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EMN.N - Q1 2021 Eastman Chemical Co Earnings Call

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OVERVIEW:

EMN reported 1Q21 results. Co. expects full-year 2021 adjusted EPS to be $8.25-8.75.

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PRESENTATION

Operator

Good day, everyone, and welcome to the First Quarter 2021 Eastman Chemical 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, Tracy, and good morning, everyone, and thanks for joining us. On the call with me today are Mark Costa, Board Chair and CEO; William McLain, Senior Vice President and CFO; and Jake LaRoe, Manager, Investor Relations.

Yesterday, after market closed, we posted our first quarter 2021 financial results news release and SEC 8-K filing, our slides and the 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 our first quarter 2021 financial results news release, during this call, in the preceding slides and prepared remarks and in our filings with the SEC, including the Form 10-K filed for full year 2020 and the Form 10-Q to be filed for first quarter 2021.

Second, earnings referenced in this presentation exclude certain noncore and unusual items. 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 first quarter 2021 financial results news release, which is available on our website.

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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're off with an excellent start to 2021, and I'm proud of the many accomplishments we've achieved in just a few short months. We've been building momentum, and the strong operational execution of our teams is paying off as the global economy improves.

There are several highlights I want to cover. First, strong demand from the end of 2020 continued through the first quarter. In many markets, demand is returning to or exceeding 2019 levels. We reported 20% higher adjusted EPS over '19 and 5% over a very strong first quarter last year before we felt the full impact of the COVID-19 pandemic.

Consistent with our track record of strong free cash flow, we also delivered record free cash flow of $125 million in the first quarter, which was up substantially from a very strong performance a year ago. We achieved these solid results despite operational logistical headwinds from winter storm Uri. I'm incredibly proud of our team in Texas who took proactive steps ahead of the storm to avoid a hard shutdown to any of our assets. Then they worked tirelessly to repair and restart our facilities, which helped ensure supply for our customers.

Thanks to their proactive planning, we were able to safely start with no injuries and well ahead of our competitors. We had half of our Texas manufacturing facility operational within 1 week of the storm, and we were more than 95% operational within 3 weeks. To all the Eastman employees who sacrificed and rose to the challenge, thank you, on behalf of our customers and all of the colleagues at Eastman.

Moving to other highlights, we've made significant progress with our circular economy efforts, which I'll talk more about in a moment. And our progress hasn't gone unnoticed with Barron's adding Eastman to its list of the 100 Most Sustainable Companies for 2021, a true honor for us. And we issued our inclusion and diversity report, which you can find on our website. At Eastman, we take our environmental, social and governance commitment seriously, and transparency is of the utmost importance.

We also continue to allocate our capital with returns to stockholders in mind. To that end, we recently completed a small bolt-on acquisition of 3F Feed & Food, a leading animal health and nutrition company with accelerated growth in the animal nutrition business. And finally, we think the favorable trends in the economy, coupled with our innovation investments and continued disciplined cost management sets us up for strong EPS and free cash flow growth this year and next.

On our January call, we gave you an update on the progress we're making to become a leader in the circular economy. We announced that we're building one of the world's largest plastic-to-plastic molecular recycling facilities at our site in Kingsport, Tennessee. Since then, we've broken ground on the facility and continue to target mechanical completion by the end of '22.

Even more impressive is the amount of momentum we're building with customers in many different markets around the world. The demand for our new branded products include Eastman Tritan Renew, Eastman Cristal Renew, is strong. At this point, demand for our specialty products and the circular economy offerings has been better than we anticipated.

And specific to the new facility we announced, we're ahead of schedule in terms of customer demand for the capacity. We have a robust pipeline for additional announcements throughout the year and look forward to sharing those with you.

Turning to our outlook. As we entered the second quarter with strong demand and mix momentum, we also expect to benefit from cost discipline, including lower operating costs from our operational transformation program. However, there are specific headwinds we face, including maintenance turnaround, supplier reliability and some slowdown in auto production. In addition, we have price increases that are continuing to catch up to higher raw material, energy and distribution costs in some products. Despite these headwinds, we expect a sequential increase in EPS, with second quarter adjusted EPS expected to be at or above second quarter of 2018 adjusted EPS of $2.22.

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Moving the full year, we expect strong market growth and product mix improvement to continue. Our innovation-driven growth model will enable us to grow faster than the underlying market recovery, and we expect a number of markets will be rebuilding inventory. We also expect much of the capacity constraints, supplier reliability and logistics headwinds to lessen alongside a potential moderation in tight commodity markets.

We expect to continue to benefit from about $100 million of full year tailwind for improved capacity utilization compared to last year when we aggressively managed inventory well below the decline in demand with our focus on cash. And we're on track to keep our cost structure flat compared with 2020 and well below 2019 and '18 levels.

We, therefore, expect adjusted EPS will be about -- be between $8.25 and $8.75 for the full year of '21. On cash, we expect free cash flow to approach $1.1 billion, which is consistent with our expectations for stronger adjusted EBITDA. We expect 2021 will be our fifth consecutive year of free cash flow greater than $1 billion, and we will work to grow free cash flow from here.

Putting it all together. These outstanding results remind me about what gives Eastman this incredible resiliency and strategic advantage. First and foremost, it's the people at Eastman who continue to persevere and help us win as we saw in Uri and a time of crisis, and this is what we see every day from this good team.

And as I reflect on how we position our company through the global trade disruptions of 2019 and then COVID in '20, I feel confident in our ability to grow EPS and cash off this new level of earnings. Despite a challenging macroeconomic backdrop over the last several years, we have not sacrificed our efforts to innovate and invest in our specialty portfolio and expect those investments to continue to pay off as we finish off '21 and move into '22. In the meantime, we'll continue to focus on what we can control and remain committed to long-term attractive earnings growth and sustainable value creation for our owners and all our stakeholders.

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

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

Thank you, Mark. Tracy, we are ready for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) We will now take our first question from Vincent Andrews from Morgan Stanley.

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

Mark, wondering if you could just give us a little bit more details on the new molecular recycling plant in terms of what you mean by being ahead of schedule. And I'm wondering if you can talk a bit to the customers that are signing up for the volume and how much volume maybe you've already contracted and what your expectations are in terms of contracting level by the time you start up.

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

Sure, Vince, and thanks for the question. We're really excited about what we're doing on our chemical recycling technologies, both our cellulosic recycling technology as well as our methanolysis. To your question around the methanolysis plant that we announced in January, we are seeing incredibly strong interest from our customers. And they're really compelled by our value proposition that has 3 key elements that's driving their interest.

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I mean, the first is that we have a solution to plastic waste that cannot be mechanically recycled, much of which ends up in landfill or in the environment. And we can use that as feedstock to upscale into more durable products from the packaging applications or carpet and other applications that we're sourcing. And we can do it with infinite loop, so that's incredibly important, is to have that solution.

Equally important to them is that there's no compromise on the polymer in its performance and quality and as a drop-in replacement. Because we're rebuilding building blocks to be identical to what we normally get from fossil fuels, the product is identical. And so it's an easy drop-in, an easy switch over to our offering, and they don't have to change the brand position and the quality of what we provide.

And the third element that's very important to everyone is that it has lower carbon footprint than fossil fuels. We want to solve the waste crisis, but we also need to be sensitive to climate at the same time, and there's no toxic waste.

So it is a great story that they want to embrace and have in their brands. And so we've seen a number of customers, as you've seen on the chart we supplied in the prepared remarks, the customers adopting. Estée Lauder is a great win that we're really excited about. And there's many other companies in the cosmetic packaging area as well as all these other fast-moving consumer goods, et cetera, that are working with us right now.

So we are ahead in securing volume. We're also ahead in securing the value that we wanted to get for this offering, and that's also coming in a bit better. We're not going to provide details on exactly what the volume percent of that is. But I can tell you, were well ahead of pace in selling out that facility, which is really exciting for us. So overall, I'd say it's really, really encouraging.

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

Excellent. If I could just ask you a follow-up question on pricing in the overall portfolio just given all the raw material inflation that's out there. I think historically, sometimes you've talked about when there's been inflation that's -- you view as temporary, you don't look to pass it all through. How are you sort of -- how do you view the current inflation across your product lines? And what is the pricing philosophy going to be for 2021 related to that?

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

Thanks, Vincent, for that question. Obviously, pricing is a very hot topic these days with a material increase in raw material and distribution costs. And we've talked about this a number of times in the past. And I'm going to revisit just what our philosophy is around pricing and value management and then talk a bit about how we view it relative to the journey we've been on since '18.

First and foremost, in the specialty business, you focus on how you get the best value for your products and selling the value of the products more so than raw material dynamics. And our strategy is completely centered on innovation and driving significant mix upgrade and growth in high-value markets that significantly improve our margins through that mix.

So if you're going to do that, and you think about a lot of the markets that we're in where we have the same set of customers for decades, you have to have a strong relationship with those customers through the years if you want to continue to innovate with them and help them succeed and win and grow the market.

So that factors into your pricing strategy. And so we want to have stability for us in our spreads and as much as possible for our customers in pricing with the dynamics of raw materials. So as we do that, we want to share some of the value when raw materials go down, and we want to recover prices when raw materials go up.

From a multiyear point of view, I think we've done an excellent job in managing price. If you go back to 2018 as a reference point, that was a very strong raw material environment. In fact, stronger so far than this year when we look at year-over-year increase and what we expect. And we're able to maintain price increases and maintain stable spreads relative to '17, in the back half of that year. And that was the strongest earnings year we had until this year. So good reference point.

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So '19 and '20, with the impact of COVID and before that, the China trade war, we saw a pretty significant drop in volume and mix, it also led to drop in raw material prices. And we shared some of that with customers, but we still expanded spreads to offset some of that volume and mix headwind that we had.

And as we go into 2021 (corrected by company after the call), our expectations are that -- and as we're increasing prices, beginning in the first quarter, more so in the second quarter, and we'll continue to do in the back half of the year, we'll get our spreads for the year in the specialties, working towards the 2018 levels, including the headwinds that we have in tires, adhesives and fibers. So making good progress in improving spreads to offset some of those headwinds and getting back towards that '18 level.

So that, I think, is a great story and one that you want to do because the story for us on the specialties is volume and mix improvement, is really significant. You saw it in the first quarter, and you're going to continue to see it through the rest of the year.

Another thing to keep in mind as you're trying to compare our pricing relative to peers is we put mix in volume, where most of our peers put mix in price. So just to give you an example, if you looked at the Q1 in Advanced Materials, if I moved mix over into price like our peers have it, we'd be up 10% in price and up 5% in volume. So just giving you an idea of the significance of mix in our strategy, which we've been explaining and talking about since 2014, is the secret to our success in leveraging the best returns from our assets.

Another way you can look at it, of course, is also EBIT margins, where you can look at first quarter EBIT margins and AM improving 370 basis points in this story. AM has doubled -- more than doubled their EBITDA margins when you look at where we expect to be this year.

And full company margins, I'd also mention, are probably -- are expected to be equal to or greater than 2018. So we're very confident about our ability to maintain and manage pricing. Obviously, CI is going to have much better spreads in the current market conditions to add to the story. And CI also provides a nice balance to the specialty. So as prices are catching up in the specialties, the CI spreads expand, and that sort of balances each other out. So I think it's a good story. And as always, we're focused on innovation.

Operator

We will now take our next question from Mike Sison from Wells Fargo.

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

Mark, when you take a look at your outlook for 2021, the $8.25 to $8.75, what do you think drives the sort of low end and the high end? And how much of that delta is within your control?

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

Sure. So I mean, first of all, it's obviously a pretty significant improvement in our outlook today from where we were in January. And Mike, that's really driven by a material improvement in the volume and mix growth that we're seeing -- saw in the first quarter, but the momentum we're seeing going into this quarter and into the back end of the year. So volume mix is, as I said just a moment ago, the sort of heart of our strategy and will continue to be how we improve earnings this year. So that's the biggest driver.

Obviously, we have tight underlying markets in the Chemical Intermediates businesses that's providing that spread expansion I just mentioned to offset some of the lag and our prices catching up in some of the other products. So one of the uncertainties, obviously, is where the spreads in CI go.

On the cost front, we feel very confident about it. It's getting our costs out. The operational transformation program is doing a great job of offsetting the return of short-term actions we took last year. And remember, that's over a $200 million program that doesn't just help this year, but also will

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help going into '22. So we feel good about that, or you can look at relative to last year, the $100 million utilization tailwind that we have from '20 into '21. I'm feeling very confident about that.

So lower-cost structure relative to '18 and utilization tailwind relative to '20. So all of that has continued to be in place. So it's really about volume mix getting better, about spreads being better and then trying to guess, frankly, at how spreads in CI may moderate in the back half of the year.

We're assuming some moderation as some of the tightness that we're seeing at some point will go to more normal balanced market conditions. A little hard to call that, and that's one of the drivers of the uncertainty, along with the macroeconomic recovery we all face with COVID and all the other uncertainties that are always out there.

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

Got it. And given that your earnings outlook is much stronger, your free cash flow as well stronger. Any update on what you want to use your balance sheet for going forward, given the outlook does look a lot better?

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

No, Mike, thanks for the question. We agree that with the outlook improving and increasing to approaching $1.1 billion, what I would say is, as we think about capital allocation in '21, we're still, I'll call it, unchanged in our priorities. So one, starts with a strong dividend, which is an increase for 11 years, and we expect that to continue. Also, we expect to continue to reduce approximately $300 million of debt. And the balance will be used for the bolt-on acquisitions and share repurchases.

We announced the attractive animal nutrition bolt-on and used strategic cash of about $70 million there. And we expect to repurchase approximately $350 million of shares in the full year. Also, we'll be remaining disciplined as we go forward. But as we think about also getting our debt to EBITDA in line with our targets, that increases our flexibility as we go forward into '22.

Operator

We will now take our next question from P.J. Juvekar from Citi.

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

Yes. Mark, Willie, I just -- it feels like you guys are ahead in molecular recycling compared to your competitors who are working in polyethylene. I guess Eastman Kodak had some great technologies, and then congrats on your Barron's ranking as well. I guess how much -- my question is, how much is the conversion cost for a new PET lower than regular PET? And I know it's a long ramp-up and you've got to get customer qualifications and all that. But if you take a long-term view, Mark, let's say, by 2030, how much PET could you replace with recycled -- molecular recycled PET? Just any guess could be helpful.

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

Sure. So as is I said, we're really excited about methanolysis and where we think it can take us. And we are trying to be a leader to demonstrate that the plastic waste crisis can be solved within plastic. Plastic is, in many applications by far, the best product for the market. It has the lowest carbon footprint versus alternative materials, whether it's glass, paper, aluminum, in many cases. So we want to keep plastic being the best solution for climate by far. And -- but we got address the waste crisis. So we do have to have a way to scale it up, and I think we're demonstrating how to do that.

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It's important to remember that we're upscaling plastic waste into durable applications. We're not trying to sort of defend a large single-use plastic business and what we're doing. So that allows us to get a lot of incremental growth in durables at high values as well as better margins. And so we haven't been focused in this first investment on really leaning in on the PET business.

From a cost point of view, to answer to your question, the costs are modestly higher than PET or copolyesters, like oil prices around where they are today. If oil prices go up, that equation changes on a relative cost basis. And what we see is a real detachment now from this business, from the sort of fuel stock market, right? When you look at PET trading at 60%, 80% premiums to -- in our PET relative to fossil fuel PET in Europe, you know that there's a completely different economic proposition going on around recycled PET or recycled specialty polyesters that we're making.

But we do think there's a significant opportunity to scale this up. And in fact, we don't just have customers calling us around, wanting our specialty products for what we can do with recycled content. We also have customers talking to us about how we could significantly scale up and make PET for their needs around packaging. We have customers calling us. We have peers calling us. We have governments calling us and asking us, can you sort of work with us to solve this problem? And so we're engaging in those conversations and trying to figure out which set of those opportunities makes the most sense for us.

I want to be very clear for everyone who's listening, we are not getting back into the normal PET business that we got out of it in 2011. We're staying out of it. So if we choose to get back, it's going to be more of an Airgas model on how we engage with solving this problem and scaling up, which means that we'll provide technology, construction, operations, feedstock sourcing. And as we build multiple plants, we'll have all the operational technical know-how that gives us an advantage in how we can do all that for our potential partners.

We will have long-term contracts to secure all the demand that -- where we will not take market volatility risk relative to feedstock prices. And -- but from a capital allocation point of view, it will likely be more of an equity participation in partnerships as opposed to putting this entirely on our balance sheet. So very different model, more like air gas. And we'll see how those conversations go. I think the need is there. Lots of people are making very significant commitments. In Europe, they're facing very significant taxes.

And to your first point, we are moving faster probably than many others because we did practice methanolysis for a very long time as part of Kodak. And so we have a lot of technical and operational expertise that's allowing us to move very quickly in how we build this up and have a robust capability with a wide set of feedstocks.

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

Great to hear. And then coming back to more nitty-gritty, on CI, as I understood after the Texas freeze, as ethylene and other commodities spiked, propylene prices collapsed by 50% because I think refinery started up before the polypropylene plant started up. And so I guess it's hard to understand from outside, but I would have expected a benefit from lower refinery grade propylene for you and higher propylene derivative prices. But can you just explain what happened with the propylene chain? And what was the benefit? Or why didn't we see more?

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

Yes, sure. P.J., so first of all, we don't sell propylene, right? We sell derivatives from propylene as you just noted. And so we saw very strong pricing momentum before Uri hit in all of our grids because the market conditions were tight. Obviously, Uri made the markets even tighter. And as a result, those derivative prices have held up quite well, and they're going to continue to increase, increase in a pretty significant way into the second quarter.

You have to remember that most of our propylene is made from propane that we buy, RGP being converted into propylene and some supply agreements that are propane based in their pricing, not propylene based. So we're not buying a lot of merchant propylene in our total feed mix. So -- and the spreads are good and attractive. The derivative markets continue to remain tight. And we think we're going to have a very good second quarter.

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It's also important to note at the segment level, when you're trying to interpret these results in CI, there's more than olefins in this segment. So 25% of our revenue is actually functional amines, which has had a tremendous and very steady track record of improving earnings from '18 through to now and is on to a great track. And the vast majority of that business is on cost pass-through contracts. Same is true with a number of our acetic anhydride customers.

And so our strategy is to have stable earnings in CI, not to have really volatile ones as we're trying to be more of a specialty company, more predictable in our earnings and cash flow. That gave us stability in '19 and '20 relative to '18. And it's going to give us stability this year, but we're not going to be popping up on spot prices as much as some others.

Operator

We will now take our next question from Jeff Zekauskas from JPMorgan.

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

In describing the dynamics in your Advanced Materials business, you talked about raw material inflation, and you pointed to VAM. I would think that you would be pretty integrated in your Advanced Materials business. How much pressure is there from higher raw material costs? And what are the raw material costs that are really lifting there?

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

So, Jeff, thanks for the question. We are very focused on the value of vertical integration. As you just noted, it creates a lot of stability for us. So in our polyester chains, acetyl chains and olefin chains. That's for the most part, a way we provide significant reliability to our customers that -- compared to some of our competitors. And through the first quarter, I received a number of calls from our very important large customers, thanking us for our demonstrated reliability that they deeply appreciated and how well we got through the storm and supplied them.

But the one place that we're not vertically integrated is from acetyl to our interlayers. We don't make VAM and rely on market suppliers for VAM. So the shortages that we saw there has created a constraint for us in interlayers. It is specific to the interlayer business. But we were already having sort of supply problems with some acetyl unreliability in the fourth quarter. Then the number of plants were down about 3 weeks ahead of the storm due to unplanned outages. So the market was already tight, then Uri took about 25% of global VAM market off-line. And while they're back operational, they're not near to full rates.

So it's really created a pretty significant global VAM shortage, as you know. And prices are high, and the volumes are forcing us to cut back on how much interlayers we can make here in the second quarter. So that's the one place out of our total portfolio where I have a supply-related problem, and it is for a lack of vertical integration.

But we're getting through it. The teams have done a phenomenal job of sourcing VAM from all places around the world, overcoming incredibly complex logistics, which is going to help us resolve this here pretty quickly. And it will help us not just now but how to have a better diverse supply base in the future.

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

I know that Eastman wants to divest various business in the AFP segment. Can you describe what the magnitude is of what you want to sell? And will it be a dilutive transaction when you sell it?

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

Yes. Jeff, this is Willie. So thanks for the question. As we have previously said, we've been actively looking at all options for the underperforming businesses and adhesives and tires. We continue to be disciplined, and we're making progress on the restructuring activities to improve these businesses. And we've actually seen strong volume improvements from both market recovery as well as innovation gains with customer wins. But as you think about the overall size of these businesses on an EBITDA basis, it's going to be less than 10% for the 2 businesses that we're talking about.

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

And it will be dilutive when you sell it?

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

No. As we think about, I'll call it, the value of the businesses and the underlying EBITDA and the optionality that we have there, that it will be, I'll call it, net neutral on an EPS basis.

Operator

We will now take our next question from Frank Mitsch from Fermium Research.

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

If I could just follow-up on that last question, Willie. Are we looking at some action here in the first half of '21? Would you put it in that sort of time frame in terms of a divestiture?

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

Frank, what I would say is we're not going to comment on ongoing processes as we're looking at continuing to improve these businesses, and we'll give you an update when it's appropriate.

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

Okay. Sure. And obviously, very impressive growth in the performance films area, in Advanced Materials overall. And I think you said 15% volume growth. Some of that was due, I guess, to the Asia -- the easy comp relative to Asia. Can you talk about how that business is trending on a geographic basis and expectations here in the second quarter?

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

Sure, Frank, and good to hear from you. The recovery of AM was substantial, and a good part of that was Asia coming back to life. So if you go back to 2020, and looked at our performance relative to '19, we had very strong performance in AFP and CI. And we actually had 15% growth overall for the company relative to '19, which is a bit unusual relative to others in the marketplace. So we were going against a really tough comp.

But AM was one place that did face challenges in Asia. Supply chain and interlayers is really short, as an example, and as well as buying films on cars. So that led to some of the spike up. Demand, trending-wise though, has held up really well, so -- well, Asia recovery. And we had growth in North America and Europe as well in the quarter.

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What I'd say is, Asia is less of a source of growth for AM and for the company in the second quarter. In the second quarter, the big driver of growth is North America as you might expect where the economy here is starting to recover quite well. And China had already started to recover a year ago in the second quarter. So as you follow COVID recovery around the world, just sort of our revenue sort of follows that trend. And Europe is still lagging and expect it to be better as we move into the back half of the year.

So -- but the overall momentum is good. Demand is incredibly strong in our specialty plastics business across a number of products, Tritan. But it's not just Tritan, our copolyesters as well. But Tritan demand in particular is just dramatically better, driven by the normal value proposition we have, better performance in BPA free. But the circular economy is adding to a lot of growth for us and engagement with customers. So much so that we were planning on converting a copolyester line to Tritan 2 years from now. And we're now having to pull that conversion forward to now and getting it done by -- at the end of this quarter to be able to serve the Tritan growth and demand that is so strong. So that's going really well.

And then performance films, back to your original question around that. That's a great story, right? We're winning on 3 dimensions. We've got the best product portfolio and performance, especially with our gen 3 paint protection film that's dramatically better than our competition. We have a great channel strategy to grow through dealers and aftermarket. And we've rolled out a new software system for patterning, the installation of PPF on cars, which is incredibly important and better than our competitors, which helps them quickly install and precisely install the product. And we have the best dealer network around the world and have put a lot of effort into making that dealer network better.

So that business is going to have a great year. It was an incredible first quarter. A little bit of that was some restocking of inventory in China, but we expect the momentum for the rest of the year to be strong on all 3 segments, especially when we get back past this supply constraint in interlayers and have more capacity for Tritan.

Operator

We will now take our next question from Duffy Fischer from Barclays.

Patrick Duffy Fischer - *Barclays Bank PLC, Research Division - Director & Senior Chemical Analyst*

First question is just around the acetyls chain. Obviously, your Dallas competitor had a great quarter, looking at a great year in that space. Your footprint is different. Can you talk about your strategic footprint in acetyls? Do you need to back integrate more into VAM over time? And then what are some of the other acetyls derivatives? And how much are they offsetting the hit from the VAM side if you look outside of tow on some of your other downstream derivatives? If you could kind of just net out the acetyls chain for us this year.

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

Yes. Sure. So trying to do comparisons of our acetyl business to our friends in Dallas is not a very good exercise because their business is just entirely different than ours. So they're an extremely large player in acetic acid, and then they go forward into VAM and emulsions that, obviously, are enjoying exceptionally tight market conditions and high prices right now.

We don't make -- we make acetic anhydride, is what we make off of our stream that goes into cellulosic products as well as a variety of other acetyl or polyester products or olefin products where there's an acetyl component. But we don't go into that VAM emulsion business at all.

So if you want to look at our total integrated acetyl stream, including all the specialties that we make in Advanced Materials and AFP and fibers, the margins that we have and the stability of those margins is extremely attractive. But if you want to just look at in isolation and what we do in CI, which is sell acetic anhydride that isn't being used for making specialties, we're selling the co-product of acetic acid for when we make cellulosics. That business is limited to those market conditions. And those market conditions are not as attractive. We do lock out in sort of stable cost pass-through contracts, anhydride and that gives us nice stable earnings, but it doesn't allow us to have big pops or drops in that profitability from year-to-year. So it's totally different.

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So from a vertical integration point of view, the place where we're not vertically integrated is when we bought Solutia and picked up the interlayers business that buys VAM and PVOH as the raw materials. We didn't forward integrate into making those raw materials because our strategy is to deploy capital predominantly in our specialties. But it is very frustrating right now when we're being shorted on those products and paying very high prices for them as we're trying to keep our auto customer -- or glass customers in the auto OEM supply.

Patrick Duffy Fischer - *Barclays Bank PLC, Research Division - Director & Senior Chemical Analyst*

Perfect. And then maybe just 1 since it got highlighted with the acquisition around animal health. Can you size your animal health business as it sits going forward? And then where is your leverage both geographically and to different animals species, chicken versus hogs versus cattle? How should we think about that going forward?

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

Willie will answer the first and I'll take the second.

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

So you can think about it as roughly 10% of Additives and Functional Products overall. And looking forward to the accelerated growth that we believe that this acquisition will add.

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

So the trends in animal nutrition are pretty significant and really attractive. As most of you probably know, good health and growth promotion in animals is obviously very, very important. Historically, we use antibiotics to do it. And most people want antibiotic-free meat and protein. And so there's a switch to organic assets. We have the broadest portfolio organic assets for this market area. But we don't do a lot of formulation of those products.

So this acquisition, combined with investments we've been making over the last several years in our sort of formulation and application development capability can dramatically accelerate our ability to actually formulate more comprehensive solutions to these challenges and leverage that growth. And the formulations get significantly higher value than selling the assets by 2 to 4x depending on the application. So it's a real classic mixed play for our strategy everywhere else in our company, of creating higher value formulations, capturing a lot more value for that solution to our customers. And this acquisition brings in a lot of capability and a nice existing marketplace in Spain of products that we can then take around the globe given our broader commercial footprint. So there's a huge upside just on our global sales capability relative to their focus on Spain.

Operator

We will now take our next question from David Begleiter from Deutsche Bank.

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

Mark, in Advanced Materials, given the further step-up in margins this quarter, can you discuss the margin profile of this business going forward, both through '21 as well as beyond?

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

David, great to hear from you, and thanks for the question. So I think the margin profile for Advanced Materials speaks for itself if you want to look at the last decade, right? Just dramatic improvement. We said this, I remember having these conversations back in 2010, '11, where we made a lot of investments in asset capability, in application development capability, but we added a lot of fixed cost, built Tritan. And we said, look, when this starts to sell and grow, the fixed cost leverage is going to be incredibly impressive.

If you go back to the 2018 Innovation Day presentation of Advanced Materials, we laid it all out for you on how fixed cost leverage works in this business. So in that sense, I think as we look at the margins this year, which will be quite attractive and as we go forward, we think these margins will continue to improve.

Now they're not going to improve like they did from '20 to '21, obviously, because we took such a hit on asset utilization, especially in Advanced Materials as we're pulling inventory down in interlayers and performance films. You have to remember, specialty plastics actually grew earnings last year relative to '19. So they provided nice stability relative to the auto exposure we had in interlayers and PF.

But as we continue to grow the circular economy, which is a value up and better margins, as we continue to grow products like Tritan and everything else, whether it's the paint protection films or pretty much anything in performance films has very attractive margins. The acoustics, heads-up display interlayers, very attractive. Electronic vehicles are another big lever for us where we see significant upside.

So it turns out to need a lot more glass than an EV. When you put batteries underneath people, their head goes up to the ceiling of the car because you don't want to raise the roof height because of aerodynamics. And so what they're doing is making windshields bigger and putting on bigger sunroofs to not make the cabin claustrophobic. So we're getting a lot more real estate of the car in glass with every EV.

And then they have much higher functionality requirements in that space. So they want better acoustics. When you don't have the engine noise, which is sort of white noise, you now have more -- other noises that people focus on, they're more sensitive to, and you actually have to not just have more acoustics, but you have to be able to have the capability to tune it to different frequency bands. They still want heads-up display for safety reasons. They want more color that they're using in parts of the windows as part of how they're adding more glass. And they want solar rejection to reduce air conditioning load.

So all these functionalities in, it takes tremendous technical sophistication to put all that functionality into 1 interlayer. And we're the world leader in how to do that. And so when we look at EVs, it's probably 2 to 3x more value per car that we're capturing. And we already have some great adoption on some of these products with a very significant leader in this space. And we expect that to continue across all the brands. So we see volumes growing, mix growing cost being controlled, spreads being managed, as I discussed earlier. And so the earnings growth will improve and the margins will incrementally improve year-to-year.

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

Sounds very good. And just on M&A, can you both size the 3F acquisition and discuss the rest of the M&A pipeline that you're seeing today?

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

So David, this is Willie. Again, the size on the 3F was roughly $70 million in acquisition price. And we paid high single digits off from a multiple perspective. Obviously, as we continue to look, we're focused on the organic growth and the investments there to ensure that we have the capacity as we go forward. But we're also looking at how do we accelerate that. And as we think about the additional flexibility that we'll have going into '22, we're filling up our pipeline of potential targets to accelerate that growth as we think about creating more value than just buying back shares.

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Operator

We will now take our next question from Alex Yefremov from KeyBanc.

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

Mark, you spoke about good demand for methanolysis-based polymers. At what point could you start thinking about additional investments in capacity? Would you have to, you think, turn on and run your initial capacity, your initial plant? Or could you think about expansions sometime earlier if demand continues to be so strong?

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

I'm sorry, I was just a little bit hard to hear your questions. So I'm going to repeat it back to make sure I got it correctly. So are you saying what capacity would we need beyond the first 100,000-ton methanolysis plant? And when would we have that?

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

I'm sorry, Mark. Let me repeat this. Demand for methanolysis-based products is strong. So at what point would you start thinking about additional expansions or can you possibly start thinking about additional expansion of capacity? Do you think you have to start-up the plant first and see how it works? Or if demand is strong enough, could you think about expansions maybe sometime in the next 12 months or so?

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

Yes. So we're not going to wait to start this plant up before we start building another plant necessarily. I mean, it will depend on the demand we see for our products internally, and it will depend on this partnership conversation. I mentioned earlier about how we're talking to people about building additional plants around the world that would be focused more on PET than our specialty plastics, but we could take a stream of that output and use it for specialty plastics if we wanted to.

But for sure, if you ask me, where are we going to be 5, 10 years from now, our goal, as we said in the sustainability report last December, is to make all of our cellulosic plastics and our polyesters from plastic waste. That's our long-term goal. So we're not stopping at this first plant. And we're -- and what we're seeing so far gives us great confidence that, that vision is possible.

It's a very attractive return for shareholders. We get better margins. We get to accelerate growth of our highest value products, and it's just a great story. So yes, I expect we'll be building more than this plant, but we're focused on doing this plant well first and having success in filling it up, and seeing if this alternative business model is something that's going to work with customers and partners.

I would also note that, that's not our only sustainability play. We've been the original biopolymer company, right? We've been making cellulose acetate for over 100 years and brought it into a wide range of products. So it's a sustainable biopolymer. It's biodegradable in a lot of applications. And now we have a very unique capability on the planet to add recycled content to the other half of that polymer, right? So half of it is made from certified and sustainable forest, the other half today is obviously made from fossil fuels in acetic anhydride to make those cellulosic products.

As we add recycled content to the other half of it, it's an extremely compelling polymer compared to anything else on the market because it's biopolymer, it's biodegradable, and it has recycled content in it and based on a wide spectrum of waste plastic, including our ability to take back products from our customers like textiles, right?

So Naia has just been a phenomenal growth story for us this year and especially in how fast it's recovered in the first quarter. And it's just got a great story as a biopolymer that's led to a lot of success, and now we're adding the Renew recycled content part of it to the story. And we expected

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just a tremendous amount of growth of that. And there's a bunch of cellulosic plastics and Advanced Materials that we see in the durable space. And we also think there's probably significant upside in the single-use plastics space as well. And that's very early stage.

So that's a whole another dimension of growth at better margins, higher value, great asset leverage to our existing capacity because there, we don't have to add capital. It's just leveraging existing capability and capacity.

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

Mark, as a follow-up, you were talking about $100 million full year benefit of higher-capacity utilization. Where do you think, relative to that annualized target, you stood in the first quarter? Do you think if we sort of -- as we ramp volume through the year, there's more? Or it fully reflected that benefit as of Q1?

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

Yes. This is Willie. And what I would highlight is we expect to see a tremendous amount of the year-over-year utilization benefits in Q2 and Q3 as a reminder. So obviously, here in the first quarter, we've had a hard time building inventories, which means we're running at high rates, but the low rate utilization that we had in 2020 or substantially in Q2 and Q3.

We're also looking at how we expand, and we're making higher investments this year to ensure that we can capture not only the existing demand, but the future demand, including expanding our interlayers facilities this year. We're bringing on amines capacity as well here in Q2 during the shutdown and as Mark has already highlighted, converting a polymer unit ahead of schedule on Tritan. So -- and we, additionally, we get roughly 2% to 3% capacity creep. So you'll get the cost benefits in Q2, Q3, but more importantly, it's about the mix upgrade and the continued growth that we're focused on and deploying the capital to do that.

Operator

We will now take our next question from Bob Koort from Goldman Sachs.

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

Mark, I wanted to -- if you could help me figure out how the how the heck you guys are keeping costs flat. I know your headcount hasn't changed, and I would assume there's some creeping back in from last year. You've got some expansionary efforts and new programs in place? How are you doing that?

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

So Bob, this is Willie. What I would tell you is we've been doing a great job of managing our overall cost structure across the company. And our teams are delivering, and it's showing up in our performance, whether it's EBIT, our EBIT margins, cash flow and EPS.

So as we think about what we've delivered, we ultimately started our COVID action plans at the end of Q1 last year, and then we accelerated transformational efforts towards the back end. As we came around here into Q1, we benefited from those cost actions year-over-year. I would point out, as you think about also our SG&A line, you probably see that going up a little bit. And as I highlighted, I believe last year, the fact that we had some market-based comp, specifically deferred comp, that was a benefit last year that's not repeating this year just due to the financial market declines.

But we're well set up and focused, so that those variable margins that we talked about last year fall through to the bottom line. Obviously, there'll be a little bit of denominator math just due to the price inflations that we're dealing with.

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

Yes. Bob, overall headcount is down. So between the assets we shut down around the world as well as some headcount optimization that we've done last year, the headcount is actually down. I'm not sure where you got the it's flat part.

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

I was looking at the 10-K. Maybe I just misread it. Mark, I did want to ask, it's been a long time since you did a blockbuster deal. And it appears that you're starting to get the traction on the EBITDA run rate, the earnings run rate. Do you have enough stuff on the organic plate to keep you busy and excited? Or do we start to put on the radar screen, maybe it's -- you deserve the right to do something big again?

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

So first of all, we love our portfolio and the innovation that we have in front of us, Bob, and it's producing very attractive earnings and exceptionally attractive cash flow. And we see a lot of innovation, positioning us to continue growth into '22. We also like the markets that we're in, and we still think there's market recovery in front of us in '22 and beyond in things like aviation, automotive. So the volume mix story, I think, will continue. The balance sheet is obviously getting stronger. And we're going to have tailwinds next year as we go into that year with cost reductions.

So all of that feels good. And our balance sheet is getting into better shape. Our strategy continues to be focused on what can we do organically, what bolt-on M&As make a lot of sense to add to what we're trying to do and buy back stock with the remainder of the cash. So that's our strategy now, and that's what we're going to stay focused on doing.

Operator

We will now take our next question from John Roberts from UBS.

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

And I'll ask just one here. Mark, methanolysis has overshadowed the activity you're doing on processing waste plastic in the gasifier. Have you taken that as far as it can go? And can you help other gasify operators process plastic waste?

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

Yes. So we're really excited about what we're doing with the gasifier and changing it from gasifying coal to what's technically called reforming plastic. And so that plastic waste, we're just getting started, Bob. It's got huge growth potential. That's the speech I just gave a moment ago about biopolymers and all the opportunities we see to grow in specialty plastics as well as in textiles.

So the great good news is it's incremental capital to continue adding plastic waste. And the great thing about the gasifier is that it can take any kind of plastic waste, mixed plastic waste, which is great. It gives us a unique advantage in buying raw materials because we can buy a puddle of plastic and then separate out the polyester and put it in the methanolysis and put the remainder into the gasifier, which gives us the ability to buy very low-cost feedstock that hasn't been sort of cleaned up. And we're really excited about that.

So no, we see a tremendous amount of growth in that space, as excited about that as methanolysis and what we can do with our polymer capacity, and we have a lot of capacity to leverage. So no, it's going to be great.

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As far as working with other people, we're not focused on that right now. To your second part of the question, we're -- at the moment, we're really just trying to deal with all the inbounds on the methanolysis side that's taking a pull of our resources.

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

Let's make the next question the last one, please.

Operator

We will now take our last question from Laurence Alexander from Jefferies.

Laurence Alexander - *Jefferies LLC, Research Division - VP & Equity Research Analyst*

Can we -- can you put the cost and productivity discussion in perspective in terms of over the next, say, 3, 5 years? Would you be able to keep the cost structures roughly flat, barring any M&A? Or is there an adjustment period? And if you do so, what would you be sacrificing? Like what are you giving up in order to do that?

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

Yes. Thanks, Laurence, for the question. As Mark sized it earlier, we started with a goal of delivering a flat cost structure in 2021, and that was on top of reducing our cost by roughly $150 million compared to '19. And as we look forward, we look to continue to grow that, and we see another $50-plus million over the next year plus.

Also, what we're trying to do there, Laurence, is that frees up capacity as we create the incremental gains to continue to fund our growth without substantially growing our cost structure. So that's the way I would frame it at this point. And we continue to also look at leveraging assets and sites, et cetera, to continue to gain better fixed cost leverage where we have additional capabilities as we've highlighted previously.

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

But to assure you, we're not making any compromise on our growth portfolio. I mean, even in '18 -- I mean, in '19 and '20, when we could have easily cut on R&D and innovation, we kept on doubling down and investing in those spaces because we knew that's our future. We, frankly, did the same thing in '08, '09, which allowed us to come out of that crisis extremely well in '10, '11.

So we're never going to compromise our long-term strategy, but we do think digital technologies and a variety of other things that are available to us today allow us to be much more efficient in how we run our operations as well as get a lot of routine tasks done in the SG&A world to enable us to invest more in growth.

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

Thanks very much, everyone, for joining us today. A replay of the remarks plus the transcript will be posted on our website this afternoon. Hope you all have a nice day.

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

Thank you, everyone. Appreciate the questions.

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Operator

This concludes today's call. Thank you for your participation. You may now disconnect.

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