Trinseo Third 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

- Frank Mitsch
- David Begleiter
- Matthew Blair
- Michael Leithead
- Hassan Ahmed
- Laurence Alexander

Presentation

Operator introduction:
Good morning, ladies, and gentlemen, and welcome to the Trinseo third 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 Friday, November 3rd. 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. And now, I'll hand things over to Andy Myers. Please go ahead.

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 archived on the Company's Investor Relations website shortly following the call. The replay will be available until November 6, 2024. Now, I'd like to turn the call over to Frank Bozich.

Frank A. Bozich

Thanks Andy, and welcome to our third quarter 2023 earnings call.

I'd like to start with a discussion of our Q3 results. As expected, our Q3 sales volume was roughly flat to Q2, and consistent with the lower demand level we've seen over the past year. This reflects lower end-customer demand, particularly in consumer durables and building & construction, continued customer destocking as well as weaker market demand in Asia leading to higher exports to Europe.

However, looking at our customers, we feel we are seeing a slowing of destocking and are hopeful this will end in the near future depending on the value chain.

Despite this prolonged period of reduced demand, we've taken numerous asset footprint and other cost reduction actions to improve our profitability. Late last year we announced the closures of our styrene plant in Boehlen, Germany and half of our polycarbonate production in Stade, Germany, along with consolidating our PMMA sheet production in North America. This year we've seen significant profitability and free cash flow improvements from these actions.

I would like to refer to the additional actions we have recently announced which are highlighted on slide four of our investor deck. First, the closure of our Terneuzen, the Netherlands styrene plant. Second, the optimization of our PMMA sheet network in Europe, including plant consolidations. And lastly, corporate cost reductions including the elimination of certain executive positions. In aggregate, these recent actions are expected to result in approximately $75 million of annual cost reductions that we expect to be realized in 2024.

We believe these actions will not only increase our profitability and cash generation but will also enable us to continue investing in transformation projects such as recycling and material substitution innovations, which offer significant growth potential even in the current market environment.

While market demand has remained challenging for the entire industry, we continue to see the benefit of the shift in our portfolio to one that is more specialty and sustainability solutions oriented. In 2023, specialty and sustainable solutions comprise about 30% of our variable margin and this is about double the level of 2020. This part of our portfolio has shown better margin resiliency in the current environment. Continued focus on growing these technologies

and also taking decisive action on our more cost sensitive assets gives us additional levers to improve profit while market demand remains depressed.

Looking at Q3 profitability, we reported a net loss from continuing operations of $38 million and an Adjusted EBITDA of $41 million. This result was below our expectations due mainly to the styrene-related impacts during the quarter, including a short-term spike in European styrene prices while we were buying all of our styrene on the spot market during the unplanned outage at Terneuzen.

However, I am proud to say that due to our continued focus on working capital, we were able to generate positive Free Cash Flow for the third consecutive quarter. In addition, as previously announced, we've successfully refinanced all of our 2024 term loan and over 75% of our 2025 notes.

Going back to the Terneuzen styrene closure, I want to be clear that we did not take the closure of this plant lightly, but styrene profitability has been negative for the last nine quarters. With elevated energy prices in Europe, styrene production cost in the region is one of the highest in the world. Plus, given recent and planned global styrene capacity additions, we believe this feedstock will remain structurally long through the end of the decade. Therefore, we believe we will be able to purchase styrene at lower prices than our production cost. The positive result of our previously announced Boehlen closure supports this as the correct course of action. This closure also reduces production risk, ongoing capital and turnaround cost, while lowering our energy intensity and carbon footprint.

With the closure of Terneuzen styrene, we will no longer produce styrene anywhere in the world. We will therefore purchase all of our styrene needs from third parties. We have always purchased all of our styrene needs in North America and Asia, as well as a significant percentage of our European requirements, so this model is not new to us. We plan to buy via diversified geographic and commercial arrangements, providing us with flexibility to optimize our purchases.

Starting in Q1 of 2024, we will no longer have a Feedstocks reporting segment, and the actual purchase cost of styrene will flow through to the derivative segments – Polystyrene, Plastics Solutions and Latex Binders. These businesses pass through styrene cost in their product prices, either through market mechanisms or via price formulas.

Because we will be buying all of our styrene and generally operate with pass-through economics in our downstream businesses, we don't expect to see the volatility of styrene margins in our results.

Before I hand the call over to Dave, I'd like to talk to you about our progress in sustainability. This continues to be a bright spot, and our sales volume for recycled-content-containing products was up 10% year-to-date from our continued focus in this very important area. On this topic, I'd like to provide more details on one of our sustainability projects that I'm particularly excited about. Earlier this year, we announced the inauguration of our polycarbonate dissolution pilot facility in Terneuzen, the Netherlands. Since that announcement, I am happy to

report that the pilot facility is fully operational, has been qualifying mixed-waste streams and producing samples of recycled polycarbonate for our customers. Through this ongoing investment and our ability to repurpose the idled polycarbonate production line in Stade, Germany for this process, we expect to be able to achieve industrial-scale production beginning in 2025 with a low capital expenditure. Now, I'd like to highlight some of the unique features of our technology and the advantages it will provide in the future.

Our process uses our proprietary advanced physical recycling technology that enables the recovery of polycarbonate polymer from end-of-life plastics, such as automotive parts and consumer electronics, that are difficult to recycle via traditional mechanical recycling methods. Our technology allows us to extract polycarbonate polymer from a mixed-waste stream, meaning polycarbonate-containing waste mixed with other plastics, metal, or glass, giving us the ability to process waste that would otherwise be unrecyclable. As a result, certain waste that could only be sent to a landfill or an incinerator in the past, can be recovered and recycled using our technology. This will enable closed-loop partnerships with automotive, electronics and consumer goods customers that currently produce end-of-life plastics. These partnerships are highly attractive to our customers as they provide circular solutions.

In addition to the sustainability advantages of our technology, the quality of the polycarbonate that we extract through the dissolution process is on par with virgin PC and contains lower levels of residual bisphenol A. These reduced BPA levels could potentially expand the types of applications for which recycled PC is approved. Our process also emits up to three times less CO2 than virgin PC production, making both the process and end-products more sustainable. Finally, because this technology permits the use of lower-value waste as feedstock, we anticipate at scale it will result in cost savings compared to virgin PC production.

I'd like to thank our research and development team for their truly innovative work and their dedication toward creating a cleaner, more circular polycarbonate technology. This is just one of the many exciting projects that we continue to focus on in order to achieve our 2030 sustainability and growth goals and continue to increase the mix of specialties in our portfolio.

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

David Stasse

Thank you, Frank. Our third quarter Adjusted EBITDA was below our expectation due mainly to lower styrene-related margin from our unplanned outage at Terneuzen as well as negative net timing from decreasing raw materials. Results included unfavorable impacts of $15 million related to the Terneuzen styrene outage, $11 million from natural gas hedge losses and $4 million from net timing. Please note that the $11 million impact from natural gas hedges has decreased from $19 million in the first quarter and $12 million in the second quarter. We expect this impact to be about $5 million in the fourth quarter and about $5 million overall in 2024.

In the second quarter we had Free Cash Flow of $16 million including a working capital reduction of $52 million which was driven by continued cash initiatives. Year to date we have reduced working capital by over $150 million, and over 80% of this reduction is from lower

working capital days as opposed to price. We are comfortable operating at this reduced level of working capital as long as this demand environment persists.

We ended the third quarter with $279 million of cash and $495 million of liquidity including our undrawn bank facilities.

The last item I'd like to discuss is our recent refinancing. As slide 13 in our deck shows, we refinanced $660 million of the 2024 term loan and $385 million of the 2025 senior notes, extending these maturities to 2028. This leaves $115 million of notes due in September 2025, and no other maturities until 2028.

Now I'll turn the call back over to Frank who will talk about our expectations for the remainder of 2023.

Frank A. Bozich

Thanks, Dave. Looking at our forecast for the rest of the year, we are guiding to a full-year net loss of $509 million to $499 million and Adjusted EBITDA of $175 million to $185 million.

This updated full-year Adjusted EBITDA outlook is below our prior guidance primarily from lower styrene-related margin and unfavorable net timing in Q3 as well as a more pronounced year-end seasonality impact in Q4.

As we continue to navigate a sustained, low-demand environment, we've been proactive by taking significant actions to enhance profitability and cash generation, including numerous initiatives regarding asset optimization, cost reductions and liquidity improvements. The year-over-year benefit of these actions, combined with lower losses from natural gas hedges, are expected to result in over $100 million of EBITDA improvement.

In addition to these improvements, the 2023 Adjusted EBITDA outlook includes Q3 year-to-date unfavorable impacts of $22 million from net timing from declining raw materials and $14 million from fixed cost under-absorption related to our inventory reduction actions. Therefore, we expect these tailwinds to result in significantly higher profitability in 2024.

And now we're happy to take your questions.

Questions and Answers

Operator

Thank you, Mr. Bozich. (Operator Instructions) We'll take our first question this morning from Frank Mitsch at Fermium Research LLC.

Q - Frank Mitsch

Good morning, and hey, congrats on the refi. I want to drill a little bit more into the '24 expectation versus '23. You outlined a $100 million benefit from the cost actions that you've taken, the plant shutdowns as well as natural gas hedges. And so far this year you mentioned

the $14 million under absorption from running your assets lower. Of course, you also had another $15 million of unplanned outage. If I add this up, you're expecting something like $40 million less in terms of nat gas hedges impact, so that implies $60 million of benefit from the restructuring actions. I believe you've previously said you expected $70 million to $90 million of benefit from the restructuring actions. Are we just rounding here? Can you talk a little bit more about the bridge from '23 to '24 from some of these various noise items?

A - Frank A. Bozich
Yeah, Frank, I think the best way to look at it is to look at Slide 4 of the presentation deck, where we talk about the tailwinds. There's a little call-out box there that shows $100 million related to the asset and cost restructuring and natural gas hedges, the $22 million of unfavorable net timing plus $14 million fixed cost under absorption.

So, I would say those are the tailwinds that we would go into next year with the benefit of. And, again, I think Q3 is representative of the demand level that we would expect to see in this environment as we bounce along at these levels. So a normalized Q3 plus those is probably a good way to think about it in this environment.

Q - Frank Mitsch
Got you. You've previously indicated $70 million to $90 million just based on the restructuring actions from the plant shutdowns, et cetera. It looks like that $100 million includes that as well as the $40 million benefit from the nat gas. You're not implying that you're expecting the benefits to be less than that $70 million to $90 million that you've previously said, are you?

A - David Stasse
No, Frank, this is Dave. You're right, $70 million to $90 million is the original range we gave, and the amount is now $75 million. So what we expect today to get out of that is $75 million. The $100 million that Frank was referring to in the slides is the sum of that $75 million plus the natural gas savings.

A - Frank A. Bozich
Frank, we're getting some partial benefit from some of these actions this year.

Q - Frank Mitsch
Okay. All right.

A - Frank A. Bozich
Yeah, there is a portion of it that we're getting this year, for example, the corporate restructuring actions. Those were in effect late in Q3. A portion of those we've already gotten, so we'll only get the year-over-year benefit as a tailwind next year and that's what we've highlighted in that call-out box.

Q - Frank Mitsch
All right. Very helpful. And then lastly, you mentioned that you're seeing a slowing of destocking, and I was wondering if you might be able to provide some color in terms of the end markets

where you might be seeing that, whether at the building and construction, specialty paper packaging or whatever. Any color there on where you're seeing this slowing?

A - Frank A. Bozich
We're seeing slowing in consumer electronics and in the CASE applications in Latex Binders. Automotive has been very steady, so that supply chain has been pretty resilient. And also, we've seen slowing in the white goods or consumer goods areas related to appliances, where we still see some destocking. Probably the most pronounced destocking that's still ongoing is in kitchen and bath-type applications for our various technologies, within building and construction.

Q - Frank Mitsch
Terrific. Got you. All right, thank you so much.

A - Frank A. Bozich
Thanks, Frank.

Operator
Thank you. We'll go next now to David Begleiter at Deutsche Bank.

Q - David Begleiter
Thank you. Good morning. Frank, do you have an update on the Styrenics sale?

A - Frank A. Bozich
So David, no real update. We continue to field questions from parties that are interested, but nothing is imminent.

Q - David Begleiter
Understood. And Dave, just on working capital, when volumes do come back to more normalized levels, how much rebuild do you think you'll need in working capital?

A - David Stasse
Well, Dave, as I said in the prepared remarks, over 80% of the reduction this year is from days. So days of working capital that we've taken out, and we believe substantially all that is structural. We've taken out those days of working capital because of the systems and processes that we've implemented specifically around S&OP and in our new ERP system.

So I think price out of that is probably 15% or less. I think when prices do rise, that will likely be indicative of a recovering environment, so we probably see higher EBITDA in that as well. But the vast majority of it, the remainder, is days of inventory and days of other working capital that we think we've structurally taken out and don't think we need to add back.

Q - David Begleiter
Thank you.

Operator
Thank you. We'll go next now to Matthew Blair at TPH.

Q - Matthew Blair
Hey, good morning, Frank and Dave. I was hoping you could help us out a little bit on the EBITDA bridge from Q3 to Q4. I think midpoint EBITDA guidance only has Q4 moving up maybe about $5 million quarter-over-quarter. It seems like you would have some pretty considerable tailwinds from rolling off the Feedstocks impact in Q3, $19 million, as well as it sounds like the nat gas headwind is effectively going to be about a $6 million tailwind. So is that the right way to think about it? And I guess the delta would be the increased seasonality as well as the benzene hit on styrene margins?

A - Frank A. Bozich
Yeah, I think that's a good way to think about it. We'll have some benefit, as we outlined, from styrene and from the actions we've taken, and those will be somewhat muted in the results because we expect extended customer shutdowns during the year-end.

A - David Stasse
And Matthew, just one other point. Frank mentioned in his prepared remarks, but I think it's important that everybody understands. You mentioned benzene, and elevated benzene putting pressure on styrene margins. And that is, in fact, happening. Now in the fourth quarter, we're seeing that in AmSty. AmSty is going to have a lower performance in Q4 due to styrene margins. But because we're no longer a styrene producer, higher benzene and styrene margins do not impact our results like they used to, so I know that's going to take some getting used to for us. But styrene margins really only affect us now in AmSty, not in our own results.

A - Frank A. Bozich
The other thing I just do want to point out is that the styrene contracts that we've negotiated begin in January of next year. We've secured the needs we have for the remainder of the year, largely through spot purchases on the market. So the timing for the contracts to kick in is January of next year.

Q - Matthew Blair
Got it. And then will feedstocks still be around for Q4? Will that be a zero or will there still be some residual negative EBITDA flowing through for feedstocks in Q4?

A - David Stasse
It will be there in Q4, Matthew. We will still have a styrene reporting segment. It's not going to reflect the production of styrene and internal sales to our internal businesses, it will just reflect purchases of styrene that we make and internal transfers of that. Because of that, I don't expect it to be a negative number in the fourth quarter.

Q - Matthew Blair
Got it. And then last question is, I believe the cash flow statement reflected $15 million or $16 million in the third quarter from proceeds from the sale of business and other assets. Can you remind us what that was for?

A - David Stasse
That was for small, immaterial sales of assets. It wasn't a business, it's miscellaneous assets that's not even worth the time on the call.

Q - Matthew Blair
Okay, sounds good. Thank you.

Operator
Thank you. We'll go next now to Michael Leithead at Barclays.

Q - Michael Leithead
Great, thanks. Good morning, guys. First, Frank, can you just speak to the intensity of lower cost Asian imports across your portfolio? Is it getting better or worse relative to maybe earlier this year?

A - Frank A. Bozich
I would say it's getting better and that's because the cost differential between European production and Asian cost has decreased, but there's still a pronounced pressure due to the lack of free capacity and underutilization of assets in Asia. So there's still pressure from imports and there's still a dislocation in cost between Europe and Asia. I would say it's most pronounced in Plastics Solutions and in EM. And due to the nature of our Latex Binders business being a water-based product, it's least pronounced or almost non-existent there.

Q - Michael Leithead
Great. That's super helpful. And then, Dave, after the recent refinancing, can you help us with what your current run rate annual cash interest is?

A - David Stasse
Yes, it's $235 million a year, Mike.

Q - Michael Leithead
Great. Thank you.

Operator
Thank you. We'll go next now to Hassan Ahmed at Alembic Global Advisors.

Q - Hassan Ahmed
Good morning, Frank and Dave. I wanted to revisit some of the moving parts associated with the initial 2024 guidance or bridge analysis you guys have given. Frank, you mentioned a good way to think about run rate quarterly EBITDA is Q3 2023 levels, right? So I annualize that and I come up with call it $164 million in EBITDA. Then you talked about the tailwinds from asset and cost restructuring, which is another $75 million, the non-presence of the unfavorable timing impacts in '23, which is another $22 million, and fixed costs under absorption which is another $14 million.

So, you sum it up and you come to at least $274 million, $275 million in 2024 EBITDA. Am I right in assuming, first of all, that is the correct way of thinking about it? And of course, that does not factor in any sort of demand improvements and it doesn't factor in potentially the benefit from the new styrene contract. Am I thinking about this the right way?

A - Frank A. Bozich
Let me play back to you how I would think about it, or how I've been thinking about it, and how we discussed it earlier when Frank asked the question. So if we take $41 million for Q3 and add back the $4 million timing, plus the negative impact from the styrene outage of $15 million, that gets us to about a $60 million underlying performance in Q3. And from that, we have an additional tailwind of $100 million related to restructuring and natural gas hedges.

So that's how I would think about it. Again, we're not guiding yet, we'll guide in February, but sitting here today, that's how I would think about next year.

Q - Hassan Ahmed
Fair enough. Fair enough. And just again, trying to sort of understand the demand side of things with this massive destock that we've seen. Back in, I believe it was Q4 of '22 during the earnings call, you talked about how historically de-stockings lasted two quarters and the restock post those two quarters of destocking historically had been quite impressive. Now here we are several quarters later with the destocking continuing. So should we expect after this level of destocking, if and when it happens, an equally impressive restocking?

A - Frank A. Bozich
We've talked about this and I don't know what to expect going forward, to be honest with you, because I think that the chemical industry in general is at an inflection point that in my 40 years I've not seen before, with overcapacities in Asia, geopolitical effects, and dislocations in cost. So it's hard for me to say what to expect going forward.

Based on our prior experience, if history would repeat itself, we would say yes. But, sitting here today, it's difficult to predict when and how that will happen or what it will look like.

Q - Hassan Ahmed
Fair enough. Very helpful, Frank. Thank you so much.

Operator
Thank you. We'll go next now to Laurence Alexander at Jefferies.

Q - Laurence Alexander
Good morning. Could you unpack the comments around extended shutdowns? Is that just in kind of the appliance industry or are you also seeing that in automotive? And are you thinking about it in terms of shutdowns starting earlier than normal? Or are you also concerned about them spilling over into January more than usual?

A - Frank A. Bozich
No. We think that the customers will be managing working capital by reducing stocks through the year end and so their shutdowns will start earlier. And I would say this is probably across the value chains. And again, if there's an exception, it's probably automotive.

Q - Laurence Alexander
And secondly, just in terms of kind of the comp effects, if you take the way your customers talked about their sense of underlying demand, is there at least a high-level of confidence that volumes are positive comparisons in Q2 year-over-year?

A - Frank A. Bozich
I just want to make sure I understand the question.

Q - Laurence Alexander
When we think about the year-over-year cadence on volumes, should you be back in positive territory by Q2 of next year based on what your customers are saying? Or are they indicating too much uncertainty on demand trends? Just trying to think about lapping the destock cycle.

A - Frank A. Bozich
So I would say in general, we would see low single-digit demand improvement is the signal we're getting across the portfolio. So some improvement, but not as Hassan asks, a recovery. So low single-digit demand improvement and it varies by specific segment when that'll kick in. That's how I would think about it and how we're thinking about it right now.

Q - Laurence Alexander
And then just lastly on the recycled polycarbonate, you made a comment if I heard properly that will actually be cheaper than virgin polycarbonate. Is there a kind of structural gap, like a rule of thumb, as to just how much of an advantage you should have? And do your customers expect you to sort of split that with them so that they get a cheaper product? Or are they telling you that they would be willing to pay a premium like we see in other plastics and then you just get a healthier margin?

A - Frank A. Bozich
I would say in general, we enjoy a premium in the recycled product based on the significant demand in many of our value chains for that type of product, for helping our customers achieve their recycling and circularity goals. So I would expect to get a healthy return on these technologies as we market those back to our customers.

From a cost standpoint, it will all depend on what feed we begin with. And I think what we tried to explain and what's unique about our technology is, we can take a mixed stream that would contain colors, other types of materials like metal, glass, or other plastics, and we can extract the polycarbonate polymer from that and get to an almost purified virgin quality polycarbonate. So depending on the cost to secure that feedstock, which in mixed waste these are largely very inexpensive or have previously been landfilled, so we would expect to be able to produce at scale a lower cost than virgin.

It's difficult to quantify because it will all depend on what partnership we have with our end customer. And let me give you an example. So we could take headlamps that are waste scrapped by our customer. It might be end of life or could be low-quality or off-grade from their production, and we can recycle it and return that material to them.

Same thing, we think about an interior door panel from a car company. We actually have taken byproduct or scrapped door panels from our existing customers and recycled it and delivered back to them the polycarbonate that we've recycled and they've made virgin door panels that meet their quality requirements. We've done the same thing in consumer electronics.

We've yet to see the full potential of it, but we're very excited about it and early indications are that we have a significant demand from our customer base, and they're excited about partnering with us.

Operator
Thank you. And ladies and gentlemen, that will conclude our question-and-answer session this morning. And we will bring us to the end of this morning's conference call. Again, we'd like to thank you all so much for joining the Trinseo third quarter 2023 financial results conference call, and wish you all a great day. Goodbye.