's overall business strategy is to be the leader in creating innovative specialty silicone products and solutions that help our customers grow their businesses. Consistent with that strategy, we're investing in innovation in flexible global assets that allow us to respond quickly to our customers' needs.

In February, we announced that Momentive will build a world-class R&D facility in the Rensselaer Polytechnic Institute Technology Park in Troy, New York. This facility will enhance our speed to market, increase our innovation, and ensure that Momentive is truly the science behind the solutions.

Likewise, our investments in specialty silicones manufacturing facilities in Nantong and Shanghai, China, Chennai, India, and our newest siloxane plant in Jiande, China position Momentive to grow our business in the parts of the world that are expanding the fastest.

In 2009, our percentage of total silicone sales, specialty products, were up 3 percentage points, finishing the year at 73%. With their high value-added properties, specialty products weathered the recession in 2009 much better than core products, which were especially impacted by weakness in the automotive, construction, and textile sectors.

At Momentive, our global silicones strategy is specialties. We do not strive to be the largest producer or lowest cost supplier of commodity undifferentiated products. As the recession unfolded and capacity utilization dropped, we consciously chose not to pursue certain commodity business with unattractive and declining margins.

As a result, our average selling price continued to improve sequentially and versus last year. This improvement in mix was an important contributing factor to our higher operating margins in the fourth quarter. With our global focus on specialties, we believe we've been successful, as measured by revenue, operating margin, and return on invested capital metrics.

In 2009, we took quick and aggressive action to reduce our cost structure commensurate with lower demand and to protect cash. The steps taken have improved our financial operating leverage and positioned Momentive for improved results in 2010 as sales continue to recover. Although we have completed the vast majority of the initiatives that we've announced to date, we are intensely focused on our cost structure and will continue to evaluate other cost and productivity actions.

Some of the steps taken in 2009 that helped us deal with the recession, such as the reduction of salaries and working hours, were always intended to be temporary. Effective January 1, 2010, we reinstated normal working hours and pay for all salaried employees affected by the cuts, which will result in higher sequential costs. We've also returned to normal work schedules in most of our factories.

Additionally in 2010, we intend to increase our expenditures in R&D and marketing to support our specialties strategy in the expected economic recovery. These increases will be partially offset by improved efficiencies in our operations and lower costs in our back office functions.

We'll also continue our expansion efforts in the emerging markets of Asia, the India subcontinent, Eastern Europe, the Middle East, and Latin America in 2010. These regions are substantially underpenetrated in terms of the amount of silicone consumed per capita, compared to the US and Western Europe, and offer the best avenue for growth as the world economies continue to improve.

We expect our new world-class siloxane manufacturing plant, which we're building with our JV partner, to start up in mid-2010. This new, low-cost plant will help fuel our domestic growth in China. We expect that our new finishing plant in Nantong, China that came online in mid-2008 will have significantly higher utilization rates in 2010.

In the upcoming year, we'll also manage the right balance of capital investment. Last year, we pulled back on our CapEx to conserve cash during uncertain times. In 2010, our CapEx will likely come in between \$90 million and \$110 million, excluding restructuring, up moderately from 2009, but still well below 2008's total of \$140 million.

This level of CapEx will ensure appropriate environmental, health and safety, and maintenance investments for our plants, and also support productivity and growth measures. In 2009, we generated cash from lower working capital and expect to continue to reduce working capital in 2010 with initiatives primarily focused in the area of inventory. And now, I'd like to turn the call over to Tony, who will take you through our full year and fourth quarter results in detail. Tony?

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**Tony Colatrella - Momentive Performance Materials - CFO**

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Thank you, Jon. I will begin by discussing our 2009 year-end results. Sales in the year ended December 31, 2009 were \$2.083 billion compared to \$2.639 billion for the same period in 2008, a decrease of 21%. This decline was primarily due to a decrease in sales volume of 21.6%, offset by an increase in selling prices and fluctuations in exchange rates of 0.6%.

Cost of sales, excluding depreciation, in the year ended December 31, 2009 was \$1.421 billion compared to \$1.838 billion for the same period in 2008, a decrease of approximately 23%. This decline was primarily due to lower sales volume of about 22% and deflation in raw material and energy-related costs of about 9%, partially offset by significantly lower factory utilization, especially in the first half of the year.

Restructuring and other costs in the year ended December 31, 2009 were \$22.9 million compared to \$44.8 million for the same period in 2008. For the year ended December 31, 2009, these costs were comprised of restructuring costs, primarily severance payments associated with announced workforce reductions of \$22.1 million and other services costs of \$0.8 million.

For the year ended December 31, 2008, these costs were comprised of restructuring costs, again, primarily severance payments associated with workforce reductions of \$20.9 million and other services costs of \$23.9 million. We also recognized a gain on the exchange of debt of \$179 million for the year in connection with the private exchange offers to exchange second lien senior secured notes for certain of our unsecured notes, which was completed in mid-June 2009.

Adjusted EBITDA, as defined in our credit agreement and indentures, was \$283.9 million in 2009 compared to \$377.1 million in 2008, a decrease of approximately 25%. Now turning to our quarterly results for the quarter ended December 31, 2009. Sales in the quarter were \$607 million compared to \$545 million for the same period in 2008, an increase of 11%. This increase was primarily due to higher sales volume of approximately 8% and changes in sales prices and exchange rate fluctuations.

Sales for our silicones segment were \$551 million compared to \$490 million for the same period in 2008, an increase of 12%. Sales for our quartz segment were \$56 million compared to \$55 million for the same period in 2008, an increase of approximately 2%.

Cost of sales, excluding depreciation, in the three-month period ended December 31, 2009 was \$392 million compared to \$417 million for the same period in 2008, a decrease of 6%. This decline was primarily due to deflation in raw materials and cost actions partially offset by volume and exchange rate fluctuations. Restructuring and other costs for the three-month period ended December 31, 2009 resulted in a credit of \$2 million compared to an expense of \$22.1 million for the same period in 2008.

Adjusted EBITDA, as defined in our indentures, was \$106.5 million for Q4 2009 compared to \$39.2 million for the same period in 2008, an increase of approximately 172%. Although our cash balance was down for the full year, we made very good progress in generating cash in the second half of the year. Cash flow from operating and investing activities in the second half came in at \$62 million as compared to a use of cash of \$116 million in the first half.

As a result of our solid cash performance and improving business prospects, we paid back \$150 million under our revolver in the fourth quarter and an additional \$50 million in early 2010, leaving outstanding borrowings at \$50 million. We also intend to pay down another \$25 million later this week. We will continue to evaluate further debt repayment, as appropriate, in the future.

Now let me give you some additional detail on our business segments. In silicones, customer demand in the fourth quarter continued to rebound on a sequential basis across all major regions, driven by strong gains in Asia-Pacific where sales came in above average 2008 levels. China, India, and Southeast Asia led our growth in the quarter.

Consistent with the past few quarters, construction, automotive, textile, and furniture lagged behind other segments, but showed improvement from the third quarter. The personal care, consumer sealants, adhesives, and healthcare sectors, with their focus on consumable products, continued to perform well.

Our quartz segment had a particularly strong fourth quarter with sales up 25% as compared to the third quarter. This business was especially hard hit in early 2009 by the cyclical downturn in the semi-conductor capital equipment industry and the effects of the global recession. However, we believe that our quartz business is now at the beginning of an up cycle. Accordingly, we expect much better operating results from this division in the coming quarters.



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Now let me talk a little bit about raw material costs. In the fourth quarter, overall, we benefited from lower year-over-year and sequential unit costs for raw materials, including silicone metal, the biggest component of our raw material purchases. We did see some inflation in platinum and other petroleum-based inputs in Q4 and are taking appropriate actions to mitigate these effects.

As we've discussed in prior calls, our strategy in 2009 to buy more silicone metal on the spot market than in past years worked very well. In the beginning of 2010, however, similar to many other commodities, we began to see some upward pressure in the spot market price for silicone metal, which we attributed to modestly improving demand in the aluminum and silicone industries and substantial amounts of idled silicone metal production capacity in North America and Western Europe.

As a result, early this quarter we entered into contracts for more of our silicone metal supplier requirements. And as we proceed in 2010, we will work with our long-term suppliers of silicone metal, support new silicone metal producers in low-cost countries, and seek to more fully utilize our free trade zone status in Waterford in order to meet our needs.

In 2010, we do not believe that demand for silicones, engineering aluminum, or solar and electronic silicone will return fully to 2008 levels and that capacity of metallurgical-grade silicone globally should meet demand. Momentive will continue to fight for the elimination of trade barriers on silicone metal in Europe and the United States that adversely affect our competitive position and unfairly impact our employees in those regions. For the full year 2010, we are expecting modest inflation that will likely increase in the second half of the year versus the first half. Now, I'd like to turn it over to Jon again for his closing comments.

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**Jonathan Rich - Momentive Performance Materials - President, CEO**

Thanks, Tony. I'm extremely proud of the entire Momentive team for their performance in 2009 in the face of unprecedented challenges in the economy. We are grateful for the support of our customers and suppliers throughout these difficult times. The steps we took in 2009 are the foundation for a better future.

With the global economic activity improving, we are cautiously optimistic about our prospects in 2010. The necessary cost actions we took in 2009 have substantially improved our operating leverage in both silicones and quartz, positioning us for a brighter future as volumes return.

In 2010, we will continue to focus on winning with customers through innovation in our products and services. We'll strive to improve our operating performance by intensely delivering on our specialty strategy, growing in the emerging market countries, aggressively controlling costs, and improving cash management. We thank you for your interest in Momentive, and now we're pleased to address any questions that you might have.

## QUESTION AND ANSWER

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**Operator**

(Operator Instructions).

Your first question comes from the line of Laurence Jollon with Barclays Capital. Please proceed.

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**Laurence Jollon - Barclays Capital - Analyst**

Good morning.

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**Jonathan Rich - Momentive Performance Materials - President, CEO**

Hi, Laurence.

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**Tony Colatrella - Momentive Performance Materials - CFO**



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Good morning.

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**Laurence Jollon - Barclays Capital - Analyst**

Tony, I wanted to dig in a little bit more on the quartz segment for the fourth quarter. If I take the full year 2009 EBIT losses, negative \$16 million, and I back out the first three quarters, I get to a substantial positive number, roughly \$28 million of EBIT for the quartz segment. And I'm trying to just get a sense for why that's risen so much sequentially from the third quarter.

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**Tony Colatrella - Momentive Performance Materials - CFO**

Okay. Well, first and foremost, we clearly see the benefits of the cost reduction actions we took earlier in the year coming through as we moved through the year. And with the additional volume that we've seen, and there has been a significant improvement in that volume as we moved from mid-year through the third quarter and again into the fourth quarter, the operating leverage that we realized and the fact that we've shrunk our global manufacturing footprint and they're basically making do with less as volumes have increased has really helped us significantly. And so the combination of the two really sets us up for a very nice rebound in 2010.

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**Laurence Jollon - Barclays Capital - Analyst**

As I just bridge from the third quarter to the fourth quarter, sales in the segment looks like they were up 25%, or roughly \$11 million, but it looks like a sequential, almost \$30 million improvement in EBIT. It just seems like a large jump. Is there anything funky running through there?

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**Tony Colatrella - Momentive Performance Materials - CFO**

No, I think you're overstating the quarter-to-quarter improvement in earnings. We should probably get back to you separately and go through that. It's not that significant. What I can say is that the volume increase has dropped through at fairly high rate in terms of the impact on contribution margin. Again, a combination of our cost-reduction actions and an improving mix as we have seen clearly a rebound in products that we sell into the semi-conductor manufacturing industry.

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**Laurence Jollon - Barclays Capital - Analyst**

Okay. I'll follow-up with Pete on that. My second question relates to CapEx in the quarter; it just seemed a little bit large. Your cash flow was pretty decent, all things considered, given the semi-annual coupon payments and the higher than expected CapEx. Can you just give us a little color on why CapEx was --?

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**Tony Colatrella - Momentive Performance Materials - CFO**

Sure. The biggest driver is we had some manufacturing assets under operating leases in Europe, and we looked opportunistically at the end of the year at the possibility to buy those leases out and that's what we did. Those operating leases represented, incrementally, \$18 million of unplanned capital expenditures.

But again, with the Board support and Jon's and my support, we went ahead and took advantage of the opportunity to buy those leases out, which will have a sequential improvement in EBITDA because those operating leases were previously booked as part of our fixed costs.

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**Laurence Jollon - Barclays Capital - Analyst**

Okay, great. My last question before I get back in the queue is, footnote nine of your 10-K, you talk a little bit about the AHYDO issue -- I'm not sure if I'm pronouncing it right -- as it relates to --

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**Tony Colatrella - Momentive Performance Materials - CFO**



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AHYDO issue, yes.

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**Laurence Jollon - Barclays Capital - Analyst**

-- as it relates to your toggle notes. I was just hoping you could dig in there a little bit more.

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**Tony Colatrella - Momentive Performance Materials - CFO**

The AHYDO issue is just simply the fact that we've been toggling those notes. There is a requirement in order to protect tax position for the Company, that certain principal payments be committed to and paid in the future. That number will be, I think, in round numbers around \$40 million, but it's not due to be paid until 2012.

So, not an immediate cash requirement; nothing unusual. When it happens, it will represent a reduction in, obviously, the principal balance of the senior toggles and, again, it's tied to the fact that we've been picking those notes over the last three quarters.

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**Laurence Jollon - Barclays Capital - Analyst**

Okay. The \$40 million number is helpful. Thank you.

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**Operator**

Your next question comes from the line of Roger Spitz with Bank of America. Please proceed.

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**Roger Spitz - Bank of America - Analyst**

Thank you. Good morning.

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**Jonathan Rich - Momentive Performance Materials - President, CEO**

Good morning.

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**Roger Spitz - Bank of America - Analyst**

Can you provide a sense of how much of your US and European silicone metal requirements you have under one-year fixed-price contracts in 2010?

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**Jonathan Rich - Momentive Performance Materials - President, CEO**

Yes, Roger. I think as we've discussed in the past, all of the metal that we buy in Asia is bought on the spot market. We're not going to detail, for competitive reasons, the ratio of spot and longer-term contracts, but I will tell you, as we said earlier, we see some inflationary pressures there as the year starts out and we made a decision to secure some longer-term supplies, and we think that's the appropriate thing to do.

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**Roger Spitz - Bank of America - Analyst**

Okay. Can you provide how volume growth in each, for silicones and quartz, in Q4 '09 on a year-over-year as well as sequential basis?

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**Jonathan Rich - Momentive Performance Materials - President, CEO**



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The Q4 to Q3 results?

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**Roger Spitz - Bank of America - Analyst**

The Q4 to Q3 volume growth and the Q4 '09 to Q4 '08 volume growth, just to give a sense of the volume growth in each of those two businesses.

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**Jonathan Rich - Momentive Performance Materials - President, CEO**

Yes.

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**Tony Colatrella - Momentive Performance Materials - CFO**

Just give us a second and we'll dig up those. Do you have another question while you're waiting?

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**Roger Spitz - Bank of America - Analyst**

Yes, sure, sure. Quarterly SG&A dropped to the high 70s in Q2 and Q3 '09 from the low 90s in Q1 and then ramped back up a little bit to about [\$95 million] in Q4. Can you provide some insight on this as well?

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**Tony Colatrella - Momentive Performance Materials - CFO**

Yes. There are really two factors. About half of the increase is due to foreign exchange differences, so just purely translational-driven foreign exchange differences. And the other half, actually, has to do with the timing of when we book unrealized gains and losses.

As it so happened, we had an unrealized gain in the third quarter of the year and reported in the fourth quarter an unrealized loss, and so that was about a \$10 million or \$11 million swing when you compare the effect quarter to quarter. And again, I just want to remind you and others on the call, Roger, that we take out, obviously, unrealized gains and losses out of adjusted EBITDA when we report under the compliance requirements for our debt and indentures.

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**Roger Spitz - Bank of America - Analyst**

Sure. And, I guess, lastly, getting back to the volume and a different take on it, you said you've seen some modest sequential silicones volume pick-up, but I think you said in a prior press release you remain near recession-level volumes. I note that Dow Corning has indicated in their press release that its volumes, they claim, are at pre-recession levels. I don't want you to discuss Dow Corning, but I wonder if you might chat about changes in market share you might have seen for yourself.

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**Jonathan Rich - Momentive Performance Materials - President, CEO**

Roger, I think the first thing that's important to understand is when we talk about normalized pre-recessionary levels, it's important to understand the definitions that we're using.

At Momentive, we consider -- we take the first three quarters of 2008 and then annualize that. So we consider that the recession started in earnest in Q4 of '08, so we take the first three quarters of '08 and annualize that to a 12-month basis and that's what we're calling normalized.

For 2010, we don't expect on a global basis yet to return to that level. We do expect the business in Asia will be above that number, but the business in the west -- in the US and the Americas and Europe -- will still be below that number.

We do expect for the entire year that the business will be significantly better than the overall year 2009 on sales, but I'm not going to quote a number and, as you already commented, I'm not going to make any comments about competitors.



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**Tony Colatrella - Momentive Performance Materials - CFO**

And again, Roger, just to emphasize a point that Jon made earlier in his remarks, our focus is specialty growth. We did see a three percentage point increase in the mix of our specialty business, which we think has contributed significantly to, all things being equal, a pretty good earnings result in a tough environment.

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**Roger Spitz - Bank of America - Analyst**

Great. Well, thank you very much.

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**Tony Colatrella - Momentive Performance Materials - CFO**

But real quick, just before you jump off, let me give you those numbers. The quarter-over-quarter comparison, Q4 versus Q3, okay? For silicones, unit volume was up 5%, and in quartz, 24%.

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**Roger Spitz - Bank of America - Analyst**

Great. Thank you very much for that.

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**Tony Colatrella - Momentive Performance Materials - CFO**

Yes.

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**Operator**

Your next question comes from the line of [Tariq Hamed]. Please proceed.

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**Tariq Hamed Analyst**

Good morning.

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**Jonathan Rich - Momentive Performance Materials - President, CEO**

Hi, Tariq.

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**Tony Colatrella - Momentive Performance Materials - CFO**

Good morning.

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**Tariq Hamed Analyst**

You talked a little bit about backlog levels starting to improve. Can you sort of put those in context, kind of where are we sort of now from where we were in the fourth quarter? And kind of how does that compare to where we were in the first three quarters of 2008?

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**Tony Colatrella - Momentive Performance Materials - CFO**

Sure. We have seen sequential improvement, Tariq, in the first quarter of this year in our backlog; it continues to build. Order rates have continued to improve thus far in Q1 versus Q4, so we've seen a steady build there.



I'm not going to get into specific numbers year-over-year in comparing the backlog, but our backlog was pretty minimal at the end of 2009. Some of you may recall in the fourth quarter of 2009, while we reported sales in the mid 500s, \$100 million of that was really eating away at the backlog that had been built up at the end of Q3 2008. So by the end of 2008, we had a very minimal backlog and that backlog has more than doubled since then.

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**Tariq Hamed Analyst**

Great. And then, obviously, Europe's been in the press a lot. Can you talk a little bit about what you're seeing in your European business sort of last two months and kind of any changes from the trend in fourth quarter?

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**Jonathan Rich - Momentive Performance Materials - President, CEO**

Tariq, what we're seeing around the world is economic recovery in all regions, right? So the business is improving in Europe. It's just a matter of magnitudes. The business has rebounded faster in Asia and the recovery there is more robust. I think of the three geographic regions, the rate of increase in Europe has been the most modest, but it continues to improve sequentially like all of the businesses.

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**Tariq Hamed Analyst**

Great. And then you mentioned on silicone metal inflation -- or that you expect some silicone metal inflation. Can you talk a little bit about your expectations in siloxane and methanol?

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**Jonathan Rich - Momentive Performance Materials - President, CEO**

On methanol, again, as you're well aware, volatility there historically is much greater, so transparency is more difficult. We don't anticipate significant increases in methanol throughout the year, but historically that depends on outages, but we don't believe there will be substantial increases in methanol costs throughout the year.

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**Tony Colatrella - Momentive Performance Materials - CFO**

Just add one other point there. Basically, in the second half of 2009, we did see increases in methanol, really driven by global market pricing. Those increases have leveled off to an extent. We haven't seen any reduction from where -- once there was a little bit of a bump, but we haven't seen substantially more inflation, either, in the last month or so.

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**Jonathan Rich - Momentive Performance Materials - President, CEO**

I think it's important also to remember that in early 2009, methanol was at historically low levels.

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**Tony Colatrella - Momentive Performance Materials - CFO**

Yes.

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**Jonathan Rich - Momentive Performance Materials - President, CEO**

Yes.

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**Tariq Hamed Analyst**



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And one last question from me. As you sort of look at the mix shift toward specialties, can you sort of talk a little bit about what the margin differential is now between kind of your specialty book of business and your more commodity book of business? Just sort of trying to get a sense of kind of what the upside is as volumes ramp up with the mix shift.

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**Jonathan Rich - Momentive Performance Materials - President, CEO**

We typically talk about the margin differential being 15% plus a little, maybe, but it's in the 15% range, the difference between our specialty average and core.

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**Tariq Hamed Analyst**

Okay. Great. That's it for me. Thank you.

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**Tony Colatrella - Momentive Performance Materials - CFO**

Thanks, Tariq.

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**Jonathan Rich - Momentive Performance Materials - President, CEO**

You're welcome.

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**Operator**

Your next question comes from the line of Bill Hoffmann with RBC Capital Markets. Please proceed.

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**Bill Hoffmann - RBC Capital Markets - Analyst**

Yes, good morning.

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**Jonathan Rich - Momentive Performance Materials - President, CEO**

Hi, Bill.

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**Bill Hoffmann - RBC Capital Markets - Analyst**

Just to follow-up on the conversation about the core versus specialty, Jon, I wonder if you could talk a little bit about maybe second half of '09 versus first half of '09, what kind of differential you saw in your core recovery? And then also, as we look going forward, you do talk about the more powerful expected recovery of core business. Just wondering what you're seeing so far year-to-date, maybe on a regional basis for that core business?

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**Jonathan Rich - Momentive Performance Materials - President, CEO**

Again, I think, Bill, clearly in the first half of '09 and the fourth quarter of '08, significant reductions in demand for all products, but core demand reductions were higher than specialty, so the core business was more affected. As we said in our prepared remarks, we made some strategic decisions to not chase unattractive business as the declines in demand occurred.

We're seeing recoveries in all parts of the business now, and recovery in the core business is also occurring in the second half of the year and is continuing to occur in the first quarter. We do believe that overall in the silicones industry demand is beginning to come more in-line with supply.



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**Bill Hoffmann - RBC Capital Markets - Analyst**

Any way you can put some percentages on those -- second half versus first half, what the core did?

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**Jonathan Rich - Momentive Performance Materials - President, CEO**

Again, I think -- I'm not going to break it out specifically, but I would say that in the second half of the year, especially in the fourth quarter, we saw core volumes beginning to recover more rapidly. As the first quarter has played out, the core business has continued to recover more rapidly.

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**Bill Hoffmann - RBC Capital Markets - Analyst**

Okay. And then, Jon, just thinking about -- obviously, there was inventory depletion in the supply chain. Do you have any sense of where your customers are right now in the supply chain, whether they've fully restocked or whether they're still doing some tentative buying at this point?

---

**Jonathan Rich - Momentive Performance Materials - President, CEO**

Look, I think we have -- as we've said in the past, it's always difficult to get transparency to customers' inventory levels. We believe that there has been some inventory restocking, but the exact magnitude is hard to assess. Again, I'll remind you that for many of our products, we're two or three steps away from the final consumer. I will say that we are pleased with demand levels that we're seeing in the first quarter to date.

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**Bill Hoffmann - RBC Capital Markets - Analyst**

Thanks. And just a last question. With the capacity that you put on in China, especially the finishing plant in Nantong and the new siloxane plant that you expect to come on sort of mid-year, any sense of what that's going to factor into from a top-line, just to help us quantify where your position is in China at this point?

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**Jonathan Rich - Momentive Performance Materials - President, CEO**

I think the best way to think about that is that the overall size of the plant is 50,000 tons of siloxane capacity and we have half of it. So 25,000 tons of incremental capacity and you can back calculate what our ASP is so you can get a sense of that.

One thing I will say is that we are very pleased with the recoveries that we're seeing in China and in Southeast Asia in general. And also, there's a significant shift towards domestic consumption as the export business there has yet to rebound. It looks more like the developed countries, but the domestic consumption there continues to be robust.

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**Unidentified Company Representative**

Record auto sales again in February in China.

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**Tony Colatrella - Momentive Performance Materials - CFO**

By the way, just to clear up one small point, Bill, which, again, that siloxane production, that 25,000 metric tons, is over the course of a full year, but this plant won't be up and running for a full year; it will be up and running for only half a year.

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**Bill Hoffmann - RBC Capital Markets - Analyst**

Sure. Yes, I get that. Thank you.

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**Tony Colatrella - Momentive Performance Materials - CFO**



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Just to be clear.

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**Bill Hoffmann - RBC Capital Markets - Analyst**

Thank you.

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**Tony Colatrella - Momentive Performance Materials - CFO**

Yes.

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**Operator**

Your next question comes from the line of Barrett Eynon. Please proceed.

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**Barrett Eynon - Brownstone Asset Management - Analyst**

SG&A, was that just higher due to higher compensation, and why was it so much higher sequentially in the fourth quarter versus the third?

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**Tony Colatrella - Momentive Performance Materials - CFO**

Okay. Well, perhaps you didn't hear my response, because it was asked earlier, but the essence of it is two-fold. One, translation-driven foreign exchange differences quarter-over-quarter and, actually, transactional differences for unrealized foreign exchange. So in the third quarter, we basically had an unrealized gain from FX in the fourth quarter that swung to an unrealized loss. That represented about \$11 million net swing quarter-over-quarter.

Our operating costs remain in control. We haven't added to headcount, so we've towed the line everywhere else. And, as I mentioned earlier, in our adjusted EBITDA, which obviously you guys that follow our debt [urged] in that, we pull out unrealized gains and losses anyway. So this is really -- when you're looking at our 10-K, obviously, those are GAAP numbers. So basically, there's nothing in the fourth quarter that represents a significant increase in our cost structure at all.

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**Barrett Eynon - Brownstone Asset Management - Analyst**

Right, but the difference is about \$20 million or so? So you're saying that \$11 million of it came from FX. What's the rest of it from? Is it all FX?

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**Tony Colatrella - Momentive Performance Materials - CFO**

No. Most of it is FX and there were some true-ups of incentive compensation-related metrics at the end of the year that we --

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**Barrett Eynon - Brownstone Asset Management - Analyst**

Okay. And then, a question on your CapEx. I don't know how much that old guidance there, but I thought your guidance was closer to 50 to 60 and you came in closer to 75 or higher. Was that expected, or do you see more opportunity and that's why you kind of ramped up CapEx in the fourth quarter?

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**Tony Colatrella - Momentive Performance Materials - CFO**

Again, this was covered earlier. Maybe you were a little late to the call.



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**Barrett Eynon - Brownstone Asset Management - Analyst**

Yes, I was late to get on the call.

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**Tony Colatrella - Momentive Performance Materials - CFO**

The question was asked earlier. What we did was we opportunistically took advantage of an opportunity to buyout a couple of European operating leases, specifically at our Leverkusen, Germany facility. So those were not planned; they were discretionary in nature.

We did it because we thought it made good sense economically. It will result in, obviously -- it resulted in higher capital spending by \$18 million from what we were targeting. But on the other hand, we will see a reduction in our operating rents as we go through all of 2010.

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**Barrett Eynon - Brownstone Asset Management - Analyst**

All right. My last question. Not sure if you answered this earlier, but on Apollo's ability to repurchase bonds, has that opportunity expired now? The one that they had -- you could repurchase --. The ones that you could repurchase for them at their cost, has that expired?

---

**Tony Colatrella - Momentive Performance Materials - CFO**

Well, there's the -- the side letter that we have allows us to repurchase those bonds within 180 days of any activity that they have, any transaction between the [rolls]. So to the extent that there would be additional bond repurchases by Apollo, we would have the opportunity to potentially to buy those out. But as you probably well know, the cost of those bonds has increased substantially --.

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**Barrett Eynon - Brownstone Asset Management - Analyst**

Right.

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**Tony Colatrella - Momentive Performance Materials - CFO**

And so the closer they get to par, the less attractive in some respects they become, certainly, to us and we have to weigh the opportunity there versus other growth opportunities that we have to invest in the business.

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**Barrett Eynon - Brownstone Asset Management - Analyst**

Great. So the ones about -- significantly below par, that opportunity you guys had to repurchase those at that level, that's expired. Is that right?

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**Tony Colatrella - Momentive Performance Materials - CFO**

It depends on when they were acquired.

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**Barrett Eynon - Brownstone Asset Management - Analyst**

I know.

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**Tony Colatrella - Momentive Performance Materials - CFO**

Well, let's be clear. Any that were acquired more than six months ago, that opportunity has expired.



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**Barrett Eynon - Brownstone Asset Management - Analyst**

All right. Thank you.

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**Tony Colatrella - Momentive Performance Materials - CFO**

You're welcome.

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**Operator**

Your next question comes from the line of [Adam Goodwin] with Goldman Sachs. Please proceed.

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**Kristin McDuffy - Goldman Sachs - Analyst**

Hi, this is actually Kristin McDuffy. Could you comment on when your PIK seller notes become callable and at what price?

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**Tony Colatrella - Momentive Performance Materials - CFO**

Oh, boy. Hold on, we'll get that. I do not have that at my fingertips, but Greg Rustowicz, who is with us, our Treasurer, will look that up and we'll get back --.

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**Kristin McDuffy - Goldman Sachs - Analyst**

Okay.

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**Jonathan Rich - Momentive Performance Materials - President, CEO**

-- to you in just a minute. Do you have any other questions?

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**Kristin McDuffy - Goldman Sachs - Analyst**

Sure. Your contract with Unimin for quartz sand ends in late 2010. Can you give us a sense for your progress in renewing this contract?

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**Jonathan Rich - Momentive Performance Materials - President, CEO**

We have been in the quartz business for a long time. Unimin has been a very long-term and consistent supplier to us. And we're in discussions with them now, but we anticipate that we will be able to reach a successful conclusion to those negotiations.

---

**Kristin McDuffy - Goldman Sachs - Analyst**

Okay. And then, I know that you're in discussions about potential reimbursements for wage cuts starting from January 2009. Can you just give us a sense for what this cash outlay would be should you be required to make that payment?

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**Tony Colatrella - Momentive Performance Materials - CFO**

Are you referring to the wage restoration --?

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**Kristin McDuffy - Goldman Sachs - Analyst**



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Yes.

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**Tony Colatrella - Momentive Performance Materials - CFO**

-- Kristin?

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**Kristin McDuffy - Goldman Sachs - Analyst**

Yes.

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**Tony Colatrella - Momentive Performance Materials - CFO**

Well, that's happened already, if that's what your question is. We have restored salaried -- for our salaried workforce, we have restored wages back, and ours, back to the levels we were at in March of -- in the first quarter of last year. We're not going to comment on how much that represents of our cost structure, but it's obviously fully baked into our operating plan for 2010.

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**Kristin McDuffy - Goldman Sachs - Analyst**

And I know that you have a hearing scheduled for April 5, just to address the relief that's being sought. And part of -- in your K you were saying the relief sought included the reinstatement of our prior wage structure. That wouldn't entail any one-time payments, then?

---

**Jonathan Rich - Momentive Performance Materials - President, CEO**

Again, Kristin, we're in the midst of a process with the NLRB and we are hoping to reach a successful conclusion to that. And until we do that, we're not going to have any comment on it.

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**Kristin McDuffy - Goldman Sachs - Analyst**

Okay. And just one last one while we're waiting for the callability of the PIK seller notes. You are paying down quite a bit on your revolver, and I was just trying to get a sense for what cash balance is comfortable for you as we exit the recession?

---

**Tony Colatrella - Momentive Performance Materials - CFO**

Oh, okay. Well, there's no hard-and-fast number; it's probably a range of cash flows. I would say as a general statement somewhere in the neighborhood of \$90 million to \$115 million, \$120 million feels about right to us.

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**Kristin McDuffy - Goldman Sachs - Analyst**

Okay.

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**Tony Colatrella - Momentive Performance Materials - CFO**

We could manage with less than that if we absolutely had to, a little bit less than that, but our preference would be to target a range of \$90 million to \$120 million.

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**Kristin McDuffy - Goldman Sachs - Analyst**

Okay.



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**Tony Colatrella - Momentive Performance Materials - CFO**

Go ahead, Greg, please.

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**Greg Rustowicz - Momentive Performance Materials - Treasurer**

Yes. On the PIK toggle note, as of December 1, 2010 it would be 105.625 -- or 0.0625 and then it would decline from there.

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**Kristin McDuffy - Goldman Sachs - Analyst**

Okay. Great. Thanks so much.

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**Tony Colatrella - Momentive Performance Materials - CFO**

Starting December 2010. Okay? Thank you.

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**Kristin McDuffy - Goldman Sachs - Analyst**

Thanks very much.

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**Operator**

You have a follow-up question from Laurence Jollon with Barclays Capital. Please proceed.

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**Laurence Jollon - Barclays Capital - Analyst**

Sorry. Just to be clear, the call price you just provided, I think was for the toggle, the 10 and one-eighth toggle notes. I think Kristin was referring to the GE seller note.

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**Jonathan Rich - Momentive Performance Materials - President, CEO**

I thought she said the toggle.

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**Greg Rustowicz - Momentive Performance Materials - Treasurer**

I believe she said the toggle.

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**Laurence Jollon - Barclays Capital - Analyst**

Okay. Well, let me ask the question differently, then. The GE seller note, as I understand it, is a PIK note. Is that callable at any point?

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**Greg Rustowicz - Momentive Performance Materials - Treasurer**

It expires in --.

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**Tony Colatrella - Momentive Performance Materials - CFO**



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It expires in 2017.

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**Jonathan Rich - Momentive Performance Materials - President, CEO**

2017.

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**Tony Colatrella - Momentive Performance Materials - CFO**

There is no call feature that I'm aware of.

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**Greg Rustowicz - Momentive Performance Materials - Treasurer**

There's no call feature on it [currently]\*.

\*Explanatory Note: Bracketed text added to clarify that although the GE seller note is callable in the future by Momentive's parent company, it is not callable at this time.

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**Laurence Jollon - Barclays Capital - Analyst**

There's no call feature? Okay. And then the second follow-up question. Your new CapEx guidance of \$90 million to \$110 million for 2010 -- or I shouldn't say new, your initial CapEx guidance of \$90 million to \$110 million, does that include any buyouts of these operating leases that occurred in the fourth quarter?

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**Tony Colatrella - Momentive Performance Materials - CFO**

Meaning additional operating leases? No.

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**Laurence Jollon - Barclays Capital - Analyst**

Okay. Thank you very much.

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**Tony Colatrella - Momentive Performance Materials - CFO**

You're welcome.

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**Operator**

And your next question comes from the line of Aaron Weitman with Appaloosa. Please proceed.

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**Aaron Weitman - Appaloosa Management - Analyst**

Hi, guys. You said we shouldn't look at the quarter-over-quarter changes between the segments as fully showing up as large a increase in quartz as we might expect. Could you go into what you think we should view that number as being and to what degree we're seeing a compression in silicones margins?

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**Jonathan Rich - Momentive Performance Materials - President, CEO**

I think the key thing is -- I don't think we've seen a compression in silicone margins. They've been increasing sequentially for the three quarters following Q1 of 2009, and we anticipate that the total margins, including silicones, will be flat to increasing throughout the year.

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We do believe the quartz business is -- obviously, it went into a deeper recession and it's getting a steeper rebound, so we expect that operating margins on the quartz side will return to sort of more normal historic levels that we've seen in the up-stages of the business cycle.

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**Aaron Weitman - Appaloosa Management - Analyst**

Okay.

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**Tony Colatrella - Momentive Performance Materials - CFO**

And we expect to see a robust sales increase in the first quarter of 2010.

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**Jonathan Rich - Momentive Performance Materials - President, CEO**

I would just add that historically through the business cycle, if you look at the averages, and obviously the quartz business has a bigger cycle, but if you look at the averages, the quartz business has historically a higher operating margin than the silicones business.

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**Aaron Weitman - Appaloosa Management - Analyst**

Okay. And again, is there a substantial difference in the way we should be looking at those segments, that there's maybe a misallocation between quartz or silicone or some allocation that we're not getting clarity on?

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**Tony Colatrella - Momentive Performance Materials - CFO**

There's no issue with allocations. There's no significant difference and there's some headquarters costs are allocated both to the silicones and to the quartz segments, but not disproportionately. The issue is that our operating margins when quartz is running at or near sort of peak sales levels, and it's not quite there yet, but when it's operating at or near peak sales levels, you can expect anywhere's from about a 5% to as much as 10 percentage points higher operating margins on the quartz business than the silicones business. It's a high margin business, again, but it's all volume dependent.

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**Jonathan Rich - Momentive Performance Materials - President, CEO**

They're both nice, high margins.

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**Tony Colatrella - Momentive Performance Materials - CFO**

They're all -- but they're both --

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**Aaron Weitman - Appaloosa Management - Analyst**

Okay.

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**Operator**

It appears there are no further questions at this time.

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**Tony Colatrella - Momentive Performance Materials - CFO**

Okay.



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**Jonathan Rich - Momentive Performance Materials - President, CEO**

Okay. Again, I'd like to conclude by thanking all of you for your participation today and your interest in Momentive, and we look forward to talking to you again at the end of the first quarter with our first quarter results. Thanks, everyone.

**Operator**

Ladies and gentlemen, that concludes today's conference. Thank you for your participation. You may now disconnect. Have a great day.

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