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Brian Lalli *Barclays - Analyst*

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Jeff Ryan *Gordon Brothers Finance - Analyst*

Bob Amenta *JP Morgan - Analyst*

PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Hexion First Quarter 2016 Earnings Conference Call. At this time, all participants are in a listen-only mode. Later we will conduct a question-and-answer session and instructions will follow at that time. (Operator Instructions) As a reminder this call may be recorded.

I would now like to introduce your host for today's conference, John Kompa, Investor Relations. Please go ahead, sir.

John Kompa - *Hexion, Inc. - VP, IR*

Thank you, Christie. Good morning, and welcome to the Hexion, Inc. First Quarter 2016 Conference Call. Leading today's call will be Craig Morrison, 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 Investor Relations section of Hexion, Inc. A replay of this call will be available for one week. And the replay dial-in information is contained in our latest earnings release.

Before we start, I'd like to review the information about forward-looking statements and the 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 recent SEC filings are also available on the Internet at hexion.com.

With that, I'll now turn the call over to Craig Morrison to discuss our financial results.

Craig Morrison - *Hexion, Inc. - Chairman, President, CEO*

Thanks, John. On Page 4, our first quarter 2016 revenues decreased 16% to \$909 million, reflecting the negative impact of the strengthening U.S. dollar, softer volumes in oilfield proppants, and lower selling prices from the decline in raw material costs. Our segment EBITDA totaled \$122 million, a 4% decrease or a 2% increase on a constant currency basis.

In our Epoxy segment, segment EBITDA decreased by \$2 million, as our specialty epoxy and Versatic Acids and Derivative businesses partially offset weaker oilfield proppant volumes and the impact of the strengthening U.S. dollar. Our global Forest Products EBITDA declined by \$5 million, primarily due to \$4 million in currency headwinds and extended customer turnaround and Latin American volatility.

We also brought online the last of our three new formaldehyde sites in February. We invested approximately \$125 million in these new facilities, which will begin to drive growth in 2016 and beyond. The operations and manufacturing teams did a tremendous job completing the projects on time and on cost.

Turning to Slide 5. We continued to see gains in key specialty product lines in the first quarter. In particular, our specialty epoxy resins business had a good quarter supported by strong demand from wind energy customers and demand from our Versatic Acid businesses rebounded after supplier force majeure last year. As previously announced, at year-end, we identified approximately \$35 million in additional productivity projects. As of March 31, we had \$38 million of structural cost savings that remained in process.

At quarter end, we had cash and available borrowings of \$418 million. In March, we also entered into a definitive agreement for the sale of our Performance Adhesives, Powder Coatings, Additives & Acrylic Coatings and Monomers businesses to Synthomer for approximately \$226 million. We plan to use the proceeds from the sale to invest back into the business and for general corporate purposes.

Turning to Slide 6, in our raw material index. You can see that our total raw material costs decreased by approximately 10% on a sequential basis. When considering our three major raw materials, phenol was flat year-over-year, while methanol and urea significantly declined. We continue to expect that raw material pricing will remain favorable in 2016.

Turning to Slide 7. We've highlighted our specialty epoxy business, which serves the key supplier to the wind energy market. Our composite solutions are used in wind turbines, as we offer rotor blade infusion systems and bonding pastes. Our specialty epoxy business continues to perform well as wind energy demand is strong, particularly in Asia. The wind power industry set new records across the world last year according to the Global Wind Energy Council. The GWEC projects that wind power installations will nearly double in the next 5 years, led by China with major contributions from both Europe and the U.S.

While we derive a significant share of our wind energy business from Asia Pacific region, our business is well positioned globally as we continue to benefit from growth in multiple regions. You can see that our specialty epoxy volumes were up significantly year-over-year in 2015 and that trend continues in the first quarter of 2016.

Turning to Slide 8. We've highlighted our strategic investments in our formaldehyde business, while simultaneously executing our targeted cost actions, which allow us to maintain a leading cost structure. And ultimately, we deploy growth capital into our business. As part of our \$125 million total investment, the new sites clearly meet the growth plan principles that we've outlined. With specialty-type margins in our formaldehyde business, the three new sites strengthened our American footprint, Americas footprint.

We are serving such notable customers, as BASF and Monsanto, and our Forest Products business team is focused on executing on our growth plans to maximize our investment returns. Our expanded productivity program is also proceeding as planned. We are working to achieve the incremental \$38 million of cost savings, which includes our announced plans to rationalize portions of our base epoxy resins business by closing our Norco site, Louisiana, by June of 2016. We expect this to add \$20 million in segment EBITDA on a run rate basis. We're also continually evaluating our network for efficiency opportunities whether as SG&A-oriented or adjusting our footprint.

I'll now turn the call over to George Knight to further discuss our financial results. George?

George Knight - *Hexion, Inc. - EVP and CFO*

Thank you, Craig. Turning to our Epoxy, Phenolic and Coating Resins segment. First quarter 2016 revenue totaled \$575 million, reflecting a 15% decrease from the prior year due to a negative price mix impact of 10%, currency headwinds of 3%, and the impact of lower volumes of 2%. Segment EBITDA decreased by \$2 million compared to the prior year as improvement in our specialty epoxy and Versatics businesses partially offset lower volumes in our oilfield business. Excluding the negative \$2 million currency impact, segment EBITDA was flat with the prior year period. Segment EBITDA margins improved by 180 basis points.

Turning to the next slide. In our Forest Products Resins segment, first quarter 2016 sales totaled \$334 million, an 18% decline from the prior year, with negative currency translation of 8%, lower volumes of 5% and negative price mix of 5%, primarily due to the pass-through of raw material price changes. Segment EBITDA declined by \$5 million or 8%, and reflects currency headwinds, unplanned formaldehyde customer outages, and softness in Latin America. Excluding the negative \$4 million currency impact, segment EBITDA declined by \$1 million. Segment EBITDA margins improved by 170 basis points in the period.

Regarding our balance sheet, our cash plus borrowing availability under our credit facilities was \$418 million at quarter end. Our first quarter 2016 capital expenditure investments totaled \$27 million. We expect our CapEx to be lower in 2016 and return to more historical levels now that our forest product expansion is complete.

Net working capital totaled \$507 million as of March 31, up from yearend 2015, reflecting the increased volumes in the first quarter of 2016 compared to the fourth quarter of 2015. In the first quarter of 2016, a portion of our inventory increase is also attributed to inventory buildup in some of our businesses in anticipation of scheduled turnarounds later in the year. Net working capital still remained a modest 14% of last 12-month sales. Overall, for the year, we expect a slight increase in net working capital with an increase in the first half of the year and a decrease in the second half consistent with historical trends.

I'll now turn the call back to Craig to wrap up.

Craig Morrison - *Hexion, Inc. - Chairman, President, CEO*

Thanks, George. Turning to Slide 14. In summary, our first quarter EBITDA 2016 gained 2% on a constant currency basis. The addition of our new formaldehyde site in Luling, Louisiana, the third in three quarters, kept the period of heightened investment for our Forest Products business that we expect will position Hexion for long-term success. We continue to drive operating efficiencies throughout our business. Our current program is progressing as planned, and we're focused on driving the \$38 million of in-process cost savings to completion.

In closing, with liquidity of \$418 million, we continue to prudently manage our balance sheet. Let me now turn it over to the operator for any questions that you might have. Operator?



QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Tarek Hamid of JP Morgan.

Tarek Hamid - JP Morgan - Analyst

Good morning, gentlemen, and thank you. On the specialty epoxy, the margin improvements, the epoxy margin improvement, how much of that is growth in specialty epoxies and wind energy as you pointed to versus structural cost saves? Can any way you can help bridge us in terms of that margin improvement year-over-year?

Craig Morrison - Hexion, Inc. - Chairman, President, CEO

In terms of specialty epoxies, it's largely driven by a combination of volume and also pricing as well as some raw material decline in cost. There's a mixture of things there.

Tarek Hamid - JP Morgan - Analyst

And sort of your disproportionate amount of the cost savings program hitting the epoxy business in aggregate?

Craig Morrison - Hexion, Inc. - Chairman, President, CEO

There's a significant amount in our base epoxy business, our specialty epoxy business. So if you're talking epoxies in total, there is a significant piece there, but it's not on the specialty side. I was interpreting your question about, more about the wind energy and the other specialty epoxy elements; if you're talking about the total epoxy businesses, significant amount of cost there.

Tarek Hamid - JP Morgan - Analyst

So sort of real cost reduction in base epoxies and then some good growth in margin expansion in specialties?

Craig Morrison - Hexion, Inc. - Chairman, President, CEO

Yes.

Tarek Hamid - JP Morgan - Analyst

Got it. And then on the -- with the new products, the new plant ramp-up in the formaldehyde business, sort of any working capital needs for that in the second quarter? Or is that mostly embedded in the first quarter?

George Knight - Hexion, Inc. - EVP and CFO

Yes, we saw some impact in the first quarter there. As we continue to ramp up, we'll see some slight increases.

Tarek Hamid - *JP Morgan - Analyst*

Do you expect the ramp-up process for that a kind of three to six months or longer?

George Knight - *Hexion, Inc. - EVP and CFO*

Yes.

Tarek Hamid - *JP Morgan - Analyst*

(Inaudible) 14:31.

George Knight - *Hexion, Inc. - EVP and CFO*

Yes.

Tarek Hamid - *JP Morgan - Analyst*

And just last one for me, looks like you guys bought back a little under \$80 million of the 1.5 liens. Could you maybe just talk about priorities for cash as you roll into the second half of the year? How you're thinking about additional buybacks versus CapEx and sort of the broader liability management framework?

George Knight - *Hexion, Inc. - EVP and CFO*

Sure. I think the share buybacks is one of our allocation of capital decisions. We look at market conditions as well as our liquidity and expected returns, and compare that to investments in growth capital. As you said, in the first quarter, we spent \$54 million on debt buybacks, the face value of \$78 million that was retired there. So we did see a nice return related to that investment for us.

Tarek Hamid - *JP Morgan - Analyst*

Got it. That's helpful. Thank you, guys, very much.

Operator

Our next question is from Roger Spitz of Bank of America Merrill Lynch. Your line is open.

Chris Ryan - *Bank of America Merrill Lynch - Analyst*

This is Chris Ryan on for Roger. Thanks for taking my questions. My first question in regards to the base epoxy business, what did the base epoxy business results do either year-over-year or sequentially, just directionally?

Craig Morrison - *Hexion, Inc. - Chairman, President, CEO*

The base epoxy in the first quarter improved and significantly improved over prior quarter -- or on a year-over-year basis improved and significantly improved on prior quarter. Base epoxy on a prior quarter basis, when you compare first to fourth, can be a little misleading because you tend to

have other factors like plant turnarounds that are in process. So it's more -- it's better from a reliability standpoint to assess on year-over-year and there was a significant improvement in that time period.

Chris Ryan - *Bank of America Merrill Lynch - Analyst*

Thank you. And what did proppants results do sequentially?

Craig Morrison - *Hexion, Inc. - Chairman, President, CEO*

They deteriorated, which I think is in line with what we saw from an industry basis and others are reporting. You still had a decent environment on a comparative basis in the first quarter of last year. It was really after that you started to see a fair, much more rapid decline in industry conditions. So you're comping against still a fairly favorable quarter last year.

Chris Ryan - *Bank of America Merrill Lynch - Analyst*

Okay. Thank you. And what was the EBITDA impact of the formaldehyde customer outage in Q1 '16? And will there be any knock-on effects in Q2 '16?

George Knight - *Hexion, Inc. - EVP and CFO*

Yes -- no, the EBITDA impact was less than \$1 million, and we don't expect any continuing ongoing impact from that.

Chris Ryan - *Bank of America Merrill Lynch - Analyst*

Okay. And just finally from me, SG&A always seems to be higher in Q1. Is there seasonality involved? And do you expect SG&A to decline for the rest of the year as it has done in the last few years?

George Knight - *Hexion, Inc. - EVP and CFO*

Yes -- no, there's really no seasonality there. We expect to see continued improvements related to some of the cost savings initiatives, so those will continue to roll in year-on-year. We did also have a positive impact in Q1 this year from FX compared to last year. But then offsetting that in the first quarter of this year, our insurance recoveries were \$3 million less on our Versatics business as well as we did have some deal-related cost that hit SG&A in first quarter this year that were not in last year's.

Chris Ryan - *Bank of America Merrill Lynch - Analyst*

Sorry, what was the insurance recoveries? Was that in -- that was in Q1 '15 or Q1 '16?

George Knight - *Hexion, Inc. - EVP and CFO*

Both. We have recoveries on the business interruption related to our Versatics business, but in 2015, it was \$3 million higher than 2016.

Chris Ryan - *Bank of America Merrill Lynch - Analyst*

Okay, thank you. That's all my questions.

Operator

Our next question is from Bill Hoffmann of RBC Capital Markets. Your line is open.

Bill Hoffmann - RBC Capital Market, LLC - Managing Director

Yes, thanks and good morning. Craig, can you talk a little bit about the formaldehyde plants that were started up last year? Like, how much was contributing here in the first quarter?

Craig Morrison - Hexion, Inc. - Chairman, President, CEO

Yes, I would say, the first quarter we had talked previously on the last call mid-teens is what we expected for the year, and I'd say you had a couple of million contribution in the first quarter as they're in startup mode and stuff.

Bill Hoffmann - RBC Capital Market, LLC - Managing Director

Okay. And you mentioned some, I guess, some customer outages in the first quarter. Any sense of what that impact was on the quarter?

Craig Morrison - Hexion, Inc. - Chairman, President, CEO

Yes, as we just talked about, slightly less than \$1 million from a customer. We don't expect bleed over into the second quarter from that.

Bill Hoffmann - RBC Capital Market, LLC - Managing Director

Okay. And then with regards to your own planned outages this year, I mean, you obviously took a lot of downtime in Q4 last year, it sort of balanced the markets. Any thoughts on how the things look this year?

George Knight - Hexion, Inc. - EVP and CFO

Yes, our turnarounds this year are going to be concentrated in Q2. As I said, that was part of the working capital build that we saw, too, in Q1 with an anticipation of those turnarounds.

Bill Hoffmann - RBC Capital Market, LLC - Managing Director

Okay. Thank you. And then more broadly, in the epoxies business with this Norco closure, where do you see your operating rates in base epoxies at this point, Craig? And do you think the industry -- it sounds like the industry is also getting better, that's why we're seeing better demand globally at this point?

Craig Morrison - Hexion, Inc. - Chairman, President, CEO

Well, there's a couple of things going on. We don't usually talk about or we don't really disclose our operating rates. But you do have capacity and number of product lines coming on in Asia still, and the first quarter was more favorable than we'd seen in a while. We do see that weakening as we move into the second quarter. That can always change fairly quickly from environmental issues, plant turnarounds, things of that nature as well as our own actions of the Norco will improve our financials. But right now, we'd say the market is actually weakening a little bit in terms of excess capacity coming on in Asia and impacting potentially the profitability there.



Bill Hoffmann - RBC Capital Market, LLC - Managing Director

Okay, thanks. And then just lastly, on these cost saves, you said you had \$38 million in profit and then you had another \$35 million on top of that. Is that correct?

Craig Morrison - Hexion, Inc. - Chairman, President, CEO

No, that -- think of the \$38 million as the total number. The \$35 million was the program, and there were three more additional still bleeding over from past (inaudible) to equal \$38 million.

Bill Hoffmann - RBC Capital Market, LLC - Managing Director

Thank you.

Operator

Our next question is from Karl Blunden of Goldman Sachs. Your line is open.

Karl Blunden - Goldman Sachs - Analyst

Hi, good morning. What if -- we [talked] 22:20 a little bit about the forest products business down in Brazil and a little bit of less of a ramp and you'd initially expected just given that customers have lower volumes than we had anticipated about a year ago. Do you have a sense of what the utilization rates can get to in those new formaldehyde plants where they're topped out just given current demand trends?

Craig Morrison - Hexion, Inc. - Chairman, President, CEO

Well, the challenge you have when we're building the plant, we have specific contracts tied to a customer plant that was simultaneously being built, and the challenge you have is everybody is well aware of the macroeconomic and political situation in Brazil. We don't have any doubt that eventually we'll be running that plant full out and will contribute what we had targeted. The only thing that may affect the bottom line EBITDA wise will be fluctuations in FX, which can obviously decrease as you translate back to the U.S. I think the challenge you're going to have, it's difficult to project because there's so many political implications as to how fast an economy will come back.

But I was just down there a few weeks ago, and we had a well-known economist briefing us, and he was saying he thought that the remainder of '16 and much of '17 will remain in depressed conditions. As you know, they are in a significant recession right now, and it will start to work its way out as the second half of '17 moving into '18. So I think you could see a delay through that time period. I certainly don't have any better information than he would have. So that's about the best kind of forecast that I can give.

Karl Blunden - Goldman Sachs - Analyst

Helpful, though. And then just moving onto proppants, is there anything you can tell us about sequential pricing or volumes in the business versus last quarter? And then, the second thing is, it would help us as we model this out to think about how large the EBITDA decline was last year in proppants from 1Q to 2Q? And that's when you really saw the big drop-off. Is there anything you can help us with in terms of gauging that impact?



Craig Morrison - Hexion, Inc. - Chairman, President, CEO

We really don't disclose the specific BU profitability. I think if you look at competitors and you look at the industry, it's indicative of what you would see in our business in order of magnitude of declines, it is very significant. That's been historically a very well performing business for us, and it's in very depressed conditions right now as an industry.

We fully expect that industry will ultimately recover. We can start to see a little bit of pricing lately with oil prices up around \$46 again. But we certainly don't expect a quick rebound, but -- it's a business that we think has good upside potential in the future. But I think you can look at competitors and see order of magnitude as to the type of declines they've seen in profitability, and it will be as applicable for us.

Karl Blunden - Goldman Sachs - Analyst

Yes. And then just finally on the working capital side of things. Working capital is pretty big. Cash used this quarter -- you stoked it a little bit in your prepared remarks that had to do with an uptick in volumes late in the quarter. Is there anything else going on there? Is there any change in customer payment terms? Any change in your terms with suppliers? Anything there that we should look into?

George Knight - Hexion, Inc. - EVP and CFO

No, no change in terms or anything like that. We did have a mix change, though, too as we talked about as our business in Asia Pacific increases there, the supply chain is longer, and some of the terms on the receivable side tend to be a little bit longer. So that also impacted the working capital along with the turnarounds and the volume increases.

Karl Blunden - Goldman Sachs - Analyst

Okay. That's helpful context. Thanks for the time, guys.

Operator

Our next question is from James Finnerty of Citi.

James Finnerty - Citi - Analyst

I just wanted to check if you had repurchased any more debt post quarter end? (Multiple speakers) --

George Knight - Hexion, Inc. - EVP and CFO

No, we don't -- yes, we don't disclose that, James.

James Finnerty - Citi - Analyst

Okay. And just with the asset sale when it does close, with regard to proceeds, is there any guidance in terms of tax impact, I'm not sure if you answered that already? And would you look to potentially pay down the ABL with the proceeds later in the year?

George Knight - Hexion, Inc. - EVP and CFO

You mean on the proceeds, taxes, we believe they will be minimal. Deal expenses will be in line with normal type things. We expect to use the proceeds to invest back in the business over a period of time.

James Finnerty - Citi - Analyst

Okay, thank you.

Operator

Our next question is from Brian Lalli of Barclays. Your line is open.

Brian Lalli - Barclays - Analyst

Good morning, guys. Craig, if I may, I thought we'd touch on this quarterly, but just on the margin side of things, it sounds like you're seeing a good mix of pricing and volume improvement in the more specialty applications. Obviously, there's a positive impact of cost saves, but some of this is also raw material driven. So is there just maybe some high-level guidance you could give us on margins in the EPCR segment? Is this 14.5% a good run rate as you see the business trending into '16? Or maybe what are just some of the puts and takes as we think about it from a high-level? That would be helpful.

George Knight - Hexion, Inc. - EVP and CFO

Yes, I think as you look at '16, that, that's indicative. You always have, I'd say, as you look a little further out, the challenges if raws start to escalate again. There could be a negative impact conversely if you get uplift from oil, which would probably be the catalyst to the raws escalating; then you would also have a counterbalancing significant positive for us because that's a very profitable business historically.

So I think for now, looking at it as indicative, we've been significantly higher than that in peak conditions. It's been 18%, 19%. So it's certainly not out of bounce at all. And depending on if something negative happens, we've also seen obviously lower. So I don't think that this is -- I think it's indicative of what you could expect.

Brian Lalli - Barclays - Analyst

Okay, that's helpful. And then maybe 1 just housekeeping. On CapEx, I know guidance is down year-over-year. The quarterly number would imply that you're pacing well below that. Any more refined thoughts on how to model out '16? Does a number like 150 make sense? I don't want to put numbers in your mouth if you don't want to. I'm just sort of thinking about how to pace the next three quarters of capital spending from a cash standpoint? Thanks.

George Knight - Hexion, Inc. - EVP and CFO

Yes, I think first quarter was a little bit lower. I wouldn't run rate that for the full year. Historically, our average has been around 130 to 140 in a normal year. So we'll probably be in the low end of that range for the full year 2016.

Brian Lalli - Barclays - Analyst

Great. Thanks, guys. I appreciate it.



Operator

Our next question is from [Malone Ma] of [Simpleport International]. Your line is open.

Malone Ma - *Simpleport International - Analyst*

Sorry, my question has been answered. Thank you.

Operator

Our next question is from Caitlin Driscoll of Gordon Brothers Finance. Your line is open.

Jeff Ryan - *Gordon Brothers Finance - Analyst*

This is Jeff Ryan, Caitlin's analyst. I know you guys touched on this earlier, but could you elaborate more on the bond buybacks of \$80 million at the half liens or what that essentially means for your capital structure going forward?

George Knight - *Hexion, Inc. - EVP and CFO*

Yes, I mean, as we said, we use \$54 million of cash to buy back \$78 million of the 1.5 lien. We're continuing to look at our capital structure and look at what our different options are going forward, but we have nothing to report specifically today.

Jeff Ryan - *Gordon Brothers Finance - Analyst*

Okay, thank you.

Operator

And our next question is from [Bob Amenta] of JP Morgan. Your line is open.

Bob Amenta - *JP Morgan - Analyst*

Yes, hi. Just one follow-up, I just want to make sure I had this right. I had notes down that after last quarter's call, with the purchase you did in December quarter that there was an RP basket that I had \$140 million number. I guess, just wanted to affirm that and then I assume if that was right, we would just roughly subtract \$55 million from that to get to what might be left under the first lien notes for your ability to buy back kind of stuff that's junior to that?

George Knight - *Hexion, Inc. - EVP and CFO*

Yes, we have no update on our basket availability today. We're just, as we said in the past, comfortable with our basket capacities.

Bob Amenta - JP Morgan - Analyst

Okay. And I'm guessing then on the concept of additional -- it's also a basket, I guess, a different basket question, additional first lien, I guess, you're not providing any guidance as to how much more first lien you could issue as of today or what that's driven by. Is that a leverage and maximum leverage calculation? Is it a pure dollar buildup kind of basket calculation?

George Knight - Hexion, Inc. - EVP and CFO

Yes, we have no additional guidance on that today.

Operator

Thank you. And I'm not showing any further questions on the phone lines. I would now like to turn the call back over to Mr. Craig Morrison for any further remarks.

Craig Morrison - Hexion, Inc. - Chairman, President, CEO

Thank you, operator. We'd like to thank, everybody, for participating today. We look forward to giving you further updates in the future quarters. And, again, thanks for participation.

Operator

Ladies and gentlemen, thank you for participating in today's conference. This does conclude today's program. You may all disconnect. Everyone, have a great day.

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