Recommendations

Trinseo (TRINSE) 5.375% Senior Notes '25

Trinseo released 3Q'17 results in early November that came in above expectations and up y/y, following 2Q'17 results that broke the streak of nine consecutive quarters of EBITDA growth y/y. EBITDA was $166 MM vs. our forecast of $115 MM and $143 MM in 3Q'16. The large beat in the quarter was driven by higher styrene margins from unplanned supply outages, including a $15 MM benefit from Hurricane Harvey, as well as from improved margins in the Basic Plastics and Latex binders segments. LTM EBITDA is $616 MM and LTM FCF is at $124 MM. Net Leverage at 1.4x has been stable for the past two years after rapidly deleveraging in FY'14 and FY'15.

Trinseo provided FY'18 guidance calling for EBITDA of $620-650 MM, which compares to consensus of $642 MM. This guidance is above LTM EBITDA as a result of the continued trend of strong styrene margins, which is supported by the outlook calling for a 2.0% growth rate in demand coupled with limited capacity additions. Further, an aging asset base increases the potential for unplanned outages and higher margins, which has aided results over the past several years. Additionally, the Company expects that Performance Materials EBITDA will increase by $100 MM in the time period of 2016-2019, more than half of which has yet to be realized, which will add incremental EBITDA. Projects contributing to driving $75 MM of identified growth include the SSBR expansion, the ABS expansion in China and a series of investments in Performance Plastics. The remaining $25 MM will be through bolt-on acquisitions, namely the acquisition of API Plastics in Italy.

On a relative value basis, we believe that the Trinseo 5.375% Senior Notes '25 offer an attractive 4.56% YTW with a spread of 226 bps, which compares favorably to its peer group. The Trinseo bonds offer an additional 115 bps of yield compared to Olin's 10.000% Senior Notes '25, which has more leverage (3.9x net leverage) than Trinseo, has a similar maturity and also has exposure to commodity products. Also, with Trinseo's split rating of B3/BB-, we believe that it is a candidate for becoming BB of both sides given its credit stats and disciplined cash deployment policy. Despite the historical cyclicality in earnings for the Company's commodity Basic Plastics & Feedstocks segments, we believe that the segment is positioned well for the next several years, as steady growth and no expected capacity additions should keep operating rates in the 90% range for the Styrenics business. As such, we rate the TRINSE 5.375% Senior Notes '25 a BUY.

Key risks for Trinseo include the volatility in earnings at the Styrenics business, the potential for competitors to increase capacity of styrene or SSBR, a substantial and prolonged rise in raw materials prices (benzene, butadiene, ethylene) and a return to recessionary conditions in Europe.