Trinseo First Quarter 2024 Earnings Call

Company Participants

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

Other Participants

- David Begleiter
- Ed Brucker
- Hassan Ahmed
- Kevin Estok
- Matthew Blair
- Roger Spitz

Presentation

Operator introduction

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

I will now hand the call over to Andy Myers.

Andy Myers

Thank you, Rob, 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 first quarter 2024 earnings call. Let me begin by saying how encouraged I am with how the first quarter progressed and how the second quarter has begun, as profitability improved steadily over that period. The initial strength in volumes that we saw in January and February continued through March, resulting in our first year-over-year volume increase in two years, and our highest volume quarter since Q3 2022.

Additionally, we believe destocking in some of our value chains has ended. Market tightness resulted in significant margin expansion in Engineered Materials and Americas Styrenics as the quarter progressed, resulting in over half of our quarterly Adjusted EBITDA coming in the month of March. We see this higher profitability continuing into Q2.

The higher profitability that we saw in March was from several factors. We saw margin expansion in MMA as a result of supply tightness that drove March MMA prices significantly higher in Europe while costs have moderated. Weakness in epoxy, nylon, and polycarbonate value chains in Asia led to reduced byproduct feedstock availability for MMA producers in that region. This dynamic, along with ongoing geopolitical tensions in the Red Sea, resulted in lower quantities of MMA shipped into Europe from Asia during the quarter, and we are seeing this continue into the second quarter. We are also seeing demand for architectural coatings and various polymer additives beginning to pick up following a period of prolonged destocking, which is further tightening the MMA market in Europe and is supportive of continued higher margins in the segment.

In North America, low acetone availability led to MMA and downstream PMMA supply tightness, resulting in higher integrated margins in the region.

Additionally, Americas Styrenics had a major turnaround at its large styrene facility in January and February and returned to production in March. Styrene supply tightness due to several industry outages, combined with low inventory levels, led to significantly higher styrene prices and margin expansion at AmSty, and we are seeing this continue into the second quarter.

While we are happy to see the improved earnings profile, increasing styrene and MMA prices exacerbated the typical first quarter seasonal working capital build, and rising spot styrene

prices negatively impacted Polystyrene, ABS and Latex Binders margins, by way of higher input costs.

I'd like to shift gears for a few minutes to discuss several actions that we took during the quarter to continue advancing our transformation strategy and optimizing our business. In March, we announced the commencement of the sale process for our interest in Americas Styrenics via the initiation of an ownership exit provision in the joint venture agreement. This process provides us with a clear pathway to divest our interest in AmSty, and we expect it to lead to a definitive agreement no later than early 2025. The proceeds will be used to pay down our highest cost debt, helping to lower our annual interest burden, which will be beneficial to future cash flows.

Also in March, we announced that we engaged the local Works Council in Germany regarding the potential closure of the remaining virgin polycarbonate production line at our Stade, Germany facility. While decisions like these are never easy, continued soft demand and price declines due to oversupply, along with significant fixed operating costs in Stade, have strained the financial viability of the site. We do not expect these challenging conditions to abate any time soon as capacity additions in Asia continue to drive down price and make operating this chemistry in Europe more difficult. If approved, we will no longer produce virgin polycarbonate and will obtain all of our polycarbonate needs for our downstream businesses via external purchases and recycling. While difficult, this decision is in line with our continued focus on continuous network evaluation and optimization, and we expect it will increase annual profitability by $15 million to $20 million compared to our 2023 results.

I also want to be clear that any decision to close the virgin polycarbonate production site in Stade will not impact our commitment to advancing our polycarbonate dissolution technology that we discussed at length in our third quarter 2023 earnings call. While Stade was previously mentioned as a potential location to bring this technology up to commercial scale, we are now exploring numerous alternative locations that could host our recycling assets. We remain committed to the integration and application of modern recycling technologies to help customers develop more sustainable product offerings, and this potential closure does not change that commitment. We continue to see excellent demand for our products that contain recycled material, with a record amount sold in the first quarter, which represents a 65% increase over the prior year.

In addition to our focus on products containing recycled material, we continue to work on other sustainably advantaged product offerings. We recently introduced flame retardant polycarbonate and PC/ABS compounds that are manufactured without the use of PFAS and will primarily be used in consumer electronics applications. PFAS chemicals, which have faced growing regulatory and consumer pressure to be reduced, are commonly used for their flame-retardant properties, as well as their resistance to heat, oil, grease, and water. These new

products maintain those critical performance attributes and use post-consumer recycled substrates but replace PFAS with other flame-retardant chemicals.

Now I'd like to turn the call over to Dave to discuss our first quarter results.

David Stasse

Thank you, Frank. Before I get into the first quarter results, I'd like to call your attention to a change in our segment reporting structure that became effective at the beginning of this year. As we have previously discussed, following the closure of our styrene production facility in Terneuzen, we no longer produce styrene and therefore no longer have a Feedstocks reporting segment. As a result, we have recast the 2022 and 2023 net sales and Adjusted EBITDA of the Feedstocks segment into the downstream segments that consumed styrene, which are Latex Binders, Plastics Solutions and Polystyrene. We have included segment results with and without this recast in the earnings presentation Appendix.

Turning back to the results, first quarter Adjusted EBITDA of $45 million was in line with our previous guidance but included $13 million of favorable net timing from rising styrene prices.

The European spot styrene price increased by about 60% in the first quarter due to planned and unplanned industry outages. In this environment, we generally will have favorable net timing and a working capital build. Conversely, when styrene declines, as we expect in late Q2 into Q3, we generally will have unfavorable net timing and a working capital release. Throughout this period, however, our underlying EBITDA ex. timing is generally unchanged as Americas Styrenics benefits in periods of styrene tightness and our Polystyrene, Plastics Solutions, and Latex Binders segments have a roughly equal and opposite effect, as they are net buyers of styrene.

Cash used in operations during the quarter was $66 million, which resulted in free cash flow of negative $82 million. This included a $61 million increase in trade working capital. Historically, the first quarter of the year includes a working capital build due to seasonal factors. However, this year's build was amplified because of the significant increase in styrene prices that I just spoke about. We expect Q1 to be the lowest free cash flow quarter of the year as our earnings improve and as our working capital normalizes from lower feedstock prices.

We ended the quarter with $171 million of cash and $423 million of liquidity including our undrawn bank facilities. We enhanced our overall liquidity by extending the maturity on our Accounts Receivable Securitization Facility by one year to November 2025, and by including new subsidiaries in the facility that helped increase the available borrowing capacity by $36 million quarter-over-quarter. Additionally, we are taking other actions such as proactively moderating lower margin sales to conserve working capital with only a nominal impact on earnings. Liquidity preservation is and will continue to be our top priority as we navigate this cycle downturn.

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

Frank A. Bozich

Thanks, Dave. I am happy to report that we are seeing the positive earnings momentum from the end of the first quarter continue into the second quarter. Tightness in the styrene and MMA markets support a continuation of the higher margins that we experienced in the latter part of Q1. This, combined with AmSty's return to normal styrene operation and seasonal increases in high margin building & construction and consumer electronics sales, gives us confidence in a meaningful sequential profitability improvement in the second quarter. As a result, we expect Q2 Adjusted EBITDA of $60 to $75 million, including approximately $5 - $10 million of negative timing.

Consistent with the outlook we provided last quarter, we still expect Q1 profitability to be the low point of the year. Our base assumption is that demand remains constrained throughout 2024, but EBITDA will be stronger due to tighter markets from destocked supply chains and the restructuring actions that we've taken.

While our first quarter results and second quarter outlook are certainly promising, we remain in one of the most challenging times for the chemical industry in several decades. I am confident that the cost actions we have taken, combined with our focus on prioritizing liquidity while improving our sustainable and differentiated materials capabilities, will have us well-positioned to rise out of this cycle when demand returns to more normal levels.

And now we're happy to take your questions.

Questions and Answers

Operator
Thank you. (Operator Instructions) Your first question comes from the line of David Begleiter from Deutsche Bank. Your line is open.

Q - David Begleiter
Thank you. Good morning. Frank, nice comeback or recovery in Engineered Materials, you looked at Q2 with the strength continuing. How are you thinking about EBITDA and earnings potential in Engineered Materials in Q2 here?

A - Frank Bozich
So we would expect Engineered Materials to be above $20 million EBITDA in Q2. It is at that run rate in March and April, and we don't see the dynamic changing in any way. These are the things that we're really acutely watching from a market standpoint. We're watching what's happening in the polycarbonate, epoxy, and nylon value chains in Asia because those value chains being depressed really constrains the byproduct feedstocks that go into MMA in that region.

Then we're also watching the Red Sea. So there are certain dynamics that are out of our control that are influencing the current short-knit tightness in North America and Europe, but we don't see any signs right now that would change that dynamic. But the other thing I'm happy to say is that the volume improvement we're seeing in MMA really cuts across all of the segments. MMA volumes are certainly up, but we're also seeing good volume improvement and a good order

book in resin and our surfaces business, as well as rigid compounds that go into consumer electronics as we enter Q2.

Q - David Begleiter
Very good. And given that strong level of earnings in Q2, can you actually grow earnings from that level in the back half the year, i.e., $20 million per quarter or higher?

A - Frank Bozich
Well it all really depends on the underlying market demand. Right now we don't anticipate a significant change in market demand. We are winning some new awards, but our outlook in the back half of the year really depends on how the markets develop, so difficult to say at this point. That's why we've neglected to give full year guidance because it's just difficult to say how the markets will develop.

Q - David Begleiter
Understood. Thank you very much.

A - Frank Bozich
Thank you, David.

Operator
Your next question is from the line of Matthew Blair from TPH. Your line is open.

Q - Matthew Blair
Thank you. And good morning. I had a few questions on AmSty. First, are you able to quantify the impact of the turnaround in Q1? What would that $6 million have looked like if you were not in turnaround? Two, what kind of interest are you seeing in marketing the AmSty JV? Then three, could you explain a little bit more about this ownership exit provision? What exactly would happen in early 2025? Would the other half go back to the other counterparty CP Chem?

A - Frank Bozich
So let me take the back half of that question, then I'll let Dave take the first part of it. We've seen indications of interest from a number of strategics and financial parties in the AmSty asset when we signaled that we would be using this prescriptive JV exit provision. But we haven't begun actively marketing the asset jointly with our joint venture partner at this point. But I can say that it's a great asset, it's recognized as one of the best Styrenics assets in the world. So I'm confident we will see interest in a good process when that begins. The JV exit provisions that are defined under the JV agreement have a number of steps. We're working through those steps. Ultimately, those steps result in a joint marketing of the asset.

There's certain prescriptive elements we need to complete before we get to that point, and we're in the process of doing that. But again, even if those preliminary steps are fully exhausted, we're very confident that this will result in a signing of a transaction by early 2025.

A - David Stasse

Matthew, related to the first part of your question, the impact to us of the AmSty outage, they were out for substantially all of January and February for a planned outage. They have two styrene units, and each one turns around every 3 to 4 years so they often have these turnarounds in the first quarter. The impact to our earnings in the first quarter of this year was probably high single digits, $8 million or so I'd say, from the turnaround. The reason it's that low is because styrene prices and margins really didn't accelerate until March, and they were up in March. As you can see, I think we had $6 million of EBITDA in the quarter, and all of that was in March.

As we look forward to Q2, we obviously expect considerably better results. I think our equity income from AmSty will probably be $20 million or higher in the second quarter because of the high margins that we continue to see. But related to styrene, kind of a tangential point I'll just say is these outages are starting to end as units are coming back online as we speak that are out. We do expect a fairly significant decline in styrene prices late in Q2 and into Q3. The working capital benefit for us associated with that will probably be a Q3 item for us. We obviously, for liquidity purposes, look forward to that.

Q - Matthew Blair
Sounds good. Then, are there any net timing inclusions in your Q2 guidance? We did see European styrene contracts in May come down, although the Q2 average is still well above Q1. So if you could help us think about the potential net timing impact in Q2, that'd be great.

A - David Stasse
Yeah, so embedded in the guidance range that we gave, Matthew, that Frank mentioned on the call of $60 million to $75 million, embedded in that we believe net timing will be negative $5 million to negative $10 million in the quarter. So that's embedded in the guidance. The working capital, as that works its way through your balance sheet there's a month or two lag, really, between the P&L impact and the recognition on your balance sheet of the lower working capital. So that's why I said the working capital benefit would probably be in Q3, but the P&L impact in Q2.

Q - Matthew Blair
Great. Thank you.

Operator
Your next question comes from the line of Hassan Ahmed from Alembic Global Advisors. Your line is open.

Q - Hassan Ahmed
Good morning, Frank and Dave. I know it's early days and some positive sort of demand signs emerging and I understand the sort of sensitivities around maybe not really sort of divulging a 2024 guidance. But I mean look, you guys did around $154 million in EBITDA in 2023, right? And from the sounds of it, the restructuring benefits certainly seem to be run rating at levels above $100 million, right? So I mean straight up, that's north of $250 million for 2024 EBITDA without even sort of factoring in some of these demand improvements that you guys are talking about and seeing. Am I sort of thinking about things the right way as it pertains to '24?

A - Frank Bozich
Yes, so thanks, Hassan. Look, I think what we've assumed is that year-over-year volume growth is going to be in the low single-digit range for the remainder of the year, and the volume dynamic will be similar to 2023, but we are confident we'll deliver the $100 million in year-over-year improvement that we anticipated. Will we get it exactly in the same buckets that we thought we would? Probably not, but I think we're confident in the $100 million and we're encouraged by the start of the year, but very difficult to anticipate how the second half of the year and the market demand will develop during the second half of the year. So, I would just leave it at that.

A - David Stasse
Hassan, let me add a couple of things to that, if you will, please. In Q1, we clearly had a step up in volume. Our volumes were up sequentially about 12% in the first quarter versus the fourth quarter, and that was very broad-based and in all segments. But on a year-over-year basis, it's up about 1%, so I'd attribute most of the Q4 to Q1 transition to seasonality. So as Frank said, I think we're very comfortable with delivering the $100 million, even in a low-growth environment like we've assumed. We're managing the business based on the assumption that we continue to have constrained growth and low single-digit year-over-year growth.

We're clearly not going to build any inventory for growth unless we see clear signs in the order book that that growth is there. I just wanted to give you that color. Everything we're talking about here for Q2 numbers is not really a demand recovery we're seeing yet, it's more of a margin recovery.

Q - Hassan Ahmed
Very helpful. And as a follow-up, on the MMA side of things, can you talk a bit about what you guys are seeing in terms of trade patterns over there? Because I know a couple of quarters ago, we were all sort of seeing that arbitrage opportunity between sort of MMA out in Asia and Europe, and you guys were sort of talking about more and more Asian products that are going into Europe. So, if you could just talk a bit about whether sort of those trade patterns have normalized, and that arbitrage opportunity is closed.

A - Frank Bozich
It's certainly reduced and the Red Sea crisis as well as the extended lead times from Asia into Europe have reduced the ability to ship this reactive monomer from Asia. But more importantly, the weakness in epoxy, polycarbonate, and nylon demand in China really constrains phenol production, which the byproduct of phenol production is acetone, which is a key building block for MMA via the C3 route, and it also affects hydrogen cyanide. HCN is one of the byproducts in the nylon chain, so that availability is reduced.

We also are seeing butadiene C4 production significantly reduced in Asia because of the slowness in that market. So these factors are constraining the ability of the Chinese MMA production, and so they are actually running at greatly reduced rates. So, the combination of those two things are creating the current dynamic.

Now while things are better and we see slight improvements, or signals of improvement, in China broadly, those specific value chains we see as currently still challenged, and we don't anticipate a significant change in that. If you look at Europe and North America, those markets for MMA are net short currently. You see a recovery in architectural coatings that have tightened the market up, so those factors combined have made it a much higher margin MMA market. We have obviously benefited from that. I hope that's helpful.

Q - Hassan Ahmed
Very much so. Thank you, so much, Frank, and thanks again Dave.

A - Frank Bozich
Thanks Hassan.

Operator
Your next question comes from the line of Kevin Estok from Jefferies. Your line is open.

Q - Kevin Estok
Hi. Thank you for taking my questions. I guess my first question just has to do with mix. I'm just curious how you would characterize that as volumes sort of rise, would your mix improve and would you benefit from basically higher margin product sales, or would you expect there to be a drag on mix? Just wanted to get some sense of how it would evolve in Q2 and Q3. Thank you.

A - Frank Bozich
Sure, yeah great question. So, while we anticipate a low-single digit volume improvement year-over-year in 2024, we do see a much more favorable mix, so EM growth will be better than the broader portfolio. EM resins, our rigid compounds in Engineered Materials that go into consumer electronics, as well as our surfaces business, which are our highest margin applications in the company, will grow faster than low-single digits. In our lowest growth area, actually, we are seeing negative growth in polystyrene, which would be one of the lower margin applications, so we will enjoy a favorable mix during the course of the year based on the current assumptions that we have.

The other thing I did want to point out is that in Q1, as Dave said, we had a 12% sequential improvement in volume compared to Q4, but also we did see 15% volume growth in Asia Pacific, but all of that was concentrated in paper and board for Latex in Asia. That was really driven by some unique industry events that we don't see continuing.

So those are the things that we are balancing, but yes, favorable mix through the full year with EM applications growing better than the rest of the portfolio.

Q - Kevin Estok
Okay. Got it. Thank you. And apologies if this question has been asked, but my service has been a little spotty on this call. I am just wondering where you are still seeing destocking, I guess in which value chains specifically? Thank you.

A - Frank Bozich

The only place where we would see some signs of destocking is in downstream building and construction related to polystyrene EPS, XPS applications. So those are the only areas where we currently see it in Q1, and that's specific to Europe and North America.

Q - Kevin Estok
Okay. Great. Thank you very much.

Operator
Your next question comes from the line of Ed Brucker from Barclays. Your line is open.

Q - Ed Brucker
Hi. Thanks for the call this morning. My first question is on demand, you mentioned that you are still not near normal levels. I guess how far below normal levels are you still? You could do it broadly or by business. For example, the Engineered Materials business, you said $20 million is your run rate, is that kind of normal demand now or is there upside if we get demand to return?

A - Frank Bozich
In the earnings presentation, there is a pretty good breakdown of the trade volumes by segment. What I would tell you is we are about 20% below the historical run rate volumes for the whole portfolio as it exists today compared to normal demand over the previous cycle, even the previous decade.

What I would tell you too is with the current mix in the portfolio, that for every 10% improvement, that's approximately a $25 million per quarter EBITDA impact, or $100 million per year for every 10% recovery. So, if we get halfway back to normal volumes, we would expect that to deliver an additional $25 million a quarter in EBITDA in aggregate.

Q - Ed Brucker
Got it. That's helpful. Thank you. My second question, the $115 million of the 2025's outstanding, I guess what was the reasoning behind leaving that outstanding? Then what are the plans to address that maturity before it goes current?

A - David Stasse
The reason behind that was for covenant reasons. We did a transaction in September of last year, as you are aware, and the sizing of that transaction was constrained by covenants. So look, we clearly have the cash and liquidity to address that. I don't view it going current necessarily as a constraining factor as to when we need to address that, I mean it also happens to be our lowest cost of debt right now.

Our plans are to either pay it off or refinance it in a transaction. We do have a number of sale processes underway that could bring in incremental proceeds. As Frank mentioned in his prepared remarks, the net proceeds from the AmSty sale would be earmarked to the most recently issued debt, but other asset sales could be used for others. So again, I think we are comfortable with our liquidity and our ability to handle that maturity, but don't feel compelled to do that before it goes current.

Q - Ed Brucker
Got it. And just one last one. I noticed the 8-K for the retention bonus that you put out at the end of February. What was the reasoning behind those retention bonuses?

A - Frank Bozich
We had several members of the team that did exceptional work navigating through the deepest part of the cycle, and at the same time, we wanted to create a strong incentive and recognition and retention for those efforts, and that's what it reflects.

Operator
Your next question comes from the line of Roger Spitz from Bank of America. Your line is open.

Q - Roger Spitz
Thanks very much. Good morning. Regarding AmSty, just to see if I understood correctly, you are saying the preliminary steps you are having to take before you start marking this will likely result in both you and CP Chemical working together to sell all of AmSty. Did I hear that correctly or did I misinterpret that?

A - Frank Bozich
These steps are prescriptive and they are precursory to a joint marketing effort, but it will certainly result in a joint marketing of the asset. It's just we have to go through these prescriptive steps.

Q - Roger Spitz
Got it. But the thinking is AmSty will be sold, both parties will sell their 50% stakes in AmSty, someone is going to be buying all of AmSty, is that correct?

A - Frank Bozich
I am sorry. Can you repeat the question? I missed it.

Q - Roger Spitz
You are going to be marking all of AmSty. Somebody, a potential buyer, will be looking to buy all of AmSty, not just your 50%?

A - Frank Bozich
That is correct.

Q - Roger Spitz
Okay. That's it. Thank you very much.

Operator
And we have now concluded our question and answer session. This concludes today's conference call. We thank you for your participation. You may now disconnect.