

ENTEGRIS INC  
Form 10-Q  
April 26, 2013  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
WASHINGTON, D.C. 20549

**FORM 10-Q**

(Mark One)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended March 30, 2013

OR

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number: 001-32598

**Entegris, Inc.**

(Exact name of registrant as specified in its charter)

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**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**41-1941551**  
(I.R.S. Employer  
Identification No.)

**129 Concord Road, Billerica, Massachusetts**  
(Address of principal executive offices)

**01821**  
(Zip Code)

**(978) 436-6500**  
(Registrant's telephone number, including area code)

**None**  
(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer   
Non-accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company   
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Outstanding at April 22, 2013
<b>Common Stock, \$0.01 par value per share</b>	<b>139,321,942 shares</b>

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ENTEGRIS, INC. AND SUBSIDIARIES

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**Cautionary Statements**

This report contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements involve substantial risks and uncertainties and reflect the Company's current views with respect to future events and financial performance. The words believe, expect, anticipate, intends, estimate, forecast, project, should, may, will and would expressions are intended to identify these forward-looking statements. You should read statements that contain these words carefully because they discuss future expectations, contain projections of future results of operations or of financial position or state other forward-looking information. All forecasts and projections in this report are forward-looking statements, and are based on management's current expectations of the Company's near-term results, based on current information available pertaining to the Company. The risks which could cause actual results to differ from those contained in such forward looking statements include, without limit, the risks described in the Company's Annual Report on Form 10-K for the year ended December 31, 2012 under the headings Risks Relating to our Business and Industry, Manufacturing Risks, International Risks, and Risks Related to Owning Our Securities as well as in the Company's quarterly reports on Form 10-Q and current reports on Form 8-K as filed with the Securities and Exchange Commission.

Any forward-looking statements in this Quarterly Report on Form 10-Q are not guarantees of future performance, and actual results, developments and business decisions may differ from those envisaged by such forward-looking statements, possibly materially. We disclaim any duty to update any forward-looking statements.

**Table of Contents****PART 1. FINANCIAL INFORMATION**

## Item 1. Financial Statements

**ENTEGRIS, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED BALANCE SHEETS**

(Unaudited)

<i>(In thousands, except share and per share data)</i>	<b>March 30, 2013</b>	<b>December 31, 2012</b>
<b>ASSETS</b>		
<b>Current assets:</b>		
Cash and cash equivalents	\$ 338,846	\$ 330,419
Short-term investments		19,995
Trade accounts and notes receivable, net of allowance for doubtful accounts of \$2,112 and \$2,314	103,573	94,016
Inventories	100,246	99,144
Deferred tax assets, deferred tax charges and refundable income taxes	13,570	20,201
Assets held for sale	5,998	5,998
Other current assets	7,505	9,551
<b>Total current assets</b>	<b>569,738</b>	<b>579,324</b>
Property, plant and equipment, net of accumulated depreciation of \$273,240 and \$263,302	164,585	157,021
Other assets:		
Intangible assets, net of accumulated amortization of \$120,147 and \$119,198	44,791	47,207
Deferred tax assets and other noncurrent tax assets	16,904	17,167
Other	9,831	10,825
<b>Total assets</b>	<b>\$ 805,849</b>	<b>\$ 811,544</b>
<b>LIABILITIES AND EQUITY</b>		
<b>Current liabilities:</b>		
Accounts payable	38,588	36,341
Accrued payroll and related benefits	19,309	29,376
Other accrued liabilities	22,164	21,887
Deferred tax liabilities and income taxes payable	1,906	5,659
<b>Total current liabilities</b>	<b>81,967</b>	<b>93,263</b>
Pension benefit obligations and other liabilities	15,258	17,066
Deferred tax liabilities and other noncurrent tax liabilities	5,457	6,416
Commitments and contingent liabilities		
<b>Equity:</b>		
Preferred stock, par value \$.01; 5,000,000 shares authorized; none issued and outstanding as of March 30, 2013 and December 31, 2012		
Common stock, par value \$.01; 400,000,000 shares authorized; issued and outstanding shares as of March 30, 2013 and December 31, 2012: 139,488,210 and 138,457,769	1,395	1,385
Additional paid-in capital	814,536	809,514
Retained deficit	(142,149)	(157,038)
Accumulated other comprehensive income	29,385	40,938
<b>Total equity</b>	<b>703,167</b>	<b>694,799</b>

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<b>Total liabilities and equity</b>	\$	805,849	\$	811,544
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See the accompanying notes to condensed consolidated financial statements.

**Table of Contents****ENTEGRIS, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

(Unaudited)

<i>(In thousands, except share and per share data)</i>	Three months ended	
	March 30, 2013	March 31, 2012
Net sales	\$ 165,070	\$ 175,403
Cost of sales	97,942	99,159
Gross profit	67,128	76,244
Selling, general and administrative expenses	32,421	35,048
Engineering, research and development expenses	12,173	11,989
Amortization of intangible assets	2,287	2,450
Operating income	20,247	26,757
Other income, net	(1,348)	(164)
Income before income taxes and equity in net income of affiliates	21,595	26,921
Income tax expense	5,198	9,065
Equity in net income of affiliates		(3)
Net income	\$ 16,397	\$ 17,859
Basic net income per common share:	\$ 0.12	\$ 0.13
Diluted net income per common share:	\$ 0.12	\$ 0.13
Weighted shares outstanding:		
Basic	139,025	136,603
Diluted	139,831	138,046

See the accompanying notes to condensed consolidated financial statements.

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**ENTEGRIS, INC. AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

(Unaudited)

<i>(In thousands)</i>	<b>Three months ended</b>	
	<b>March 30, 2013</b>	<b>March 31, 2012</b>
Net income	\$ 16,397	\$ 17,859
Other comprehensive income, net of tax		
Foreign currency translation adjustments	(11,596)	(2,981)
Pension liability adjustments	43	(7)
<b>Other comprehensive income</b>	<b>(11,553)</b>	<b>(2,988)</b>
Comprehensive income	\$ 4,844	\$ 14,871

See the accompanying notes to condensed consolidated financial statements.

**Table of Contents****ENTEGRIS, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF EQUITY****(Unaudited)**

<i>(In thousands)</i>	<b>Common shares outstanding</b>	<b>Common stock</b>	<b>Additional paid-in capital</b>	<b>Retained deficit</b>	<b>Foreign currency translation adjustments</b>	<b>Defined benefit pension adjustments</b>	<b>Total</b>
Balance at December 31, 2011	135,821	\$ 1,358	\$ 788,673	\$ (225,766)	\$ 44,737	\$ (764)	\$ 608,238
Shares issued under stock plans	1,438	15	3,321				3,336
Share-based compensation expense			1,763				1,763
Tax benefit associated with stock plans			290				290
Pension liability adjustment, net of tax						(7)	(7)
Foreign currency translation					(2,981)		(2,981)
Net income				17,859			17,859
Balance at March 31, 2012	137,259	\$ 1,373	\$ 794,047	\$ (207,907)	\$ 41,756	\$ (771)	\$ 628,498
<i>(In thousands)</i>	<b>Common shares outstanding</b>	<b>Common stock</b>	<b>Additional paid-in capital</b>	<b>Retained deficit</b>	<b>Foreign currency translation adjustments</b>	<b>Defined benefit pension adjustments</b>	<b>Total</b>
Balance at December 31, 2012	138,458	\$ 1,385	\$ 809,514	\$ (157,038)	\$ 41,997	\$ (1,059)	\$ 694,799
Shares issued under stock plans	1,418	14	4,859				4,873
Repurchase and retirement of common stock	(388)	(4)	(2,265)	(1,508)			(3,777)
Share-based compensation expense			1,688				1,688
Tax benefit associated with stock plans			740				740
Pension liability adjustment, net of tax						43	43
Foreign currency translation					(11,596)		(11,596)
Net income				16,397			16,397
Balance at March 30, 2013	139,488	\$ 1,395	\$ 814,536	\$ (142,149)	\$ 30,401	\$ (1,016)	\$ 703,167

See the accompanying notes to condensed consolidated financial statements.



**Table of Contents****ENTEGRIS, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(Unaudited)**

<i>(In thousands)</i>	Three months ended	
	March 30, 2013	March 31, 2012
<b>Operating activities:</b>		
Net income	\$ 16,397	\$ 17,859
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	7,296	6,487
Amortization	2,287	2,450
Share-based compensation expense	1,688	1,763
Other	2,043	2,161
Changes in operating assets and liabilities:		
Trade accounts receivable and notes receivable	(12,893)	(12,811)
Inventories	(3,758)	(7,506)
Accounts payable and accrued liabilities	(7,015)	(279)
Other current assets	1,970	(1,068)
Income taxes payable and refundable income taxes	318	(4,678)
Other	(898)	(4,004)
<b>Net cash provided by operating activities</b>	<b>7,435</b>	<b>374</b>
<b>Investing activities:</b>		
Acquisition of property, plant and equipment	(16,140)	(10,605)
Proceeds from maturities of short-term investments	20,000	
Other	12	3
<b>Net cash provided by (used in) investing activities</b>	<b>3,872</b>	<b>(10,602)</b>
<b>Financing activities:</b>		
Issuance of common stock	4,873	3,336
Repurchase and retirement of common stock	(3,777)	
Other	741	290
<b>Net cash provided by financing activities</b>	<b>1,837</b>	<b>3,626</b>
Effect of exchange rate changes on cash and cash equivalents	(4,717)	(60)
<b>Increase (decrease) in cash and cash equivalents</b>	<b>8,427</b>	<b>(6,662)</b>
Cash and cash equivalents at beginning of period	330,419	273,593
<b>Cash and cash equivalents at end of period</b>	<b>\$ 338,846</b>	<b>\$ 266,931</b>

**Supplemental Cash Flow Information**

<i>(In thousands)</i>	Three months ended	Three months ended
	March 30, 2013	March 31, 2012
<b>Non-cash transactions:</b>		

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Equipment purchases in accounts payable	\$	4,149
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See the accompanying notes to condensed consolidated financial statements.

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ENTEGRIS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Nature of Operations** Entegris, Inc. (Entegris or the Company) is a leading provider of a wide range of products for purifying, protecting and transporting critical materials used in processing and manufacturing in the semiconductor and other high-technology industries.

**Principles of Consolidation** The condensed consolidated financial statements include the accounts of the Company and its majority-owned subsidiaries. Intercompany profits, transactions and balances have been eliminated in consolidation.

**Use of Estimates** The preparation of condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, particularly receivables, inventories, property, plant and equipment, and intangibles, accrued expenses and income taxes and related accounts, and disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**Basis of Presentation** In the opinion of the Company, the accompanying unaudited condensed consolidated financial statements contain all adjustments necessary to present fairly, in conformity with accounting principles generally accepted in the United States of America.

The condensed consolidated financial statements and notes are presented as permitted by Form 10-Q and do not contain certain information included in the Company's annual consolidated financial statements and notes. The information included in this Form 10-Q should be read in conjunction with Management's Discussion and Analysis and consolidated financial statements and notes thereto included in the Company's Form 10-K for the year ended December 31, 2012. The results of operations for the three months ended March 30, 2013 are not necessarily indicative of the results to be expected for the full year.

**Fair Value of Financial Instruments** The carrying value of accounts receivable and accounts payable approximates fair value due to the short maturity of those instruments.

**Recent Accounting Pronouncements**

In December 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2011-11, *Amendments to Disclosures about Offsetting Assets and Liabilities*. The objective of ASU No. 2011-11 is to provide enhanced disclosures that will enable users of its financial statements to evaluate the effect or potential effect of netting arrangements on an entity's financial position. In January 2013, the FASB issued ASU No. 2013-01, *Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities*, which clarifies what instruments and transactions are subject to the offsetting disclosure requirements established by ASU No. 2011-11. Derivative instruments accounted for in accordance with Accounting Standards Codification (ASC) 815, are subject to ASU No. 2011-11 disclosure requirements. These amendments are disclosure related and will not have an impact on the Company's financial position, results of operations, comprehensive income or cash flows. ASU Nos. 2011-11 and 2013-01 are effective for reporting periods beginning after December 15, 2012. The disclosures associated with ASU Nos. 2011-11 and 2013-01 are included in note 4 to the Company's condensed consolidated financial statements.

In February 2013, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2013-02, *Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income* that amended ASU No. 2011-12 and ASU No. 2011-05. ASU No. 2013-02 requires an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component. In addition, an entity is required to present, either in the consolidated statements of operations or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income. These amendments are disclosure related and will not have an impact on the Company's financial position, results of operations, comprehensive income or

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cash flows. ASU 2013-02 is effective for reporting periods beginning after December 15, 2012. Accordingly, the Company adopted ASU 2013-02 in the first quarter of fiscal 2013. The disclosures associated with ASU No. 2013-02 are included in the Company's condensed consolidated statements of equity.

Other ASUs issued not effective for the Company until after March 30, 2013 are not expected to have a material effect on the Company's condensed consolidated financial statements.

**2. INVENTORIES**

Inventories consist of the following:

<i>(In thousands)</i>	March 30, 2013	December 31, 2012
Raw materials	\$ 29,779	\$ 27,720
Work-in process	13,403	10,242
Finished goods <sup>(a)</sup>	56,572	60,667
Supplies	492	515
<b>Total inventories</b>	<b>\$ 100,246</b>	<b>\$ 99,144</b>

(a) Includes consignment inventories held by customers for \$6,202 and \$5,229 at March 30, 2013 and December 31, 2012, respectively.

**3. EARNINGS PER COMMON SHARE**

The following table presents a reconciliation of the denominators used in the computation of basic and diluted earnings per common share (EPS):

<i>(In thousands)</i>	Three months ended	
	March 30, 2013	March 31, 2012
Basic weighted common shares outstanding	139,025	136,603
Weighted common shares assumed upon exercise of stock options and vesting of restricted common stock	806	1,443
<b>Diluted weighted common shares and common shares equivalent outstanding</b>	<b>139,831</b>	<b>138,046</b>

The Company excluded the following shares underlying stock-based awards from the calculations of diluted EPS because their inclusion would have been anti-dilutive for the three months ended March 30, 2013 and March 31, 2012:

<i>(In thousands)</i>	Three months ended	
	March 30, 2013	March 31, 2012
Shares excluded from calculations of diluted EPS	2,194	1,535

**4. FAIR VALUE****Financial Assets Measured at Fair Value on a Recurring Basis**

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The following table presents the Company's financial assets that are measured at fair value on a recurring basis at March 30, 2013 and December 31, 2012. Level 1 inputs are based on quoted prices in active markets accessible at the reporting date for identical assets and liabilities. Level 2 inputs are based on quoted prices for similar instruments in active markets and quoted prices for identical or similar instruments in markets that are not active, or model-based valuation techniques for which all significant assumptions are observable in a market.

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(In thousands)	March 30, 2013				December 31, 2012			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
<b>Assets:</b>								
Cash equivalents								
Commercial paper	\$	\$ 9,999	\$	\$ 9,999	\$	\$ 59,980	\$	\$ 59,980
Money market fund deposits	123,045			123,045	73,026			73,026
Short-term investments								
Commercial paper						19,995		19,995
Total assets measured and recorded at fair value	\$ 123,045	\$ 9,999	\$	\$ 133,044	\$ 73,026	\$ 79,995	\$	\$ 153,001
<b>Liabilities:</b>								
Foreign exchange forward contracts	\$	\$ 3,354	\$	\$ 3,354	\$	\$ 4,603	\$	\$ 4,603
Total liabilities measured and recorded at fair value	\$	\$ 3,354	\$	\$ 3,354	\$	\$ 4,603	\$	\$ 4,603

The following table provides information about derivative positions held by the Company as of March 30, 2013 and December 31, 2012:

(In thousands)	March 30, 2013			December 31, 2012		
	Gross amounts of recognized liabilities	Gross amounts offset in the condensed consolidated balance sheet	Net amount of liabilities in the condensed consolidated balance sheet	Gross amounts of recognized liabilities	Gross amounts offset in the condensed consolidated balance sheet	Net amount of liabilities in the condensed consolidated balance sheet
Derivatives	\$ 3,635	\$ 281	\$ 3,354	\$ 4,730	\$ 127	\$ 4,603

**5. SEGMENT REPORTING**

The Company's financial reporting segments are Contamination Control Solutions (CCS), Microenvironments (ME), and Specialty Materials (SMD), each of which provide unique products and services, are separately managed and have separate financial information evaluated regularly by the Company's chief operating decision maker in determining resource allocation and assessing performance.

*CCS:* provides a wide range of products and subsystems that purify, monitor and deliver critical liquids and gases used in the semiconductor manufacturing process.

*ME:* provides products that protect wafers, reticles and electronic components at various stages of transport, processing and storage related to semiconductor manufacturing.

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*SMD*: provides specialized graphite components used in semiconductor equipment and offers low-temperature, plasma-enhanced chemical vapor deposition coatings of critical components of semiconductor manufacturing equipment used in various stages of the manufacturing process as well as graphite and silicon carbide for certain critical industrial markets.

Inter-segment sales are not significant. Segment profit is defined as net sales less direct segment operating expenses, excluding certain unallocated expenses, consisting mainly of general and administrative costs for the Company's human resources, finance and information technology functions as well as interest expense, and amortization of intangible assets.

Summarized financial information for the Company's reportable segments is shown in the following table:

<i>(In thousands)</i>	Three months ended	
	March 30, 2013	March 31, 2012
Net sales		
CCS	\$ 103,961	\$ 115,552
ME	44,132	40,705
SMD	16,977	19,146
<b>Total net sales</b>	<b>\$ 165,070</b>	<b>\$ 175,403</b>

<i>(In thousands)</i>	Three months ended	
	March 30, 2013	March 31, 2012
Segment profit		
CCS	\$ 22,078	\$ 32,069
ME	9,325	5,528
SMD	2,216	4,668
<b>Total segment profit</b>	<b>\$ 33,619</b>	<b>\$ 42,265</b>

The issuer shall, or shall cause the calculation agent to, (i) provide written notice to the trustee, on which notice the trustee may conclusively rely, and to the depositary of the amount of cash to be delivered as contingent quarterly coupon, if any, with respect to each security on or prior to 10:30 a.m. (New York City time) on the business day preceding each coupon payment date, and (ii) deliver the aggregate cash amount due, if any, with respect to the contingent quarterly coupon to the trustee for delivery to the depositary, as holder of the securities, on the applicable coupon payment date.

The issuer shall, or shall cause the calculation agent to, (i) provide written notice to the trustee, on which notice the trustee may conclusively rely, and to the depositary of the amount of cash to be delivered with respect to each stated principal amount of the securities, on or prior to 10:30 a.m. (New York City time) on the business day preceding the maturity date, and (ii) deliver the aggregate cash amount due with respect to the securities to the trustee for delivery to the depositary, as holder of the securities, on the maturity date.

Morgan Stanley Finance LLC

Contingent Income Buffered Auto-Callable Securities due May 5, 2022, with 6-Month Initial Non-Call Period

All Payments on the Securities Based on the Worst Performing of the Russell 2000<sup>®</sup> Index, the S&P 500<sup>®</sup> Index and the Dow Jones Industrial Average<sup>SM</sup>

Principal at Risk Securities

Additional Information About the Securities

**Additional Information:**

**Minimum ticketing size:** \$1,000 / 1 security

**Tax considerations:** **Prospective investors should note that the discussion under the section called “United States Federal Taxation” in the accompanying product supplement does not apply to the securities issued under this document and is superseded by the following discussion.**

The following is a general discussion of the material U.S. federal income tax consequences and certain estate tax consequences of the ownership and disposition of the securities. This discussion applies only to investors in the securities who:

- purchase the securities in the original offering; and
  
- hold the securities as capital assets within the meaning of Section 1221 of the Internal Revenue Code of 1986, as amended (the “Code”).

This discussion does not describe all of the tax consequences that may be relevant to a holder in light of the holder’s particular circumstances or to holders subject to special rules, such as:

- certain financial institutions;
  
- insurance companies;
  
- certain dealers and traders in securities or commodities;



- investors holding the securities as part of a “straddle,” wash sale, conversion transaction, integrated transaction or constructive sale transaction;
  
- U.S. Holders (as defined below) whose functional currency is not the U.S. dollar;
  
- partnerships or other entities classified as partnerships for U.S. federal income tax purposes;
  
- regulated investment companies;
  
- real estate investment trusts; or
  
- tax-exempt entities, including “individual retirement accounts” or “Roth IRAs” as defined in Section 408 or 408A of the Code, respectively.

If an entity that is classified as a partnership for U.S. federal income tax purposes holds the securities, the U.S. federal income tax treatment of a partner will generally depend on the status of the partner and the activities of the partnership. If you are a partnership holding the securities or a partner in such a partnership, you should consult your tax adviser as to the particular U.S. federal tax consequences of holding and disposing of the securities to you.

As the law applicable to the U.S. federal income taxation of instruments such as the securities is technical and complex, the discussion below necessarily represents only a general summary. The effect of any applicable state, local or non-U.S. tax laws is not discussed, nor are any alternative minimum tax consequences or consequences resulting from the Medicare tax on investment income. Moreover, the discussion below does not address the consequences to taxpayers subject to special tax accounting rules under Section 451(b) of the Code.

This discussion is based on the Code, administrative pronouncements, judicial decisions and final, temporary and proposed Treasury regulations, all as of the date hereof, changes to any of which subsequent to the date hereof may affect the tax consequences described herein. Persons considering the purchase of the securities should consult their tax advisers with regard to the application of the U.S. federal income tax laws to their particular situations as well as any tax consequences arising under the laws of any state, local or non-U.S. taxing jurisdiction.

**General**

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Morgan Stanley Finance LLC

Contingent Income Buffered Auto-Callable Securities due May 5, 2022, with 6-Month Initial Non-Call Period

All Payments on the Securities Based on the Worst Performing of the Russell 2000<sup>®</sup> Index, the S&P 500<sup>®</sup> Index and the Dow Jones Industrial Average<sup>SM</sup>

Principal at Risk Securities

Due to the absence of statutory, judicial or administrative authorities that directly address the treatment of the securities or instruments that are similar to the securities for U.S. federal income tax purposes, no assurance can be given that the IRS or a court will agree with the tax treatment described herein. We intend to treat a security for U.S. federal income tax purposes as a single financial contract that provides for a coupon that will be treated as gross income to you at the time received or accrued in accordance with your regular method of tax accounting. In the opinion of our counsel, Davis Polk & Wardwell LLP, this treatment of the securities is reasonable under current law; however, our counsel has advised us that it is unable to conclude affirmatively that this treatment is more likely than not to be upheld, and that alternative treatments are possible.

**You should consult your tax adviser regarding all aspects of the U.S. federal tax consequences of an investment in the securities (including possible alternative treatments of the securities). Unless otherwise stated, the following discussion is based on the treatment of each security as described in the previous paragraph.**

#### **Tax Consequences to U.S. Holders**

This section applies to you only if you are a U.S. Holder. As used herein, the term “U.S. Holder” means a beneficial owner of a security that is, for U.S. federal income tax purposes:

- a citizen or individual resident of the United States;
  
- a corporation, or other entity taxable as a corporation, created or organized in or under the laws of the United States, any state thereof or the District of Columbia; or
  
- an estate or trust the income of which is subject to U.S. federal income taxation regardless of its source.

***Tax Treatment of the Securities***

Assuming the treatment of the securities as set forth above is respected, the following U.S. federal income tax consequences should result.

*Tax Basis.* A U.S. Holder's tax basis in the securities should equal the amount paid by the U.S. Holder to acquire the securities.

*Tax Treatment of Coupon Payments.* Any coupon payment on the securities should be taxable as ordinary income to a U.S. Holder at the time received or accrued, in accordance with the U.S. Holder's regular method of accounting for U.S. federal income tax purposes.

*Sale, Exchange or Settlement of the Securities.* Upon a sale, exchange or settlement of the securities, a U.S. Holder should recognize gain or loss equal to the difference between the amount realized on the sale, exchange or settlement and the U.S. Holder's tax basis in the securities sold, exchanged or settled. For this purpose, the amount realized does not include any coupon paid at settlement and may not include sale proceeds attributable to an accrued coupon, which may be treated as a coupon payment. Any such gain or loss recognized should be long-term capital gain or loss if the U.S. Holder has held the securities for more than one year at the time of the sale, exchange or settlement, and should be short-term capital gain or loss otherwise. The ordinary income treatment of the coupon payments, in conjunction with the capital loss treatment of any loss recognized upon the sale, exchange or settlement of the securities, could result in adverse tax consequences to holders of the securities because the deductibility of capital losses is subject to limitations.

***Possible Alternative Tax Treatments of an Investment in the Securities***

Due to the absence of authorities that directly address the proper tax treatment of the securities, no assurance can be given that the IRS will accept, or that a court will uphold, the treatment described above. In particular, the IRS could seek to analyze the U.S. federal income tax consequences of owning the securities under Treasury regulations governing contingent payment debt instruments (the "Contingent Debt Regulations"). If the IRS were successful in asserting that the Contingent Debt Regulations applied to the securities, the timing and character of income thereon would be significantly affected. Among other things, a

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U.S. Holder would be required to accrue into income original issue discount on the securities every year at a “comparable yield” determined at the time of their issuance, adjusted upward or downward to reflect the difference, if any, between the actual and the projected amount of any contingent payments on the securities. Furthermore, any gain realized by a U.S. Holder at maturity or upon a sale, exchange or other disposition of the securities would be treated as ordinary income, and any loss realized would be treated as ordinary loss to the extent of the U.S. Holder’s prior accruals of original issue discount and as capital loss thereafter. The risk that financial instruments providing for buffers, triggers or similar downside protection features, such as the securities, would be recharacterized as debt is greater than the risk of recharacterization for comparable financial instruments that do not have such features.

Other alternative federal income tax treatments of the securities are possible, which, if applied, could significantly affect the timing and character of the income or loss with respect to the securities. In 2007, the U.S. Treasury Department and the IRS released a notice requesting comments on the U.S. federal income tax treatment of “prepaid forward contracts” and similar instruments. The notice focuses on whether to require holders of “prepaid forward contracts” and similar instruments to accrue income over the term of their investment. It also asks for comments on a number of related topics, including the character of income or loss with respect to these instruments; whether short-term instruments should be subject to any such accrual regime; the relevance of factors such as the exchange-traded status of the instruments and the nature of the underlying property to which the instruments are linked; whether these instruments are or should be subject to the “constructive ownership” rule, which very generally can operate to recharacterize certain long-term capital gain as ordinary income and impose an interest charge; and appropriate transition rules and effective dates. While it is not clear whether instruments such as the securities would be viewed as similar to the prepaid forward contracts described in the notice, any Treasury regulations or other guidance promulgated after consideration of these issues could materially and adversely affect the tax consequences of an investment in the securities, possibly with retroactive effect. U.S. Holders should consult their tax advisers regarding the U.S. federal income tax consequences of an investment in the securities, including possible alternative treatments and the issues presented by this notice.

### ***Backup Withholding and Information Reporting***

Backup withholding may apply in respect of payments on the securities and the payment of proceeds from a sale, exchange or other disposition of the securities, unless a U.S. Holder provides proof of an applicable exemption or a correct taxpayer identification number and otherwise complies with applicable requirements of the backup withholding rules. The amounts withheld under the backup withholding rules are not an additional tax and may be

refunded, or credited against the U.S. Holder's U.S. federal income tax liability, provided that the required information is timely furnished to the IRS. In addition, information returns will be filed with the IRS in connection with payments on the securities and the payment of proceeds from a sale, exchange or other disposition of the securities, unless the U.S. Holder provides proof of an applicable exemption from the information reporting rules.

### **Tax Consequences to Non-U.S. Holders**

This section applies to you only if you are a Non-U.S. Holder. As used herein, the term "Non-U.S. Holder" means a beneficial owner of a security that is for U.S. federal income tax purposes:

- an individual who is classified as a nonresident alien;
- a foreign corporation; or
- a foreign estate or trust.

The term "Non-U.S. Holder" does not include any of the following holders:

- a holder who is an individual present in the United States for 183 days or more in the taxable year of disposition and who is not otherwise a resident of the United States for U.S. federal income tax purposes;
- certain former citizens or residents of the United States; or
- a holder for whom income or gain in respect of the securities is effectively

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connected with the conduct of a trade or business in the United States.

Such holders should consult their tax advisers regarding the U.S. federal income tax consequences of an investment in the securities.

Although significant aspects of the tax treatment of each security are uncertain, we intend to withhold on any coupon paid to a Non-U.S. Holder generally at a rate of 30% or at a reduced rate specified by an applicable income tax treaty under an “other income” or similar provision. We will not be required to pay any additional amounts with respect to amounts withheld. In order to claim an exemption from, or a reduction in, the 30% withholding tax, a Non-U.S. Holder of the securities must comply with certification requirements to establish that it is not a U.S. person and is eligible for such an exemption or reduction under an applicable tax treaty. If you are a Non-U.S. Holder, you should consult your tax adviser regarding the tax treatment of the securities, including the possibility of obtaining a refund of any withholding tax and the certification requirement described above.

### ***Section 871(m) Withholding Tax on Dividend Equivalents***

Section 871(m) of the Code and Treasury regulations promulgated thereunder (“Section 871(m)”) generally impose a 30% (or a lower applicable treaty rate) withholding tax on dividend equivalents paid or deemed paid to Non-U.S. Holders with respect to certain financial instruments linked to U.S. equities or indices that include U.S. equities (each, an “Underlying Security”). Subject to certain exceptions, Section 871(m) generally applies to securities that substantially replicate the economic performance of one or more Underlying Securities, as determined based on tests set forth in the applicable Treasury regulations (a “Specified Security”). However, pursuant to an IRS notice, Section 871(m) will not apply to securities issued before January 1, 2021 that do not have a delta of one with respect to any Underlying Security. Based on our determination that the securities do not have a delta of one with respect to any Underlying Security, our counsel is of the opinion that the securities should not be Specified Securities and, therefore, should not be subject to Section 871(m).

Our determination is not binding on the IRS, and the IRS may disagree with this determination. Section 871(m) is complex and its application may depend on your particular circumstances, including whether you enter into other transactions with respect to an Underlying Security. If Section 871(m) withholding is required, we will not be

required to pay any additional amounts with respect to the amounts so withheld. You should consult your tax adviser regarding the potential application of Section 871(m) to the securities.

***U.S. Federal Estate Tax***

Individual Non-U.S. Holders and entities the property of which is potentially includible in such an individual's gross estate for U.S. federal estate tax purposes (for example, a trust funded by such an individual and with respect to which the individual has retained certain interests or powers) should note that, absent an applicable treaty exemption, the securities may be treated as U.S.-situs property subject to U.S. federal estate tax. Prospective investors that are non-U.S. individuals, or are entities of the type described above, should consult their tax advisers regarding the U.S. federal estate tax consequences of an investment in the securities.

***Backup Withholding and Information Reporting***

Information returns will be filed with the IRS in connection with any coupon payment and may be filed with the IRS in connection with the payment at maturity on the securities and the payment of proceeds from a sale, exchange or other disposition. A Non-U.S. Holder may be subject to backup withholding in respect of amounts paid to the Non-U.S. Holder, unless such Non-U.S. Holder complies with certification procedures to establish that it is not a U.S. person for U.S. federal income tax purposes or otherwise establishes an exemption. The amount of any backup withholding from a payment to a Non-U.S. Holder will be allowed as a credit against the Non-U.S. Holder's U.S. federal income tax liability and may entitle the Non-U.S. Holder to a refund, provided that the required information is timely furnished to the IRS.

**FATCA**



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Legislation commonly referred to as “FATCA” generally imposes a withholding tax of 30% on payments to certain non-U.S. entities (including financial intermediaries) with respect to certain financial instruments, unless various U.S. information reporting and due diligence requirements have been satisfied. An intergovernmental agreement between the United States and the non-U.S. entity’s jurisdiction may modify these requirements. FATCA generally applies to certain financial instruments that are treated as paying U.S.-source interest or other U.S.-source “fixed or determinable annual or periodical” income (“FDAP income”). Withholding (if applicable) applies to payments of U.S.-source FDAP income and to payments of gross proceeds of the disposition (including upon retirement) of certain financial instruments treated as providing for U.S.-source interest or dividends. Under recently proposed regulations (the preamble to which specifies that taxpayers are permitted to rely on them pending finalization), no withholding will apply on payments of gross proceeds. While the treatment of the securities is unclear, you should assume that any coupon payment with respect to the securities will be subject to the FATCA rules. If withholding applies to the securities, we will not be required to pay any additional amounts with respect to amounts withheld. Both U.S. and Non-U.S. Holders should consult their tax advisers regarding the potential application of FATCA to the securities.

**The discussion in the preceding paragraphs, insofar as it purports to describe provisions of U.S. federal income tax laws or legal conclusions with respect thereto, constitutes the full opinion of Davis Polk & Wardwell LLP regarding the material U.S. federal tax consequences of an investment in the securities.**

**Use of proceeds and hedging:** The proceeds from the sale of the securities will be used by us for general corporate purposes. We will receive, in aggregate, \$1,000 per security issued, because, when we enter into hedging transactions in order to meet our obligations under the securities, our hedging counterparty will reimburse the cost of the agent’s commissions. The costs of the securities borne by you and described beginning on page 4 above comprise the agent’s commissions and the cost of issuing, structuring and hedging the securities.

On or prior to the pricing date, we hedged our anticipated exposure in connection with the securities by entering into hedging transactions with our affiliates and/or third party dealers. We expect our hedging counterparties to have taken positions in the stocks constituting the underlying indices and in futures and/or options contracts on the underlying indices or the component stocks of the underlying indices listed on major securities markets. Such purchase activity could have increased the initial index value of an underlying index, and, as a result, could have increased (i) the level at or above which such underlying index must close on any redemption determination date so that the securities are redeemed prior to maturity for the early redemption payment (depending also on the

performance of the other underlying indices), (ii) the level at or above which such underlying index must close on each observation date in order for you to earn a contingent quarterly coupon (depending also on the performance of the other underlying indices) and (iii) the level at or above which such underlying index must close on the final observation date so that you are not exposed to the negative performance of the worst performing underlying index at maturity (depending also on the performance of the other underlying indices). These entities may be unwinding or adjusting hedge positions during the term of the securities, and the hedging strategy may involve greater and more frequent dynamic adjustments to the hedge as the final observation date approaches. Additionally, our hedging activities, as well as our other trading activities, during the term of the securities could potentially affect the value of an underlying index on the redemption determination dates and observation dates, and, accordingly, whether we redeem the securities prior to maturity, whether we pay a contingent quarterly coupon on the securities and the amount of cash you receive at maturity (depending also on the performance of the other underlying indices).

**Benefit plan  
investor  
considerations:**

Each fiduciary of a pension, profit-sharing or other employee benefit plan subject to Title I of the Employee Retirement Income Security Act of 1974, as amended (“ERISA”) (a “Plan”), should consider the fiduciary standards of ERISA in the context of the Plan’s particular circumstances before authorizing an investment in the securities. Accordingly, among other factors, the fiduciary should consider whether the investment would satisfy the prudence and diversification requirements of ERISA and would be consistent with the documents and instruments governing the Plan.

In addition, we and certain of our affiliates, including MS & Co., may each be considered a “party in interest” within the meaning of ERISA, or a “disqualified person” within the meaning

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of the Internal Revenue Code of 1986, as amended (the “Code”), with respect to many Plans, as well as many individual retirement accounts and Keogh plans (such accounts and plans, together with other plans, accounts and arrangements subject to Section 4975 of the Code, also “Plans”). ERISA Section 406 and Code Section 4975 generally prohibit transactions between Plans and parties in interest or disqualified persons. Prohibited transactions within the meaning of ERISA or the Code would likely arise, for example, if the securities are acquired by or with the assets of a Plan with respect to which MS & Co. or any of its affiliates is a service provider or other party in interest, unless the securities are acquired pursuant to an exemption from the “prohibited transaction” rules. A violation of these “prohibited transaction” rules could result in an excise tax or other liabilities under ERISA and/or Section 4975 of the Code for such persons, unless exemptive relief is available under an applicable statutory or administrative exemption.

The U.S. Department of Labor has issued five prohibited transaction class exemptions (“PTCEs”) that may provide exemptive relief for direct or indirect prohibited transactions resulting from the purchase or holding of the securities. Those class exemptions are PTCE 96-23 (for certain transactions determined by in-house asset managers), PTCE 95-60 (for certain transactions involving insurance company general accounts), PTCE 91-38 (for certain transactions involving bank collective investment funds), PTCE 90-1 (for certain transactions involving insurance company separate accounts) and PTCE 84-14 (for certain transactions determined by independent qualified professional asset managers). In addition, ERISA Section 408(b)(17) and Code Section 4975(d)(20) provide an exemption for the purchase and sale of securities and the related lending transactions, *provided* that neither the issuer of the securities nor any of its affiliates has or exercises any discretionary authority or control or renders any investment advice with respect to the assets of the Plan involved in the transaction and *provided further* that the Plan pays no more, and receives no less, than “adequate consideration” in connection with the transaction (the so-called “service provider” exemption). There can be no assurance that any of these class or statutory exemptions will be available with respect to transactions involving the securities.

Because we may be considered a party in interest with respect to many Plans, the securities may not be purchased, held or disposed of by any Plan, any entity whose underlying assets include “plan assets” by reason of any Plan’s investment in the entity (a “Plan Asset Entity”) or any person investing “plan assets” of any Plan, unless such purchase, holding or disposition is eligible for exemptive relief, including relief available under PTCEs 96-23, 95-60, 91-38, 90-1, 84-14 or the service provider exemption or such purchase, holding or disposition is otherwise not prohibited. Any purchaser, including any fiduciary purchasing on behalf of a Plan, transferee or holder of the securities will be deemed to have represented, in its corporate and its fiduciary capacity, by its purchase and holding of the securities that either (a) it is not a Plan or a Plan Asset Entity and is not purchasing such securities on behalf of or with “plan assets” of any Plan or with any assets of a governmental, non-U.S. or church plan that is subject to any federal, state, local or non-U.S. law that is substantially similar to the provisions of Section 406 of ERISA or Section 4975 of the Code (“Similar Law”) or (b) its purchase, holding and disposition of these securities will not constitute or result in a non-exempt prohibited transaction under Section 406 of ERISA or Section 4975 of the Code or violate any Similar

Law.

Due to the complexity of these rules and the penalties that may be imposed upon persons involved in non-exempt prohibited transactions, it is particularly important that fiduciaries or other persons considering purchasing the securities on behalf of or with “plan assets” of any Plan consult with their counsel regarding the availability of exemptive relief.

The securities are contractual financial instruments. The financial exposure provided by the securities is not a substitute or proxy for, and is not intended as a substitute or proxy for, individualized investment management or advice for the benefit of any purchaser or holder of the securities. The securities have not been designed and will not be administered in a manner intended to reflect the individualized needs and objectives of any purchaser or holder of the securities.

Each purchaser or holder of any securities acknowledges and agrees that:

- (i) the purchaser or holder or its fiduciary has made and shall make all investment decisions for the purchaser or holder and the purchaser or holder has not relied and

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shall not rely in any way upon us or our affiliates to act as a fiduciary or adviser of the purchaser or holder with respect to (A) the design and terms of the securities, (B) the purchaser or holder's investment in the securities, or (C) the exercise of or failure to exercise any rights we have under or with respect to the securities;

(ii) we and our affiliates have acted and will act solely for our own account in connection with (A) all transactions relating to the securities and (B) all hedging transactions in connection with our obligations under the securities;

(iii) any and all assets and positions relating to hedging transactions by us or our affiliates are assets and positions of those entities and are not assets and positions held for the benefit of the purchaser or holder;

(iv) our interests are adverse to the interests of the purchaser or holder; and

(v) neither we nor any of our affiliates is a fiduciary or adviser of the purchaser or holder in connection with any such assets, positions or transactions, and any information that we or any of our affiliates may provide is not intended to be impartial investment advice.

Each purchaser and holder of the securities has exclusive responsibility for ensuring that its purchase, holding and disposition of the securities do not violate the prohibited transaction rules of ERISA or the Code or any Similar Law. The sale of any securities to any Plan or plan subject to Similar Law is in no respect a representation by us or any of our affiliates or representatives that such an investment meets all relevant legal requirements with respect to investments by plans generally or any particular plan, or that such an investment is appropriate for plans generally or any particular plan. In this regard, neither this discussion nor anything provided in this document is or is intended to be investment advice directed at any potential Plan purchaser or at Plan purchasers generally and such purchasers of these securities should consult and rely on their own counsel and advisers as to whether an investment in these securities is suitable.

However, individual retirement accounts, individual retirement annuities and Keogh plans, as well as employee benefit plans that permit participants to direct the investment of their accounts, will not be permitted to purchase or hold the securities if the account, plan or annuity is for the benefit of an employee of Morgan Stanley, Morgan Stanley Wealth Management or a family member and the employee receives any compensation (such as, for example, an addition to bonus) based on the purchase of the securities by the account, plan or annuity.

**Additional considerations:**

Client accounts over which Morgan Stanley, Morgan Stanley Wealth Management or any of their respective subsidiaries have investment discretion are **not** permitted to purchase the securities, either directly or indirectly.

Selected dealers, which may include our affiliates, and their financial advisors will collectively receive from the agent a fixed sales commission of \$6 for each security they sell.

**Supplemental information regarding plan of distribution;**

MS & Co. is an affiliate of MSFL and a wholly owned subsidiary of Morgan Stanley, and it and other affiliates of ours expect to make a profit by selling, structuring and, when applicable, hedging the securities.

**conflicts of interest:**

MS & Co. will conduct this offering in compliance with the requirements of FINRA Rule 5121 of the Financial Industry Regulatory Authority, Inc., which is commonly referred to as FINRA, regarding a FINRA member firm's distribution of the securities of an affiliate and related conflicts of interest. MS & Co. or any of our other affiliates may not make sales in this offering to any discretionary account. See "Plan of Distribution (Conflicts of Interest)" and "Use of Proceeds and Hedging" in the accompanying product supplement for auto-callable securities.

**Validity of the securities:**

In the opinion of Davis Polk & Wardwell LLP, as special counsel to MSFL and Morgan Stanley, when the securities offered by this pricing supplement have been executed and issued by MSFL, authenticated by the trustee pursuant to the MSFL Senior Debt Indenture (as defined in the accompanying prospectus) and delivered against payment as contemplated herein, such securities will be valid and binding obligations of MSFL and the related guarantee will be a valid and binding obligation of Morgan Stanley, enforceable in accordance with their terms, subject to applicable bankruptcy, insolvency and similar laws affecting creditors' rights generally, concepts of reasonableness and equitable principles of general applicability

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(including, without limitation, concepts of good faith, fair dealing and the lack of bad faith), *provided* that such counsel expresses no opinion as to (i) the effect of fraudulent conveyance, fraudulent transfer or similar provision of applicable law on the conclusions expressed above and (ii) any provision of the MSFL Senior Debt Indenture that purports to avoid the effect of fraudulent conveyance, fraudulent transfer or similar provision of applicable law by limiting the amount of Morgan Stanley's obligation under the related guarantee. This opinion is given as of the date hereof and is limited to the laws of the State of New York, the General Corporation Law of the State of Delaware and the Delaware Limited Liability Company Act. In addition, this opinion is subject to customary assumptions about the trustee's authorization, execution and delivery of the MSFL Senior Debt Indenture and its authentication of the securities and the validity, binding nature and enforceability of the MSFL Senior Debt Indenture with respect to the trustee, all as stated in the letter of such counsel dated November 16, 2017, which is Exhibit 5-a to the Registration Statement on Form S-3 filed by Morgan Stanley on November 16, 2017.

**Contact:**

Morgan Stanley clients may contact their local Morgan Stanley branch office or Morgan Stanley's principal executive offices at 1585 Broadway, New York, New York 10036 (telephone number (866) 477-4776). All other clients may contact their local brokerage representative. Third-party distributors may contact Morgan Stanley Structured Investment Sales at (800) 233-1087.

**Where you can find more information:**

Morgan Stanley and MSFL have filed a registration statement (including a prospectus, as supplemented by the product supplement for auto-callable securities and the index supplement) with the Securities and Exchange Commission, or SEC, for the offering to which this communication relates. You should read the prospectus in that registration statement, the product supplement for auto-callable securities, the index supplement and any other documents relating to this offering that Morgan Stanley and MSFL have filed with the SEC for more complete information about Morgan Stanley, MSFL and this offering. You may get these documents without cost by visiting EDGAR on the SEC web site at [www.sec.gov](http://www.sec.gov). Alternatively, Morgan Stanley, MSFL, any underwriter or any dealer participating in the offering will arrange to send you the prospectus, the product supplement for auto-callable securities and the index supplement if you so request by calling toll-free 1-(800)-584-6837.

You may access these documents on the SEC web site at [www.sec.gov](http://www.sec.gov) as follows:

**[Product Supplement for Auto-Callable Securities dated November 16, 2017](#)**

**[Index Supplement dated November 16, 2017](#)**

**Prospectus dated November 16, 2017**

Terms used but not defined in this document are defined in the product supplement for auto-callable securities, in the index supplement or in the prospectus.

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