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Conference Call Transcript

OLN - Q1 2009 Olin Corporation Earnings Conference Call

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Olin Corporation first quarter 2009 earnings conference call. My name is Michelle, and I will be your coordinator for today.

At this time, all participants are in a listen-only mode. We will be facilitating a question-and-answer session towards the end of today's conference. (Operator Instructions) As a reminder, this conference is being recorded for replay purposes.

And I would now like to turn the presentation over to your host for today's call, Mr. Joseph Rupp, Chairman, President and CEO. Please proceed.

Joseph Rupp - ***Olin Corporation - Chairman, President & CEO***

Good morning, and thank you for joining us today. With me this morning are John Fischer, Vice President and Chief Financial Officer; John McIntosh, Vice President and President of our Chlor Alkali Products business, and Larry Kromidas, our Assistant Treasurer and Director of Investor Relations.

Last night, we announced that earnings from continuing operations in the first quarter of 2009 were $46.7 million, or $0.60 per diluted share, compared to $37.3 million, or $0.50 per diluted share, in the first quarter of 2008. During the first quarter of 2009, the Winchester business achieved the highest level of quarterly earnings in the history of the business.

In the first quarter of 2009, we realized $5 million of pretax gains associated with the sale of land and other asset disposals. Our first quarter results also included a $4.9 million increase in the allowance for doubtful accounts related to the deterioration in customer credit. Sales in the first quarter of 2009 were $400.6 million compared with $399.1 million in the first quarter of 2008.

Chlor Alkali earned $68.7 million in the first quarter, as the record ECU netback of approximately $765 offset historically weak volumes. Combined first quarter 2009 chlorine and caustic soda volumes declined 29% from the first quarter of 2008 levels. Our first quarter operating rate was 65% compared to 82% in the first quarter of 2008.

In the first quarter of 2009, Winchester continued to experience the stronger-than-normal demand that began in the fourth quarter of 2008. The increased demand, in combination with a year-over-year improvement in pricing, resulted in record quarterly Winchester earnings of $17 million.

Earnings in the second quarter of 2009 are projected to be in the $0.30 to $0.40 per diluted share range. This forecast reflects the combination of continued weak demand and lower ECU pricing in Chlor Alkali. We expect ECU pricing in the second quarter to decline from the first quarter of 2009, but be higher than the second quarter of 2008. We do expect Chlor Alkali volumes, including bleach, to improve in the second quarter of 2009 when we compare it to the first quarter. Winchester's second quarter 2009 earnings are expected to decline from first quarter levels, which is really due to a normal seasonality of second quarter being a weaker quarter as it's a nonhunting-season quarter. But we are expected to be well above historic second quarter levels.

Let me discuss the Chlor Alkali and Winchester segments in more detail.

First Chlor Alkali. The major issue our Chlor Alkali Products faced in the first quarter was the continuation of the historically weak demand environment that we began to experience in the fourth quarter of 2008. As I just mentioned, combined chlorine and caustic soda volumes declined 29% from the first quarter of 2008 and were lower than we experienced in the fourth quarter of 2008. As a further point of reference, while chlorine shipments to vinyls customers in the first quarter of 2009 were similar to the first quarter of 2008, chlorine shipments to urethane customers were 48% lower, and chlorine shipments to titanium dioxide customers were 16% lower. One other characteristic of chlorine demand that we have seen in the first quarter is an erratic ordering pattern. For example, chlorine demand in February was significantly higher than in March, and we have seen better order flow in early April than we experienced in March. We believe this erratic ordering pattern reflects the low levels of inventory at most end users.

We also experienced a significant decline in caustic soda demand during the first quarter, and we believe that overall demand for caustic soda may now be weaker than the overall demand for chlorine. For the first time in several years, we ended the first quarter of 2009 with a meaningful level of caustic soda inventory. Shipments of caustic soda are obviously a key variable in the achievement of our second quarter earnings. On a positive note, we did experience a 4% year-over-year first quarter 2009 improvement in shipments of hydrochloric acid and an 11% year-over-year increase in shipments of bleach.

As we look to the second quarter, we expect our operating rate to increase to the low to mid 70% range. Demand in our industrial bleach business should increase as the quarter progresses. We also expect ECU netbacks to decline in the second quarter from the first quarter as the continuation of weak overall demand for both chlorine and caustic put pressure on pricing. We have already seen a meaningful decline in caustic soda prices. In an absolute dollar sense, industry publications are forecasting the first to second quarter decline in ECU netbacks to be one of the largest ever.

We currently expect that ECU netbacks in Olin's system will decline over the course of 2009. Consistent with what we view as the normal chlor alkali cycle, the amount and rate of decline will be dependent on the demand for both chlorine and caustic soda. While imports of caustic soda have had a near-term impact on North American prices, we do not expect this to continue. Due to weaker demand for caustic soda in North America, U.S. producers have adjusted prices in an effort to regain market share. It is our view that caustic soda imports are a normal part of the North American caustic soda pricing dynamics, but there are a number of factors that can limit their impact. The first factor is typically a six- to eight-week lag between the time imported caustic soda is ordered and is actually available for use in North America. And secondly, there is a limited amount of terminal and storage facilities in North America to store imported caustic soda. The cost of ocean freight can be a significant deterrent to the economics of importing caustic soda, and this was demonstrated during late 2007 and early 2008 when higher fuel costs reduced these imports. And there are additional shipping costs that are incurred after caustic soda is received on one of the coasts to deliver it to the end-use customer. Additionally, over the past several years, the North American chlor alkali industry has seen a net reduction in capacity, and additional reductions are possible. The combination of these factors lead us to believe that while ECU netbacks are likely to decline over the balance of 2009, they will remain significantly higher than we have seen in previous downturns.

On February 4th, we restarted our Henderson, Nevada facility which had been shut down due to equipment failure since early December. The shutdown of this facility, which represents approximately 8% of our total chlor alkali capacity, resulted in a force majeure declaration for product shipments from both the Henderson, Nevada facility and the Santa Fe, California, and Tracy, California bleach facilities. This force majeure was lifted on March 2nd.

Additionally, our St. Gabriel, Louisiana facility, which is nearing completion of a major conversion and expansion project, did not operate during the first quarter. We expect the facility, which represents approximately 10% of Olin's chlor alkali capacity, to be restarted in June. Once the St. Gabriel plant is restarted, and assuming demand continues at our near current levels, we intend to utilize our multi-plant system to optimize margins. This may include the idling of capacity at some sites.

In addition to the Henderson, Nevada, and St. Gabriel, Louisiana outages -- in addition to Henderson, we had other outages in the first quarter. Our McIntosh, Alabama facility, including the SunBelt joint venture, had a ten-day planned outage and a three-day unplanned outage during the quarter. The unplanned outage, which occurred at the end of the quarter, was caused by flooding that caused utility disruptions, but there was no damage to our facilities. The combination of Henderson, McIntosh and St. Gabriel outages resulted in approximately 18% of our capacity being idled in the quarter. The combination of McIntosh, Alabama, and Henderson, Nevada outages reduced pre-tax earnings during the first quarter by $4.2 million.

In spite of the weak volumes, we continued to experience higher freight costs in the first quarter of 2009 compared to both the first quarter of 2008 and the fourth quarter of 2008. On a positive note, the rate of increase has been slowing. During the first quarter, the average cost of electricity purchased declined, driven by our Henderson, Nevada facility that purchases power from utilities that use a fuel mix that contains a significant natural gas component.

Now let me turn to Winchester. During the first quarter, Winchester experienced a continuation of the above-normal levels of demand that began around the November presidential election. The surge in demand has been across the majority of Winchester's product offerings, including rifle, pistol and rimfire. Powder actuated tool volumes, which are directly related to the construction activity, declined during the quarter.

The strength of the Winchester market is evidenced by their sales dollars and unit shipments. First quarter 2009 Winchester sales were $132.9 million compared to $110.8 million in the first quarter of 2008. And total unit shipments increased 21% in the first quarter of 2009 compared to the first quarter of 2008. The quarter-over-quarter increase in commercial volumes was approximately 57%. The strength of the demand is further evidenced by Winchester's first quarter backlog position. The commercial backlog at the end of the first quarter 2009 was $148 million compared to $45 million at the end of the first quarter of 2008. But during April, this backlog has grown to $193 million.

The higher level of demand allowed Winchester to exceed our prior expectations and to realize the highest level of quarterly earnings in the history of the business. Winchester earned $17 million in the first quarter of 2009 compared to $10 million in the first quarter of 2008. The highest previous level of quarterly earnings in the Winchester business, was $11 million. Winchester quarterly results benefited not only from the higher volumes but also favorable pricing, the combination of which more than offset higher material costs. We expect Winchester to begin to realize lower material costs beginning in the third quarter.

Winchester also continued to experience strong demand from law enforcement and military customers. During the quarter, Winchester received a $22 million 50 caliber award, which provides for deliveries through May of 2011, and a $12 million 9-millimeter NATO award, which provides for deliveries into 2011. At the end of the first quarter, the total law enforcement and military backlog totaled $144 million, which is an increase from the first quarter of 2008 level of $85 million.

Winchester quarterly results also reflect excellent performance in its operations. The benefits of the relocation of activities to Oxford, Mississippi, where we have seen an increase in productivity, as well as lower costs, have been amplified by the higher volumes. This progress on the cost front will benefit Winchester after the current surge in demand stops.

The obvious question surrounding Winchester is "How long can this last?" And the honest answer is we don't know. The last time the business experienced a surge of this type was in the early 1990s, and it lasted approximately six quarters. We are now in the third quarter of this surge, and as our backlog numbers illustrated, there is no sign of it easing. I would emphasize that the continued success the business has had in expanding its law enforcement and military business, which currently account for 25% to 30% of Winchester's sales compared to the approximately 15% several years ago. The increase in the law enforcement and military business will likely continue after the surge runs its course.

Before I turn the call over to John for some financial comments, I'd like to emphasize that I believe Olin is well positioned as we enter into this phase of the chlor alkali cycle. The acquisition of Pioneer has allowed us to reduce costs and provides increased flexibility in dealing with lower levels of demand. It has also increased our presence in the industrial bleach market segment, which provides the advantages of being essentially a non-cyclical business that commands a price premium while consuming both chlorine and caustic soda. We currently have the capacity to sell approximately 10% of our ECUs as bleach. And finally, as we have discussed, Winchester business is well positioned for both near and longer term favorable performance.

Now I'd like to turn the call over to our Chief Financial Officer, John Fischer, who will review several financial items with you.

John.

John Fischer *- Olin Corporation - VP & CFO*

Thanks, Joe. First, I'd like to discuss a few items on the income statement. Selling and administrative costs increased $5.9 million in the first quarter of 2009 compared to the first quarter of 2008. The increase was primarily due to a $4.9 million increase in the provision for doubtful accounts receivable.

During the quarter, both the Chlor Alkali and Winchester businesses encountered credit issues among their customer base. In Chlor Alkali, these issues were most evident among pulp and paper customers, while in Winchester, the issues were focused in smaller retail accounts. Also during the quarter, higher salary and benefit costs were offset by a lower level of management incentive costs, which included a $1.2 million reduction due to mark-to-market adjustments on stock-based compensation. As a reminder, a one-dollar change in the price of Olin's common stock changes pretax stock-based compensation by approximately $400,000.

First quarter 2009 environmental investigatory and remediation expenses were $4.8 million compared to $5.1 million in the first quarter of 2008. These expenses relate primarily to remedial and investigatory activity associated with former waste sites and past operations. We continue to anticipate that full year 2009 charges for environmental investigatory and remedial activities will be similar to the full year 2008 level.

On a total company basis, defined benefit pension plan income was $3.9 million during the first quarter of 2009, compared to $3.0 million of defined benefit pension plan income in the first quarter of 2008. We are not required to make any cash contributions to our domestic defined benefit plan in 2009 and also believe it is unlikely we will be required to make any cash contributions in 2010. During the first quarter of 2009, a $1.0 million cash contribution was made to our Canadian defined benefit pension plan.

Defined contribution pension plan expense in the first quarter of 2009 was $4.0 million compared to $3.2 million in the first quarter of 2008. Over that period, the number of employees participating in the defined contribution plan increased approximately 20% compared to the first quarter of 2008. This reflects the continued transitioning of employees from the defined benefit plan to the defined contribution plan.

The tax rate for the first quarter of 2009 was 37.2% compared to 36.7% in the first quarter of 2008. We now expect the full year 2009 tax rate from operations to be in the 37% to 38% range.

Now turning to the balance sheet. Cash and cash equivalents at March 31, 2009, were $168.6 million compared to $276 million at the end of March 2008. The decline reflects the higher-than-normal levels of capital spending in 2008 which carried over into the first quarter of 2009 and higher levels of working capital in both businesses. The year-over-year increase in working capital reflects the high level of activity in Winchester and higher caustic soda and potassium hydroxide inventories in chlor alkali. March 31, 2009 working capital balances were approximately $89 million higher than the December 31, 2008 balances. Olin typically experiences a significant increase in working capital during the first two quarters of every year. This reflects the seasonal aspects of both the Chlor Alkali and Winchester businesses. Based on our current forecast, we expect working capital to be a full year source of cash in 2009.

In addition to the expected increase in working capital during the first quarter, Olin also made a $20.6 million payment for the final settlement of the working capital adjustment on the sales of Metals. This payment was consistent with the estimated working capital adjustment we anticipated from the transaction.

Capital spending during the first quarter of 2009 was $49.8 million compared to $23.1 million in the first quarter of 2008. Approximately two-thirds of the 2009 spending was related to the St. Gabriel, Louisiana conversion and expansion project. Based on the completion of this project, we now expect 2009 capital spending to be in the $135 million to $140 million range. We also anticipate that approximately 65% of this spending will occur in the first half of 2009. We continue to expect full year 2009 depreciation expense to be approximately $80 million.

On April 23, Olin's board of directors declared a dividend of $0.20 on each share of Olin common stock. The dividend is payable on June 10, 2009, to shareholders of record at the close of business on May 11, 2009. This is the 330th consecutive quarterly dividend to be paid by the company.

Before we conclude, let me remind you that throughout this presentation, we have made statements regarding our estimates of future performance. Clearly, these are forward-looking statements, and results could differ materially from those projected. Some of the factors that could cause actual results to differ are described without limitations in the "Risk Factors" section of our most recent Form 10-K and in our first quarter earnings release. A copy of today's transcript will be available this afternoon on our website in the Investors section under Calendar of Events. The earnings press release and other financial data and information are available under Press Releases.

Operator, we are now ready to take questions.

QUESTION AND ANSWER

Operator

(Operator Instructions) Your first question comes from the line of Frank Mitsch of BB&T Capital Markets. Please proceed.

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

Hey, good morning, guys. Hey, Joe, back on March 17th, you put out some guidance for the first quarter of a range of $0.60 to $0.65, which included $0.03 unusual in terms of a land sale so that it would make it, on an operational basis, $0.57 to $0.62, and you post $0.56 on an operational basis. What accounts for the -- what accounts for the decline versus that mid-March update?

Joseph Rupp *- Olin Corporation - Chairman, President & CEO*

He can give it to you here, Frank.

John Fischer *- Olin Corporation - VP & CFO*

Frank, this is John. There's three things that happened right at the end of the quarter. First, we had a second asset disposal that was $1.3 million that happened right at the end of the quarter that we didn't think was going to be in the quarter. Second, we experienced significantly weaker sales of caustic during the last ten days of the quarter. And that reduced earnings between $3.0 million and $3.5 million. And finally, one of the bad debts that we discussed actually occurred after the quarter ended, and we were forced to bring the effect of that back into the third quarter. And that was about $1.0 million. So if you net those three things, that's somewhere in the neighborhood of $3.0 million of pretax.

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

Mm-hmm.

John Fischer *- Olin Corporation - VP & CFO*

That's really the difference.

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

Yeah. I don't recall your bad debts being this high. Am I mistaken? Is this an unusual high level of bad debt expense?

Joseph Rupp *- Olin Corporation - Chairman, President & CEO*

It is unusual.

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

And any thoughts on whether or not given the economy, that we should anticipate this order of magnitude for 2Q and beyond?

John Fischer - ***Olin Corporation - VP & CFO***

I have no reason to believe we'll see this level of magnitude in Q2. I think it would be safe to say that in this economy, we're going to see more bad debts going forward than we've seen in the last couple years, where essentially, we haven't had any.

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

Mm-hmm. Okay. All right. Fair enough.

Mr. McIntosh, can you talk a little bit about the import situation to the West Coast coming from Asia in terms of where's pricing in Asia, and talk a little bit about the shipping costs. And I know that there was a discussion about some of the factors that you did not anticipate the level of imports to remain at high levels. Can you add some granularity to that?

John McIntosh - ***Olin Corporation - VP & President, Chlor Alkali Products***

Yes, sir, I can. If you go back to the last half of last year when caustic demand really, in pulp and paper and aluminum, took some very precipitous declines, at the end of the year, the Asian producers really found themselves with a surplus of caustic soda, no demand for the export markets that they normally would serve. At the same time, in the North American continent, we had historic high prices for caustic. And the combination of those two created what, for lack of a better term, I'll call an arbitrage opportunity for bringing caustic into the U.S., not only the West Coast, but to the Gulf Coast and the East Coast as well. FOB Asia caustic prices, which were in the $500 range at the beginning of the year, dropped by the end of the first quarter to $200. And when you take that kind of a number, and then you add $170 freight to it to get it to the Gulf Coast, and then you add a $50 cost to get it through a shore tank, then you've got an FOB Gulf Coast caustic price in the $450 -- $420 to $450 range. And that's what led to the increase in imported caustic material coming into the U.S. in the first quarter.

Now, a couple of things have happened subsequent to that. Number one, the FOB caustic price in China has stopped dropping. And, in fact, in April, there are reports that it's gone up some $30 to $50. And so that's created -- you know, that ripples through and creates a little higher landed price for caustic in North America.

The other thing that's happened is that the North American producers have met competitive situations to take back market share that they lost to imported caustic. Realistically, you have to understand that the total import caustic numbers, if you look historically, from China into North America, are in the 800,000 to 900,000 tons a year, which represents a minority of the 13 million to 14 million tons market in North America for caustic. So although North -- although imported caustic into the U.S. isn't the primary driver from a supply standpoint, right now, it is the primary driver from a price decline standpoint. But as we see results from April, we see some of that leveling out and stabilizing at least in the short term.

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

John, is it fair to say that, given the very high freight costs that are involved to ship the material over from Asia -- and by the way, just for clarification purposes, I know there's some confusion out in the marketplace. But caustic soda is typically shipped as a liquid and not a solid; is that correct?

John McIntosh - ***Olin Corporation - VP & President, Chlor Alkali Products***

Correct.

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

Yes. Thank you. Given the very high freight and stevedore costs, et cetera, you're basically looking at a floor in the $400-plus range, such that the decline from the hurricane spike that we saw in the fourth quarter, and that carried through in the first quarter, the declines that you're talking about are starting to level out. Is that not fair to say?

John McIntosh *- Olin Corporation - VP & President, Chlor Alkali Products*

From our perspective, we believe that's a fair statement based on what we're seeing in the market and what we're seeing reported for pricing, not only FOB Asia but also pricing in North America.

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

So it's really more of a volume issue in terms of the economic activity.

Joseph Rupp *- Olin Corporation - Chairman, President & CEO*

Exactly.

John McIntosh *- Olin Corporation - VP & President, Chlor Alkali Products*

For us, it is a volume issue.

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

Thank you, guys.

Joseph Rupp *- Olin Corporation - Chairman, President & CEO*

Thank you.

Operator

Your next question comes from the line of Don Carson of UBS. Please proceed.

Don Carson *- UBS - Analyst*

Yes, thank you. John McIntosh, I just wanted to add -- ask a few more Chlor Alkali questions. First off, if you could maybe outline the difference between your realizations in the market, how much is your contract lag going to help you this quarter? For example, you talked about your expectation that this quarter's realizations will be above last year's Q2 $590. And what impact does bleach play on your realizations in Q2 and Q3? Do you still expect bleach to be $100, $120 ECU premium?

John McIntosh *- Olin Corporation - VP & President, Chlor Alkali Products*

Let me do the last question first, Don. We continue to see bleach at the high end of the premium range from comparative to an ECU. And we have said historically that range can be anywhere from $100 to $175. So what we've seen so far would put us at the high end of that range both in our year-to-date performance and what we're seeing in this quarter.

In terms of your first question was --

Joseph Rupp *- Olin Corporation - Chairman, President & CEO*

Contract lags.

John McIntosh - ***Olin Corporation - VP & President, Chlor Alkali Products***

Oh, contract lags, let me just give you an example of how that would work. This is an ideal world example. Our caustic pricing for contracts that are indexed in the second quarter of 2009 would be impacted by a comparison of what the fourth quarter of 2008 pricing was relative to the first quarter of 2009 indexes, comparing those indexes for those two periods and then applying the change to a customer's price at the end of the first quarter to give a 2Q price. So in an ideal world, if the fourth quarter index averaged $1,000 a ton, first quarter index averaged $800 a ton, then customer contracts, driven by those indexes in the second quarter, would see a 20% reduction. And that -- because we're comparing quarters that are lagging, that's what drives the fact that our prices lag going up because the same mechanism works on the way up as it does on the way down. So we continue to expect to see that continue.

Now, in the real world, the thing you overlay onto that is the fact that there are competitive situations that you're forced to meet because volume is an important consideration for us. But in balance, when you put everything together, we still see our prices lag going on -- going down, and that's because of the contract mechanisms.

Don Carson - ***UBS - Analyst***

And John, two followups. What percentage of your shipments in Q2 and Q3 are bleach? And then you thought that the floor might be around this $420 range. I assume that's a contract floor, because we do see some reports of even domestic spot business at prices slightly below that.

John McIntosh - ***Olin Corporation - VP & President, Chlor Alkali Products***

Well, those numbers I reported were really a combination of some spot prices that were reported and then some contract -- some competitive situations where contracts are being forced to lower levels. So it depends upon the situation. But in terms of bleach, we have said that bleach represents about 10% of the ECUs we produce. There is a seasonal component to that, obviously. So 2Q and 3Q bleach volumes are higher than the other two quarters of the year, so it's not a 10% number across -- evenly split amongst the four quarters, and there will be some seasonal strength that we expect to see in the next two quarters.

Don Carson - ***UBS - Analyst***

And just one question on volume. I have heard reported that you've put order control on chlorine. Is that just to manage your caustic inventories? And then secondly, once again, we've seen proposals to perhaps force a closure of mercury cell plants. I assume that could actually -- first senator proposed that, I noticed now president. But if the current bill is more successful, could that help from a capacity standpoint if mercury plants have to be closed?

John McIntosh - ***Olin Corporation - VP & President, Chlor Alkali Products***

Don, let me answer the first question, and I'll let Joe answer the second one. We did enact order control for chlorine for our customers system-wide early in the month of April. Driven by the dynamics of the situation that changed in our remarks, we commented that caustic demand is now what's driving industry operating rates. And that's the first time that's been in place for several quarters. And that reversal or flip-flop between demand for the various parts of the ECU that are driving operating rates has created the situation where we're significantly behind in chlorine shipments to our customers. And in order to protect our entire customer base, we established order control for that part of our customer portfolio.

Joseph Rupp - ***Olin Corporation - Chairman, President & CEO***

Don, on the mercury question, as you correctly pointed out, similar legislation was introduced -- actually Barack Obama introduced legislation a couple years ago. So as in the past, we're monitoring it. And we're going to evaluate it carefully. And one part of the evaluation is, does it make sense to convert to another technology or not? And one option, obviously, is no conversion at all. So we will evaluate all options.

Don Carson *- UBS - Analyst*

Thank you.

Joseph Rupp *- Olin Corporation - Chairman, President & CEO*

Thank you.

Operator

Your next question comes from the line of Christopher Butler of Sidoti & Company. Please proceed.

Christopher Butler *- Sidoti & Company - Analyst*

Hi, good morning, guys.

Joseph Rupp *- Olin Corporation - Chairman, President & CEO*

Good morning.

Christopher Butler *- Sidoti & Company - Analyst*

I was hoping you might be able to speak to your utilization rates as they progress through the quarter. I understand that you are at like 65%, which is a little less than the fourth quarter. But can you give us a map of how things progressed?

John McIntosh *- Olin Corporation - VP & President, Chlor Alkali Products*

If you're talking about the first quarter, Chris, we were an average of 65% for the quarter. But that really spanned numbers as low as the low 50s in March and as high as upper 70s in February. And as our comments said, the order pattern for chlorine over the quarter was in fact very erratic.

Joseph Rupp *- Olin Corporation - Chairman, President & CEO*

We're saying they'll be in the low 70s is what we're saying --

John McIntosh *- Olin Corporation - VP & President, Chlor Alkali Products*

And we had significant outages which helped drive March's number low, as we saw it in March, in the low 50s. In the second quarter, we said in our remarks, we expect to be operating rates in the low 70s.

Christopher Butler *- Sidoti & Company - Analyst*

And talking to the weak caustic demand, could you give us a little bit of -- little bit more color on exactly what's going on there? Is this something that we can expect continues through the remainder of the recession, or is this more temporary? What are you seeing there?

John McIntosh *- Olin Corporation - VP & President, Chlor Alkali Products*

Well, I would tell you that from a visibility standpoint, we just don't have visibility to see when demand is going to return. I will tell you -- I'll give you some first quarter facts to help you with the demand in the two key market segments that are really driving caustic consumption. One, pulp and paper, global operating rates for pulp and paper, in March were 88%. And that's better than North America which was only 77%. In aluminum, global aluminum consumption in the first quarter was down 20% year over year. So at least looking backwards in the very short term, both those industries, which are key caustic soda consumption end markets, are weak. And there isn't anything that leads us to believe, in the short term, that there's going to be a very dramatic turnaround. How far we go before we start to see strength in those markets is the unknown that creates the lack of visibility we have.

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

And if we're looking at the netback side of the ECU netback equation, strictly be giving a bit of a benefit to year-over-year with energy prices being down?

John McIntosh - ***Olin Corporation - VP & President, Chlor Alkali Products***

Well, energy prices will be down. And we've seen that in our comments about lower electricity prices. In terms of netbacks, our remarks said we expected netbacks in the second quarter to be better than they were in Q2 '08. And that's driven, I think, more by the fact that our contract prices -- our contracts lag in prices going down. That lag will be prevalent as we look into the second quarter.

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

I appreciate your time.

Joseph Rupp - ***Olin Corporation - Chairman, President & CEO***

Thank you.

Operator

Your next question comes from the line of Edward Yang of Oppenheimer. Please proceed.

Edward Yang - ***Oppenheimer - Analyst***

Hi, good morning.

Joseph Rupp - ***Olin Corporation - Chairman, President & CEO***

Good morning.

Edward Yang - ***Oppenheimer - Analyst***

Are you expecting any alleviation on freight costs? Certainly, up 10% is better than up 30%, which has been more the recent trend. But with volumes down, do you think that freight costs will come down?

John McIntosh - ***Olin Corporation - VP & President, Chlor Alkali Products***

I guess I would hope that the trend we saw in the last year was one that could be repeated. But in all honesty, the railroads are under similar financial pressures because the overall economic condition reduced their revenue and reduced the volume of material they are moving. And they continue to try to put pressure on the industry, on our industry, on the chemical industry, to raise rates to cover the risk profile that they say is inherent upon the chemicals that they move for us. So although I would hope that we're not going to see 30% kinds of annual increases in the future, I don't expect our freight costs to go down any time soon.

Joseph Rupp - ***Olin Corporation - Chairman, President & CEO***

The rate at which they will rise will be lower, we hope.

Edward Yang - ***Oppenheimer - Analyst***

Okay. Thank you. And back to the bad debt expense. How was that distributed in the income statement? And was it one or two particular customers within pulp and paper, or was it much more broad based?

John Fischer - ***Olin Corporation - VP & CFO***

In the income statement, it shows up in the SG&A line. If you look at the segments, it is included in the business segment operating income of the segment where it has the bad debt. The pulp and paper was actually two customers that were substantial. And that was really, for Chlor Alkali, where it was.

Edward Yang - ***Oppenheimer - Analyst***

And, John, do you expect additional -- I mean, it sounds like -- how does two customers compare to your overall pulp and paper customer base? Do you have 30 customers? Or just size that relatively, please.

John McIntosh - ***Olin Corporation - VP & President, Chlor Alkali Products***

Well, I don't know the exact number. I mean, we have a significant number of pulp and paper customers and an even larger number of total mills that we serve, serving multiple locations within one customer entity. So it's not a -- obviously, it's not a large percentage of our portfolio of pulp and paper customers.

Edward Yang - ***Oppenheimer - Analyst***

Okay, and a final question on the clarification on free cash flow, the decline in cash, your cash balance decline of about around $78 million or so, and most of that, as you noted, was in the working capital side. I understand what's going on with the inventory situation with caustic. What's going on on the payable side? Was that just all related to Metals, or is there something else going on there as well?

John Fischer - ***Olin Corporation - VP & CFO***

The majority of it is the Metals thing that I discussed.

Edward Yang - ***Oppenheimer - Analyst***

Okay. Thank you.

Joseph Rupp - ***Olin Corporation - Chairman, President & CEO***

Thank you.

Operator

Your next question comes from the line of Thomas Hu of Epoch. Please proceed.

Thomas Hu - ***Epoch Investment Partners - Analyst***

Good morning, guys.

John Fischer - ***Olin Corporation - VP & CFO***

Good morning.

Thomas Hu - ***Epoch Investment Partners - Analyst***

I just wanted to know a little bit more detail about the regional supply demand dynamics that you see especially when the St. Gabriel facility is coming back up. What kind of impact do you expect that's going to insert on your target market going forward?

Joseph Rupp - ***Olin Corporation - Chairman, President & CEO***

The question is what kind of impact will the startup of St. Gabriel have on our target market?

Thomas Hu - ***Epoch Investment Partners - Analyst***

Yep.

Joseph Rupp - ***Olin Corporation - Chairman, President & CEO***

As we mentioned in the comments is that we're not expecting that facility to come up until June. And when it comes up, based upon market conditions, we will optimize running our multiple plants to where we get the best margins, meaning that some, if necessary, other operations will be curtailed if that's required.

Thomas Hu - ***Epoch Investment Partners - Analyst***

And then would you say that going forward that the entire industry will be even more rational in terms of pricing?

Joseph Rupp - ***Olin Corporation - Chairman, President & CEO***

I don't know what's going to happen with the industry from a pricing perspective, to be honest about it at this point.

John McIntosh - ***Olin Corporation - VP & President, Chlor Alkali Products***

But I think it's fair to say that the industry, in the first quarter, has demonstrated that they are willing to take capacity off line based on reduced overall demand. And most recently, there's been an announcement that a producer is going to idle a plant, a chlor alkali facility in Geismar, Louisiana, for at least the majority of the month of May. So the producers are continuing to react to the North American supply-demand dynamics, and I think we'll continue to see that.

Thomas Hu - ***Epoch Investment Partners - Analyst***

Okay. Thank you.

Operator

That concludes the question-and-answer session. I will now turn it back to Mr. Rupp for closing remarks.

Joseph Rupp - ***Olin Corporation - Chairman, President & CEO***

Thank you for joining us today, and we look forward to speaking with you in July where we will announce the results of our second quarter. Thank you.

Operator

Ladies and gentlemen, thank you for your participation in today's conference. This concludes the presentation. You may now disconnect. Have a great day.