Third Quarter 2017 Financial Results Conference Call Transcript
November 3, 2017

Operator introduction

Good morning ladies and gentlemen, and welcome to the Trinseo Third Quarter 2017 Financial Results Conference Call. We welcome the Trinseo management team, Chris Pappas, President & CEO, Barry Niziolek, Executive Vice President & CFO, and David Stasse, Vice President of Treasury and Corporate Finance.

Today's conference call will include brief remarks by the management team followed by a question and answer session. The company distributed more detailed remarks on its financial results, along with a press release and presentation slides, at close of market yesterday. These documents are posted on the Company's Investor Relations website and by means of a Form 8-K filing with the Securities and Exchange Commission.

If anyone should require operator assistance during the call, please press *, then zero, on your telephone. I will now hand the call over to David Stasse.

Dave Stasse

Thank you Michelle and Good Morning everyone. At this time, all participants are in a listen-only mode. After our brief remarks, instructions will follow to participate in the question and answer session.

Our disclosure rules and cautionary note on forward-looking statements are noted on slide 2. During this presentation, we may make certain forward-looking statements, including issuing guidance and describing our future expectations. We must caution you that actual results could differ materially from what is discussed, described or implied in these statements. Factors that could cause actual results to differ include, but are not limited to, factors set forth in our annual report on Form 10-K under the Item 1A, "Risk Factors".

Today's presentation includes certain non-GAAP measurements. Reconciliation of these measurements is provided in our earnings release and in the appendix of our investor presentation. A replay of the conference call and transcript will be archived on the Company's Investor Relations website shortly following the conference call. The replay will be available until November 3, 2018. Now, I would like to turn the call over to Chris Pappas.

Chris Pappas

Thanks, and welcome to Trinseo's third quarter 2017 financial results conference call. I would like to highlight a few key points on our financial results and strategic initiatives.

First, we continue to see strong business fundamentals across our portfolio. Third quarter net income was $33 million which included a $66 million pre-tax charge related to our debt refinancing. Adjusted EBITDA for the quarter was $166 million, which exceeded the guidance of $110 million to $120 million from our second quarter call. Our improved operating performance was due primarily to higher styrene margin from unplanned supply outages as well as improved margin in our Basic Plastics and Latex Binders segments. This result included a $25 million, unfavorable pre-tax net timing impact.

Second, in September, we closed a refinancing of our balance sheet that will reduce our annual cash interest by $25 million per year.

Third, at our Investor Day in November 2016, we laid out a series of actions that we said would increase the EBITDA of our Performance Materials segments by $75 million. These actions, along with an EBITDA contribution of $25 million from actions that were not yet identified at that time, would increase EBITDA from 2016 to 2019 by a total of $100 million. I am pleased to report that, one year later, we are making significant progress toward this goal. Let me provide an update on some of these actions.

In the third quarter we closed on the acquisition of API Plastics and are working to integrate the business. In particular, we are already identifying and executing on complementary technology opportunities, where we can offer products to differentiate Trinseo's offerings to the automotive and consumer essentials markets.

Also, we recently completed the construction of our new ABS plant in China – an 18-month project that was completed on time and injury free. We expect to begin selling ABS from this plant in the fourth quarter of this year.

In the fourth quarter, Trinseo will open a new SSBR pilot plant in Germany. This pilot plant will allow for more efficient use of our production facilities and help speed-up innovation in the Performance Tire market from lab sample to commercialization. The pilot plant will also deliver sufficient quantities of new SSBR formulations required for real-life tire testing.

Fourth, we expect higher full-year operating results in comparison to the outlook we provided on our second quarter call. We expect net income of between $280 million and $288 million and Adjusted EBITDA of between $605 million and $615 million. For earnings per share, we expect diluted EPS of $6.23 to $6.41 and adjusted EPS of $7.53 to $7.71. Our outlook assume $25 million of unfavorable net timing impacts, on a pre-tax basis, including minimal impact in the fourth quarter. This higher expected operating performance is driven by the strong third quarter discussed earlier as well as additional improvement in the fourth quarter from stronger market conditions in Basic Plastics.

And lastly, looking into 2018, we expect net income of between $343 and $367 million, Adjusted EBITDA of between $620 and $650 million, and diluted earnings per share of $7.66 to about 35% of the $100 million Performance Materials EBITDA growth target.

And now, Michelle you may open the phone line for questions.

Operator

At this time if anybody would like to ask a question, please press star 1 on your telephone keypad. That would be star 1 on your telephone keypad.

Your first question comes from David Begleiter. Your line is open.

David Begleiter - Deutsche Bank

Thank you; good morning. Chris, looking at the 2018 guidance, what are your expectations for the styrene market next year and how that translates – you know progresses through the course of the year? Thank you.

Chris Pappas

Hi David. Thank you, David. We've been saying, as all of you know, for some time now that the styrene market and the styrenics market in general are trending positively in the sense that the supply / demand dynamic continues to move generally favorably, and we would see that continuing into 2018 for styrene. So there's limited supply, only really a couple of small plants in the interior of China coming on over the next couple of years. Demand forecast continues to be in the 2.1 percent per year growth, and on that basis, David, we would say generally improving conditions. So that's really the baseline view, if you will, of styrene for us. Now, of course, we have had a series of unplanned outages in this business, and we do not forecast those as, you know, and we do not include any of that in our guidance. We do, however, have at least somewhat of a view of the planned outages next year, and they would appear to be perhaps slightly higher than 2017. I'm talking about the industry now on planned outages. I think if you add all that up, we're generally constructive year over year, as we have been continuously now for the last several years.

David Begleiter - Deutsche Bank

Very good Chris and just on the $100 million, on the incremental EBITDA from the Performance Materials growth projects, I think it's $25 million incremental. Is that all from the SSBR pilot expansion, and will the balance of that $65 million be in 2019? Thank you.

Chris Pappas

Well, for next year we're going to see some of the expansion from rubber kicking in, but it will be about $10 million dollars. We'll have additional growth of our Performance Materials business next year from other items, like latex binders, and we'll of course have the contribution from API Plastics. So yes, rubber's part of that, but the major growth from rubber from the expansion will occur later in '18 and into '19.

David Begleiter - Deutsche Bank Securities, Inc.

Thank you very much.

Operator

Our next question comes from Bob Koort. Your line is open.

Dylan Campbell - Goldman Sachs & Co. LLC

Hi. This is Dylan Campbell on for Bob. Quick question: can you help us understand how you got to that $30 million dollars impact from unplanned styrene outages during the quarter?
Is that essentially just increase in margins during the time with unplanned outages, or does it include kind of a time post outages, where the industry broadly will rebuild inventories during that period?

Chris Pappas

Well, it's clearly an estimate. We've been through this kind of exercise before where we've tried to quantify the effect of unplanned outages, and generally it's the combination of all of that. So, I would not want you to think there is obviously a lot of precision in that number. It's a number that we put our best efforts in to calculate. And we try to make a judgment, and an assessment

of if the outages did not occur, the unplanned outages, how would the margins have been going forward, and we do a calculation on that, including building and rebuilding an inventory, and we come up with that number. So I think you should take it as it's stated, as an estimate of the effect. It's clearly not possible to precisely calculate the effect of unplanned outages. But we think it's important that you have a sense of that because it's an unplanned event, and that's the reason we disclose that calculation to you.

Dylan Campbell - Goldman Sachs & Co. LLC

Okay. Thank you. And during the first half of the year we saw some additional unplanned outages. Does that kind of imply in your guidance that you thought it was kind of a normal rate per se of unplanned outages during the first half of the year?

Chris Pappas

Again I think that – Yeah. Again, we've tried in the past, and will in the future, to characterize and give you a financial monetization of significant events in the styrene industry. Obviously, the hurricane was a significant event. There are always going to be smaller events during the year, and anything that happened really in the first half of the year, in our view, would be characterized that way, and just not a substantial effect on the numbers.

Dylan Campbell - Goldman Sachs & Co. LLC

Okay. Thank you.

Operator

Your next question comes from Frank Mitsch. Your line is open.

Frank Mitsch – Wells Fargo Securities LLC

Hey. Good morning, guys. Hey, Chris coming back to the 2018 guidance, I believe, well, if you to go back to 2014, that's when Performance Materials I think was ahead of Basic Plastics, but that was the last time I think. Are you looking at 2018 Performance Materials being greater than Basic Plastics? How should we think about the interplay between the two major segments?

Chris Pappas

I think compositionally that's correct for 2018. If you take the $35 million dollars that we've kind of forecast of the $100 million, and if you look at the puts and takes, Frank, and we'll talk a lot more about this in February on our call, you would expect Performance Materials to be a little bit higher next year than Basic Plastics. So in the construct of the guidance, yes, they're still pretty close, but Performance Materials would be in aggregate a little bit higher than Basic Plastics.

Frank Mitsch – Wells Fargo Securities LLC

All right. Great. And obviously, that doesn't take into account potential outages in the industry, which almost we can start forecasting because it seems to happen on a very regular basis. And then, looking at your slide on European and styrene margin trends, December is forecast to be flat with November in both Europe and Asia. Is that just a placeholder estimate, or what are some of the assumptions behind December holding flat with November?

Chris Pappas

I think, it's more than a placeholder. We are sitting here, on November 3; we have a decent view of the world. But we basically think it's going to be similar, and rather than try and call a difference, Frank, of 10 or 15 either way, I think, in fairness, we would just call it similar, and put the same gray bar in. It's not meant to be precise, obviously, but I think the takeaway is we think the margins will be pretty similar to our November.

Frank Mitsch – Wells Fargo Securities LLC

All right. Terrific. Thank you so much.

Operator

Your next question comes from Hassan Ahmed. Your line is open.

Hassan Ahmed - Alembic Global Advisors

Good morning, Chris.

Chris Pappas

Hey, Hassan.

Hassan Ahmed - Alembic Global Advisors

Chris, question around inventories: sort of generally, where are inventories? How do you see them sort of globally? And, more specifically, I mean if I sort of sit there and think about how the year has progressed, obviously, it seems that there was a sort of major restocking, call it, in Q1 in China, followed by a major de-stocking thereafter. So, just any help with regards to where you see global inventories, and more specifically Chinese inventories as well for styrene?

Chris Pappas

I'm sorry you said it again for styrene, right, that's not...

Hassan Ahmed - Alembic Global Advisors

For styrene correct, yes.

Chris Pappas

Yeah, for styrene, yeah. I think you're exactly right, there was a bill, there was a depletion, there was actually a little bit of a lift kind of in the third quarter in China. But as we end the quarter, they're back down, and then we're talking just styrene now, and they're running about 40% of what we would call normal inventory at the moment. They had been at that level, a little lower, they came up, but the fact is the best data we have, today there are about 40% or normal as we head into Q4.

Hassan Ahmed - Alembic Global Advisors

Understood, understood. That's helpful.

Chris Pappas

So they're still pretty low. The answer is, they are still pretty low. Yeah.

Hassan Ahmed - Alembic Global Advisors

Got it, got it. Now, moving on to the supply side of things, as I sort of take a look at what some of the sort of industry elites have been talking about, there was supposed to be incremental capacity for styrene coming in Brazil. And then you had one facility, one styrene monomer line, coming online in China, then one sort of smaller expansion in China as well. So have those facilities come online, have they been digested quite well by the market? What's the status on those?

Chris Pappas

The facility in China that was supposed to come up later this year, we believe has been pushed; we kind of have pretty good data on that. And, that was pushed primarily due to continued regulatory discussions, if you will. As far as Brazil goes, we believe that capacity is in fact up, and we think, maybe some smaller capacity in Korea, but it's hard to tell precisely. But our net answer is, we would say that they're – if they're not up, they're going to be. Maybe Brazil is shifted into 2019, maybe it's coming up in the fourth quarter, but it's probably going to make it in early 2019 at the latest. And I should have added Hassan, on your question about inventories, I think it's important to note that the inventories in China are the way we stated them, as we head into the generally high turnaround season in Q1. So I think that's a positive construct as we look into at least the first part of next year.

Hassan Ahmed - Alembic Global Advisors

Understood. Understood. Very helpful, Chris. Thanks so much.

Operator

Your next question comes from Laurence Alexander. Your line is open.

Nick Cecero – Jefferies

Yes. Hi. This is Nick Cecero for Laurence. How are you?

Chris Pappas

Good. How are you doing?

Nick Cecero– Jefferies

Good. So can you give an update on the three to five year pipeline of growth products in your more differentiated downstream businesses?

Chris Pappas

Sure. I think, we gave a quite detailed version of that at the Investor Day just about a year ago. And then, I gave kind of a high level overview of our progress. But, the main projects that are driving the $75 million dollars of identified growth in Performance Materials include the S-SBR expansion that's coming up in January of 2019, the ABS expansion in China that is up and running, and we're going to start selling commercially out of that in the fourth quarter, a series of investments, we're making in Performance Plastics. Our pilot plant for S-SBR rubber that I described, is coming up in the fourth quarter. It allows us to free up some capacity in the main plants in S-SBR.

And, we also made some latex footprint changes. Now at Investor Day, we said that we had $75 million dollars identified in the pipeline investments we were making for Performance Materials growth. Those are the ones I described. We also said that we would be working towards an additional $25 million dollars to the identified EBITDA growth projects for Performance Materials.

And, of course, one of those is the acquisition of the API Plastics business in Italy, where we're buying a very, very good set of TPE technologies that we can take globally across our Performance Plastic's footprint to our customers, and add it to our own offering in a way that we think we can create growth. So, some of that $25 million, we have already committed to deliver by way of an acquisition. And, I think that's probably about as composite as we can be on the landscape of that, Nick.

Nick Cecero– Jefferies

Great. Thank you very much.

Operator

And if anybody would like to ask a question, please press star 1 on your telephone keypad. Your next question comes from Matthew Blair. Your line is open.

Matthew Blair - Tudor, Pickering, Holt & Co. Securities, Inc.

Hey, good morning, Chris.

Chris Pappas

Hi. How're you doing?

Matthew Blair - Tudor, Pickering, Holt & Co. Securities, Inc.

Good, good, thanks. I had a question on capital allocation in 2018. So, your guidance on EBITDA is moving up, your guidance on CAPEX is falling. So, free cash flow, it seems, could be pretty strong next year; balance sheet is already in great shape. Any targets on share repurchases next year, and I guess any sort of general thoughts on the M&A landscape? Thanks.

Barry Niziolek

Hey, Matt, it's Barry. I mean I think maybe it's going to take a step back in that, and look at over the past two years, we've repurchased about 280 million of shares. And, we initiated a dividend of first ever in June of 2016. We increased that by 20% in 2017. And, what we've said is that we would balance growth investment with return of cash to shareholders. So, as we move forward, you think about this quarter even, we used $80 million of cash for an acquisition, and about $130 million for debt refinancing. So, our share repurchase was a bit wider. But as the future unfolds, we'll continue to balance growth investment with returning cash to shareholders as we move into 2018.

Matthew Blair - Tudor, Pickering, Holt & Co. Securities, Inc.

Okay. Thanks. And then I was hoping you could comment on these potential anti-dumping duties in China for styrene. Some of the numbers being thrown around anywhere from 2% to a 50% tariff. U.S. is a net exporter of styrene. U.S. is one of the countries on the list. So, how do you view this as impacting the overall market? How is it going to change styrene pricing? Is it going to have any impact on your AmSty, JV? Any comments that would be helpful? Thanks.

Chris Pappas

Yeah. I think it's early to tell. This is Chris. They haven't obviously landed on anything. But for sure, especially if it's a relatively large number, it'll start to shift trade flows around. But the fundamental supply demand dynamics are still what they are. There is a certain amount of styrene capacity that's out there, and it can run at certain rates including the interior plants in China. And so there may be an economic effect in shifting the trade flows, but until we see the numbers and really start to see it in action, our view would be that it should not have a large impact on the view we gave on styrene earlier. We might find out that the styrene assets in Europe run a little bit harder in that construct, depending on trade flows, for example. So I think we have to wait to see the numbers, and then see how the market kind of deals with it in terms of trade flows, and other dynamics.

Matthew Blair - Tudor, Pickering, Holt & Co. Securities, Inc.

Great. Thank you.

Operator

And our final question for the Q&A portion of today's program comes from Vincent Andrews. Your line is open.

Vincent Stephen Andrews - Morgan Stanley & Co. LLC

Thanks. I just was wondering if we can give a little bit more detail on the working, I'm sorry the free cash flow and working capital trends. It looks like you're starting to get the butadiene release as those prices come down. Do you think you're going to true that up by the end of the year, or will more of that flow through into 2018?

Chris Pappas

Vincent. Hi, it's Chris. I'll turn this over to Barry in a minute, but you're right. We did see some of that in Q3 and the very short answer is, I don't think we're going to get it all back in Q4. There are some other dynamics in Q4, and I'll let Barry comment on that. But butadiene actually came down again now. So it had gone back up, it's come back down. So it's pretty dynamic. But Barry, any more detail on the way you see the working capital flows?

Barry Niziolek

Yeah. Maybe just pick it up a little to our overall free cash flow. Year-to-date is about $85 million of free cash flow. So you're going to hit about $240 million. Now, that would mean about $150 million dollars in the fourth quarter. And seasonally, that's our strongest quarter, particularly as we recover receivables as shipments start to slow, and our receivable balance shrinks.

Chris Pappas

But at that $240 million year-end free cash flow, we would still see a net outflow in working capital of about $50 million dollars. That's the current sense of it, but again, these move around a lot. But so that you know, that free cash flow forecast would still have a working capital build, if you will, from the beginning of year to the end of the year.

Vincent Stephen Andrews - Morgan Stanley & Co. LLC

Right. So that you could theoretically, all things equal, recover in 2018 on top of your normal generation. Okay. My only other question was, you mentioned a little bit of destocking in synthetic rubber. It seems like it's come back, so maybe not an issue. But just any sense on what went on there?

Chris Pappas

Well, I think it was price behavior-driven. People had - and we're anticipating a drop in the price of rubber. They had bought quite heavily in the first half of the year. Our sales in the first half of the year for rubber were 15% higher this year than last year. So, clearly they were – there was a reasonable amount of buying going on. I would call that ahead of general demand growth. And then as they started to see the prospect of rapidly dropping butadiene, they retrenched. I think that's the basic dynamic, and as you mentioned, it's already coming back to "normal levels" as we enter the fourth quarter.

Vincent Stephen Andrews - Morgan Stanley & Co. LLC

Okay. Great. Thanks very much.

Chris Pappas

Okay. You're welcome.

Operator

I have no questions in the queue. I'll turn the call back over to the presenters for closing remarks.

Chris Pappas

Okay. Thank you, Michelle. Thanks everybody.

Operator

Thank you everyone. This will conclude today's conference call. You may now disconnect.