

# **Trinseo First Quarter 2023 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**

- David Huang
- Stefan Diaz
- Kevin Estok
- Priya Rangarajan

## **Presentation**

### **Operator introduction:**

Good morning, ladies, and gentlemen, and welcome to the Trinseo first quarter 2023 Financial Results Conference Call. We welcome the Trinseo management team, Frank Bozich, President & CEO, David Stasse, Executive Vice President & 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 Thursday, May 4. 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.

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, [operator], 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 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

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archived on the Company's Investor Relations website shortly following the conference call. The replay will be available until May 5, 2024. Now, I would like to turn the call over to Frank Bozich.

**Frank A. Bozich**

Thanks Andy, and welcome to our first quarter 2023 earnings call. I would like to start by addressing the spill at our Bristol, Pennsylvania PMMA operations that occurred in late March.

Let me begin by saying that our organization is deeply disappointed in this event and the disruption to our neighbors and the concerns of our stakeholders. We are working very hard to regain everyone's confidence.

Due to an equipment failure, an accidental release of an estimated 8,100 gallons of acrylic latex emulsion occurred and some portion of this material was not contained at our facility and ultimately flowed into a local waterway. We immediately reported the event, and cooperated closely with local, state, and federal authorities on the response activities, while at the same time collecting material and preventing further flow into the waterway.

This material is used in various downstream industrial, consumer and medical applications including dialysis filters and is approved by the FDA for use in medical devices. Importantly, our acrylic polymer latex emulsion has a non-hazardous OSHA classification. Within our material, there are certain precursor chemicals that are potentially present. Our estimates of these chemicals dispersed within the 8,100 gallons of material, and reported to the Pennsylvania Emergency Management Agency, was 0.32 pounds of butyl acrylate, 1.62 pounds of ethyl acrylate, 27.22 pounds of methyl methacrylate, and 0.26 pounds of styrene. None of the water samplings conducted by authorities detected these chemicals. Due to the onsite containment and cleanup activities as part of the initial response to the release, we believe that portions of the material never reached the waterway.

Additionally, I'd like to take this opportunity to address the record about the historical environmental performance of our facility at the multi-tenant Bristol site that includes other companies' operations. Our facility has a history of compliance with environmental regulations. As indicated by the EPA's Enforcement and Compliance History Online database, not including this event, our facility has had no significant violations, no quarters of noncompliance and no formal enforcement actions.

As you all know, we are committed to strong environmental, health and safety performance, and as a Company we've had an overall outstanding EHS record. I am proud of the response of our employees and emergency responders to handle this in a cooperative and transparent way.

Now I'd like to turn to the first quarter results. As we entered Q1, 2023 in a continued low demand environment, we established three near-term priorities for Trinseo. First, to focus on working capital management to increase cash. Second, to recover volumes that may have been lost to low-cost imports in Europe in the second half of last year. And lastly, to continue driving organic growth programs targeting material substitution and sustainability.

I am happy to say that our efforts around working capital management were very successful in Q1 as we reduced working capital by \$52 million in the quarter. Dave will elaborate on our cash

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management actions in more detail, but based on the actions we are taking, we are confident we will be Free Cash Flow positive in 2023 even at these reduced demand levels. From a market and volume standpoint we saw a 4% increase in volume over the levels of Q4. This volume increase reflected normal seasonal improvements rather than a broad recovery in our end markets. Business conditions in the first quarter were broadly the same as what we experienced in the fourth quarter, with continued destocking in building and construction, weak demand in consumer electronics, but healthier automotive demand.

While our total sales volume for the company was down 20% year-over-year, volume for specialty and modified resins, as well as for CASE applications in Latex Binders, declined at about half that rate, which shows that these offerings have more resiliency during periods of destocking and lower structural demand. The volumes and margin for our technologies that enable our growth programs in general outperformed the broader portfolio, and at the Q1 run rate, should deliver year-over-year margin growth. The volume of products containing recycled materials, which are in very high demand by our customers, grew 1% year-over-year during Q1.

So far in the second quarter, April volumes are consistent with Q1. Structural demand remains low and the recovery in China has been softer than expected. While we have seen an increase in orders for some high-value specialties in China for May and June, it is too early to tell if this represents sustainable demand. Therefore, we have implemented a series of cash improvement initiatives. We've already seen a benefit of these with our strong first quarter cash generation and we'll continue to take action. While the timing and trajectory of the market recovery is unknown, we are addressing what we can to optimize near-term performance while preparing for the market recovery.

I would like to comment on the results of our engineered materials segment in Q1. While volume and unit margins were largely as expected in almost all of our EM product lines, our MMA margins were significantly lower due to ongoing ammonia force majeure of our supplier and the impacts of the natural gas hedges against declining gas prices. These costs could not be recovered through sales of MMA into the merchant market or through our sales of ammonium sulfate byproduct into the fertilizer market. However, our input costs have decreased significantly in the second quarter as our ammonia supplier has restarted local production and we expect to see a significantly lower natural gas hedging impact in Q2. For these reasons we expect to see significant sequential improvement in EM results.

One last comment I would like to make is related to our process to sell our styrenics assets. We continue to have ongoing dialogue with parties interested in specific assets and regional business activities related to our styrenics business. As we have previously stated, separating these assets is part of our long-term strategy and monetizing them is an important part of deleveraging the balance sheet. Given the continued interest in specific assets, as well as improvements we have made in them through our restructuring actions last year, we are restarting the sales process of our styrenics business which will include the marketing of individual assets and regional businesses.

And now I'd like to turn the call over to Dave.

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### **David Stasse**

Thanks, Frank. Our first quarter Adjusted EBITDA was below our expectation due to unfavorable impacts of \$19 million for natural gas hedges and \$10 million for fixed cost under absorption related to inventory reduction actions.

I'd like to spend a minute on both of these topics as it's instructive for modeling for the rest of the year. Of the \$19 million loss related to natural gas hedges in the first quarter, \$7 million was from realized hedges related to gas purchased in the quarter, and the other \$12 million was related to mark-to-market on hedges that settle in future quarters. This was the result of a €30, or approximately 40% drop in the price of European natural gas in the quarter.

Moving to the second quarter, the forward curve is substantially the same now as it was at the end of the first quarter. Based on this, we expect minimal P&L effect from the mark-to-market on hedges related to future periods. However, we expect a realized loss of about \$10 million on hedges related to gas purchased in Q2, and lower amounts in Q3 and Q4.

As it relates to fixed cost absorption, preserving liquidity is one of our foremost priorities in this environment. In the first quarter, we drained \$50 million of inventory by running the plants at lower operating rates, in so doing generating a negative P&L impact of \$10 million. This cash flow versus P&L tradeoff was clearly the right decision for us, and we will be prioritizing cash flow if and when these decisions arise during the rest of this year.

The \$52 million working capital release we had in the first quarter led to our positive \$24 million of free cash flow, which is significant for us given the relatively low profitability in the quarter and the fact that the first quarter is seasonally our lowest quarter for cash generation.

For the full year, we are increasing our cash generation guidance due to a series of actions, despite reducing our EBITDA guidance.

First, we signed an agreement to sell our cast acrylic sheet site in Matamoros, Mexico for \$19 million. We expect that transaction to close shortly. Second, we will be substantially reducing our dividend, beginning with the dividend payable in the third quarter of this year. Third, we are reducing our capex by \$10 million by deferring discretionary project spend unrelated to maintenance or EH&S. And finally, as I mentioned earlier, we are aggressively reducing working capital across the company, and we are off to a good start on this initiative with the result in Q1.

Our strong liquidity position and improving results gives us great confidence in our ability to weather this economic downturn while continuing to support our strategic initiatives. Now I'll turn the call back over to Frank who will talk about our expectations for the second quarter and the remainder of 2023.

### **Frank A. Bozich**

Thanks, Dave. Looking ahead to the second quarter, we expect a significant sequential profit improvement of about \$40 million from lower raw material and Corporate costs, a lower natural gas hedge loss, and higher fixed cost absorption. These are the driving factors in our Q2 guidance of a net loss of approximately \$15 million and an Adjusted EBITDA of approximately

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\$80 million. This outlook assumes no volume growth, and therefore demand improvement would represent an upside.

For the full-year 2023 we are guiding to a net loss of \$94 million to \$61 million and an Adjusted EBITDA of \$275 to \$325 million. This updated outlook is \$100 million below our prior guidance due to \$45 million of natural gas hedge losses, \$10 million from the first quarter fixed cost absorption, and the remainder from slower market recovery.

While we are expecting a gradual demand increase through the end of the year, the low end of this full-year guidance range assumes no demand improvement for the rest of the year and, at the high end, about a 10% improvement beginning in Q3. We see this set of 2023 forecast assumptions as independent from a full economic recovery or a restocking cycle, both of which represent upsides.

There's no question that we continue to face very challenging business conditions and we've reduced our 2023 outlook to reflect this. Amid these conditions, and uncertainty around the timing of a market recovery, we've taken cash improvement actions to maintain our strong liquidity position. We expect increased cash generation compared to our prior guidance, with cash from operations of approximately \$165 million and Free Cash Flow of approximately \$75 million. This reflects more than \$100 million of cash improvement actions that Dave described earlier.

Our capex guidance of \$90 million includes all necessary plant maintenance as well as the funding of growth and sustainability programs.

While we are taking actions for the short-term, we are also focused on strategic long-term initiatives such as our sustainability and material substitution offerings. These programs offer us growth opportunities irrespective of the market environment.

And now we're happy to take questions.

### **Questions and Answers**

#### **Operator**

Thank you. (Operator Instructions) We'll take our first question from David Begleiter with Deutsche Bank. Your line is now open.

#### **Q - David Huang**

Hi, this is David Huang. I guess first question is on Styrenics business sale. Can you talk about the potential timing? And I guess -- are there any additional closure actions you can take if there are pieces of the business that you can't sell during the process?

#### **A - Frank A. Bozich**

Maybe let me step back and just give more color. And as I said in the prepared remarks, when we paused the process last year, we saw significantly deteriorating results beginning in Q3. And we took action to close our Boehlen styrene monomer plant, which had historically been the least productive of our sites, and that's permanently closed.

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During our entire process, we had a number of parties, mainly regional strategics and other interested parties in specific assets, that continued to express that interest and we've had new inbounds. And for that reason, we're going to engage them formally in a process to investigate the sales. I can't really comment more than that to say when we might see a positive outcome from this. But suffice it to say that, we are engaging and will engage in the near term in active discussions with those interested parties.

The second part of your question about asset rationalizations, look we're always going to look at our assets in our sites against the forward outlook in the market and relative to their competitiveness. And that's part of our ongoing business activity. So, at this point, we don't have anything that would be on the table that's in our mind, but we always would look at those activities as part of the ongoing strategic review of our assets.

**Q - David Huang**

Okay. And then I guess, how should we think about the long-term normalized earnings potential for the core portfolio ex-Styrenics?

**A - Frank A. Bozich**

In a mid-cycle EBITDA, I would argue that the core portfolio should perform in the \$350 million range excluding the Styrenics assets.

**Operator**

Thank you. Next we'll go to Angel Castillo with Morgan Stanley. Your line is now open.

**Q - Stefan Diaz**

This is actually Stefan Diaz sitting in for Angel. Thanks for taking my question. You called out absorption costs. How much of this is baked into the midpoint of your guide going forward? And then maybe specifically on the EM segment, how much of the absorption costs were felt in EM in 1Q? And what would you say utilization rates are in the segment and how do you see that progressing going forward?

**A - David Stasse**

Angel, I'll take a crack at the first part of that. So, of the under absorption, we had \$10 million in the first quarter. \$6 million of that was in the Engineered Materials segment, and the rest was spread amongst the other segments. I would say, going forward for the rest of the year, I don't expect anything of materiality to be going through the P&L in terms of under-absorption. And that's what our guidance reflects.

I think it's helpful to maybe point out a couple of other things just to kind of transition -- I want to stay on the Engineered Materials for a minute -- the transition from Q1 to Q2 in that business because we do see a pretty significant increase in EBITDA from the first quarter to the second quarter. So, as we just talked about, there is plus \$6 million of under-absorption, I don't see that repeating in the second quarter.

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Engineered Materials had \$7 million of negative timing in the first quarter. And that negative, what we call negative timing is, we're in an environment now in the first quarter, and we see this continuing in the second quarter, we're seeing rapidly decreasing input costs, specifically ammonia and natural gas. And because we're on a FIFO basis, the realization of that in our P&L can be somewhat lagged. So when I call out that \$7 million, that's what that is. It's kind of that lag effect of the realization in our P&L. We're not going to have that in the second quarter. We see that kind of stabilizing in the second quarter. We also have \$3 million less of natural gas hedge impact in the second quarter.

And then the last thing is just the overall benefit of decreasing input costs. So, if you add all that up for the segment, the results in the second quarter, \$25 plus million higher than it was in the result in the first quarter, just Engineered Materials.

**Q - Stefan Diaz**

Great. That was super helpful, thanks for the color. And then maybe you could just speak about some of the demand trends by region?

**A - Frank A. Bozich**

Let me start globally by segment. Automotive is the one market that we're seeing increases year-over-year versus the second half of last year. And what I would tell you is that, U.S. demand has held up relatively well. European demand is improved slightly over where it had been in the second half. And then Asian demand is lower. So on balance, we're at a consistent level of demand from where we were in the second half, as I indicated. And what we saw, the 4% increase in Q1 is really reflective of more seasonal uplift than any structural change in the underlying market.

Just maybe let me add. I did reference in the prepared remarks that we have seen a reestablishment of orders into certain higher value specialties in China beginning in May and June, and that's a very positive sign. Again, it's difficult to say whether that's sustainable or not. But it's a good signal that these companies have come back to the market and reestablished purchasing. So, we're watching that closely to see if it's structural.

**Operator**

(Operator Instructions) Next we'll go to Kevin Estok with Jefferies. Your line is now open.

**Q - Kevin Estok**

Hi, this is actually Kevin sitting on for Laurence Alexander. Thank you for taking my question. So just curious, in the event of a recession, let's say in the back half of the year into 2024, I'm just curious what sort of levers you guys could expect to pull to sort of mitigate that loss and sort of improve operating performance? Thank you.

**A - Frank A. Bozich**

Sure. So let me start. One, we see input costs going down fairly rapidly across the portfolio. So one, that's a tailwind, if that continues and a recessionary environment would typically also come with continued lower input costs. But that being said, the destocking that we've seen, again if you look across our portfolio, volume is 20% down year-over-year in the first quarter

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versus prior year. Clearly, the broader economy isn't down 20%. So there is a significant destocking effect that we're still seeing throughout most of our value chains, which, in a normal recessionary environment, we would actually see demand stabilize at a higher level, or we wouldn't see a significant decrease from where we are today with the destocking still ongoing. So again, it's difficult to say and unpack the difference between destocking and the underlying market demand. But again, I would not anticipate that we would see significant further decrease in some of our value chains beyond what the destocking levels are showing.

As it relates to levers, there are always opportunities for us to use regional arbitrage, as well as reflex our network to reduce our fixed cost. And what I would tell you is that, while we took \$60 million in fixed cost out through the restructuring actions that we had last year, there were other actions that are available to us that required some capital investment for us to be able to implement. So many of those investments will be completed by the end of Q3, so it gives us optionality in the future to run our assets and our network slightly different.

**Operator**

Next we'll go to Priya Rangarajan with RBCCM. Your line is now open.

**Q - Priya Rangarajan**

Hey, guys. Thank you so much for the call. Can you talk a little bit -- when you say that volumes are flat in your \$275 million expectations on EBITDA, is that flat to first quarter 2023?

**A - David Stasse**

Yes, it is, Priya. I think if I heard your question correctly, was at the low end of the range or \$275 million of EBITDA, is the volume assumption flat to the first quarter of 2023. And the answer to that is, yes. So, look, we give fairly explicit guidance in our materials that we put out of \$80 million EBITDA for the second quarter. So, that \$275 million, obviously, reflects three-quarters of \$80 million plus the \$35 million, that we had in the first quarter. So, that's a flat EBITDA environment from where we operate in the first quarter.

**Q - Priya Rangarajan**

Got it. And then on the hedge losses, is there a way to quantify to the extent that natural gas prices go, say, 10% from here, how much further losses you would potentially see from your guidance?

**A - David Stasse**

Yeah, it's very hard. We've talked about that, it's very hard to kind of quantify or to give you a rule of thumb that says, if gas prices go down X, this is the hedge loss. Because as we go forward in time, our hedges expire. And the other thing I would point out is, you really can't just look at the spot price, you have to look at the forward curve. So the entirety of the forward curve and how much the forward curve shifts, that impacts the mark-to-market of all our future hedges. What I can tell you, Priya, is that, in the first quarter, as I said, there was a EUR30 drop in European gas prices, and that resulted in a \$19 million hedge loss in the first quarter. And again, I think it's very important to distinguish, Priya, that \$19 million is comprised of \$12 million that is mark-to-market on hedges that are four quarters other than Q1, okay? And \$7 million of it is actually cash and related to hedges that settled in Q1.

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Now I just want to warn that, I don't think you can take that ratio and assume a 30 EUR change going forward is going to be \$19 million a quarter because it will be less than that. And the other thing I'd say is with natural gas trading at EUR35 right now, you certainly can't have a EUR30 on the downside. Our belief is that, we're probably near the bottom, I think on the European natural gas right now. And we actually think there is a very credible and plausible scenario that natural gas prices rise and could even spike in the upcoming winter. Whether you look at the drop in natural gas prices has stimulated demand or kind of incited industrial and residential demand is up considerably in Europe, is the statistics we look at, it's early in the year. So without the flow of Russian gas, LNG is not going to offset what used to be Russian imports. So, a cold winter could result in what we think is a very credible scenario for higher natural gas prices, in which we would obviously see a benefit from the hedge results.

**Operator**

And those are all the questions we have at this time, I will now like to conclude today's conference. We thank you for your participation. You may now disconnect.