

Westlake Chemical Corporation

NYSE:WLK

Analyst: Eric Crown

Sector: Materials

HOLD

Price Target: \$63.52

Key Statistics as of 10/07/2016

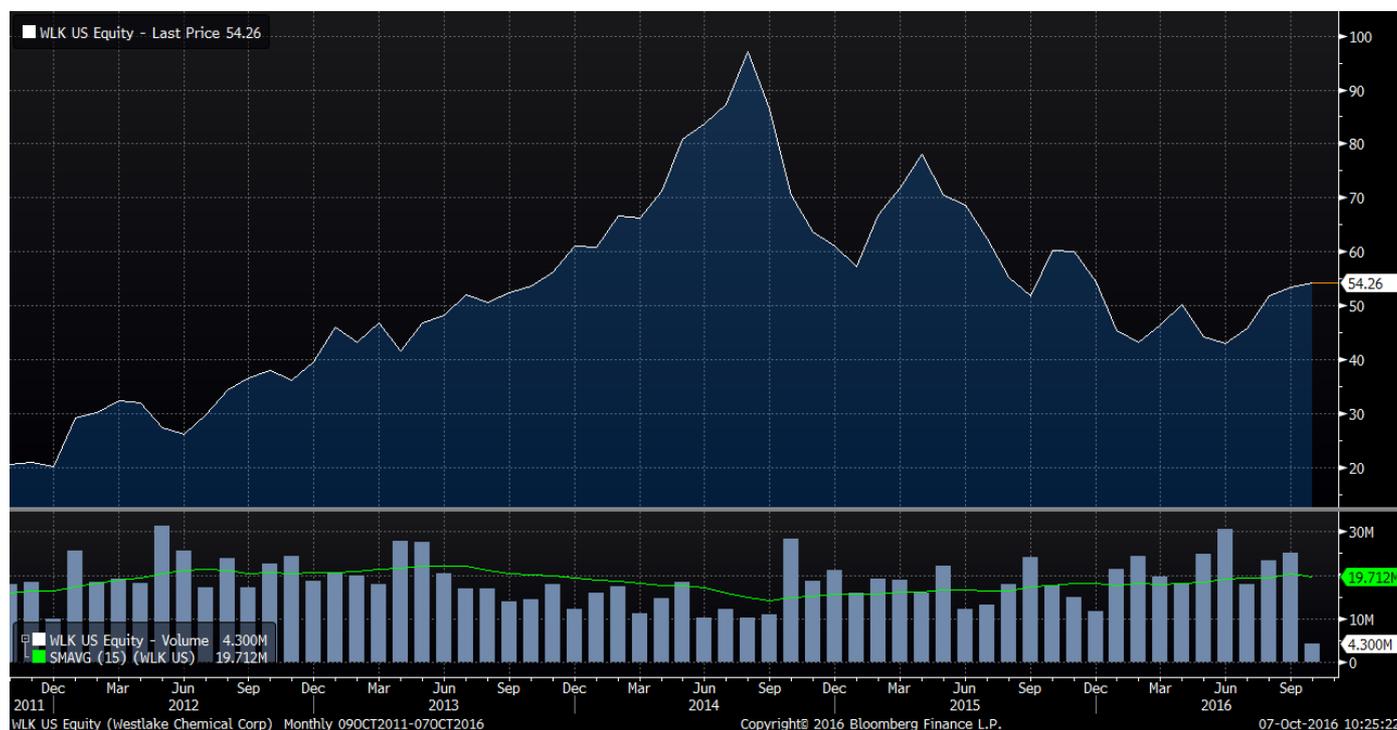
Market Price:	\$54.43
Industry:	Chemicals
Market Cap:	\$7.01 Billion
52-Week Range:	\$39.48-63.56
Beta:	1.65

Catalysts:

- Managing Changing Feedstock Prices
- Acquisitions Leading to Growth

Company Description:

Westlake Chemical Corporation is a global manufacturer and marketer of chemicals, vinyls, polymers, and building products headquartered out of Houston, Texas. Westlake's chemicals are used in a number of markets to produce products such as: flexible and rigid packaging, automotive products, coatings, construction goods as well as other durable and non-durable goods. The core business is segmented into two segments being Olefins and Vinyls. Olefins are mainly used in the production of plastic wrap, coating, and packaging. Vinyls are used in the production of chemically molded products such as PVC and other plastic goods.



Thesis

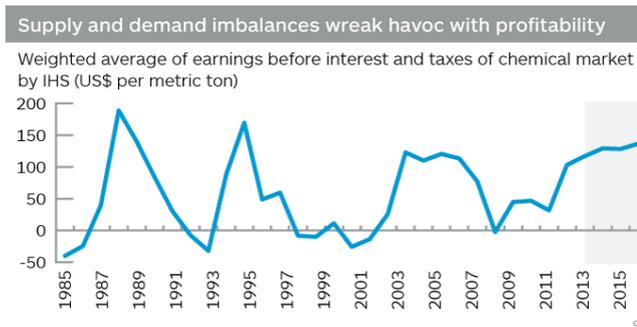
The chemical industry is a very cyclical industry in which the profits rely heavily on the price of commodities such as natural gas, ethane, ethylene, salt, and electricity. Westlake Chemical Corporation is a smaller company within the industry but has been growing rapidly in recent years. This growth has been achieved by strategic acquisitions which has also helped to further vertically integrate the company. Being more vertically integrated in this industry helps eliminate some of the risk associated with the volatile commodities pricing. With experienced management Westlake is in the position to grow within the industry and potentially outperform competitors and increase the value of the stock.

Cyclical Nature of Industry

As stated in the thesis the chemical industry is very cyclical. One of the main reasons is that the feedstock (raw materials needed for production) fluctuates in price. This change in price can dramatically effect operating expenses. There are a number of factors that can affect the price of feedstock:

- The availability of feedstock as a byproduct from shale gas and oil drilling.
- Supply, demand, and price of crude oil.
- Shortages of raw materials due to increasing demand.
- Ethane and liquefied natural gas exports.
- The direct or indirect effect of governmental regulation.

These factors affect both the Vinyl and Olefin aspect of the business. The top companies in this industry know how to minimize these risk. To help further illustrate the cyclical nature of this industry a graph of earnings has been provided.



These are inherent risk for all the companies in this industry making managing this risk is a key catalyst in the pricing of this industry.

Rising Oil Prices

One of the key feedstocks is oil. For the past several months oil prices have been low, with a very recent increase in price. The pumps that Westlake uses are natural gas liquids based ethylene crackers. The low oil prices have caused a reduction in the cost advantage for such pumps in North America. As compared to the more cost effective naphtha-based ethylene crackers that use crude oil derivatives. As a result, Westlake's margins and cash flow have been negatively impacted. However this impact should begin to be minimized as oil prices begin to rise. This may partially explain the slightly lower stock price in recent months.



Experienced Management

The management team is headed by the Chao brothers, whom between the two of them have 85 years of global experience in the chemical industry. James Chao has been the chairman of the board of directors since July 2004. Albert Chao has been the president since May 1996 and the CEO as of July 2004. They bring a wealth of experience and leadership the company needs to compete in this industry. Their growth strategy focuses on plant acquisitions, new plant construction and internal expansion.

Ownership

Ownership Type		10/02/16
1) Corporation		68.38
2) Investment Advisor		21.26
3) Hedge Fund Manager		6.59
4) Bank		1.28
5) Government		0.67
6) Pension Fund		0.60
7) Individual		0.49
8) Insurance Company		0.29
9) Brokerage		0.23
20) Family Office/Trust		0.19
21) Other		0.00

As can be seen in the table above the primary ownership of Westlake is in corporations. The corporation with around 70% of the holdings is TTWF LP. This is a private company owned by the Chao family. This shows us that they are heavily invested in the success of the company and have a major incentive to increase the stock price.

Growth through Acquisitions

One of Westlake Chemical's primary strategies for growth is through acquisition. They recently acquired Axiall Corporation for \$2.3 billion in cash and assume about \$1.5 billion of Axiall's debt. The combined company will be the third largest chlor-alkali producer and the second-largest polyvinyl chloride (PVC) producer in North America. This will help Westlake eliminate downstream cost while expanding their business. Westlake has made numerous acquisitions such as this one and will likely continue this strategy to grow the business.

Financials

A couple things stand out when looking at Westlake's financials. The first thing is the growing EBITA Margin which was last reported as 19%. This beats the industry average of 15% and shows that the growth through acquisitions is leading to increased earnings. Another factor that should be noted is the large amounts of cash on hand. Last reported cash holdings was well over 1 billion dollars. This will allow Westlake to be able to pounce on any potential acquisition opportunities.

The last ratio to look at is ROIC.

	ROIC		ROIC W/O GW	
	History	LFY	History	LFY
WLK:	0.16174793	0.139973378	0.16376	0.1423573
Competitors:	0.156614981	0.133775911	0.19067	0.1705074

As can be seen the ROIC it is fairly close to the industry. This can be concerning because it could mean there is not much room for growth. However if you look at the ROIC without Goodwill you can see that Westlake has room to grow. If Westlake can match the industry ROIC without Goodwill they could likely surpass the industry ROIC with Goodwill.

Porters Five Forces

Bargaining Power of Suppliers: Westlake scored a 56.25 on bargaining power with suppliers. The cost of supplies are very important to the bottom line of Westlake. This makes it critical for Westlake to get a good price however there are few alternatives to the materials they require for production.

Bargaining Power of Customers: Westlake scored a 71.43 because the goods they create are essential in the production for other companies. This allows them to adjust the price when feedstock cost is increasing.

Intensity of Existing Rivalry: Westlake scored a 33.33 because the chemical industry is a very competitive industry. There are other larger company such as DOW chemical that can use their size to their advantage.

Threat of Substitutes: Westlake scored a 91.67 because there is no real substitute to the product they manufacture.

Threat of New Competition: Westlake scored a 66.67 because if other companies had the money they could compete with Westlake because the product is not unique, however it would take lots of capital.

Summary

I believe we should hold Westlake Chemical in our portfolio. In the chemical industry it is important for companies to effectively manage the risk associated with the commodities used in production. I believe Westlake Chemical has an experienced and very motivated management. They are growing their company through tactical acquisitions and expansion that will lead to a more vertically integrated company. By doing this they will be able to minimize their materials risk and potentially bring down their operating cost. I believe that all these factors will lead to an increase in price.



Westlake Chemical Corp.
(wlk)

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NEUTRAL

Analysis by Eric Crown
10/7/2016

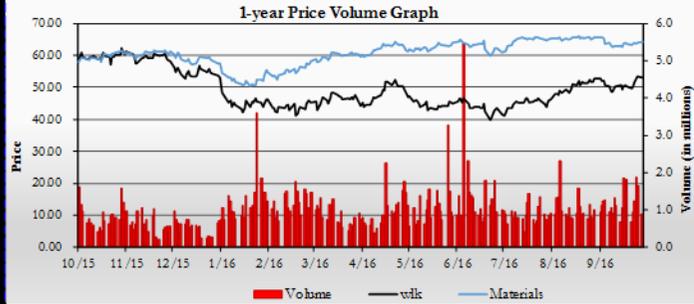
Current Price:
Divident Yield:

\$54.84
1.7%

Intrinsic Value:
Target Price:

\$56.05
\$63.52

Target 1 year Return: 17.54%
Probability of Price Increase: 88.4%

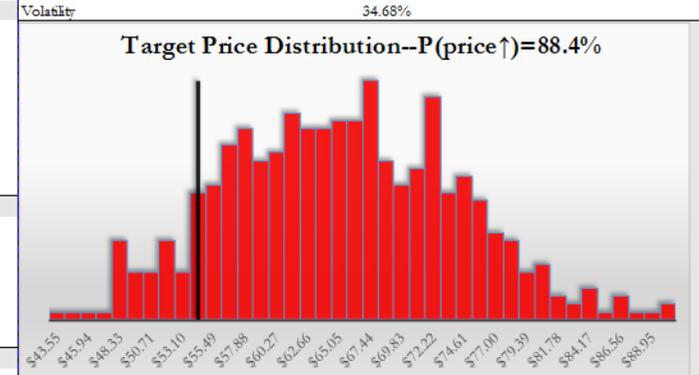


Description	
Westlake Chemical Corporation manufactures and markets basic chemicals, vinyls, polymers, and building products.	
General Information	
Sector	Materials
Industry	Chemicals
Last Guidance	November 3, 2015
Next earnings date	November 3, 2016
Estimated Country Risk Premium	5.75%
Effective Tax rate	36%
Effective Operating Tax rate	26%

Market Data	
Market Capitalization	\$7,066.37
Daily volume (mil)	1.18
Shares outstanding (mil)	128.85
Diluted shares outstanding (mil)	130.88
% shares held by institutions	75%
% shares held by investments Managers	22%
% shares held by hedge funds	7%
% shares held by insiders	0.45%
Short interest	2.65%
Days to cover short interest	3.29
52 week high	\$63.56
52-week low	\$39.48
Levered Beta	1.61
Volatility	34.68%

Past Earning Surprises	
Quarter ending	Revenue
6/30/2015	2.16%
9/30/2015	-3.96%
12/31/2015	-12.24%
3/31/2016	-9.37%
6/30/2016	-8.04%
Mean	-6.29%
Standard error	2.5%

EBITDA		Peers	
5.24%	Olin Corp.	2.73% per annum over 5y	
-8.79%	Taiseo SA	2.73% per annum over 5y	
-19.37%	Celanese Corporation	0% per annum over 0y	
-4.05%	LyondellBasell Industries N.V.	0% per annum over 0y	
-13.99%	Eastman Chemical Co.	N/M	
-8.19%	Ashland Global Holdings Inc.	N/M	
4.2%	Huntsman Corporation	N/M	
	Westlake Chemical Partners LP	N/M	

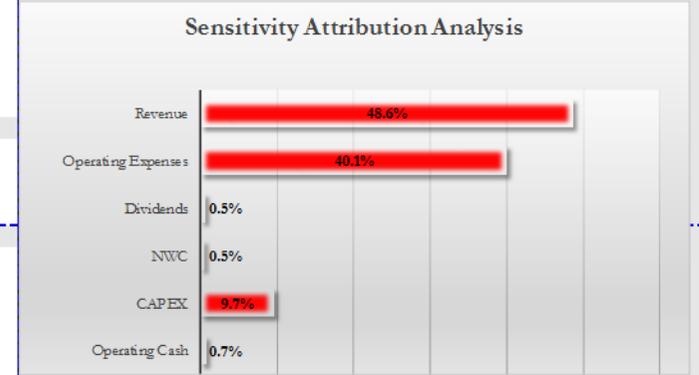


Management	Position
Chao, Albert	Chief Executive Officer, Pre
Bender, M.	Chief Financial Officer, Sen
Buesinger, Robert	Senior Vice President of Vin
Kenner, Andrew	Vice President of Manufactur
Mangieri, George	Chief Accounting Officer and
Ederington, L.	Chief Administrative Officer

Total compensations growth	Total return to shareholders
19.32% per annum over 5y	2.73% per annum over 5y
19.15% per annum over 5y	2.73% per annum over 5y
N/M	0% per annum over 0y
N/M	0% per annum over 0y
N/M	N/M
N/M	N/M

Profitability	wlk (LTM)	wlk (5 years historical average)	Industry (LTM)
ROIC	16.3%	21.56%	11.67%
NOPAT Margin	18%	16.61%	11.6%
Revenue/Invested Capital	0.93	1.30	1.00
ROE	18.1%	25.14%	14.70%
Adjusted net margin	17%	15.87%	9.9%
Revenue/Adjusted Book Value	1.07	1.58	1.48

Invested Funds	wlk (LTM)	wlk (5 years historical average)	Industry (LTM)
Total Cash/Total Capital	20.8%	21.6%	10%
Estimated Operating Cash/Total Capital	8.6%	10.1%	N/A
Non-cash working Capital/Total Capital	8.3%	11.3%	16%
Invested Capital/Total Capital	93.7%	91.1%	86%



Capital Structure	wlk (LTM)	wlk (5 years historical average)	Industry (LTM)
Total Debt/Common Equity (LTM)	0.21	0.15	0.33
Cost of Existing Debt	4.98%	5.61%	3.70%
Estimated Cost of new Borrowing	3.74%	3.75%	3.70%
CGFS Risk Rating	BB	BB	B
Unlevered Beta (LTM)	1.46	1.54	1.12
WACC	11.94%	12.51%	9.63%

Porter's 5 forces (scores are out of 100)	Period	Revenue growth	Valuation
Bargaining Power of Suppliers 56	Base Year	-9.4%	NOPAT margin 17.5%
	6/30/2017	29.6%	9.0%
	6/30/2018	18.8%	8.2%
	6/30/2019	17.2%	8.8%
	6/30/2020	15.6%	9.5%
	6/30/2021	13.0%	10.0%

Valuation	ROIC/WACC
NOPAT margin 17.5%	1.37
9.0%	0.85
8.2%	0.76
8.8%	0.88
9.5%	0.97
10.0%	1.04