Trinseo First Quarter 2021 Earnings Call

Company Participants

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

Other Participants

- Frank Mitsch
- David Begleiter
- Angel Castillo
- Hassan Ahmed
- Eric Petrie
- Matthew Blair

Presentation

Operator introduction:
Good morning, ladies and gentlemen, and welcome to the Trinseo First Quarter 2021 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, Director 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 yesterday. These documents are posted on the Company's Investor Relations website and furnished on the Form 8-K filed with Securities and Exchange Commission.

If anyone should require operator assistance during the call, please press *, then zero, on your telephone. I will now hand the call over to Andy Myers.

Andy Myers
Thank you, Tabitha, and good morning, everyone. (Operator Instructions) 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 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 conference call. The replay will be available until May 7, 2022. Now I'd like to turn the call over to Frank Bozich.

Frank A. Bozich

Thanks Andy, and welcome to Trinseo's first quarter earnings call. I want to begin with our recent news regarding the closing of the transaction to acquire Arkema's PMMA business, which we first announced last December. The newly acquired business, the results of which will be reported in our Engineered Materials segment, represents the first major step in the transformation of Trinseo. As we have stated, our goal is to become a higher margin, less cyclical specialty materials and sustainable solutions provider. The end uses of PMMA overlap with our current offerings in many end markets including automotive, construction, medical and consumer electronics.

This acquisition is not only expected to generate approximately $50 million of annual synergies but it is also expected to enhance our customer intimacy in these markets. With additional investment in Asia, we will broaden the geographic scope to allow us to serve global customers in that region who are currently not served by the business. The integration of the Arkema team will largely be complete once we have migrated them to our new ERP system and eliminate the Transitions Services Agreements, which is planned to occur in mid-2022. The deployment of the new ERP system is expected to result in harmonized IT systems and business processes across regions and business units that will lay the foundation for future growth. As a reminder, we expect this alignment will result in at least an additional $25 million of cost synergies. I want to welcome the almost 900 new employees as well as numerous new customers to Trinseo, and I'm looking forward to growing our business together.

Turning to our first quarter results, we started the year on a great note with very strong net income, and a record quarter in Adjusted EBITDA. The recovery in demand for many of our products, which began in the second half of 2020, continued into the first quarter. Our total sales volume in the first quarter was 5% higher than the prior year, and 8% higher if Feedstocks is excluded. We observed strong demand in most applications including appliances, building and construction, consumer electronics, tires, board packaging, and even automotive despite the current semi-conductor and raw material shortages.

We continue to grow in products that support higher margin, less cyclical applications like Engineered Materials and CASE applications, where we enjoyed their highest quarterly volume in our history in Q1. Engineered Materials volume was fueled by strong demand for consumer electronics and footwear, especially for products including bio-materials, while CASE benefited from solid demand in construction applications and from our continued growth in the form of new customers and expanding our product offerings to existing customers.

During the quarter we captured higher margins versus both the prior year and the prior quarter for a number of products including ABS, polycarbonate, polystyrene and styrene. This can be attributed to a combination of factors including solid demand, numerous commercial excellence actions and tighter market conditions.

The most prominent example of tighter market conditions was in styrene, where unexpected external events like winter storm Uri in North America and the Suez Canal blockage caused production and supply issues which, combined with normal planned seasonal maintenance and strong demand, led to extremely high styrene margins in our Feedstocks segment in March. In addition, our joint venture Americas Styrenics was fortunate in that its styrene plant in Louisiana was able to continue running without major issues during winter storm Uri, which allowed the JV to capitalize on higher industry margins.

We also benefited from higher margins in our ABS and polycarbonate products within Base Plastics due to high demand and industry supply outages, including some from raw material shortages. These tighter market conditions resulted in higher margins in Base Plastics but I will say that they did cause a headwind in our downstream segment Engineered Materials where higher raw material costs, like polycarbonate, caused margin pressure for our rigid compound products.

The large cost increase in raw materials also created a use of working capital during the quarter, but we were still able to generate Cash from Operations of $51 million which led to positive Free Cash Flow of $38 million. We finished the first quarter with $618 million of cash on hand, of which we used $200 million in May as part of the financing of the PMMA acquisition. With the acquisition complete, we still have a very strong balance sheet and a very positive outlook on earnings for the remainder of the year, especially for the second quarter.

Before I touch on our forward outlook, I want to highlight a few updates on sustainability. First, we recently announced a collaboration with BASF with the goal of increasing styrene production from circular feedstocks. We have already achieved Mass Balance certification for some of our plants and this new collaboration will help our customers reach their sustainability goals by offering them more sustainable solutions. Second, we recently committed to and were qualified for Apple's program asking manufacturers to use 100% renewable energy in Apple production.

We also announced our plans to build a commercial polystyrene recycling plant in Tessenderlo, Belgium which is expected to be operational in 2023 and is expected to convert 15 kilotons per year of polystyrene waste into chemically recycled styrene. Prior to the plant's construction, Trinseo, INEOS and our newly selected technology partner Recycling Technologies, plan to build a polystyrene recycling pilot plant in the UK in 2022. This pilot plant will look to develop Recycling Technologies' depolymerization solution, which provided the highest yields in the conversion of Polystyrene to styrene monomer and provided some of the most scalable solutions. Not only will the development of this technology reduce greenhouse gas emissions as compared to polystyrene production from traditional petroleum-based feedstock, it will also position polystyrene as an integral player in sustainable plastics solutions.

These initiatives strongly align with our 2030 Sustainability Goals, including the reduction of greenhouse gas emissions and creating a product portfolio that is at least 40% sustainably advantaged. It's satisfying to see that as we continue to make sustainability a core piece of our transformation journey, we are being increasingly recognized for our efforts. EcoVadis, a global sustainability rating agency, recently issued Trinseo a Silver rating and our score placed us in both the top 20% of all rated companies and in the top 13% of the category "Manufacturers of Plastic Products." Favorable ratings like this one, as well as our 2021 rating of AA by MSCI, are

a positive byproduct of managing our Company by using sustainability as a main tenet. The addition of PMMA to our portfolio is consistent with our goal of reducing our CO2 intensity as it has a CO2 intensity that is one quarter of Trinseo's current average. I look forward to sharing more exciting updates in this area in the future.

Turning to our outlook for the second quarter, we expect that overall earnings will be similar to the first quarter. We are observing demand levels sequentially in line with Q1 in many of our applications including appliances, building and construction, tires and automotive, where the platforms we serve, such as SUVs and light trucks in North America, and premium cars in Europe, are more highly prioritized by OEMs. As a consequence, they are less likely to experience lost production as a result of the semi-conductor or other raw material shortages. Margins in most of our segments should also be sequentially similar in the second quarter. In Feedstocks, we expect another strong quarter of earnings based on high margins observed in April and May. However, we anticipate that as more supply is made available, the styrene market will find balance and the Feedstocks segment profitability will be closer to breakeven in the back half of the year.

Given the strength in earnings in the first half of the year, and the expectation of a strong demand environment in the second half along with our structural business excellence initiatives, we are revising our previous full year guidance to an Adjusted Net Income of $303 million to $343 million and an Adjusted EBITDA of $625 million to $675 million. This range assumes a full year of Synthetic Rubber and no contribution from the PMMA acquisition. While we are not in a position to provide guidance on PMMA at this time, I will say that we expect eight months of solid earnings contribution from the acquisition given the positive demand we're observing in many of the applications it serves including automotive and construction.

Given our current outlook on earnings, we are confident that we will be able to reach a pro forma net leverage in the low 2's by the end of 2021. This represents an approximately 18-month acceleration from our previously disclosed deleveraging plan.

It's an exciting time at Trinseo and we continue to transform into a specialty materials and sustainable solutions provider. The PMMA acquisition has closed and we are on track to complete the evaluation of the divestiture of our Synthetic Rubber business by mid-year. I'm looking forward to a strong year of earnings, integrating the PMMA business, welcoming our new employees, and implementing best practices as well as upgrading and harmonizing our IT systems and business processes. While the PMMA acquisition is a large step forward for the Company in its transformation, we will continue to look for ways to organically and inorganically grow Trinseo that align with our strategy of higher margins and lower cyclicality with an underlying focus on sustainability.

And now Tabitha you can open the phone line for questions.

Questions and Answers

Operator
And your first question is from the line of Frank Mitsch.

Q – Frank Mitsch
Hey good morning, and nice start to the year and congrats on closing the PMMA deal. I understand that you can't offer full year guidance for the PMMA deal. But I was wondering if you might be able to talk about where their earnings were in the first quarter? What they posted and put that into context with where it might have been a year ago?

A – Frank A. Bozich
Thanks, Frank. And maybe let me make one comment that I didn't have in our notes. The transition this week went extremely smooth and I want to point out that our team, and the team from Arkema, did a great job preparing for the separation and all signs are that we're running extremely well from a business continuity standpoint. I think we can't really give any guidance at this point, but I think the best thing to think about for PMMA is that last year they did $140 million in Adjusted EBITDA.

Q – Frank Mitsch
Got you, got you. I mean if I look at some of the pricing charts today relative to where they were when you announced the deal it is looking a bit better. And I was struck by the comment in terms of the expansion into Asia, could you talk about the timeline that you might be looking to do that? Obviously, you had the facilities -- the manufacturing facilities I guess are in the U.S. and Europe. Is there a thought process to build over there or to acquire over there? Any color there would be helpful.

A – Frank A. Bozich
So, we would expect to make an investment to put a PMMA plant and compounding line in Asia-Pacific, frankly, as soon as possible. Given that we've only had days to really work without any constraint with the group, it's -- all I can say is we're anxious to do this. And the upside for us here is that we can broaden our offering to those global customers that we currently don't serve in that region. So, I don't have a specific timeline and I think we can probably give more updates on that as we go forward in future quarterly earnings.

Operator
Your next question is from the line of David Begleiter with Deutsche Bank.

Q – David Begleiter
Thank you. Good morning. Frank, just on the Feedstocks and styrene how are you thinking about styrene margins beyond this year in terms of supply demand fundamentals, in terms of new supply coming on in China?

A – Frank A. Bozich
Yeah. Hi, David. So, we believe that styrene will normalize at a level that is sort of a cash breakeven for the near-term after the first half of this year. And that new capacity will cause

some rationalization of marginal producers, mainly the non-integrated producers in China, and that's the level that we anticipate being at for beyond the first half of this year until we start seeing more structural change in growth absorbing that capacity or industry consolidation occurs. So, the simple answer is after the first half we believe it will normalize around a cash breakeven basis or a zero EBITDA basis.

A – David Stasse
Hi Dave, this is Dave Stasse. I think that comment is applicable to our Feedstocks segment not -- AmSty is obviously styrene business and it has a cost advantage, so we do expect to make money there. But for a European EBSM producer like us I think what Frank says is correct. What's implied in our guidance for the next several years at least we would assume other than these events that happen like these recent fly-up margins -- but for that we expect limited earnings contribution in Feedstocks.

Q – David Begleiter
Got it. And just looking forward with PMMA closed and the rubber sale on track for this year, how are you thinking about the rest of the portfolio Frank in terms of Styrenics? Is it going to remain a part of Trinseo longer term and if it's not what's the timeframe?

A – Frank A. Bozich
Yeah. So, as we've said in our previous calls in December when we announced this transaction -- we'll continue looking at the portfolio and finding opportunities to inorganically add higher margin, less cyclical, higher growth parts of the business. And we'll look for other parts of the more cyclical part of our business to separate to finance that. So, I would anticipate that some of our more commodity plastics could be separated at some juncture when we find the appropriate opportunity. But we don't have any specific timeline. And it's an important part of our portfolio now from a cash contribution standpoint, so no specific timeline. And the other thing I would point out is we do have significant opportunities to improve our Base Plastics business with additional investment and the harmonization of our systems. So again, no immediate plans, but longer term that's our goal.

Operator
Your next question is from the line of Angel Castillo with Morgan Stanley

Q – Angel Castillo
Hi, good morning. Thanks for taking my question. Just to kind of look at the other side of that I guess as you look at your specialty businesses as styrene and other feedstocks normalize kind of in the back half. Could you just talk about the net timing and how we should think about whether that's a kind of an opportunity or benefit in the second half and in the second quarter? And then also just as you think about kind of the pricing power that there were some headwinds here in the first quarter that because the raw material was being higher, but as we move into the second quarter and second half with styrene going lower, do you see some benefit that as you price some of the raw materials that the margins could actually expand a little bit? If you could give more color it would be helpful.

A – David Stasse
Hi Angel. This is Dave. I'll take a crack at that and maybe Frank can add. I think based on the feedstock curve that we envision and what's kind of baked in our guidance, we don't see significant timing either positive or negative in Q2 or Q3, and Q4 frankly is a little hard to predict. But we just don't see it right now being a significant factor either way.

I guess I could -- maybe a follow-on to that related question -- would be working capital because feedstocks prices are the biggest driver of our working capital, and we saw that in the first quarter with about $120 million outflow. I think based on the feedstocks curve as we currently envision, I think we'll make back about half of that $120 million in really in the back half of this year. So, I think working capital will be an inflow in the back half a year making back about $60 million of that $120 million.

The answer as it relates to feedstock prices and kind of little bit tailwind and the ability to pass that through the downstream businesses, like I think that's an applicable conversation really more for our Engineered Materials segment. The rubber segment largely operates with pass-throughs as you know latex is the same thing. I'm not going to speak to PMMA but in our existing Engineered Materials business, particularly the rigid compounds portion of it which is about two thirds of the segment, we did see a headwind in the first quarter just due to the extremely steep magnitude and timing of the polycarbonate increase that we just weren't able to get passed through fast enough in the quarter. I do think we'll be able to, as polycarbonate prices come down in the back half of the year, I do think we'll be able to make that back in that particular segment. But as I said, Angel, it's not a particularly relevant conversation in the other specialty segments.

Q – Angel Castillo
That's very helpful. And then just in terms of capital allocation, you noted that you might end the year at kind of low 2s and well ahead of schedule. So that's fantastic. So just as we think about potential bolt-ons, could we see you look at potential bolt-ons within 2021 or even early 2022 or will that focus kind of be right now on rubber and maybe 2022 is more a year that you could start to do some other capital allocation whether it's M&A or even repurchases or anything given the stronger balance sheet.

A – Frank A. Bozich
Yeah, to be clear, our number one priority is to integrate the PMMA business and execute against the integration plan that we've got and then complete the assessment for synthetic rubber and execute against that. So, we will evaluate other opportunities in 2021 but the characteristics of those would have to be that they would be not disruptive to our ability to execute under the integration plan that we have. So again, we'll look at things but our first priority, it will be the integration and execution of those activities we've announced so far.

Operator:
Your next question is from the line of Hassan Ahmed with Alembic Global.

Q – Hassan Ahmed
Good morning, Frank and Dave. Just wanted to touch on obviously conscious of the fact that you can't give guidance related to PMMA, but if I heard you correct, you said that the business

did $140 million in EBITDA in 2020, which I would imagine I think would imply that EBITDA was relatively flat year-on-year in 2020 despite the year being -- as quirky a year as it was. So, first question is: did that imply flat EBITDA in PMMA year-on-year? And part and parcel with that question, obviously the end markets at PMMA building and construction, autos, all looking quite strong this year, and then obviously it has a big China exposure, again a geography doing really well. So, knowing that you can't give forward guidance, can you at least touch on how these end markets have fared and the business has fared thus far through May?

A – Frank A. Bozich
What I would say is that there's been very strong, consistent with our existing business, and we have -- as I've said, we have some end market and end application overlaps. We're seeing very robust demand in the applications that PMMA goes into. We are confident that that is sustainable. But what I would say is PMMA was also affected by the supply chain disruptions in Q1 probably more than our broader portfolio so that the production of MMA in the Gulf Coast and the Feedstocks that go into MMA production were quite disrupted. And so, as we're looking at the supply chain inventories are relatively low. And we would see that there's some pent-up demand in addition that needs to be refilled in the supply chain after the disruptions of Q1. So, I would say in general strong demand with very low inventories is how I would characterize the PMMA market right now.

Q – Hassan Ahmed
Understood. And maybe following up on that, particularly as you talked about sort of lean inventory levels and the like, look, as I take a look at your second half implied guidance you guys are guiding to call it slightly north of $400 million in EBITDA in the first half of the year. And looking at your full year guidance that obviously implies that EBITDA half and a half H1 to H2 will be down, call it, anywhere between $125 million to $175 million. And you've also touched on how you're not really factoring in any contribution from styrene. So, I'm just trying to reconcile that half and half decline in light of demand continuing to remain strong, obviously turnarounds happening, backfilling of orders and lean inventory levels, right? I mean it suggest that maybe the second half at least Q3 rise maybe a bit better than what's implied in this sort of half and half EBITDA compression that the implied guidance suggests?

A – Frank A. Bozich
Yeah. So, I guess, let me give you some qualitative view on the second half in relation to the first half. While the demand we see remaining pretty strong and the COMEX initiatives that we've implemented will remain -- those structural initiatives, what we anticipate is no contribution from styrene as it was pointed out and that's about a $100 million of contribution. And then also the tight supply dynamic that exists right now and existed in Q1 and into Q2 will normalize. So that supply dynamic that going away or that tightness of supply will normalize feedstock costs. And to be fair, we benefited from some of that in Q1 and we see some of that benefit more broadly happening in Q2. So, when you normalize that, that's how we get to that second -- first half second half comparison.

Operator
Our next question comes from the line of Eric Petrie with Citi.

Q – Eric Petrie
Hi. Good morning Frank. I just wanted to go back to your announcement on circularity with PSS. How much of your products for S-SBR and PS have recycled content? Is it 10%, 20% or 30% or is it more?

A – Frank A. Bozich
So, I heard S-SBR and what I would tell you is a very small percentage of our portfolio of our sales -- I'm going to say negligible today have recycled content, and the main driver for that is the fact that there is a very long qualification and approval cycle for those products. So, we're excited about what we're doing there as we were able to introduce products to the tire companies last year and we were the first to do this in many of those advanced S-SBR applications and again that coincides with our investment in Tire Recycling Solutions. So, today it's small but we have material that's out there for qualification and over time we would see that building rapidly. The second product that you mentioned -- I heard S-SBR, the second one I missed.

Q – Eric Petrie
Yeah. So polystyrene, and just to clarify too, not as a percentage of overall volume but is it mixed with virgin so you're only looking at 10% recycled content or how does that mix work out?

A – Frank A. Bozich
Okay. Yeah, sorry I misunderstood the question. So, in S-SBR the content will depend on what type of product we're offering. So, if we're using a recycled content from spent tires like we would produce from TRS it would be in the 5% up to 15% loading level for those materials. However, if it's from chemically recycled styrene and/or bio-based butadiene or bio-based styrene we have the ability to go up to 100% in the formulation without any change in the physical attributes, because the styrene and the feedstocks have the same characteristics as virgin petrochemical based materials. So, in those products, it's a wide range depending on many factors. In polystyrene, by memory I believe that the first grades that we did sell last year that used mass balance were 40% chemically recycled styrene monomer as a content.

Q – Eric Petrie
Okay, great. And then secondly, could you talk a little bit more about ABS profitability now that prices are going up globally? Strong appliance demand. Do you see softening comps as we kind of lap the stay-at-home orders? And then I think your plant in China started up in 2017. Is that sold out and potentially in an area that could invest further besides potential PMMA investment in that area?

A – Frank A. Bozich
So, ABS is a great example of the three characteristics that I tried to explain earlier where we have a great franchise and a great product offering and our team has done a fantastic job value-pricing that into very specific applications like appliances and automotive where we see good, strong demand. So, the combination of demand and commercial excellence activities has been good. What I would say though is ABS also was really affected by tightness of raw material feedstock. So, acrylonitrile was very tight in the beginning of the year and so it created some

exceptional earning potential if you were able to supply and we enjoyed some of that in the first quarter.

A – David Stasse
Eric, I'll add, as it relates to the second part of your question, I think you were getting at would we spend capital to increase the supply at our China plant. And the answer to that Eric is no, I don't think we've -- our investment directed toward waste plastics would not be toward expansion but rather toward sustainability and recycled initiatives, which we will invest in.

Operator
And your next question is from the line of Matthew Blair [Tudor Pickering Holt].

Q – Matthew Blair
Hey, good morning, Frank. Curious if you're seeing any demand destruction or substitution in polystyrene just given the high price environment?

A – Frank A. Bozich
I think the simple answer is right now, no, we are not. And I guess I'd like to remind you we have a pretty small exposure in the packaging in our polystyrene business and a lot of our polystyrene is going in to applications where HIPS, high impact polystyrene, is required, etc., so where substitution isn't viable. In packaging, we have not yet seen much traction in attempts to substitute to other products and in fact -- the awareness that is building that polystyrene is able to be recycled effectively and recycled materials becoming available has pushed the pause button at a lot of the big converters or big end market users of polystyrene that would cost billions of dollars to retool to other materials. So, at this point we have not yet seen that.

Q – Matthew Blair
Terrific. And could you provide an update on just the synthetic rubber divestiture process? How are you doing about that I mean given the recent uptick in profitability? Is there a chance that you might hold on to that business for the long term?

A – Frank A. Bozich
So, I feel very good about our process. We've had a lot of interest from parties in the market and it's a great franchise. And frankly, I'm very proud of what that team has done. But if we think forward -- our rationale for reshaping the portfolio more around CASE applications and Engineered Materials applications remains. It's not going to change. And we believe that there are other parties in the market who are better able to invest and grow synthetic rubber and our asset and invest in it than we would be able to have yet a third growth platform, if you will, within the company. So again, even though it's improving and it's doing great and we love the business and we think it's a great franchise, our priorities are in CASE and growing Engineered Materials.

Operator
Ladies and gentlemen, that does conclude today's conference call. You may now disconnect.