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# Olin Corp. (OLN)

Q3 2018 Earnings Call

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## MANAGEMENT DISCUSSION SECTION

**Operator:** Good morning and welcome to the Olin Corporation Third Quarter 2018 Earnings Conference Call. All participants will be in listen-only mode. [Operator Instructions] After today's presentation, there will be an opportunity to ask questions. [Operator Instructions] Please note this event is being recorded.

I would now like to turn the conference over to Larry Kromidas, Olin's Director of Investor Relations. Please go ahead.

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### Larry P. Kromidas

*Director-Investor Relations & Assistant Treasurer, Olin Corp.*

Thank you, operator. Good morning, everyone, and thank you for joining us on our third quarter earnings call.

Before we begin this morning, I want to remind everyone that this presentation along with the associated slides and the question-and-answer session following our prepared remarks will include statements regarding estimates of future performance. Please note that these are forward-looking statements and that actual results could differ materially from those projected. Some factors that could cause actual results to differ from our projections are described without limitations in the Risk Factors section of our most recent Form 10-K and in yesterday's third quarter earnings press release.

A copy of today's transcript and slides will be available on our website in the Investors section under calendar of events. The earnings press release and other financial data and information are available under Press Releases. With me this morning are John Fischer, Olin's Chairman, President and Chief Executive Officer; Pat Dawson, Executive Vice President and President, Epoxy and International; John McIntosh, Executive Vice President, Synergies and Systems; Jim Varilek, Executive Vice President and President, Chlor Alkali Products and Vinyls and Services; and Todd Slater, Vice President and Chief Financial Officer.

Now, I'd like to turn the call over to John Fischer. John?

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### John E. Fischer

*Chairman, President and Chief Executive Officer, Olin Corp.*

Thank you, Larry. Good morning and thank you for joining us today. During this morning's call, I will begin by highlighting the key takeaways from the third quarter, followed by a more detailed discussion of each of our business segments and the current market environment for each segment.

If we now turn to slide 3, I'll talk about some highlights. Building upon record performance in the second quarter, Olin's third quarter 2018 adjusted EBITDA was \$398 million. This is the highest quarterly adjusted EBITDA level since the acquisition of the Dow Chlorine Products assets in late-2015. As we progress through the balance of the year, there are several short-term market headwinds that I will discuss in more detail in a moment, in addition to the normal seasonal demand slowdown. These will likely dampen our earnings performance in the fourth quarter. As a result, we now expect full year 2018 adjusted EBITDA to be in the \$1.26 billion range with upside opportunities and downside risks of approximately 2%.

Now, turning to the business segments beginning with Chlor Alkali Products and Vinyls which is summarized on slide 4. For the third quarter of 2018, Chlor Alkali Products and Vinyls reported adjusted EBITDA of \$333 million,

an improvement of more than 40% over the third quarter of 2017. The increased earnings were primarily due to higher pricing for caustic soda, chlorine, ethylene dichloride, and other chlorine-derivatives. For example, ethylene dichloride prices in Olin system have more than doubled so far this year.

During the third quarter, we experienced higher ethylene costs as a result of higher ethane prices, in addition to higher freight costs. Ethane, which averaged approximately \$0.27 per gallon during the first half of the year, averaged \$0.43 per gallon during the third quarter, a 60% increase. We are forecasting that ethane prices will average in the mid-\$0.40 per gallon range in the fourth quarter. We expect ethane prices to remain higher than the first half of 2018 through 2019. And as a reminder, a \$0.01 change in the price of a gallon of ethane impacts our EBITDA by approximately \$3.2 million on a full year basis. In addition, freight costs increased approximately 15% in the third quarter of 2018 compared to the third quarter of last year, reflecting both higher truck and railroad freight rates.

Now, turning to caustic soda pricing on slide 5. Over the past year or so, caustic soda pricing has been influenced by a series of one-time events, including Hurricane Harvey, the European mercury shutdowns, and most recently the Alunorte alumina plant curtailment. The first two were supply disruptions that created favorable price momentum. The Alunorte curtailment represents the demand disruption. This demand disruption combined with seasonally strong PVC operating rates has been putting pressure on caustic soda pricing in the export market, which will impact caustic soda export and domestic contract prices into the first quarter of next year. On a positive note, we have recently seen caustic soda prices in both China and Europe increase from their recent lows.

If Olin's caustic soda price remains at the current fourth quarter 2018 levels, 2019 adjusted EBITDA would have a headwind of approximately \$100 million compared to 2018 levels. As we look forward into 2019, there are opportunities that can provide offsets to the earlier challenge that caustic soda pricing presents. If pricing in our chlorine-derivative portfolio, including merchant chlorine, bleach, hydrochloric acid, ethylene dichloride and chlorinated organics, remains at current fourth quarter 2018 levels, 2019 adjusted EBITDA would improve by \$60 million to \$75 million compared to 2018 levels.

We expect chlorine, ethylene dichlorine (sic) [ethylene dichloride] (00:06:14), and chlorine-derivatives pricing to improve further in 2019. In addition, maintenance turnaround costs, especially in the Epoxy business, are forecast to be approximately \$30 million to \$40 million lower in 2019 compared to 2018. Finally, while we expect our ethylene costs to be higher in 2019 compared to 2018 due to higher ethane pricing, we anticipate higher ethylene dichloride pricing in 2019 to more than compensate for these higher ethylene costs.

Let's move now to the performance of our Epoxy segment, which is summarized on slide 6. Third quarter 2018 Epoxy adjusted EBITDA of \$56 million was approximately \$33 million higher than the third quarter 2017 results. The significant earnings improvement was driven by higher product pricing and volumes, partially offset by higher raw material costs, primarily benzene and propylene. Sequentially, the \$6 million adjusted EBITDA improvement from the second quarter was driven by lower turnaround costs and higher volumes, partially offset by higher raw material costs, primarily propylene.

The third quarter is typically the strongest seasonal quarter for the epoxy resin demand. Therefore, we are forecasting fourth quarter epoxy resin sales and adjusted EBITDA to be sequentially lower than third quarter results. We are encouraged by the results in the Epoxy business this year and the overall supply and demand dynamics present in the market. With the successful completion of our maintenance turnarounds earlier this year in North America and late last year in Europe, we expect to improve volumes and improve results into 2019.

On slide 7, we have a chart that displays liquid epoxy resin pricing in the United States, Europe and Asia. Resin pricing has improved in each region since the beginning of 2016. A portion of these increases have been in necessary to recover the higher raw material costs experienced, primarily benzene and propylene. Supply and demand fundamentals have resulted in tighter market conditions for liquid epoxy resin adding to the price momentum.

Epoxy resin pricing dynamics have been different by region. In Asia, resin prices have increased dramatically in the latter part of 2017 into early-2018 and moderated during the first and second quarters of 2018. In North America and Europe, prices increased late in the fourth quarter of 2017 and through the beginning of the second quarter of 2018, and then declined slightly. During the third quarter of 2018, resin prices were stable globally. Increased global pricing for bisphenol A and epichlorohydrin have continued to support the current epoxy resin pricing levels.

Moving on to our Winchester business on slide 8. Third quarter 2018 Winchester adjusted EBITDA was \$15.2 million, a decrease of \$6.8 million from the third quarter of 2017. The year-over-year decrease is attributable to higher commodity and other material costs of \$4 million, lower commercial volumes and pricing of \$5 million, partially offset by lower operating costs of \$3 million. During the first nine months of 2018, commodity and other material costs have increased approximately \$18 million as compared to the first nine months of 2017.

We now expect overall 2018 commercial demand to decline by approximately 20%, which follows a 17% decline in commercial demand in 2017. While we have confidence that ammunition usage at the consumer level has remained strong, we believe consumers are continuing to reduce their personal inventories. The fourth quarter has historically been the weakest ammunition demand quarter, and as a result, we expect that there will be a normal sequential decline in fourth quarter results as compared to the third quarter.

Turning to slide 9, I will discuss our view of the market. Olin continues to be bullish about the long-term prospects for its chemical businesses. This bullishness reflects the continuation of the favorable energy position that produces in North America realize, forecast for continued growth in key product areas that will drive improvement in the supply and demand dynamics for caustic soda, chlorine-derivatives, epoxy resin and epoxy resin precursors, and the cost and related investment requirements of new capacity for both chlor alkali and the required vinyls or other derivatives required to utilize the chlorine, as well as the cost of new capacity for the upstream products of allyl chloride, phenol, bisphenol A and epichlorohydrin required to produce additional liquid epoxy resin.

More specifically on these points, over the next five years, we expect global caustic soda demand to grow by approximately 3% annually, led by growth in the alumina industry of 5%. We also expect global chlorine demand to grow at approximately 2.5% with the largest growth area being in the PVC industry. This growth will translate into increased global ECU demand of approximately 10 million tons. At this point in time, there's only been approximately 2 million tons of capacity additions announced.

We do not believe that the current economics justify the additional investment required to fill this gap. We also do not believe this additional demand can be filled by higher operating rates, which would have to increase and be sustained at approximately 10 percentage points higher than the long-term global average. These factors lead us to continue to believe the chlor alkali and the caustic soda business is in the midst of a structural change that will result in improved profitability over time. The improved profitability would be necessary to justify the additional investments needed to meet chlorine and caustic soda demand growth.

Now, turning to slide 10. In the past, we've referred to a mid-cycle adjusted EBITDA forecast of \$1.5 billion. This forecast was developed based on our view of the business when the Dow Chlorine Products transaction closed in October of 2015. Today, we believe \$1.5 billion of adjusted EBITDA is a point on a long-term improvement curve that will be achieved in the next 24 months. As a point of reference, the impact of higher ethane prices, lower export caustic soda pricing, and weaker commercial ammunition sales reduced Olin's third quarter adjusted EBITDA by approximately \$25 million. The third quarter performance plus those adjustments demonstrate our ability to achieve the \$1.5 billion of adjusted EBITDA.

Finally, it is our intention to host an Investors' Day in New York in early-February to provide a detailed analysis of our industry views.

Now, I'd like to turn the call over to Todd Slater, Olin's CFO.

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## Todd A. Slater

*Chief Financial Officer & Vice President, Olin Corp.*

Thanks, John. Let's turn to our 2018 cash flow forecast which is on slide 11. We expect to generate approximately \$550 million of free cash flow this year. Our top priority for free cash flow remains debt reduction. And with the combination of debt reduction and EBITDA growth over the last 12 months, as of September 30, our net debt-to-adjusted EBITDA leverage ratio has been reduced to 2.6 times. We expect the leverage ratio to be in the 2.5 times range by year-end and to be further improved in 2019 to the 2 times range.

Starting with the midpoint of our full year adjusted EBITDA forecast of \$1.26 billion on the far left of the waterfall chart, we deducted \$50 million in estimated cash tax payments, which primarily reflect income tax payments made to foreign jurisdictions in 2018. We're forecasting that our cash tax rate will be in the 10% to 15% range for the year. Since 2015, Olin has not been a U.S. federal tax payer, because of the utilization of net operating loss carryforwards, primarily arising out of costs associated with the acquisition in 2015. Because of this, we do not expect to be a U.S. federal tax payer in 2018.

While we are continuing to analyze the full impact of the Tax Cuts and Jobs Act of 2017, which was signed into law in December 22, 2017, the cash tax benefit to Olin of the changes in the tax law is minimal in 2018 due to the tax credit carryforwards. We do expect the new tax law to provide cash tax benefits to Olin beginning in 2019. The new tax law is currently estimated to reduce our cash tax rate for 2019 and beyond in the 10% to 20% range.

Column three reflects the midpoint of our current forecast for capital spending of \$400 million, which includes annual maintenance capital spending of between \$225 million and \$275 million and the investment associated with our multiyear information technology project of approximately \$100 million. As we've previously discussed in 2017, we began a multiyear project to implement a new enterprise resource planning, manufacturing, and engineering systems across the heritage Olin and the acquired Dow Chlorine Products businesses. The project includes the required information technology infrastructure.

Now, turning to the fourth column, we're expecting working capital to be a use of cash in 2018 of approximately \$50 million. The estimated increase in working capital is primarily due to higher selling prices and inventory costs associated with higher propylene costs in the Epoxy business. We currently expect revenue in 2018 to increase approximately 12% compared to 2017 levels.

In the next column, one-time items represent a full year benefit of approximately \$30 million. The one-time items include: an \$88.5 million insurance recovery, net of legal costs incurred, for various environmental remediation sites; integration and cash restructuring costs; and the first quarter's \$8 million business interruption insurance

recovery; and the approximately \$15 million for the expense portion of the multiyear IT project that I just spoke about.

During the third quarter, we settled certain disputes with respect to insurance coverage for costs at various environmental remediation sites totaling \$120 million, which was reduced by an estimated liabilities of \$10 million associated with claims by subsequent owners of certain of these settled environmental remediation sites. Furthermore, we recognized a pre-tax – therefore, we recognized a pre-tax gain of \$110 million. Olin incurred legal fees of \$21.5 million in 2018 to effect this insurance recovery. As a result, adjusted EBITDA excludes the \$88.5 million of environmental insurance recoveries. The cash associated with this recovery was received in the fourth quarter.

The next column represents an estimate of interest expense. We currently have approximately 15% of our debt at variable interest rates after the debt refinancing we completed in January, and we're forecasting 2018 interest rates to be higher than those we experienced in 2017.

Now, turning to capital allocation. During the first nine months of the year, we prepaid approximately \$250 million in debt. In addition, we've returned \$117 million to shareholders in the form of dividends and share repurchases. Given our confidence in the outlook for the chemicals businesses and our positive outlook for cash generation and the environmental insurance recovery received, we expect to be more balanced in our capital allocation in the fourth quarter.

Finally, on Thursday, October 24, Olin's board of directors declared a dividend of \$0.20 on each share of Olin common stock. The dividend is payable on December 10, 2018 to shareholders of record at the close of business on November 9, 2018. This is the 368th consecutive quarterly dividend to be paid by the company.

Operator, we are now ready to take questions.

## QUESTION AND ANSWER SECTION

**Operator:** We will now begin the question-and-answer session. [Operator Instructions] And our first question comes from Don Carson of Susquehanna. Please go ahead.

Emily Wagner

*Analyst, Susquehanna Financial Group LLLP*

Q

Good morning. This is Emily Wagner on for Don. Just going over the guidance update, we calculate that the \$45 million EBITDA decline from the lower caustic prices translates to roughly about \$30 per short ton for lower prices in the second half. So, knowing that the index declined about \$25 in 3Q, could you give us some more color on the change in export pricing and what do you expect to happen to the index in the fourth quarter?

James A. Varilek

*Executive Vice President & President, Chlor Alkali Vinyls and Services, Olin Corp.*

A

Emily, this is Jim. The index – the domestic index, as you mentioned, has moved down in the third quarter and currently is forecast for another \$15 a ton in the fourth quarter. As far as export pricing goes, it's a dynamic marketplace right now and we are seeing some of the reductions that are taking place, bottoming out and we're expecting to see some leveling out right now. And we would expect, with a few of the demand changes taking place, early part of next year, we would expect that to start to reverse.

Emily Wagner

*Analyst, Susquehanna Financial Group LLLP*

Q

Thank you. And then for a follow-up, if you take those three items reducing guidance, it seems to imply \$12 million, \$15 million for the full year. What is the offset from that? It seems like it's about \$45 million that's better offsetting those things. Is that just better Epoxy or can you break that down a little bit?

John E. Fischer

*Chairman, President and Chief Executive Officer, Olin Corp.*

A

We talked about the year-over-year improvement and the - [ph] that we've been – or the year (00:22:07), improvement we've seen on the chlorine side, the chlorine-derivatives, et cetera, and that is the biggest driver of that.

Emily Wagner

*Analyst, Susquehanna Financial Group LLLP*

Q

Okay. Thank you.

**Operator:** Our next question comes from Jim Sheehan of SunTrust. Please go ahead.

James Sheehan

*Analyst, SunTrust Robinson Humphrey, Inc.*

Q

I think you talked about ethane impacts and you might see those continuing in 2019. Ethane prices have collapsed back into the [ph] low-30s (00:22:38). Do you think your 2019 outlook might be more conservative or are you banking on volatility in ethane next year?



James A. Varilek

*Executive Vice President & President, Chlor Alkali Vinyls and Services, Olin Corp.*

A

Yeah. I think the thing about ethane right now is that it is very volatile. And so, we do expect that from the spikes that we've seen here in the September-October timeframe, we do expect it to settle back, albeit, we do expect that to be at a higher level than we experienced in the first half of 2018.

James Sheehan

*Analyst, SunTrust Robinson Humphrey, Inc.*

Q

Thanks. And on the Alunorte situation, when would you expect that facility to return to operating rates above 50%?

James A. Varilek

*Executive Vice President & President, Chlor Alkali Vinyls and Services, Olin Corp.*

A

It's a good question. It's one we've been asking for a while. The situation is that, one of the barriers has been recently removed last week from the equivalent of the Brazilian EPA removed their embargo on the site. And so, now it's strictly in the hands of the Federal Court to remove that embargo. And now that elections are over, we're hopeful that that will be resolved. I can't give you any kind of date, it's really in their hands, but the technical hurdles have been removed.

James Sheehan

*Analyst, SunTrust Robinson Humphrey, Inc.*

Q

Thank you.

**Operator:** Our next question comes from Frank Mitsch of Fermium Research. Please go ahead.

Frank J. Mitsch

*Analyst, Fermium Research LLC*

Q

Yes. Hi. Good morning, gentlemen. And not following-up on Alunorte, Jim, but what about the RUSAL sanctions? What are you hearing there, what is your expectation there, and what impact that might have on caustic export pricing?

James A. Varilek

*Executive Vice President & President, Chlor Alkali Vinyls and Services, Olin Corp.*

A

Yeah. I don't – RUSAL, we had earlier in the year and it caused a bit of excitement for a couple of months, but I would not expect anything more from RUSAL on the sanctions. Trade flows adjust relatively quickly, so I'm not expecting any impact.

Frank J. Mitsch

*Analyst, Fermium Research LLC*

Q

All right. Terrific. And Todd, you made the comment that you anticipate being, quote, more balanced in capital allocation in 4Q. Can you elaborate on what that means and what might be the implications in terms of money spent on share buyback, et cetera?

Todd A. Slater

*Chief Financial Officer & Vice President, Olin Corp.*

A

Yeah. Frank, as we said we repaid approximately so far in 2018 \$250 million of debt and we returned \$117 million to the shareholders in dividends and share repurchases. What I would say is we expect a higher percentage of our free cash flow in the fourth quarter to be returned to shareholders.

Frank J. Mitsch

*Analyst, Fermium Research LLC*

Q

All right. Terrific. So, the flywheel is obviously share buyback. All right. I appreciate it. Thanks so much.

**Operator:** Our next question comes from Neel Kumar of Morgan Stanley. Please go ahead.

Neel Kumar

*Analyst, Morgan Stanley & Co. LLC*

Q

Hi. Good morning. On the \$100 million headwind in 2019 EBITDA, you expect that caustic price stay at 4Q levels. Does that incorporate any decline in the October caustic price which [ph] IHS seem to be (00:25:52) projecting? And also, does that consider any improvement in your [ph] existing pricing kind of reset (00:25:56) some of your legacy contract at the end of the year?

John E. Fischer

*Chairman, President and Chief Executive Officer, Olin Corp.*

A

No. It is simply a point in time measurement of the prices we had in our system at the end of – that we had in our system as of last week. So, if we get a favorable reset from our contract pricing, that's a positive, and if the indices move up, that's a positive, if they move down, that's a negative.

Neel Kumar

*Analyst, Morgan Stanley & Co. LLC*

Q

Also, we've seen some reports of [indiscernible] (00:26:24) Asian export prices coming down recently due to a disruption of trade flows in India from the new [ph] Bureau of Industrial Standards (00:26:29). Can you give us your thoughts on how you think it will play out and will be resolved in near-term?

James A. Varilek

*Executive Vice President & President, Chlor Alkali Vinyls and Services, Olin Corp.*

A

Neel, this is Jim. Yeah. The India situation, it's basically a – it's a reset on registration that needs to take place to import product into India. What it really means is that, for a period of time, there'll be some kind of activity that will be taking place again as caustic is – the trade flows are adjusted. I don't expect it to be a long-term thing. It's a technical government registration that will pass, because frankly India will need to continue to import caustic.

Neel Kumar

*Analyst, Morgan Stanley & Co. LLC*

Q

Thank you.

**Operator:** Our next question comes from Kevin McCarthy of Vertical Research Partners. Please go ahead.

Matthew DeYoe

*Analyst, Vertical Research Partners LLC*

Q

Good morning. It's Matt on for Kevin. So, I've a question that relates to the ethylene component of your guidance. I mean, what is the ethane feedstock cost kind of baked into that number? And shouldn't least most of this be recovered by better EDC prices? I mean, it seems like particularly, throughout the year, that guidance has been fairly conservative on EDC price. We're going to continue to push to the upside on that. So, I'm a little confused as to why there's a negative discrepancy of that size coming into 4Q.

Todd A. Slater

*Chief Financial Officer & Vice President, Olin Corp.*

A

I think what's embedded in our guidance, as we've said – this is Todd – the mid-\$0.40 a gallon range, and just let's go back a second to what's in our guidance. We've said we're going to make \$1.26 billion, and that compares to what we've said before, plus or minus 2%. We said \$1.3 billion plus or minus 4%. We gave a bridge of \$25 million associated with ethane, \$45 million associated with caustic, and \$15 million associated with Winchester. So, if you add that off of the \$1.26 billion, that puts you right at the top end of our prior guidance that we had given on August 1. So, yes, there were offsets as John mentioned for chlorine, all the chlorine-derivatives, as well as EDC.

Matthew DeYoe

*Analyst, Vertical Research Partners LLC*

Q

Okay. And then, as it relates to Winchester, copper prices starting to move lower year-over-year basis, lead prices moving down. Do you expect to receive any kind of raw material relief or benefits on that end or do you just think that most of it, okay, competed away on price until we have a better volume return to the market? Thanks.

John E. Fischer

*Chairman, President and Chief Executive Officer, Olin Corp.*

A

My gut tells me that the answer to that is the latter. I think when you see a 35% decline in commercial volumes, I think it would normally get competed away. I think what you will stop hearing next year is that the year-over-year is impacted negatively by higher commodity costs.

Matthew DeYoe

*Analyst, Vertical Research Partners LLC*

Q

So, it's probably tricky to put a number on this, but do you have any idea about inventories on the commercial side and on the consumer end, and how elevated they might be versus historic and how much we've to work through here?

John E. Fischer

*Chairman, President and Chief Executive Officer, Olin Corp.*

A

I would be lying if I said I had any idea. I mean other than, if you look at – you can go back and look at ammunition purchases in North America from the period, the very end of 2018 through the end of 2016, and look at them compared to an historic level, and they were 30% to 40% higher for almost seven years.

Matthew DeYoe

*Analyst, Vertical Research Partners LLC*

Q

Okay. That's helpful. Thank you.

**Operator:** Our next question comes from Jeff Zekauskas of JPMorgan. Please go ahead.

Jeffrey J. Zekauskas

*Analyst, JPMorgan Securities LLC*

Q

Thanks very much. In your near-term adjusted EBITDA potential, you say your potential is about \$1.5 billion. And over a shorter period of time, the value of Olin has really come down, I think because people have economic fears. And you have all kinds of both cyclical businesses and countercyclical businesses, in a normal recession, what might your EBITDA potential be?

John E. Fischer

*Chairman, President and Chief Executive Officer, Olin Corp.*

A

Well, Jeff, the first thing I would say is, typically, if you think back through what happens in a chlor alkali cycle as we enter a recession...

Jeffrey J. Zekauskas

*Analyst, JPMorgan Securities LLC*

Q

Yeah.

John E. Fischer

*Chairman, President and Chief Executive Officer, Olin Corp.*

A

...you'd see a significant drop off in demand for chlorine before you see a significant drop off in demand for caustic. So, at the front end of any recession – and we saw this in spades in 2008 and in early-2009, you get a near-term run up in caustic.

Jeffrey J. Zekauskas

*Analyst, JPMorgan Securities LLC*

Q

That's right. You bet.

John E. Fischer

*Chairman, President and Chief Executive Officer, Olin Corp.*

A

And then, you get a rollover. So, we don't – we're not in the business of forecasting recessions, but I think in a recession, the first step for Olin would be – the results would be more positive on the caustic side than they are today. And we're obviously very highly levered to caustic.

Jeffrey J. Zekauskas

*Analyst, JPMorgan Securities LLC*

Q

Okay. And where – can you talk about some of the dynamics behind positive chlorine pricing and how sustainable you think they are?

John E. Fischer

*Chairman, President and Chief Executive Officer, Olin Corp.*

A

I think Jeff, what's happened over the long span of time, and I can go back 25 or 30 years, is the merchant market for chlorine has shrunk dramatically primarily because most of the vinyls producers in North America have over the last 20 years backward integrated and become their own chlorine supplier. So, the merchant market itself has shrunk quite a bit.

On top of that, there's been significant increase in freight rates around delivery of chlorine by rail. So, merchant market itself has shrunk as has the supply. And I think in an environment where chlorine and chlorine-derivatives are growing at 1% to 2% a year were actually shrinking the available supply, because some of that growth is in the vinyls chain and it's being handled by the vinyls guys. We're actually shrinking the amount of chlorine available for the merchant market and that is putting pressure upward on chlorine itself.

Jeffrey J. Zekauskas  
*Analyst, JPMorgan Securities LLC*

Q

Okay, great. Thank you so much.

**Operator:** Our next question comes from Mike Leithead of Barclays. Please go ahead.

Michael Leithead  
*Analyst, Barclays Capital, Inc.*

Q

Good morning, guys. Just to piggyback a bit on Jeff's question on the \$1.5 billion EBITDA number. Just to be clear here, is that no longer considered a mid-cycle target? And if so, what would be a fair new mid-cycle number?

John E. Fischer  
*Chairman, President and Chief Executive Officer, Olin Corp.*

A

I think the way I would answer that is, yes, it is no longer considered a mid-cycle target, it is a point on a long-term improvement curve. And what we would say to you is we think the structural changes that have occurred in the chlor alkali and chlorine-derivatives business and in the Epoxy business are such that we're really not going to see cycles like we've seen in the past. We will see supply and demand changes and price changes around broader economic levels of activity, but we're not going to whipsaw up and down like we have in the past. Therefore, I don't want to call a mid-cycle, because I don't think we're really looking at a cycle here.

Michael Leithead  
*Analyst, Barclays Capital, Inc.*

Q

Okay. And then, in your 2019 comment, you talked about if we flat line today's caustic soda price. But can you maybe just expand a bit upon how you're seeing caustic soda dynamics here so far in the fourth quarter and how you guys expect it to trend heading into 2019?

James A. Varilek  
*Executive Vice President & President, Chlor Alkali Vinyls and Services, Olin Corp.*

A

Yeah. Mike, this is Jim. Yeah. As far as the caustic soda demand, what we're seeing is on the export market in particular, we've been the beneficiaries in the past of a number of supply events, as John mentioned in his comments that have spiked the market quite honestly. And you can go back to – whether they be mercury shutdowns, whether they be outages of any individual plant freeze hurricane, those things spike the market. And now, since that time, we've had a demand event or that has limited the demand, and that's specifically the Alunorte. So, what you're seeing is, you're seeing a readjustment of the trade flows out of the Gulf Coast that have impacted the export market. And interestingly enough in September, for example, the exact amount of export, spot export that was done was 25,000 tons, which is about the exact amount you would expect from Alunorte on an ongoing basis.

So, you've got that readjustment taking place. And we believe that when that comes back, that demand event is over, then we'll start to see a more balanced approach in the upward positive movement that we've seen in the past on the caustic side of things. And just like on the upside, there was some – there is some pressure on the domestic market that pulls the domestic market up, and we're seeing the same thing on the downside, which is why you're seeing a minor move in the indexes over the past period of time. So, that's really what's taking place right now. The dynamics are there. We do expect the seasonal slowdown on chlorine in operating rates, and that should also help the market pull out.

Michael Leithead

*Analyst, Barclays Capital, Inc.*

Got it. Thanks, guys.

Q

**Operator:** Our next question comes from Aleksey Yefremov of Nomura Instinet. Please go ahead.

Aleksey Yefremov

*Analyst, Nomura Instinet*

Hi. Thank you. Good morning, everyone. Just going back to your guidance, you mentioned lower expected caustic soda pricing of \$45 million. Is this really – should we think about this as a sequential decline in the fourth quarter? Is that really your realized price decline in Q4 versus Q3?

Q

John E. Fischer

*Chairman, President and Chief Executive Officer, Olin Corp.*

No. That was designed to describe the difference between the guidance we provided at the end of the second quarter, which was \$1.3 billion, and the guidance we provided at the end of the third quarter for the full year. So, that is the full year impact that we've realized from lower caustic pricing than we would have expected when we gave you guidance on August 1.

A

Aleksey Yefremov

*Analyst, Nomura Instinet*

All right. So, it's a really representative of the second half of the year sort of say change in your price expectations?

Q

John E. Fischer

*Chairman, President and Chief Executive Officer, Olin Corp.*

Yes. So, that is true also of the comment on ethane and true of the comment on Winchester.

A

Aleksey Yefremov

*Analyst, Nomura Instinet*

Understood. Thank you. In your caustic soda export contract, will you – do you expect to renegotiate any of those contracts as far as the customer commitments, the level of pricing relative to the benchmark, et cetera? And then, have you concluded any of those negotiations if so?

Q

James A. Varilek

*Executive Vice President & President, Chlor Alkali Vinyls and Services, Olin Corp.*

Those are...

A

Aleksey Yefremov

*Analyst, Nomura Instinet*

Q

And I'm really talking about 2019, sorry.

James A. Varilek

*Executive Vice President & President, Chlor Alkali Vinyls and Services, Olin Corp.*

A

Yeah, understood. The contracts, we're in a constant state of renegotiation and we have contracts that come up all the time. There is a significant amount of the volume that is contracted over the last two years, given the tightness in supply in caustic, we have – and the industry has moved towards increased amount of caustic that is contracted. So, the answer is, yes, we'll continue to contract that and there's always price discussions in those contracts.

Aleksey Yefremov

*Analyst, Nomura Instinet*

Q

Thank you.

**Operator:** Our next question comes from John Roberts of UBS. Please go ahead.

John Roberts

*Analyst, UBS Securities LLC*

Q

Thanks. I think China exports caustic soda to the West Coast to the U.S. Has there been any change in the dynamics of that particular part of the market?

John E. Fischer

*Chairman, President and Chief Executive Officer, Olin Corp.*

A

No. Other than there were in early part of [indiscernible] (00:39:03) mid-summer and late-summer, there were some pricing impacts that are well-known, but the dynamics and the movements haven't dramatically changed.

John Roberts

*Analyst, UBS Securities LLC*

Q

Okay. Do you think it will be stable here as we go through the end of the year?

John E. Fischer

*Chairman, President and Chief Executive Officer, Olin Corp.*

A

I think it won't change that much over time. China has continued to export less, and if there's a demand pick up in China, you may see less movement to the West Coast.

John Roberts

*Analyst, UBS Securities LLC*

Q

Okay. And then, you indicated there really hasn't been any end demand destruction in Winchester. Could you just give us an update on some of the metrics that you look at to give yourself comfort with that?

John E. Fischer

*Chairman, President and Chief Executive Officer, Olin Corp.*

A

We have – well, first, the National Shooting Sports Foundation looks at consumption around shooting ranges, et cetera, and that's our primary data source. So, there is that actual activity of going out and finding out what activity levels are at different shooting ranges which is where the predominance of the ammunition is consumed.

John Roberts

*Analyst, UBS Securities LLC*

Q

Okay. Thank you.

**Operator:** Our next question comes from Eric Petrie of Citi. Please go ahead.

Eric B. Petrie

*Analyst, Citigroup Global Markets, Inc.*

Q

Hi. Good morning. What are your expectations for alumina capacity closures in China during this winter and do you expect to see a similar ramp up in prices as we did last year into November?

James A. Varilek

*Executive Vice President & President, Chlor Alkali Vinyls and Services, Olin Corp.*

A

I don't have really good visibility into what the Chinese are going to do for this particular season. Over the last couple of years, we've seen shutdowns or curtailments that had taken place that have impacted the supply side, which obviously increased the pricing, and then we've also seen the demand side being impacted by curtailments as well. So, I don't have a real good visibility into what to expect this year.

Eric B. Petrie

*Analyst, Citigroup Global Markets, Inc.*

Q

Okay. U.S. contract prices for caustic soda have increased to premium compared to export. Is that just purely a function of lower exports to Alunorte or do you expect greater pressure on contract prices as export prices continue to decline?

James A. Varilek

*Executive Vice President & President, Chlor Alkali Vinyls and Services, Olin Corp.*

A

As I mentioned before, I think the export prices have probably bottomed out and there is going to be pulls in either direction – if export pricing is above U.S. pricing, then you're going to see an upward pull; if it's down, you're going to see a downward pull. The volatility on that export market has been significant, and when it moves to the upside, it'll – once it crosses over the equivalent value, then you'll start to see upward pressure. But yes, it does create some amount of pressure in either direction.

Eric B. Petrie

*Analyst, Citigroup Global Markets, Inc.*

Q

Great. Thank you.

**Operator:** Our next question comes from Matthew Blair of Tudor, Pickering, Holt. Please go ahead.

Matthew Blair

*Analyst, Tudor, Pickering, Holt & Co. Securities, Inc.*

Q



Hey. Good morning. I think you mentioned a normal seasonal demand slowdown in your opening remarks. When I look at The Chlorine Institute data, it really doesn't show that much of a reduction in average Q4 operate compared to average Q3 operate. So, I was hoping you could maybe just quantify what kind of impact seasonality should have in Q4 whether in terms of volume or perhaps EBITDA?

Todd A. Slater

*Chief Financial Officer & Vice President, Olin Corp.*

A

Matthew, this is Todd. I guess, if you look historically, we would say chlor alkali industry operating rates declined between 3% and 8% between the third quarter and the fourth quarter. So, that's what – we would expect a similar decline in Q4 compared to Q3.

Matthew Blair

*Analyst, Tudor, Pickering, Holt & Co. Securities, Inc.*

Q

Very helpful. Thanks. And then, can you talk about any sort of demand trends you're seeing on the chlorine and chlorine-derivatives side, maybe today versus six month ago? I think, housing and construction is perhaps one-quarter of chlorine demand. Are you seeing any softness there?

James A. Varilek

*Executive Vice President & President, Chlor Alkali Vinyls and Services, Olin Corp.*

A

This is Jim. Actually, the chlorine side of the equation has been very interesting over the last year, year-and-a-half. In that – in typical times, when you see caustic pricing move as aggressively as it has, you oftentimes see the opposite side of the ECU be under pressure. What we've seen over the last year to two years is actually both sides of the ECU moving up, the chlorine on the merchant chlorine, the chlorine-derivatives whether it be HCL or whether it be EDC, you're seeing upward movement on that side of the equation. So, we're seeing both sides of the ECU move, which speaks to the structural change that we believe is taking place in the industry. So, we do expect that to continue over the course of the next several years.

Matthew Blair

*Analyst, Tudor, Pickering, Holt & Co. Securities, Inc.*

Q

Thank you.

**Operator:** Our next question comes from Stephen Byrne of Bank of America Merrill Lynch. Please go ahead.

Steve Byrne

*Analyst, Bank of America Merrill Lynch*

Q

Hi. Your longer term demand growth forecast for caustic is more robust than the chlorine-derivatives. And my question for you is, how does the industry balance that differential given the production is [ph] equimolar (00:44:51)?

John E. Fischer

*Chairman, President and Chief Executive Officer, Olin Corp.*

A

The normal way that gets balanced is by pricing, and that leads us to a bullish outlook on caustic soda pricing long-term.

Steve Byrne

*Analyst, Bank of America Merrill Lynch*

Q

But does the end market make the adjustment in switching to some other alternative raw materials given there will be more production of caustic than chlorine – there will be more demand for caustic than chlorine?

John E. Fischer

*Chairman, President and Chief Executive Officer, Olin Corp.*

A

I think on the margin, there is an ability to convert from caustic soda to soda ash, but that is not – that it would not be sufficient to plug a 10 million ton shortfall.

Steve Byrne

*Analyst, Bank of America Merrill Lynch*

Q

And have you seen any increase in that switching over to soda ash in this year?

John E. Fischer

*Chairman, President and Chief Executive Officer, Olin Corp.*

A

No. That's not a decision you make every day. It's an expensive process change. And historically, when you look at people that did it, they more often than not regret that they did it, because the time they spend the money and get it done, you see a reversal in caustic prices that makes it not justifiable. So, we are not concerned about that.

Steve Byrne

*Analyst, Bank of America Merrill Lynch*

Q

And are there any new technologies in development that would potentially increase demand for chlorine-derivatives?

John E. Fischer

*Chairman, President and Chief Executive Officer, Olin Corp.*

A

Nothing that jumps out at this point. No.

Steve Byrne

*Analyst, Bank of America Merrill Lynch*

Q

Okay. Thank you.

**Operator:** Our next question comes from Arun Viswanathan of RBC Capital. Please go ahead.

Arun Viswanathan

*Analyst, RBC Capital Markets LLC*

Q

Great. Thanks. Good morning. Just wondering if you still a trajectory towards \$1.5 billion as mid-cycle EBITDA over the next couple years? And if so, how would that kind of breakout in the different businesses, you still see in light of the Winchester pullback and some of this caustic kind of moderation recently? Thanks.

John E. Fischer

*Chairman, President and Chief Executive Officer, Olin Corp.*

A

I think we said a little bit earlier, we no longer look at \$1.5 billion as mid-cycle, we look at it as a point on a longer term improvement slope that the businesses are on, and we said that we think it's achievable in the next 24 months. And obviously, if you looked at our Q3 and adjust it for the ethane penalty and the caustic penalty, and add it that back in the EBITDA, you can clearly see a path on a quarterly basis to getting there.

Our view is that we're going to see continued growth in demand across the core alkali portfolio, both on the chlorine side and the caustic side as Jim just talked about. And we also expect the same dynamics to play out in the Epoxy chain. We've seen improved liquid epoxy resin pricing very consistently since 2016, and we also are starting to see tightness in the precursors of Epoxy, which are real chloride, epichlorohydrin, phenol, and bisphenol A. All of which, as those get tighter, they're going to force liquid epoxy resin prices up longer term. So, we don't view the \$1.5 billion as a mid-cycle now, we just view it as a point in a longer term improvement trend...

Arun Viswanathan

*Analyst, RBC Capital Markets LLC*

Q

Okay.

John E. Fischer

*Chairman, President and Chief Executive Officer, Olin Corp.*

A

...and that improvement trend will come from the chemical businesses.

Arun Viswanathan

*Analyst, RBC Capital Markets LLC*

Q

Thanks. And then on the cash flow, obviously, you're generating a lot of cash for the next couple years. Your leverage, I think, will be in a relatively manageable level, 2 times or so. How do you, I guess, prioritize buybacks and other investments, given where your leverage would be and your generous cash flow? Thanks.

Todd A. Slater

*Chief Financial Officer & Vice President, Olin Corp.*

A

Arun, this is Todd. I think consistently with what we have said on the call, as we look in the fourth quarter, we expect the higher percentage of free cash flow to be returned to shareholders, and as we delever, we would expect to continue to have a higher percentage of free cash flow going forward to shareholders.

Arun Viswanathan

*Analyst, RBC Capital Markets LLC*

Q

Thanks.

**Operator:** Our next question comes from Karl Blunden of Goldman Sachs. Please go ahead.

Karl Blunden

*Analyst, Goldman Sachs & Co. LLC*

Q

Hi. Good morning, guys. I think we started touching on epoxy resin pricing in the last question. I just wanted to get more detail on what your thoughts are on the margin outlook for that business? And for 2019, clearly feedstocks you mentioned are tight now pushing and supporting Epoxy prices, but how do the puts and takes all balance out for your business?

Pat D. Dawson

*Executive Vice President & President, Epoxy and International, Olin Corp.*

A

Yeah. Karl, this is Pat. Listen, we've seen a pretty dramatic run up on the indices, market indices in Epoxy here over the last 12 months. I mean, since the beginning of 2016, liquid epoxy resin is up almost 56%. If you just look quarter-on-quarter at the market indices, liquid epoxy resin is up 41%, EPI is up 49%, bisphenol A up 40% on a

year-over-year third quarter basis. So, we see – we saw a big change in epichlorohydrin here about this time last year, and we see the supply/demand fundamentals continue to be very favorable outside of China.

It would appear that in China, what we've seen is any EPI that comes out, which there's very little EPI that comes out of China, has been coming out at \$600 a ton to \$800 a ton higher than the chlorohydrin EPI, because a lot of that EPI in China is based on glycerin to EPI. So, I think that is potentially a structural change that we've not seen in the past. So, I see fundamentals on EPI continuing to stay high. Phenol, as John mentioned, there's been a lot of pressure on phenol with some decreases in capacity out in the industry that's tightened that market. The polycarbonate market has been strong and robust, that has driven BPA prices up. And there hasn't been any capacity of any significance built on EPI or BPA in recent times, nor have we've seen any additional significant capacity built for liquid epoxy resin.

So, I think the fundamentals around supply/demand and some of the changing dynamics due to things going on in China bodes well for good stability at the prices that you're seeing right now. And Olin's epoxy resin prices have been very stable here in Q3. So, the puts and takes, I think it also calls for ongoing demand. Europe, one of the cautious optimisms out there is that Europe has been growing at 3% or 4%. It looks like more like 1% or 2%. On the flip side of it, the U.S. market has been stronger this year than past years, mainly driven by oil and gas. So, overall, I would say the input costs, the supply/demand fundamentals, the fact that there hasn't been any capacity additions made either on the input costs or the precursors or in the resin market would bodes well for stable margins. And I think you could see a run up in price again here like we saw earlier in the year, if you have a few unplanned events.

Karl Blunden

*Analyst, Goldman Sachs & Co. LLC*

Q

That's a lot of detail. I appreciate it. Just a quick one on the balance sheet, is it too early or would you intent to at some point give a reduction goal for 2019 or are we at a place where when you look at the equity, there's just too many things to consider to give that kind of guidance?

Todd A. Slater

*Chief Financial Officer & Vice President, Olin Corp.*

A

I think – Karl, this is Todd, in early – when we provide our fourth quarter results in early-February, I think we'll be able to give a better sense as to what our expectations are for 2019 on that area.

Karl Blunden

*Analyst, Goldman Sachs & Co. LLC*

Q

Okay, great. Thanks a lot. Appreciate it.

**Operator:** Our next question comes from Roger Spitz of Bank of America. Please go ahead.

Roger N. Spitz

*Analyst, Bank of America Merrill Lynch*

Q

Thanks very much and I apologize if I had missed this explanation. But how much of the ethane price spike that we see in Q3 2018, was it some of it or all of it or will some of which happened in Q4 2018? And should we think about the impact of Dow's ethylene capacity for you having a half-month or a one-month delay before it goes to your income statement?

John E. Fischer

*Chairman, President and Chief Executive Officer, Olin Corp.*

A

The impact that we gave for ethane was on the second half of our 2018 results, so it covered both Q3 and Q4. And the answer to your second question is, no, we essentially pay an average market price for the month.

James A. Varilek

*Executive Vice President & President, Chlor Alkali Vinyls and Services, Olin Corp.*

A

For ethane.

John E. Fischer

*Chairman, President and Chief Executive Officer, Olin Corp.*

A

For ethane.

Roger N. Spitz

*Analyst, Bank of America Merrill Lynch*

Q

Okay. So, you're going to see it, if it happens, [ph] that's going to (00:54:34) show up in your income statement in that month?

John E. Fischer

*Chairman, President and Chief Executive Officer, Olin Corp.*

A

That's correct.

Roger N. Spitz

*Analyst, Bank of America Merrill Lynch*

Q

Perfect. And then, on the Epoxy side, could you comment whether your – in Q3, if your Epoxy spreads were out flat or down year-over-year? I mean, the prices were up. You also mentioned that the benzene, propylene costs were up. I'm assuming the margin expanded, but I just want to – or the spread expanded. I just want to hear what you have to say.

John E. Fischer

*Chairman, President and Chief Executive Officer, Olin Corp.*

A

Yeah. Listen, Rodger, I think I'm not commenting specifically here on the spread, I mean what we saw in Q3 versus Q2 is that propylene was up 17% in North America and propylene was up 5% in Europe. So, there is no question that the hydrocarbon headwinds curtailed our margin expansion in Q3.

Roger N. Spitz

*Analyst, Bank of America Merrill Lynch*

Q

All right. Thank you very much.

**Operator:** As there are no further questions. This concludes our question-and-answer session. I would like to turn the conference back over to John Fischer for closing remarks.

John E. Fischer

*Chairman, President and Chief Executive Officer, Olin Corp.*

Yes. Thank you to everyone for joining us today and we look forward to speaking to you again at the end of our fourth quarter. Thank you.

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

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