Trinseo Second Quarter 2024 Earnings Call

Company Participants

- Andy Myers, Vice President of Investor Relations
- Frank A. Bozich, President and Chief Executive Officer
- David Stasse, Executive Vice President and Chief Financial Officer

Other Participants

- Frank Mitsch
- Matthew Blair
- Hassan Ahmed
- Daniel Rizzo
- Michael Leithead

Presentation

Operator introduction

Good morning, ladies and gentlemen, and welcome to the Trinseo Second Quarter 2024 Financial Results Conference Call. We welcome the Trinseo management team, Frank Bozich, President and CEO; David Stasse, Executive Vice President and CFO; and Andy Myers, Vice President of Investor Relations. Today's conference call will include brief remarks by the management team, followed by a question-and-answer session. The company distributed its press release, along with its presentation slides, at close of market Tuesday, August 6. These documents are posted on the company's Investor Relations website and furnished on a Form 8-K filed with the Securities and Exchange Commission. (Operator Instructions).

I will now hand the call over to Andy Myers.

Andy Myers

Thank you, Abby, and good morning, everyone. At this time all participants are in a listen-only mode. After our brief remarks, instructions will follow to participate in the question-and-answer session. Our disclosure rules and cautionary note on forward-looking statements are noted on Slide 2.

During this presentation, we may make certain forward-looking statements, including issuing guidance and describing our future expectations. We must caution you that actual results could differ materially from what is discussed, described or implied in these statements. Factors that could cause actual results to differ include, but are not limited to, risk factors set forth in Item 1A of our Annual Report on Form 10-K or in our other filings made with the Securities and Exchange Commission. The company undertakes no obligation to update or revise its forward-looking statements.

Today's presentation includes certain non-GAAP financial measurements. A reconciliation of these measurements to corresponding GAAP measures is provided in our earnings release and

in the appendix of our Investor presentation. A replay of the conference call and transcript will be archived on the company's Investor Relations website shortly following the call. The replay will be available until August 7, 2025.

Now, I'd like to turn the call over to Frank Bozich.

Frank A. Bozich

Thanks Andy, and welcome to our second quarter 2024 earnings call. I'd like to start by discussing our Q2 results, which were in line with our expectations. The market conditions that we saw at the end of the first quarter continued through the second quarter, which resulted in our highest adjusted EBITDA since the second quarter of 2022, despite $10 million of unfavorable net timing. This was the second straight quarter of sequentially higher profitability. We continued to see positive momentum in our Engineered Materials segment as moderating input costs, normalization of MMA market dynamics, and steady demand for our downstream applications led to the segment's highest sales volumes and adjusted EBITDA since the second quarter of 2022.

We believe this higher level of profitability is sustainable in the current challenging macroeconomic environment due to the significant restructuring and footprint actions that we've taken over the past two years. And while free cash flow remained negative in the second quarter, we anticipate that it will turn positive in the second half.

I'd like to shift gears to talk about sustainability. In July, we issued our 14th Annual Sustainability and Corporate Social Responsibility report, which shows how our company and employees helped cultivate a circular transformation in 2023. I'm very proud of the exceptional progress we made toward our 2030 sustainability goals, especially the continued progress on our polycarbonate dissolution facility, breaking ground on our PMMA depolymerization facility, and achieving critical milestones in the implementation of our decarbonization strategy. We are committed to continued investment in recycling technologies and sustainable product offerings in order to support a circular economy while reducing our carbon footprint, creating a sustainable workforce, and operating responsibly. We had another record quarter in Q2 for sales of products containing recycled material, so our investments are already paying off, and we anticipate more growth in the future.

With that in mind, I'd like to provide a brief update on two of our major ongoing recycling projects. At the end of the second quarter, we announced the opening of our PMMA depolymerization facility in Rho, Italy. The facility utilizes a novel continuous chemical recycling process that returns industrial and post-consumer acrylic waste to its constituent monomer MMA while emitting one-fourth the amount of CO_2 as virgin MMA production with yields that exceed industry standards. Our technology also allows us to recycle several PMMA solutions that previously could not be recycled, creating a truly circular process with advantaged economics. The result of our process is high-quality recycled MMA monomer with purity levels comparable to virgin MMA. This enables the recycled MMA to be used in higher-end applications such as vehicle taillights and caravan windows that require exceptional optical properties. The high

purity levels also allow for higher concentrations of recycled content to be used in certain acrylic solutions without sacrificing the desired properties of the end-product.

I'd also like to highlight some of the exciting technological advancements that we've made in our polycarbonate dissolution pilot facility. The newly developed technology at the pilot plant allows us to recycle polycarbonate waste containing high levels of residual BPA back into polycarbonate resins that contain levels of BPA that are orders of magnitude lower than virgin PC. Additionally, we are able to repair current end-of-life polycarbonate waste that is degraded over time due to the exposure to natural elements such as sunlight, humidity, and temperature, by restoring its molecular weight so that it can be recycled and reused even in the most demanding applications. These PC waste streams until now have not been suitable for mechanical recycling due to degradation and can be sourced at advantaged costs.

The technological advancements in PC dissolution, along with the beginning of our PMMA depolymerization journey, are a testament to the bright minds we have at Trinseo and are examples of how our investment in sustainable solutions continues to spawn industry-leading innovations that will help build a more sustainable future and at the same time, are economically advantaged.

Before I turn the call over to David, I'd like to give a brief update on the planned sale of our Americas Styrenics joint venture. The procedural steps defined under the exit provision of the joint venture agreement have progressed. Therefore, we have agreed with our partner, Chevron Phillips Chemical, to pursue a joint sales process, which we expect to kick off this quarter, and in the ordinary course should lead to a definitive agreement in the first half of 2025.

Now Dave will discuss our second quarter results.

David Stasse

Thank you, Frank. Second quarter adjusted EBITDA of $67 million was in line with our previous guidance and included $10 million of unfavorable net timing from falling styrene prices. Mix improvement led to a higher year-over-year adjusted EBITDA despite a 5% decline in volumes. This was driven by volume growth in all of our targeted growth areas including case and battery applications in Latex Binders, formulated resins for building and construction and consumer electronics applications in Engineered Materials, and automotive compounds in Plastic Solutions.

Substantially all the year-over-year volume decline was in Polystyrene, where we shed uneconomic volumes in Asia and Europe to optimize plant operations and working capital.

Cash used in operations during the quarter was $42 million, which resulted in free cash flow of negative $56 million. We expect free cash flow to turn positive in the second half from lower styrene prices and from seasonal factors in the fourth quarter. We ended the quarter with $108 million of cash and $352 million of total liquidity including our two committed financing facilities. In July, we entered into a new Accounts Receivable Securitization facility that extends the

maturity date from 2025 to January 2028. Liquidity preservation will continue to be our top priority for the foreseeable future as we navigate this prolonged industry downturn.

Now I'll turn the call back over to Frank.

Frank A. Bozich

Thanks, Dave. Looking ahead to the third quarter, we expect market conditions and adjusted EBITDA to be similar to the second quarter. While decreasing styrene margins and an unplanned outage are expected to negatively impact Americas Styrenics, unfavorable net timing is not expected to repeat at the same magnitude as Q2. Seasonal improvements in our higher-margin building and construction and consumer electronics applications are expected to continue through the third quarter, and more normalized MMA market dynamics should continue to support improved margins in Engineered Materials. As a result, we expect Q3 adjusted EBITDA of $65 million to $75 million.

While we are not providing a specific range for the fourth quarter, we do expect Q4 profitability to be sequentially lower than Q3 due to normal year-end seasonality. However, we anticipate free cash flow to increase sequentially from Q3 to Q4 as we typically have a substantial working capital release at year-end.

We are encouraged by the second consecutive quarter of sequentially higher profitability and expect to extend this similar level of profitability in the third quarter despite persistently weak end market demand and a challenging macroeconomic environment. We continue to see the benefit of the cost actions we have taken and are confident that we will emerge from this low demand cycle stronger than we were before.

And now we're happy to take your questions.

Questions and Answers

Operator

(Operator Instructions) And your first question comes from the line of Frank Mitsch with Fermium Research, LLC.

Q - Frank Mitsch

Thank you and good morning all. I want to drill down a little bit more into the free cash flow expectations for the balance of the year, given it's been a use of close to $140 million in the first half of the year. I understand that you're expecting styrene monomer prices down, you mentioned seasonal factors and a working capital release by year-end. Where can we get the free cash flow back to? I mean are you looking forward to get to neutral? And if so, how does that play out given the fact that we're at a $140 million hole as we enter the second half of the year?

A - David Stasse

Look, I think as we said, we expect it to be positive. I think Q3 will be fairly neutral, kind of flattish free cash flow and then Q4 will be positive. For the year, because of how we started the year with the high styrene prices, I think that puts us in a situation where for the full year, this year, our free cash flow will be negative.

Looking forward to next year, we have a slide in our presentation where we show our cash outflows for the year, and it totals about $350 million. So that's the sum of CapEx, interest, restructuring, et cetera, and that includes $45 million of restructuring spend for this year. So I think the takeaway from that is at this level, you need $345 million of EBITDA to be cash flow neutral.

So look, we're clearly not in a position today to give guidance for 2025, but if I roll this page forward to next year, I think the restructuring costs will be lower. We still have a lot of spend this year for the two styrene plants that we closed. Cash interest I also expect to be lower. We have $1.8 billion of floating rate debt, and I think everybody has followed what's going on with rates recently so the current trajectory of the forecasted interest rate cuts would lead you to think that's going to be lower. Every 100 basis points is $18 million a year of interest for us, so I think there's four cuts baked in the forward curve today for this year alone, so I think that the interest number will be lower next year. And all of that puts us in a position where this year's $345 million or $350 million of EBITDA cash flow neutral next year should be closer to $300 million. And $300 million as a run rate of EBITDA is not far from where we are right now in Q2 and Q3.

Q - Frank Mitsch

That's very helpful, David.

If I could just stick with the restructuring spending as you mentioned, there was an expectation that ‘24 would see, between restructuring benefits and the natural gas hedges, et cetera, that we'd see a $100 million benefit in '24 versus '23. Can you give us a sense as to how that is trending, and is that $100 million still Trinseo's expectations for 2024?

A - David Stasse

It is, yes. The $100 million is absolutely in the numbers for this year. I’m very confident that we will fully recognize those cost savings, which is the sum of both the natural gas hedges going away plus the benefits of no longer running the two styrene plants. So we're very confident that we'll realize that full $100 million this year.

Q - Frank Mitsch

Thank you so much.

Operator

And your next question comes from the line of Matthew Blair with TPH.

Q - Matthew Blair

Thank you, and good morning Frank. I thought in your Engineered Materials segment, the commentary on the PMMA volume improvement is pretty encouraging. Can you talk about which end markets are maybe looking a little better for you, and which end markets are still a little softer?

A - Frank Bozich

Thanks for the question. I would say automotive has been steady, and we saw building and construction applications where we're offering sort of a unique solution into many building and construction applications, for example, capstock, to be actually very strong and have steady demand. So I would say in end markets, it's been steady in PMMA. The growth in volume is really recovering volumes in Europe. It's sort of geographical where our European volumes have come back this year much stronger than they were last year.

Q - Matthew Blair

Then on the guidance, I guess I was a little surprised the Q3 number does not include any sort of big assumptions on net timing. I think contract prices for styrene in the U.S. and Europe are down in the third quarter versus second quarter, so is there an offsetting factor to those lower styrene prices once again this quarter?

A - Frank Bozich

In Q3, we expect AmSty to have some headwinds compared to Q2 due to lower styrene prices as well as the unplanned outage they have at one of their plants. Then as usual, you have in some of our end markets, a weaker August because of the vacation period in Europe. So that's how we're looking at Q3.

A - David Stasse

Matt, this is Dave, I'll add something. Related to timing specifically, you're right, we did see a big drop in prices at the end of Q2 into Q3, which you would infer from that, we'd have negative timing. But there was an increase in contract prices in the month of August. There's a couple of outages, probably short term in duration, that I think will probably largely offset that timing.

One other point, you referenced North America contract styrene prices, but that doesn't influence our net timing. It's really, by far, the European prices are the largest, and Asian prices

would be the second. So, as I said earlier, sitting here today Matt, I don't anticipate timing of any significance in the quarter.

Operator

And your next question comes from the line of Hassan Ahmed with Alembic Global Advisors.

Q - Hassan Ahmed

Good morning Frank and Dave. You guys talked about how within the MMA business, conditions are normalizing. Certainly on the surface, it seems certain other businesses seem to be quite far away from more normalized levels, so if you wouldn't mind, could you revisit what your assumption of the normal earnings power of the company is? I mean you guys obviously did around, on an annualized basis, $270 million in EBITDA in Q2. Obviously, the EM business popped nicely EBITDA margin-wise, close to 11%. So, if you wouldn't mind reminding us where we stand with the state of affairs the way they are in terms of the normal earnings power of the company.

A - Frank Bozich

It's really difficult and almost impossible to predict what normal looks like right now, so I think we can expect to see improvements going forward from the actions we've taken, and we continue to have additional opportunities that we'll pursue. But to predict what a normal market looks like in many of our end segments against the backdrop of all the geopolitical uncertainty and market uncertainty, I think it is really difficult.

Q - Hassan Ahmed

And on a separate note, during the Q1 call you guys talked about how in China, weakness in the polycarbonate market within epoxies and within nylon was impacting phenol and in turn acetone production, which obviously thereon forward was limiting MMA production. So where do we stand with regards to that now?

A - Frank Bozich

We see the MMA market is tight in basically all regions, and the factors that we highlighted in the Q1 call still exist. I would say the other thing that you need to remember is the MMA market varies by region, but also a significant portion of MMA, almost half of it, goes into polymer additives as well as architectural coatings.

You can see that in the architectural coatings market, volumes have improved and are coming back. So that's created a tightening effect at the same time the feedstocks' availability in Asia are limited. So it's a tight market, and absent something dramatic changing, we don't see the current conditions for MMA changing.

Operator

And your next question comes from the line of Laurence Alexander with Jefferies.

Q - Daniel Rizzo

Good morning, this is Dan on for Laurence. Within the new PMMA facility in Italy that's now ramping up, do you have a timeline of when that is going to be positively contributing to EBITDA? And at mid-cycle, what it could potentially mean to you guys in terms of EBITDA and earnings?

A - Frank Bozich

We don't have a forecast for that right now because as a practical matter, this is a demonstration facility for a much bigger investment that we'll have to do in the future, and that's in engineering analysis at the current time. So I can't really give you an expectation for the EBITDA contribution or exact timing for when it will occur. But I can say that we see that as favorable to virgin production from a cost standpoint and with similar quality, so it's a very exciting opportunity for us.

Q - Daniel Rizzo

Then you highlighted the battery market as being one that's doing fairly well. I was wondering if your outlook for that market has been altered at all just given a lot of the headlines we're reading with electric vehicles, or just battery demand in general.

A - Frank Bozich

Our growth in battery continues into this year and is significant growth. Now, what's driving our growth is technological advancement. Our technology, or our solution, goes into binding the anode in an energy battery like NCM, nickel cobalt manganese, captive battery that goes into EVs, and our technology allows the producer to have a higher energy density in the battery. We have a small percentage of the market, but as our technology is qualified at other producers, we anticipate to see growth even in sort of a flat EV market because we're going to penetrate because of the innovation and the technical advantage of our solution.

Operator

And your final question comes from the line of Michael Leithead with Barclays.

Q - Michael Leithead

Thank you, good morning guys. First, I just had two on cash interest. One, it looks like you decided to pick $15 million of cash interest in your updated forecast for this year. I guess Dave, can you just help us understand the change in thinking there versus last quarter, sort of how you

rise at that $15 million number versus say a higher or lower amount? Then two, related to that, what is the incremental cost for you guys on that $15 million interest by deferring that?

A - David Stasse

Sure, so for the benefit of everyone, what Mike is referring to is we have a PIK option, pay-in-kind option, on the term loan that we put in place in September of last year. That term loan carries interest of SOFR plus 8.5%, and we have the ability to pick, or pay-in-kind, 4.25% of that coupon. So today SOFR is about 5.25%, plus the 8.5% spread, that's about a 13.75% coupon right now. We have the ability to pick, or not pay interest and instead capitalize, 4.25% of that, which is about a third of the coupon. And there's a 1% penalty for doing that.

So for the coupon that was payable in July, we elected that pick option. Again, it's capped at what I just described, Mike, and it was about $11 million, the amount of interest that was picked, or capitalized. I think the $15 million that you're referring to is probably the change in interest from the last time we saw this. The other thing that influences that number is the forward curve, so we're obviously in an environment today where it looks like there's going to be more cuts versus less this year.

So, the other question about why did you decide to do that? As I said in my prepared remarks, Mike, preserving liquidity in this environment is our absolute top priority. What's changed from a year ago when we issued this debt is that we're a year further into this downturn, and there's been no demand recovery to speak of, so we just think it's prudent to take all possible actions to preserve liquidity. We'll obviously revisit the election to PIK or pay in cash in the future as we reach future coupon dates.

Q - Michael Leithead

Great, that’s helpful. Then for Frank, with the joint sale of AmSty now, you guys have obviously surveyed the market before. By now going with the whole asset for sale with CP Chem, how do you think that changes the attractiveness of the sale? And maybe how does that influence your confidence about now getting this deal done given your experience here before?

A - Frank Bozich

We got very clear signals from the participants in our previous process that there was an overhang on their interest to enter into a joint venture. The strong preference was to own 100% of AmSty because it's a great asset, it's performed very consistently, and I think people want to buy control, not into a JV. So that experience and those market signals we got in the previous process make it clear to us that the concerns related to this that were expressed by some of the participants will be minimized.

Operator

And ladies and gentlemen, this concludes today's conference call. And we thank you for your participation. You may now disconnect.