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March 3, 2017

NYSE- Trinseo S.A. (TSE)

Analyst: Joseph Nastasi

Sector: Materials
Industry: Chemicals

Company Description:

Trinseo S.A. is a global materials company and manufacturer of plastics, latex, and rubber. Trinseo's products are incorporated into a wide range of industries such as home appliances, automotive, building and construction, carpet, consumer electronics, consumer goods, electrical and lighting, medical, packaging, paper and paperboard, rubber goods and tires. Trinseo has 434 manufacturing plants in 14 countries. Prior to Trinseo's formation, it was wholly owned by Dow Chemical Company, and in 2010 was acquired by Bain Capital. Trinseo S.A. went public in 2014 and Bain Capital has divested its entire ownership in Trinseo during 2016.

BUY

Current Price:	$71.80
Target Price:	$85.79
Market Cap:	3.16B
S&P Debt Rating:	B+
Ke:	15.5%
ROE:	43.2%
Net Income Margin:	7.0%
Total Asset Turnover:	1.6
Equity Multiplier:	5.63
Cash/Total Assets:	19.3%

Catalysts:

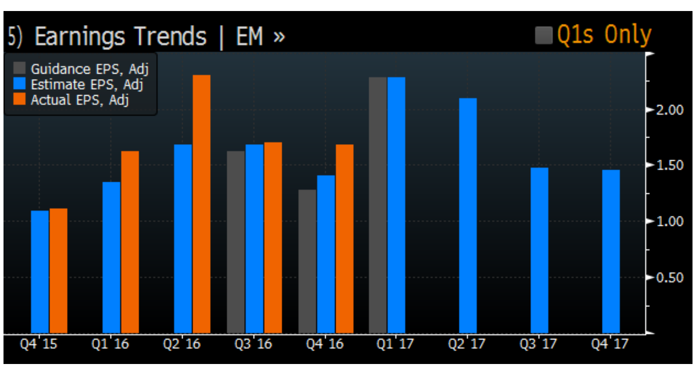
- **Short Term(within the year):** Q1 2017 Earnings
- **Mid Term(1-2 years):** President Trump's Fiscal promise of $1 trillion for infrastructure revitalization, massive tax cut, and reduced regulation (from agencies like the EPA)
- **Long Term(3+):** Innovative new products that will lead to sustainable margins and increased market share

Thesis:

Trinseo S.A. has been rapidly growing since its IPO inception in 2014. Prior to its IPO, Trinseo was wholly owned by DOW Chemical Company, which gave it a great foundation. Trinseo has consistently beat earnings expectations, generated increasing cash flows from operations, and greater free cash flow. This free cash flow has been spent well from management on R&D, capital expenditures, stock buybacks, and dividends. Trinseo has been able to be highly successful in a challenging Chemical Industry environment that is highly dependent on commodity prices due to its great products. Trinseo's products are incorporated into countless industries where there is market share to be gained. These new innovative products are able to take advantage of new trends and consumer demands. The marketing strategy of passing lower cost onto consumers with more efficient products that are environmentally conscious is a huge selling point. Even with these lower cost, Trinseo is able to operate at high profitability margins, which is impressive. Trinseo is underpriced right now compared to its competitors even considering its significant run. Trinseo is in its early growth stage and has great foundations to continue its upward movement in its stock price.

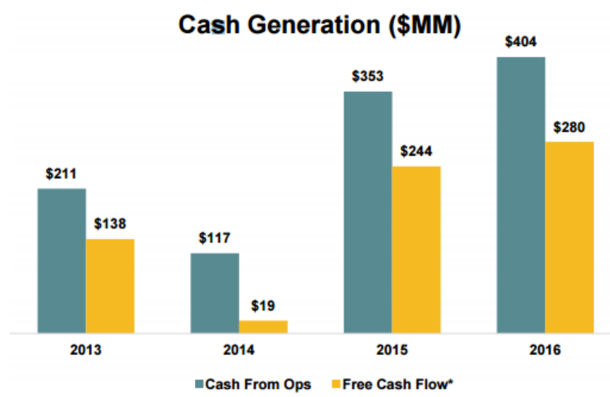
4th Quarter Earnings Performance:

Trinseo S.A. reported strong 4th Quarter earnings with CEO Chris Pappas stating, "We has record performance across several metrics, including net income, adjusted EBITDA, and cash generation. Trinseo has consistently beat earnings and guidance EPS estimates for the past five quarters.



Net income was reported at $78 million for this quarter, which is a 18% increase from the previous quarter and a 82% increase from the previous year. EBITDA was reported at $142 million for this quarter, which is a 13% increase from the previous quarter and a 23% increase from the previous year.

Cash flow generation is one of the driving growth factors of Trinseo.



The increase in cash flow from operations has given Trinseo flexibility. Trinseo has increased capital expenditure from $109 million in 2015 to $124 million in 2016. In the 4th quarter, Trinseo repurchased $21 million or about 9% of their outstanding stock. Also in the 3rd quarter, Trinseo initiated an annualized dividend of $1.20 per share. In total, $242 million or about 86% of free cash flow was returned to shareholders. Trinseo set very strong guidance by adjusting Q1'17 net income of $100 million to $108 million and Adjusted EPS of $2.19 to $2.37. Also, full year 2017 net income guidance of $310 million, Adjusted EBITDA of $580 million, and Adjusted EPS of $6.82.

Industry Outlook:

The Chemical Industry is highly cyclical with demand driven by economic growth. The energy, consumer goods, and industrial manufacturing sectors are highly dependent on chemical products in order to operate. President Trump's new administration should improve demand for the industry with the campaign promise of revitalizing U.S. manufacturing. Recovery in crude oil and natural gas prices will spur higher demand from the energy industry. The Chemical Industry contains high barriers to entry, which allows prices and margins to remain stable and increase. This industry is generally considered slow growth and has lagged behind other sectors due to volatile commodity prices, which accounts for a majority of these companies cost of goods sold.

Trinseo S.A. is a leader of growth in this industry with leading market positions worldwide in styrene-butadiene latex, European styrene, European synthetic rubber, and European polystyrene. Trinseo gains its competitive edge by innovating new products to meet consumers changing demands. Trinseo's CEO Chris Pappas described the industry outlook as "Better across the board." Pappas stated, "We have sold out in rubber. Good performance in the tire market. Our latex business I would describe as better. Price increases are taking hold. Cost reductions are taking hold. Performance plastics continues to be strong, better. Polycarbonate we are sold out."

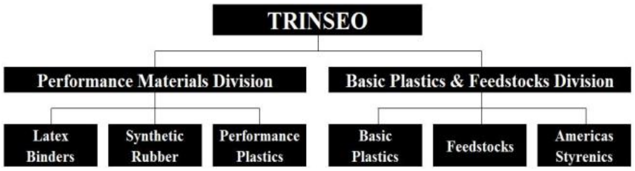
Innovative Products:

- **SPRINTAN SLR 3402:** Synthetic rubber tire that provides excellent rolling resistant, wet grip, and abrasion resistance for more balanced tire properties. Trinseo marketing efforts for these are labeling them as "green tires" because tires account for 20 to 30 percent of total fuel consumption and the low rolling resistance tires can reduce fuel consumption up to three percent. This means saving 21 gallons of fuel compared to traditional tires over a typical life span of a tire. Trinseo will be attending the Tire Technology Expo, Europe's leading international Tire Design Manufacturing Exhibition and Conference.
- **EMERGE PC:** Offers design freedom and high-quality aesthetics together to meet the requirements of both residential and commercial automotive charging stations. Provides materials for public charging stations that will withstand aggressive conditions like weather, high impact performance, and weather resistance.
- **CALIBRE Polycarbonate Resins:** These materials allow superior processing which can be modeled into complex shapes and forms, giving LED lighting manufactures a flexibility in product design. Also, materials are nearly as transparent as acrylic and glass and can help customers achieve uniform light diffusion, while maintaining maximum light output. By 2020, LED lighting is expected to represent 36 percent of all lighting sales. The widespread use of LED light is a great potential for energy savings.
- **PULSE GX50:** Developed for automotive interior component applications. The material offers a four percent decrease in density enabling lighter final parts, increasing efficiency. This is giving car manufacturers an alternative to aluminum that is cheaper and more efficient. This product is used in the BMW i8.

Business Model:

Trinseo S.A. has a diversified net sale by end market for its products. The proportion of 2016 Net Sales by End Markets are 15% Automotive, 14% Building & Construction/Sheet, 12% Tires/Rubber Goods, 9% Board & Specialty Paper, 8% Graphical Paper, 8% Appliances, 7% Packaging, 5% Consumer Electronics, 5% Textile, and 17% Other. The proportion of 2016 Net Sales by Geography were 60% Europe, 22% Asia Pacific, 14% United States, and 4% Other.

Trinseo operates its business under two divisions: Performance Materials and Basic Plastics & Feedstocks, which are split further into three segments shown below.



The Performance Materials division in 2016 had adjusted EBITDA of $341 million and Basic Plastics & Feedstocks had adjusted EBITDA of $364 million. The strategy of the Performance Materials division is to accelerate growth and for the Basic Plastics & Feedstocks division is to improve profitability. In the Latex Binders segment margins were improved, cost were reduced, and there was a new investment of a reactor in China resulting in an increase of annual adjusted EBITDA from the prior year of 19%.

There was an Asia sales volume record in the 4th quarter. Another sector to highlight is the Performance Plastics with an annual adjusted EBITDA increase of 26%. There was record sales volume to the automotive market. A positive trend that Trinseo is taking advantage of is the regulatory reforms in the EU, Japan, and Korea to improve fuel efficiency with its rolling resistant tires and lightweight plastic interior for automobiles. Trinseo's business strategies are to:

- Provide sustained cash generation that allows the Company to return cash to its shareholders through quarterly cash dividends and repurchasing of shares.
- Making strategic capital investments to extend market share position and meet expected growing demand
- Pursuing strategic acquisitions and joint ventures to extend market share especially in emerging markets
- Continuing to innovate and provide technological differentiation

Leverage Comparison:

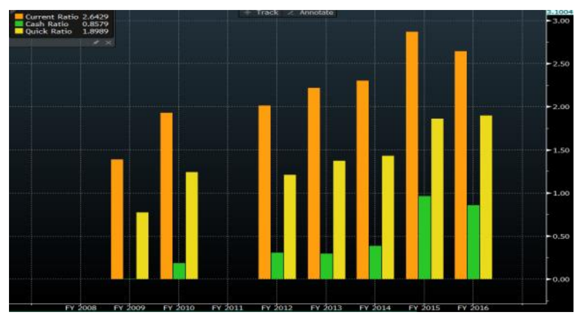
Trinseo uses significantly higher leverage compared to its competitors.

Capitalization (Debt/Equity)	History	LFY
TSE	1.14	0.44
Competitors	0.25	0.30

Kd	History	LFY
TSE	9.3%	7.0%
Competitors	5.0%	3.9%

Millions of USD	FY 2013	FY 2014	FY 2015	FY 2016
Months Ending	12/31/2013	12/31/2014	12/31/2015	12/31/2016
Market Capitalization	–	851.0	1,375.5	2,892.5
- Cash & Equivalents	196.5	220.8	431.3	465.1
+ Preferred & Other	0.0	0.0	0.0	0.0
+ Total Debt	1,336.4	1,202.2	1,207.8	1,165.4
Enterprise Value	–	1,832.5	2,152.1	3,592.8

Trinseo's high debt to equity and cost of debt is a concern. However, this is drastically improving. Trinseo has drastically increased its cash from operations and thus created much greater free cash flow. This has given Trinseo the flexibility to pay back some of its outstanding debt. This rapidly growing amount of free cash flow also has brought up conversation of potential acquisitions, which CEO Chris Pappas responded with "I guess that's always a possibility." The table above shows how Trinseo's cash & equivalents have been increasing and total debt has been decreasing. The graph shows Trinseo's increasing liquidity with the current ratio (in orange), the cash ratio (in green), and the quick ratio (in yellow) all with a positive trend.



These positive indicators of improving debt along with greater profitability, specifically in the Performance Products segment led to Moody raising Trinseo's debt rating from B2 to B1 on February 28th. I believe Trinseo's debt to equity ratio and cost of debt will move towards the industry average. Trinseo went public in 2014, so it is in its growth phase and being highly leveraged helps spur even greater growth. Trinseo with its rapidly increasing free cash flow and with management focused on debt reduction will become less leveraged, the cost of debt will decrease, and the WACC will decrease which is at 12.1% compared to the industry average of 9.3%. This reduction in the cost of debt is one area of value creation in the future.

Profitability Comparison:

Trinseo has rapidly been increasing its profitability with positive trends of gross profit, EBITDA, and net income. This is shown below:

In Millions of USD	FY 2013	FY 2014	FY 2015	FY 2016
12 Months Ending	12/31/2013	12/31/2014	12/31/2015	12/31/2016
Revenue, Adj	5,307.4	5,128.0	3,971.9	3,716.6
Growth %, YoY	-2.7	-3.4	-22.5	-6.4
Gross Profit, Adj	358.0	297.3	469.1	587.6
Margin %	6.7	5.8	11.8	15.8
EBITDA, Adj	311.3	289.4	501.1	621.4
Margin %	5.9	5.6	12.6	16.7
Net Income, Adj	14.5	-14.9	197.4	340.5
Margin %	0.3	-0.3	5.0	9.2

EBITA Margin	*History*	*LFY*
TSE	4.8%	10.6%
Competitors	14.1%	18.3%

ROIC	*History*	*LFY*
TSE	11.9%	23.2%
Competitors	21.8%	20.3%

The revenue decrease was primary due to lower raw materials costs. The rapid increase in net income is due to improved performance across all segments, including record sales volume in Synthetic Rubber.

The increase in these profitability margins show how management has been have to generate greater profits out of every dollar of revenue. Even with the high margins, Trinseo's EBITA margin is still behind the industry average, which shows there is room for growth. Trinseo's sensitivity attribution analysis is highly dependent on revenue, operating expense, and CAPEX. Revenue has been depressed due to commodity prices, which makes the rapid increase in this stock very impressive compared to its competitors who have been lacking in growth. Trinseo's strategy is all about passing fewer costs to its customers, but is still able to retain its high margins.

Summary:

In conclusion, Trinseo is a buy at its current price due to its upward growth potential. Management set very strong Q1'17 earnings guidance that shows their optimism about the current macroeconomic environment the company is operating in. President Trump's objectives to massively increase spending on infrastructure will spur economic growth due to the infrastructures sector dependence on chemical products in order to operate. Even though Trinseo net sales by geography were only 14% in the United States, about 75% of its total income is taxable in the United States. A tax reduction, promised by President Trump, is also a catalyst for growth.

Trinseo's innovative diverse range of products transformed into end products in almost every industry is what sets them apart from their competitors. Also, how their strategy is to pass on lower cost to consumers that keep up with the trends of consumers changing needs. Trinseo operating cash flow is consistently improving which is key to their long-term growth of greater capital expenditure and R&D expenditure to retain and improve their market share in countless industries worldwide. Management's strategy to provide sustained cash generation in order to return cash to shareholders through quarterly dividends is key. Trinseo's one-year target price of 85.79 is reasonable due to all their potential areas of growth.

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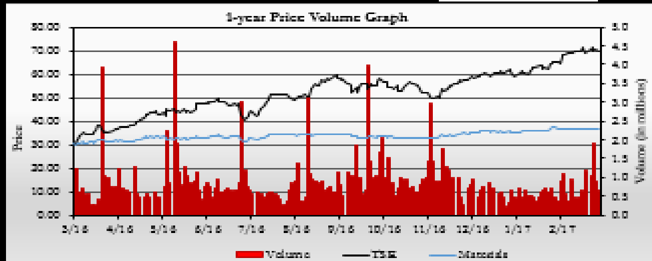
Trinseo S.A. (TSE) — **NEUTRAL**

Analysis by Joseph Nastasi	**Current Price:**	$71.80	**Intrinsic Value**	$100.62
3/3/2017	**Divident Yield:**	0.5%	**Target Price**	$85.79

Target 1 year Return: 19.96%
Probability of Price Increase: 92%



Description

Trinseo S.A., a materials company, manufactures and markets synthetic rubber, latex, and plastic products in Europe, the Middle East, North America, Latin America, and the Asia Pacific.

General Information

Sector	Materials
Industry	Chemicals
Last Guidance	November 3, 2015
Next earnings date	NM
Estimated Country Risk Premium	5.97%
Effective Tax rate	18%
Effective Operating Tax rate	16%

Market Data

Market Capitalization	$3,156.20
Daily volume (mil)	0.85
Shares outstanding (mil)	43.96
Diluted shares outstanding (mil)	47.48
% shares held by institutions	103%
% shares held by investments Managers	61%
% shares held by hedge funds	32%
% shares held by insiders	0.15%
Short interest	3.11%
Days to cover short interest	2.19
52 week high	$72.60
52-week low	$29.89
Levered Beta	2.43
Volatility	0.00%

Past Earning Surprises

Quarter ending	Revenue	EBITDA
12/31/2015	-8.01%	-24.34%
3/31/2016	-11.60%	-16.01%
6/30/2016	-1.10%	-0.18%
9/30/2016	-6.09%	-24.48%
12/31/2016	0.56%	-17.46%
Mean	-5.25%	-16.49%
Standard error	2.2%	4.4%

Peers

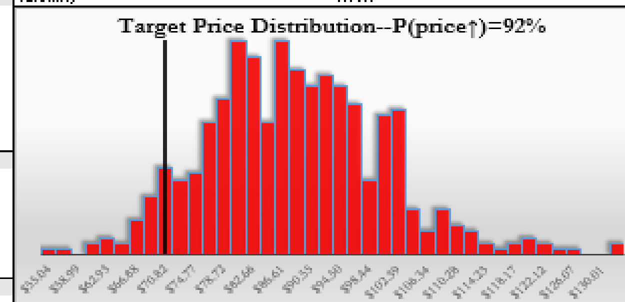
Westlake Chemical Corporation
Celanese Corporation
Eastman Chemical Company
LyondellBasell Industries N.V.
Air Products and Chemicals, Inc.

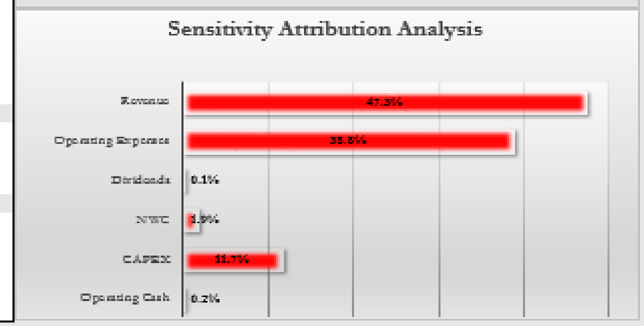
Management	Position	Total compensation growth	Total return to shareholders
Pappas, Christopher	Chief Executive Officer, Pre	-100% per annum over 4y	N/M
Chaclas, Angelo	Chief Legal Officer, Senior	N/M	0% per annum over 0y
Harner, Marilyn	Senior Vice President of Hum	64.86% per annum over 1y	61.6% per annum over 1y
Nizialek, Barry	Chief Financial Officer and	N/M	N/M
Leib, Ryan	Principal Accounting Officer	N/M	N/M
Stasse, David	Vice President of Treasury &	N/M	N/M

Profitability	TSE (LTM)	TSE (5 years historical aver	Industry (LTM)
ROIC	29.0%	11.56%	15.05%
NOPAT Margin	11%	4.14%	14.4%
Revenue/Invested Capital	2.76	2.79	1.04
ROE	51.3%	30.48%	18.19%
Adjusted net margin	9%	2.22%	12.7%
Revenue/Adjusted Book Value	5.92	13.73	1.43

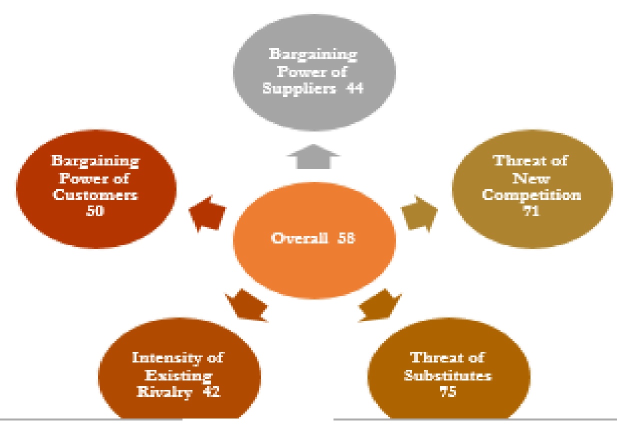
Invested Funds	TSE (LTM)	TSE (5 years historical aver	Industry (LTM)
Total Cash/Total Capital	23.6%	16.0%	13%
Estimated Operating Cash/Total Capital	9.6%	10.8%	N/A
Non-cash working Capital/Total Capital	21.9%	27.3%	12%
Invested Capital/Total Capital	66.1%	75.7%	82%

Capital Structure	TSE (LTM)	TSE (5 years historical aver	Industry (LTM)
Total Debt/Common Equity (LTM)	0.42	0.54	0.26
Cost of Existing Debt	7.74%	9.28%	3.77%
Estimated Cost of new Borrowing	5.74%	5.04%	3.77%
CGFS Risk Rating	D	C	B
Unlevered Beta (LTM)	1.46	0.87	1.02
WACC	13.01%	9.66%	9.65%





Porter's 5 forces (scores are out of 100)



Valuation

Period	Revenue growth	NOPAT margin	ROIC/WACC
Base Year	-6.4%	10.5%	2.23
12/31/2017	-3.5%	12.8%	2.74
12/31/2018	4.6%	12.8%	2.63
12/31/2019	-0.9%	13.2%	2.32
12/31/2020	25.2%	14.9%	2.98
12/31/2021	22.2%	15.6%	2.82
12/31/2022	19.1%	16.3%	2.62
12/31/2023	16.1%	17.0%	2.42
12/31/2024	13.1%	17.6%	2.24
12/31/2025	10.0%	18.2%	2.07
12/31/2026	7.0%	18.8%	1.92
Continuing Period	4.0%	19.3%	1.78

Period	Invested Capital	Net Claims	Price per share
Base Year	$1,650.17	$707.55	$137.57
12/31/2017	$1,587.03	$462.27	$155.01
12/31/2018	$1,609.75	$311.63	$174.05
12/31/2019	$1,487.32	$106.76	$194.77
12/31/2020	$1,346.68	$178.95	$217.56
12/31/2021	$1,301.61	$279.55	$242.99
12/31/2022	$1,409.91	$363.49	$271.30
12/31/2023	$1,633.56	$403.46	$302.54
12/31/2024	$1,795.26	$308.86	$337.85
12/31/2025	$2,433.95	$137.35	$375.00