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Corporate Speakers:

- John Kompa; Hexion Inc.; IR
- Craig Rogerson; Hexion Inc.; Chairman, President & CEO
- George Knight; Hexion Inc.; CFO

Participants:

- Roger Spitz; BofA Securities, Inc.; Analyst
- Richard Kus; Jefferies Group LLC; Analyst
- Oren Shaked; BTIG, LLC; Analyst
- Brian DiRubbio; Robert W. Baird & Co.; Analyst

PRESENTATION

Operator^ Good day, and thank you for standing by. Welcome to the Hexion Second Quarter 2021 Earnings Conference Call.

(Operator Instructions)

Please be advised that today's conference is being recorded.

(Operator Instructions)

I would now like to hand the conference over to your speaker today, John Kompa, Investor Relations for Hexion. Please go ahead.

John Kompa^ Thank you, Pasha. Good morning, and welcome to Hexion's second quarter 2021 conference call. Leading today's call will be Craig Rogerson, Chairman, President and CEO; George Knight, Executive Vice President and Chief Financial Officer; and Mark Bidstrup, Senior Vice President and Treasurer.

As a reminder, this call is also being webcast and the slides referenced in today's conference call are available through the hexion.com website under the IR section. A replay of this call will be available for 1 week, and the replay dial-in information is contained in our latest earnings release.

Before we start, I'd like to review information about forward-looking statements and use of non-GAAP information as part of this call. As you know, some of our comments today may include statements about our expectations for the future. Those expectations are subject to known and unknown risks, uncertainties and other factors that may cause the company's actual results and performance to be materially different from any future results or performance suggested by these expectations. The slide you now see gives you more information on the assumptions and factors we consider in making those forward-looking statements. We can't guarantee the accuracy of any forecasts or estimates, and we undertake no obligation to update any forward-looking statements during the quarter except as otherwise required by law. For more information on our risk factors, please see our earnings press release and our SEC filings.

In addition, some of our comments may reference non-GAAP financial measures. A reconciliation of the most directly comparable GAAP financial measure and other associated disclosures are contained in our earnings release and on our website. Our earnings release and our SEC filings are available on the Internet @hexion.com.

With that, I'll now turn the call over to Craig Rogerson.

Craig Rogerson^ Thanks, John, and good morning, everyone. I'm pleased to discuss our exceptionally strong second quarter performance with you this morning, and more importantly, I'll also highlight where we stand in our ongoing efforts to create and maximize shareholder value.

As we recently announced, Hexion Holdings Corporation, our indirect parent submitted a draft Form S-1 registration statement for a proposed public offering of its common stock later this year. This is only possible due to our dedicated associates around the globe that have managed to keep our plants operating in the face of the pandemic and our financial results over the last 4 quarters as we posted year-over-year growth in each period. We believe we are well-positioned for a planned potential equity offering or other strategic options to create shareholder value.

Turning to our results. Our financial statements reflect the divestiture that was just completed on April 30. Our results from operations and cash flows continue to be differentiated between continuing and discontinued operations. Second quarter sales totaled $848 million, reflecting pricing actions throughout the portfolio, the pass-through of raw material costs and sharper highly volumes in both segments. Segment EBITDA from continuing operations jumped to $160 million, increase of 186% compared to $56 million in the prior year and improved 40% sequentially compared to the $114 million in the first quarter of this year.

Our results reflected significant volume gains and strength throughout the portfolio as well as the impact of COVID-19 on the prior year period, which made for an unusual comp. Several key end markets such as housing, remodeling and architectural coatings reflected strong demand as second quarter EBITDA margins approached 19% and increased 830 basis points compared to the prior year. Finally, following completion of our recent divestiture, we repaid $150 million of the euro-denominated term loan, which put our net debt to pro forma EBITDA leverage ratio at a modest 3x.

Turning to Slide 5. We continue to benefit from the housing and remodeling market tailwinds driving continued year-on-year growth within our Adhesives segment. Strong market demand again drove double-digit increases in our Adhesives segment sales and segment EBITDA in the second quarter, reflecting both total and single-family housing starts that are continuing to increase. We believe these growth trends will continue for some time as we are just emerging from a period of under-building and finally surpassed the 50-year average for housing starts. Most recently, total housing starts increased 29% year-over-year. Both new residential construction and remodeling remains robust, and this continues to create a strong pull throughout the entire supply chain. Numerous multiyear forecast from multiple sources also remain positive.

Turning to Slide 6. We've highlighted a few benefits of wood-based construction enabled by our Adhesives technology. First, 11% of total global carbon dioxide comes from the manufacturing of building materials and construction, which compares favorably against the other sectors, you can see in the pie chart above. While the historical focus has been our operational carbon dioxide savings, the focus has shifted to CO2 release from the materials used to build the structures. When you look at the underlying sustainability benefits, the story is even more promising is the processing of wood requires less energy, resulting in fewer greenhouse gas emissions than other major building materials. For example, it takes 5x as much energy to produce glass as lumber or wood for construction, 7x more for steel, 40x more for aluminum and 100x more for cement. Building with wood can also materially reduce costs compared to weather building materials with estimates ranging between 25% to 50%.

In addition, our sustainability metrics were developed with our residential construction customers in mind, considering wood is inherently a renewable resource supported by responsible forestry practices. Again, for example, our wood adhesives practically allow for the full utilization of a tree. These adhesives are used in plywood, particle board, oriented strand board, which sequesters carbon dioxide throughout its lifecycle. Our adhesive resins serve as the enabling technology behind these sustainable applications.

Turning to Slide 7. Our Coatings and Composites segment, developing strategic partnerships like the one we've recently announced with Rassini as part of our innovative approach towards new product development. This partnership is focused on leveraging our EPIKOTE epoxy resins for use in a rear suspension system in Ford's F-150 pickup. The application developed for Rassini consists of a main steel component supported by a composite helper spring that uses our composite materials. This delivers the same stiffness and durability, but with significant weight reduction and a lower carbon footprint. This is an example of how we work to meet our customers' increasing need for strong yet lightweight alternatives to metal that can be produced at faster speeds.

Now turning to Slide 8. Our second quarter results marked the fourth consecutive quarter where we've driven year-over-year gains in segment EBITDA. We continue to believe that our product portfolio is well positioned to benefit from the improving demand we are seeing from new home construction, remodeling, coatings and general commercial construction as well as a general economic recovery from the pandemic. We expect a strong third quarter of 2021 due to this positive underlying demand. We continue to drive various strategic actions to capitalize on our results and the favorable market trends, all of which we would expect to support our value creation initiatives. For example, again, we've also increased ArmorBuilt manufacturing capacity and plan to add a second automated line to the network, while our Brimbank Australia expansion should come online in mid-2022 to meet growing demand for resins used in fire-resistant cladding.

As previously announced, we were pleased to complete our recent divestiture and use a portion of the proceeds to further reduce our debt. We're driving steadily improving margins that are approaching 19%, and our net debt-to-EBITDA ratio was also trending positively as it stood at 3x. Finally, as disclosed, Hexion Holdings submitted a draft Form S-1 registration statement on a confidential basis last week. The company and its Board of Directors believe that our strong financial performance, favorable end-market exposure and the continued transformation makes an IPO or other value-creating strategic opportunities compelling to consider in the second half of 2021.

I'll now turn the call over to George Knight to discuss our financial results in more detail.

George Knight^ Thank you, Craig.

In our Adhesives segment, second quarter 2021 revenue totaled $409 million, a 62% increase from the prior year, reflecting positive volume gains of 32% and price/mix increases of 23%, largely through the pass-through of raw material price increases and positive foreign currency translation of 7%. Segment EBITDA increased sharply compared to the prior year, reflecting positive demand in North American residential construction and repair and remodeling markets. We also clearly benefited from another strong quarter in Latin America following the restart of our Montenegro Brazil site and volume and profitability gains in our global Formaldehyde business. Segment EBITDA margins also increased 120 basis points versus the prior year.

Turning to the next slide. In our Coatings & Composites segment, second quarter 2021 revenue increased by 57% to $443 million, which reflected positive price/mix of 44%, volume gains of 5% and positive foreign currency translation of 3%. Segment EBITDA more than tripled on pricing actions in both our base and specialty epoxy businesses as well as strong growth in our architectural coatings business driven by Versatics volumes. These trends more than offset some volume declines in our China wind business we saw late in the quarter as demand softened a bit as customers were reacting to higher raw material costs. EBITDA margins also increased sharply and exceeded 24% for the quarter.

Turning to the next slide. Our balance sheet remains strong as liquidity totaled $646 million at quarter end. We remain focused on carefully managing our capital allocation in 2021. We plan to expand our investments in productivity and growth capital expenditures to drive free cash flow and future EBITDA growth in 2021 and beyond. The second quarter saw us invest $28 million in CapEx. We continue to expect to invest approximately $115 million to $125 million in capital expenditures this year. We expect our cash taxes to now range between $30 million to $40 million due to our stronger results.

Based on our strong customer demand and higher volumes, we build working capital in the first half of the year and expect to see a decrease in the second half of the year consistent with historical trends. However, because of the strong rebound in our business this year, we expect to have an overall increase in working capital for 2021. Based on our positive second quarter and second half outlook, we expect to generate significant free cash flow this year. As Craig mentioned, following our recent divestiture, we repaid $150 million of the euro-denominated senior secured term loan in early May, and our net debt to pro forma EBITDA leverage stood at 3x at quarter end.

I'll now turn the call back to Craig.

Craig Rogerson^ Thanks, George.

As I said opening the call, our global teams are committed to driving shareholder value. You can see that across the board, we are trending favorably against all of our key 2021 priorities. First, we continue to drive significant top line and earnings growth. Looking ahead, we expect strong growth in earnings in the third quarter of 2021 versus the prior year as we're seeing broad-based strength throughout the portfolio. And while there's some uncertainty in the fourth quarter due to potential customer manufacturing turnarounds and typical seasonality, we do expect a strong fourth quarter as well compared to the prior year.

Secondly, our past cost control initiatives underpin our increased segment EBITDA margins, and those will continue. Following a strong first half performance, as George said, we expect to generate significant free cash flow this year, while our highly targeted growth CapEx, including self-help productivity investments and new product development initiatives position us for future growth. We're also committed to maintaining our disciplined approach to capital allocation, and we've achieved our initial targeted net debt-to-EBITDA ratio of less than 3x due to our strong earnings growth. Finally, we'll look to maximize long-term shareholder value through a variety of strategic actions, including the recent S-1 filing over the second half of this year.

Operator, that concludes the prepared remarks. We'd now like to open the line for questions. Thank you.

QUESTIONS AND ANSWERS

Operator^ (Operator Instructions)

And our first question is from the line of Roger Spitz with Bank of America.

Roger Spitz^ Starting with the strategic alternatives, I don't know if you'll answer this, but will you be considering running a dual-track IPO or sale process? Or -- because you talk about strategic alternatives, but you only show one strategic alternative at the moment?

Craig Rogerson^ Yes. We showed the one, and our attention is to do something this year because of all the reasons I mentioned. The tailwinds that we have, both our performance, the markets we serve, the financial markets. So we think that window is very appropriate for us to try to take advantage of and create that value. The one that we control totally ourselves, again, outside some big market disruption is the IPO.

So we certainly are moving down that track. Clearly, our objective is to maximize value creation for our shareholders. So whether you call it a dual-track or not, I guess that would be appropriate. We're looking at not only incoming, but we're actively looking at potential alternatives that could create more value than we think we could create in the public markets. And so yes, we are actively pursuing all of those variety of options.

Roger Spitz^ All right. Great. And I mean, you're a public filer, I'm not sure why you're filing a confidential IPO, but we can take that offline. What I'd really like to ask is, can you give a sense if you want to disclose sort of within base epoxy, and specialty epoxies, how much on a percentage basis, because I know you don't want to give numbers, but how much each increased? Was most of this was in base epoxy or was specialty epoxy equally as strong. I mean, it sounds like they were both very strong. But I'm just trying to get a sense of it.

Craig Rogerson^ Yes. I would say -- yes, certainly, all of the segments, whether it's -- in both reporting segments. So in the wood adhesives business, the Formaldehyde business, specialty epoxy businesses, all were strongly up in the second quarter. The most significant increase, certainly from a percentage basis was from base epoxy. And it's probably not surprising. But along with that, specialty epoxy, again, as I said, Formaldehyde and the Adhesive segments were all up significantly as well. But relatively speaking, base epoxy was the highest, yes.

Roger Spitz^ 18.24 Great. Lastly, on Versatic Acids and Derivatives, you do have a comment in the slide that it was strong in architectural coatings, but I noticed there wasn't a comment because I didn't see it in the press release. I guess Versatic Acids were up like everything goes up. But I take it of all the things on the 5 key business, base epoxy, specialty epoxy, Versatic Acids and Derivatives, global Formaldehyde and resins, maybe Versatic Acid was laggard in terms of percentage up year-over-year. Is that a fair comment?

George Knight^ Yes. That's fair, Roger. Versatics had a very good second quarter and year last year. So while they were improved, as you put them on the scale, it would be at the lower end of the improvement year-on-year.

Operator^ Our next question is from the line of Richard Kus with Jefferies.

Richard Kus^ So I'm curious on a few different things. First, on the epoxy -- base epoxy side of the business. Could you maybe talk to the pricing rationality or pricing discipline that you're seeing in that business relative to how it's historically been? I mean, clearly, demand is very strong and supportive of higher pricing in addition to the raw materials you're seeing, but have you seen any change in that market, big picture, that should lead to better pricing on a more consistent basis over time?

Craig Rogerson^ I think that -- well, I'm certainly not going to say it's not a cyclical business. We've seen that over and over. We're clearly at a high point in the cycle at this point. There are a couple of reasons why I think that's going to have a little more legs than maybe it has in the past. Epichlorohydrin is tight, is one of the precursors. I don't think that's going to be solved anytime in the near term future. And the other one that's really a differential than past cycles is the impact of logistics.

So it's very difficult for a product to flow from Asia into Europe or the States just because of lack of ships. And if you can find them the cost of shipping. And so it's really caused a change in the fundamentals of the pricing dynamic. Typically, the prices drop in China first and then it flows to the West. But right now, because of the lack of ships, and again, even if you could get them, the confidence on when the product will arrive is really questionable. But the cost of getting the product over here is kind of putting a -- raising the bar right now.

And depending on who you ask, there is a view that, that will certainly last through a significant part of all of '22 and go into '23 before that issue is resolved at all. We're doing things that we can do to try to raise the bottom of the cycle relative to looking at our sites through these self-help projects to raise the bottom, from a cost side, improve our cost structure. But clearly, the high demand right now, there were effects of winter storm Uri that flowed through the early part of the year have constricted some supply that's kind of behind us now. But this issue of not being able to really tap into the Asian market to get it to the West is also a significant component. And I don't see how that's going to change in any short or medium term.

Richard Kus^ Got it. Okay. That makes a lot of sense. And then you talk about your target net leverage ratio being under 3x. When you think about that, what type of gross debt level are you really targeting?

George Knight^ Yes. I mean, I think we've been thinking about it on a net basis so -- and maintaining the flexibility with what we do with our cash. So we'll continue to review that. And really from a gross debt level standpoint, we don't have a real target now. Again, we're looking at it on a net basis.

Craig Rogerson^ If you look at it as the second -- as the third quarter commences and we get in the fourth quarter or by the year-end, we should be significantly below 3x. To your point, because of the EBITDA and not because of the lower debt, but we're generating significant cash flow as well. So on a net debt basis, obviously, the debt is also going down because we have cash on the balance sheet. And to George's point, we'd like to maintain the flexibility to use that cash. Again, we can use it to pay down debt, if we don't have a better use for it, but we're looking at growth opportunities, organic growth opportunities and inorganic as well on bolt-on acquisition types. But that flexibility right now is important to us as we try to continue to drive the improvements we've seen in 2021.

Richard Kus^ Got it. Understood. And then with respect to the IPO, if that's the track you guys end up going down, what do you see as use of proceeds -- of any primary proceeds that you would receive from that IPO?

George Knight^ Yes, it would be to pay down debt as well as invest back in some growth initiatives that we have on our planning board.

Craig Rogerson^ We've got ideas of where we'd like to invest both organically and inorganically. Clearly, the bolt-on acquisition is tougher because we will be disciplined on what we'll pay. But we can accelerate some of those programs that we are intending to over the next couple of years with some of the proceeds from the IPO. We're in a different position than when we initially were thinking about this even 6 months ago because the performance is so much better in our -- to George's point, our net debt-to-EBITDA leverage ratio has dropped just because of the improvement in earnings, but it's still something we want to look at and maintain. And as we go forward and there's some cycle in the Epoxy business, we want to maintain that kind of leverage ratios. And so we may use some of the proceeds for that as well, just depending on how we look at the time.

Richard Kus^ Got it. Makes sense. Really appreciate the comments. Congratulations, guys.

Operator^ Our next question is from the line of Oren Shaked with BTIG.

Oren Shaked^ So I have a few questions. On the Adhesives side of the business, the margin improvement in the second quarter was lower than the first quarter performance. And actually, the margin was lower. The absolute margin was lower as well. So is there any color you can provide on that and how to think about the second half margin profile?

George Knight^ Yes. I mean, I think when you look at the margins, one of the positives/negatives that we have on the Adhesives business, close to 80% of the volumes we've got pass-throughs for raw material price changes. So in situations when the price of raw materials is going up, and we're passing those on to our customers, mathematically, that has a negative impact on the overall margins. And we think that, that was probably a 1% to 2% impact on our margins in the second quarter.

Craig Rogerson^ So we hold the margin dollars, but the margin percent that is down because of the math, right? That's it.

Oren Shaked^ Understood. And so as we think about the second half, would do you expect that trend to continue?

George Knight^ Yes. I mean, I think from overall margins, we should see things probably coming down slightly again just because of the mathematics involved with the raw material pass-throughs.

Oren Shaked^ Got it. Okay. And then, Craig, as we think about the third quarter, you made some comments in the release that you do expect the strong year-over-year growth. Can you maybe help us with some of the puts and takes as we bridge from this very strong second quarter performance, I'm not sure what the impact from Pernis was in 2Q, but I would imagine that having that facility up and running for all of 3Q should help. So maybe just give us some thoughts as you think about 3Q versus 2Q?

Craig Rogerson^ Yes. We had fairly good performance through most of the second quarter at Pernis. We had issues certainly in the first quarter into the beginning of the second quarter. It's running well now. Deer Park is running well now. That was affected by Uri as well. And so we expect that the volume will continue to be strong in the third quarter. I would expect, as we sit here now, we're almost halfway through the quarter, right, that we could have a sequentially better quarter than the second quarter.

We'll have to see how it all plays out, but it was a very strong comp if you look at this, obviously, if you look at the second quarter. But we see a lot of positives as we go in. Pricing in the Epoxy market, a lot of it is tied to indices, and those indices are coming out. And so we expect strong pricing, at least through August. We'll see how it plays out as we go into September. But we expect a very strong third quarter.

I expect a strong fourth quarter as well. I made the comment that the fourth quarter is typically affected by inventory adjustments at our customers, which is part of that seasonality, I'm talking about, there is some seasonality in the end markets we sell into. But with the issues early in the year, where there's a lot of restricted supply and problems due to the storms, we'll see how the effect is. Maybe that will be different this year because people are running hard to catch up. There are not a lot of inventory in the pipeline, either on our side or through our customers.

So we'll see how the fourth quarter plays out. But as we sit here right now, I think the third quarter will be strong. And again, volume should be strong. We're seeing effects of those high prices of Epoxy in certain areas like wind in China. There are some areas where some markets where they can afford to just not run at this point in time and wait for things to -- from their perspective, hopefully moderate.

We'll see how that plays out. But that pent-up demand, I think, is good from the volume perspective as we look into '22 and '23 on the wind side because they're committed to meeting their requirements of transition from coal to wind over a 5- year period, and it's just backing up a little bit in '21. So again, very optimistic as we go into '22 relative to that following the positive momentum developed late last year into this year and continuing into the second half of '21.

Oren Shaked^ That's super helpful. And then lastly for me, you actually just touched on it, but I wanted to delve on it a little bit more deeply. Well, you've seen this type of slowdown in the past that obviously sounds like it's much more of a response to pricing than it is a reflection of absolute demand. How long does that typically play out? Is that just a few months of a pause as everybody gets their bearings? Could this last a few quarters? Maybe if you could just give us a little bit more clarity around that.

Craig Rogerson^ I would say that's very -- the comment I was making was very specific to wind in China. We've seen demand hold up well even at the increased prices in most of our -- essentially all of our non-wind markets and certainly, wind in the other parts of the world, the U.S. or Europe has stayed very strong. So that's a very specific China comment. So how long can they hold back? I think based on our projections, we're assuming sometime in the latter part of '22, maybe we're being too conservative, but latter part of '22 into 23, it will have to come back.

But even if it doesn't, even if it stays kind of soft into the first half, because of the other markets we sell into, we expect a very solid volume year in '22. And again, we'll see where pricing plays out. It's all dependent on a lot of market dynamics that we've talked about already around supply demand and then these freight logistical issues coming from the East. So I think as we sit here right now, typically, in markets, you think they could wait a little while. But right now, it's again, very specific to China wind on the comment of waiting to see what happens to pricing. I haven't seen -- we haven't seen anywhere else.

Oren Shaked^ Thank you very much and best of luck.

Operator^ Your next question is from the line of Brian DiRubbio with Baird.

Brian DiRubbio^ Maybe starting off with capacity utilization, recognizing you got an eclectic group of businesses. But can you give us any sense of what your operating rates in either as a whole or in some of your businesses? And what I'm trying to drive at is, are you running out of capacity and you could have to add capacity in some of your more legacy lines?

Craig Rogerson^ In the Adhesives segment, I would say the one area where we would be tight and it's the Formaldehyde area. There's a lot of pipeline customers, and we work hard to try to rightsize that with the demand on these long-term contracts. We can build more capacity fairly readily. We have one opportunity to debottleneck or restart an asset that could allow us to have some surge capacity if it's right, you'll spend money. But that's a possibility. But in the resins business, that's not a problem. In the Epoxy area, I don't think it's an issue right now.

We're trying to make up for the fact that we had those impacts of the storm and build inventory because the demand's so high, we had an issue doing that. But all things being equal, we're in pretty good shape from the Epoxy side as well. So that's certainly not going to be a limitation for us to continue to grow in '22, probably not in '23. We are putting capital investments in some specific new product applications. I mentioned the resin plant that's going in, in Brimbank, Australia relative to making products for this is fire-resistant cladding. The ArmorBuilt and the wrap that we're making to protect utility pools, and there's other applications that's expanding rapidly out in the Northwest.

We put in some capacity for Versatic Acids. In Europe, we put in some capacity to make some coatings in South Korea. So we're adding those capacity, but it's more capabilities than absolute capacity. And so we're spending money on those kind of things. But from a base capacity, we're really not restricted in most areas, say Formaldehyde, maybe the one inception to continued growth in the near term.

Brian DiRubbio^ Great. I appreciate the color on that. As you're talking about new products, have you thought about publishing or talking about sort of a new product vitality or a new product index percentage of growth or percentage of revenues that new products have generated over the last couple of years?

Craig Rogerson^ Yes. We do have a metric of -- the typical vitality metric that's a percent of your revenue from products less than 5 years old. And it's pretty good. 20%, about 20% at Chemtura or at Hercules prior to that when I was there, we were always shooting for 18% to 20%. We never guide there. At Hexion, we've been in low 20% range for a number of years. And that's important. It's kind of the frustration we've had in the past is typically, you see that reflected in your margins.

And we hadn't seen that necessarily. So a lot of our new products or replacement products is going to stay ahead of the competition, ahead of the curve. We are starting to see the value of that now. And part of the improvement you saw on the margins is not just the fact that Epoxy margins are moving up, but margins across the sectors, Formaldehyde being the exception for the reason that George talked about, it's math relative to those long-term contracts we have with the raw material pass-through.

But in Adhesives, you can see it in and in some of the Versatics areas, you can see it, where the new products come in at higher-margin and lift us. We're seeing some of the effect of that in the margin improvements we saw in the second quarter, and we expect to see as we go forward. So it's starting to work, but our new product vitality metric is relatively good compared to our peers.

Brian DiRubbio^ Got it. I appreciate that. And then just finally, I want to circle back on the question on your target leverage. Everybody recognizes that you're seeing some pretty good cyclical tailwinds right now. Should we -- are you thinking about or should you be thinking about your leverage target maybe on a trailing average 3-year EBITDA number, because you don't want to get too excited when leverage is below 3x at peak EBITDA and then too depress, if it goes to 6x, just throwing out a number.

Craig Rogerson^ Well, I think that, that -- yes, it wouldn't go to 6x, it could go towards 4x, probably. But I don't think right now that we see that as an issue. To your point, though, that's the point George made. Right now, we wouldn't use IPO proceeds to pay down debt because our leverage ratios as such to be closer to 2 than 3 probably by the end of the year. But if you go at mid-cycle, they could move back above 3x. And if that's the case, it would look like that's the case, we could potentially use some of the IPO proceeds to pay down debt to keep us below 3x, especially as a publicly traded company, that seems to be kind of a marker out there for a business that has some cyclical component.

And clearly, there is that component on the Epoxy side. So that's why we want to maintain the flexibility relative to even the assets -- the cash we have on the balance sheet. Now we could, again, from a net debt basis, it doesn't matter, because the cash accounts is anything else. But actually paying down debt. We want to see if we -- how these are -- these current margins, these current returns on EBITDA are maintained, and we'll make that decision as we go forward. But to your point, mid-cycle, we'd like to be below 3x. And we'll be close to that. And if not at that, but if not, we'll use some of the IPO proceeds to make sure we're there.

Brian DiRubbio^ Got it. And just final question for me. It's still about a year away, but we had the first call date on the 7.875% notes next year. Any thoughts on the disposition of that?

George Knight^ Yes. No, we're just watching that very closely. And depending on market conditions and what our opportunities are, we'll make some decisions on that next year.

Brian DiRubbio^ Understood. Appreciate the color.

Operator^ (Operator Instructions)

And at this time, there are no further questions. I'd like to turn the call back over to Craig Rogerson, Chairman, President and CEO.

Craig Rogerson^ Thanks. Thanks for joining our call today. We're pleased that we continue to drive strong year-over-year and sequential earnings growth, and we remain committed to delivering sustainable and profitable growth and consistently increasing value for our shareholders. We look forward to updating you again on our next earnings call in November and look forward to another very positive report. So again, thank you for your interest.

Operator^ Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.