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Conference Call Transcript

OLN - Q2 2009 Olin Corporation Earnings Conference Call

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Olin second quarter 2009 earnings conference call. I will be your coordinator for today. At this time all participants are in 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.

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

Thank you. 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 net income in the second quarter of 2009 was \$27.8 million or \$0.36 per diluted share compared to \$35.5 million or \$0.47 per diluted share in the second quarter of 2008. During the second quarter of 2009 the Winchester business achieved the highest level of quarterly sales and earnings in the history of the business. These results reflect the continuation of the stronger than normal demand that began in the fourth quarter of 2008. Winchester earnings doubled in the second quarter of 2009 compared to the second quarter of 2008 driven by commercial sales which increased 33% year-over-year.



Chlor alkali earnings declined 32% in the second quarter of 2009 compared to the second quarter of 2008. This decline reflects lower shipment volumes of both chlorine and caustic soda which declined 32% year-over-year. ECU netbacks in the second quarter of 2009 declined slightly compared to the second quarter of 2008. The second quarter 2009 chlor alkali operating rate was 70% which was slightly improved from the first quarter 2009 rate of 65% but well below the second quarter of 2008 rate of 89%. Third quarter 2009 earnings per share are forecasted to be in the \$0.20 per diluted share range. This forecast includes an anticipated \$44 million pre-tax recovery of environmental costs incurred and expensed in prior periods. The combination of the precipitous decline in caustic soda prices and the continuation of weak demand will likely result in a third quarter segment loss in the chlor alkali business.

ECU netbacks are expected to decline approximately 40% in the third quarter of 2009 when compared to the second. Winchester expects continued strong demand in the third quarter of 2009 with earnings comparable to the second quarter which were well above historic levels. During the second quarter the chlor alkali business and more specifically the caustic soda business began to catch up to the overall economy. From the perspective of Olin in a declining economic environment the chlor alkali business typically lags the general economy by one to two quarters. While we saw the overall economy decline beginning in the fourth quarter of last year, these declines were not fully evident in our business until the second quarter of this year. The declines which we expect to continue into the third quarter are most evident in demand for caustic soda. While these declines are following a normal cyclical trend, the rate of decline has been more rapid than we have experienced in prior cycles. We believe this rate of decline reflects the severity of the slowdown in the overall economy. That said, we're clearly entering a cyclical trough period for the business sooner than we anticipated, and our third quarter outlook obviously reflects this.

Now let me discuss the Chlor Alkali and Winchester segments in more detail. First Chlor Alkali. The three major issues the Chlor Alkali products business continued to face during the second quarter were the weak demand environment that we began to experience during the fourth quarter of 2008, the resulting impact on caustic soda prices, and the lack of visibility. As I just mentioned, combined chlorine and caustic soda volumes declined 32% from the second quarter of 2008 and during the first six months of 2009 these volumes have declined 31%.

During the second quarter we experienced some improvement in chlorine demand compared to the first quarter, but we saw continued declines in caustic soda demand. At this juncture chlorine demand exceeds caustic soda demand. We believe, however, that the quarter over quarter increase in chlorine demands only reflects normal seasonal patterns. The weakness in chlorine demand is reflected in the 32% year-over-year decline in chlorine shipments to vinyls customers, a 59% decrease in shipments to urethane customers, and the 23% decrease in shipments to titanium dioxide customers. The decline in demand is also reflected in our operating rate which was 70% in the second quarter of 2009 compared to 89% in the second quarter of 2008. Our third quarter 2009 operating rate is currently projected to be in the 70 to 75% range.

We also experienced a decrease in demand for both hydrochloric acid and potassium hydroxide. These also reflect significantly weaker end market demand. Two of our largest markets for hydrochloric acid are steel production and oil and natural gas drilling. The largest market for potassium hydroxide is agricultural chemicals. The bright spot in the business was the year-over-year improvement in bleach shipments which increased 13% in the second quarter of 2009 compared to the second quarter of 2008 and have increased 12% during the first six months of 2009. Bleach accounted for approximately 10% of the chlorine shipped by Olin during the second quarter of 2009, and as we have said before bleach is an attractive market for Olin for several reasons.

Bleach consumes both chlorine and caustic soda, is a value-added product that typically commands a \$100 to \$200 premium in the market when compared to that of chlorine and caustic soda, and in addition because bleach typically contains 80 to 90% water it is both expensive and difficult to ship long distances which makes the geographic location of our manufacturing plants an asset in serving these regional markets. We continue to look at opportunities to expand this business.

During our first quarter earnings remarks we described an erratic ordering pattern for chlorine, and during the second quarter we have seen that extend to caustic soda. Large chlorine customers continue to have significant variations in order size from month to month. On the caustic side, likely in reaction to declining prices we have seen customers reduce inventory levels and place orders on an as-needed basis only. Over the past six months caustic soda pricing has been negatively impacted by several factors. Early in 2009 the significant difference between caustic soda prices in Asia and caustic soda prices in North America created an export opportunity for Asian producers. The increase in export shipments that occurred put pressure on North American prices. This situation was in our view compounded by North American production levels that while approximately 25% lower in the first half of 2009 when we compare to 2008, they still exceeded the level of caustic soda demand. This put further pressure on caustic soda prices.

Finally, in a market where prices are declining, it is not unusual for the consumers of caustic soda and the large distributors to reduce inventory levels in anticipation of lower prices. This has occurred throughout the first half of 2009, and this results in higher inventory levels at the producers which further pressures prices. As a point of reference Olin's caustic soda inventories have been approximately 70% higher than

normal during the first six months of 2009. Recently we have seen positive signs from our caustic customers that their inventory levels have bottomed out.

Our ECU netback in the second quarter of 2009 was \$585 compared to \$590 in the second quarter of 2008. The second quarter 2009 netback was lower than we had forecast which reflects a larger than expected decline in caustic soda prices. We experienced a \$190 decline in caustic soda prices from March to June, and that said the year-over-year second quarter 2009 caustic soda prices actually increased compared to the second quarter of 2008. This increase was more than offset by year-over-year declines in chlorine prices.

We currently expect ECU netbacks in the third quarter of 2009 to be significantly lower than the second quarter of 2009 due to a continued decline in caustic soda prices. We're forecasting a 40% decline in our ECU netbacks. Due to the nature of our contracts the positive impact of chlorine price increases in our system typically lags the announcement by two quarters. Chlorine prices in the third quarter of 2009 are expected to improve compared to the second quarter with a continued improvement into the first quarter of 2010. As a reminder, there were three chlorine price increases totaling \$300 per ton announced during the second quarter.

In spite of the weak volumes we continue to see freight costs increase during the second quarter. Freight costs per ECU increased 9% during the second quarter of 2009 when compared to the second quarter of 2008. A positive for the business is electricity costs. The lower operating rates we have been running significantly increases the opportunities to optimized these costs. And as a result electricity costs per ECU produced decline 12% in the second quarter of 2009 when compared to the second quarter of 2008. Second quarter 2009 electricity costs per ECU were also lower than the first quarter of 2009.

During the second quarter we continue to make progress toward the completion of our St. Gabriel, Louisiana conversion and expansion project. The project will be completed late in the third quarter, and it has experienced some delays due to higher than normal water levels in the Mississippi river which delayed the installation of a Bryant pipeline. The St. Gabriel facility which represents approximately 10% of our total chlor alkali capacity has been idle since the fourth quarter of 2008. At current demand levels the St. Gabriel start up will require a curtailment or idling of other facilities in our system.

Finally, during the second quarter of 2009 a bill was introduced in the United States House of Representatives which if enacted would ban the production of chlor alkali products using mercury cell technology two years from the date it is enacted into law. A companion bill was introduced in the United States Senate earlier this month. Olin currently operates two facilities which utilize mercury cell technology totaling approximately 350,000 ECUs or 18% of our capacity. Olin has and continues to operate these facilities in full compliance with all rules and regulations. We are closely monitoring the progress of these bills, but it is too soon to estimate the likelihood of enactment, and therefore to determine what impact they will have on Olin or the chlor alkali industry.

Now turning to Winchester, during the second quarter Winchester experienced a continuation of the higher than normal levels of demand that began in the fourth quarter of 2008. We continued to see elevated demand across the majority of the product lines including rifle, pistol, and rim fire ammunition. We also continued to see a weakness in powder actuated tool volumes which are directly related to the construction activity. Winchester's record second quarter 2009 sales of \$140.6 million represents a 21% increase over the second quarter of 2008. Commercial sales increased by 33% which reflects a 34% increase in units shipped. Contract sales which include military and law enforcement activities increased 5% in the second quarter of 2009 when compared to the second quarter of 2008.

In addition to the record level sales Winchester continued to see its backlog increase. The commercial backlog at the end of the second quarter of 2009 was \$240 million which represents a 62% increase from the backlog level at the end of the first quarter of 2009 and is more than triple from last year's level. Total backlog including military and law enforcement contracts at the end of the second quarter was \$395 million. A word of caution on the backlog. It has been our experience that in the aftermath of periods of heavy demand some of the commercial backlog is ultimately cancelled by our customers. The higher level of demand allowed Winchester to exceed our prior expectations and for the second consecutive quarter realized the highest level of quarterly earnings in the history of the business. Winchester earned \$19.1 million in the second quarter of 2009 compared to \$9.5 million in the second quarter of 2008. The prior record quarterly earnings were \$17 million in the first quarter of 2009. The record quarter level prior to that was \$11 million.

Winchester's segment earnings during the first six months of 2009 of \$36.1 million exceed the previous full year record earnings of \$32.6 million. Winchester's quarterly results benefited not only from the higher volumes but also improved pricing, lower commodity costs, and other material costs. Winchester expects to experience lower commodity and other material costs in the third quarter of 2009 when compared to the second quarter. The question we continue to be asked about the Winchester business is how long can this last?



The third quarter of 2009 will represent the fourth quarter of this increase in demand and as the backlog numbers I just discussed indicate, there is no apparent end in sight. The conditions that typically fuel an increase in ammunition purchases, the threat of regulatory action and economic uncertainty both continue to be prevalent in the market. It is important for me to commend the Winchester organization, I believe, on how well they have performed over the past several quarters. There have been significant manufacturing and logistical challenges in managing a 30% increase in the commercial volume, and they have occurred without incurring unfavorable cost variances. As Winchester's results illustrate, they have been very successful.

In summary, the rate of decline in the chlor alkali industry was more rapid than we expected, and we're disappointed by our third quarter 2009 outlook. That said, I believe actions taken during the second quarter within the industry to idle capacity and to increase chlorine prices bodes well for the long-term. Within Olin we have left our St. Gabriel facility idle, and we're preparing to idle additional capacity. As we move through the balance of 2009 and into 2010, we will reduce both costs and capital spending aggressively. We are well-positioned financially with a strong balance sheet as we enter into a cyclical trough in a chlor alkali business. Our balance sheet and cash management remains strong as evidenced by our quarter end cash balance which increased by \$24 million during the second quarter of 2009 to \$192 million. I would 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

Thank you, Joe. First I would like to discuss a few items on the income statement. Selling and administrative expenses increased \$500,000 or 1% in the second quarter of 2009 compared to the second quarter of 2008. The increase was primarily due to a \$2.9 million increase in legal and legal related settlement costs. A significant amount of these legal costs relate to the recovery of environmental costs that were incurred and expensed in prior periods which we anticipate realizing in the third quarter. The balance related primarily to legal costs for other legacy environmental sites both former manufacturing and waste disposal sites. The increase was offset by decreased management incentive costs of \$2.6 million primarily related to favorable mark-to-market adjustments on stock-based compensation. The favorable mark-to-market adjustment reflects an approximately \$2 per share decline in the Olin stock price during the second quarter.

Second quarter 2009 selling and administrative expense decreased by \$3.1 million compared to the first quarter of 2009 due to a lower level of bad debt expense. During the first quarter of 2009 both the Chlor Alkali and Winchester businesses encountered credit issues in their customer base. These issues did not occur in the second quarter. Second quarter 2009 environmental investigatory and remediation expenses were \$7.2 million compared to \$9.7 million in the second quarter of 2008. The second quarter 2009 expense includes approximately \$800,000 of recoveries from third parties of costs incurred and expensed in prior periods. These expenses related primarily to remedial and investigatory activities associated with former waste sites in past operations. As Joe mentioned earlier, we're anticipating a \$44 million pretax recovery in the third quarter of environmental costs incurred and expensed in prior periods. Without giving consideration to the anticipated \$44 million recovery in the third quarter, we currently expect full year 2009 charges for environmental, investigatory and remedial activities will be in the 20 to \$25 million range.

As a further point of reference we believe that additional cost recoveries of environmental expenses incurred and expensed in prior periods are possible. The timing of these recoveries which have the potential to be material is difficult to predict. We last experienced material environmental recoveries in 2005. On a total Company basis defined benefit pension plan income was \$4.8 million during the second quarter of 2009 compared to \$1.9 million of defined benefit pension plan income in the second quarter of 2008. Second quarter 2008 defined benefit pension plan income included an \$800,000 curtailment charge associated with the conversion of our McIntosh, Alabama, Chlor Alkali hourly workforce from a defined benefit pension plan to a defined contribution pension plan. We're 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.

Defined contribution pension expense in the second quarter of 2009 was \$3 million compared to \$2.4 million in the second quarter of 2008. During the second quarter of 2009 there were approximately 20% more employees participating in the defined contribution plan than there were in the second quarter of 2008. The tax rate for the second quarter was 37.9% compared to 35.2% in the second quarter of 2008 and 37.2% in the first quarter of 2009. The second quarter 2009 tax rate included several out of period adjustments that increased second quarter 2009 tax expense by \$1 million. Based on these items and our revised outlook for the business, we now forecast the full year 2009 tax rate to be in the 35 to 36% range.

Now, turning to the balance sheet, as Joe mentioned, cash and cash equivalents at June 30, 2009, were \$192.2 million compared to \$186.4 million at June 30, 2008, and \$168.6 million at the end of March 2009. The year-to-date increase in working capital during the first six months of 2009 has been approximately \$50 million less than the first six months of 2008. This lower increase reflects the higher than normal level of Winchester activity in the fourth quarter of 2008 which resulted in higher than normal beginning of the year levels of receivables. Working capital has also



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been affected by the lower level of Chlor Alkali sales during the first six months of 2009 partially offset by higher caustic soda inventories. Olin typically experiences a \$50 to \$100 million increase in working capital during the first two quarters of each year due to the normal seasonality of the ammunition, vinyls and bleach businesses.

Capital spending during the second quarter of 2009 was \$37.8 million compared to \$39.3 million in the second quarter of 2008. Year-to-date capital spending has totaled \$87.6 million compared to the first six months of 2008 spending of \$62.4 million. Approximately 71% of the second quarter and 66% of the year-to-date spending in 2009 has been for the St. Gabriel, Louisiana, conversion and expansion project. We expect capital spending in the third and fourth quarters of 2009 will be approximately 50% lower than the first and second quarter 2009 levels. We have reduced our full year 2009 forecast to the \$130 to \$135 million range from our previous forecast of \$135 to \$140 million. We now expect full year 2009 depreciation expense to be in the \$75 million range.

On July 23, Olin's Board of Directors declared a dividend of \$0.20 on each share of Olin common stock. The dividend is payable on September 10, 2009, to shareholders of record at the close of business on August 10, 2009. This is the 331st 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 sections of our most recent Form 10-K and in our second quarter earnings release. A copy of today's transcript will be available this afternoon on our website in the investor section under calendar of events. The earnings press release and other financial data and information are available under press releases. Operator, we're 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*

Good morning, guys.

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

Good morning.

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

Hey, on the environmental recovery, refresh our memory, 2005 the recovery then, was that order of magnitude was something like 15 million to \$20 million?

John Fischer - *Olin Corporation - VP, CFO*

It was \$48 million, Frank.

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

Oh, it was \$48 million? So it's a similar size to what you realized this time. And when you talk about this referring to prior periods, how far back are you going in terms of these recoveries?



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John Fischer - Olin Corporation - VP, CFO

We're going back into the 1950s.

Frank Mitsch - BB&T Capital Markets - Analyst

Actually I wasn't around then. All right. So I think, John, you alluded that you could expect to see -- that we might possibly see more of these down the line as well?

John Fischer - Olin Corporation - VP, CFO

We said additional recoveries that are material are possible, yes.

Frank Mitsch - BB&T Capital Markets - Analyst

All right. Okay. Thanks, and then I think you indicated that absent these recoveries the spending that you have been doing right now is ticking along at a normal rate?

John Fischer - Olin Corporation - VP, CFO

Yes, that's correct.

Joseph Rupp - Olin Corporation - Chairman, President, CEO

Correct.

Frank Mitsch - BB&T Capital Markets - Analyst

And then I think you're talking about chlorine price hikes, three of them being implemented as we speak here in the third quarter, perhaps some in the first quarter, but I guess from your perspective you're likely to see most of those increases in the first quarter?

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

Frank, this is John McIntosh. Let me talk just a minute about chlorine price increases and chlorine contracts to try to put those two things in perspective. There were two price increases in May and one in June, so all three second quarter price increases in aggregate totaled \$300 a ton. Those increases have now been reflected starting in indices that were published in July which is the beginning of the third quarter. You may remember that our contracts have lags built into them, and so in a general sense increases announced in any quarter would typically be recognized in a subsequent quarter and then quarters after that we would get some realization of value. So in this specific case we had second quarter announcements, they are being recognized and published pricing for the third quarter, and we should start to see the impacts of those in both Q4 and then Q1 of 2010. This isn't a ceiling issue for us. It is just a normal contract lag issue.

Frank Mitsch - BB&T Capital Markets - Analyst

Great. John, if you look at where caustic prices are falling here in the third quarter, it would almost suggest that you would see a bottoming of the ECU prior to year end. Is that how, with chlorine moving up is that how we should think about that?

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



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I think it is just as likely that that will be the case, Frank, that we would see it by the end of the year. A lot has to deal with the phenomenon of inventories, caustic inventories are high, and those inventories are being reworked now or being worked out of the producer's system, and I think that's putting some additional pressure on pricing. Hopefully that phenomena will be over and we'll see the trough before the end of the year.

Joseph Rupp - Olin Corporation - Chairman, President, CEO

I think, Frank, just to come back to that, this is Joe. John's point is the inventory has to clear out, and that's really where we are. We're expecting those inventories to clear out here in the last two quarters of the year. When that happens, we'll have bottomed out.

Frank Mitsch - BB&T Capital Markets - Analyst

I think you were suggesting that it was more of an issue at the producer level than at the customer level right now?

Joseph Rupp - Olin Corporation - Chairman, President, CEO

What's happened is that customers aren't ordering, and it is backed up with the producers. That's what happened, so we have to clear our inventories out.

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

Customers have managed their inventories to almost zero levels because they're anticipating -- have been anticipating lower pricing, and so they're going to wait until they think pricing is close to the bottom before they replenish.

Frank Mitsch - BB&T Capital Markets - Analyst

Great. Joe, I think in your remarks you talked about some cost reduction efforts in the latter part of the year. Is there any way that you can quantify that for us?

Joseph Rupp - Olin Corporation - Chairman, President, CEO

He won't, but we'll be quantifying it as we move forward, Frank.

Frank Mitsch - BB&T Capital Markets - Analyst

Great. Thanks, guys.

Joseph Rupp - Olin Corporation - Chairman, President, CEO

Thank you.

Operator

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

Christopher Butler - Sidoti and Company - Analyst

Hi. Good morning, guys.



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

Good morning.

Christopher Butler - *Sidoti and Company - Analyst*

Just wanted to circle back on the pricing environment and some of this you touched on, but we're looking at customers reducing inventory, we're looking at imports that were coming in from Asia, both of these things would seem that given enough time should dissipate to some degree. Is that your expectation and will that help solidify caustic soda prices?

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

Chris, this is John. If you look at caustic soda demand in the first half of 2009 and compare it to 2008, every market segment has double-digit decreases in demand led by aluminum and pulp and paper that bear an excess of 20%. That has created the obvious demand back drop for the inventories, caustic inventories across North America that have increased, creating a situation where pricing pressure has caused this precipitous drop in caustic pricing. Those things will work themselves out. The timing is unclear, but we expect that there will be some return, some beginning of return to demand in some of those key sectors, and we obviously expect that inventories will be worked down.

Christopher Butler - *Sidoti and Company - Analyst*

As far as the imported caustic, have you seen a slowdown on that front?

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

That's just relatively dried up.

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

For sure imports from China have really gone back to the normal historical operating mode where they're importing into the West Coast where they traditionally have. There is very few imports into the East Coast. There are some -- is some material coming in from Europe, but in Europe their situation is not good either. Demand is down, inventories are high for the European producers, so in some cases they're trying to import product into the Eastern U.S. but the current pricing for caustic in North America really precludes much capability for anybody to import successfully.

Christopher Butler - *Sidoti and Company - Analyst*

And shifting gears to this mercury bill a little bit, the first thing that occurs to me is that if I am not mistaken the bill was first proposed about a year-and-a-half ago, a time in which 2012 seemed at least a more reasonable timeframe as it continues to be reviewed. Do you think 2012 is a reasonable timeframe for the final bill, and what kind of costs are we looking at to upgrade your two facilities?

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

The cost to upgrade a facility as we've talked about in the past is in the \$800 to \$1,000 per ECU range, and as we indicated we have 350,000 ECUs at these two facilities. The type -- that's the cost to upgrade. As far as 2012, we believe that that's too tight a timeframe, but the government is going to decide what they want to decide.

Christopher Butler - *Sidoti and Company - Analyst*

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And looking at the balance sheet a little bit, it seems that if we're looking at losses on the chlor alkali side and they continue into 2010 to any degree, the leverage ratio is going -- as far as your debt covenant starts to become a bit of a question? You do have cash on the balance sheet? Do you expect that you would use cash to reduce debt here looking forward?

John Fischer - Olin Corporation - VP, CFO

Chris, the next time we have a debt payment is at the end of 2011 which is \$75 million. I think if we did a forecast, the cash on the balance sheet and liquidity of the Company would clearly allow us to repay that. We do have debt covenants in our revolving credit agreement that are cash flow based and obviously a prolonged period of negative earnings could create some issues there. Those issues are not immediate.

Christopher Butler - Sidoti and Company - Analyst

I appreciate your time. I will go back in the queue.

John Fischer - Olin Corporation - VP, CFO

Thanks.

Operator

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

Edward Yang - Oppenheimer & Co. - Analyst

Good morning.

Joseph Rupp - Olin Corporation - Chairman, President, CEO

Good morning.

Edward Yang - Oppenheimer & Co. - Analyst

I would like to ask the previous questions maybe in a different way, but in terms of chlor alkali pricing, chlorine price is up, caustic price is down. Isn't that typically what you see at the start of a new chlor alkali cycle?

Joseph Rupp - Olin Corporation - Chairman, President, CEO

That is correct.

Edward Yang - Oppenheimer & Co. - Analyst

And when I look at industry ECU netbacks this morning, they're up about 25% from a couple of weeks ago on a contract basis and they're up on a spot basis as well. You mentioned that you see pricing with somewhat of a lag versus the industry. Not to jump the gun, but this is the first sort of price increases we have seen for the entire chain in the last seven months or so. Is it possible that again, we're kind of looking at the rearview mirror in terms of the chlor alkali bottom?

Joseph Rupp - Olin Corporation - Chairman, President, CEO



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I think to come back to it, Edward, I think the points John McIntosh made earlier which is that we have to get the inventory cleared from a caustic perspective, and I think once we get that accomplished then all of the above is true.

Edward Yang - Oppenheimer & Co. - Analyst

Caustic prices on a spot basis, they have fallen about 93% from the peak, so I think mathematically you would start to see -- not see any more downside there. If caustic prices do start to rebound, would the magnitude of the increase relative to your historical experience, would that be similar to what you're seeing in the chlorine price increases currently? Chlorine prices on a percentage basis are up quintuple or so I think on a spot basis.

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

I would think when you look at caustic prices going forward, you're going to have to have some demand in the segments where caustic is consumed, and you're going to have to have some general economic recovery across the entire economic sectors before you're going to see the dynamics for caustic price increases. So I think we've got the phenomenon of inventory overhang to work through and then we have got the phenomenon of some type of recovery in the economy that translates into a late increase in demand for caustic which typically lags economic recovery by a quarter or two.

Edward Yang - Oppenheimer & Co. - Analyst

John, it sounds like your guidance for ECU netback in the third quarter is in the \$351 range, and again, on your guidance it looks like the chlor alkali business will have negative margin, and comparing to previous periods when you have had ECU netbacks in that range, you were actually profitable. Is a disconnect really just on a function of the plant utilization?

Joseph Rupp - Olin Corporation - Chairman, President, CEO

Volume was the hugest impact on what we're talking about here.

Edward Yang - Oppenheimer & Co. - Analyst

Okay. Great. And lastly on Cap Ex spend, it's obviously been very elevated from the St. Gabriel upgrade. In the past I think you talked about trough Cap Ex, or maintenance Cap Ex around 75% of D&A. Is that still the right number and I get to something around \$55 million or so on a going forward basis?

John Fischer - Olin Corporation - VP, CFO

We would say maintenance capital right now, Edward, is probably in the \$60 to \$65 million range. We would expect depreciation going forward to be something in the \$85 million range. The St. Gabriel project is in the full year number.

Edward Yang - Oppenheimer & Co. - Analyst

Okay. Lastly, on, just potential uses for cash, you're sitting on almost \$200 million of cash. You have an overfunded pension, the dividend is about \$60 million a year, so that's pretty well covered. You've talked about a bleach I think positively in your comments, and you also mentioned previously other kind of acquisition areas. What's your thinking philosophically, Joe, in terms of fundamentals look kind of ugly right now, but is this precisely the right time to pick up distressed assets?

Joseph Rupp - Olin Corporation - Chairman, President, CEO

If we could find the right assets, Edward, we would go after them to be quite honest about it. If the question is do we still have an interest in expanding down stream into bleach, the answer is yes.



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Edward Yang - Oppenheimer & Co. - Analyst

And are any of the potential sellers, are they getting more -- are they coming down in terms of price expectations?

Joseph Rupp - Olin Corporation - Chairman, President, CEO

I suspect that most people's view of value is higher than what our view may be at this point in time.

Edward Yang - Oppenheimer & Co. - Analyst

Okay. Thank you very much.

Operator

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

Don Carson - UBS - Analyst

Thank you. Just a question on bleach pricing and the impact on the third quarter ECU. Joe, you mentioned that bleach traditionally sells for \$100, \$120 premium per ECU, but is that the case at these much lower ECU levels and as you switch from a heavy bleach season in Q3 into Q4, what impact will that have on ECU?

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

Don, the premium for bleach typically tends to cycle and in periods where ECU prices are dropping that premium tends to be higher than it is when ECU prices are increasing. A lot of that is driven by the fact that there is a lot of bleach contracts that are annual contracts, specially in the municipal water treatment sector, so it tends to almost counter cycle with the direction for ECU pricing. We're seeing that premium in our current bleach business be a more positive contributor.

Don Carson - UBS - Analyst

John, as that premium drops off as you get into seasonally slow fourth quarter for bleach demand, how much will that offset the positive impact of chlorine contract price increases starting to roll through?

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

It will not be a significant offset.

Don Carson - UBS - Analyst

Okay. John, you mentioned earlier that chlorine demand still remains quite weak. Do you think that pricing has peaked on chlorine, i.e. if you got up say to the upper 70s or 80% range for operating rates would that result in chlorine prices kind of flattening out or even having to cut them in order to move more product? Just what the dynamics of demand are there?

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

I guess I would say that we looked at the -- we have been on order control for chlorine for some period of time. As we look at some of the segments, market segments for chlorine demand, we have seen some very modest stabilization if not slight improvement. However, it is not

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sufficient because of where caustic inventories and caustic demand are to drive operating rates even higher, so we continue to see pressure, continued pressure on chlorine supply, and that's what drove the chlorine price increases in the second quarter. That type of -- that number of increases and that kind of total, \$300 a ton is unprecedented for the chlorine side of the (inaudible) historically.

Don Carson - UBS - Analyst

I was going to ask, typically how often are you caustic constrained on chlor alkali production? That's pretty rare, isn't it?

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

Very rare.

Joseph Rupp - Olin Corporation - Chairman, President, CEO

Real rare.

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

Not happened probably since the last cycle since we were in the trough the last time which was in the '99, 2001 time period.

Don Carson - UBS - Analyst

And so how would you see as caustic demand improves and you can bump up chlor alkali production, how would you see chlorine price unfolding then?

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

Well, I think that it is going to improve the situation, but again there is going to be the lag between when we actually see demand for caustic start to improve and that allows us to raise operating rates, and hopefully implicit with that will be an increase in demand for vinyls and the other key market segments where chlorine is consumed.

Don Carson - UBS - Analyst

Thank you.

Joseph Rupp - Olin Corporation - Chairman, President, CEO

Thank you.

Operator

Your next question comes from the line of Mike Judd of Greenwich Consultants. Please proceed.

Mike Judd - Greenwich Consultants - Analyst

Good morning. Just want to make sure I have got the right capacity numbers for you guys. Sort of on annualized basis in the second quarter you had approximately 1.7 million short-terms, is that right?



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Joseph Rupp - Olin Corporation - Chairman, President, CEO

If you don't include--.

Mike Judd - Greenwich Consultants - Analyst

I am excluding St. Gabriel. Is that right?

Joseph Rupp - Olin Corporation - Chairman, President, CEO

If you take St. Gabriel out on annualized basis it is about right. We're \$1.950 million with St. Gabriel and half of Sun Belt.

Mike Judd - Greenwich Consultants - Analyst

And St. Gabriel has not been operating since when?

Joseph Rupp - Olin Corporation - Chairman, President, CEO

Since last November.

Mike Judd - Greenwich Consultants - Analyst

Okay. And the plan is to bring it back up, did you say, in the latter part of third quarter or fourth quarter? I am sorry. I missed that.

Joseph Rupp - Olin Corporation - Chairman, President, CEO

Third quarter, Mike, it is going to start up.

Mike Judd - Greenwich Consultants - Analyst

When in the third quarter?

Joseph Rupp - Olin Corporation - Chairman, President, CEO

Latter part of third quarter it will start up in September.

Mike Judd - Greenwich Consultants - Analyst

Okay. So does that imply that the -- usually things slow down at the end of the year. So the operating rates should decline even further, right? In the December--?

Joseph Rupp - Olin Corporation - Chairman, President, CEO

Mike, what we said from our perspective is that we will high level capacity as we bring that back up.

Mike Judd - Greenwich Consultants - Analyst

Will it be the same amount that you -- because if I understand when it is up it is, it's, let's see here, capacity here--?



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

250,000 tons of capacity when it comes up.

Mike Judd - *Greenwich Consultants - Analyst*

Will you take out the like amount somewhere else?

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

We will balance our system, yes.

Mike Judd - *Greenwich Consultants - Analyst*

Okay. All right. Thank you very much.

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

Thank you.

Operator

Your next question comes from the line of Gregg Goodnight. Please proceed.

Gregg Goodnight - *UBS - Analyst*

Good morning, gentlemen.

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

Good morning.

Gregg Goodnight - *UBS - Analyst*

You mentioned that you had a 12% year-over-year reduction in electrical costs. I am assuming some of that at least comes from natural gas. My question is do you hedge gas and if you did, what was the impact in the quarter?

John Fischer - *Olin Corporation - VP, CFO*

We do buy natural gas forward. We have not disclosed the impact of that.

Gregg Goodnight - *UBS - Analyst*

Okay.

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



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The majority of our--. Gregg, go ahead. We're not a big gas user.

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

Majority of our electricity favorability comes from the fact that we're operating at lower demand across our system, lower operating rates and so therefore we're able to optimize the use of power and avoid buying high cost peak power priced.

Gregg Goodnight - UBS - Analyst

Sure. Really that was going to be my second question is what under your current operating rate configuration, what percentage of your electricity is obtained from coal-based sources, hydro sources and gas sources, just roughly?

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

I haven't done that calculation at the current operating rates, but the top four fuel sources for us are coal, hydro, natural gas, and nuclear.

Gregg Goodnight - UBS - Analyst

Okay. All right. So looking forward, then, to the next quarter, if gas prices stay where they are and other energy sources stay where they are, would you expect the same sort of year-over-year benefit from lower electrical costs?

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

Yes.

Gregg Goodnight - UBS - Analyst

Okay. That's all I had. Thanks.

Joseph Rupp - Olin Corporation - Chairman, President, CEO

Thanks, Gregg.

Operator

Your next question comes from the line of Kristin McDuffy of Goldman Sachs. Please proceed.

Kristin McDuffy - Goldman Sachs - Analyst

Do you expect cash to be a source of working capital -- working capital to be a source of cash for 2009?

John Fischer - Olin Corporation - VP, CFO

Yes, we do.

Kristin McDuffy - Goldman Sachs - Analyst



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Can you give us a sense of magnitude on that?

John Fischer - Olin Corporation - VP, CFO

We have not, no, but if you look at the year-over-year change in revenue in chlor alkali, that will give you a good sense.

Kristin McDuffy - Goldman Sachs - Analyst

Okay. In the \$44 million pretax recovery for environmental charges, will that be cash that you receive?

John Fischer - Olin Corporation - VP, CFO

That will be cash that we receive, yes.

Kristin McDuffy - Goldman Sachs - Analyst

Okay. Can you explain how that works? I don't quite understand how that process works. Do you take a charge and then the actual costs are lower and you get some kind much cash back?

John Fischer - Olin Corporation - VP, CFO

If you look at the details of our corporate and other section in our balance sheet, we have a category other section in our balance sheet, we have a category called, environmental costs. Those are costs that we incur to remediate legacy sites, primarily former manufacturing sites and former waste disposal sites. For a period of time in our history we had insurance covering those, and we have made claims to recover those costs after they have been incurred to recover from the insurance companies.

Kristin McDuffy - Goldman Sachs - Analyst

Got it. And then you guys use FIFO accounting. Could you break out the impact of using FIFO accounting in this environment of rapidly declining caustic prices?

John Fischer - Olin Corporation - VP, CFO

We do not use FIFO accounting. We use LIFO accounting.

Kristin McDuffy - Goldman Sachs - Analyst

Okay. If you were to shut down some of your facilities when you bring St. Gabriel back up, could you give a sense for which facilities those might be?

Joseph Rupp - Olin Corporation - Chairman, President, CEO

We wouldn't say that at this point in time.

Kristin McDuffy - Goldman Sachs - Analyst

Okay. Thanks.



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Joseph Rupp - Olin Corporation - Chairman, President, CEO

Thanks.

Operator

Our next question comes from the line of Michael Wasserman of Moors & Cabot. Please proceed.

Michael Wasserman - Moors & Cabot - Analyst

Good morning.

Joseph Rupp - Olin Corporation - Chairman, President, CEO

Good morning.

Michael Wasserman - Moors & Cabot - Analyst

In trying to understand the potential impact of the mercury sell chlor alkali plant legislation, what percentage of your -- how does the percentage of Olin capacity compare to the percentage that your competitors would need to upgrade also should that legislation come to pass?

Joseph Rupp - Olin Corporation - Chairman, President, CEO

There is four mercury cell plants. We have two, another competitor has one, and another competitor has the fourth one. As we stated, Michael, our capacity, 18% of our capacity is mercury cell capacity.

Michael Wasserman - Moors & Cabot - Analyst

Right. Do you know what the other's percentages are?

Joseph Rupp - Olin Corporation - Chairman, President, CEO

No.

Michael Wasserman - Moors & Cabot - Analyst

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

Joseph Rupp - Olin Corporation - Chairman, President, CEO

Thanks. Bye.

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. We'll look forward to speaking with you in October with results of our third 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.

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