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PRESENTATION

Operator

Good morning, and welcome to Olin Corporation's Third Quarter 2020 Earnings Conference Call. (Operator Instructions) Please note, this event is being recorded.

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

Steve A. Keenan ***Olin Corporation - Director of IR***

Thank you, Grant. Good morning, everyone, and thank you for joining us today. Before we begin, let me remind you that this discussion, along with the associated slides and the question-and-answer session that follows, will include statements regarding estimates or expectations of future performance. Please note that these are forward-looking statements and that the actual results could differ materially from those projected.

Some of the 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, the third quarter 2020 Form 10-Q, 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 Past Events. The earnings press release and other financial data and information are available under press releases.

With me this morning are Scott Sutton, Olin's President and Chief Executive Officer; Pat Dawson, Executive Vice President and President, Epoxy & International; Jim Varilek, Executive Vice President & Chief Operating Officer; and Todd Slater, Vice President and Chief Financial Officer.

We will begin with brief remarks. And thereafter, we will be happy to take your questions.

I'll now turn the call over to Scott Sutton.

Scott McDougald Sutton ***Olin Corporation - President, CEO & Director***

Yes. Thanks, Steve, and hello to everybody. I've been Olin CEO for a couple of months now. And I can tell you that I'm just plain lucky to be here in this great company and working with this passionate team. In fact, I'd ask you to watch carefully what this team is going to do with this company as it will surely be exciting.

So my role is to lock arms with this team and win our way back to a much higher equity value. So let me start my comments with Slide #3 in the presentation and an update on market and business fundamentals. Look, I would say the summary is that global industry fundamentals are still intact, though currently pressured by COVID-19. In our Chemicals business, the supply-demand balance is expected to push back toward demand as only limited, meaningful supply additions are foreseen on the horizon.

In fact, 80%-ish effective industry utilization rates with a sophisticated player is a really good place to be as long as that player is focused on driving value. So we are that player. We're going to be that leader. I mean, for example, competing in a way that represents the value we bring to the market as we will discuss further today.

In our Winchester business, demand in the U.S. far outstrips supply because of long-term positive demand attributes. Sporting participation, new firearms owners and self-defense readiness is way up. Military programs have multiyear growth needs under long-term commitments. I mean, we are the absolute small caliber ammunition leader.

In fact, I'd say that under John Fischer's leadership, Olin has built undisputable #1 global leadership positions in every single business, Chlor Alkali, Epoxy and Winchester. And when you break down the businesses into specific sources of value, the list of #1s expands to numerous product and geographic positions.

John and the team did that. I mean, the necessary spending to complete that building process of approximately $1.4 billion for IT, ethylene payments and transition cost is done. It's finished.

So what is next for Olin? Well, we are leaping from building to leading in terms of value. So building to leading.

So I'm moving to Slide #4 now. The next step in that evolution takes off today. Our value is not determined by industry trade indices or other items like asset utilizations and changes in input costs. Those may well be influencers, but they will not be main drivers of Olin's value. We are more eager to talk about and implement our own Olin initiatives to create main drivers. I mean look, we're committed to showing outcomes from those initiatives, too. That means, financial outcomes as well.

So we are accelerating the implementation of an Olin unique winning model. All of our initiatives will evolve principally around 2 foundational elements. Number one is exercising and getting value from our undisputable leadership positions as Olin is critical in this world. And number two is driving and prioritizing productivity from a large, motivated and engaged employee base.

Some new things that you should look for from our winning model, particularly from the #1 foundational element of exercising our leadership, include that we will start talking about how Olin can increase the value of the ECUs it sells. And we will measure that through an Olin ECU Profit Contribution Index. This type of ECU metric is the best indicator of our success. I mean, it's really the #1 indicator of our success. And that's what Olin does. Increases returns on ECUs, and we are the clear global leader.

Merchant caustic soda is only one element of our business, maybe up to 25% by sales, thinking prospectively. In fact, and really as a side note, caustic is certainly not a singular driver. There are no independent caustic dynamics. If the caustic market quality is exceptionally poor, we might back down caustic and change our trading and inventory mix, resulting in slowing chlorine chain sales in order to maximize the Olin ECU value, as we proactively manage our landscape.

We will be sharing that ECU Profit Contribution Index with you quarterly. In fact, take a look at Slide #5 now. And it will represent the unit contribution value of chlorine and caustic soda through our complete and broad derivative chain, even including Epoxy, and of course, including merchant sales of chlorine and caustic, too. Our index will be used to set an ever-rising floor on the unit ECU profit we will accept. It is the #1 marker of us resetting business value and exercising our leadership, and it covers about 75% of this company's total business.

A companion discussion is that, unfortunately, some industry trade indices have come to be thought of as leading indicators of our business. We plan to make them a trailing indicator only as we control our own destiny. We will do this by shifting more of our business to be based on a freely negotiated basis and negotiating directly with customers for our value. We just don't feel the industry trade indices represent the full value we will transact at.

Our view of a timely example of this is the miss of the North American chlorine pricing by an index here over the last month. Obviously, this unwinding from some industry trade indices gives us more ability to positively control the Olin ECU Profit Contribution Index. As a point of reference, in Q3, we sold some railcar chlorine at the highest price since 2003, and we lifted some spot EDC pricing by more than 10x the Q2 low price.

In early Q4, we just asked for and received the largest Winchester commercial ammunition price increase in many years. And this comes on the heels of 2 other successful commercial price increases this year. So what's the expected outcome from our new unique winning model?

Well, this is on Slide #6. Of course, we're thinking in terms of multiples of our current equity value. But in terms of 2021, you should expect us to target an EBITDA margin roughly in the mid-teens, composed of the following elements.

One, is an expected $100 million of improvement from confirmed items. So that is our Lake City Army Ammunition contract in operation and a new VCM deal. Another expected $100 million of improvement over 2020 from not repeating the second quarter COVID shutdown.

Additionally, we expect up to $100 million of net, and that is net, productivity savings as our gross actions more than offset inflation pressures. And the big one is up to $200 million expected from our acceleration of leadership activities, as I just previously described.

So our levered free cash flow and -- so that's after all of our capital spending is expected to be quite positive, somewhere between $2 and $3 a share. I'd say at today's stock price, it's a huge return. So we mean for every business to deliver in 2021, and every business is positioned to do so. So with that introduction, I look forward to your questions on these next steps and how we will be controlling our own destiny and how we will significantly lift our equity value. That completes the opening comments.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Our first question will come from Hassan Ahmed with Alembic Global.

Hassan Ijaz Ahmed ***Alembic Global Advisors - Partner & Head of Research***

Scott, and congratulations on the new job. A question around strategy. Appreciate some of the color that you gave in your earlier remarks. Can't help but sort of think about your past life and your time at Celanese and the sort of similarities between the acetyls chain and the chloro vinyls chain in terms of oligopolistic nature and the like. And as I sort of sit here and think about the evolution of the acetyls chain, there was a step change in profitability over there, call it from 2011, 2012 onwards. And if one thinks about some of the strategic changes that were implemented, I broadly think about 4 silos.

There was utilization rate management that was exercised, doing more with the network as you guys used to call it, feedstock optionality and commercial flexibility. And it seems all of those things are pretty applicable to chloro vinyls, and it seems that, that's the direction you guys are headed in. So is it fair to assume that each and every one of those things can be hit? And this $50 million to $200 million number that you're talking about in terms of exercising your leadership position, over the long run, actually could be far greater than that?

Scott McDougald Sutton ***Olin Corporation - President, CEO & Director***

Yes. Thanks, Hassan. I mean I guess what I would say is, look, I mean, we're going to go out and lead with this winning model, right? You described some parts. The main feature of it is, we're going to exercise our #1 positions. And so how are we going to do that, right? We're going to be interacting with global supply-demand. We're going to be impacting our own global supply-demand. And that means we're going to be surging inventory when it's appropriate, releasing inventory when it's appropriate. We're likely to do more trading as we reach into pockets of global liquidity that are already out there.

We're not going to be selling into poor quality markets. And when we do that, we're going to be overlaying a price increase, and that lets us open and close arbitrage window. So that's the main elements of how we're going to go out and manage our landscape. And Hassan, underneath all that, we will certainly have rigorous commerce. We use the terms edgy commerce in here to make sure we get the next -- or the best price that we can get and get the breadth, best deal in place at every customer.

Overlaying all this in the future, you'll hear us talk about using forward intelligence. You can think of it as AI, almost, to predict the best point that we should run at. So where are we going to set our ECU knob and know that 3 months in advance? So it really contains a number of elements, right? You've got that umbrella of where to set our ECU knob, how we manage our landscape and then our edgy commerce activities. So that's what it sets up for. In the future, Hassan, I expect it to bring more than the numbers we quoted.

Hassan Ijaz Ahmed ***Alembic Global Advisors - Partner & Head of Research***

Very helpful, Scott. And as a follow-up on the near-term side of things, obviously, you touched on the chlorine price hike that has been announced. So question is that, how sustainable do you think in the near-term that price hike is, keeping in mind some facilities in the U.S. coming back online and then chatter about a Brazilian facility on the Chlor Alkali side coming back online as well. And part and parcel with that is we're talking about some of the pricing moves. On the raw side of things, how are you guys thinking about the recent move up that we've seen in natural gas prices?

Scott McDougald Sutton ***Olin Corporation - President, CEO & Director***

Yes. Yes. I mean, from our side and for our business, right on, I think the sustainability and materialization of that chlorine price increase are good. If you looked at our portfolio, certainly, in our small amount of spot business, we've achieved it, both price increases and more. Where we have contracts and negotiate every month, I would say that we've generally achieved it as well. Some customers have not picked up all the volume they normally do.

And I would say even further evidence of that, Hassan, is that, where we have contract business on an index, and we have caps on the amount we have to supply, we're actually able to get some premiums upon volumes above those caps. So for us, it's really sustainable.

As far as your second part of that, where does natural gas take us? I mean, this is out of all the inputs, this is the one that we have to go out and recover. And I think this model lets us be able to do that.

Operator

Our next question will come from Mike Sison with Wells Fargo.

Michael Joseph Sison ***Wells Fargo Securities, LLC, Research Division - Senior Analyst***

Scott, welcome back and look forward to working with you. In terms of exercising your leadership position and correlating that with the ECU contribution index, how do we think your variables or your actions will change, depending on where that index sort of lies?

Scott McDougald Sutton ***Olin Corporation - President, CEO & Director***

Yes. Well, thanks, Mike. And of course, our intention is to steadily move that index over time. And yes, there could be some quarters where it flattens a bit. But the reason it's the #1 indicator of our business, it represents value per unit more than anything else. And clearly, right, there's multiple things that go into our value equation. You have the unit contribution, which this index represents, you have our volume and you have our fixed cost, right? We can talk about what we're doing on fixed cost and productivity in a bit, and Jim will comment on a question on that later.

We'll be watching volume carefully. But once you lose unit contribution across something that represents such a large part of your company, it can take you months and years to recover it. So here's what you should expect us to do, Mike. If some part of our whole ECU value chain, whether it's on chlorine derivatives side or the caustic side, is showing bad quality out there in the marketplace, we're very likely to withdraw, right? Or slow down inserting material into such a bad quality market for us.

And therefore, the repercussions of that will be that, it will likely shorten us on the other side, and we have to decide what derivatives we're going to put it in? And we're going to put it into the derivatives with the best opportunities for Olin. So that's one way that it will guide us.

Michael Joseph Sison ***Wells Fargo Securities, LLC, Research Division - Senior Analyst***

Got it. And then, when you think about that $50 million to $200 million, those are drivers for '21, right? And so what do you think that potential is over a cycle over the next 5 to 6 years? And then, it doesn't seem like there's any major capacity coming on. So maybe your thoughts there over the next several years.

Scott McDougald Sutton ***Olin Corporation - President, CEO & Director***

Yes. Yes. I mean, here's what I would say to that, Mike. I mean, first of all, global dynamics only get better. I mean demand is going to continue to increase. There's no meaningful supply coming online. And therefore, the application of our unique model only gets better as well. As far as where we're going, I would just refer back to our Investor Day at the start of 2019, where we said we had a couple of clear milestones being $1 billion of EBITDA, $1.5 billion of EBITDA and then $2 billion of EBITDA that we will pass within the time frame that you asked about.

Operator

Our next question will come from Kevin McCarthy with Vertical Research Partners.

Kevin William McCarthy ***Vertical Research Partners, LLC - Partner***

Scott, I was wondering, if you could address your go-to-market strategy around the ECU in some practical terms. So for example, would the mix of contract versus spot business change? And to the extent that you have contracts, would the percentage linked to benchmark assessments go down? And then finally, what do you think -- or what are your initial thoughts about price protection? It seems that convention in the industry has been that many large buyers enjoy quarterly price protection. What do you think about quarterly versus monthly versus spot?

Scott McDougald Sutton ***Olin Corporation - President, CEO & Director***

Yes. Thanks a lot for the question, Kevin. I mean, what I would say that, those 3 things that you asked about, I mean, they will absolutely all involved to be in more open and much more freely negotiated, because in order to be effective to run this kind of model, we've got to have knobs that we can turn that are totally under our control every day. It's an essential component of that.

So today, we're much too heavily weighted toward having contracts that are tied to perhaps, an external indices. So we're going to be working to reduce that. And we're going to try to even pull forward some of that work because we have the ability to trade, getting control over that knob today or given customer security of supply out in the future, and that allows us to open up contracts that you might think that we couldn't otherwise open up.

And as far as our sort of go-to-market strategy and view, right, I'd just like to point out that this is not just a commercial business strategy, by the way. This engages the whole company and you may have heard me during the first Q&A that we had talk about all those activities it takes to effectively manage our landscape and interact with global supply/demand in a positive way. So it takes every support team in this company to be coordinated on that.

And the real business that we're running here is, lifting people and teams and connecting them to this winning model.

Kevin William McCarthy ***Vertical Research Partners, LLC - Partner***

That's very helpful. And then secondly, if I may. Would you comment broadly on your expectations in the fourth quarter as it relates to seasonality against the current market backdrop of many supply dislocations across the industry? How do you think volumes will play out relative to a normal seasonal pattern?

Scott McDougald Sutton ***Olin Corporation - President, CEO & Director***

Yes. And I would echo a little bit about what we put in our press release. We're going to see a little bit of that. That's not, honestly, a real big factor. I think the bigger volume factor is that, we're choosing not to participate in a poor quality market there, certainly, for caustic or participate as much as we normally might, would. So that's going to be the bigger volume hit to us than probably the inventory reductions are at end of year. But it's not bad in the fourth quarter in terms of supply-demand.

Operator

Our next question will come from Frank Mitsch with Fermium Research.

Frank Joseph Mitsch ***Fermium Research, LLC - Senior MD***

Yes. Scott, and let me echo the congratulations on the new role and the chance to reconnect. Yes, clearly, pretty fairly dramatic changes with respect to how chlorine is treated at Olin. So I was wondering, if you could update us on your ability to flex between captive and merchant on chlorine. And with respect to merchant, some of it is railcar, some of it is pipeline, and I'd assume that on the pipeline side might be -- might have more price protection. Is there any way that you can kind of quantify some of these metrics here so we can understand how some of the new changes on chlorine pricing actually will flow through for Olin?

Scott McDougald Sutton ***Olin Corporation - President, CEO & Director***

Yes. I mean, sure. I'll start, and Todd might want to join in here a little bit. For chlorine, we're just -- we're heavily weighted today on contracts that are tied to index. And we have a good bit of business that goes into pipeline. But -- and I think we've shared before that, if you think about merchant chlorine, it's around 1/5 right of our total chlorine. But on the large part that is railcar chlorine, which, by the way, rail capacity is certainly a limiting factor right now out there in the marketplace. I mean, we have and are gaining every day more flexibility. If the merchant world doesn't look good to us, we have the ability to push that back through a number of derivatives, all the way out to the end of our Epoxy chain, but I'll let Todd comment.

Todd A. Slater ***Olin Corporation - VP & CFO***

Scott, and I would echo the comment about rail -- chlorine by rail is very tight in our system. And you can see that, by lead times that we've implemented over the last -- over the last month, 1.5 months and the requirements related to that. So I'd say chlorine by rail is especially tight in rail.

Frank Joseph Mitsch ***Fermium Research, LLC - Senior MD***

Got you. Got you. Understood. And just coming back to the upside here in the third quarter that you announced, we'd imagine that some of that -- some of these indices that you've talked about are showing caustic, having declined in the third quarter and an expectation that will actually happen here in the fourth quarter as well. But your contracts are with a lag. Any way to quantify the benefit in terms of the lag that you saw in the third quarter and kind of what your expectations are for caustic price realizations in the fourth quarter in the Olin system relative to the third quarter?

Scott McDougald Sutton ***Olin Corporation - President, CEO & Director***

Yes. I have a specific number for the benefit. I mean, you're right. I mean, we do get a little bit of lag there. So there's some level of benefit. But I would also, kind of speaking about the fourth quarter, right, I would just refer back to our earlier discussion a little bit there, that it's not about a singular product, right? I almost don't care or it doesn't matter because we're going to run our model, just like in the fourth quarter, such that we have a lot of places to get value from.

And we -- one of the ways we generate value is not selling into a poor quality market. And so the more the quality decreases, the more we're going to turn that knob, right? So it's not significant.

Operator

Our next question will come from Vincent Anderson with Stifel.

Vincent Alwardt Anderson ***Stifel, Nicolaus & Company, Incorporated, Research Division - Associate***

When I think about the $50 million to $200 million target, how are you thinking about the near-term balance between maybe some additional SG&A for those direct negotiations, incremental capital for inventory management infrastructure, fixed cost coverage, things like that, kind of relative to what you see as easy wins in the near term?

Scott McDougald Sutton ***Olin Corporation - President, CEO & Director***

Yes. Yes, sure. So Jim is going to answer the bulk of this question. I mean, I would just say that we have broad opportunities across all those buckets for productivity and it's many small things that are going to add up to a big thing. Internally, I like to say we're masters of the small on this. But I'll let Jim answer this.

James A. Varilek ***Olin Corporation - Executive VP & COO***

Sure. Yes. I would say that your comment on adding SG&A to have these capabilities and so forth and, quite honestly, we'd probably be working at getting more efficient rather than adding and still being able to cover what we need. From a productivity standpoint, we actually have very well established programs here, and in every division, every function, every site has productivity goals and objectives for not only the coming year but have had the past years.

In fact, just a point of reference, we actually have 1,127 active projects across the company, all geared towards driving productivity and getting our fixed costs and are costing down to be able to make sure that we can pull that lever and deliver on that $50 million to $100 million net productivity objective that we have. So we do have momentum on productivity, things like -- you've heard about our Vinylidene chloride asset closure, the chlorine closure that we announced about a year ago or so. Epoxy Novalac plant is closing as well.

So we have a number of projects and so forth that will deliver momentum as we head into 2021. And there -- some are large, some are small, but they all add up at the end of the day. So we feel confident about that $50 million to $100 million.

Vincent Alwardt Anderson ***Stifel, Nicolaus & Company, Incorporated, Research Division - Associate***

That actually answered my next question, so I'll try a different one here. When you think about your position in kind of globally traded EDC volumes, I'm just curious to see, do you see that as a particularly attractive near-term opportunity to maybe smooth out that volatility through your commercialization changes? Or do you have a house view on non-integrated PVC expansions that would largely solve some of that volatility through higher demand?

Scott McDougald Sutton ***Olin Corporation - President, CEO & Director***

Yes. I guess as an umbrella statement, right, because we're doing broad portfolio management under a unique model. Generally speaking, any volatility, up or down, is going to be good for Olin, right? And we're going to be able to take advantage of that. Specifically for EDC being the largest merchant player there, yes, we are able to provide a number of activations out there to get the right value. So we are getting value from that, and we expect to continue to get some more value from that.

What I will say, I mean, you brought up sort of the PVC demand versus caustic and so forth. If you think about our configuration right now, we're not participating in an optimal configuration, right? Because PVC is exceptionally strong, which, of course, is spinning out a lot of caustic, and we are a smaller participant in the chain to PVC. And I guess the reason I point that out is because it's a real testament to how we're starting to run the company and how we're running our model right now, today, because we're doing okay, even in that dynamic, which isn't our best dynamic. So we're able to do things with PVC.

We had the discussion earlier on chlorine, and there are some strong parts there in other thermosets and thermoplastics that it goes into in the inorganics as well. So yes, I mean, that's how our model has got to work.

Operator

Our next question will come from Eric Petrie with Citi.

Eric B Petrie ***Citigroup Inc., Research Division - VP & Senior Associate***

Olin acquired the Dow Chlorine Products business to expand the chlorine envelope. Where are you thinking that value could be uplifted and captured from those downstream products? And what currently now is in your view, poor quality or low economic return?

Scott McDougald Sutton ***Olin Corporation - President, CEO & Director***

Yes. I would say that it's going to be across the entire portfolio, right? And there's been a lot of effort and money and sweat of many people to put this company together that we don't have to go out and build anymore, right? And we don't have to pump a lot more money into that building process. So I mean we have a game plan to start leading, using what's already been built. And that's going to be our game plan until that ECU Profit Contribution Index gets to, whatever, 1.5 or 2. We've got to get up in that range to match what we said we do at Investor Day. And we're going to do it.

As far as areas that we're lifting, I mean, lifting merchant chlorine is fundamental to this company. And so you see us out there doing that. That's going to -- that's going to push along and drive many things. In fact, all the way through our Epoxy business, which I'm going to ask Pat to come in on here in just a minute. And our Epoxy business is one of our downstream businesses that is subject to this chlor alkali ECU winning model and also has its own similar landscape management model built in around epichlorohydrin and Epoxy. So Epoxy, to your question, is one area that we can absolutely lift margins on. And so I'll ask Pat, will you comment a little bit on that?

Pat D. Dawson ***Olin Corporation - Executive VP and President of Epoxy & International***

Sure, Scott. Can you hear me?

Scott McDougald Sutton ***Olin Corporation - President, CEO & Director***

Yes.

Pat D. Dawson ***Olin Corporation - Executive VP and President of Epoxy & International***

Like you were saying this little bit of the lead in around epichlorohydrin. We're the only producer of epichlorohydrin now in North America, and of course, we got a major leadership position on epi in Europe as well. And so epi is really critical to strategically what we're trying to do with our Epoxy portfolio and then how we monetize that Epi in the form of liquid epoxy resin, solid epoxy resin and other ways we can sell those epoxy resin equivalents into the downstream.

So back to the plot here, of not selling into low return segments applies to Epoxy, just like it does in the rest of the portfolio. Driving productivity, Jim mentioned, we just made the announcement to shut down a Novalac plant in North America, which wasn't productive. And we have other ways to still participate in that market, but in a more productive way with our asset capabilities in Europe. So I think through epi and how we monetize that epi into various channels, where we select having a sharper edge on where we sell, the epi and the liquid epoxy resin is exactly what we're going to do.

Eric B Petrie ***Citigroup Inc., Research Division - VP & Senior Associate***

Great. And then my follow-up question is on the leadership position bucket of $50 million to $200 million. It's quite a bit of a range. So what is your view on industry conditions in ECU? Chlorine is beginning to increase in price, which leads recoveries and then caustic soda typically bottoms within a quarter to 2 but consultancy still expect price degradation in caustic soda into next year. So what is your view? And do you agree with consultants or do you take a different stance?

Scott McDougald Sutton ***Olin Corporation - President, CEO & Director***

Well, yes, thanks for the question. I mean, my view is that our ECU value is going to go up, no matter what. And that's how we're going to run our model. Look, I mean, I'll certainly acknowledge that we need to continue to give our model more tools and more degrees of freedom and that takes just a little bit of time to get in place. But even with the degrees of freedom that we have today, right, I'm confident that we can make ECU values move up.

And I think the proof of being the pudding in our ECU Profit Contribution Index, which is that measure of all variable margin for all our products that use chlorine or caustic divided by our total volume of ECUs. And I think, to some extent, we're having to prove that a little bit here in the fourth quarter. Because yes, I acknowledge that caustic is moving down in the public indexes. And we haven't built a plan for next year, that's only based on caustic flattening or going back up, right? We built a plan that's based on a model of portfolio management where we can work through any situation and make some of those valleys much higher than they otherwise would have been and make some of those peaks much higher than they otherwise would have been and also sort of shorten the distance between valleys and peaks as well.

Operator

Our next question will come from Mike Leithead with Barclays.

Michael James Leithead ***Barclays Bank PLC, Research Division - Research Analyst***

Great. And Scott, welcome. I do want to go back to the chlorine conversation and the pricing dynamic. I guess my understanding is, call it, roughly 1/3 of your chlorine goes to Dow, which I assume there's not really much pricing flexibility there. Another 1/3 goes into what I would call, more pure global commodities like EDC or liquid epoxy resin where I think pricing power is probably a bit challenging on your own. And then the remaining 1/3, potentially, you can drive more value, whether it's merchant chlorine, epi that you mentioned earlier, chlorinated organics. Am I kind of thinking about that bucket of opportunity correctly? Or kind of where among that chlorine envelope do you think you can drive the most value per se?

Scott McDougald Sutton ***Olin Corporation - President, CEO & Director***

Yes, Mike. I mean, that's not too bad, but I would just add a little bit to that. I mean it's -- while it's not a whole third, right? It's not far off. That goes to 1 single consumer that is more cost based. So we've sort of taken that out of the equation. It's not even represented in our ECU profit contribution indexes, basically the only thing that's not really represented there.

And then you get to the other, call it, at least 70%. We've recently proven that we're able to materialize price increases there. And in many cases, we've done both of our price increases. We had announced $80 a ton, and we followed it up by $100 a ton. And that's on the business that is open. So it works.

The other part, a little bit to your point is that, we're priced on index contractually, right? And unfortunately, that index completely missed the run in chlorine here, that's going to continue, and that goes back to some of my opening comments. And yes, that limits us today, right. So we're going to be working to make sure that, that misrepresentation no longer takes place.

Michael James Leithead ***Barclays Bank PLC, Research Division - Research Analyst***

Got it. That's super helpful. And then a question for Todd. A bit of a technical question, but I think important. Could you maybe clarify how you're treating or accounting for the delta between what you believe Oxy contractually owes you under your chlorine arrangement and what you've been getting paid? I know you won't comment on the litigation. But I guess, how has that amount -- has that amount been fully included in adjusted EBITDA? And have you taken any bad debt allowance on that?

Todd A. Slater ***Olin Corporation - VP & CFO***

We would not comment on the amount, other than to say, we think we've recorded the dispute between Olin and Oxy appropriately. Obviously, any resolution associated with that dispute could only be positive from a cash flow perspective as we go forward.

Michael James Leithead ***Barclays Bank PLC, Research Division - Research Analyst***

I guess just from an adjusted EBITDA perspective, that $80 million last year, was that included or is that not included?

Scott McDougald Sutton ***Olin Corporation - President, CEO & Director***

From an adjusted EBITDA perspective? I'm not sure where $80 million would come from. I think, directionally, the annual dispute is in the $50 million range.

So Mike, I mean, just to make sure it's clear, right? I mean we recorded that where we think it should be, I guess, is the thing we would say. But I do want to clarify. I mean, I think Todd said exactly the right thing. Win or lose that, right, it's only cash positive for us. So win or lose that, it's only cash positive for us. Just to give some perspective around it. And we haven't said much more than that about it, right.

Operator

Our next question will come from John Roberts with UBS.

John Ezekiel E. Roberts ***UBS Investment Bank, Research Division - Executive Director and Equity Research Analyst, Chemicals***

And congrats, Scott, welcome back to the public company quarterly earnings call.

Scott McDougald Sutton ***Olin Corporation - President, CEO & Director***

Thanks, John.

John Ezekiel E. Roberts ***UBS Investment Bank, Research Division - Executive Director and Equity Research Analyst, Chemicals***

It was unclear to me if the ECU profit contribution includes variable margin on ethylene since your contracts are based on cost, not market price of ethylene. And obviously, the margin on ethylene is going to go up and down with energy prices?

Scott McDougald Sutton ***Olin Corporation - President, CEO & Director***

Yes. And so John, I mean, it includes the variable margin of any product that we sell that uses or starts with chlorine or caustic. So therefore, let's take EDC as the example. It's the one that uses most of the ethylene, right? So you look at the sales revenue of EDC, less all the variable cost of which ethylene is one component of that, right? And that is the total variable profit that goes into the index.

John Ezekiel E. Roberts ***UBS Investment Bank, Research Division - Executive Director and Equity Research Analyst, Chemicals***

Yes. I guess, I'll go through a little bit more offline as well. But secondly, if you went -- look backwards to the second quarter where this variable margin index dropped to 92.7%, do you have in mind a pro forma level that the new approach might have held it to? I mean, what might you have done back in the second quarter did not drop down to 92.7%?

Scott McDougald Sutton ***Olin Corporation - President, CEO & Director***

Well, I mean, John, so it's a little bit of a hypothetical question. I would say, just look at third quarter as an example, right. We were able to move it back up. The other way I would try to address your question is that until that ECU Profit Contribution Index gets up to around 1.5 or 2, then we're not running this business at a place that represents reinvestment economics, right? So our model has a lot of potential to really pull that up. And so that's pretty substantial, John.

I mean, if you think about raising it to 1.5, it being 75% of the company's business, right? That means we have to increase our variable margin by effectively 50% to get it there across all those products. So I don't know that I'm answering your question or not?

Operator

Our next question will come from Aleksey Yefremov with KeyBanc.

Aleksey V. Yefremov ***KeyBanc Capital Markets Inc., Research Division - Research Analyst***

Scott, congratulations and good luck. Just to come back to your 2021 EBITDA driver's slide, you show $50 million to $200 million opportunity for exercising leadership positions. How do you think about caustic soda scenarios in that bucket roughly? Something similar to the price level that we see today, improvement or potentially further deterioration? I know its -- do you think of it as a system, but caustic has pretty high sensibility to your numbers.

Scott McDougald Sutton ***Olin Corporation - President, CEO & Director***

Yes. I'll answer your -- yes, thanks for the question. I'll answer your question specifically. But first, I'll sort of say, I don't know and it doesn't matter, almost, right? I mean caustic could end up in a number of places within reason. And because we're going to thrive on that volatility and lead with this winning model of exercising our #1 positions across our whole portfolio that will come out with a good outcome. I guess to be more specific on your question, I mean if it stayed where it was today, I mean, clearly, we're in great shape, because we've just started really implementing this model and practicing it a little bit.

And in September there, it was a great month for us, and I'm really proud of the team, not just the commercial team like I said before, but the whole company, for really attaching to it. So I would say, we have miles and miles of runway to get better at this. So I'm just trying to put it in perspective. If caustic just stops where it is today, I'd say we're golden. And do we expect a little more decline? Yes, there's going to be some decline here in the near term.

Aleksey V. Yefremov ***KeyBanc Capital Markets Inc., Research Division - Research Analyst***

And coming back to chlorine, can you give us some sense, what percent of your merchant chlorine business is tied to the indexes? And how long it might take to get away from that? Are we looking for maybe 1 year, a couple of years or something longer?

Scott McDougald Sutton ***Olin Corporation - President, CEO & Director***

Yes, I probably won't give you an exact number, but maybe you can hypothesize what it is from that. My answer is, way too much, okay, is tied to the index. And as far as, how long it's going to take us to work our way out of that, I mean, we are working on it hard today. And I expect, as we go through 2021, we're going to get a chunk unwound. And we'll still have part of it tied to an index in 2022.

Operator

Our next question will come from Steve Byrne with Bank of America.

Matthew Porter DeYoe ***BofA Merrill Lynch, Research Division - VP***

It's Matt DeYoe on for Steve. So operating rates in the U.S. aren't actually tight for much of these products. I mean PVC maybe, aside. So you bust up the contract and you're no longer on index and you start moving price where you can. How do you expect competition to respond to this? I would imagine they're not going to sit back idly and kind of let you get away on the margin end. I mean I realize a lot of chlorine can be a local market and so there's a lot of the commentary relating to just the merchant opportunity and turning levers where you can, where you don't have much competition, because given so much of its kind of pipeline in a very competitive Gulf Coast, I would think there would be kind of natural buffers with competition?

Scott McDougald Sutton ***Olin Corporation - President, CEO & Director***

Yes. I mean, thanks for the question. I won't comment on what competition might do. I would just sort of put up a few points here. Number one is, we're the leader in chlorine and derivatives. And we're critical to the world. It doesn't matter what the operating rate is. We're critical to the world. That's the first point, I would say. The second point I would offer is that, effective utilization rates are quite different than nameplate utilization rates. And when you have assets and maybe others face the same, right, that haven't necessarily been fully invested in or certainly don't meet reinvestment economics that, that effective utilization rate really becomes the nameplate operating rates.

So I would just contend a little bit that ECU operating rates are a bit tighter than you might think. And again, demand is okay there, inorganic. So you think of titanium dioxide and bromine, it's all okay. Polyurethanes and epoxies as well. So that's kind of how I respond.

Matthew Porter DeYoe ***BofA Merrill Lynch, Research Division - VP***

Understood. And then if I were to think about maybe like 3 to 4 big opportunities you think you have in your back pocket to drive growth, I know you mentioned like epoxy being one -- or sorry, epi being one, but perhaps other things that we're not thinking about as it relates to kind of what can be kickers on EBITDA over the next 2 years?

Scott McDougald Sutton ***Olin Corporation - President, CEO & Director***

Yes. Well, in the next 2 years, right, it's all about growth in ECU contribution profit, right? I mean, we have some opportunities for volume growth, but it's not about volume growth, right? We lead in volume. We can get volume any day that we want to get it. But it's all about growth in unit profitability, because that's the #1 thing we need to be the value player and be the value leader.

Some of those things that are certainly solid growth in volume is epoxy. And Pat spoke to that earlier, and you look at some of the applications we sell into like turbine blades, blades on the power generation wind mills, right? We were probably the epoxy in 1 of every 3 of those that's in the world, and that's definitely a growing segment for us as an example. I would say some of our coordinated organics that go into next-generation refrigerants are a good source of growth for us. And perhaps, the #1 source of growth for us is in small caliber ammunition as there's great positive fundamentals there on both the military side, and the consumer side as well as participation is way up.

And just as an example of that, more people are now doing shooting sports and target shooting than they're fishing, then they're camping, then they're golfing, whatever the case is. And that's a long-term fundamental that's driving demand right now, and it's where we have our biggest backlog in the company by far.

Operator

Our next question will come from Matthew Blair with Tudor, Pickering, Holt.

Matthew Robert Lovseth Blair ***Tudor, Pickering, Holt & Co. Securities, Inc., Research Division - MD of Refining and Chemicals Research***

I had a question on the new model here. It definitely sounds a lot more nimble. I think you make a good case that there's more upside down the road, but it also seems like there's a potential for just a lot more volatility in your bottom line results. Is that fair? Would you agree with that? And if so, is that something that you're comfortable living with? Or do you expect to take specific actions to keep things pretty stable?

Scott McDougald Sutton ***Olin Corporation - President, CEO & Director***

Yes. Thanks. I mean, that's a good question. And I think you heard me say before that I actually think volatility up or down in the drivers for us now is a good thing because we get the opportunity to turn a number of knobs. But you're right. I mean, in the near term, there could be some volatility because until the model is fully functioning and we have our optimal configuration in place, we may choose to hold value up on the ECU. And to do that, we move a lot less volume through one particular quarter. But if we do that, I would rest assured, that it will be a purposeful activity. And as soon as we come out of that activity, apply the volume back to it. I think we'd be in pretty good shape.

Matthew Robert Lovseth Blair ***Tudor, Pickering, Holt & Co. Securities, Inc., Research Division - MD of Refining and Chemicals Research***

Sounds good. And then my follow-up is on ECU costs in the fourth quarter here. So we can all see natural gas prices are moving up. It looks like at the same time that electricity prices are coming down. Does that present any sort of an opportunity for Olin? And if so, would you be able to capitalize on that?

Scott McDougald Sutton ***Olin Corporation - President, CEO & Director***

Yes. Maybe others don't want to comment on this. I mean, we have a mix of electricity. Some is self-produced, some is purchased. I'm not seeing big swings in our purchased electricity. We commented a little earlier on potential for gas to move up, which is really more a European driver for us right now than anything. But yes, you're right. I mean, we've got to go out and capture any movements in this. This is the one thing that maybe is less pass-through than some of our other raw materials, some of the other hydrocarbons that we buy. We have a lot of pass-through activity on those. Go ahead, Todd.

Todd A. Slater ***Olin Corporation - VP & CFO***

Matthew, we -- you do know we hedge gas and about 70% of our power comes from gas. So any increases you'll see or decreases you'll see through our system over time. So realistically, it's not that big of a near-term headwind into the fourth quarter for us. The other thing -- the other big area for power is hydro power. So you won't necessarily see swings in cost that you're talking about associated with that.

Operator

Our next question will come from Travis Edwards with Goldman Sachs.

Travis Edwards ***Goldman Sachs Group, Inc., Research Division - Research Analyst***

We agree since we're getting to the end of the call, but just 1 on capital allocation in the last few quarters. Your team has gotten questions just on the -- how you fund debt? And sort of capital allocation priorities, I think, as an extension of that question. It feels like that sentiment has sort of shifted from a full refi, obviously, of the high coupon debt to more paying down with incremental free cash flow generation. Just curious how you're thinking about sort of cadence of debt pay do as well as sort of priorities across -- how you fund debt that still outstanding versus no more near term maturities?

Todd A. Slater ***Olin Corporation - VP & CFO***

Travis, this is Todd. Obviously, with the action that we did in the middle of October by taking $100 million of cash and reducing the 9.7% acquisition bonds, that's the model you should continue to expect from Olin. Obviously, as we generate free cash flow, you'll see us fund the dividend and pay down debt. As opposed to a rate arbitrage, we would expect to delever the balance sheet with excess cash flow. We have, as you saw on one of the slides in the back, minimal cash requirements over the next 3 years for debt repayment. The biggest one would be $200 million in 2022. So that gives us a lot of opportunity to use our excess cash flow to take out high cost debt.

Travis Edwards ***Goldman Sachs Group, Inc., Research Division - Research Analyst***

Got it. And then can you just remind us what, I guess, you would consider excess free cash flow or excess cash? From the outlook?

Scott McDougald Sutton ***Olin Corporation - President, CEO & Director***

Yes. I mean, I was just jumping -- I mean, for next year, it's $2 to $3 a share. So that's lever-free cash flow. So it's after interest, after all capital, all fixed capital, all working capital, that $2 to $3 a share is available to do exactly what Todd said. Of course, we're going to pay the rock-solid dividend, and then we're going to use the rest to pay down some high-cost debt.

Operator

Next question will come from Arun Viswanathan with RBC Capital Markets.

Arun Shankar Viswanathan ***RBC Capital Markets, Research Division - Senior Equity Analyst***

Congrats on the new role and success over there, Scott. I guess my question is, first off, I'd start by -- on the leadership strategy, it sounds like there's maybe 2 things in the strategy which is detaching from the contracts and then only selling in higher-value parts of the chain. It does a little bit remind me of Celanese's options to move acetic into VAM. So I guess -- and other part, is that somewhat of a fair characterization? And then maybe you can just offer your thoughts on what changed within the company for you to affect the strategy? I'm just curious because historically, these opportunities have been there maybe over the last couple of years, but is it just the kind of the contracts that you want to move away from? Is it the opportunities that you can sell more of the chlorine, you have more outlets for the chlorine or a combination of all that?

Scott McDougald Sutton ***Olin Corporation - President, CEO & Director***

Yes. Thanks. I mean, the way I would characterize this, it's really Olin-unique. It's our own winning model. It's a much more sophisticated model than you might have seen in other places in the industry because if you think about it, we have many multiple sets of supply-demand characteristics that are all somewhat tied together. So the smartest player is going to win in that. And the player that can connect everybody in the company to that model, because it really is like a 3D game of chess. That's what you have to envision with this model, and it's doing many, many things, some of those things that I named earlier. And it's doing them all at the same time, putting those activations or activities in place, all at the same time that we drop in a war room sort of every day and play out every week, okay?

So I just want to say that it's quite an Olin unique situation. As far as why are we doing this now? I mean the -- I mean the team has been incredibly occupied with trying to build to the point that we could do this. This was always the next step in the evolution, and we're just here. I mean, I, arrived and everybody is carrying me on their back for what they intended to do. And like I said, I'm just glad to lock arms and be able to do that. So that's it.

Arun Shankar Viswanathan ***RBC Capital Markets, Research Division - Senior Equity Analyst***

Okay. I appreciate that. And then just the last question is just on the portfolio itself. Given what you just said, are there any areas in the portfolio that you feel like you need to potentially exit? Have they consistently been low-value contributors? Yes. That's it.

Scott McDougald Sutton ***Olin Corporation - President, CEO & Director***

Yes. Sure. I would say everything is going to contributed a lot higher value. And of course, we'll always do what delivers the best return to shareholders. But knowing our future outlook, no one's going to pay the multiple that they're worth right now. Okay.

Operator

This will conclude our question-and-answer session. I would like to turn the conference back over to Scott Sutton for closing comments.

Scott McDougald Sutton ***Olin Corporation - President, CEO & Director***

Yes. Thanks a lot. I mean, so with that, I would just say that Olin will meet the expectation that's been set for us. We're going to lead. We're going to be productive. We're going to be very engaged, and we're going to win our way back to a much higher equity value. So I would just say, thanks to everybody for joining us today.

Operator

Thank you for attending today's presentation. You may now disconnect.