Trinseo Fourth 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 Begleiter
- Frank Mitsch
- Hassan Ahmed
- Laurence Alexander
- Matthew Blair

Presentation

Operator introduction

Good morning, ladies and gentlemen, and welcome to the Trinseo Fourth Quarter 2023 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 Monday, February 12. 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. Please go ahead.

Andy Myers

Thank you, Audra, 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 February 13, 2025.

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

Frank A. Bozich

Thanks, Andy, and welcome to our year-end 2023 earnings call. Although this was arguably the most challenging year in our company's history and one of the most difficult in recent memory for the chemical industry, I'm proud of what we accomplished during the year to improve our cost position and strengthen our market position when global markets normalize.

While unprecedented customer destocking, competitive pressure from imports into Europe and weak market demand persisted throughout the year, we didn't sit idle. We took decisive action on items within our control to liberate cash, improve profitability and extend our near-term maturities to provide ample runway for the continued shift of our portfolio.

In the second half of 2023, we announced a series of additional restructuring actions, including the closure of our styrene facility in Terneuzen, the Netherlands, the consolidation of operations across our PMMA cast and extruded sheet network in Europe, as well as other cost savings measures.

In addition, we structurally reduced our working capital days to further preserve cash, and we expect to improve on these lower levels. We also successfully refinanced $1.1 billion in near-term maturities until 2028, which will allow us to continue advancing our market-leading sustainability programs. These actions helped us generate positive free cash flow for the year despite the macroeconomic challenges we faced, resulting in $47 million of year-over-year increase in cash on our balance sheet.

Regarding our sustainability investments, I would like to point out that we have remained focused on advancing our sustainability initiatives and working toward our 2030 sustainability goals. Through continued investment and significant advancements made in recycling over the past year, we are becoming a larger contributor to the circular economy. We have commenced full operation at our polycarbonate dissolution pilot facility in Terneuzen, the Netherlands, and recently announced the inauguration of our PMMA depolymerization plant in Rho, Italy, which is on track to be commissioned later this quarter. Once operational, this facility will be able to recycle a broad range of PMMA waste, including end-of-life PMMA, by reducing it back to its constituent monomer, MMA.

These recycled monomers can then be used to produce PMMA resins, sheets and compounds containing recycled materials that will match the quality of virgin materials. In summary, this depolymerization facility will help promote a circular plastics value chain without compromising quality or performance.

I'm also happy to report the sales of our recycled-content-containing products were up 16% year-over-year, and we expect continued growth as our recycling operations mature and we continue to develop new sustainable solutions for our customers for these high-demand offerings.

Additionally, our specialty and sustainable solutions technologies, which include most of our formulated technologies in Engineered Materials, such as Rigid Compounds, PMMA Resins, Continuous PMMA Sheets, and TPEs, as well as CASE and Battery applications in Latex Binders, continue to see stable margins and experience less volume decline than our commodity applications.

From an EHS standpoint, I'm happy to share that 72% of our eligible sites received our Triple Zero Award this year, meaning the site achieved no injuries, spills, or process safety events. This is a testament to the diligence that our people work with on a daily basis, and I'm extremely proud of this industry leading EHS performance.

Now I'd like to take a few minutes to provide an update on our fourth quarter results. As we expected, adjusted EBITDA was sequentially lower than Q3, as year-end customer inventory management and destocking led to a more pronounced seasonality than usual. We saw this dynamic throughout our value chains, but most predominantly in building and construction, appliances, and consumer durable applications. However, we've already seen volume recovery early in the first quarter and expect sequentially better results, which I'll discuss later.

Now I'd like to turn the call over to Dave to discuss our fourth quarter and full year results.

David Stasse

Thanks, Frank. Fourth quarter adjusted EBITDA was below our expectations due to pronounced seasonality and destocking as well as $9 million of unfavorable impacts from natural gas hedges. However, we expect a significant rebound in Q1, which Frank will discuss in more detail.

Our full-year adjusted EBITDA results included unfavorable impacts of $51 million from natural gas hedges, $20 million from net timing, and $13 million from fixed cost under-absorption related to our actions to reduce inventory. Despite the challenging macroeconomic environment that we endured throughout the year, we generated cash from operations of $149 million and free cash flow of $79 million in 2023, which reflects the significant efforts by our organization to manage CapEx and working capital very tightly, realizing the benefits of our ERP and supply chain investments.

We released $250 million of working capital in 2023, and about two-thirds of that is a structural reduction in days that we believe we can keep when market conditions improve. For the full year in 2024, we will continue to maintain a very disciplined cash focus with lower than historical CapEx of about $70 million, as well as further progress in reducing our working capital days. While we expect a working capital release for the year, please keep in mind that working capital is likely to increase in Q1 due to seasonality.

We ended 2023 with $259 million of cash and $471 million of liquidity including our undrawn bank facilities. While we are comfortable with our cash and liquidity levels heading into 2024, we remain highly focused on opportunities that prioritize liquidity and profitability improvement while exercising disciplined working capital management.

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

Frank A. Bozich

Thanks, Dave. So far to begin the year, we're seeing sequentially higher volumes in Q1 due to customer orders reflecting underlying market demand levels following the strict inventory management that we saw at the end of 2023. We're also beginning to recover volumes in Europe that had been taken by imports from Asia. Additionally, starting in Q1, we expect to see the full benefit of the restructuring initiatives that we took in the second half of last year, as well as much lower natural gas hedge losses.

As a result, we expect Q1 profitability to be significantly higher than Q4, with adjusted EBITDA of about $40 million to $50 million. We view first quarter profitability as the low point of the year due to turnaround activity in the first quarter, seasonally lower volumes, non-recurring costs in Q1, and growth from new business awards that phase in later in the year. In addition, we're currently seeing higher input costs in several segments related to Red Sea shipping surcharges that we expect to fully recover in our prices in Q2.

Please note that we don't believe these higher sequential Q1 volumes represent a broad underlying market recovery, and for the full year we currently anticipate underlying market demand to remain constrained and generally in line with 2023. Despite this, we expect higher volumes in our more specialty businesses as we recover share against Asian imports due to moderating costs in Europe, and as we win new business in our target applications.

In addition, we expect significantly higher profitability in 2024 as the restructuring actions we've taken, combined with expected lower natural gas hedge losses, are expected to contribute approximately $100 million of sequential benefit. While we anticipate the logistics cost increase related to the Red Sea shipping crisis may help reduce cost differential between our European products and imports from Asia, it's difficult to determine the impact of this at this time. Along with this, we have additional network optimization opportunities in Europe that we continue to explore, which we hope to benefit from later in 2024.

I want to be clear that our strategy remains unchanged. Since the second half of 2022, our company has faced unprecedented challenges marked by persistent customer destocking throughout our value chains, along with geopolitical conflicts that have significantly impacted trade flows and the competitiveness of European chemical production.

Amid this environment, we took decisive actions to increase our manufacturing network flexibility, which enables us to take advantage of regional cost differences while reducing capital expenditures and optimizing working capital, and we will continue to assess additional opportunities. In fact, since 2022, we have reduced fixed costs by over $70 million while also offsetting inflation. These actions have improved profitability and cash flow, allowing us to continue investing in higher value product offerings and sustainable solutions, and to be in a better position when demand returns to normalized levels.

Lastly, I want to take a moment to thank our employees across the globe for their relentless efforts in 2023, and for the dedication to our transformation strategy as we continue to navigate this difficult macroeconomic environment.

And now, we're happy to take your questions.

Questions and Answers

Operator
Thank you. (Operator Instructions) We'll take our first question from Frank Mitsch at Fermium Research.

Q - Frank Mitsch
Hey, good morning. Frank, as we're sitting here in the middle of February, you indicated that you're seeing sequentially higher volumes so far relative to the fourth quarter. And you also mentioned you're getting a volume benefit in Europe due to less imports coming out of Asia. Can you be more granular in terms of the end markets that you're seeing those impacts?

A - Frank A. Bozich
I would say it's mainly in our specialty business applications in Europe; automotive, some of the building and construction applications, and some of the consumer products applications is where we're seeing those volumes come back. But look, for the first time in 20 months in January, we saw year-over-year volume increases, and the order book in February looks similar.

So, I would say, it's clear two months don't make a trend, and I would say it's too early to tell if this reflects the end of destocking or some of this is from orders that shifted from Q4 to Q1. But again, it's significantly better than Q4, but difficult to say that it's a trend.

Q - Frank Mitsch
Okay. All right. That's helpful. And if I look at your Slide 13 where you list all the puts and takes in terms of cash flow components, that nets to about $300 million cash outlay in 2024. So how are you thinking about your ability to progress through the year, based on your profitability levels in terms of will you have to drawdown cash, will you have to borrow cash or your expectation on profitability will more than exceed those puts and takes on cash from operations? I know it's kind of early in the year to forecast that with the uncertain economic background, but I'm just curious how you're thinking about the cash generation or cash burn in '24?

A - David Stasse
Hi. Good morning, Frank. It's Dave, I'll answer that. So, you're right, we have a page in our Slide deck, 13, that shows our cash flow components for the year and included in that is an estimated working capital benefit of $50 million, and we've got actions identified and already underway to realize that. So, I'm confident we're going to be able to achieve that working capital release again in 2024.

So nonetheless, all that adds up to about $300 million of cash outlays. You'll notice, obviously, that we're not giving annual guidance on this call because of the degree of uncertainty and the pretty significant lift in volume that we've seen, we need to see if that persists or not. But to the extent our EBITDA for the year is higher or lower than $300 million that would be the positive or negative free cash flow for the year.

Now, what I would say related to drawing on lines, if we ended the year with $260 million of cash on the balance sheet, and we do have undrawn lines behind that for a total of almost $500 million of liquidity, we've not drawn on any of our lines. I don't expect to need to with what we generate this year. I think we have plenty of cash on the balance sheet. If we do in fact have a negative free cash flow year this year, I would expect us to finance that with cash off the balance sheet and not drawing on lines.

Q - Frank Mitsch
Sounds good. Just lastly, what is the kind of minimum cash level you feel comfortable with having on the balance sheet to run the company?

A - David Stasse
Look, the way I would define that minimum level, first of all, is how much cash you need to weather intra-month working capital swings, ups and downs. And I'd say that's probably about $100 million.

Q - Frank Mitsch

Very helpful. Thanks so much.

A - David Stasse
Okay. Thank you, Frank.

Operator
We'll take our next question from David Begleiter at Deutsche Bank.

Q - David Begleiter
Thank you. Good morning. Frank and Dave, you talked about Q1 being a low point of the year for a number of reasons. How should we think about the ramp to Q2?

A - Frank A. Bozich
In terms of what elements will contribute to a buildup in Q2, I would say the drivers for that are normal seasonality in building and construction. We would always see those applications' volumes improve in those end markets.

The other significant impact that will go away in Q1 is that the AmSty turnaround is going to be over in Q1, and so we'll have a full benefit of AmSty's earnings contributions in Q2. And then we'll see mid-single-digit million per quarter EBITDA contributions from new business awards that will phase in, in subsequent quarters. I can't predict exactly what it'll be Q2 to Q3, but I would expect it to be mid-single-digit contributions from those.

The other thing that we're seeing that's somewhat depressing Q1 relative to what we expect in Q2 is the freight surcharges that we're seeing related to raw materials that we source from Asia now are a couple hundred dollars a ton higher due to freight. That's mainly in our Plastics Solutions value chain and we expect to recover that in pricing beginning in Q2 if it still persists.

Q - David Begleiter
Very good. You mentioned this, again, $100 million in cost improvement, including natural gas hedge losses in 2024. What's the potential that number to be higher than the $100 million you've forecasted?

A - Frank A. Bozich
Can you just repeat the question? What's the potential for the savings associated with all the restructuring to be higher than $100 million? Is that the question?

Q - David Begleiter
Correct. Yes.

A - Frank A. Bozich
Okay.

A - David Stasse
Yes. I'll try and take a stab at that, Dave. Look, I think the largest contributor of that $100 million is obviously shutting down the styrene facilities. And I wanted to say this on this call, just Dave, you've been following us since we've been public, in almost that entire duration since we've been public, a large part of our identity has been a styrene producer, so we've been long styrene. We're the opposite now, we're short styrene. We're a buyer of styrene for our downstream businesses. So what would lead to that number being higher is a more depressed styrene market.

So we're no longer producing styrene, we're buying it. If we were producing it now, we would have significant losses as our other European styrene producers have as we speak. So, kind of in a perverse way, a worsening environment would result in that $100 million being higher, because we would benefit from lower styrene pricing now. That kind of environment would be apt to have maybe a negative environment elsewhere in the business, but look, I'm very comfortable on the $100 million number. Starting in Q1, we no longer have a feedstock segment, but if we did and we were producing it would be significantly negative.

A - Frank A. Bozich
Yes, let me just add one thing. I said this in my prepared remarks, but we have additional opportunities that we continue to evaluate that we would expect if we implement those and move forward that they would accrue in the latter part of the year. And so again, our significant market opportunities take advantage of inter-regional cost differences and change our supply chain and flex the network and we will continue to evaluate those. So those could be additive to the $100 million also.

Q - David Begleiter
Thank you.

Operator
We'll take our next question from Matthew Blair at TPH.

Q - Matthew Blair
Hey, good morning. I was wondering if there's any update on the styrene sale process, the styrenics sale process, and is that something that could happen in 2024?

A - Frank A. Bozich
So we don't really have an update. I would say there's nothing imminent. We continue to field questions about and field interest on specific assets, but nothing is imminent.

Q - Matthew Blair
Okay. And then I was hoping you could help us just a little bit more with the bridge from the $20 million in Q4 to $40 million to $50 million in Q1. It sounds like some of the specialty volumes are picking up a little bit. Are you seeing margin improvement anywhere? And then also, do you expect to roll off any of the natural gas headwinds or net timing benefits into Q1?

A - Frank A. Bozich
There's three elements that are driving the improvement from Q4 to Q1, and number one is volume. Number two is the full benefit of the restructuring activities, and the third thing I would say is, we did have a turnaround in our EM business at our biggest resin plant in Bristol had an extended turnaround in Q4, and that's behind us now. So those are the drivers; volume, the restructuring benefit, and the turnaround. As it relates to natural gas, Dave can comment.

A - David Stasse
Yes. Matthew, as it relates to the natural gas hedges, there was a $9 million loss in Q4, and it's going to be about a $5 million loss in Q1. I expect to not really be talking about that anymore. There was a significant number in 2023, and for the full year 2024 it's going to be about $10

million. And as I said, $4 million or $5 million of that is going to be in Q1 and then it falls off. So there is a sequential pickup of four there.

Q - Matthew Blair
Great. Thank you very much.

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

Q - Hassan Ahmed
Good morning, Frank and Dave. Look, I obviously understand that you guys aren't giving full-year 2024 guidance with all the uncertainties and macro issues and the like. But again, back in Q3, you guys were alluding to somewhat of a bridge to 2024 in terms of all the controllables, right? And you alluded to the restructuring benefits, the benefits from the Terneuzen side of things. Restructuring was call it $100 million, net timing was another $16 million tailwind, and Terneuzen was around $60 million, so call it $175 million of tailwinds.

Now if I tack that on to, even the low point, call it annualized Q4 EBITDA of $80 million, I come up with a number which is $250 million to $260 million for 2024. But if I were to then get a little more aggressive, annualize your Q1 guidance, we're well north of $300 million. How are you thinking about at least the floor for 2024 EBITDA?

A - Frank A. Bozich
Look, maybe let me start with what's changed since Q3 and what we're seeing in the markets, because, sitting here today, I don't think we can look at Q3 as a reference and build off of that. The reason is that we've seen a significant margin deterioration in polycarbonate, ABS, and polystyrene. What those chemistries all have in common is a significant overhanging capacity in China, and absent some market recovery in China, I don't really expect to see margins at the Q3 levels in the near-term.

And I would say, frankly, this is very consistent with the views expressed by all of our industry peers. And I would just give you an anecdote. I spent the last two weeks in Asia visiting clients across our value chains, and what I would tell you in general is that all of our Chinese customers are of a view that there will be no domestic demand growth in their business in 2024. And the growth that they can expect and they're planning for is due to exports into Europe, which is the highest cost region.

So, I think that's what's changed and why we're reluctant at this point to provide any certainty about the full-year 2024. There are just too many moving parts in how China will develop and some of the other costs will develop. However, that being said, there are opportunities for us to continue flexing the network and to take advantage of regional cost arbitrage as well as reduce fixed costs, and that's what we're focused on what's in our control.

Q - Hassan Ahmed
Understood. Understood. And let me take another stab at the market environment, right? Particularly as it pertains to, call it, seasonality, inventory levels and the like. I mean, in terms of your Q4 results and the weakness over there, you guys talked about pronounced seasonality particularly in Asia and Europe, right? Which kind of surprised me a little bit keeping in mind, how severe the "destock" has been, right? I mean, as I sort of sit there and listen to some of the other companies, some of the other companies are talking about the lack of seasonality in Q4

because of how destocking started, call it, in the back half of 2022 and carried on through most of 2023.

So, what I'm trying to understand is, what on the inventory side and the demand side is cyclical versus secular, right? I think that coming out of the lockdowns, with COVID and the like, maybe people overbought. Have buying patterns, with China the way it's looking and with Europe the way it's looking, have buying patterns at least for the foreseeable future changed relative to history?

A - Frank A. Bozich
I think the simple answer is yes, and in particular in Europe. And what I would say is in Asia in general, what we're seeing is consumer behavior changing significantly and that changing buyer patterns as it relates to building and construction applications, as well as consumer durables, in particular in those two areas.

And against that backdrop of lower consumer demand, you have continued capacity additions in Asia in some of these chemistries. So, I do think demand patterns and demand has certainly changed over the past several quarters, to answer the question simply.

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

A - Frank A. Bozich
Sure.

Operator
We'll take our next question from Laurence Alexander at Jefferies.

Q - Laurence Alexander
Good morning. Two quick ones. First, can you characterize the mix effects you're seeing as volumes start to improve? Are your higher margin products rebounding first, or should we expect as we go into Q2 and Q3 a bit of a drag on mix?

A - Frank A. Bozich
So, we are seeing the more formulated solutions being more resilient and the volume improvement being more significant in those than in the more commodity, base polymer type products. So, the simple answer is yes.

Q - Laurence Alexander
And secondly, now that you're seeing sort of markets revert to baseload demand, can you give a sense for just how much of the volume hit in retrospect was just the destock? So, if your volumes were down 7%, is the kind of new run rate down 3% year-over-year? Can you give some sense so we can try and think about what the cadence of the bounce may be, just to adjust from the destocking environment to the underlying demand environment?

A - Frank A. Bozich
Well, this goes back to the question that David asked, or Frank, I can't recall. Right now, it's difficult to pinpoint that, because in the first two months of the quarter, we're seeing a solid volume improvement after a very low volume in Q4. So, it's difficult for us to unpack how much of that is actually volume shift from Q4 into Q1 and do the arithmetic that you're looking for. I think we need to get through Q1, or begin to see March orders, and then we'll be able to see

more effectively, when we see the Q2 order book begin to develop, we'll have a better understanding of what that is.

Q - Laurence Alexander
Okay. Great. Thank you.

Operator
And this concludes today's question-and-answer session and today's conference call. Thank you for your participation. You may now disconnect.