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Trinseo

Strengthening performance materials as profits improve

Christopher Pappas
President and CEO

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Trinseo

A carve out of Dow's rubber, latex, and styrenics-based plastics business, Trinseo (Berwyn, PA) has upgraded its performance and portfolio since being sold to Bain Capital in 2010.

President and CEO Christopher Pappas says Trinseo is in a strong position to accelerate earnings growth. Work over the past five years has focused on building the infrastructure needed to support a standalone company that would eventually go public—which it did last year—as well as upgrade the portfolio and improve earnings performance. That effort has created a franchise built on emulsion-based polymers and plastics that will generate Ebitda of nearly $500 million in 2015, up from $220 million in 2010. Bain Capital took Trinseo public in June 2014 and retains a 76% stake. Trinseo's performance materials businesses have stronger and more durable margins regardless of industry conditions, and a cyclical upturn in feedstocks and basic plastics is providing another boost to earnings.

To focus strategy, Trinseo reorganized earlier this year around four reporting segments across two major business units. Three businesses—latex, synthetic rubber, and performance plastics—together account for 55% of overall revenue and form the performance materials core. These businesses will draw the investment for expansion and acquisitions. And the fourth segment—basic plastics and feedstocks, including polystyrene (PS), acrylonitrile butadiene styrene (ABS), styrene acrylonitrile (SAN), and polycarbonate (PC)—will focus on cash generation and operating efficiency.

Trinseo's major products include styrene-butadiene (SB) latex and styrene-acrylate latex in the latex business; solution styrene butadiene rubber (SSBR), lithium polybutadiene rubber (Li-PBR), emulsion styrene butadiene rubber, and nickel polybutadiene rubber (Ni-PBR) in the synthetic rubber business; ABS, PC, and polypropylene (PP) blends and compounds in performance plastics; and styrene monomer, ABS, PC, PS, and SAN in feedstocks and basic plastics.

Trinseo expects to deliver adjusted Ebitda of $485-495 million this year, up roughly 50% from 2014. Trinseo's Ebitda-to-debt ratio peaked at 4.8 times in 2012. At the end of the second quarter of 2015 it was 2.8 times and is forecast to be below 2.5 by the end of the year.

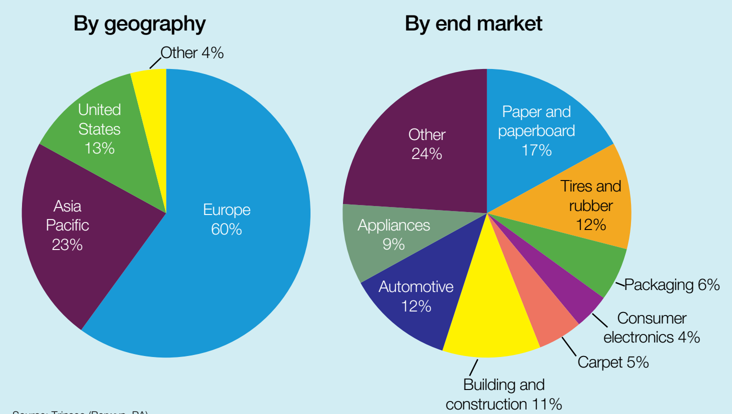
"We've been through a value-progression from $220 million Ebitda when we bought the company in 2010, to the past two years at about $320 million, to this year's consensus projection of almost $500 million," Pappas says. Trinseo has reduced its fixed-costs base by almost $100 million since 2011. The improved cost structure positions the company to grow, Pappas says. Trinseo now has a portfolio well positioned to compete in attractive and growing segments of key customer end-markets where demand is supported by favorable trends such as improving living standards in emerging markets, fuel efficiency, and the increasing use of lightweight materials. Also, key markets such as automotive, construction, household, and appliance will grow at rates exceeding the rate of global GDP, Trinseo says.

Pappas says the work over the past five years has helped establish roughly $500 million in Ebitda as a solid floor that can now grow incrementally as a result of targeted investment in performance materials as well as cyclical margin recovery in basic feedstocks and plastics as styrene and PC margins recover. "We have had a substantial step change in the performance of the company along with this transition," Pappas says. Trinseo has worked to recast its identity as well, reflected in a change of name from Styron that was completed last year. "The company is much more than styrenics and we wanted to reflect that in the name," Pappas says. "Trinseo comes from the word intrinsic, which is important because of the idea that our products are intrinsic to our customers."

The company started in 2010 with 2,100 employees, substantially all from Dow. "Today we have about the same number of people, but 600-plus are new to the company. We have built a new population. That gave us the opportunity to bring in very specific people and skills that we needed." Trinseo's culture and behavior has maintained best practices from Dow with adjustments to reflect Trinseo's areas of focus, Pappas says. "We forged out of that what we think is the right culture for our company, which is transparent, extremely committed to results, low-to-no bureaucracy, and we accomplished that with a very lean structure," he says.

Trinseo at a glance

(2014 revenue: $5.1 billion)



Source: Trinseo (Berwyn, PA)

Performance driven

Margins in performance materials range from high-single digits in latex to more than 20% for rubber. "The business here is driven by markets, customers, segments, intimate interactions, as well as engineering and technical dialogue," Pappas says. "Profitability is more influenced by our ability to deliver product and technology to the market than the cycle. Seventy-plus percent of our capital expenditure will go to these businesses."

Latex is the largest performance materials segment with revenues of $1.1 billion for the 12-months ended 30 June. Roughly 50% of the latex business is in paper coatings, 20% board coatings, 20% carpet, and 10% performance latex. Paper coatings are declining in Europe and the United States, but China remains a growth market. Trinseo added 25,000 m.t./year of SB latex capacity at its facility in Zhangjiagang, China in the third quarter to meet that demand. Board applications are growing, and carpet is rebounding, he adds. Trinseo remains underrepresented in performance latex and that is a focus of growth.

"Our strategy in latex has been to maintain our position in coated paper with what we think is the world's leading technology in starch-based emulsions," Pappas says. That technology has been introduced over past two years in the United States and in Europe and demand is growing. "It allow us to deliver a lower-cost latex to the paper coating segment yet maintain margins because our costs are lower," Pappas says. "That allows us to maintain a very strong market position in paper coating."

Performance latex is targeted for growth, and the company will need to broaden beyond its strengths in areas such as SB latex. "We have a strong desire to grow that business. To grow it substantially, we need to broaden our technology package," Pappas says. "We would be interested in bolt-on acquisitions that would help us grow performance latex." Overall, however, a worldwide footprint and strong position in segments where it operates, such as paper, have allowed Trinseo to "maintain relatively good and consistent Ebitda despite tough conditions in latex markets," he says.

In rubber, which posted sales of $537 million in the 12-months ended 30 June, the company is focused on SSBR as well as polybutadiene rubber technologies such as neodymium polybutadiene rubber (Nd-PBR) and Li-PBR with a particular emphasis on high-performance tire applications. The market for performance tires is expected to grow at a rate that is 3-4 times that of the standard tire market, Trinseo says. The company is converting Ni-PBR production capacity at Schkopau, Germany to the production of Nd-PBR, a key material in the latest generation of performance tires.

Rubber assets are based in Germany but the business is global, Pappas says. "We serve the world from that plant, not just Europe," Pappas says. "We're now on our 4th-generation technology in SSBR and will go beyond that. We are upgrading our mix from nickel to neodymium, and growing SSBR. That's been our strategy." Trinseo would consider SSBR production in Asia but there are no firm near-term plans and any investment would likely be with a partner, Pappas adds.

Performance plastics, with annual revenues of $791 million, is focused on compounds and blends. Dow largely focused the ABS and PC business that now forms part of Trinseo on automotive applications. Trinseo is seeking to extend that position through expansion in PP blends for automotive customers as well increasing its presence in consumer markets. "Consumer essential markets (CEM) have become a real point of focus for us over the last two years," Pappas says. "Medical, LED lighting, and electronics with a focus on connected devices are the three main market segments that we think are important for CEM. We have put, I think, a good set of technologies together now that are going to allow us to grow that business." Automotive accounts for 70-75% of sales in performance plastics with 25% in CEM. "The CEM portion is beginning to show real growth and interesting opportunities," Pappas says.

Performance materials will get Trinseo's growth investments. "All three have a very strong profile of return on capital and can be invested in for high returns," Pappas says.

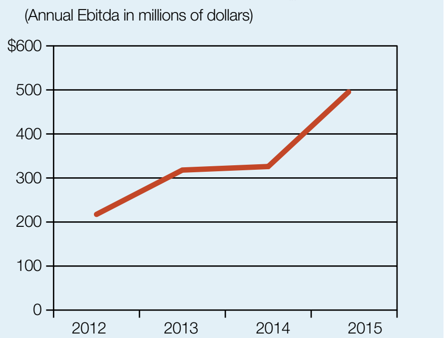
Basics back in black

The basic feedstocks and plastics unit accounts for roughly $2 billion in annual revenue, or 45% of Trinseo's overall sales. "Operating rates in all those materials are rising or have already risen substantially due to restructuring in industry or simple demand growth," Pappas says. "Margins and Ebitda are growing very quickly, and we think it is sustainable." Growth is modest, ranging from 2% in PS and styrene, to 5% in PC, but there is no supply being added, he says. "As growth continues even at modest levels with no new capacity, we see rising operating rates. The investment strategy is not to build in these areas but ensure best-in-class efficiency and operations to fully capture the upside here," Pappas says.

Pappas, who previously held senior positions at Dow and was COO and CEO at Nova Chemical, has overseen styrenics operations for more than 15 years, a generally difficult period for styrene and its key derivatives. Rationalization and consolidation have finally put the sector in a better position, he says. "Operating rates for styrene are in the mid-80s globally, up about 6% over the past two years. Consolidation and restructuring over 10 years has finally caught up, with styrene operating rates now at 86%." Operating rates for PC, meanwhile, are up about 10% in 18 months because of restructuring, including Trinseo's decision to shut a PC plant at Freeport, TX that Dow had been operating for Trinseo. Asian producers have also shut production and slowed investment.

Unlike performance materials, feedstock and basic plastic earnings are dictated by the petrochemical cycle. "The driver of profitability here is supply-demand and operating rates," Pappas says. "Our view is if the operating rate of polystyrene, styrene, and polycarbonate is relatively high, which they are now, then we can make money whether feedstock costs are high or low. We will invest to ensure world-class operations of assets through maintenance and world-class cost performance through productivity improvements, but we will not invest here for new capacity," Pappas says. The company would have interest in being a consolidator in these businesses, particularly styrenics. "That's something we would look at but those opportunities are quite limited today," Pappas says. "Much of that has been accomplished."

Earnings improvement*



*2012-2014 Reported adjusted Ebitda including inventory adjustment.
2015 is mean analyst Ebitda forecast as reported by Thomson Reuters (New York).
Sourec: Trinseo (Berwyn, PA); Thomson Reuters (New York).

Trinseo's basics unit includes Americas Styrenics, 50-50 joint venture with Chevron Phillips Chemical (CPChem) that has leading US market share in PS with revenue of about $2 billion/year. "We are quite happy with the structure of Americas Styrenics and I think CPChem feels the same," Pappas says. "Their goal in life is simple. Run world-class facilities, capture the benefit of a rising operating rate, produce more cash, and give dividends to their parents, which they've done an excellent job of over the last 2 or 3 years."

Trinseo's largest market is Europe, which accounted for 60% of sales in 2014. That share will decline as other regions grow but Pappas is comfortable with a large European exposure. "We actually like the position we have today," Pappas says. "I've been saying for 18 months that the headlines in Europe are much worse than actual business conditions. That's proven to be true. The general direction for investment would be Asia-biased for products such as rubber, but not exclusively. We would put compounding capability into Europe and the Americas as needed, and more broadly look into the Americas if needed."

Trinseo is expected to hit its 2–2.5 debt ratio target by the end of the year, which should free up cash for investment. "We'll look at continued organic and bolt-on growth in performance materials," Pappas says. "We will look at strengthening the balance sheet, as we always do, and also look at dividend policy. Those are the three broad buckets for deployment of cash at the moment."

Private to public

Pappas says the experience with private equity has been positive as Trinseo transitioned from a carve out to private equity ownership through the initial public offering in June 2014. "We started in June of 2010," Pappas says. "In September, three months later, the board authorized the largest capital project in the history of the business, construction of a new SSBR rubber plant." Bain Capital "wanted to grow the company. They know that taking Ebitda from $220 million to $500 million is the pathway to creating value for their stakeholders and there are a whole number of ways to that. Of course we pay attention to costs when appropriate. But, we also pay attention to investing in the right places, which for us has been a big positive. I'm a fan of the model," he says.

Trinseo has more than doubled Ebitda over the past five years, and Pappas says the $500-million threshold will prove durable. "We've reached a level of profitability that has strength and sustainability and we think it can grow from here," Pappas says. "It can grow for two reasons: Continued growth in margin from rising operating rates in feedstocks and basic plastics, and continued growth from investments in performance materials. Our earnings are in the best position we've ever had. Our cash flow is in the best position we've ever had and our people and our culture I think is jelling at the right time so we feel pretty excited about the future."

—ROBERT WESTERVELT IN BERWYN, PA