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OLN - Q3 2014 Olin Corp Earnings Call

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OVERVIEW:

Co. reported 3Q14 sales of $593.6m and income from continuing operations of $26.1m or $0.33 per diluted share. Expects 4Q14 diluted EPS to be $0.20-0.25.

CORPORATE PARTICIPANTS

Joseph Rupp *Olin - Chairman & CEO*

John Fischer *Olin - President & COO*

Todd Slater *Olin - VP & CFO*

John McIntosh *Olin - SVP, Chemicals*

CONFERENCE CALL PARTICIPANTS

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Edward Yang *Oppenheimer & Co. - Analyst*

Christopher Butler *Sidoti & Company - Analyst*

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Richard O'Reilly *Revere Associates - Analyst*

PRESENTATION

Operator

Good morning, everyone, and welcome to Olin's Third Quarter 2014 Earnings Conference Call. All participants will be in a listen-only mode.

(Operator Instructions)

After today's presentation, there will be an opportunity to ask questions.

(Operator Instructions)

Please also note that today's event is being recorded. At this time, I would like to turn the conference call over to Mr. Joseph Rupp, Chairman and CEO. Sir, please go ahead.

Joseph Rupp - ***Olin - Chairman & CEO***

Good morning, and thanks for joining us today. With me are John Fischer, President and Chief Operating Officer; John McIntosh, Senior Vice President of Chemicals; Todd Slater, our Vice President and 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 third quarter of 2014 was $26.1 million, or $0.33 per diluted share, which compares to $69.7 million, or $0.86 per diluted share in the third quarter of 2013. Sales in the third quarter of 2014 were $593.6 million, compared to $670.7 million in the third quarter of 2013.

Third quarter 2014 results included $1.2 million of pretax restructuring charges and $9.5 million of pretax expense for the call premium and the write-off of unamortized deferred debt issuance costs related to the $150 million of Senior Notes that were redeemed in the third quarter. Those Notes would have matured in 2019.

Third quarter of 2013 results included $1.6 million of pretax restructuring charges, the net recovery of $11.4 million of pretax legacy legal costs, a pretax gain of $11 million for the favorable Chlor Alkali Products contract settlement, and $8.8 million of favorable tax adjustments.

The high level of commercial demand that was experienced by Winchester in 2013 continued in the third quarter of 2014, and Winchester generated the second highest level of quarterly sales in segment income in its history. As we move forward into the seasonally weaker fourth quarter, we continue to see strong commercial demand for pistol and rimfire ammunition.

In Chlor Alkali and Chemical Distribution, the environment has been more challenging. During the third quarter of 2014, Chlor Alkali experienced both lower chlorine and caustic soda volumes and prices, compared -- when compared to the third quarter of 2013. These were partially offset by higher hydrochloric acid and potassium hydroxide volumes and lower operating costs. Third quarter 2014 Chemical Distribution shipments and segment earnings declined, compared to the third quarter of 2013.

Olin's third quarter 2014 adjusted EBITDA was $92.7 million. Fourth quarter 2014 net income is forecast to be in the $0.20 to $0.25 per diluted share range. Chlor Alkali fourth quarter 2014 earnings are expected to improve, compared to the fourth quarter of 2013, due to higher volumes and lower operating costs, partially offset by lower ECU netbacks. Chlor Alkali fourth quarter 2014 segment earnings are also expected to improve sequentially from third quarter of 2014, due to lower electricity and other operating costs, and improved chlorine and caustic volumes, partially offset by lower ECU netbacks.

Fourth quarter 2014 Chemical Distribution earnings are expected to improve in the fourth quarter of 2013, due to increased sales of Olin-produced hydrochloric acid and potassium hydroxide. Earnings in the Winchester segment are expected to decline from the record fourth quarter 2013 levels, but are expected to be similar to fourth quarter 2012 levels.

Fourth quarter 2014 earnings are also expected to include pretax restructuring charges of approximately $1 million. As a result of the continued weaker-than-expected chlorine and caustic soda demand and pricing, we've revised our full-year adjusted EBITDA forecast to $345 million to $365 million range.

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

In the Chlor Alkali business, we are continuing to pursue sales growth for our value-added co-products, bleach, hydrochloric acid, and potassium hydroxide. During the third quarter of 2014, over half of our Chlor Alkali segment earnings were generated from the sale of these value-added products.

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

I continue to be optimistic about the prospects for Olin. While we believe our Chlor Alkali business is in a trough period for both demand and pricing, the business is continuing being strengthened by the increased production in sales co-products. We also believe that the prospects for Winchester are brighter than they have ever been, and are we being strengthened by ongoing centerfire ammunition relocation.

In the Chemical Distribution business, we're seeing gradual improvements, and we have seen quarterly segment earnings improve sequentially during 2014. As a result, Olin is well positioned to generate consistent, positive cash flows to further grow the business and to reward our shareholders.

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

John Fischer *- Olin - President & COO*

Thank you, Joe. Let me begin with Chlor Alkali.

Demand for chlorine and caustic soda continued to be uneven during the third quarter. Thirdquarter 2014 chlorine and caustic soda shipments declined 9% compared to the third quarter of 2013, as we experienced lower levels of demand for both chlorine and caustic soda. Chlorine shipments to major end-use customers illustrates this uneven demand.

Third quarter 2014 chlorine shipments to vinyls customers decreased by 47% compared to the third quarter 2013, while shipments to titanium-dioxide customers increased 19%, and shipments to urethane customers increased 17% from the third quarter of 2013.

The third quarter 2014 operating rate of 78% was lower than the third quarter 2013 rate of 86%. During the third quarter, our operating rate was impacted by customer outages and planned and unplanned maintenance outages. The customer outages reduced our third quarter operating rate by approximately 6 percentage points, and these outages reduced third quarter earnings by approximately $8 million compared to the second quarter.

As we had previously discussed, in late June, we experienced an incident at one of our two chlor alkali production units at our Becancour, Canada facility. The other unit has continued to operate at normal rates.

The damaged unit, which represents approximately 50% of the facility's capacity, did not operate in the third quarter and is not expected to operate in the fourth quarter. This unit represents approximately 9% of our total capacity. Based on the current demand forecast, we expect that this outage will have a limited impact on the fourth quarter 2014 results.

Third quarter 2014 shipments of hydrochloric acid increased 3% compared to last year's third quarter. Cooler-than-normal weather conditions during the traditional bleach season caused third quarter 2014 shipments of bleach to decrease by 1%, compared to the third quarter 2013, but we expect full-year 2014 bleach shipments to improve 4% compared to the 2013 level.

During the third quarter of 2014, ECU netback was approximately $505 per ton, compared to approximately $570 per ton in the third quarter of 2013, and this was a reduction from the second quarter of 2014 level of approximately $510 per ton. This decline in ECU netbacks did not meet our expectations of the sequential improvement and reflects caustic soda pricing that was in line with the second quarter and slightly lower chlorine pricing. In the fourth quarter of 2014, we expect ECU netbacks to decline slightly compared to the third quarter of 2014, and to be lower than the fourth quarter of 2013 levels.

Third quarter 2014 hydrochloric acid prices declined compared to the third quarter of 2013 levels, but increased compared to the second quarter 2014 levels. During the third quarter, there was an additional hydrochloric acid price increase that we believe will have success in the market, and as a result, we anticipate that the fourth quarter of 2014 hydrochloric acid prices will improve compared to the third quarter 2014 levels. Hydrochloric acid sales continue to carry meaningful premium to the price of chlorine.

During the third quarter, the caustic soda pricing indices declined $10 per ton, and this will negatively impact Olin's fourth quarter ECU netbacks. In September, there was a $30perton caustic soda price increase announced that to date has not yet been accepted in the market.

Year-to-date 2014 electricity costs per ECU produced were comparable to the first nine months of 2013. The third quarter represents the peak quarter for electricity costs per ECU, due to higher summer rates at several of our chlor alkali facilities. This seasonal cost increase represented a sequential quarterly cost increase for the business of approximately $4 million from the second quarter of 2014 to the third quarter of 2014.

As Joe said earlier, we expect fourth quarter electricity costs to be lower than the third quarter level. Chlor Alkali third-quarter 2014 segment earnings were $26.2 million, compared to third-quarter 2013 segment earnings of $64.4 million, which included an $11million favorable contract settlement. The year-over-year decline reflects lower chlorine and caustic soda volumes, lower ECU netbacks, and lower hydrochloric acid prices, partially offset by higher volumes of hydrochloric acid and potassium hydroxide and lower operating costs.

Third quarter 2014 Chlor Alkali segment EBITDA was $52.4 million. Fourth quarter 2014 Chlor Alkali segment earnings are forecast to improve compared to the fourth quarter of 2013, due to higher volumes and lower operating costs, partially offset by lower ECU netbacks. We expect the fourth quarter 2014 operating rate to be in the low 80% range.

We continue to grow the amount of our chlorine capacity that is sold as bleach or hydrochloric acid. Over the past five years, our bleach volumes have grown at a compound annual growth rate of 11%, and our hydrochloric acid volume has grown at a rate of 5%.

Now, I would like to talk about Chemical Distribution. We have continued 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 third quarter of 2014, the business achieved the highest level of shipments of Olin-produced hydrochloric acid, and the second highest quarterly shipments of Olin-produced bleach and potassium hydroxide. We are encouraged that these products are beginning to gain traction with our distribution customer base.

In spite of a business environment that continues to be challenging, the financial performance in the third quarter of 2014 improved compared to the second quarter of 2014. During the third quarter of 2014, the business experienced growth in the shipments of Olin-produced hydrochloric acid, potassium hydroxide, and bleach. Increased sales of these co-products will be key components for the improvement of Chemical Distribution profitability as we move forward.

In the third quarter of 2014, the business experienced a decline in caustic soda shipments of approximately 18% compared to the third quarter of 2013, but saw an improvement of 2% compared to the second quarter of 2014. As a result of a cooler-than-normal weather conditions during the traditional bleach season, the third quarter 2014 bleach volumes decreased approximately 2% compared to third quarter 2013 levels.

ChemicalDistribution third quarter 2014 segment earnings were $800,000 compared to the thirdquarter 2013 segment earnings of $3.4 million. The year-over-year decline reflects lower caustic soda volumes.

Third quarter 2014 Chemical Distribution segment EBITDA was $4.8 million. We expect Chemical Distribution earnings in the fourthquarter 2014 to improve from the fourth quarter of 2013. In the fourth quarter, we anticipate continued sequential improvement in Chemical Distribution sales of Olin-produced hydrochloric acid and potassium hydroxide.

While the financial performance in Chemical Distribution has not met our expectations, the business has continued to be a positive cash generator for Olin. Since the acquisition, the after-tax cash flow has been approximately $45 million.

As a result of the growth in co-product sales and the continued focus on improving the returns in caustic soda, we expect the EBITDA generated by Chemical Distribution to double over the next two years. In addition to the growth in Chemical Distribution segment EBITDA, we expect the Chlor Alkali business to realize $10 million to $15 million of annual benefit beyond the Chemical Distribution EBITDA from producing the co-products, as well as from logistics and infrastructure cost savings.

Finally, Winchester: Third quarter 2014 Winchester sales and segment earnings both reached the second highest level of quarterly results in the history of the business. Commercial demand continued at surge levels for pistol and rifle ammunition, while shotshell and rifle ammunition demand declined from last year.

Third quarter 2014 sales were $209.6 million, which is 2% lower than the record third quarter 2013 sales, and segment income was $38.5 million, a 5% decline from the record third quarter of 2013 level. The third quarter 2014 year-over-year decline in Winchester segment earnings reflects the combination of lower volumes, which were partially offset by improved pricing and lower manufacturing and other costs. Third quarter 2014 Winchester segment EBITDA was $42.3 million.

As we move into the fourth quarter, consumer demand for pistol and rifle ammunition remains robust, while demand for shotshell and rifle ammunition has declined compared to surge levels. The commercial backlog at September 30, 2014 was approximately $195 million, which, while below the $400 million level we experienced throughout most of 2013, is substantially higher than the pre-surge levels experienced in 2012. As a point of comparison, the pre-surge September 30, 2012 commercial backlog was approximately $90 million.

During the third quarter of 2014, the purchased cost of copper declined compared to the third quarter of 2013, while the purchased cost of lead and zinc increased compared to the third quarter of 2013. We currently expect the full-year 2014 purchased price for copper to be lower than the 2013 price, and the full-year 2014 purchased price for lead to be higher than the 2013 price. In total, commodity metal costs in 2014 are forecast to be higher than they were in 2013.

The centerfire relocation project continues to move forward and to generate cost reductions. During the third quarter of 2014, approximately 60% of rifle ammunition and all pistol ammunition were produced in Oxford, Mississippi.

During the first nine months of 2014, the cost savings realized exceeded $17 million, and we now believe the full year 2014 cost savings will be in the $25 million range. We expect that by the end of 2014, between 750 and 800 of the 1,000 total jobs 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 fourth quarter 2014 segment earnings are currently forecasted to decline compared to the earnings in the fourth quarter of last year, but are expected to be similar to fourth quarter 2012 levels. This decline from the fourth quarter of 2013 reflects strong commercial demand, but at lower than surge levels experienced in the fourth quarter of 2013.

During the fourth quarter, Winchester still expects to sell all the centerfire pistol and rimfire ammunition that it can manufacture. We continue to see 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 who have become regular target shooters will 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 the Winchester business can, under the new normal demand conditions, generate annual EBITDA in the $125 million range.

Now I would 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 would like to discuss the balance sheet and the third quarter 2014 cash flow. Cash and cash equivalents at September 30, 2014, including the restricted cash associated with the Go Zone financing that were classified as long-term assets on the balance sheet, totaled $265.6 million.

During the first three quarters of 2014, working capital employed increased by approximately $80 million. Olin typically experiences seasonal working capital growth during the first three quarters of the year of between $50 million and $100 million. During the first three quarters of 2013, the working capital increase was approximately $17 million.

The increase in seasonal working capital growth in 2014 compared to 2013 occurred because Winchester began to replenish inventories in 2014 that were liquidated in 2013. We expect for the full year of 2014 that working capital will increase approximately $20 million to $30 million. Capital spending in the fourth quarter of 2014 was $17.2 million, compared to $15.8 million in the third quarter of 2013.

Depreciation and amortization expense during the third quarter of 2014 was $34.9 million. We have further reduced our expectations for the full-year 2014 capital spending, and are now forecasting that the full-year capital spending will be approximately $75 million. We forecasted the full-year 2014 depreciation and amortization expense will be approximately $140 million.

As Joe mentioned, during the third quarter of 2014, we redeemed our $150million Senior Notes, which would have matured on August 15, 2019. During the second quarter, we entered into a $150 million delayed draw term loan facility that was used to refinance these Notes. As a result of the redemption, we recognized pretax expense of $9.5 million for the call premium and the write-off of unamortized deferred debt issuance costs during the third quarter of 2014. We anticipate interest savings of approximately $10 million during the first year after redeeming these Notes.

Now, let's turn to the income statement, selling and administration expense increased $6.3 million in the third quarter of 2014 compared to the third quarter of 2013. This year-over-year increase was primarily due to an $11.9 million net recovery of legacy legal costs in 2013. This was partially offset by lower incentive compensation expense of $3.4 million, which includes mark-to-market adjustments on stock-based compensation, lower salary and benefit costs of $1.7 million, and lower legal and legal-related settlement costs of $1.1 million.

Third quarter 2014 charges to income for environmental investigatory and remedial activities were $1.6 million, compared to $700,000 in the third quarter of 2013, which included a $1.3 million of pretax recoveries of costs incurred and expensed in prior periods. Without these recoveries, charges to income for environmental investigatory and remedial activities would have been $1.6 million in the third quarter of 2014, compared to $2 million in the third quarter of 2013. These charges relate primarily to expected future investigatory and remedial activities associated with past manufacturing operations and former waste disposal sites.

Fourth quarter 2014 expenses for environmental, investigatory and remedial activities, are expected to be in the $3 million to $4 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 $6.6 million in the third quarter of 2014 compared to $5.2 million in the third quarter of 2013. We expect defined benefit pension plan income in 2014 will be approximately $25 million.

We are not required to make any cash contributions to our domestic defined benefit pension plan in 2014. In addition, under the pension 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.

In the third quarter of 2014, Olin recorded a pretax restructuring charge of $1.2 million associated with the exiting use of mercury cell technology in our chlor alkali manufacturing process, and the ongoing relocation of the Winchester centerfire ammunition operations from East Alton, Illinois to Oxford, Mississippi.

We anticipate fourth quarter 2014 restructuring charges of approximately $1 million. The effective tax rate from continuing operations in the third quarter of 2014 was 35.2%. We continue to believe that the full-year 2014 effective tax rate will be in the 35% to 37% range. We also forecast that the 2014 cash tax rate will be in the 25% to 30% range.

During the third quarter of 2014, we repurchased approximately 550,000 shares of Olin stock at a cost of approximately $15 million under the April 2014 eight million share authorization. A total of 1.7 million shares have been repurchased during 2014 at a cost of approximately $45 million.

There are approximately 6.9 million shares remaining under the current authorization. As Joe said earlier, we intend to continue to repurchase shares on a consistent, steady, and opportunistic basis.

Yesterday, Olin's Board of Directors declared a dividend of $0.20 on each share of Olin common stock. Dividends payable on December 10, 2014 to shareholders of record at the close of business on November 10th, 2014. This is the 352nd 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 statements, and results could materially differ from those projected. Some of the factors that could cause actual results to differ are described, without limitation, in the risk factor section of our most recent Form 10-K and in our third quarter earnings release.

A copy of today's transcript will be available on our website in the investor section under Calendar of Events. The earnings press release and other financial data and information are available under the press release section.

Operator, we are now ready to take questions.

QUESTION AND ANSWER

Operator

(Operator Instructions)

Our first question today comes from Frank Mitsch from Wells Fargo Securities. Please go ahead with your question.

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

Good morning, gentlemen, and sorry about the Cardinals.

Joseph Rupp - ***Olin - Chairman & CEO***

Thank you, Frank.

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

Joe, in looking at the guidance for Winchester back to Q4 '12 levels, I assume you're looking at something closer to $17 million. Back then, I think there was a gain there of a few million dollars, but I think that's the number that you guys would be guided to. Obviously, a material decline sequentially. Obviously, September is a great month for you guys and Q3 is always strong.

But given the backlog, that seems like it's a rather stark drop. Are you guys being conservative there? What would be some of the key factors that would lead to that drop?

Joseph Rupp - ***Olin - Chairman & CEO***

Frank, I think what happens, as you know, historically, the fourth quarter used to be a drop that was somewhere between zero and a couple million dollars of EBIT that we would make in that quarter. So from our perspective, we think that this has been a gradual decline, and we're not concerned about that drop at all. We think it's really seasonal related. And I think that it has benefits in it of Oxford and benefits of the new shooters here in the marketplace.

John Fischer - ***Olin - President & COO***

Frank, this is John. I think to give you one more data point, if you looked at the fourth quarter of 2010, which was the first fourth quarter after the end of the surge, our earnings in Winchester were $3.5 million. So, if you look at where we are today, forecasting the fourth quarter after the end of the surge, taking into account the growth in shooters and the benefits of Oxford, it's dramatically improved.

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

Okay. That's, that's a fair point. And just in looking at Chlor Alkali, what is the current thinking with respect to Olin's interest in participating in industry consolidation?

Joseph Rupp - ***Olin - Chairman & CEO***

Publicly, we've stated, Frank, that we believe in consolidation, and I think that's probably the best thing we should say at this point in time. We think it's good for the industry.

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

And Olin would be looking to be a consolidator, is that correct?

Joseph Rupp - ***Olin - Chairman & CEO***

We've always said we would like to participate in consolidation.

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

Okay. Fair enough. And then lastly, Todd, you mentioned that the Company wants to be a -- wants to continue its steady pace of share repurchase. You've been at $15 million a quarter for the first three quarters. Is there anything that -- what would be the factors that might lead Olin to change that higher or lower in terms of that $15 million per quarter pace?

Todd Slater - ***Olin - VP & CFO***

Frank, based on what we would see today in our outlook, in the near term, we would expect a similar pace to continue.

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

All right. Thank you.

Joseph Rupp - ***Olin - Chairman & CEO***

Thank you.

Operator

And our next question comes from Edward Yang from Oppenheimer. Please go ahead with your question.

Edward Yang - ***Oppenheimer & Co. - Analyst***

Hi, good morning. Question on Winchester and the backlog coming down from $400 million to $195 million. You mentioned that it was $90 million pre-surge. Do you expect that backlog to continue to drift down to those levels, as conditions normalize from the elevated demand that you saw previously? And maybe just a more real time update on that commercial backlog now versus the end of the third quarter, that $195 million level?

John Fischer *- Olin - President & COO*

Well, as you know, Edward, the largest quarter for sales for Winchester is always in the third quarter. So the backlog, if we looked at it today, would be lower than the $190 million and that's the normal progress.

I think what we haven't -- the backlog will continue to decline, because we still see what we would consider to be closer to surge levels of demand for pistol and rimfire ammunition. And obviously, at some point in the future here, the shelves will get filled up and that will back off also.

Edward Yang *- Oppenheimer & Co. - Analyst*

Okay, and I've noticed that just in my local Wal-Marts anyway, things was very threadbare and customers were on allocation previously, and it looks like those allocations have been taken off. And then a little bit more inventory in the shelves. Now long term, you'd expect Winchester to be $125 million EBITDA type of business.

John Fischer *- Olin - President & COO*

We do.

Edward Yang *- Oppenheimer & Co. - Analyst*

But considering that you have seen -- you were running above that for a period of time, for the outlook for next year, do you think that we overshoot, below that level in the short-term, just to even things out?

John Fischer *- Olin - President & COO*

I think from a demand perspective, you may have a decline that overshoots a little. But remember what's continuing to happen here that's really bolstering the Winchester results, which is the cost savings from Oxford. We talked about realizing $25 million this year, getting to $35 million to $40 million run rate by the end of next year, so there's a meaningful positive contribution going to come from that in 2015 that we think is going to help mitigate any declines in demand.

Edward Yang *- Oppenheimer & Co. - Analyst*

And longer term, you've also seen more shooters come in, first time shooters, women shooters, et cetera, and that helps the long-term demand there?

John Fischer *- Olin - President & COO*

Absolutely.

Joseph Rupp *- Olin - Chairman & CEO*

Exactly.

Edward Yang *- Oppenheimer & Co. - Analyst*

Quickly on the caustic side, I guess there's been some talk that because of imports, you actually saw higher caustic soda prices, $5 or $10 per ton on the East Coast and maybe that will help lift caustic prices a little bit in the fourth quarter, at least industry ECU netbacks, but doesn't sound like that's your view at the present?

John McIntosh *- Olin - SVP, Chemicals*

This is John. I think there's a couple things that I would speak to on the potential for caustic increase. There was an increase announced in September that would have translated into an improvement in indexed pricing in October, had it been accepted in the marketplace. That didn't happen. And -- but I haven't given up that there's some potential movement on caustic pricing. And the reason I say that is I think there's a series of events that could well happen in the fourth quarter that could well lead to some improvement in caustic pricing.

We believe that the industry operating rate will go down from the current 86% level that it ran in the third quarter. We believe that will be driven by PVC operating rates that will be off, and that's because of higher ethylene pricing and reduced ethylene supply for the PVC manufacturers.

We believe that EDC exports could return to a more normalized level. They are 30% higher year to date, 2014 versus 2013. All of those things could potentially tighten the supply on caustic and could help the dynamics for a caustic increase.

Also, in Europe, there are two producers on force majeure, so we believe that the European community will do well to provide caustic for their own consumption. And their ability to export in coming months is going to be reduced, quite possibly to where they will become a net importer until all of their issues are resolved.

So I believe there's a potential for caustic pricing movement to occur in a positive way yet this quarter.

Edward Yang *- Oppenheimer & Co. - Analyst*

Okay. Thank you, John. And just final question, on hydro HCl demand, oil prices have come down considerably. Who knows if it's going to move up or down from here. But if it does stay at current levels, $80 or so WPI, is that going to impact HCl demand next year?

John McIntosh *- Olin - SVP, Chemicals*

I think what will have a bigger impact on HCl demand, there's two parts to the HCl issue. Right now, we're impacted favorably, because the byproduct asset generators, producers are significantly off, and so that's really tightened up the supply.

And on the demand side, there are new burners that were scheduled to come online in the end of this year that have now been pushed back into the middle of 2015. So those two things are going to help the supply side.

We, so far, haven't seen, or heard from the oil field, the oil patches, that there's significant belief that that's going to be different going forward. I think that's bracketed around where does oil settle out. If it gets significantly lower, I've heard numbers that $50 oil will really shut things down. Well, $50 oil is going to impact a lot of things. But we just haven't seen it yet, even with the decrease in oil supply.

Edward Yang *- Oppenheimer & Co. - Analyst*

All right. Thank you, gentlemen.

Operator

Our next question comes from Christopher Butler from Sidoti & Company. Please go ahead with your question.

Christopher Butler *- Sidoti & Company - Analyst*

Hi. Good morning, guys.

Joseph Rupp - ***Olin - Chairman & CEO***

Good morning.

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

Could you speak to the outages that you discussed in your prepared remarks and how much of that is lingering over into the fourth quarter? I think you had mentioned that Becancour wasn't going to be an issue, but that's probably just seasonality. But anything with your customers lingering?

John McIntosh - ***Olin - SVP, Chemicals***

Well, we do have some customer outages that started at the end of the third quarter that will, that -- carried over into the fourth quarter. Those outages, though, were known before -- when we put together our guidance. And with the exception of any significantly delayed startup or any issues with those plants returning to normal operating rates, those shouldn't be an issue. The problem we ran into in the third quarter is we had some significant unplanned customer outages, which we didn't account for in our forecast, and which were significant, as were said in the remarks earlier, to our profitability in the third quarter.

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

As we look at bleach production, is that something that, or bleach demand, I should say, is that something that gets a boost from Ebola and other fears that have now come to the US?

John McIntosh - ***Olin - SVP, Chemicals***

We -- bleach is a very significant tool, if you are trying to sanitize for potential from Ebola exposure. We have gotten some notification from our larger bleach customers that they expect volumes to move upward in the fourth quarter from what their original forecasts were.

So there is evidence that there is an increase. It's probably not going to be significant enough to be necessarily seen when we look at fourth quarter earnings in totality. But we do see some impact.

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

Shifting gears over to the Distribution business, as we move more into the seasonally weaker months, are you thinking about restructuring that business and finding ways to cut costs? Is that something that we could see for starting for the first quarter, something like that?

John Fischer - ***Olin - President & COO***

We talked about profit improvement initiatives. That encompasses what I think you're talking about there, Chris.

But as I said in my remarks, I think the bigger driver here, and it's consistent with the story we told when we made the acquisition, is our ability to move these co-products at distributor prices versus producer prices and getting the double benefit of producer economics followed by distributor economics is the real key to driving the profitability of that back to the levels we would have expected and that we talked about two years ago when we made the acquisition. And I think we're in a good place to do that.

I think if you looked at where the numbers of what got sold in Q3 versus where we've been over the last four quarters, the improvement's dramatic and we're very encouraged by that.

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

Thanks for your time.

Operator

Our next question comes from Herb Hardt from Monness Crespi. Please go ahead with your question.

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

Actually, two questions. One is, what part of the caustic market has been supplied by imports? You talk about Europe maybe slowing down. And the second question is what had Distribution operating income been when you first purchased the operation?

Joseph Rupp - ***Olin - Chairman & CEO***

Caustic distribution.

John McIntosh - ***Olin - SVP, Chemicals***

Caustic distribution, export or imports have tended to be more focused on the coastal part of the US. Exports from China tend to show up on the West Coast. And exports from Europe historically, when they have occurred, tend to show up on the East Coast. And as we see European capacity rationalize or European operating issues, we expect to see less caustic on the Eastern seaboard.

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

What part of the market, what percent on imports?

Joseph Rupp - ***Olin - Chairman & CEO***

Well, total imports in the United States run, what, in the 500,000 ton range.

John McIntosh - ***Olin - SVP, Chemicals***

Well, net.

Joseph Rupp - ***Olin - Chairman & CEO***

That's imports, and exports are 1.5 million.

John McIntosh - ***Olin - SVP, Chemicals***

Yes, that's right. Exports -- imports, half a million tons, exports, 1.5 million from the US. So the net is we're a net exporter of 1 million tons. And that half a million tons is mostly, is -- more than 50% of that is West Coast volume.

John Fischer - ***Olin - President & COO***

Herb, the EBITDA that we bought for the Company, KA Steel, we believe on the date of acquisition was approximately $25 million per year.

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

Okay. So doubling that would get you kind of close to that.

John Fischer - ***Olin - President & COO***

I think if we double, we'll be well past that.

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

Okay. Thank you.

Joseph Rupp - ***Olin - Chairman & CEO***

Thank you.

Operator

Our next question comes from Edlain Rodriguez from UBS. Please go ahead with your question.

Edlain Rodriguez - ***UBS - Analyst***

Thank you. Good morning, guys. Just a couple questions on Chlor Alkali. What do you think is going on right now, as we look towards year end and the volatility in energy prices? Do you expect to see significant inventory de-stocking taking place?

And also, as all the new capacity that came online earlier this year, like fully online, or are some producers still ramping up production?

Joseph Rupp - ***Olin - Chairman & CEO***

All the new capacity is fully online.

John McIntosh - ***Olin - SVP, Chemicals***

To the extent we know, that's what we believe to be the case.

The volatility -- your question about volatility and will it lead to inventory de-stocking, we believe because net exports from the US are at or slightly better than they have been historically, we don't believe there's a lot of inventory in the US. So we don't believe there's the potential for a lot of end-of-the-year destocking in caustic inventory.

Edlain Rodriguez - ***UBS - Analyst***

Okay. And also, in terms, as you noted, that we are bouncing along the bottom for Chlor Alkali for ECU what needs to happen for that to change? And when do you think that could happen to see a recovery in Chlor Alkali.

John McIntosh - ***Olin - SVP, Chemicals***

I mentioned some of the things earlier that we believe in the short-term could lead to a caustic, to a change in the supply/demand balance for caustic. I think when you really look at what's going to drive a change for the, for pricing for the ECU, it's going to be when we leave the trough that we're currently sitting in now and follow what's a normal, historical cycle for Chlor Alkali. And those -- it's demand-driven.

We have not seen appreciable improvements in demand for chlorine in recent history, and caustic demand is at or below what it was in 2013. We don't see evidence of anybody planning on additional, adding additional new capacity. So to us, this is just a matter of when demand will return, driven by the economics that has been typical for the industry cycles in the past.

Edlain Rodriguez - ***UBS - Analyst***

Okay, and one last one on Winchester. Just to clarify, do you believe this is an inventory de-stocking taking place in the fourth quarter? Or this is just the beginning of that gradual slide-off you've been expecting?

John Fischer - ***Olin - President & COO***

If you look at Winchester historically, the fourth quarter is always its weakest quarter, because the big sales quarter for Winchester is the third quarter, which is people buying in advance of hunting season. There's very little hunting demand, if you will, in the fourth quarter historically.

Joe mentioned earlier, if you looked at the 10 years from 2002 through 2011, in the fourth quarter Winchester averaged segment EBIT of less than $3 million a year. And we had some years where we actually lost money.

I think what you're seeing right now is a normal seasonal pattern for Winchester in Q4, and the fact that it's up where it is, is a reflection of both the benefits from Oxford and the fact that we think the market has grown and there is more demand out there going forward. The kind of forecast we're giving is very -- we talked -- if you would have told us 10 years ago we would make that kind of money in Q4, we would have never believed you. I think what you're looking at is the normal, seasonal pattern of Winchester, just at a higher level than it's been historically.

Edlain Rodriguez - ***UBS - Analyst***

Okay. That makes sense. Thank you.

Joseph Rupp - ***Olin - Chairman & CEO***

Thank you.

Operator

Our next question comes from Jason Freuchtel from SunTrust Robinson Humphrey. Please go ahead with your question.

Jason Freuchtel - ***SunTrust Robinson Humphrey - Analyst***

Good morning.

Joseph Rupp - ***Olin - Chairman & CEO***

Good morning.

Jason Freuchtel - ***SunTrust Robinson Humphrey - Analyst***

Could you provide some additional detail around your profit improvement initiatives in the chemical distribution segment? What will they encompass, and do you have an expectation on how much the initiatives will contribute to segment income?

John Fischer - ***Olin - President & COO***

Well, we said in the remarks that we saw the opportunity to double the segment EBITDA over the next two years, and I would tell you that we see that that kind of improvement to be fairly linear between now and where we expect to be in 2016. The biggest component of that is going to be the growth in the sale of co-products.

Jason Freuchtel - ***SunTrust Robinson Humphrey - Analyst***

Okay, and the profit improvement initiatives would just be segment -- removing costs from the segment, et cetera?

John Fischer - ***Olin - President & COO***

That's correct.

Joseph Rupp - ***Olin - Chairman & CEO***

Correct.

Jason Freuchtel - ***SunTrust Robinson Humphrey - Analyst***

Great. Thank you. And was there anything specific that led to the sequential improvement in caustic sales in the distribution segment?

John McIntosh - ***Olin - SVP, Chemicals***

No, nothing specific. We've stabilized caustic volumes in that segment in the 43,000 to 45,000 tons a month and are on a mission to grow our caustic volume.

Jason Freuchtel - ***SunTrust Robinson Humphrey - Analyst***

Okay. Thank you.

Joseph Rupp - ***Olin - Chairman & CEO***

Thank you.

Operator

Our next question comes from John Roberts from UBS. Please go ahead with your question.

John Roberts - ***UBS - Analyst***

Good morning, guys.

Joseph Rupp - ***Olin - Chairman & CEO***

Good morning.

John Roberts - ***UBS - Analyst***

If the Winchester earnings in the fourth quarter are going to be comparable with 2012 fourth quarter, and the costs are lower because of the relocation, so the revenue is going to be lower than fourth quarter 2012 for Winchester?

John Fischer - ***Olin - President & COO***

I think that's correct.

John Roberts - ***UBS - Analyst***

Why would the revenue be below fourth-quarter 2012?

John Fischer - ***Olin - President & COO***

Fourth quarter 2012 was actually a period of surge demand.

John Roberts - ***UBS - Analyst***

Okay.

John Fischer - ***Olin - President & COO***

It was the quarter after the second presidential election and we saw significant uptick in demand.

John Roberts - ***UBS - Analyst***

Okay. So we wouldn't use fourth quarter 2012 as the last normal period. We would have to go back even further than that?

John Fischer - ***Olin - President & COO***

No. I pointed out to an earlier question that the fourth quarter of 2010 is the last -- is a fourth quarter after the end of the surge. That was the first fourth quarter after the end of the surge, which is what we're forecasting now for the fourth quarter of 2014.

John Roberts - ***UBS - Analyst***

All right. Thanks for the clarification.

John Fischer - ***Olin - President & COO***

Thank you.

Operator

Our next question comes from Dmitry Silversteyn from Longbow Research. Please go ahead with your question.

Dmitry Silversteyn - ***Longbow Research - Analyst***

Good afternoon, or good morning, guys. Sorry, it's still not even noon yet. Question for you on the caustic side of the demand. You provided very good granularity into the chlorine major markets of how they moved for you. Can you talk about where the demand pressure points of caustic are, and where maybe some of the brighter markets in caustic, where demand may be higher?

John McIntosh *- Olin - SVP, Chemicals*

When we look across all the caustic segments that we serve, probably the only segment in the third quarter that was down on a percentage basis, higher, was pulp and paper. And we did see some weakness there.

We do believe and have seen in the past strength in caustic into the urethane segment. We believe caustic into super-absorbants will continue to be a strong point for us. But caustic ends up in so many market segments and is used in so many applications that it's not as easy to pick out the winners or losers, so to speak, in that as it is, in say, looking at chlorine market segments.

Dmitry Silversteyn *- Longbow Research - Analyst*

But that's what I thought, and my understanding has been the caustic was a proxy for the industrial demand or the industrial environment, if you will. And if that's true, industrial production rates in the US have certainly been better than anywhere else in the world in terms of growth versus declines elsewhere, or slowing growth elsewhere. I would have thought they would've been robust enough now to generate a little bit more demand and meet a little bit more pricing stability. I'm just wondering if there is one or two markets or maybe a group of markets that are keeping that from happening.

John McIntosh *- Olin - SVP, Chemicals*

As you look at ours, we don't really see much growth or much reduction in caustic demand into segments across our whole portfolio. We just haven't seen that. It's been flat. We haven't seen anybody's -- any market segment break out yet.

Dmitry Silversteyn *- Longbow Research - Analyst*

Okay. All right. Your 1% decline in bleach volumes year over year in -- that you blame on the weather comps, does that mean that we're done with the rapid penetration phase of bleach growth? And going forward, bleach is going to grow more, or less, in line with industry demand for you versus the very strong penetrating rates you've had over that last two, three years since you've launched the initiative?

John McIntosh *- Olin - SVP, Chemicals*

No, sir. We -- bleach demand as a market, bleach growth is 2% to 3% a year. And our expectation and plan is to grow at a rate significantly higher than that.

John Fischer *- Olin - President & COO*

I would also point out, Dmitry, that the third quarter of 2014 bleach volume was the second-best quarterly volume in our history, and only 1% below the prior record.

Dmitry Silversteyn *- Longbow Research - Analyst*

Okay, that's helpful as a bracketing data point.

And then final question, there's been some capacity addition to the market in chlor alkali. You guys have taken capacity out a little bit by shutting down one mercury plant and converting the other one with a little bit of loss of capacity with -- after the turnaround.

We've been in this -- a three-year hiatus, if you will, in terms of nothing really improving in terms of end-market demand. The chlorine demand growth is slower. Is it time for you to revisit perhaps, further rationalization of your chlor alkali capacity, to at least improve your utilization rates, if not the industry's? So if you don't get the benefit of pricing, at least you get the benefit of fixed-cost absorption?

Joseph Rupp - ***Olin - Chairman & CEO***

I would think that the whole industry would be looking at that. If we come to the conclusion that there's not going to be enough growth, then I think high-cost capacity will be looked at by everybody.

Dmitry Silversteyn - ***Longbow Research - Analyst***

Okay. Including yourselves?

Joseph Rupp - ***Olin - Chairman & CEO***

Including ourselves.

Dmitry Silversteyn - ***Longbow Research - Analyst***

Okay. Thank you.

Joseph Rupp - ***Olin - Chairman & CEO***

Thank you.

Operator

Our next question comes from Arun Viswanathan from RBC Capital Markets. Please go ahead with your question.

Arun Viswanathan - ***RBC Capital Markets - Analyst***

Hi, guys. Thanks. I wanted to follow up on Dmitry's point. If I go back several years and look at ECU pricing, it looks like the only time we really got a decent cycle was back in '08 after the hurricanes and there was a lot of supply offline. Do you expect that we could ever get back into that 600 or 700 range on ECUs, just from demand, and what makes you believe that?

John McIntosh - ***Olin - SVP, Chemicals***

Go ahead.

John Fischer - ***Olin - President & COO***

I clearly believe that we can do that. I think we've been sitting here with very low chlorine prices based on low operating rates for a period of several years. And what we haven't seen, really since back in 2005 and early 2006, is the chlorine molecule carrying its share of the value. And what we need is a pickup in demand, as John talked about earlier, across the economy, including the chlorine side. And if you see demand pick up there, we're going to get pricing there, and that usually has a pull-through effect on caustic, and then we would be back in a normal cycle. And that, in a normal cycle, we would see a meaningful -- we believe, price improvement in chlorine followed, by stronger caustic pricing.

Arun Viswanathan - ***RBC Capital Markets - Analyst***

Right, but I'm struggling with that, because even in '06 and '07, the operating rates in chlor alkali were in the 90s. And that ultimately put pressure on caustic, because chlorine was up there. But it looked like caustic suffered from oversupply. So, in your scenario, when we have demand improvement in chlorine, why should caustic benefit?

John Fischer *- Olin - President & COO*

Well, the big benefit in the front part of that is when chlorine demand picks up, your operating rates pick up, your fixed cost absorption improves, and your chlorine price improves. And if that produces caustic - a little bit of weakness in caustic, you're still way ahead of the game.

Arun Viswanathan *- RBC Capital Markets - Analyst*

Right.

John Fischer *- Olin - President & COO*

That's really where you need to be. The key point there is, the difference between running an 85% and 95% operating rate on a consistent basis is enormous from a profitability standpoint.

John McIntosh *- Olin - SVP, Chemicals*

Caustic will always be -- there will always be a caustic flywheel, in terms of what is produced in the US. And historically, that's been handled by exporting it to parts of the world where caustic demand exists and chlor alkali capacity doesn't. So I think the other thing that has to happen, and has historically happened, and we believe it will again, is some of the emerging economies that have industries with high caustic demand have to improve as well. And when that happens, then you're somewhat insulated from quote, unquote, excess caustic in North America that impacts prices too much.

Arun Viswanathan *- RBC Capital Markets - Analyst*

Okay, great. And I the last question I had was just on the non-ECU side, more on the co-products. Do you see an increased or continued growth there? And how much more capacity can you convert into value-added products? And maybe on a percentage basis, where do you see some of these products growing over the next couple years or are you at the limit?

John McIntosh *- Olin - SVP, Chemicals*

Well, no. We're not at the limit. We constantly look at opportunities to either de-bottleneck or make more significant capacity investments and co-products is an area that we -- gets that kind of attention constantly. And as we look forward, we have plans to increase capacity in our co-products businesses, because we're uniquely positioned geographically and competitively to be able to increase capacity and generate meaningful economics from doing that.

Arun Viswanathan *- RBC Capital Markets - Analyst*

Okay, thanks.

Joseph Rupp *- Olin - Chairman & CEO*

Thank you.

Operator

And our next question comes from Richard O'Reilly from Revere Associates. Please go ahead with your question.

Richard O'Reilly - ***Revere Associates - Analyst***

Thank you. Good morning, guys.

Joseph Rupp - ***Olin - Chairman & CEO***

Good morning.

Richard O'Reilly - ***Revere Associates - Analyst***

Two quick questions. The first is, did you give your total chlorine molecule volume change year over year? That is chlorine and HCl and bleach all together?

Joseph Rupp - ***Olin - Chairman & CEO***

We don't. We do not.

Richard O'Reilly - ***Revere Associates - Analyst***

Oh, okay. I thought in the past you might have given that number.

Joseph Rupp - ***Olin - Chairman & CEO***

No.

Richard O'Reilly - ***Revere Associates - Analyst***

Okay. Second question then is, in the distribution business, talking about the percentage of your co-products going through distribution, if we look at that intersegment sales elimination line, is that the best indicator for us to look at? Is that all pure sales going from chlorine to distribution?

John Fischer - ***Olin - President & COO***

That includes caustic soda.

Richard O'Reilly - ***Revere Associates - Analyst***

That includes caustic soda. That's all coming from the Chlor Alkali to the Distribution business.

John Fischer - ***Olin - President & COO***

That's a good way. If you're looking at the total, that's the understanding of mine.

Richard O'Reilly - ***Revere Associates - Analyst***

Okay. So that was about 28% of Distribution sales. So that's a good indicator of what percentage you're talking about.

John Fischer *- Olin - President & COO*

Yes.

Richard O'Reilly *- Revere Associates - Analyst*

Okay, fine. And it might have been a little higher in the second quarter, because I think that line went down quarter to quarter, but okay, fine. Okay. Good. Thank you, then.

Joseph Rupp Thank you, Richard.

Operator

And, ladies and gentlemen, at this time showing no additional questions, I would like to turn the conference call back over to management for any closing remarks.

Joseph Rupp *- Olin - Chairman & CEO*

Yes. We would like to thank you for joining us today, and look forward to joining, or speaking with you in January when we announce results of our full-year 2014. Thank you.

Operator

Ladies and gentlemen, that does conclude today's conference call. We do thank you for attending. You may now disconnect your telephone lines.