Trinseo – Agreement to Purchase Aristech

Company Participants

- Andy Myers, Director of Investor Relations
- Frank A. Bozich, President and Chief Executive Officer
- David Stasse, Executive Vice President and Chief Financial Officer

Other Participants

- David Huang
- Hassan Ahmed
- Matthew Blair
- Laurence Alexander
- Angel Castillo

Presentation

Operator introduction:
Hello ladies and gentlemen, and welcome to today's Trinseo conference call. We welcome the Trinseo management team, Frank Bozich, President & CEO, David Stasse, Executive Vice President & CFO, and Andy Myers, Director of Investor Relations. Today's conference call will include remarks by the management team followed by a question and answer session. The company previously distributed its press release and presentation slides. These documents are posted on the Company's Investor Relations website and furnished on a Form 8-K filed 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 Andy Myers.

Andy Myers
Thank you, Rein, and good morning, everyone. (Operator Instructions) Our disclosure rules and cautionary note on forward-looking statements are noted on Slides 2 and 3.

During this presentation, we may make certain forward-looking statements, including expectations concerning our proposed acquisition of Aristech Surfaces, including cost saving and synergy expectations and describing our future earnings and other 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, our ability to complete the transaction and meet the conditions to closing, including obtaining required regulatory approvals; our ability to generate expected cost savings and revenue synergies from the transaction, our ability to generate margins and grow the acquired business, the factors described in our press release and investor presentation, as well as the risk factors set forth in Item 1A of our annual report on Form 10-K or in our other filings made with the Securities and Exchange Commission. The Company undertakes no obligation to update or revise its forward-looking statements.

Today's presentation includes certain financial information related to Aristech Surfaces, LLC which is unaudited and derived from information provided to Trinseo by Aristech Surfaces, with certain Trinseo management adjustments reflected. This information does not reflect conformance to accounting principles and policies followed by Trinseo. 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 July 20, 2022. Now, I would like to turn the call over to Frank Bozich.

Frank A. Bozich

Thank you, Andy, and good morning everyone. We are very excited to announce the next step in our ongoing transformation into a specialty materials and sustainable solutions provider with the acquisition of Aristech Surfaces for $445 million dollars. Aristech is a leading supplier of continuous cast acrylic sheets and solid surface materials for wellness and architectural applications. These very attractive applications in the Building and Construction market offer very stable and high margins due to the demanding technical requirements of the end users. Furthermore, these technologies are mainly based upon PMMA and ABS resins where Trinseo has a leadership position.

As you recall, in December of last year we announced our intention to transform our business into a downstream specialty materials and sustainable solutions provider with the announcement of the approximately $1.4 billion acquisition of Arkema's PMMA business and the intention to sell our Synthetic Rubber business. In May of this year, we announced that we reached an agreement with Synthos to sell the Synthetic Rubber for nearly $500 million. We are very excited to now announce a key next step in our portfolio transformation with the acquisition of Aristech. This acquisition will build on Trinseo's industry leading PMMA and ABS franchises by providing continuous cast acrylic sheet technology to complement our existing PMMA cell cast sheet, extruded sheet and resins offerings.

I'd like to provide you with some highlights of the acquisition:

First, we are looking forward to welcoming the approximately 300 Aristech employees to the Trinseo family and we are excited about the growth that we see ahead. The Aristech management team has done a fantastic job over the past several years of developing new innovative products and expanding geographically. Their expertise in product innovation and marketing will complement our already strong team in Engineered Materials, where we will report their financial results. With this acquisition, we will add two state-of-the-art manufacturing facilities in Florence, Kentucky and Belen, New Mexico. The Florence facility is one of the largest continuous cast facilities in the world and operates four of the five continuous cast lines in North America.

Second, Aristech's customer base operates in niche high-end and high-margin markets – including the wellness and architectural markets – both of which are positioned to deliver sustainable long-term growth. The wellness market is particularly attractive to us, as we see growth not only in North America, but globally as well – especially in Asia. Aristech is ideally positioned to capitalize on market growth in Wellness as 76% of its estimated 2021 sales come from this attractive market.

Third, Aristech has a large and growing customer base in Asia, a region we believe has significant upside over the coming years. This acquisition will catalyze our expansion and footprint in Asia and provide us with industry leading products that can better serve our existing and future customers.

Fourth, Aristech is the provider of choice to its customers, and its products are used in applications that in many instances cannot be supported by other materials or manufacturing technologies. In addition to its existing products, Aristech has a strong track record of innovation and a pipeline of new products that is expected to fuel continued growth. As I mentioned, these material innovations are mainly based upon chemistries where Trinseo has a global leadership position.

Finally, we have identified significant run-rate cost synergies which we estimate to be approximately $10 million per year and will be fully realized by 2024. We also expect to receive $50 million in value from a tax basis step-up. In addition to our identified cost synergies, we believe there are meaningful revenue synergy upsides that are achievable through the combined positions of our Engineered Materials Business and Aristech. For example, our Engineered Materials business is already a supplier into architectural applications in Europe where we can broaden our offering with Aristech's products.

Now I would like to hand the call over to Dave to describe more specifics on the transaction and the Aristech financials.

David Stasse

Thank you, Frank, and good morning everyone. I'd like to build on Frank's comments by providing a little more financial color.

The purchase price of $445 million represents a 9.7x multiple of 2021 estimated EBITDA. When adjusting for an estimated $50 million of tax benefits from step-up depreciation and $10 million of cost synergies, that multiple decreases to 7.0x.

The $10 million in cost synergies we've identified are split roughly 50/50 between operating efficiencies and procurement and supply chain optimization. We expect to reach this $10 million synergy run rate by the end of the third year.

We intend to finance the transaction with a combination of cash on hand and existing credit facilities. We remain highly focused on maintaining a strong balance sheet and we expect to have a year-end net leverage ratio in the low 2-times range, proforma for the Synthetic Rubber divestiture as well as the proposed Aristech and recent Arkema PMMA acquisitions.

As Frank mentioned earlier, this transaction represents the third step in Trinseo's portfolio transformation. Each successive step has significantly improved the profile of Trinseo's earnings and cash generation. Aristech Surfaces, like the PMMA business we acquired in May, has EBITDA margins in the mid-20s and cash flow conversion of over 80%. These two acquisitions on a combined basis have historically had about $30 million of annual spending on CapEx and turnarounds. Conversely, our Synthetic Rubber business, which has about a quarter of the EBITDA of these two businesses, has had about $20 million of annual spending on CapEx and turnarounds.

We expect the transaction to close by the end of 2021 and be immediately accretive to earnings, margin and free cash flow. With that, I'll turn the call back over to Frank.

Frank A. Bozich

Thanks Dave. Let me conclude by reiterating our excitement about this transaction. We believe Aristech's technology, the markets they serve, and their talented people will be a great fit within Trinseo and is an excellent next step in our transformation to becoming a specialty materials and sustainable solutions provider. This continued transformation will result in higher free cash flow and profit margins for Trinseo while reducing our earnings volatility. Thank you for your time, and we're happy to open the line for questions.

Questions and Answers

Operator
Your first question comes from David Begleiter from Deutsche Bank. Your line is open.

Q – David Huang
Hey, this is David Huang here for Dave. Congrats on the deal. I can see the slides you gave us the revenue and margin estimates for 2021. Can you also talk about what those numbers were in 2020 and 2019? And maybe then you can talk about the current trends you're seeing in the various end markets and by geography?

A – Frank A. Bozich
Sure, let me start. I'll go to 2020 because I have those numbers on the top of my head. So, in 2020 the business generated $30 million approximately in adjusted EBITDA. And what I would tell you is that even in Q2, they held up -- Q2 2020, they held up very strongly and didn't see a marked decrease in their business. And so, that helped us realize how -- or proved to us how resilient this business is and certainly much less cyclical than many of the markets that we work in. I think the second part of your question was talking about the growth they experienced and new products and expansion into other regions; is that correct?

Q – David Huang
Yes.

A – Frank A. Bozich
Okay. So, actually the team has done a great job expanding geographically and what I would tell you is since 2018 they've more than doubled their sales – the sales volumes outside the United States or outside North America. And it's not on a small base; it's 25% - 2021. It's 25% of their volume goes outside the U.S. So, they've been very, very successful doing that.

And the other thing that's been very successful for this group is their new product launches, where in 2021, 16% of their sales volume are -- is coming from products that were developed in the past five years. So, they have a very strong product vitality index. And those new products, as I said, represent about 16% of the total sales. So, those are two of the characteristics we really like and what's been driving their growth in 2021.

Q – David Huang
Thanks. And then I guess post the two acquisitions, your specialty business will be north of 50% of the portfolio. Is this the type of balance you wish to maintain the next few years or how do you think about the rest of the commodity business you have?

A – Frank A. Bozich
This is a continued progression in our long-term transformation, but ultimately our goal will be to become a pure-play in specialty materials and sustainable offerings. And so, we will continue to reshape the portfolio. We would look at some of those commodity businesses and when the time and market conditions are correct, we would look to divest those to continue that reshaping of the portfolio. So that's inevitable that we would continue to decrease the amount of our commodity business as a percentage of our overall profit.

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

Q – Hassan Ahmed
Good morning, Frank. Frank, question around what the portfolio looks like now; meaning, obviously, the PMMA acquisition, now this. So, as I take a look at where we were towards the end of last year, you guys, on a 2022 basis, were trading at, and these are consensus numbers, around 6.7 times EBITDA, right? And if I take a look at where that figure is today, it's around 4.1 times EBITDA. And along this period, it seems your EBITDA revisions have been over 40% on the positive side of things. So, clearly, the market is missing something here, right? Because it seems the portfolio is getting to be higher margin, more free cash generative. So, my question is, could you give us a peek of -- into what the sort of margin profile looks like in 2022 or 2023 once these acquisitions have been digested.

A – Frank A. Bozich
Yeah, let me start by saying what our goal is for the specialty materials business and the portfolio that are specialty products because, I guess I'm hesitating to be too specific on what our outlook is as we have an earnings call coming up in a couple weeks and we'll be more fulsome in our outlook then but…

Q – Hassan Ahmed
Yeah, but you know literally I'm talking about sort of out years, relative to where we are today. Will the margin be 1,000 basis points better three years out? More stable free cash flow conversion improvement? How much will that improve? Just broad stroke.

A – Frank A. Bozich
Okay. Sure. So, I'm going to speak aspirationally. And what our goal is, is obviously to reduce the complexity of the business, which we're doing and improve free cash flow generation of the business while we reduce cyclicality and improve growth. Now the quality of our earnings, we would expect to be north of 20% EBITDA margins as a consolidated portfolio when we've completed our transformation, so -- with gross profits in above 30%. So, those are the figures or the goals that we have for the

transformation, and I think where these acquisitions and the transactions that we've done are consistent with that. So, I'm very confident we can achieve it. And so, I think that's the way to think about our portfolio is 20%-plus EBITDA margins and gross margins in the 30% range.

Q – Hassan Ahmed
Very helpful. Now, as a follow-up, just in terms of timing of this acquisition, I mean, you did PMMA in December. As you did that acquisition, were you always thinking about Aristech being sort of the next step or was this something that sort of opportunistically popped up on the radar, and you guys are sort of invited into the whole bidding process? I'm just trying to get a sense of how the timing of it as well as strategically how you guys were thinking about the acquisition.

A – Frank A. Bozich
So, yeah, thanks for that question. And let me say this was not opportunistic at all, and I think we've talked about this in the past that over the past -- two years ago, Dave led an effort within Trinseo to develop our portfolio strategy. That -- we -- from that, we had an M&A roadmap or a technology roadmap that we were trying to follow, where PMMA was one pathway in the chemistry at the very top of the list that we were interested in acquiring. And we understood that the adjacencies to PMMA or the Arkema business, which had been signaled to be for sale, was continuous cast PMMA sheet, so, continuous cast acrylic sheet. So, it was on our radar and obviously, the owners of the business -- their timing for when they chose to begin a process just happened to work for us and it was late Q1, early Q2 of this year, and they began a process and we were able to prevail in that competitive process. So, again, I wouldn't care -- it absolutely was not opportunistic and it was something that had been on our radar screen for the past two years.

Q – Hassan Ahmed
And Frank, and maybe also for Dave, if I could sneak one more in, again there've obviously been a bunch of moving parts in the portfolio and it's sort of quite dramatically changing. You mentioned that you'd give more details as you guys report Q2. I mean, are you thinking about maybe hosting some sort of mini-Analyst Day or something where you're actually going to show the Street what the sort of new and improved portfolio looks like and provide more details?

A – David Stasse
Hi Hassan, this is Dave. Yes, we absolutely are. We've talked about that, the timing of it. I would guess it's probably going to be early next year. You know, I think it would be helpful, obviously, to get this transaction as part of the portfolio and integrated and then come out with something that kind of further elaborates on the question you asked about strategy and what does ultimately the company look like. So, sitting here today I would guess probably early next year but that's still TBD, but it's been several years since we had the last one. So, it's definitely in the plan.

Q – Hassan Ahmed
Perfect. Thank you so much, David and Frank.

Operator
Your next question comes from Matthew Blair from TPH. Your line is open.

Q – Matthew Blair
Hey, good morning and congrats on the deal here. Frank, could you talk about the downstream integration this deal might provide? What percent of the Arkema PMMA might go into Aristech and what's the right way to think about that.

A – Frank A. Bozich
So, this business actually produces, or polymerizes, their own PMMA on their site in Florence, Kentucky directly from MMA monomer. So, the overlap is in MMA from a material standpoint, which as you know we produce in Europe and we have long-term favorable supply agreements in the U.S. The other thing that's important to realize is the second biggest single resin product that they source is ABS. And so, they are a merchant buyer of ABS that's used in, I'm going to call it a backing resin for many of the laminates that they sell into various applications, which as you know, we're a global leader in ABS resins. So, that's a nice integration overlap with us. So, from the standpoint of the synergies that we have in raw materials, we see that greater scale in MMA as well as the overlap in ABS as an opportunity for us to continue to deliver a significant portion of the $10 million in synergies.

Q – Matthew Blair
Okay, and then I guess as a follow-up, the 2021 EBITDA estimate of $46 million, how is that impacted by the extreme tightness in the PMMA market right now? Is that a headwind because of the higher costs flowing through or would that be a tailwind to that $46 million number?

A – Frank A. Bozich
So, like PMMA, this business has a value-based pricing model. So, it's not a cost plus pricing model. And so, I would say -- I would characterize 2021 as having a negative impact in terms of volume from the availability of PMMA, or MMA, which they converted into PMMA, just like our -- the business we acquired from Arkema. So, there was a negative volume impact, but the businesses are very, very strong in their commercial excellence activities and value price their product. So, they don't typically see much margin compression and rising raw material environments or they haven't.

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

Q – Laurence Alexander
Good morning. Are there other markets where continuous casting should be more relevant but Aristech is under-represented for historical reasons? And can you provide a benchmark for the new integrated portfolios, CapEx and D&A run rates?

A – David Stasse
Yeah. Hi, Lawrence. Good morning. It's Dave. I guess in terms of -- I guess I'll answer the question by how I think about market penetration, and I would say there is under-representation of the business in the bath and architectural markets. Now when we say architectural, that's a lot of things. I mean that's countertops, signage, retail signage, things like that. Very low -- I would say, this business has a low penetration in those markets, certainly relative to hot tubs and swim spas, which are much higher penetration.

The other area, which is -- and by the way, I would say bath and architectural, as we look at growth rates, over the next five years have kind of mid-to-high single-digit growth rates for these types of products. So, I think that presents a big opportunity for us. The other area -- there is a wide variety of industrial applications, some transportation markets, rail, truck, airplanes, things like that, where that represents a very small percentage of their business. And it's a very large market, very fragmented market, and I think that presents opportunity also. So, those are kind of the areas, where penetration for this business is low, but the market size is quite high.

CapEx, if you look over the last four years or so, their average CapEx, it's been about $5 million a year, which again I think as we said, this year is about $6 million, but average is $5 million. So, that's what gives us kind of that mid-80s type cash conversion that I talked about. D&A, I'll have to -- we'll have to get back to you on that one, Laurence. I don't have that one handy, but I would guess it would be somewhere in the neighborhood of CapEx. But obviously, we're going to have a step-up from the purchase price allocation, which will increase that number.

Q – Laurence Alexander

And if the end market's application that they can go after are growing high single digits, are you telling them – joining the Trinseo family – that they should be growing double digits?

A – Frank A. Bozich

No. I guess when I look at this, this is really a project and a customer-specific business. So, when we look at the pipeline of opportunities that they have, there are very specific customers that they're working with to qualify these new products and develop these new applications and materials that they're launching. So, again, I think we want to give them the resources to be more successful and improve the cost base by the synergies that exist between our business, but we have a lot of confidence in this management team and maybe it's important to state this.

One of the things that we really liked about this business was that it has such a strong management team and it's proven it can operate independently, and it's our intention to allow it to continue to run independently for a short period of time, while we complete the systems integration related to the Arkema acquisition at which point then we'll begin the -- I guess a structural integration into our engineered materials business.

So, we like what this management team has done and what they've been able to deliver, and frankly we're going to, I wouldn't be pushing them to say well, you need to double that now that you're part of Trinseo. We want to give them the support and let them do what they do, which has been very, very good.

Q – Laurence Alexander

And maybe just can you flesh out your impression of sort of the degree to which the sales force is right-sized? Is there other advantages to them now being part of the larger organization where they can grow the sales force in ways they may not have considered as a smaller company?

A – Frank A. Bozich
That's a big opportunity for us and where we see the combined presence of engineered materials geographically and with, in particular, Asia and Europe, where we'll have a stronger presence and greater coverage into building and construction markets where we can leverage the overlap in our sales coverage to those customers. So, we see that as an upside. As I stated in my prepared remarks, we already supply the building and construction markets for, let's say, bath applications in Europe through the cast sheet business that we acquired from Arkema, and those same customers buy continuous cast technology or have the ability to do that. So, we see that as an opportunity and an overlap that we want to take advantage of.

Operator
Your next question comes from Angel Castillo from Morgan Stanley. Your line is open.

Q – Angel Castillo
Hi and congratulations, Frank on the announcement of the deal. Just wanted to follow up on that last, I guess, discussion around the revenue synergies and potential overlap. I was curious as you think about, I think you mentioned growth in Asia as one of the primary focuses of the strategy and when you acquired PMMA from Arkema you talked about building some capacity in that region. So, as we think about how this particular acquisition helps you in that process, could you just walk us through I guess where the overlap may be or how does it expand or kind of progress that Asia expansion?

A – Frank A. Bozich
Let me spend a minute on this. It's important to understand that the plant in Florence, Kentucky has quite a bit of available capacity, and because these products are very high margin, and -- we can transport them, we would believe that we can grow significantly in other regions through export sales, using that asset. So, we don't anticipate any capital investment outside of the region or incremental capital investment in the business to be able to affect that growth. But what we do believe is that the commercial overlap between Engineered Materials and the global presence of Trinseo, and access that we have into these interesting markets will provide channels to sell more of the continuous cast sheet and that overlap -- the customer overlap and market overlap will provide opportunities.

So, we think it's more of a channel synergy but, I want to just reiterate the point, we don't need to make capital investments outside of the U.S. or incremental investments in the existing facilities to support that growth, because they have plenty of free capacity.

Q – Angel Castillo
That's very helpful. Thank you. And then as we think about going forward, so you've done a number of announced growth and your leverage is still in a great place in terms of giving you flexibility. So, as you move forward I think you had talked about in the past wanting to do more of this kind of specialty expansion, and then you would look to potentially expand the dividend or grow that back maybe to what it used to be. So, as we think about I guess next steps, is it more bolt-on M&A around specialty or could there be more shareholder returns focus?

A – Frank A. Bozich
Yeah, obviously we've taken three big steps this year and we will need to digest those. We'll be focused on making sure that we deliver the synergies from both Arkema and completing the transactions in Synthetic Rubber and Aristech now. So those will be top priorities. But to be sure later this year we're in an excellent position. We'll have a discussion with our Board about normalizing our dividend at an appropriate level given the relatively modest leverage that we have now on a forward-looking basis.

Operator
There is no further question at this time. You may continue.

A – Frank A. Bozich
I want to thank everybody for participating and thank you for your questions.