Trinseo Third Quarter 2024 Earnings Call

Company Participants

- Bee van Kessel, Senior Vice President of Corporate Finance and Investor Relations
- Frank A. Bozich, President and Chief Executive Officer
- David Stasse, Executive Vice President and Chief Financial Officer

Other Participants

- Frank Mitsch
- Matthew Blair
- Laurence Alexander

Presentation

Operator introduction

Good morning, ladies and gentlemen, and welcome to the Trinseo Third 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 Bee van Kessel, Senior Vice President of Corporate Finance and 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, November 6. 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 Bee van Kessel.

Bee van Kessel

Thank you, Gavin, 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 financial 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 after the conference call. The replay will be available until November 7, 2025.

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

Frank A. Bozich

Thanks Bee, and welcome to our third quarter 2024 earnings call. Before we get to our Q3 results, I would like to introduce everyone to Bee van Kessel, who will be moving back into the Finance organization with responsibility for Investor Relations, Treasury, and Corporate Development. Bee brings a wealth of company and industry knowledge with her, as she most recently served as Senior Vice President leading the Plastics Solutions, Polystyrene and Feedstocks business segments. Prior to that, Bee served as Senior Director of Global Business Finance, where she led the business finance organization for all of Trinseo's reporting segments. I want to thank Andy Myers for his many years leading the Investor Relations group and look forward to continuing to work with him as he takes on other responsibilities within the Finance organization. Andy and Bee will be working closely together over the coming weeks to ensure a smooth transition.

Now I'd like to turn to our Q3 results. As expected, market conditions and Adjusted EBITDA were similar to the prior quarter. MMA supply dynamics and moderating European input costs continued to support healthier margins in our Engineered Materials segment. While demand remained weak in many of our end markets, particularly building and construction and consumer durables, we saw significant year-over-year profitability improvement largely resulting from our earlier restructuring actions. We also had our second consecutive quarter of sequential improvement in free cash flow and anticipate this trend will continue as free cash flow is expected to turn positive in Q4. Our third quarter results were negatively impacted by unplanned outages at two of Americas Styrenics' production facilities during the quarter, which pushed Adjusted EBITDA to the lower end of our guidance range.

While volumes in the quarter decreased 8% year-over-year, this was largely driven by our efforts to shed uneconomic sales in Asia and Europe to optimize plant operations and working capital, particularly in Polystyrene. However, excluding Polystyrene, volumes were basically flat versus prior year while product mix improved as volumes increased in several of our higher margin, targeted growth areas. This includes a 36% increase in compounds for consumer electronics applications in Engineered Materials due to higher demand and new business wins, and a 7% volume increase in CASE and battery applications in Latex Binders. Additionally, sales of recycled-content-containing products increased 40% in Q3 versus prior year and 57% year-to-date, demonstrating our continued focus and the success we are seeing in making sustainable offerings a larger part of our portfolio. In fact, sales of recycled-content-containing products represented 6% of the total company margin in the third quarter.

Now I'd like to discuss several strategic actions that we took during the quarter. As the macroeconomic landscape remains uncertain and demand weakness has persisted, we

continue to take decisive action to improve our footprint and cost structure. At the end of the third quarter, we announced additional restructuring initiatives in order to better position the business for longer-term growth and to reduce our Corporate and functional costs to reflect the smaller footprint we currently operate. This included combining the management of our Engineered Materials, Plastics Solutions and Polystyrene businesses, resulting in workforce reductions from the consolidation of business management roles and support functions. We believe this will result in a more streamlined organizational structure that will fuel our ability to continue growing in our core markets and in our higher value offerings. These actions are expected to result in cost savings of approximately $25 million in 2025 and afull run-rate savings of $30 million by the end of 2026.

We also announced the decision to exit virgin polycarbonate production at our Stade, Germany facility following the discussions with the relevant works councils. Once operations have concluded, we will purchase all of polycarbonate needs for our downstream, differentiated products from external suppliers. As we previously stated, this is expected to increase annual profitability by $15 million to $20 million in comparison to producing virgin polycarbonate. We remain committed to developing and investing in our polycarbonate dissolution technology, which will replace a portion of our external polycarbonate purchases with our own recycled polycarbonate as that technology continues to grow to commercial scale.

Now Dave will discuss our third quarter results.

David Stasse

Thanks, Frank.

Third quarter Adjusted EBITDA of $66 million was $25 million higher than prior year and similar to the second quarter. Year-over-year results improved across all business segments except for Americas Styrenics, which had unplanned outages at two facilities, leading to a $10 million negative impact on equity affiliate income during the quarter.

Cash provided by operations during the quarter was $9 million, which resulted in free cash flow of negative $3 million. This included a $14 million decrease in trade working capital. We expect free cash flow to turn positive and be significantly higher in the fourth quarter due to typical seasonal working capital improvements.

We ended the third quarter with $165 million of cash and $342 million of total liquidity including our two committed financing facilities. Cash preservation and liquidity management continues to be our top priority.

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

Frank A. Bozich

Thanks, Dave.

Looking ahead to the fourth quarter, we expect seasonally slower market demand to result in sequentially lower Adjusted EBITDA. While October volumes are in line with our average for the year, we anticipate a more pronounced year-end seasonality compared to the typical year. However, we expect higher profitability in Q4 compared to prior year due to the benefits of our restructuring initiatives as well as a full quarter of operations at Americas Styrenics. As a result, we expect Q4 Adjusted EBITDA of $40 million to $50 million.

We are pleased how the third quarter evolved in line with our expectations and understand that the fourth quarter will be more challenging due to the year-end seasonality and continued macroeconomic uncertainty. However, seasonal working capital improvements should result in a stronger liquidity position at the end of the year despite the lower sequential profitability. I want to thank our employees around the world for their continued focus and dedication to Trinseo as we continue to drive productivity and innovation in our core technologies.

And now we're happy to take your questions.

Questions and Answers

Operator

(Operator Instructions) And your first question comes from the line of Frank Mitsch from Fermium Research.

Q – Frank Mitsch

Frank, can you just give us an update on the AmSty sales process? And Dave, I appreciate that $10 million negative headwind for 3Q. The unplanned outages, is that all behind us and a smooth sailing in 4Q there?

A – Frank Bozich

Maybe I'll just answer both of those. The answer to the second question is, yes, that's behind us. They restarted both of those units, and we expect to see a full contribution from AmSty in Q4. The status of the process is, we've said this before, we have a joint agreement with CPChem to jointly market the asset. We began our process in Q3, and we continue to expect that we would sign a transaction in the first half of next year.

Q – Frank Mitsch

Terrific.

Then I guess on financing, is there any update on the timing and process regarding the extension of the May 2026 revolver? And as it stands now is the plan to utilize that revolver to repay the stub note?

A – David Stasse

So Frank, the stub notes is $115 million, just for clarity, $115 million due in September of next year. The plan would be either to use cash on hand or a refinancing transaction to handle that. We are continuing to look at both, and we'll announce something when we have something more concrete to say publicly about it.

Q – Frank Mitsch

Thanks so much.

Operator

Your next question comes from the line of Matthew Blair with TPH.

Q – Matthew Blair

Thank you, and good morning. Just regarding the Q4 guide, it seems like there'll be some tailwinds from AmSty getting back up, call it, approximately $10 million.Then you mentioned the seasonality that you're expecting in the more differentiated parts of the business, but could you provide just a little bit more explanation and color around that? I guess that would imply some pretty severe drop-offs in Plastic Solutions and Engineered Materials, potentially Latex Binders as well.

So is this just seasonality? Is this just being conservative? Are there any other factors like raw materials or net timing that you're also anticipating would be headwinds in the fourth quarter?

A – David Stasse

Yes, I'll help you with the bridge on that. So at the midpoint of our guide, $45 million, we're down, let's call it, $20 million quarter-over-quarter plus $10 million of AmSty, so what we're bridging is $30 million. About half of that bridge is explained by fixed cost absorption related to running the plants. Like Frank said, we do expect a more pronounced shutdown season this year at a lot of our customers and we'll operate similarly. So we will have a fairly significant inventory drain in the fourth quarter, whereas we had a build in the third quarter, preparing for the shutdown. So about half of that $30 million bridge is explained by that, just fixed cost absorption.

The rest is volume and margin really across all of the businesses. We do expect demand to be lighter just due to seasonality. I think that's been a consistent theme during this earnings season, so we will see that as well.

I do think, Matthew, we would expect negative timing in the quarter standing here today, $5 million or so, just due to styrene prices going down. But that should help with the bridge.

Q – Matthew Blair

That does help, thank you.
Then thinking about some of the moving parts on the 2025 free cash flow outlook, your 2024 guidance includes a $45 million restructuring cost. Do you have a sense of what restructuring would look like in 2025? And aside from just EBITDA, are there any other discrete moving parts we should be thinking about with 2025 free cash flow?

A – David Stasse

So Matthew, I'd refer you to Slide 11 in our charts where we list out all the pieces for our free cash flow for 2024. You're right, we expect to spend $45 million this year on restructuring. I expect that to be a similar number next year. Obviously the spend related to the shutdown of the styrene plants is tailing off, but we do have the shutdown from the Stade facility as well as the corporate actions that we took that will kick in. So I expect restructuring to be similar in 2025 and then drop off materially in 2026. But all of the other pieces on this bridge, I would expect to be materially the same in 2025 versus 2026.

So CapEx, cash taxes, turnaround, et cetera. If you add all those up, it's $340 million.
So the cash outflows, if you will, for this year is $340 million, so we would need $340 million of EBITDA to be cash flow breakeven. Now, the one-line item that I think is worth mentioning is cash interest. We have $200 million this year. Clearly, we're in an easing cycle now. We'll see later this afternoon what happens with the Fed, but as I said on our call we have $1.8 billion of floating rate debt, so every 100 basis points reduction reduces our cash interest by $18 million. So I would expect the $200 million of cash interest to be lower next year depending on the pace of Fed cuts.

I think to sum all that up, Matthew, our cash flow breakeven drops to more like a low 300s type number for 2025.

Operator

Your final question comes from the line of Laurence Alexander from Jefferies LLC.

Q – Laurence Alexander

Can you give some sense on what your customers are saying about once we get through the year-end seasonal adjustments, how much pent-up demand they're seeing for the first half of next year? Any innovation cycles that would be pulling products forward? Can you just give a sense for kind of how we should think about the demand side for the bridge for next year?

A – Frank Bozich

Yes, Laurence, as I've been at customers as recently as Monday, what I'm hearing is that they see that Q4 is sort of a declining raw material environment and so I think in general, most of our customers are not building inventory and are waiting for Q1. I think there was also some uncertainty about the regulatory environment and the election results more broadly even across the world, and so the tone I'm hearing from most of our customers is that they expect Q1 to be stronger and that they expect to see modest improvement in their outlooks.

For us, as you know, building and construction is a big part of our portfolio. Their anticipation is that easing interest rates will stimulate pent-up demand in building and construction, so I would say modestly positive for Q1 is the outlook.

Maybe let me build on that just a bit because if I think about next year, while we're not giving guidance at the current time, we anticipate that there are three factors that will give us support for next year as we head into 2025. Those are the restructuring initiatives, known business wins that we have today that we've achieved during 2024 and will achieve in 2025 that will fully accrue, plus the full year benefits from AmSty. So those collectively are the things that are factoring into improvement for next year, and we would expect that the adjusted EBITDA for next year would have a three in front of it, be a $300 million plus.

Operator

There are no further questions. I would like to thank the Trinseo management team and you all for joining. That does conclude our conference for today, thank you for participating. You may now disconnect.