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OLN - Q2 2014 Olin Corp Earnings Call

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OVERVIEW:

OLN reported 2Q14 sales of $570m and net income of $37.3m or $0.47 per diluted share. Expects 3Q14 diluted EPS to be $0.30-0.35.

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PRESENTATION

Operator

Good morning, and welcome to the Olin Corporation second-quarter 2014 earnings conference call. All participants will be in listen only mode.

(Operator Instructions)

Please note this event is being recorded.

I would now like to turn the conference over to Joseph Rupp, Chairman and CEO. Please go ahead, sir.

Joseph Rupp - *Olin - Chairman, CEO*

Good morning, and thank you for joining us today.

With me this morning is John Fischer, President, Chief Operating Officer; John McIntosh, Senior Vice President of Chemicals; Todd Slater, Vice President, Chief Financial Officer; and Larry Kromidas, our Assistant Treasurer and Director of Investor Relations.

Last night we announced that income from continuing operations in the second quarter of 2014 was $36.6 million, or $0.46 per diluted share, which compares to $43.7 million or $0.54 per diluted share in the second quarter of 2013. Sales in the second quarter of 2014 were $570 million, compared to $652 million in the second quarter of 2013. Second quarter 2014 results included pretax restructuring charges of $2.3 million and pretax gain for the resolution of a contract matter of $1 million.

Second quarter 2014 net income included after-tax income from discontinued operations of $700,000 or $0.01 per diluted share. This aftertax gain reflected a favorable resolution of a certain indemnity obligation related to our Metals businesses that were sold in 2007. As a result, second-quarter 2014 net income was $37.3 million or $0.47 per diluted share.

The high level of commercial demand that was experienced by Winchester in 2013 continued in the second quarter of 2014. Winchester generated the second highest level of second quarter sales and segment income in its history.

As we move forward, we continue to see strong commercial demand in our system, especially for pistol and rimfire ammunition. In Chlor Alkali and chemical distribution, the environment was more challenging.

During the second quarter of 2014, Chlor Alkali experienced both lower chlorine and caustic soda volumes and prices, compared to the second quarter of 2013. These were partially offset by higher bleach and hydrochloric acid volumes and lower operating costs.

Second-quarter 2014 chemical distribution shipments declined, compared to the second quarter of 2013. Second quarter 2014 adjusted EBITDA was $99.1 million.

Our third quarter 2014 net income is forecast to be in the $0.30 to $0.35 per diluted share range, which includes approximately $9.5 million of pretax expense for the call premium and unamortized deferred debt issuance costs related to the $150 million, 8.875% senior notes that are due in 2019 and that we intend to redeem in the third quarter. We anticipate interest expense savings of approximately $10 million during the first year after the redemption of these notes.

Chlor Alkali third quarter 2014 earnings are expected to decline, compared to the third quarter of 2013, due to lower ECU netbacks, partially offset by lower costs. Last year's Chlor Alkali third quarter earnings included an $11 million favorable contract settlement.

Third quarter 2014 Chemical Distribution earnings are expected to improve from the second quarter of 2014, but to be lower than the third quarter of 2013. Earnings in the Winchester segment are expected to decline from the record third quarter 2013 levels, but are forecast to reflect strong seasonal demand.

Third quarter 2014 corporate and other expenses are forecast to be higher, compared to the third quarter of 2013. Third quarter 2013 corporate and other expenses included a pretax recovery of $11.4 million of legacy legal costs. Third quarter 2014 earnings are also expected to include pretax restructuring charges of $1.5 million as a result of a weaker than expected chlorine and caustic soda demand in pricing.

We have revised our full year adjusted EBITDA forecast to be in the $350 million to $400 million range.

The outlook for the Winchester business continues to be positive. We're continuing to see ammunition demand at high levels, and we now believe that the commercial ammunition demand will remain above the levels experienced prior to the surge that began in 2012. We also expect Winchester will continue to realize additional cost savings from the ongoing centerfire relocation project.

In the Chlor Alkali business we continue to emphasize the sale of our value-added co-products, bleach, hydrochloric acid, potassium hydroxide. During the second quarter 2014, Chlor Alkali achieved record levels of hydrochloric acid shipments. The first half of 2014 potassium hydroxide shipments were also a record. We expect third quarter 2014 bleach shipments to be a record.

We continue to look for ways to deploy our cash flow and in ways that can increase shareholder value. We'll continue to consider accretive acquisitions and investments, share repurchases, and dividend policy. During the second quarter, we repurchased approximately 550,000 shares of our common stock, and we continue to be a consistent, steady and opportunistic buyer of our shares over time.

Finally, I'd like to make the comment that I continue to be optimistic about the prospects for Olin. We believe our Chlor Alkali business is in a trough period for both demand and pricing and has consistently been strengthened by the increased production and sale of co-products.

We also believe the prospects for Winchester are brighter than they have been, and it's being strengthened by the ongoing centerfire ammunition relocation. As a result, we are well positioned to generate consistent positive cash flows to further grow the business and reward our shareholders.

Now, I'm going to turn the call over to our President and Chief Operating Officer, John Fischer, and John's going to discuss the businesses in more detail with you. John?

John Fischer - *Olin - President, COO*

Thanks, Joe.

Let me begin with Chlor Alkali. Second quarter 2014 chlorine and caustic soda shipments declined slightly, compared to the second quarter of 2013, but improved sequentially by 3% from the first quarter 2014 volumes.

We continue to experience an erratic demand pattern for both chlorine and caustic sodas, similar to what we've been experiencing for the last three years. This is evidenced by the second quarter Chlor Alkali monthly operating rates, which range between 80% and 91% and averaged 86% for the entire quarter. The second quarter operating rate was a slight improvement from the second quarter 2013 rate of 84%.

Second quarter 2014 shipments of hydrochloric acid were a quarterly record and increased 32%, compared to last year's second quarter. In spite of a slower start to the traditional bleach season due to weather conditions, second quarter 2014 shipments of bleach increased 5%, compared to the second quarter of 2013, and this represents the 26th consecutive quarter of quarterly year-over-year increases in bleach shipments. Including the year-over-year improvements in bleach and hydrochloric acid, total second quarter 2014 Chlor Alkali product shipments declined 1%, compared to the second quarter of 2013.

Second quarter 2014 ECU netbacks declined approximately 11%, compared to the second quarter of 2013, and declined approximately 2%, compared to the first quarter 2014 level. This year-over-year ECU netback decline reflects both lower chlorine and caustic soda prices.

The sequential decline in ECU netbacks from the first quarter of 2014 to the second quarter of 2014 reflects lower chlorine prices. Second quarter of 2014 hydrochloric acid prices also declined, compared to the second quarter of 2013 levels, but still represented a meaningful premium to the price of chlorine.

During the second quarter, there were two hydrochloric acid price increases that we believe will have success in the market, and, as a result, we anticipate that third quarter 2014 hydrochloric acid prices will improve from the second quarter 2014 levels.

In the third quarter of 2014, we expect ECU netbacks to improve slightly, compared to the second quarter of 2014, but they are likely to be lower than the third quarter of 2013 levels. The expected improvement in the third quarter of 2014, compared to the second quarter, reflects the positive impact of the reinstatement of the fourth quarter 2013 caustic soda price increase that occurred in the first quarter of 2014. In May, there was additional $60 per ton caustic soda price increase announced that, to date, has not yet been accepted in the market.

Chlor Alkali second quarter 2014 segment earnings were $40.8 million, compared to the second quarter 2013 segment earnings of $50.2 million. The year-over-year decline reflects lower ECU netbacks, lower hydrochloric acid prices, and lower chlorine and caustic soda volumes, partially offset by higher bleach and hydrochloric acid volumes and lower costs. Second quarter 2014 Chlor Alkali segment EBITDA was $67.4 million.

Third quarter 2014 Chlor Alkali segment earnings are forecast to decline, compared to the third quarter of 2013, as lower ECU netbacks are partially offset by lower costs. We expect the third quarter 2014 operating rates to be in the mid-80% range. The third quarter of 2013 Chlor Alkali segment earnings included an $11 million favorable contract settlement.

Electricity costs per ECU produced in the first half of 2014 were comparable to the first half of 2013. Typically, the third quarter represents the peak quarter for electricity costs per ECU due to summer demand rates at several of our Chlor Alkali facilities. This seasonal cost increase can represent a sequential quarterly cost increase for the business of approximately $5 million to $10 million, and we expect a similar cost increase from the second quarter of 2014 to the third quarter of 2014.

In late June, we experienced an incident in one of our two chlor alkali production units at our Becancour, Canada facility. The other unit continued to operate at normal rates. There were no injuries as a result of the incident.

The unit, which represents approximately 50% of the facility's capacity, is not expected to operate in the third quarter. Based on the current demand forecast, we expect that this outage will have a limited impact on the third quarter 2014 results.

We continue to make progress in our objective in the Chlor Alkali business of growing the amount of chlorine capacity that is sold as bleach or hydrochloric acid. Second quarter 2014 bleach volumes were almost double the second quarter level of five years ago, and year-over-year volume improvements in both products offset most of the year-over-year decline in chlorine and caustic soda volumes. As we continue to grow these businesses, we expect operating rates in our system will improve, and that will improve profitability.

Now turning to Chemical Distribution. The Chemical Distribution business continues to be challenging. While the business improved compared to the first quarter of 2014, chemical distribution did not meet our expectations. We continue to experience aggressive pricing in the caustic soda market from large global distributors and, as a result, we are aggressively pursuing profit improvement initiatives in the business.

During the second quarter of 2014, the business achieved the highest level of shipments of Olin-produced hydrochloric acid, bleach, and potassium hydroxide. We encourage that these are beginning to gain traction in our distribution customer base. In the second quarter of 2014, the business experienced a decline in caustic soda shipments of approximately 29%, compared to the second quarter of 2013, but saw an improvement of 5%, compared to the first quarter of 2014.

Second quarter 2014 bleach volumes increased approximately 8%, compared to the second quarter of 2013 levels. Chemical Distribution second quarter 2014 segment results were breakeven, compared to the second quarter 2013 segment earnings of $2.2 million. The year-over-year decline reflects lower caustic soda volumes, partially offset by higher bleach volumes. Second quarter 2014 Chemical Distribution segment EBITDA was $3.9 million.

The third quarter is typically the strongest quarter of the year for Chemical Distribution bleach sales. The third quarter of 2014, bleach sales are expected to represent approximately 10% of the total sales in Chemical Distribution and a greater percentage of its profit contribution. We also expect sequential improvement in Chemical Distribution sales of Olin-produced hydrochloric acid and potassium hydroxide in the third quarter of 2014 from the second quarter of 2014.

We expect Chemical Distribution earnings in the third quarter 2014 to improve from the second quarter of 2014, but to decline compared to the third quarter of 2013, due to lower year-over-year caustic soda volumes. While the financial performance in the Chemical Distribution has not met our expectations, the business has been a positive generator of cash for Olin. Since the acquisition, the after tax cash flow has been approximately $40 million.

And now Winchester. Second quarter 2014 Winchester sales and segment earnings both reached second highest level of second quarter results in the history of the business. While second quarter 2014 segment earnings declined, compared to the second quarter of 2013, segment earnings for the first six months of 2014 increased approximately 4%, compared to the first six months of 2013.

Commercial demand continued at surge levels for fiscal and rifle ammunition, while shotshell and rifle ammunition demand has declined from last year. Second quarter 2014 sales were $181 million, 9% lower than the second quarter of 2013 sales, and segment income was $33.1 million, an 11% decline from the second-quarter of 2013 levels. The second quarter 2014 year-over-year decline in Winchester segment earnings reflects the combination of lower volumes and higher commodity and other material costs, which were partially offset by improved pricing and lower operating costs.

Second quarter of 2014 Winchester segment EBITDA was $37 million, which was below the second quarter of 2013 segment EBITDA of $40.8 million. While we continued to see strong commercial demand as we move into the third quarter of 2014, we have started to see some products such as shotshell and rifle ammunition decline compared to surge demand levels.

The commercial backlog at June 30, 2014 was approximately $345 million which, while below the $400 million level we experienced throughout most of 2013, is substantially higher than pre-surge levels experienced in 2012. As a point of comparison, the pre-surge June 30, 2012, commercial backlog was approximately $125 million.

During the second quarter of 2014, the purchase cost of copper declined, compared to the second quarter of 2013, while the purchase cost of lead and zinc increased, compared to the second quarter of 2013. We currently expect the full-year 2014 purchase cost for copper to be lower than 2013, and the full-year 2014 purchase price for lead to be higher than the 2013 price.

The centerfire relocation project continues to move forward and to generate cost reductions. During the first half of 2014, the cost savings realized exceeded $10 million, and we believe that full-year 2014 cost savings will be in the $22 million to $26 million range.

We expect that by the end of 2014 between 750 and 800 of the 1000 total jobs to be relocated will have been moved. We also continue to believe the annual cost savings realized from the project will be $35 million to $40 million and that this level of savings will be realized annually beginning in 2016.

Winchester's third quarter 2014 segment earnings are currently forecast to decline, compared to the earnings in the third quarter of last year, which were the highest quarterly earnings ever for Winchester. This decline reflects strong commercial demand but at a lower than surge level demand for shotshell and rimfire -- excuse me, shotshell and rifle ammunition.

From the third quarter, Winchester expects to sell all the centerfire, pistol, and rimfire ammunition that can be manufactured. We continue to see very strong demand for these products.

As we look at the Winchester business going forward, we continue to believe that the significant increase in gun ownership that has occurred over the past five years, as well as the increase in the number of people that have become regular target shooters, result in commercial ammunition demand in excess of historic levels.

The combination of the improved demand profile and the full realization of the $35 million to $40 million of annual cost savings from the centerfire ammunition relocation project makes us believe that Winchester can, under the new normal demand conditions, generate annual EBITDA in the $125 million range.

Now, I'd like to turn the call over to our Chief Financial Officer, Todd Slater, who will review several financial matters with you.

Todd Slater *- Olin - VP, CFO*

Thanks, John.

First, I'd like to discuss the balance sheet and the second quarter 2014 cash flow. Cash and cash equivalents at June 30, 2014, including restricted cash associated with the Go Zone financings that are classified as long-term assets on the balance sheet, totaled $248.2 million.

During the first two quarters of 2014, working capital employed increased by approximately $93 million. Olin typically experiences seasonal working capital growth during the first two quarters of the year between $50 million and $100 million. During the first two quarters of 2013, the working capital increase was approximately $66 million.

During the second quarter of 2014, Winchester was able to begin to replenish a portion of their typical seasonal inventories. We expect that the full-year 2014 working capital will increase between $25 million to $35 million. Capital spending in the second quarter of 2014 was $13.9 million, compared to $24.4 million in the second quarter of 2013.

Depreciation and amortization expense during the second quarter of 2014 was $35.2 million. We have reduced our expectations for the full year 2014 capital spending and are now forecasting that the full-year capital spending will be between $80 million and $90 million range. We continue to forecast that the full year 2014 depreciation and amortization expense will be in the $135 million to $140 million range.

As Joe mentioned, we provided notice of our intent to call our $150 million, 8.87% senior notes that would have matured on August 15, 2019. We are anticipating recognizing pre tax expense of approximately $9.5 million for the call premium and the write-off of an amortized debt issuance costs during the third quarter of 2014 related to this action. Based on current interest rates, we anticipate interest expense savings of approximately $10 million during the first year after redeeming these notes.

During the second quarter, we entered into a new $415 million five-year senior credit facility, consisting of $265 million senior revolving credit facility, which replaced the previous $265 million senior revolving credit facility, and $150 million delayed-draw term loan facility that will be used to refinance the $150 million notes that would've been due in 2019. The new credit facility will expire in June of 2019. Borrowing options and restrictive covenants are similar to those of our previous $265 million senior revolving credit.

Now turning to the income statement. Selling and administration expenses declined $6.7 million in the second quarter of 2014, compared to the second quarter of 2013. This year-over-year decrease reflects the combination of lower legal and legal-related settlement costs of $3.2 million and a decrease in incentive compensation of $2.4 million, which includes mark-to-market adjustments on stock-based compensation.

Second quarter 2014 charges to income for environmental investigatory and remedial activities were $1.2 million, compared to $2.4 million in the second quarter of 2013. These charges related primarily to expected future investigatory and remedial activities associated with past manufacturing operations and former waste disposal sites.

In the third quarter of 2014, expenses for environmental investigatory and remedial activities are expected to be in the $1 million to $3 million range. This forecast does not include any recovery of environmental investigatory and remedial costs incurred and expensed in prior periods.

On a total company basis, defined benefit pension plan income was $5.9 million in the second quarter of 2014, compared to $5.1 million in the second quarter of 2013. We expect defined benefit pension plan income in 2014 to be higher than the 2013 level of $20.5 million.

We are not required to make any cash contributions to our defined benefit pension plan in 2014. In addition, under the pension plan funding relief provisions of the Moving Ahead for Progress in the 21st Century legislation that was enacted in 2012, we may not be required to make any additional cash contributions to our domestic defined benefit pension plan for several years. During 2014, we do expect to contribute approximately $1 million to our Canadian defined benefit pension plan.

During the second quarter of 2014, Olin recorded a pretax restructuring charge of $2.3 million, associated with exiting of the mercury cell technology in our chlor alkali manufacturing process and the ongoing relocation of the Winchester centerfire ammunition manufacturing operations from East Alton, Illinois, to Oxford, Mississippi. We anticipate third quarter 2014 restructuring charges of approximately $1.5 million.

The effective tax rate from continuing operations in the second quarter of 2014 was 33.2%, which included a $600,000 favorable tax adjustment associated with the finalization of our 2013 U.S. federal and state income tax returns, partially offset by the re-measurement of deferred taxes due to an increase in state effective tax rates.

We continue to believe that the full-year 2014 effective tax rates will be in the 35% to 37% range. We are also forecasting the 2014 cash tax rate will be in the 25% to 30% range.

Also, during the second quarter, we made a payment of $5.5 million to resolve certain indemnity obligations related to our Metals business sold in 2007. As a result of this favorable resolution, we recognized an after-tax gain of $700,000 and income from discontinued operations.

During the second quarter of 2014, we repurchased approximately 550,000 shares of Olin stock at a cost of approximately $15 million under the April 2014, 8 million share authorization. A total of 1.1 million shares have been purchased during 2014 at a cost of $30 million.

There was approximately 7.5 million shares remaining under the current authorization. And as Joe said earlier, we intend to continue repurchase shares on a steady and opportunistic basis. We continue to feel confident about our financial condition, and we believe the company is well positioned to generate cash.

We expect capital spending to remain well below depreciation for the foreseeable future, and between now and the second quarter of 2016, we face only $30 million of required debt repayment. In addition, we do not face any cash contributions to our large domestic defined benefit pension plan.

Yesterday, 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, 2014, to shareholders of record at the close of business on August 11, 2014. This is the 351st 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 estimates of future performance. Clearly these are forward-looking statement, 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 second-quarter earnings release.

A copy of today's transcript will be available on our website in the investors section under calendar of events. Earnings press release and other financial data and information are available under press releases.

Operator, we are now ready to take questions.

QUESTIONS AND ANSWERS

Operator

Thank you.

[Operator Instructions]

Our first question will come from Frank Mitsch of Wells Fargo Securities.

Frank Mitsch - *Wells Fargo Securities, LLC - Analyst*

Good morning gentlemen.

Joseph Rupp - *Olin - Chairman, CEO*

Good morning.

Frank Mitsch - *Wells Fargo Securities, LLC - Analyst*

I just want to make sure we're all on the same base in terms of your guidance here of $350 million to $400 million of EBITDA. That excludes the charges for debt redemption and restructuring and so forth, and if I look at what you've earned so far this year, at the midpoint you're looking for something around $185 million in EBITDA for the balance of the year? Is that correct?

John Fischer - *Olin - President, COO*

Frank, it includes the restructuring; it excludes the debt refinancing.

Frank Mitsch - *Wells Fargo Securities, LLC - Analyst*

Includes restructuring excludes debt refinancing.

John Fischer - *Olin - President, COO*

Yes.

Frank Mitsch - *Wells Fargo Securities, LLC - Analyst*

Okay. Terrific. And really, I guess I have a question to regarding the distribution business. We're seeing, what was that I think, volumes were down 29% year-over-year. Obviously, that's well above what the market would have done. What's the situation there? Is it market share loss? Is it supplier issues? What exactly is going on in that business, and when might we expect it to be back at the level of sales and profits that we thought that business would deliver?

John McIntosh - *Olin - Sr. VP, Chemicals*

Frank, we are in a very hyper-competitive market in the caustic distribution business. And that's really borne by the fact that we're in a no-growth environment for caustic demand period. And because of that, the competitive situation is that we have -- our volume is off because -- we have lost market share to some aggressive actions by national distributors competing with us in that area.

We are also faced with issues with our suppliers who are pushing price increases. That they're announcing into our purchased cost of material, which we're not able to recover in the marketplace. So we're getting some margin compression as well. Quite frankly until we see a return to an environment in which we see demand growth for caustic, we're going to be in this kind of competitive environment, working hard just to maintain the situation we have today.

Frank Mitsch - *Wells Fargo Securities, LLC - Analyst*

So your chlor alkali business is not necessarily seeing caustic prices go up but your distribution business is taking price increases from the other suppliers?

John McIntosh - *Olin - Sr. VP, Chemicals*

In some cases, yes.

Frank Mitsch - *Wells Fargo Securities, LLC - Analyst*

You mentioned the national distributors being very aggressive on price. Are they making money at these levels? Can they continue at these levels? I mean, volumes down 30% is pretty significant. Frank, we don't know.

Joseph Rupp - *Olin - Chairman, CEO*

Frank, their information is not public so we assume that they are in the same situation we're in. We're in a no-growth situation at this point in time from a caustic perspective. We would not anticipate that that's going to last forever. If we were to take a higher level view, we'd say that we actually feel chlor alkali and distribution caustic is in a trough, and the upside is when we come out of that trough, there's opportunities in both businesses.

Frank Mitsch - *Wells Fargo Securities, LLC - Analyst*

All right. And how are you feeling about -- how should we be thinking about the $35 million in synergies from KA Steel. I know you had mentioned in the past that that was somewhat delayed. Can you give us an update on what your thought process is there?

Joseph Rupp - *Olin - Chairman, CEO*

We still feel Frank that on the co-products the synergies are there, and, unfortunately, with the headwinds of what we just talked about from a caustic, they're not as apparent. So, we still feel okay from a synergy perspective.

Frank Mitsch - *Wells Fargo Securities, LLC - Analyst*

Can you give us some guidelines on what --

Joseph Rupp - *Olin - Chairman, CEO*

I think we said $35 million -- we were about a year delayed is what we said from a synergy perspective.

Frank Mitsch - *Wells Fargo Securities, LLC - Analyst*

It was like $35 million by the end of year three, and the expectation is that's one year delayed.

Joseph Rupp - *Olin - Chairman, CEO*

Yes.

Frank Mitsch - *Wells Fargo Securities, LLC - Analyst*

Thank you so much.

John Fischer - *Olin - President, COO*

Thank you, Frank.

Operator

Our next question will come from Christopher Butler of Sidoti & Company.

Christopher Butler - *Sidoti & Company - Analyst*

Hi, good morning everyone.

Joseph Rupp - *Olin - Chairman, CEO*

Good morning.

Christopher Butler - *Sidoti & Company - Analyst*

Just wanted to you talk to the inventory levels that you're seeing for caustic soda out there in the industry, and then specifically for you with your inventories up it sounds like that's primarily Winchester. Is that the right read there?

John Fischer - *Olin - President, COO*

That's correct in terms of our balance sheet inventories being up. That's Winchester, yes.

John McIntosh - *Olin - Sr. VP, Chemicals*

Let me talk about caustic inventories in general. If you look at year-to-date 2014 versus year-to-date 2013 there's a 26% reduction in net exports from the US. And so, the implication of that is that with no demand growth for caustic domestically and with that kind of reduction in net export numbers, we are seeing caustic inventory levels increase in North America. And if you talk to people who are out buying caustic, you will hear that caustic is available. Membrane caustic is available. Diaphragm caustic is available. So, we're seeing that happen in the marketplace. That does not -- is not the recipe for getting price increases. That's just the reality of what's going on today.

Christopher Butler - *Sidoti & Company - Analyst*

And if we are looking at peer capacity expansion and reduction that's taken place in the first half of this year, has that had any effect on this marketplace?

Joseph Rupp - *Olin - Chairman, CEO*

The biggest effect on the marketplace is really the demand, Chris.

Christopher Butler - *Sidoti & Company - Analyst*

And as we look to the third quarter, what kind of maintenance should we be thinking about as far as this quarter is concerned, especially with the outage?

John Fischer - *Olin - President, COO*

Nothing that would create an unfavorable comparison between Q2 and Q3 of 2014.

Christopher Butler - *Sidoti & Company - Analyst*

And then, just shifting over to Winchester. Was working out something else, but did you say you were expecting $125 million of annual EBITDA when things normalize in Winchester, and isn't that an increase of where you've been previously?

John Fischer - *Olin - President, COO*

Yes. That's what we said. We said last quarter $110 million to $125 million.

Christopher Butler - *Sidoti & Company - Analyst*

I appreciate your time.

Joseph Rupp - *Olin - Chairman, CEO*

Thank you.

Operator

The next question will come from Edward Yang of Oppenheimer.

Edward Yang - *Oppenheimer & Co. - Analyst*

Hi, good morning guys.

Joseph Rupp - *Olin - Chairman, CEO*

Good morning.

Edward Yang - *Oppenheimer & Co. - Analyst*

I want to better understand what's going on with your ECU netback that was down 11% year-over-year and that seemed worse than the industry, and maybe compare and contrast your pricing trends versus the industry.

John McIntosh - *Olin - Sr. VP, Chemicals*

Well the industry is -- our pricing trends are no different than the industry. If you look at -- I'll talk about chlorine and caustic both. If you look at chlorine in the last 10 quarters, there have been three announced price increases in the merchant chlor alkali market. And during that same period of time, indexed pricing for chlorine is lower today than it was 10 quarters ago. So the net effect of that is price increases have been totally offset by the market situation, and we're no different than anybody else in that regard. On the caustic side, in the last 10 quarters, there have been price increase announcements in nine of those 10 quarters. If you look at that same period of time, index pricing is lower today than it was 10 quarters ago. And again, in the merchant business, we're seeing the same kind of headwinds on pricing that's driven by demand that everybody else is seeing.

Edward Yang - *Oppenheimer & Co. - Analyst*

Maybe just to clarify my question, John, I understand directionally, but magnitude-wise -- and I understand your pricing is also with a contractual lag in certain instances. If I look at ECU netbacks for the industry year-over-year in the first quarter, in the second quarter it was down about 5%. Your ECU netbacks were down about 11%. And last quarter with the caustic price increase you saw some sequential improvement in industry pricing, but we didn't see any sequential improvement in Olin's ECU netback. Was it just more, kind of, timing issues or something else?

Joseph Rupp - *Olin - Chairman, CEO*

No. There's timing issues associated with that.

John Fischer - *Olin - President, COO*

And we just said, we're to see sequential improvement in Q3 2014 versus Q2 of 2014.

Edward Yang - *Oppenheimer & Co. - Analyst*

Okay, got you. So the industry $60 per ton caustic price increase that's been outstanding, that hasn't been accepted by the marketplace yet. What your thoughts there?

John McIntosh - *Olin - Sr. VP, Chemicals*

Well we have not been able to take that price increase and make it happen in our system with our accounts, whether they're indexed accounts or accounts where we negotiate prices. Our Chemical Distribution business says the same story that they don't see the price increase sticking in the distribution market. So, as it stands right now, unless something changes -- and this industry is dynamic enough that something can change -- we don't look for that to have any benefit for us.

Edward Yang - *Oppenheimer & Co. - Analyst*

Okay and maybe a question for Joe. Any updated thoughts on industry consolidation and, more specifically, the Dow assets.

Joseph Rupp - *Olin - Chairman, CEO*

We've consistently said that we believe in consolidation, and when the Dow assets become available, I'm sure there'll be a lot of people who'll take a look at them, but we believe in consolidation.

Edward Yang - *Oppenheimer & Co. - Analyst*

Okay. Just finally, on Winchester: you saw some sanctions come in for Russian rifles. Are there any possibility that could extend to ammo, and if so, how would that affect pricing dynamics for the ammunition business?

Joseph Rupp - *Olin - Chairman, CEO*

We'd love to see it go to ammo, and there's a nice little niche market there with its steel ammo that they bring into the United States, but it would be helpful to the market if there were some curtailment to their access to the market.

John Fischer - *Olin - President, COO*

In terms of the source of ammunition imports into the United States, the largest source is Russia.

Edward Yang - *Oppenheimer & Co. - Analyst*

All right, thank you.

Operator

Next we have a question from Herb Hardt of Monness.

Herb Hardt - *Monness, Crespi, Hardt & Co. - Analyst*

Good morning, I'd like to go back to the caustic situation. With exports down that much, 26%, is that Latin American pulp and paper? Or can you determine why it's down so sharply?

John McIntosh - *Olin - Sr. VP, Chemicals*

Herb, part of it is that. As a matter of fact, there have been instances in the last quarter where caustic has been exported from Brazil to the US east coast. That's a phenomenon that we haven't seen for a long time and has to be some indication of pulp and paper demands in South America. We have not seen or heard anything from export companies or anyone else that tells us that this is a long-term trend. We still expect Latin and South America to be a market an export market that the US is most strategically and most cost-effectively able to handle, and we expect to see that export demand pick back up. But, so far this year it has not been as robust as in previous years.

Herb Hardt - *Monness, Crespi, Hardt & Co. - Analyst*

Thank you. The other part of the same question is my understanding was caustic goes into a lot of industrial processes, and with the US economy grinding forward, it seems a little surprising that you say there's absolutely flat demand in the US as well.

John McIntosh - *Olin - Sr. VP, Chemicals*

Well, we serve a wide variety of the market segments where caustic is used in North America, and for the most part, if you just look at all the market segments that we track, demand is either flat or off.

Herb Hardt - *Monness, Crespi, Hardt & Co. - Analyst*

Okay. Thank you very much.

Operator

The next question comes from Don Carson of Susquehanna Financial.

Don Carson - *Susquehanna Financial Group / SIG - Analyst*

Yes, thank you. Couple things: Just back to caustic. Obviously, the $60 issue is dead as you mentioned, but I was wondering why you thought you were able to revive a fourth quarter price increase that died in the first quarter, so maybe if you just go through some of those dynamics?

John McIntosh - *Olin - Sr. VP, Chemicals*

There was a price increase that was announced back in the fourth quarter on caustic. It wasn't followed by really -- it wasn't followed by many producers, and it wasn't accepted in the marketplace. In the first quarter there was some improvement in caustic demand early in the first quarter, and several producers, including Olin, who had not received that price increase, but put it on hold basically reinstated that price increase based on the market conditions. A lot of that was driven by weather, you may remember the first quarter was a real difficult time for the transportation industry and a real difficult time for parts of the country where there were production curtailments because of the weather.

When that part of that increase was reinstated, that helped move some of the indexed pricing up in the first quarter, which we will see some -- have seen -- and will see some small benefit too, as John referenced earlier. But the $60 increase, which has been announced since then -- as a matter of fact it was announced at the end of May -- which would've meant the first time we would've seen any impact for that would've been the third quarter, has not been reflected at all in price increases.

Don Carson - *Susquehanna Financial Group / SIG - Analyst*

So as you look at what index you're posted in the newsletters, what sequential improvement should you see in caustic pricing in Q3 versus Q2?

John McIntosh - *Olin - Sr. VP, Chemicals*

We have no idea what the indexes will publish. The only -- in the third quarter. The improvement in the second quarter index number was only $10.

Don Carson - *Susquehanna Financial Group / SIG - Analyst*

Okay, so you'll see a portion of that in Q3 then.

Joseph Rupp - *Olin - Chairman, CEO*

A portion, right.

Don Carson - *Susquehanna Financial Group / SIG - Analyst*

Okay. And then, on Winchester: why is shotshell and rifle down? Is it a case of demand finally subsiding? And does this really result in -- I mean, normally you have a Q3 seasonal surge as people get ready for hunting season -- does that mean that that seasonal surge is not going to be there this year?

John Fischer - *Olin - President, COO*

No, I think you're going to see a normal seasonal pattern, Don, where Q3 for shotshell and rifle is much stronger than Q2 were, and I would say that Q2 just represents a step back from surge levels where we could sell anything we could make in the second quarter of 2013. That wasn't as much the case in the second quarter of 2014. And where we saw it step back was shotshell and rifle.

Don Carson - *Susquehanna Financial Group / SIG - Analyst*

Right. And you said pistol is still strong, but is that kind of abating now? I noticed my local ranges giving five boxes for the price of four 9mm now. Is that an indication that things are about to subside?

Joseph Rupp - *Olin - Chairman, CEO*

In certain categories, it is not. We still feel that there's going to be a fair, robust market there, Don. A lot of that's driven by the fact that a lot of the gun sales etc. and increase in shooters has come right in the pistol category.

Don Carson - *Susquehanna Financial Group / SIG - Analyst*

Okay. Thank you.

Operator

Our next question will come from Edlain Rodriguez of UBS.

Edlain Rodriguez - *UBS - Analyst*

Good morning, thank you for taking my question. Quick question on chlor alkali. You mentioned the erratic pattern in demand. What do you think is behind that? Is that the new normal?

John McIntosh - *Olin - Sr. VP, Chemicals*

Well, quite frankly, I hope it's not the new normal because it's disruptive to the supply chain, and it's disruptive to a producer being able to most effectively and efficiently use your manufacturing assets. I think what we saw was in the early part of the quarter we saw some recovery in operating rates that was driven by some of the downsizing of weather-related problems from the first quarter. So, we saw some improvement early in the quarter.

Then, we saw it back off a little bit and then we saw some improvement late in the quarter. I think the volatility is just -- it is becoming more of an issue. It's more of an issue when it plays into seasonality. It becomes more of an issue as supply chains get to be managed more tightly and producers want to minimize inventories, or consumers want to minimize inventories. And so, to the extent it becomes somewhat of a new norm, it'll just be another challenge the industry will have to deal with.

Edlain Rodriguez - *UBS - Analyst*

And also, another question. If I'm looking at IHS Chemicals' forecast for ECU margins going forward, it looks like they're not forecasting an up cycle for ECU. Margin seems to be flattish to down slightly. Do you share that view, and where can they be wrong? What would cause an up cycle in ECU?

John McIntosh - *Olin - Sr. VP, Chemicals*

I don't share the cycle that margins are going to remain that flat for that extended period of time. My perspective is that margins will improve when demand improves and operating rates improve, and there are a variety of things that can cause that to happen: capacity rationalization, consolidation. There's a lot of things the industry -- over the years that have driven industry to higher operating rates. And if demand improves at all, the industry has done a good job of taking costs out, and the industry, I believe, is in a trough and is well positioned to get significant benefit when demand patterns change.

Edlain Rodriguez - *UBS - Analyst*

Okay. And one last question on Winchester. There is a Reverse Morris Trust between ATK and Orbital Science. Does that mean anything for Winchester? What do you think?

John Fischer - *Olin - President, COO*

Well, the outgrowth of that is it creates an ATK that is focused on sporting products, which includes their ammunition business, which competes with us. I don't think it changes the competitive landscape on the ammunition side at all because those businesses are there in ATK today.

Joseph Rupp - *Olin - Chairman, CEO*

And 10 years ago they were independent of ATK. Just to return.

Edlain Rodriguez - *UBS - Analyst*

Return to normal. Okay, thank you very much.

Operator

The next question is from Dmitry Silversteyn of Longbow Research.

Dmitry Silversteyn - *Longbow Research - Analyst*

I guess it's still good morning. Couple of questions sort of along the lines that other people have been asking the questions. On the KA Steel part, the distribution part of the business. How can we think about the improvements there? Is it basically tied to your chlor alkali business in terms of profitability? And, we're not going to see improvement there until we see improvements in ECU pricing? Or is there something that the distribution can do independently to start generating positive EBIT?

Joseph Rupp - *Olin - Chairman, CEO*

You're going to see improvement in the business because we will generate positive EBIT on the co-products. We will continue to increase our penetration with hydrochloric acid, potassium hydroxide, and bleach. To get the significant improvement, the headwinds in the caustic have to be abated, and that will happen as this cycle moves forward.

Dmitry Silversteyn - *Longbow Research - Analyst*

Okay. Secondly, you keep talking about utilization rates being low and demand not really being there to drive price increases. We've been stuck in this for about two, three years, and capacity keeps being added. Is there any sense in the industry that demand may not come back in the near term, and, therefore, something needs to be done with capacity? Or are people still willing to suffer through these lower rates in hopes of an eventual rebound, and what will drive the rebound for caustic?

John McIntosh - *Olin - Sr. VP, Chemicals*

My perspective on that is: I'd like to think that people will not invest significant money in capital intensive chlor alkali assets with the kind of industry dynamics that we see today. You know, I also believe that there's opportunities for capacity rationalization. Every producer probably has the opportunity to think about how most effectively to use their assets. I know over the last several years we've reduced capacity in our system, and it was the most effective and economic approach to move forward. I like to think everybody is in the same position and is constantly looking at that among other options they have to improve the contribution of their business. The industry is proof that it will consolidate and it will rationalize. I believe that that track record will continue.

Dmitry Silversteyn - *Longbow Research - Analyst*

Okay. Alright; thank you.

Joseph Rupp - *Olin - Chairman, CEO*

Thank you.

Operator

The next question is from Jason Freuchtel of SunTrust.

Jason Freuchtel - *SunTrust Robinson Humphrey - Analyst*

Hey guys, good morning.

Joseph Rupp - *Olin - Chairman, CEO*

Good morning.

Jason Freuchtel - *SunTrust Robinson Humphrey - Analyst*

Are you seeing any regional differences in the demand and pricing for caustic?

John McIntosh - *Olin - Sr. VP, Chemicals*

No more than we would routinely see historically. I mean, some of the coastal markets that are served by product, either moved from the Gulf Coast or product moved from offshore, have tended, in some cases, to be more competitive. We don't see any trends that are different than what we've seen historically.

Jason Freuchtel - *SunTrust Robinson Humphrey - Analyst*

Okay. And then, on Winchester: how much of the Winchester results were constrained by lower demand for shotshell and rifle ammunition versus the lower inventory levels of pistol rifle and rimfire in your system that you identified last quarter? And, how to the margins for pistol and rimfire compare to shotshell and rifle?

John Fischer - *Olin - President, COO*

We have never really disclosed margins across the breadth of the product line. First, I would just say earning $33 million in the quarter hardly is bad news when you look at the history of Winchester. I would say that the shotshell and rifle, the demand in the second quarter was better than what we've seen historically, just less than what we saw in the second quarter 2013. And, there was probably a small amount of sales loss associated with pistol and rimfire just because we were out of inventory.

Jason Freuchtel - *SunTrust Robinson Humphrey - Analyst*

Right. Okay, great. Thank you.

Operator

Our next question comes from Arun Viswanathan of RBC Capital Markets.

Arun Viswanathan - *RBC Capital Markets - Analyst*

Hi guys. Thanks for taking the question. I guess I had a question on distribution. Is there a possibility to increase the forward integration from chlor alkali products into distribution? And would that be a benefit to you guys at all?

John Fischer - *Olin - President, COO*

That is what we've been talking about, what Joe talked about, we're trying to do in the context of our co-products, hydrochloric acid and potassium hydroxide.

Arun Viswanathan - *RBC Capital Markets - Analyst*

Right but I guess I was asking more on the caustic side. Because you said you'd have to -- you've been taking price increases from some of your suppliers but not able to get it in your own products.

John Fischer - *Olin - President, COO*

I think you could rest assured that we look at how much we supply versus how much we buy and attempt to optimize that across Olin.

Arun Viswanathan - *RBC Capital Markets - Analyst*

Okay. And then on Winchester: did I hear you right when you said that you're actually sold out in 3Q, but it's just the surge levels -- it's lower than prior surge levels?

John Fischer - *Olin - President, COO*

We said we were sold out on pistols and rimfires, certain categories.

Arun Viswanathan - *RBC Capital Markets - Analyst*

Okay. Thanks.

Operator

Next we have a question from Richard O'Reilly of Revere Associates.

Richard O'Reilly - *Revere Associates - Analyst*

Thank you, good morning guys. I'm going to ask you to repeat a couple numbers, and then I have a bigger question. What was the operating rate in the second quarter in the Chlor Alkali, and what was the absolute ECU number that you're going to show?

John Fischer - *Olin - President, COO*

The operating rate was 86%. the ECU was 510.

Richard O'Reilly - *Revere Associates - Analyst*

510. Okay, fine. Okay, good. The second question is, it's on uses of cash flow, your free cash flow, and you've commented earlier about your view about industry consolidations and that's opportunities when opportunities come up. And I think the comment about the share buyback was you'd be a steady buyer of stock. How about another wave -- the second wave returning to shareholders, looking at the absolute dividend payment? It hasn't been changed many years.

John Fischer - *Olin - President, COO*

I think if you look at our dividend, and we've looked at that and compared it to share repurchase, both our payout ratio and our yield is at the high-end of our peer group, and we think, therefore, that level is appropriate, and we've chosen at this juncture to return cash to shareholders by a share repurchase.

Richard O'Reilly - *Revere Associates - Analyst*

Good. Thanks a lot then.

Joseph Rupp - *Olin - Chairman, CEO*

Thank you, Richard.

Operator

And this concludes our question and answer session. I would like to turn the conference back over to Joseph Rupp for any closing remarks.

Joseph Rupp - *Olin - Chairman, CEO*

We'd like to thank you for joining us today, and we look forward to speaking with you at the end of October as we announce the results of our third quarter. Thank you.

Operator

The conference is now concluded. Thank you for attending today's presentation. You may now disconnect.