Fourth Quarter 2017 Financial Results Conference Call Script

Operator introduction:

Good morning ladies and gentlemen, and welcome to the Trinseo fourth quarter and full year 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 Investor Relations.

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.

David Stasse

Thank you Mariana 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 February 20, 2019. Now, I would like to turn the call over to Chris Pappas.

Chris Pappas

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

First, we ended 2017 with a very strong fourth quarter as business fundamentals across our portfolio continue to be positive. Fourth quarter net income was $118 million, which included a $22 million pre-tax gain related to a change made to one of our pension plans. Adjusted EBITDA was $169 million, inclusive of $15 million of favorable timing impacts. These results exceeded the guidance we gave on our third quarter earnings call of $68 to $77 million of net income and $130 to $140 million of Adjusted EBITDA. For the full year, we achieved record net income, earnings per share, and Adjusted EBITDA.

Second, in addition to the record operating results, we made significant progress towards achieving our goal of increasing EBITDA by $100 million in our Latex Binders, Synthetic Rubber, and Performance Plastics segments from 2016 to 2019. Although the details are explained in the management commentary we published yesterday, I want to review some of those briefly now as well.

In Latex Binders, we've made tremendous progress over the last several years in transforming the business from a predominantly North American and European supplier of SB latex to the paper industry, to a globally diverse, leading manufacturer of latex products to a broad spectrum of industries. We've added capacity to grow our footprint in China, and we've invested in developing chemistries beyond traditional SB latex to serve faster growing markets such as adhesives, construction, and paper board. All of this has enabled us to offset declines in the North American and European graphical paper markets and grow Adjusted EBITDA from $79 million in 2015 to what we believe will be $120 million in 2018.

We've also made a lot of progress in Synthetic Rubber, where we've significantly improved our mix of products to include more SSBR for the performance tire market. In 2017, about half of the synthetic rubber volume we sold was SSBR, and half of that was our most advanced grades that we call enhanced SSBR. These grades provide performance tires with superior grip, rolling resistance, and noise levels. We'll continue this portfolio shift in 2018 and beyond as we qualify the additional capacity created by the SSBR expansion and pilot plant that we completed late last year.

In Performance Plastics, we expanded our ABS capacity in China and are working on selling out this capacity. We also opened a new Plastics Research Center, which modernized and consolidated two existing technical support centers and research lab under one roof in The Netherlands.

Finally, we completed our first acquisition - API Plastics - adding soft polymers that complement Trinseo's strengths in rigid polymers, expanding our offerings to the automotive and consumer essentials markets.

Third, I would like to address the styrene duties that were imposed by China last week. We continue to monitor the situation closely. We believe the market had been expecting some form of duties and, in anticipation, there has already been some rebalancing of trade flows. A further rebalancing could occur as China will continue to import material, especially since the Chinese non-integrated styrene plants perform at the high-end of the cost curve. We will see how the market and legal process develops, but we do not expect any material impact to Trinseo in 2018.

Fourth, starting in the first quarter of 2018 we are introducing a change to our segment reporting. We will now be reporting financial results for the following six segments: Latex Binders, Synthetic Rubber, Performance Plastics, Polystyrene, Feedstocks, and Americas Styrenics. Our new segmentation groups together similar businesses in order to improve efficiency and portfolio management. It also reduces internal complexity and engages both of our business presidents with our growth agenda.

As a result, we have made the following management changes. Tim Stedman has been named Senior Vice President and Business President for Feedstocks, Plastics and Global Integrated Business Services. He will now have responsibility for all Plastics businesses, as well as Styrene Monomer, Americas Styrenics, and Integrated Business Services. As part of this, we've added polycarbonate, ABS, and SAN to the Performance Plastics segment. This concentrates our more specialized plastics into one integrated business segment under one business leader.

Hayati Yarkadas has been named Senior Vice President and Business President for Latex Binders, Synthetic Rubber, Global Procurement and Asia Pacific. He will continue to have responsibility for Latex Binders and Synthetic Rubber, and will add responsibility for Procurement and the Asia Pacific region, an important area for Trinseo's growth.

Now, I would like to discuss first quarter and 2018 guidance. For the first quarter, we expect net income of between $104 million and $113 million and Adjusted EBITDA of between $175 million and $185 million. This outlook assumes minimal net timing impacts, and includes a favorable impact from known planned, and unplanned, styrene outages, impacting our Feedstocks and AmSty segments, as well as solid performance across all of our other segments.

Moving to full year 2018, we expect net income of between $369 and $386 million, Adjusted EBITDA of between $640 and $660 million, and diluted earnings of $8.26 to $8.63 per share. This outlook assumes minimal impact from net timing, no impact from unplanned styrene outages beyond what we currently have visibility into for the first quarter, and it includes about 35% of the $100 million EBITDA growth target in the Latex Binders, Synthetic Rubber, and Performance Plastics segments. Finally, as part of our balanced capital allocation approach, we anticipate we will spend about $100 million in 2018 on share repurchases.

In closing, I want to reiterate how proud I am of Trinseo's team for delivering record results in 2017. We look forward to continuing this momentum into 2018, and delivering strong profitability, and cash generation.

And now, Mariana, you may open the line for questions.

Operator

At this time, I would like to remind everyone, in order to ask a question, please press star and then the number one on your telephone keypad. We'll pause for a brief moment to compile the Q&A roster.

Your first question comes from the line of Frank Mitsch with Wells Fargo Securities. Your line is open.

Frank J. Mitsch, Wells Fargo Securities LLC

Hey. Good morning, gentlemen, and nice end to the year, and nice start to the year.

Chris Pappas

Thank you.

Frank Mitsch

Chris, on the movement of ABS Polycarbonate and SAN into the Performance Plastics area, I guess part of that is some of the compounds that you sell out of, that you the currently sell out of performance plastics, are coming from those materials. Can you give us a sense as to what the – what the percentages are of products that would be sold as is, versus compounded after you make this move in Performance Plastics?

Chris Pappas

Yes, sure, Frank. I mean, first of all, on the move, as we said on the comments, we really believe this concentrates for the external world, a better view of all of our high-value products into really three areas. One is the newly defined performance plastics, and of course latex binders, and synthetic rubber. But importantly, we also now have both of our business Presidents, two very talented executives, engaged in part of the growth agenda of the company, and also in Performance Plastics as it's reconfigured we have integrated, if you will, the polycarbonate in ABS that goes into compounding, into that same reporting segment. The change is subtle, but not insignificant in terms of volumes and numbers. We always sold certain amounts of

polycarbonate into the open market, and we will continue to do that; we'll just do that under the performance – under the performance plastic segment. So our goal there, as you know, is to sell less polycarbonate as an uncompounded product, and more in what we call compounds and blends. Roughly a third of our polycarbonate that we make is consumed internally. That's a historic number, and as I said, our goal is to increase that. The only other real change is that the – automotive ABS that was not in performance Plastics is now moving into Performance Plastics, and that includes the new China capacity, Frank. So that's kind of the structural change. Rather than give specific numbers, I think the thing to concentrate on is, we now have about 65% of our EBITDA on a 2017 basis in what we call the highest value segments in markets of our business, and those are represented by the combination of a new Performance Plastics, Synthetic Rubber, and Latex Binders.

Frank Mitsch

Understood. Understood. And I guess on the other side of the equation, it certainly allows for greater transparency on styrene monomer in your Feedstocks business, and polystyrene in your Basic Plastics business.

Does this open up the possibilities, or, how are you thinking about the strategic outlook with those businesses as part of the Trinseo portfolio, and might we see some activity on that side, on the lower value side, or the more commodity side?

Chris Pappas

Well, this structural change in segment reporting really is not driven by anything other than what I just said. It's not driven by either an easier or harder strategic step for the company. Our strategic outlook for the company remains the same. We have a terrific set of assets that have proven to operate at a high level. We think they're going to continue to operate a high level. We think the supply demand dynamics of styrene, polystyrene, polycarbonate going forward are all very positive. We're committed, and are delivering the $100 million of EBITDA growth. So, that all stays the same. We have commented, and continue to believe that if there were consolidated steps we could take in the Styrenics world, if you will, then that would be an attractive thing to do strategically for the company. But that hasn't changed as a result of this segmentation. It's still the primary focus of any strategic step we might take.

Frank Mitsch

All right, great. Very helpful, thank you so much.

Chris Pappas

Thanks Frank.

Operator

Your next question comes from David Begleiter with Deutsche Bank. Your line is open.

David I. Begleiter, Deutsche Bank Securities, Inc.

Thank you. Good morning.

Chris Pappas

Good morning.

David Begleiter

Chris, just on the Chinese anti-dumping duties, what do they do to your cost position in terms of importing styrene into China?

Chris Pappas

You know we have this chart, David, on the deck that showed, at least last year, the flow of styrene around the world. It's chart – page 14 in the – in the slide deck. There'll be some rebalancing. I think it's important to note that number one, this has been kind of known in the market, and the market has been adjusting, for some period of time in terms of trade flows.

Number two, maybe most important, there's nothing about this announcement that adds any capacity to the industry. So the Chinese are still importing 3 million tons of styrene. Where they import it as a result of this will probably shift around a little bit. Our expectation is that their imports will shrink from the U.S., they'll probably grow from the Middle East, and as a result of that, a certain amount of styrene from the Middle East that goes to Europe, may not go to Europe, and a certain amount of styrene from the U.S. will probably go to Europe. That's a very rough cut of what we see at a high level that could happen. We'll have to see how it plays out. But it's really a rebalancing of trade flows in our view. The fundamentals of supply demand have not changed, the fundamentals of relatively high cost integrated Chinese producers with limited ability to run at high rates has not changed. And as we said on the call, we don't expect any material impact from this in 2018 on our business.

David Begleiter

Very good. And, Chris just on synthetic rubber, how is the new expansion ramping up? I know there are qualifications involved. And how do you think about the earnings progression from 2018 to 2019 in these segments?

Chris Pappas

The plant is running very well. I will tell you we're also commissioning the pilot plant, which is important in the whole equation for rubber. The plant is producing excellent product. We are qualifying as rapidly as possible; it does take time. If you look at the guidance we gave for rubber in 2018, and if you compare that to their results in 2017, especially when you correct, David, 2017 for some of the anomalies in rubber, you'll notice there's some growth in that guidance from 2017 to 2018. But it's also fair to say, as we've said, that the majority of the new capacity growth of rubber to EBITDA will occur in 2019 from that new capacity. We could perhaps see a third of it or so placed in 2018, but the majority of it's going to go into 2019, as it takes that long to qualify.

David Begleiter

Thank you very much.

Operator

Your next question comes from Hassan Ahmed with Alembic Global. Your line is open.

Hassan I. Ahmed, Alembic Global Advisors LLC

Good morning, Chris.

Chris Pappas

Hi, Hassan.

Hassan Ahmed

Chris, obviously we've seen some volatility in crude oil prices, you know, since the start of – call it year-end last year, beginning of this year. Obviously that has had an impact on benzene as well. So historically, when we've seen these sort of swings in crude/benzene pricing, they've had some sort of an impact on the inventory side of things as well. I mean, obviously, the notion being that you will obviously see some destocking as roles come down, and restocking, as well as stabilize and go up. So just broadly love to hear your views on where, sort of across the various products that you produce, where you see inventory levels. Are you seeing any sort of impact of this raw material pricing volatility on where inventory levels are right now, be it destocking, restocking, or whatever the case may be?

Chris Pappas

Sure. Well, there's a lot that goes on that drive customers, Hassan, as you know in relationship to inventory, not just the price of oil there. There's the timing of year end for example, which we experience in our rubber business, where certain customers were electing to put off purchases. But on the concept of rising Feedstocks, of course styrene, and butadiene, and benzene are what affect us.

Now if you look at our grey bars on page 15 for styrene that we've got February and then the forecast for March, you would expect, given that profile, which is driven by the planned, and certain unplanned outages right now, that styrene derivatives, particularly polystyrene customers are not buying very heavily in the month of March, or in the month of February. So that would be a very good example. We've lived this example many times where due to a rise in styrene, and in this case not so much driven by oil, but driven by unplanned, and planned outages, customers will hold back certain purchases; in this case, polystyrene, to some degree ABS, and they will wait for what they think is a better opportunity to buy, if and when styrene were to come down, you know, later in the year. So that dynamic is clearly happening in the polystyrene business, you know, as we speak today.

And I think that's really the one business we have, Hassan, that has the most effect from these feedstock movements. Otherwise, unless butadiene were to rise sharply, that would affect the way the rubber producers think about buying, the tire producers think about buying. But in the case of oil in general, think about polystyrene, and styrene, being the main actors for us.

I want to be clear, the styrene rise that you see right now, the styrene rise in price, and the margin, really is unrelated to anything to do with oil or feedstocks. In fact benzene recently has been pretty benign, recently in the last several months. So the margin you see in styrene is a function, as we've said many times, of planned and unplanned outages, and supply-demand dynamics driving margin. That's been our thesis since we started the company, and it continues to be the thesis going forward.

Hassan Ahmed

Understood, understood. Now, you know obviously you have a chart in there about the whole sort of China anti-dumping duty side of things. But you know, there's obviously the whole China pollution curve sort of side of things prevalent as well. Is that impacting you guys in any way? Are there any curtailments within the sort of world you live in, and if there are, you know how should we think about the sort of sustainability of those curves, and the magnitude of those curves?

Chris Pappas

You mean, you're talking about styrene? I just want to be sure, you're...

Hassan Ahmed

Correct.

Chris Pappas

...you're speaking about the world of styrene, okay. Yeah. No we haven't seen anything like that. Now, of course, Americas Styrenics is an exporter of styrene. So they have, and will have to, adjust further to these trade flows. So in that sense, they would be a company that will adjust from trade flows over time. But no, we don't see anything at the moment that has anything to do with, here on the anti-dumping, that has anything to do with that. I should make one other comment about anti-dumping. I believe this is my view, because now we have the Chinese exerting these duties, I think it's going to exacerbate, and continue to make it very difficult for people to make investments in styrene, outside of China. So you can imagine if it were a complicated uncertain future about making a styrene investment six months ago, I would argue that's even less likely that somebody would look at that today, other than what's already been kind of planned for China.

Hassan Ahmed

Understood. Understood. Thanks so much, Chris.

Operator

Your next question comes from Bob Koort with Goldman Sachs. Your line is open.

Robert Koort, Goldman Sachs

Thanks. Good morning.

Chris Pappas

Hi, Bob.

Robert Koort

Chris, I liked slide 14. There you give an interesting cost curve across the industry. Could you tell me where we would draw the line that would show the current market price, relative to that cost curve?

Chris Pappas

Well, I guess I would answer the question this way: somewhere about the middle of this chart and left, the margins are reasonable today. And to the right of that, so somewhere between 10 and 20 cumulative KT, the margins are not so good. And maybe you could bifurcate it into three zones, obviously, the left the margins are pretty good, that zone between 10 and 20, and maybe 22 is okay, and beyond that the margins are not that great. So that's the way I'd answer the question Bob without trying to exactly pin a price to cost on there. I think that might be the root to your question, hopefully, I don't know, but...

Robert Koort

Yeah. And then the concept for China to say that those three regions were dumping product. What was the basis of the genesis of that conclusion from them?

Chris Pappas

Don't know. You know we're not party to that. So actually, we have no real data on it. We're not involved in the process at all. So it'd be hard for us to comment.

Robert Koort

And then on polycarbonate, things have gotten quite a bit better, certainly dramatically better from a few years ago. Do you know what the polycarbonate cost curve would look like, and similarly, where prices are relative to possibly inspiring some reinvestment, which I guess would sound crazy from a few years ago, but maybe you are making enough money now that, that could happen?

Chris Pappas

Well, I can tell you, as we've said many times, we are not building polycarbonate, period. We're a small player in polycarbonate. Our position is really now in one region of the world; it's in Europe, and we're about 13% in the European polycarbonate world. And we exited North America as you know, and we exited Asia recently by selling our 50% interest in the JV. So we're very small. The two major players in polycarbonate around the world of course are SABIC and Covestro. They would be certainly the low cost producers, and the capacity expansions in that

business that have been announced are minimal, and it takes two to three years to build polycarbonate. You're right, the margins have moved up. Again, as we suggested they would, quite well, quite strongly. They're operating at pretty high margins today. But our plant is a competitive plant, but the low cost plants are certainly in the hands of those two major producers, Bob. And they have no plans that are announced to build any capacity of substance.

Robert Koort

Got it. Thank you very much.

Operator

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

Nick Cecero, Jefferies, LLC

Hi, this is Nick Cecero on for Laurence. So, just wondering if you might be able to provide some color on demand trends by region, and if there's any areas where you see demand that might be decelerating?

Chris Pappas

Nick, we have said, kind of continuously, that Europe is operating better than people believe. I think, the press has caught up with Europe now. In other words, I think what you read about Europe is about accurate. I would have said, and I have said, as long as a couple of years ago, Europe is better than the press. I think the U.S. again continues to look pretty good. China, on a call or two ago, we expressed some concern about perhaps there was some slowing in China. I would say today that I'm less concerned about that. So I'm beginning to be in the mode of believing that we're in the zone where generally the world economies look pretty good. And that's starting to be reflected in our business.

Nick Cecero

Great. Thank you.

Operator

Your next question comes from Matthew Blair with Tudor, Pickering, Holt. Your line is open.

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

Hey, good morning. The release mentions that you're reducing your age of styrene exposure to 185 KT from 300 KT, but you are also pretty constructive on styrene going forward. So I was just hoping you could provide a little more background here? I know it says that it will better align your styrene production with your styrene consumption, but was this your decision to reduce this exposure, and should we expect any additional reductions going forward?

Chris Pappas

It was our decision. The relationship we have - that's a purchased styrene component. We purchased it under a purchase contract that has some cost based characteristics to it. We just felt that again, aligning to our capacity, our production base, we have said all along that Asia is not an attractive place for the world of styrenics, with the exception of ABS. I'm talking about our portfolio. And that's why we invest in ABS. But we have been reducing our polystyrene activities in that region. It's the part of the world that's most difficult to make money in styrenics. That includes styrene, by the way. And so, we just felt that that was the right thing to do to get a little bit more matched to our end production of polymers in that part of the world. It's the lowest profitability of the world, in both styrene and polystyrene, and we'd rather have less of it.

Matthew Blair

Got it. Thank you. And then just in terms of the guidance, so the net income guidance is showing interest expense of $60 million, the cash flow guidance has $50 million in cash interest. Could you just remind us on, I guess, discrepancy here, and is there still a chance that your net income guidance would reflect a $50 million number?

David Stasse

Hi, Matt, this is Dave. The reason for that discrepancy is, we have $500 million in U.S. dollar bonds that we issued in September of last year. We swapped those bonds via a cross currency swap into euros. The reason we did that is two-fold: one is, because it gives us synthetic euro debt, which is a nice natural hedge for us. But the second reason is because it lowers our absolute interest rate on that, albeit synthetically, debt. The accounting rules have just recently changed as of the first of the year for accounting for cross currency swaps. And in our case, putting on that cross currency swap has the effect of reducing our cash interest by about $10 million a year.

Now, we just haven't gone through the process yet of fully reviewing the applicability of the change in accounting policy to our swap. We need to do that over the course of the next month. And we are hopeful that will apply in our case, and we'll be able to change the accounting, such that it would match up the cash and the accrual on that. So that on a cash

basis, we do expect to pay $50 million, hopefully after we finish reviewing the new accounting guidance for the swap, the accrual or the P&L impact will also be reduced to $50 million.

Matthew Blair

Okay. Thank you.

Operator

Your next question comes from P.J. Juvekar with Citi. Your line is open.

Eric B. Petrie, Citigroup Global Markets, Inc.

Hi. Good morning. Chris. It's Eric Petrie on for P.J.

Chris Pappas

Hey, Eric. How are you doing?

Eric Petrie

I'm well. Thanks. Just a question with the styrene anti-dumping in China. Have you seen any of the higher cost production ramp back online, or rather than saying a trade flow adjustment, you could see actually China produce more of their own styrene?

Chris Pappas

Hard to tell. Remember, they have two issues in interior styrene plants in China. One is cost-well, they have three, really. One is cost, one is just capability, but a third, and maybe most important, is availability of inputs. So they have to be able to get the ethylene and benzene, often from a great distance, often competing away. So I think my short answer would be, yes, we would expect perhaps to margin some of that. But again, no fundamental shift in the basic thesis that we have, other than trade flows. That's why we said no material impact. So we'll have to see how it plays out, but there could be some marginal higher run rates. They have to get ethylene and benzene. Let's see how it plays out. We don't expect any material impact. That's all we can say at this point.

Eric Petrie

Okay. As a follow-up, are you, outside of AmSty, styrene neutral, so that now you're not selling any styrene into the open market with the reduction in Asia from 300,000 tons to 185,000 tons?

Chris Pappas

Outside of AmSty, we have been, and are, a net purchaser of styrene. We always have been.

Eric Petrie

Okay.

Chris Pappas

From day one.

Eric Petrie

And last, I know you didn't provide guidance by segment during last quarter, but at the midpoint it looks like 2018 EBITDA went from $635 to $650. Was that just due to the $15 million from unplanned outages in first quarter? Did you see any underlying drivers in the rest of the businesses?

Chris Pappas

At this point, that would be a good summation of the change in guidance. It's February 20, we have a very constructive view of the year for 2018 across all of our businesses. And we'll continue to update you guys as we go forward. Obviously, we have a strong view of the first quarter, which we gave the midpoint guidance of $180 million of EBITDA.

Eric Petrie

Great. Thank you.

Operator

There are no further questions at this time. I will now turn the call back over to the presenters.

Chris Pappas

Okay. Thank you everyone. We'll talk to you in a few months. Take care, bye-bye.

Operator

This concludes today's conference call. You may now disconnect.