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EDITED TRANSCRIPT

EMN.N - Q3 2020 Eastman Chemical Co Earnings Call

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Co. reported 3Q20 results.

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PRESENTATION

Operator

Good day, and welcome to the Eastman Chemical Third Quarter 2020 Conference Call. Today's conference is being recorded. This call is being broadcast live on the Eastman's website, www.eastman.com. We will now turn the call over to Mr. Greg Riddle of Eastman Chemical Company Investor Relations. Please go ahead, sir.

Gregory A. Riddle - *Eastman Chemical Company - VP of IR & Communications*

Thank you, Maria, and good morning, everyone, and thanks for joining us. On the call with me today are Mark Costa, Board Chair and CEO; Willie McLain, Senior Vice President and CFO; and Jake LaRoe with Investor Relations.

Yesterday after market close, in addition to our third quarter 2020 financial results news release and SEC 8-K filing, we posted slides in related prepared remarks in the Investors section of our website, www.eastman.com.

Before we begin, I'll cover 2 items. First, during this presentation, you will hear certain forward-looking statements concerning our plans and expectations. Actual events or results could differ materially. Certain factors related to future expectations are or will be detailed in the company's third quarter 2020 financial results news release. During this call, in the slides and prepared remarks and in our filings with the Securities and Exchange Commission, including the Form 10-Q filed for second quarter 2020 and the Form 10-Q to be filed for third quarter 2020.

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Second, earnings referenced in this presentation exclude certain non core and unusual items and use an adjusted effective tax rate using the forecasted tax rate for the full year. Reconciliations to the most directly comparable GAAP financial measures and other associated disclosures, including a description of the excluded and adjusted items, are available in the third quarter financial results news release.

With that, I'll turn the call over to Mark.

Mark J. Costa - *Eastman Chemical Company - Chairman & CEO*

Thanks, Greg. Before we answer your questions, I want to take a few minutes to make some comments. We've had a strong recovery in the third quarter and solid performance through the first 9 months of 2020 despite the challenges associated with COVID-19. Our employees around the world have done a great job of taking actions necessary to keep their coworkers and themselves safe and healthy. We remain steadfast in this effort, especially as we see a resurgence of COVID-19 and continue to be committed to build a more inclusive teams so everyone can fully contribute at work.

As we think about the impact of the pandemic on our business, we're leading from a position of strength with our innovation-driven growth model, which continues to be at the heart of how we win. As we move through the third quarter, demand across our businesses improved, particularly for markets most impacted by COVID-19, especially auto, building construction, consumer durables and some other markets.

Our earnings were strong with almost a 60% improvement from the second quarter, driven by innovation and market development and the outstanding work of Eastman employees as they navigate this challenging and unprecedented environment. Additionally, we made progress in our plan to generate $25 million to $50 million of licensing technology earnings over the next few years with $14 million of earnings in the third quarter. End markets are recovering as the third quarter reflected a strong improvement. We saw a 10% sequential recovery in volume and mix from Q2 that got us back to within 5% of last year, which was limited by our planned shutdowns in CI.

On a 9-month basis, our volume and mix is down 6%, which is well above underlying markets. This resilient performance is due to our robust and diverse end market positions and the strength of our innovations. We realized a strong improvement in our most impacted and mixed impacted markets. In our resilient end market, the benefit we enjoyed in the first part of the year moderated as expected. That said, volume in our resilient markets is approximately flat year-over-year through the first 9 months. We see continued momentum in October and into November.

Based on what we know today, we project that volume and mix of Eastman will approach fourth quarter levels of '19. A testament to the resiliency of our portfolio and the great work of the Eastman team has done to mitigate the impacts of COVID-19.

All that said, we continue to be focused on what we can control. Across the portfolio, we continue to create our own growth through our innovation-driven growth model, whether it's in performance films, specialty plastics or architectural coatings, among others, we are performing better than our recovering end markets. Prepared remarks are shared with you how we're leading the way in innovation and market development.

I'm excited about the early strong customer engagement with a new potentially revolutionary product in architectural space, which has the potential to become one of Eastman's top 3 growth platforms.

We've expanded our paint protection portfolio by launching a black PPF, expanding our position from clear products to opaque, a market with tremendous growth. In a world where sustainability is driving consumer behavior, we've had a number of wins across our sustainable product offering that leverage our innovative molecular recycling technologies. Assuming economic conditions remain as they currently are, we expect our fourth quarter adjusted EPS will be similar to the fourth quarter of 2019 adjusted EPS of $1.42. If the volume mix strength in October continues to the remainder of the quarter, our EPS could be above the prior year.

Obviously, there's uncertainty of the impact of COVID resurgence, but we expect to provide an update in Q4 December. Finally, on cash, we've made a priority given the uncertainty. We've done a great job managing working capital, and in particular inventory. As a result of free cash flow for the first 9 months is the highlight of our company's history, and we are on track for a fourth consecutive year of greater than $1 billion of free

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cash flow. All this gives me confidence, we continue to be well positioned to manage in this uncertain environment and deliver long-term attractive earnings growth and sustainable value creation for our owners and all of our stakeholders.

With that, I'll turn it over to Greg.

Gregory A. Riddle - *Eastman Chemical Company - VP of IR & Communications*

Thanks, Mark. Malia, we are now ready for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question today will come from Jeff Zekauskas of JPMorgan.

Jeffrey John Zekauskas - *JPMorgan Chase & Co, Research Division - Senior Analyst*

In your script, you say that the impact of lower capacity utilization was $60 million in the third quarter versus $140 million in the second quarter. And then I think you also said that you thought your volumes in the fourth quarter year-over-year wouldn't be so different than what they were last year. And you also said that earnings would be flat relative to last year. But if you have a $60 million penalty in the third quarter, and that seems to go away in the fourth, shouldn't you just earn a lot more in the fourth quarter?

William Thomas McLain - *Eastman Chemical Company - CFO & Senior VP*

So Jeff, this is Willie. So let me start with the response. So as you've highlighted in Q3, we had a headwind on a year-over-year basis of roughly $60 million. And what I would highlight, in Q3, we actually sequentially reduced our inventories about 5% while volume was increasing 10%. As we think about where we sit at this point in time, we see volume levels being similar and approaching last year's level, while we expect, I'll call it, to slightly have higher capacity utilization.

So as we think about the year-over-year performance in Q4 and/or sequentially, we should have a slight tailwind, but it's not a full $60 million impact because you'll have to recall that volume was down quite substantially on a year-over-year basis, whereas it will be coming back. So you have to take the volume component of that, that partially offsets the $60 million.

Mark J. Costa - *Eastman Chemical Company - Chairman & CEO*

And look, the cost actions we took, Jeff, as well as improving utilization certainly is going to help the quarter. We said volumes are going to approach '19 levels, not get all the way back there. So we're seeing great recovery in the auto markets and B&T, et cetera. And -- but you also have some markets that are off like aviation, some specific coating additives in China that are still in the process of recovering. So we have a few markets off, netting out some of the recovering markets. And the ones that are off for very high mix value.

So it's strong recovery, great momentum as we go into '21, but not quite all the way back on the sort of volume mix side, and you've got a bit of spread pressure as well as you go into the Q4 number with the improvement in increase in raw materials and energy costs, we've got some price contracts that lag and how you catch up to that better problem over time. Just in a quarter, you could cut that lag and some of the competitive pressures in tires. So when you net it all together, we definitely see a way to get back to '19 levels and earnings. And potentially better if the strength holds up, that obviously, with COVID lockdowns in Europe and, et cetera, we're going to have to see how that plays out.

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Jeffrey John Zekauskas - *JPMorgan Chase & Co, Research Division - Senior Analyst*

Okay. You said you have a goal of $25 million to $50 million in licensing revenues. And through the first 9 months, I think, you reported $18 million. So does that mean there's $7 million to go on the bottom end? Or is this $25 million to $50 million some kind of annual number?

William Thomas McLain - *Eastman Chemical Company - CFO & Senior VP*

Jeff, just to refer back to our January call, the $25 million to $50 million was between '20 and '22. So what I would say is this is great progress by the team. We're delivering on that front. And what you should expect is we'll probably have the confidence that we're at least in the middle of the range. And over the next couple of years, we can deliver on top of that.

Mark J. Costa - *Eastman Chemical Company - Chairman & CEO*

Yes. It's a great multiyear program, Jeff. We have a lot of incredibly valuable technology, some of which very much is on strategy for we're growing our specialties and some of which we've developed over time that doesn't really fit with where we want to go. So this is an MEG technology that allows you to successfully convert through gasification -- co-gasification into making a high-quality MEG product, which the current technology in China does not do.

So we've seen strong engagement, and this is the first license to sort of do this. Obviously, there are other companies who are very interested in being in the MEG business in China. So we expect to get more of these licenses in the future, building on this first one. And then there's other normal licensing activity we have with some of our other technologies that are a little bit lower in value per license. But this is a great example. It's a little chunky when it shows up. But it's one we would expect to repeat again and again in the coming years.

Operator

Our next question will come from Bob Koort from Goldman Sachs.

Robert Andrew Koort - *Goldman Sachs Group, Inc., Research Division - MD*

Mark, you talked about the October conditions prevail for the quarter. So does that mean better than typical from a seasonality standpoint? When I would presume November, December are usually weaker months. Or does it just mean typical seasonality from that October level? Trying to sort of gauge what you baked in, in terms of what may or may not be atypical this fourth quarter.

Mark J. Costa - *Eastman Chemical Company - Chairman & CEO*

Yes. This is in the atypical category, Bob. So normally, you have a really strong third quarter and second quarter, and then things trail off in the fourth quarter as people -- we as well as our customers, sort of destock for cash reasons and the primary demand in some markets like B&C and other things slow down. That's normal.

On a primary demand basis, some things will still slow down like building construction to some degree, but even that is showing some more strength than normal because of all the delays that occurred in the summer. So primary demand seems a little bit stronger, but the more significant driver of why we're going to have much better performance than a normal seasonal pattern is a number of our customers were like us, aggressively destocked inventory through the summer.

I think we can all acknowledge and see that demand came back in the third quarter, better than we expected. So people are really tight on inventory. The automotive companies are really tight. B&C is obviously very tight relative to the way demands come back, and that's true in consumer durables

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and a bunch of other markets. And so what you see is people trying to build back to normal inventory levels. I don't think they're trying to build to something excessive. They're just trying to get back to stable natural inventory levels to support the now -- the better demand than we probably expected in the second quarter, so that's all sort of good news.

But normally, you've got this destocking going on, instead, you've got the sort of restocking back to normal levels that we can see. So that's going to give us a lot more stability, especially true in AM. We're seeing this both in the auto side as well as some of the durables but also to everywhere else. I mean we're running utilization flat out in CI. A number of products we're running flat out to support this demand and building action in the quarter. Did that answer your question, Bob?

Robert Andrew Koort - *Goldman Sachs Group, Inc., Research Division - MD*

Yes. Yes, absolutely. I mean, obviously, typically, the fourth quarter destock ramifications can be pretty negative, but it sounds like just the reverse this year. As you look to next year, your cash flow has been very impressive. As you contemplate having to rebuild that working capital in your own franchise for next year, have you sort of reconciled what that might be, what kind of drag on cash flow that could be for next year?

William Thomas McLain - *Eastman Chemical Company - CFO & Senior VP*

Bob, this is Willie. Let me highlight. We have factored, I'll call it, in the increased business activity. But I'd also highlight to you that we've made significant progress this year on, I'll call it, structurally changing the levels, and we're making investments in our integrated business planning on an enhanced level such that we ultimately have a pathway to preserve the gains this year and mitigate any headwinds on inventory with business activity.

Additionally, I would highlight that we will continue to leverage our accounts receivable and accounts payable programs. So as I sit here today, I see a pathway to a fifth consecutive year to greater than $1 billion in free cash flow.

Mark J. Costa - *Eastman Chemical Company - Chairman & CEO*

Some of it is a natural hedge, Bob, where you've got earnings improving and inventory, to some degree, will come up, but lesser than in the past because of the investments really made, but those sort of actually hedge each other, right? So if EBITDA grows, the inventory comes, the value of the EBITDA is greater than the cost of inventory and that sort of balances each other out. CapEx will be a little bit higher, too, as we start ramping up some of our circular investments. But we've modeled this a lot and netted it out. We think it's going to be roughly sort of similar to this year.

Operator

Our next question will come from Matthew DeYoe of Bank of America.

Matthew Porter DeYoe - *BofA Merrill Lynch, Research Division - VP*

Yes. So performance films seem to have somewhat of a blowout quarter. Why are we seeing so much demand for window tinting? Is this expected to continue? Or is there some sort of pent-up demand trend that wouldn't necessarily be obvious kind of on the back of the lockdowns?

Mark J. Costa - *Eastman Chemical Company - Chairman & CEO*

Yes. Well, let's start with performance films had a blow out a couple of years and blow out first 9 months of the year. So on the first 9 months, their volume mix is only down 5% in a market that's down 20%, and they're up year-over-year in the third quarter. So they're having a great year. And it's a combination of things. One, the window film business is very solid and always growing. Two, our paint protection films are growing tremendously

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fast at very high values. As that marketplace has just taken off, and we've talked to you about that over the years, and now we're even expanding from just clear into black or opaque products as we go into next year, which is going to give us a whole new addressable market.

So a lot of growth potential there. But it's not just that. The bigger part, frankly, is an excellent channel strategy and a service model. We have an incredible team out there, especially in the key markets we serve, like North America, China and the rest of Asia that have instituted a far superior model, and how we support both the aftermarket dealers but also building these auto dealership programs where they can now sell these products as a value up with the car, which they're always looking for and where we sort of train, develop, support them in doing that at the auto dealerships.

And we have huge relationships with the top 2 auto chains here in the U.S. as well as the big auto chains in China. So it's a combination of multiple things that's getting us to win great products, great new markets growing but an excellent service model that gives us durability.

And now we're going to add on also a whole new digital tool that dramatically improves the installability of the product with installers and that's very attractive and launching as we speak.

Matthew Porter DeYoe - *BofA Merrill Lynch, Research Division - VP*

That's helpful. And I was interested to pick your brain a little bit more on the new market for the heat transfer fluids. I mean I think that's one of the higher-margin businesses in AF&P, and clearly, expectations were pretty soft on the aero side. So can you talk maybe about growth there and the margin profile associated with that growth?

Mark J. Costa - *Eastman Chemical Company - Chairman & CEO*

Sure. So if you go back 5, 10 years ago and say what was the business, it was primarily heat transfer fluids for chemical plants like polyester plants, et cetera. And that was really the predominant source, very attractive business, lots of growth in China, consuming it. But the market -- end markets have dramatically diversified. The first big new market was solar. So you have to use -- when you heat up these panels, these reflective panels out in the desert, you got to get the heat transferred to the turbine engine and our fluid does that.

So solar has been a huge driver of growth for us over the few -- last few years. And a new market that's really taken off for us is LNG. So they also consume and use these products in those facilities, and that's added on a whole another dimension. So while some of the traditional chemical markets are slowing down a bit, obviously, with different capital cycles. We are seeing these other markets deliver growth and enable us to have a lot more stability as well going forward in this business.

Operator

Our next question will come from P.J. Juvekar from Citi Group.

Prashant N. Juvekar - *Citigroup Inc., Research Division - Global Head of Chemicals & Agriculture Research and MD*

In CI, you mentioned that you're running flat out. What are propane to propylene spreads? And also you're using more refinery propylene, how did all that play out in the quarter? And then just in CI, you also have a smaller ag business. How did that do? I guess last year, you had some tough comps. I guess this year should have more stability in that ag business.

William Thomas McLain - *Eastman Chemical Company - CFO & Senior VP*

P.J., just first on the spreads. Obviously, as we think about the integrated spreads to our derivatives, with raw materials increasing here during the quarter. Our pricing lagged. So there was, I'll call it, some compression within the olefins. Obviously, on our RGP investment, we're still very positive on how that has provided a return and paid off and giving us a little more stability. But again, I thought the key thing is it's slight compression. And

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we also had highlight, had some, I'll call it, planned turnarounds like at our Singapore facility. That will give us some opportunity for a little bit higher volumes than we had in Q3 as we come out of those planned turnarounds.

Mark J. Costa - *Eastman Chemical Company - Chairman & CEO*

And in ag, seasonally, ag always declines for us in the third quarter, P.J., there's a lot of build to get the products to the customers, the farmers. And by the third quarter, the plant takes over. So that always trends off for us. But this year was also more of a headwind than normal because one of our largest customers there had a very long shutdown in the quarter. And so that has a real mix impact. It's not just a volume impact on CI because the amines business is very high-value attractive business in CI. And so you feel both on the volume and mix. Some of it normal, some of it was unique to this quarter.

Prashant N. Juvekar - *Citigroup Inc., Research Division - Global Head of Chemicals & Agriculture Research and MD*

Great. And in your prepared comments, you talked about molecular recycling. Clearly, there's something that the world needs today. You talked about the happening in Tritan and Naia yarn fiber. Can you talk about what are the inputs to this molecular recycling? And what's the product quality? And when does it become economical?

Mark J. Costa - *Eastman Chemical Company - Chairman & CEO*

Sure. So we're incredibly excited about the circular economy. Over a decade ago, we've been focused on sustainability and how that is a critical driver of change in innovation in our industry. We saw that all the way back to Tritan when we were launching that in 2009 around health and wellness, natural resource efficiency, feeding the world -- a world. All those trends have been core. You've heard us talk about all of them and essential renovation. In fact, we require every new product development program to be connected to something sustainable, if it's going to be durable. That's been true for the last decade.

The circular economy is a whole new dimension of growth for the company. We're really excited about it. The reality is plastic waste is a crisis. It's just also ridiculous to waste that much carbon in the environment, we should be capturing and keeping other environment and reusing it. A lot goes into making that happen, and we can play a critical role in that. Obviously, a lot of infrastructure outside of our scope to get it to us, but we need to prove that it can be reprocessed, reused effectively.

Mechanical recycling, which is the way it's done today, it's very energy efficient. So wherever you can do it, you should do it. Problem is, it requires extremely clean feedstock and as limitations on its quality as well as how many times you can reuse it mechanically. So while important, very limited to solving the total plastic problem. So molecular recycling is required. It's not an option. It's required to actually solve the plastic waste problem. And we're excited because we have 2 technologies that are commercial now that are going to prove that it's both commercial and scalable and economic returns for our shareholders to do so.

And so those technologies, the first is what you're mentioning around cellulosic. So we have the ability to do reforming with our gasifier. And so instead of gasifying coal, we can reform waste plastic and return that into feedstocks for making our cellulosic plastics. That includes our Naia yarns as well as the thermoplastics we sell in specialty plastics and it's a huge opportunity. We already were picking up a lot of momentum from sustainability on these products because in the yarn, 60% is bio content from FSC certified sustainably grown forests. That alone was driving a lot of growth for us.

I mean if you look at womenswear this year for us, our volume is flat last -- relative to last year, where the market is down 30%. So we're seeing tremendous success there in that part of the market and that also will go into thermoplastic. So we are the largest player by far in ophthalmics, in sunglasses, eyewear for the high end plastic that goes in those frames, Marshawn, one of the key leaders in that market already launched with us using our recycled content to have that offer. So we see a lot of opportunities to grow the cellulosic plastics, even opportunities in electronics, toys, even cellulose plastics is an opportunity in a market that we see.

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So on that side, tremendous opportunity, a lot of growth allows us to grow in existing applications. It allows us to grow new applications like electronics, where we're not today in opaque applications, and it comes at a higher margin. And the polyester technology is the same thing, P.J. We've got our Tritan Renew product already getting orders from 2 iconic brands like CamelBak and Nalgene. We have a number of customers working with us in cosmetics, in ophthalmics as well, durables, more hydration customers as well as single-use plastics.

So when you look across those 2 markets. As of now, we already have 100 customers doing trialing with us across all these different markets and opportunities around these 2 technologies to grow the volumes as well as get a better premium. And we know we can get the better premium, we're getting it now. And if you look at a better, broader market about how important this is, food-grade PET recycled in Europe is going at a substantial premium to sort of virgin PET. So markets are willing to pay and support the investment necessary to solve this problem. So a great return on investment for everyone. So we're really excited about this. We think it's a great way to defend our existing business, grow our businesses and solve a real challenge in the world that we need to resolve.

Operator

Our next question will come from Alex Yefremov from KeyBanc.

Aleksey V. Yefremov - *KeyBanc Capital Markets Inc., Research Division - Research Analyst*

Mark, just to continue on the subject, have you made any progress in your decision-making on methanolysis project? Are you any closer to investment or defining the economics for that business?

Mark J. Costa - *Eastman Chemical Company - Chairman & CEO*

Yes. So methanolysis is key to our strategy. The -- it is a meaningful advancement to build one of those plants, and we're close to refining and finalizing the details of exactly when we're going to build it. We're committed to making this investment. We believe it's the right thing to do. The economics are very attractive for all the reasons I just mentioned.

And in the January call and the fourth quarter call, we'll provide you more details as we're just finishing up the final analysis of timing and capital scope, et cetera.

Aleksey V. Yefremov - *KeyBanc Capital Markets Inc., Research Division - Research Analyst*

And just to follow-up on that, Mark, is it fair to say that regardless of what decision you make with that methanolysis project, your kind of free cash flow parameters that you outlined for next year are still there, $1 billion plus with potential methanolysis CapEx?

Mark J. Costa - *Eastman Chemical Company - Chairman & CEO*

Yes, that includes -- when we were talking about free cash -- the free cash flow earlier, that includes the capital for methanolysis. That's the reason CapEx would go up next year. We've already built a lot of specialty capacity. So where we believe we'll have tremendous growth, are we seeing great recovery where we could get back to almost '19 levels in the fourth quarter of this year. You got to remember, back in '18, we built a lot of plants, right? A lot of different specialty plants to support growth and Tritan and a number of other products, ketones, et cetera.

And so we're well positioned in our cost structure to support growth. The one exception is the circular economy, which is relatively new. And we are completing in this year an expansion of our performance films capacity to support its tremendous growth. So I think we're in good position on that. Our ability to do all that is the testament to our team's operational excellence. We've made a lot of investments in the business operating model and how we operate our company in the systems on how we're managing production, and we're continuing to make more investments on this to be much more efficient in our working capital, so we can transfer that improvement into growth capital.

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Operator

Our next question comes from David Begleiter from Deutsche Bank.

David L. Begleiter - *Deutsche Bank AG, Research Division - MD and Senior Research Analyst*

Mark, just on your cost savings, I believe about $100 million of these $150 million are somewhat temporary interim cost savings. How should we think about how they flow back into the cost base in 2021?

Mark J. Costa - *Eastman Chemical Company - Chairman & CEO*

David, I'm going to let Willie take that one.

William Thomas McLain - *Eastman Chemical Company - CFO & Senior VP*

Sure. David, thanks. As we think about the $150 million of actions that we're taking this year, and we've highlighted 2/3 of those are discretionary. We're trying to match those as you think about with the level of business activity. I would highlight that we do expect, over the long term, that some of that discretionary spend would become structural as well as we think about the leveraging of technologies and how we do business.

But fundamentally, as we think about 2021, we have cost actions that include site shutdowns as well as, I'll call it, labor cost actions that are going to approach $100 million, and we're taking actions on those this year. So as you think about 2021, we will not only generate cost savings that offset any of the discretionary that's flowing back. We actually expect through digitization, the integrated business planning and other network optimizations to actually give us capacity to invest in growth and capabilities. And it's with that confidence that we're going to deliver $150 million net to about $225 million gross as we go into 2021.

And much of those actions are already in play, and we're making strong progress this year so that those structural actions are in place as we start 2021. As we think about 2022, we expect that to grow to a total of $200 million net and beyond.

David L. Begleiter - *Deutsche Bank AG, Research Division - MD and Senior Research Analyst*

Very helpful. And Mark, just on the 1/3 of AF&P that has performed fully over the years. I know you suspended in a sense any actions during the pandemic. But as you head into '21 for us have been able to improve these businesses through further cost actions and each thinking any different about the role this 1/3 of the business going forward in the Eastman portfolio?

Mark J. Costa - *Eastman Chemical Company - Chairman & CEO*

Thanks, David. So look, we've always been a disciplined portfolio manager. It was a while ago, when we had our significant portfolio transformation. But we've sold off a lot of underperforming businesses in our history, and we've had very successful acquisitions of great specialty businesses to give the portfolio the strength not just in the stability of revenue that you're seeing this year. And let's not forget, we started with a trade war and then COVID.

Over the last 2 years, we've shown, I think, good resilience in the top line with this portfolio, but also tremendous cash flow with the value of the acquisitions. So I think we're good at being disciplined. And as we said, we saw 2 businesses, tires and adhesives, that we're developing instability that wasn't consistent with our strategy, especially as part of AFP and needed to address that. I think we've made great progress on managing the cost structures, especially in tires, where we're going to take out a couple of plants and improve its cost structure in a meaningful way and that allows us to lever up our new plant, that's a much lower cost plant as well in tires.

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And then innovation is also going really well in both businesses. But the reality is the tires business has really challenged in the competitive dynamics. The ADD (anti-dumping duties) tariffs that got put in place shoving China tires back into China. Then the broader trade war with China, kicked off by Trump, just created a huge drop in demand, while competitive capacity is coming online, and that just created a food fight at the tire company level, as you can see, and at our level with our competitors in this business.

So the volume recovery has been great in the back half of this year, and the earnings in the back half of tires will be much better than the first half. But it's still a competitive environment and a headwind relative to '19. And so that's one we're going to do everything we can to improve the business. The innovation is giving us the ability to sustain premiums above our competitors in a meaningful way. But it's a business where we're going to continue looking for either JV or divestiture options. And as -- hopefully, we'll get to stability at some point here with COVID and be able to sort of pursue that. But we're committed to dealing with the portfolio.

Adhesives is actually holding up relatively well in 2020 relative to '19, volume is actually up about 5%. Price is stable to the back half of '19, managing cost there like everywhere else. That business is stable. Innovation is getting a lot of great traction. Our APOs are really winning in the marketplace with superior environmental footprint as well as better sprayability and allows you to lose less resin, so great growth there. Great growth, we've talked to you a number of times about our low odor, low VOC resins that we've launched.

So it's stabilizing, but we're also still looking for opportunities to improve its performance if we can through partnership, and how we continue to improve that business. So we're still working it. It's not going as fast as we liked at the beginning of the year with COVID.

Operator

Our next question comes from Vincent Andrews of Morgan Stanley.

Vincent Stephen Andrews - *Morgan Stanley, Research Division - MD*

Mark, maybe you could just touch on what you're seeing in building and construction. In the prepared remarks, you talked about benefiting from the DIY market. So how big is that for you versus sort of regular construction? And as we think about going into next year, I know you have some innovation, I see the optifilm in the deck. But as we go into next year, if DIY sort of softens a little bit, how is that going to impact the portfolio? Or do you have other things that will come back to offset that?

Mark J. Costa - *Eastman Chemical Company - Chairman & CEO*

So in our coatings business, roughly half of our coatings business is B&C and half is transportation roughly. And on the auto side, remember, again, half OEM, half refinished. But on the B&C side, we are more weighted towards residential than commercial, which positions us well for benefiting from the DIY demand buildup. So we certainly are seeing the benefit. Our additives that go into architectural paint did quite well, consistent with what you've heard from the architectural coating companies in the third quarter. So we're tracking with that fairly well.

It's not a huge part of the revenue -- total revenue of AFP but it is helpful, combined with the stability we're getting in Care Chemicals, the great performance we've had in heat transfer fluids that's offset the headwinds or some of the headwinds, I should say, and aviation fluids. Innovation is helping, too, as we talked about in the growth story around optifilm. So it's market recovery. It's good positions with the winners in the marketplace that we always focus on and a great example of the sort of resiliency of our portfolio and how it provides stability where, well, some things might be challenged, other parts do well and that sort of balances out nicely.

Vincent Stephen Andrews - *Morgan Stanley, Research Division - MD*

Okay. And just on Advanced Materials, obviously, the volume performance all year, and obviously, it's been a challenging year, has been very strong, and it seems like a lot of it's innovation-driven. But as we think about going into next year, presumably, the innovation continues to compound.

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But are there parts of that portfolio that have struggled this year that we will actually see some recovery in next year? Or is it just going to kind of be steady as she goes?

Mark J. Costa - *Eastman Chemical Company - Chairman & CEO*

No, AM is doing really well. So I wouldn't call it struggling, but obviously, demand and transportation was down this year. So we certainly took an impact in Advanced Materials, especially in the second quarter. When our customers shut their plants down and we shut our plants down accordingly in interlayers. So we took a hit there. Obviously, even performance films, while it did well, was still down year-over-year and faced some challenges there. But overall, I'd say the portfolio is doing great. I mean it's got innovation driving growth across all 3 main elements of it, especially plastics has been incredibly steady through this year, where things like some durables were off in the second quarter, but we had tremendous sort of COVID-driven strength in shrink for packaging that goes into grocery stores, our sneeze guards, the polymers that we make has great chemical resistance for cleaning.

So it's very popular for all these sneeze guards you're seeing in stores or restaurants, et cetera. And see you had growth in that offsetting some of the weakness and good price stability relative to raw materials, delivering good success. And you've seen the snap back already, right? The earnings in the third quarter are better than the first quarter of this year. So we've had great snap back, volumes almost getting back to last year's level with the rebound in automotive and the great performance in performance films that I talked about earlier.

So I think this business is really on track to deliver a great result this year, but build on it with continued great results next year. Even in interlayers, which we didn't talk much about, we've launched a number of new products. We've enjoyed a lot of success with our acoustics and head-up display premium products. We've told you we've been working on next-gen for all of those, and we've had great wins on all 3 fronts.

We've had a next-gen acoustic product with superior sound dampening, just get selected by one of the leading sort of EV OEMs out there on 2 of their iconic models. Noise is a huge issue in the EVs because you've lost the sound of the combustion engine. So sound dampening in a variety of places in the car is critical. And we -- and the biggest place where you get sound coming into a car is actually the window. So we play a critical role in addressing some of those issues. We've had a multifunctional product we've been working on that is much more difficult for our competitors to do that combined solar rejection, acoustic and HUD, all in one. And it's been just adopted by a leading Japanese OEM, and we've had great success also on our next-gen HUD.

It's in trials right now with a leading German OEM that's going to be part of their augmented reality HUD that they're building, and that market will continue to grow. So a lot of success there. Tritan is doing great. And then you've got the circular economy piling on top of this, as I mentioned earlier, delivering a lot of growth on many different fronts and the portfolio is diverse and gave its stability. So we feel good about that.

Operator

Our next question will come from Frank Mitsch of Fermium Research.

Frank Joseph Mitsch - *Fermium Research, LLC - Senior MD*

Mark, just a follow-up on kind of the auto side. You just talked about acoustics and heads up displays, et cetera. But I guess part of the reason why you're outperforming the auto OEM builds is due to paint protection that got some nice airplay in your remarks. Can you talk about the growth prospects there? I guess in the market segmentation there because I guess my thought was that, that was more geared towards kind of hiring a vehicle. So that might suggest that you're in the early innings of being able to roll out that product as you move to more mainstream on a base. Can you spend a moment or 2 describing the growth prospects there?

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Mark J. Costa - *Eastman Chemical Company - Chairman & CEO*

Yes, it's tremendous growth opportunities, Frank. It's a segment that been growing and it's got growth opportunities both geographically as well as within the category. So you're right, it started out with very high-end hyper-cars and expensive cars for people to protect them. It's already starting to move into that normal luxury market and the mid-tier market even. Especially in China, it's amazing. The number of people who are interested in sort of protecting their car, which for them is a very significant investment.

And so there's a lot of growth and addressable market in front of us in this -- on the markets. And while it's growing really well in China, North America, we're at very early stages of this growing in Europe. So that's a whole another region of growth for us on top of growing the category. So we believe these sort of very strong double-digit growth rates will continue for quite some time.

Frank Joseph Mitsch - *Fermium Research, LLC - Senior MD*

So we should be dialing in greater than auto OEM growth for EMN for the near future, near or midterm future?

Mark J. Costa - *Eastman Chemical Company - Chairman & CEO*

Absolutely. In Advanced Materials, that's true. In automotive, in coatings, I'd say we're tracking more with the market.

Frank Joseph Mitsch - *Fermium Research, LLC - Senior MD*

Okay. Great. Great. And then a question for Willie. You talked about $600 million plus in net debt paydown in '20 implying $250 million or so here in the fourth quarter. How should we start thinking about '21 in terms of the prior uses of cash and expectations on debt pay down in '21?

William Thomas McLain - *Eastman Chemical Company - CFO & Senior VP*

Yes, Frank. On the capital allocation front, our priorities have not changed. We've increased our dividend for 10 consecutive years, and that's an important mechanism for us returning cash to stockholders. Also, to your point, we're committed to our investment-grade credit rating. And 2021 will really depend on the pace of economic and economic recovery, but we will continue to stay focused on getting our debt-to-EBITDA ratio closer to that 2.5x. Here at the end of Q3, our net debt is about, I'll call it, 3x our leverage. And also, we're committed to offsetting the dilution right now. And obviously, the pace of EBITDA growth will be as we think about allocating beyond that in 2021.

Operator

Our next question comes from Kevin McCarthy of Vertical Research Partners.

Kevin William McCarthy - *Vertical Research Partners, LLC - Partner*

Mark, you've done a tremendous amount on the innovation front in recent years. And I would like to hear more about optifilm as you highlighted in the prepared remarks. But more broadly, intended to ask, is there a way to quantify the benefit that you anticipate from new products either on a top-down basis across the portfolio or perhaps bottom-up thinking about what the top 2 or 3 contributors could be in coming years?

Mark J. Costa - *Eastman Chemical Company - Chairman & CEO*

So Kevin, we do -- we gave you a metric called new business revenue from innovation. So we -- there's lots of new business revenue, just within market share and things like that. But we isolate out what comes from integration platforms and we had a target of this year getting to $500 million. We were well on track at $400 million last year, even in the trade war, and we continue to have great engagement, even virtually with customers.

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We've told you about all kinds of wins we're having in this year across our product portfolio. So we feel good about it, but it's not going to be at the level that we aim for.

So we'll always give that to you. And I would note that, that new business innovation will build, and I think we can get back to that level, that target next year in 2021. So I feel good about the growth that we can sort of put together there. And it really fits with where we think we're headed for delivering a very attractive 2021.

So Willie's told you, we've got fixed costs basically flat. We've told you that we have a $100 million tailwind in asset utilization next year relative to this year if volumes are just flat in '21 versus '20, right? Because we took all these aggressive inventory management actions this year to go beyond demand to generate cash, and we're quite happy we did that. And that inverts becomes $100 million tailwind on flat volumes.

And then it's innovation from new business that we're just talking about here, the market recovery that you might have at some level, depending on how COVID and everything plays out. All create incremental growth above that. And because of the inventory actions we've taken this year, the innovations at the growth that we're getting there is above-average margins for the company. Because of the inventory management we've done, we don't have any fixed cost headwinds. The incremental margins for growth next year are probably going to be 60% -- 50% to 60%, so very attractive margins. So that growth flows the bottom line. And we put out together $0.60 just with flat volume on utilization and flat costs and then growth on top, it could get us back to '19 levels.

Kevin William McCarthy - *Vertical Research Partners, LLC - Partner*

Okay. That's helpful. And then secondly, Mark, I wanted to ask about interlayer films. You talked about the acoustic films and heads up displays. Do you feel as though you're gaining market share in that business? Or is it more a situation where volumes could be exceeding auto sales as a function of restocking or perhaps both of those things? How would you characterize the market dynamics in the interlayer films?

Mark J. Costa - *Eastman Chemical Company - Chairman & CEO*

Yes, interlayer is a great business. It's more directly tied to OEM production, obviously. So that production goes up and down so will our volume. We still benefited and did better than the underlying market this year, Kevin, with acoustic and heads-up display, but not to the same extent as performance films because performance films is expanding its overall market that it serves and so it's doing well. The HUD and acoustic doing well. This next-gen set of products, I just mentioned, are going to give us additional tailwind as we go into next year.

So we feel that it will continue on a volume mix basis. It will do well. The mix is incredibly important to keep in mind about this -- the entire company, especially in AM. So when you're selling paint protection films or window films or acoustic or heads-up display, that's way above segment average margins in AM, including Tritan and the circular economy products we're selling, same thing. So all those growing isn't just volume, it's a mix upgrade.

Operator

Our next question will come from Mike Sison of Wells Fargo.

Michael Joseph Sison - *Wells Fargo Securities, LLC, Research Division - Senior Analyst*

Nice quarter. Just curious, and I think I'm doing the math right, it looks like sales will be up sequentially, right? Fourth quarter versus third quarter? And I apologize I missed this, but why is EBIT -- your guidance would imply EBIT is down, right? So anything I'm missing? I would have thought maybe you'd have flow through up on an EBIT basis.

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William Thomas McLain - *Eastman Chemical Company - CFO & Senior VP*

So thanks for the question. So on the volume mix, we expect it to be approaching Q4 levels of prior year. As we think about raw materials continuing to be, I'll call it, increasing, we would expect to continue to potentially have some, I'll call it, slight spread compression as we think about our chemical intermediates and some of the AFP 1/3, potentially tires. So as we think about the balance of that, also, we'll have a little less of the cost actions benefit. So I'll remind you, in Q3, we had roughly $50 million. Q4, will have roughly $40 million as the activity continues to increase. So all in, that's a sequential view as well as some of the key inputs on a year-over-year. So as we think about it, EBIT being similar to prior year is where we come out as we look through that.

Mark J. Costa - *Eastman Chemical Company - Chairman & CEO*

Yes, there's always some normal -- I mean, while we don't have normal seasonality of the drops based on things I said earlier. We still expect demand to be a little bit less in products with some seasonality. So tremendous strength to get back to last year's levels and earnings. So I think that's a great accomplishment as we look at it, a little bit less than third quarter.

Michael Joseph Sison - *Wells Fargo Securities, LLC, Research Division - Senior Analyst*

Right. No, I agree. And then in terms of -- if demand levels stay sort of around this third quarter level or second half level. And then given some of the cost-saving efforts you have for '21, where do you think your run rate level of earnings are -- is tracking? And I know it may be too early to give a specific guidance, but are you above '19? Are you closer to '18? Just maybe just give me a sense of where earnings should maybe lay out if things stay at these levels.

Mark J. Costa - *Eastman Chemical Company - Chairman & CEO*

Yes. So I was trying to get at that -- around the growth question a moment ago, assume fixed costs flat, assume a tailwind of $0.60 a share in asset utilization of flat volumes. So then you build on that with volume growth, mix improvement, as I was just talking about, the power of mix is incredible in this. It's not just volume that was a headwind this year, it was mix as a big driver because the markets that were impacted by COVID were our highest value markets. So you're already seeing the value of them coming back in the third quarter. You'll see that more progress in the fourth quarter. But next year, you'd expect to get all the way back there on mix.

And then the asset leverage of that fixed cost with sort of that 50% to 60% incremental margins. I think when you put all that together, there's still some spread headwinds you're going to have with pricing catching up to raws because we assume raws will be increasing next year with an improving economy. So you have a little bit of that as a headwind and some competitive pressure in tires and acetyls, offsetting some of that growth and success. So put it all together, we think we can get back to around 2019 levels, could be a bit better, but there's a lot of moving parts on that. And we got to see how we get through this COVID crisis, which obviously is going to have some amount of impact. And there's the U.S. election, there's China trade tensions, et cetera. So there's a lot of things to factor in and refine that outlook, which we'll give you in January.

Operator

Our next question will come from John Roberts from UBS.

John Ezekiel E. Roberts - *UBS Investment Bank, Research Division - Executive Director and Equity Research Analyst, Chemicals*

You have all these great ESG initiatives. How does the CigTow business fit into that mosaic? And do you have to carve that out at some point? Or can it coexist as you ramp up the other ESG initiatives?

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Mark J. Costa - *Eastman Chemical Company - Chairman & CEO*

Yes. So that's -- so obviously, we've considered carving to -- out of the portfolio a number of times, especially back in 2015. Unfortunately, it can't be carved out, John. It's so integrated into the Kingsport site and so interdependent with all the cellulosic growth we have in AFP and AM and shared assets and recycled loops, you just can't separate it, it would be a disaster. So you have to grow out of it. And that's what we're doing, right?

So our strategy is through -- ultimately, if you go long-term enough, replace all the tow with textiles and other applications with that growth. And obviously, that's going to take some time. But our strategy and the answer to that question when it comes up is we have to maintain the economic integrity of the company to invest in growth and support our success. So tow is part of that, but we're going to work as hard as we possibly can to grow in textiles, which also has attractive margins and grow that business as the tow business declines over time. So that's sort of the answer to the question, and it's also a way to leverage a lot of excess tow capacity that we have right now that has great incremental margins will grow textile against 0.

John Ezekiel E. Roberts - *UBS Investment Bank, Research Division - Executive Director and Equity Research Analyst, Chemicals*

Okay. And then secondly, back to the performance films, the interlayer business is almost all OEM, can be paint protection in the OPAC films go OEM as well? And maybe just give us a little bit of parameters. If interlayer profitability or content is 1x per car, the opaque films go on the side windows and rear windows. So that's got to be much bigger than 1x. And then the paint protection goes on a much larger surface area. And so that's got to be even higher than the darkening films. Kind of give us what are the 1x and then for the interlayers and what are the opaque films and the paint protection films?

Mark J. Costa - *Eastman Chemical Company - Chairman & CEO*

Yes. So John, I don't have a quick easy answer to that question. What I can tell you, I just know what sort of refine a little bit about what the paint protection film is. So paint protection film comes in 2 versions. One is the full wrap of the car, but a lot of people just wrap the vulnerable -- put the film on just the vulnerable parts of the car, the front, the side, the door handles, et cetera. So it comes in 2 different versions on how much you sell per car when you do PPF.

And it is certainly additive when you think about our presence on a car because the interlayers is doing one thing in Acoustics and HUD, the films on the windows are, as you've noted. So it's not just tinting. It's actually solar rejection is the big value proposition. So we sell a lot more in hot locations than cool locations because the films are much more advanced today than they were 20 years ago, and the big value proposition isn't just a tinting. It actually rejects a tremendous amount of solar heat that actually gives you better fuel efficiency since you use less air conditioning. And so that's additive.

And then you've got the PPF. But we don't break it down on a sort of ratio basis like that. It's something we probably should do, and we'll take a look at that. but what we do know is we're getting a lot of more presence on each car sold. And the dealers, as you mentioned, are really getting interested in it, right? It used to be very much an aftermarket business in PF. And a lot of our growth is now in collaboration with these programs we're doing with the auto dealers where they sell it as upsell in the car. Sometimes it's preinstalled on luxury cars. So you don't have a choice about it, when you're buying it. A lot of it is after sort of an upsell at the point of sale. So a lot of different ways to grow.

Operator

Our next question comes from Matthew Blair of Tudor, Pickering, Holt & Co.

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Matthew Robert Lovseth Blair - *Tudor, Pickering, Holt & Co. Securities, Inc., Research Division - MD of Refining and Chemicals Research*

I want to circle back to tire additives. The Michelin data showed pretty rapid improvement in replacement tire demand through Q3. I think they have both North America and China, up 9% year-over-year in September. So I just wanted to see, does that match with what you have? I know your tire market is much more commercial, but any comments there?

Mark J. Costa - *Eastman Chemical Company - Chairman & CEO*

No, we've seen the same rapid recovery demand in tires in the third quarter has been quite good and consistent with what you're talking about.

Matthew Robert Lovseth Blair - *Tudor, Pickering, Holt & Co. Securities, Inc., Research Division - MD of Refining and Chemicals Research*

Sounds good. And then all these forest fires have caused a pretty big wood shortage, lumber shortage. Is that having any impact on, I guess, either fibers or any other parts of your business?

Mark J. Costa - *Eastman Chemical Company - Chairman & CEO*

No. Where those fires are occurring are not where we would be getting our wood. We only get wood pulp from sustainably grown forest. They're growing purposely to be regenerated and taken care of it in very different locations and where these fires are occurring in East Coast, Brazil, different locations than the West Coast.

Gregory A. Riddle - *Eastman Chemical Company - VP of IR & Communications*

If we could make the next question the last one, please?

Operator

Our last question today will come from Arun Viswanathan of RBC Capital Markets.

Arun Shankar Viswanathan - *RBC Capital Markets, Research Division - Senior Equity Analyst*

Just 2 quick ones. So first off, could you just remind us sequentially what was the benefit from lower idle facility charges, I guess, Q2 to Q3? And then secondly, if you could just address maybe the benefits to Eastman from a potential infrastructure bill, if there's maybe 1% of your portfolio that's weighted there. And how potentially Eastman would be positively impacted by that?

William Thomas McLain - *Eastman Chemical Company - CFO & Senior VP*

Sure. So if I answer the question, so I'll answer it 2 ways: one, which is you saw our decremental margins go down roughly 60% from Q1 to Q2 and our incrementals be about 60%. I would say over 90% of our period of costs associated with our facilities basically went away in the quarter on a sequential basis as our plants came back and became fully operational throughout the quarter.

Mark J. Costa - *Eastman Chemical Company - Chairman & CEO*

And then on the infrastructure question, it will benefit us. We're not really focused on large infrastructure projects and the kind of materials we make. We tend to go more into consumer durables, cars, building construction, but more commercial than bridges. So it depends on the nature of what the infrastructure is. What's great about that is it just creates broader economic growth, which we're highly levered to. So while we may

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not be participating directly in some of the infrastructure projects, we are certainly tied to macroeconomic demand. People will have more pickup trucks going to work in construction, which is good for us, et cetera. So we'll certainly benefit like everyone does from the improving economy driven by.

Gregory A. Riddle - *Eastman Chemical Company - VP of IR & Communications*

Thanks, again, everyone, for joining us this morning. We appreciate you dialing in and look forward to talking with you again soon. Have a great day.

Operator

This will conclude today's conference call. Thank you all for your participation. You may now disconnect.

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