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PRESENTATION

Operator

Good day, everyone, and welcome to the First Quarter 2023 Eastman Conference Call.

Today's conference is being recorded. This call is being broadcast live on the Eastman 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*

Thanks, Brenda, 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 2023 financial results news release and SEC 8-K filing. Our slides and the related prepared remarks in the Investors section of our website, 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 2023 financial results news release.

During this call, in the preceding slides and prepared remarks, and in our filings with the Securities and Exchange Commission, including the Form 10-K filed for full year 2022 and the Form 10-Q to be filed for first quarter of 2023.

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 2023 financial results news release.

As we posted the slides and accompanying prepared remarks on our website last night, we'll go straight into questions. Brenda, please let's start with our first question.

QUESTIONS AND ANSWERS

Operator

Our first question comes from the line of David Begleiter of Deutsche Bank.

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

And Mark, just on Fibers. I saw you increased the full year guidance, what was behind that? And how sustainable is this new high level of earnings in Fibers?

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

David, great question. What -- we're really excited about it. It's just fantastic to see this kind of improvement in the Fibers business, which we do think is structural and stable going beyond this year into the future. The key drivers for the improvement were obviously a pretty significant increase in price associated with making sure we're providing enough earnings and cash flow from this business to invest in it and be a secure supplier.

So we've got improvements on price/cost relationship. We've got improvements in our operational performance, which has turned out to be better than expected because we've also raised our guide from \$275 million to \$350 million that price cost being better. Our operational cost improvements in this business being better and the textile business, really showing a lot of growth right now. Even though the overall market is pretty depressed, the sustainable value propositions we have are really driving a lot of growth for us relative to the underlying markets. It's just another example of how our innovation model creates a lot of growth even in tough markets.

When it comes to the stability question, there are some factors that I discussed in January, and I'll just hit them again quickly. The market structure in the tow business, has fundamentally changed from what we've been facing over the last decade. Part of it is the demand didn't decline nearly as much as we feared over the last 10 years, really declined only about 1% a year decline versus 2% to 3%.

And we've had the heat-not-burn segment really growing quite strongly. That also still uses filter tow, in fact more filter tow than a traditional cigarette growing over 15% a year, creating stability in that market. So the market is only down about 10% when you look at the last decade, and now China is even showing some modest growth in sort of the 1% range, which is about half of the cigarette global market.

So that's been really helpful. In addition, our growth in textiles allowed us to focus and fill up our assets and repurpose assets towards textiles in a way to sort of see value not just on focusing on the tow market.

On the supply side, we've also seen pretty significant reduction in supply on 2 fronts. First, about 15% of capacity has been shut down by a number of players in the industry, including us repurposing some of our capacity towards the textile business. And we've probably lost effective capacity in the 10% to 15% range as we've gone to making much more specialty items, the slim tow filters as well as TiO₂ free, the heat-not-burn are all more complicated and run slower on the assets.

So we've lost a lot of effective capacity. So you're at least a net 15% reduction in capacity, putting us in the 90% to 100% range on utilization.

So the markets are tight, and that's resulted in customers being very focused. Again, on security of supply, the cost of a tow filter is a small percent of the price of the cigarette. So you don't want to be missing out supplying the market for such a small cost item. And we're working very closely to make sure we've got contracts in place, which we do for this year and by the summer, probably the vast majority of the contracts will be completed for the next 2 years beyond this one. And that sort of puts these kind of improvements in place.

So we feel really good about where we're at, and this is a great source of earnings and cash flow to invest in the growth of the overall portfolio.

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

Very good. And just a methanalysis, given the delay you highlighted today in the project in Kingsport, do you have an updated forecast of losses or EBITDA drag from this business in 2023?

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

What I would highlight is, I don't expect a significant increase in the growth spend for the full year. I would highlight the key point is we're on track to produce commercial quantities this fall, and we'll have revenue before year-end. So on the cost basis, not a significant impact. I would highlight our overall capital spend expectations for 2023 at \$800 million. I'm confident that we'll be able to complete the construction within that level of investment as well. And we will deliver the investment returns that we've committed to for this project.

Operator

Our next question comes from Vincent Andrews with Morgan Stanley.

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

Mark, I saw this week an article talking about that you had the successful completion of sort of recycling project for automotive mixed plastic waste. I think they call it automotive shredder residue. Could you talk a little bit about that? And what you think the opportunity set is for you here? Is it similar to what you're doing on the consumer side of the equation? Just where is this in its life cycle?

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

Vince, a great question. And it highlights that sustainability and opportunities to grow our portfolio go well beyond just polyester cycling and our cellulosic growth. We're looking at all forms and fashions of how we can lean into this trend that's disrupting the markets and creating a lot of growth opportunity.

As you know, the automotive market has a huge need to do with how to recycle all these cars and all the components of the cars as well as the waste in the process before making it through making the car. And so we have several programs, we're doing both in Europe and the U.S. on looking at every place that we can lean into that. So, for example, with all the interiors, all of the polyester that's involved in the making of the interiors or recycling that polyester that is a take-back program, we can do effectively for our polyester recycling technology project.

We're also working with the auto sector on how to recycle all the PVB polymer and the interlayers around glass. It's a stunning amount of waste, both in the glass and the interlayers and we are developing our own molecular recycling processes on how to take that PVB back and close that loop as another circular program. We don't talk that much about it because it's a little bit earlier in development. But it's another driver for advanced materials and how we can be a much more unique supplier to the auto industry.

Lots of companies are engaging these programs for all the interesting reasons. We're pretty uniquely positioned for the textile part of a car as well as the glass part to really be the leader in delivering those solutions versus anyone else on the planet. So a lot is going on in that space.

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

And then just as a follow-up in your regular business, you called out auto as being strong in the quarter, and you also anticipate there being growth in the second quarter sequentially. I'm just trying to compare and contrast that some of the other folks that are out there that have a lot of auto exposure, thought that maybe 1Q builds, maybe were a little bit of a pull forward from 2Q. So is that not what you're seeing? Or is your comments reflective more of just your portfolio of products rather than sort of what's going on in the broader industry from a builds perspective.

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

Yes. From a total builds perspective, Vincent, I don't think our view is all that different than what you just said. I mean Q1 was certainly a bit better than expected as we highlighted. I don't think we're seeing in a total production basis, a big sequential trend of improvement from Q1 to Q2. I'd say it's holding. It's incrementally better. But our position in the market is very different than this broad production data.

So when you think about the Advanced Materials business, the products that we're making, whether it's the high end, high-value paint protection films or window films or it's the high interlayers or the multifunctional films going into EVs. We're really positioned in the much higher premium into the marketplace. So about 70% of these very high-value products are targeted at high-end premium market, which is about 25% of auto builds. And that part of the market is actually growing in the sort of high-single digits.

So those markets are holding up a lot better than the overall market. And so we're getting a lot of lift, it's because of our unique focus in that space and growing at the double-digit level. So not only we growing with those markets, we're winning a lot of very high-value mix applications in that space.

And what also helps us is we're not losing any volume because we're not in the combustion engine drivetrain at all. We have no presence there, right? We're in glass. We're in the coatings. And so as these markets do well, we get absolute growth, and we don't have any offsets because we don't have exposure to the engines that are being sort of switched over to electric.

So in that, I think we're really in a good position about that. And as we've told you, you get that additional leverage with 3.5x the volume in EVs, et cetera. So we're doing really well because of our strategy, because of our innovation and because of the position we have in the market. And that's a pretty good for AM. I would note that AFP is more connected to the broad auto production market. So their growth rates a little more modest because they serve the broad spectrum of the market versus just the high end.

Operator

We now have Josh Spector from UBS.

Joshua David Spector - *UBS Investment Bank, Research Division - Equity Research Associate - Chemicals*

Just curious if you could talk to what you see the underlying level of volume declines in the portfolio today, kind of excluding destocking and really trying to think about how you're thinking about volumes developing from first quarter, second quarter and what's baked into the second half and drive some of your EPS uplift that you're looking for?

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

Sure. So I think it's important to start with the total volume numbers, and then I'll try and sort of bring it down to the specifics on your question. So if you think about the fourth quarter and the first quarter, the consumer discretionary markets like consumer durables, B&C, those kind of markets, electronics have seen a just significant drop in primary demand as well as a significant amount of destocking, and it goes back to the retail channel massively overstocked going from sort of an inventory ratio 1x to sales to 2x plus led to a huge amount of change in demand. And then

pull that apart, that story that we told in January about the markets, this market area being down 40% and retail sales being down about 10%. You got to remember, retail sales is dollars. So if you back out inflation, you're talking about volumes being down 15%, 20% on a volume basis. It's a pretty significant drop in demand for all the reasons I think have been well discussed about, COVID and supply chain, et cetera.

And that trend continued, in fact, got a little bit worse in the first quarter from the fourth quarter when it came to the destocking. So we see that playing out and that destocking in durables continuing to go. There's just phenomenally long supply chains in this space, especially for us because we're manufacturing. We're very -- North America centric manufacturing. So all of our; specialty plastics are made here, then they have to be shipped to China, typically to be made into different components and then go through warehouses and then component makers and then brands and then warehouses and then finally at retail back in the U.S. and Europe. So it's just a very long supply chain to destock.

And that's sort of what you see going on. We do see signs of that destocking ending in May. But what we would say about these discretionary markets, whether it's durables or the same kind of story in building construction, those trends on the primary demand, we are now forecasting to stay at these low levels for the rest of the year. It's possible the world will get stabilize and get better and there will be some restocking, but none of that is in our forecast. We just have the end of destocking in these discretionary markets. I would note in building construction, we're assuming things have been bad for a while in Europe and Asia. So that's not really a destocking sort of just low demand. But we do see things decelerate in the U.S. and have factored that in consistent with our coating customers.

On the stable markets, I would note that we have a very different situation. Obviously, they are stable, but they still are under pressure. Low single-digit, lower demand when you look at some of the customers in that space in personal care and water treatment, et cetera, because even their demand is off. And yes, they are doing additional destocking and that, I think, has mostly played out in the first quarter. And so we're now moving back to more just sort of lower primary demand as we go into the second quarter.

So those are sort of the dynamics across the market, and I just made comments on the auto market, which is obviously a source of strength. I'd note ag is a source of strength and holding up well. And I would note that aviation is recovering well and also a source of strength. So -- there are a few places that things are going well, places like medical and pharma, where things are really stable. And then you've got the story just hit on these demand situations.

So as you look at the first half to second half, we've really moved to our new forecasting primary demand is going to stay at these challenged levels for the rest of the year and the only lift in demand in the back half is the end of destocking that's part of the first half challenge, that doesn't continue into the second half.

Joshua David Spector - UBS Investment Bank, Research Division - Equity Research Associate - Chemicals

Okay. I guess maybe if I could try to quantify some of that. So your volumes were down 9% in the first quarter, is your primary demand down low-single digits. Just when you talk about demand consistent first half, second half, you talked about a number of weak markets going through your Slide 13, and I don't need to rehash all that. But just what numbers are we looking at there roughly in terms of some of those markets?

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

Yes. So I think every story is a little bit different. But to keep it simple, you've got primary demand that's down and probably explaining aggregate, it's a little tough to break that out, but it's 1/3 to 1/2 of the -- let's call it, 1/3 of the story, probably 50% of the story is destocking in the first quarter. And then there is a 10%, 20% of the total decline that is places where we're seeding share. So discipline in price means you don't chase every KG. And in that case, what we have is place like especially AFP and CI, very low-value markets where we're just not chasing that share.

Architectural in China margins are incredibly low. We're not going to compete with the Chinese on share. We'd rather they serve that market than sort of export their products and it hits volume, but it doesn't actually hit earnings for the values although. Same is true in Chinese exports hitting Europe right now in different products, and we're choosing not to meet some of those very low offers, which is low-value market applications for us because we just sort of exacerbate price competition and it doesn't really have that big of an impact on earnings.

So some of the volume mix is certainly market driven, as I described, some of it, which is a much smaller portion of that 9% is these kind of choices we make because that's how you have commercial excellence to maintain price discipline and stability in your important valuable markets and customers and regions. So that's how we break down this plan.

Operator

We now have Jeff Zekauskas with JPMorgan.

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

With your molecular recycling facility that will come on late this year or early next year, is all of the material that's going to be made Tritan?

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

No. So the molecular facility, which will be coming on this fall with the current schedule that we have we'll be providing recycled content that goes into Tritan, but it also goes into a number of copolyesters. So the cosmetics sector, for example, uses our copolyesters, it's a great market. It's actually another place where demand is actually better right now with people, especially the Chinese getting back into traveling.

And those brands, LVMH, L'Oreal, Clarins, all the brands, Chanel, et cetera, that we're working with in that space. They're some of the front leaders, frankly, on sustainability. They have the most aggressive recycle content targets, and they're the most determined to achieve those targets given their luxury position with the consumers that they serve. And so we see a lot of opportunity and growth in that space with recycled content.

Tritan obviously has a huge amount of opportunity. I mean one of the best market opportunities for Tritan sustainability is hydration bottles, right, whether it's Nalgene, CamelBak, all these reusable water bottles to get use -- to move away from single-use plastic is a very high value, very high-growth market, including YETI, et cetera.

And that market actually didn't come off as much as some of the other consumer durable markets, and it's going to show a lot more growth. So recycle content of going everything that you would think of that's natural like that, and I think it goes into products like the power tools gamble we told you with Black & Decker.

And some of these other applications in electronics, where other brands are very focused on their sustainability position, and we're winning in new applications, opaque applications that are not normally where we play with Tritan because our strength is chemical resistance, durability and clarity that commands a very high price from the market because no one has a product that can match us, including being BPA free. But now we're getting to applications where the value propositions are a bit wider and still winning. So it's a combination of both. That's why the plant in France also will be half specialty to serve that cosmetics market in Europe and other high-value applications, including shrink packaging, et cetera. So it's broad-based.

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

So maybe I'll try it again. So I think polyester demand or Tritan demand was negative in 2022. It's negative this year because of weakness in the durable goods market. And now you're going to bring on more capacity, which the market really wants over time, but it may -- mightn't it be difficult to get up to high utilization rates in 2024, given how weak the durable goods market is or the overall demand for Tritan and other polyesters, maybe it will take you 3 years to ramp up your capacity. Is that right?

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

Yes. So Jeff, that's a very good and related question to my answer. We are adding a significant chunk of capacity in Tritan, as we've told you, that is a way to sort of grow total volume for the company and sort of very strong drive demand. And you're correct, Tritan goes into consumer durables, -- that is one of its key end markets and certainly seeing significant demand pressure in the fourth quarter of last year and this year.

something we may not have been clear about in how we manage our assets and our expansions that I'll address right now. So we have flexibility to swing our Tritan lines back to copolyester, right? They were originally -- if you want to go back in history, they are originally PET lines that we modified to make our specialty copolyesters and then we modify them again to make Tritan. But we've always retained flexibility in these assets to make different products.

So our strategy was always when we brought on this very large chunk of capacity to swing one of the smaller Tritan lines back to making copolyester. So the net effective add of Tritan capacity will be about 25% when it comes online because of how we've swung that other line back to making copolyesters. And this works because the copolyester markets we have to serve there are much bigger markets and a wider set of markets to serve.

And as I just explained, the recycled content value isn't constrained to Tritan. It very much applies to cosmetics. It applies to the shrink packaging, which was however a big market where people in that business going on bottles needs to have their sustainability recycle content targets hit there too as part of those bottles.

And so we'll run the methanolysis plant full in serving all of those end markets and our capacity will be balanced. And this is a huge advantage of our asset strategy, the flexibility to swing assets to make a wide range of products to adjust to whatever is going on in the market dynamics that we face.

So no, it's not a problem. And then as we fill out that first 25%, we'll swing that asset back to Tritan to get to, in the end, a 50% capacity expansion. But you can do that over time and make sure you have volume and variable margin paying for the whole fixed cost and getting that leverage bottom line.

Operator

The next question comes from Aleksey Yefremov from KeyBanc Capital Markets.

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

Mark, if I remember correctly, last quarter, you said you were looking towards the lower end of the annual guidance. Is this still the case for this update?

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

No, we're feeling very good about our range and how we think about it. And if you think about the guidance we gave in January, it was a balance of volume recovery, price cost improvement with the trends that we see in raw materials, energy and distribution and the cost actions that we were taking, those obviously changed, but to hit the 2 positives first the price cost improvement is pretty substantial and the fibers improvement is obviously substantial relative to our January guidance.

And if you look at the strength of what we already have shown in the specialties or on the spread improvement, in the improvement in fibers and think about how that rolls through the rest of the year. That's about \$1 -- it's at least \$1 per share improvement in our outlook for fibers and spreads in the specialties. So that's a tailwind.

So then you get to -- we didn't change our range with investors. And that's due to the conversation we've just had around the weakness in the market on the demand front being pretty substantial. And when you think about how we've sort of adjusted our guidance when you look at the next 3 quarters, you're about \$2.08 I guess, in the mean. So our midpoint of our guidance range for Q2 is \$2.00. So it's a pretty modest adjustment for some of that demand not being better in the second quarter sequentially being partially offset by better spread netting out to that sort of 2Q number.

And then we've really pulled the vast majority of that dollar per share improvement in our outlook into the second half of the year, and that really is predominantly volume and mix and the associated asset utilization headwind that comes with it. And you've got that -- as we're sort of seeing this weaker demand, we're taking actions to reduce our operating rates, full inventory down, make sure we hit our \$1.4 billion of cost -- I'm sorry cash flow generation. And that led to that \$50 million of asset utilization headwind we identified and about half of that occurs in Q2 and the rest in the back half of the year. So that's all sort of fed into this mix.

But what it really does is derisk the guidance. You don't have as much of a step-up into the second half of the year that we had in January. So I think it's a much more balanced forecast. I think we feel very good about the range and our ability. We're certainly not at the low end of it anymore, and we'll focus on what we can control. I mean it's a pretty uncertain environment. I think the volume forecast now is pretty conservative or balanced based on how you want to look at the world. But certainly not optimistic.

And we're going to focus on controlling our costs, focus on our price discipline, focus on innovation to create value and growth above the underlying markets and make sure we deliver our cash flow.

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

And on one of the slides, you're talking about interlayers being better positioned or gaining content in electric vehicles versus ICE. I thought both EVs and ICE use interlayers and especially the premium ICE cars. Could you talk about this? Why is there a content gain?

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

So in the EVs versus ICE cars, they both have safety windows for sure. But we've walked through this a couple of times on ceiling of EVs. And there's a lot of detail on Innovation Day on this. There's about 3.5x more content in the EV car than an ICE car when it comes to interlayers. Part of it is you're sitting on batteries, your heads pushed up higher into the ceiling. They can't raise the outside ceiling for aerodynamic efficiency, so they make the sunroof a lot bigger. So you're now riding around in a bubble.

And so there's a lot more glass going to laminate it. There is the sunroof, the side windows, the back windows because it's also a way to take steel out of the car by getting more structural strength from the glass with the laminate. They want more functionality in it. So they want the heads-up display. They want more solar rejection to reduce the load on HVAC. So we're putting a lot of solar rejection properties so that inside the car doesn't get heated up. They need more specific styled colors, et cetera. So all this is leading to a lot more value per square meter in addition to a lot more square meters when you go to an EV. And we've already seen tremendous success with a 70% increase in our sales last year over '21 from EVs and it's now up to sort of 10% of our exposure in that business. So -- it's just -- it's a great story. And fortunately, we're not losing anything in the transition with -- being in other parts of the car.

Operator

We now have Michael Leithead of Barclays.

Michael James Leithead - Barclays Bank PLC, Research Division - Research Analyst

Great. First -- just 2 around inventory and working capital. First, you talked about \$50 million of incremental headwinds from lower asset utilization to manage your inventory. Can you just speak to what business or businesses are seeing the most pain there? And then second, Willie, just what's the working capital assumption and your cash flow guide this year?

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

Yes. So what I would highlight from a business standpoint, as Mark has highlighted, the end markets of durables, building and construction are the ones that are most under pressure. So you can think about that being in our specialty businesses as we level out and have the fixed cost impact the remaining parts of the year. Ultimately, what we've said at the beginning of the year to achieve the \$1.4 billion of cash hopefully, we were expecting, I'll call it, year-over-year working capital to be flat.

You can see we're off at the beginning of the year, and that being a net I'll call it the net usage of cash and we're focused on driving that cash as we hold our earnings guide flat for the full year that we delivered that through to the bottom line. So we're not waiting to the back half to see how it unfold. We're taking action now so that it is across the last 3 quarters.

Michael James Leithead - Barclays Bank PLC, Research Division - Research Analyst

Great. And then just quickly, Mark, on methanolysis. You mentioned seeing revenue before year-end. But just -- when do you think that facility will be ramped up to a point where we'll sort of see a normalized kind of EBITDA run rate from the plant?

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

So the ramp-up of the facility will be quite fast getting to sort of full capacity and recycled content will be the priority valued by our customers. So we expect the facility and the recycled content to start going into a wide range of products pretty quickly through 2024.

Now filling out the capacity of the -- Tritan capacity, obviously, as I discussed a moment ago, to Jeff's question, will take some time, but we have a way to flex our assets to sort of sell recycled content into wide range of markets, including PET if we want to sort of run it full.

So there's plenty of market demand -- unlimited market demand in PET relative to this capacity. So we feel good about deploying with the capacity pretty quickly. It will be across a spectrum of markets and then over time, we'll value up that mix, like we always do to the higher and higher value specialties as we continue to penetrate and grow in those markets like Tritan over time. So we'll get to a pretty good fill out rate on the actual investment in the recycled content within 12 to 18 months.

Operator

Your next question comes from Matthew DeYoe with Bank of America.

Matthew Porter DeYoe - BofA Securities, Research Division - VP

Just wanted to ask quickly on the 2Q guidance. The 2Q guidance range, I mean, the segment commentary is fairly tight at -- like ex -- AM, but I'm just kind of wondering as we look at it, what maybe takes you to low end versus the high end of the range.

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

So when you think about the sequential trends, we obviously did a lot better than expected in the first quarter, which was principally driven by price/cost favorability especially from natural gas that we can see continuing sequentially into the second quarter. So that part, I think, is pretty clear. The cost actions we're taking on the \$200 million cost reduction program and how some of that certainly showed up and help to the first quarter, but more of that will show up in help in the second quarter, that's pretty easy to see and predict how those elements are going to play out.

So the wildcard is purely back to the full year, which is how is volume and mix going to play out? And how does that also impact asset utilization? And that's really where things sit.

When it comes to the stable markets, I think we've got a pretty good understanding of that sort of half of our revenue that -- and where the trends in those markets are headed. There's still a little bit of destocking in personal care and water treatment and AFP that's uncertain.

And then the big question is an AM associated with what's going on in these more discretionary markets in consumer durables and when that destocking ends and at what rate. I mean we do see if order books being sort of weak and similar to March. So normally, you'd see a real step up in March that didn't play out sort of we're steady through the month when it comes to sort of the specialty plastics world. And -- but we do see order books being a lot stronger in May now. So we're finally starting to see some actual turn here in that marketplace, which is encouraging. And that turn is built into our guidance.

And then on building construction, I think that's the other wildcard. I think Europe and China were presuming to be relatively stable at the levels not getting worse but not really getting much better. And we do see things getting a little bit more challenging in building construction in the U.S. as that market is starting to now finally face the lower housing starts and existing home sales, et cetera.

So I think we feel pretty good about this range with the wildcard is going to be -- we're in a pretty volatile time when it comes to demand and how much destocking really has played out yet or not, et cetera. And that's why we've sort of pulled our sort of view this quarter down a bit. But we feel good about this range, and we're going to pull every lever where we got to head.

Matthew Porter DeYoe - *BofA Securities, Research Division - VP*

And if I can, on the Ai-Red Tech acquisition, like I'm assuming this is pretty small, but I know you like the paint protection film business a lot. And I know Asia is growing quickly. So I mean, how fragmented is that market. What's kind of the margin differential for there if we look versus the U.S.? And how big of an opportunity could the paint protection and expansion data be for Eastman as you look over the next few years?

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

Yes. So we're very excited about the bolt-on that we added in our performance films business in Advanced Materials. To your point, we're always looking for bolt-ons in AM as well as Additives & Functional Products. Our two key end markets within this space are in Asia, specifically China and the U.S., Americas.

Now we have a global asset footprint to better serve and to achieve the higher growth rate. Ultimately, this is a premium set of products. And we're really excited about how this is going to help AM grow in the long term and specifically the films business.

Operator

We now have Kevin McCarthy of Vertical Research Partners.

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

Mark, you moved your functional amines business for reporting purposes over to A&FP from the Chemical Intermediates segment. Can you talk about why you did that? And with regard to the first quarter, what were the sales and earnings associated with that business? I saw the sort of the retrospective disclosures for 2022. It looks like it was \$310 million in annual sales with EBIT margin slightly north of 20%. Are those sorts of run rates reasonable to apply to the first quarter that you just reported as well?

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

Thanks, Kevin. Great question. Functional amines business is just an absolutely fantastic business. And it's one that we saw a lot of opportunities to sort of operate and manage better by integrating it with the personal care business that's the other half of Taminco that sits in AFP and sort of bring the band back together again. And so from operational asset efficiency, business management point of view, made sense to bring them together.

And it also allowed us to help investors better understand the quality of this business. I mean it's got 70% of its revenue in really stable, attractive markets from ag to pharma to water treatment, very solid study businesses. The nature of its business doesn't really face competition from Asia. It's very difficult to ship these intermediates around the world for safety reasons.

So we don't compete against Asia in these markets. And we're by far the strongest leader in these products with a great competitive position in North America and Europe. So very solid margin position, very attractive margins, as you mentioned. And we do most of this business in both here as well as personal care and cost pass-through contracts. So the margins are very stable through the sort of ups and downs with inflation.

So it's also good on that and had some great growth opportunities as well. We make a critical ingredient for Corteva Enlist product called C-Base. We're -- they're a great company, and we hope to be -- continue to great partner with them and see a lot of growth in front of us, on top of the normal ag market. Once again, innovation partnerships leading to above market growth. So great business to have integrated. And they have -- because we're at scale, our vertical integration model here creates a lot of value.

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

And Mark, if I can add. As we look at our Q1 results and the -- I'll call it the strong performance related to our January guide. The way I look at that is we beat our expectations of about \$75 million. So if you look at that, that's roughly 1/3rd, 1/3rd, 1/3rd across AFP Fibers and our Chemical Intermediates business as you look at the guide prior to the resegmentation.

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

Okay. And secondly, if I may, Mark, I wanted to revisit the fibers discussion in response to David's question earlier. You talked a lot about what's changed in that business. But at a very high level, if I look at history, your segment margins were in the low 30% range and very stable from 2013 to 2016. And then in the next 4 years, we descended through the '20s and then that dovetailed into this inflationary year where -- call it, mid-teens last couple of years.

In the first quarter, your price went up 40% year-over-year and now we're back to the low 30% range, 31% in the first quarter. So should we understand from your comments that, that margin level will be sustainable for the foreseeable future? And if so, can you talk about what's changed with regard to your contracts in terms of pricing and procurement, if that makes sense?

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

Sure. So it's a great question. It's been a long journey for this business. It's always -- if you go back to the history you're talking about was a great source of earnings, margin and importantly, cash flow because it doesn't require much CapEx historically. And so it was just a great part of our portfolio, and it went through a very difficult time when sort of demand came off significantly.

And as I said, and I'm not going to repeat it. The trends in demand and supply have changed a lot over the decade to get us back to high utilization rates. And the key here is the customers in a loose market, we're very focused like every department does on how to get the best price. But in the end, security supply is a lot more important than incremental price improvements. And we're now in an industry situation because of the last decade, there hasn't been very much investment in this industry and the need to continue to be a reliable supplier to our customers requires us to make some investments. So we've seen inflation and costs go up a lot. We obviously raise prices to cover that.

But we also need appropriate margins in this business to make the reinvestments in asset reliability, and for us, expansion of capacity on our existing assets. So to be clear, not a new plant, but debottlenecking because we have so much growth in textiles and we have so much growth in this Aventa product line that is going to go into food service that we're expecting in '24 and '25.

The whole cellulose ester stream as we talked about at Innovation Day is making a pivot to being a growth stream as opposed to an optimization stream, which we're incredibly excited about because not only do we have a lot of huge upside of that \$450 million coming out of the polyester recycling with this cellulose set of products that we have -- we've now got \$200 million of growth opportunity in the future on top of this improved Fibers business and the margins as you look over the next 5 years. So this is really exciting new dimension for us to get to this higher altitude on the base and then build on it with growth.

But we do believe the margins are at appropriate levels for the importance of this product to our customers and funding our investment to be a highly reliable supplier. I'd also note, as I said, contracting typically, there's a lot of our contracts that are multiyear contracts. We have added provisions in there to make some adjustments for how raw materials go up and down to provide more margin stability for this business. And so we've got -- we're fully contracted this year and we're making great progress in getting the contracts in place for the next couple of years. And so we'll share more with you about how we've progressed on that through the summer.

So we do think the margins are the right attitude there's always some uncertainty of energy costs, for example, that will move the number up and down a bit.

Operator

We now have Michael Sison of Wells Fargo.

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

Nice start to the year. Market in Advanced Materials, your margins did improve reasonably well in the first quarter versus the fourth and you're sitting here in the low teens. Where do you think we can get those margins back to -- it used to be a high teens, maybe 20% business? And is it just simply volumes coming back to get there?

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

So Mike, before I let Mark respond, I would just highlight, we've had a significant amount of inflation over the last couple of years. We're talking about, I think almost \$2.5 billion, between that and FX, that's about 300 basis points at the corporate level and about 2/3 of that has been in our Specialties and Advanced Materials. So as we look back over a couple of years, we're going to be approaching pre-COVID levels adjusted for inflation.

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

And just putting that aside, I think there's a lift in margins that are pretty substantial in front of us from 2 components, Mike. First is obviously, there's prices we have increased last year where we did keep up with inflation through last year, which was pretty extraordinary inflation when you think of PVOH being up 45%, energy up 70%, PX up 40%. So a lot of inflation in this segment, 2/3 of the \$2.4 billion of inflation over the last 2 years goes into Specialty and a lot of it into AM.

And we've done a great job. But there was certainly an amount of compression we didn't keep up with in 2021. And so as we hold our prices up and start realizing some cost benefits from that in this segment, we'll see margins improve as a result of that. So that's a big driver of where you'll see progressive improvements in margins through this year.

But the other factor here in the short term is demand, right? So when demand is off as much as it is, and we're running our assets slower to control inventory and generating cash flow, and that's just going to have an asset utilization hit to the EBIT margins and a good portion of that \$50 million that we called out, lands in the Advanced Materials segment.

So the margins will get better this year. But when you go to '24 with the assumption that demand starts to improve and people bring restocking back to sort of normal levels of inventory, you'll see another big step-up in margins next year as we progress. And then you've got the circular economy kicking in through next year. And then we're getting the premiums in existing applications and just new sales at much higher prices. So that will continue to drive margins up. And so I think we get back to our old margins and continue lifting the margins from there.

Operator

We now have Arun Viswanathan from RBC Capital Markets.

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

So it looks like just given your guidance for '23, we can kind of assume maybe at the midpoint that the second half, you'll be exiting the year at around a \$4 EPS run rate. And if you look at next year then, not to just annualize that number, but if you were, that would get you to \$8, is that a base case from which we can build off of? And maybe if you get some more normal volume growth if you get back into the mid 8s into the 8% to 10% EPS growth range or 8% to 12%. Is that how you're thinking about the main drivers that will get you back into that range? It's mainly volume? Or what else should we be expecting, I guess.

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

Yes. So I would highlight here, we're delivering \$3.60 with our guide here in the first half as we think about achieving the midpoint that number is going to be closer to \$4.25 in the back half as we're focused on achieving the midpoint. As you take that number, it's roughly \$8.50 for the full year. And as we think about getting back to I call it a more normal demand environment versus an extreme demand environment, we are focused on getting back to that 8% to 12% EPS earnings growth.

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

No, I think that's right. I mean, when you think about the portfolio, you've got fibers at much higher altitude and it's going to hold there. You've got CI at bottom cycle kind of spreads in margins in this current competitive environment. So stable to maybe up next year. So you've got that carrying in as a solid base to next year. And then the question then focuses on to what degree are we going to have specialties grow versus this year. Well, last year and this year has got an extraordinary amount of destocking and very low demand because in the world we live in materials, we're very much in a serious recession. I mean the service sector with consumers may not be there yet, but our industry is certainly at recessionary levels.

So you've got a lot of recovery or just stabilization in some of these markets as upside on volume mix, you've got auto that has a lot of recovery in front of it. So if any version of that where the world is better in '24 versus this year, you're definitely adding on to this back half performance. You got to adjust for seasonality, but it's a very strong improvement in EPS next year versus this year in that macroeconomic scenario.

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

And then similarly, on the free cash flow side then, does that push you closer to \$2 billion, maybe by '25. And if so, would you be allocating more capital to growth investment at that point? Or is it possible that we could reprioritize share repurchases?

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

So just to highlight. First, we're focused on delivering a \$1.4 billion of this year. And yes, as we think about a more normalized demand environment and building on the back half of this year, getting back to the \$1.6 billion of operating cash flow and above that we committed to at Innovation Day is definitely within our side.

And I think, again, we've been focused on discipline with our capital allocation. So one, first, the growing dividend; two, driving our organic growth and the innovation-driven growth model and this new vector of growth with our circular investments; and then bolt-ons, and we will always put cash to use and not let it sit on the balance sheet. So if there's left over, yes, we'll do more than offset inflation with share repurchase or dilution with share repurchases.

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

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

Operator

Absolutely. Our final question on the line comes from John Roberts with Credit Suisse.

John Ezekiel E. Roberts - *Crédit Suisse AG, Research Division - Research Analyst*

The Saflex film is also used in laminated window glass for commercial construction. Those are long lead time projects. Can you see the bottom yet in the U.S. commercial construction backlog? And can some of that production be pivoted to auto?

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

So John, the interlayer assets that make the auto and the architectural windows are flexible. So they very much can swing between auto and building construction. I would note that the vast majority of our business in laminated architectural glass is actually in Europe, not here.

So slowdown in this Europe construction market that's occurred for quite some time, sort of is embedded in our forecast. So we're at lower levels in that part of the industry. They really just isn't that much laminate glass because it's really isolated to commercial here and where the regulations drive a lot more laminate glass to both commercial and residential in Europe.

So that's embedded in there. That excess capacity very much will just be redeployed to auto recovery as we see it. And then eventually, you're right, it's long lead. The housing market will improve over time. It's honestly held up reasonably well. It's not off that much.

John Ezekiel E. Roberts - *Crédit Suisse AG, Research Division - Research Analyst*

Okay. And then what's the delay in announcing the location for the second U.S. methanolysis plant? Are you pushing that out because of the delay in the Kingsport side?

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

John, there's no delay. We had always anticipated that we would do it in the first half of the year, and the expectation is that we'll make the announcement in the second quarter here.

That's our last question. Thanks again, everyone, for joining us. We appreciate your time, and I hope you have a great day.

Operator

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

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