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EMN.N - Q1 2022 Eastman Chemical Co Earnings Call

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CORPORATE PARTICIPANTS

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

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

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

CONFERENCE CALL PARTICIPANTS

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

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

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

Jaideep Mukesh Pandya *On Field Investment Research LLP - Analyst*

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

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

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

Maria Milina *Jefferies LLC, Research Division - Equity Associate*

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

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

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

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

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

PRESENTATION

Operator

Good day, everyone, and welcome to the First Quarter 2022 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, Keith. Hello, everyone, and thanks for joining us. On the call with me today are Mark Costa, Board Chair and CEO; Willie McLain, Senior Vice President and CFO; and Jake LaRoe, Manager, Investor Relations.

Yesterday after market closed, we posted our first quarter 2022 financial results news release and SEC 8-K filing, our slides and the related 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. Cautionary statements regarding forward-looking information and certain factors related to future expectations are or will be detailed in our first quarter 2022 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 2021 and the Form 10-Q to be filed for first quarter 2022.

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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 2022 financial results news release.

As we posted the slides and accompanying prepared remarks on our website last night, we will now go straight into Q&A. Keith, please, let's start with our first question.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) We'll take our first question from Vincent Andrews with Morgan Stanley.

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

Wondering if you could talk a little bit about just sort of how the second U.S. project in molecular recycling is developing. I see you're now mentioning that you're talking to several global brands. I'm wondering if anything is changing about the size, scope or scale of the expected initiative. As well as, I think you had originally said you might have something formalized in the first half of this year, and here we are almost in May. So just curious for an update there.

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

Sure, Vincent. So on the circular economy, we're really excited about how well it's been going across all projects, right? So we've got the Kingsport project that's going to be starting up in the next 9 months. And then you've got the -- looking at the France project. And so a lot of momentum going on in those 2 fronts.

As we look at the U.S. project, we would expect it to be similar in size to what we're doing in France. It would be focused on predominantly packaging and textiles since we already have a nice specialty play in the Kingsport side.

And we do see tremendous engagement from several brands on wanting to be sort of significant offtakers of that project. When you think about just the scope and need that these brands have for recycled content in the projects and the targets they've set for 2025, they really need to endorse molecular recycling.

When you look at mechanical recycling, it just has limitations in truly creating a circular economy because when you look at the packaging waste, only about 20%, 30% of it can really be looped back into food-grade bottles. And so they have a real shortness of how they're going to get this recycled content, right? 70% is going to get down-cycled into strapping or part benches or in the U.S. landfill or incinerated in France. So that's just perpetuating the linear economy and not disconnecting from fossil-based feedstocks.

So mechanical is great and it's energy efficient, but it's completely insufficient, not to mention it also degrades over time. So they realize that to maintain high quality of their packaging in a long-term solution, molecular recycling has to be around to support that and enable all of the packaging waste to be recycled. I mean, our position is you should reduce and reuse as much as possible, but much of this is still going to be needed at packaging. Or in textiles, same story.

And we are the required solution to actually eliminate all the waste. And so they get that. They understand it. They also understand that plastic is a much more energy-efficient product than glass and aluminum. So if you first want to assume green energy is limited in the planet, then you should use the most energy-efficient product, not glass that's 4x more energy; or aluminum, 2x more energy to make than plastic.

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So they're very focused on this. And that's why we've got such good engagement. And they understand the sort of cost pass-through contract nature of what we're trying to do. So we feel really good about where we're at. But as you know, with these kind of very complicated long-term commitments, it takes time to work out the details.

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

Sure. And maybe just as a follow-up, I noticed there were no buybacks in the quarter, but you're still committed to doing at least $1 billion in the year. So how should we think about the cadence during the balance of the year to get to that at least $1 billion goal?

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

Sure. Thanks, Vincent, for the question. We did wrap up the ASR that we launched in December here in early March, completing the $1 billion from last year. We've also, I would say, here in April closed on the transaction. We had $1 billion of cash. So I want to complement our teams and also with our Adhesives teams success as they transition. And also, we're continuing to partner providing transition services on both transactions here through the end of the year.

If you think about how we started Q2, we've already purchased $200 million of shares here in the month of April. And you can expect pace similar to that through the rest of the quarter. For the full year, I expect, again, to be at the $1 billion or greater as we deliver on the commitments that we made, and you can look at that on a full year basis as basically providing about $0.75 a share to offset the roughly $100 million of impact from the divestitures. I would say that's about $0.30 in the first half, growing into the second half as we complete the purchases here in Q2 and Q3.

Operator

We'll take our next question from Kevin McCarthy with Vertical Research Partners.

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

Yes. Mark, you affirmed the annual EPS range. I was wondering if you could speak to the seasonality in the back half of the year as you're recovering operationally at Kingsport. Speak to 3Q versus 2Q and then the seasonality in fourth quarter.

For example, I think you mentioned you got a plant turnaround in Chemical Intermediates later in the year. How do you see that unfolding through the coming quarters?

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

Thanks, Kevin. And a very important question. We spend a lot of time trying to think about how our cadence of earnings and value creation go through the year.

When you think about this year and you look at sort of the guidance we gave for the second quarter and add that together with what the results that we had in the first quarter, the first quarter (sic) [first half] looks to be around $4.75, if you look at -- use the midpoint of our second quarter guidance. So to get to our midpoint of our full year guidance, you're talking about $5 a share in the back half, which is about 5% higher than the first half, to your sequential question, or $0.75 a share on a year-over-year basis.

So that's a strong back half quarter for us. We don't really have it normal that we can look to in the past because we've had so many different events that our first or second half floated if you look at 2018 to now. But we can recognize that's a little bit stronger than normal.

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And I think the easiest way to talk about it is on a year-over-year basis. And when you really think about delivering that $5 a share in the back half of the year, it really comes down to a question of what is AM going to deliver relative to what normalization in CI occurs? Because obviously, the steam line event in the first quarter, we had a sort of significant setback on that to the first half of the year.

So when you look at it and do the math on sort of the midpoint of our guidance for the full year of AM of $650 million to $700 million, that means we basically have to be about $200 million over the back half of last year.

Now roughly half of that -- actually probably greater than half of that, will come from how we're managing spreads. So almost all of the spread compression last year that occurred in this segment was in the back half of last year. We've been incredibly successful in implementing price increases in the -- to begin the first quarter and get the spreads that we were aiming to get that we discussed in January, and that sequential improvement in spreads is still expected in the second quarter. So we have a lot of great momentum in the pricing actions we've taken, including implementing a whole set of additional price increases in this month, to cover the inflation that occurred through the first quarter.

So you've got $100 million -- greater than $100 million, really, of spread improvement in the back half of last -- in the back half of this year relative to the compression that occurred in the back half of last year, right? So recovering that compression, if you will. So that's half of it, or more than that.

And then you've got strong volume growth. And the volume growth in the back half will be a little bit different. First of all, you've got incredibly unmet need, especially in specialty plastics, given how we were not able to serve that market. So markets are incredibly strong. No one has inventory. So the likelihood of destocking in the fourth quarter is much less because there's nothing to destock.

You've got the automotive market, we're assuming, starts to get better in the back half relative to the first half. And we expect logistics to -- constraints to ease, which is really one of the bigger limiters of our ability to sort of serve demand.

And then you've got the production catch up, right? So we lost about $75 million of volume in the first quarter, and we think roughly half of that will be recovered through the year. But most of that recovery is going to occur in the third and fourth quarter because we're just ramping up production. And with logistics these days, getting all that out the door and recognizing that in the second quarter is going to be a bit of a challenge. So a lot of factors that drive volume to be a lot better.

So then you weigh that against what's going to happen in CI normalization. And I think we've taken our standard approach of assuming it's going to normalize at some point. And for now, we're expecting that in the back half of the year, and there's some higher growth spend.

So you put all that together, you net out, you're going to come up with positive EBIT relative to last year in a meaningful way. And then you've got $0.45 a share from the share repurchase we're doing to replace the divested earnings. So $5 is a very reasonable improvement to get when you think about it and those dynamics, and that gets you that sort of 5% sequential improvement versus the first half.

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

Great. And then as a follow-up, Mark, have auto production forecasts bottomed at this point, from your perspective? I appreciate any updated thoughts on what you're seeing in terms of order books and expectations for that particular end-use market.

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

So on the auto market, we had an expectation of demand being relatively stable in the first quarter and the second quarter and then modestly improving in the back half of the year. I'd say first quarter turned out to be a little bit softer than our expectations, and we expect the second quarter to be down a bit relative to the first quarter, principally due to the Ukrainian war impact on European auto production and some of the slowdowns we're seeing in the COVID lockdown situation in China.

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So a little bit lower base than what we started the year with, but we still expect it to improve in the back half of the year as China gets its COVID situation under control, is our base assumption, as well as the European situation starts to stabilize, supply chains start to improve.

But we're still looking at an annual number in our forecast that's below last year a bit. Obviously, LMC is above last year in their current forecast, and we're not using that. Just to be clear, we're using something lower than that in what's loaded into our forecast. So I think we're taking a reasonable approach to what we're estimating and what we're seeing in the marketplace.

Operator

We'll take our next question from Josh Spector with UBS.

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

I guess just specifically on AFP, I'd be curious on the new portfolio, if you'd comment on a couple of things. One, how you're thinking about longer-term growth in that restructured business now versus GDP or whatever metric you look at in that perspective.

And then also, you have a relatively strong first half in that business your guidance leaves it pretty open-ended in terms of where things could be in the second half. And just wondering, what drives perhaps a lower second versus first half in AFP? Or is that not the right way to think about that earnings trajectory?

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

Yes. So we're really excited about the new AFP. It's a business that's very focused. It has a lot of great end market growth rates that are both stable in things like personal care, animal nutrition, and has opportunities for accelerated growth in places like automotive and aviation recovery, so -- and B&C has also been incredibly strong. So end markets are great.

Like AM, our innovation is starting to really gain traction. So it's creating the ability to grow faster than the underlying markets. When you look at Tetrashield going into packaging, you look at how we're moving into higher-value formulations in animal nutrition versus just selling the organic acids. The microbead opportunity, not really relevant to this year, but significant upside in the future. So there's a lot of growth programs that are out there that allows us to grow better than the underlying market.

And then on the spread side, similar to AM, there's some spread recovery that's going to be in this year relative to last year. It's not quite as large as AM, but that accelerated path of inflation last year, prices were still catching up in this business as well.

So you see price implementation being very aggressive in the AFP business to cover all of those raw material, energy and distribution cost headwinds. And we did a great job in the first quarter in getting prices up to sort of cover that and improve spreads. That will continue to be true year-over-year in the second quarter. But sequentially, we'll see the second quarter come off a little bit just because it takes a year for the CPTs -- I'm sorry, it takes a quarter for the cost pass-through contracts to catch up.

So overall, a very strong first half, both by strong volume, that 10% volume mix that will continue into the second quarter, and spread improvement.

As we look to the back half, there's some seasonality, we're just assuming, in how demand comes off in some of these industries, like B&C and the ag business, where that will soften up a bit in the second half of the year. And we think that we'll see spreads continue to improve relative to the back half of last year. So it's still going to be a very good second half, but not quite as strong as the first half.

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Operator

We'll take our next question from Mike Leithead with Barclays.

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

Great. Maybe just 3 quick-hitters on the methanolysis facility in Tennessee. So first, it looks like maybe a slight delay with supply chain. So can you just flesh out what's moving the time line, whether it's equipment or labor?

Second, is the $250 million capital cost still the right number for the facility?

And maybe finally, if we do get mechanical completion in 1Q '23, when should investors anticipate it sort of reaching kind of full commercial operations there?

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

Sure. So when it comes to the sort of 1-quarter delay we've identified the mechanical completion, it's equipment-related. Just like the automotive industry, getting all the parts to build your plant isn't the easiest to do in this environment. The team has done an extraordinary job of locking down and securing all those components being supplied. But just being realistic, in the environment we're in right now, we expect about a quarter delay. It's not a labor issue, it's just a supply chain issue.

When it comes to the capital, we're still on track for the capital. We did a lot of securing, especially on the equipment side, before the inflation started, when we were -- when you go back to when we actually started this production. So we think we're in a good position to manage that and keep that around that number.

And then when it comes to start-up, we're always going to -- aiming for a start-up in the first half of next year. We always assume that there will be some bumps along the road in how we get there. So we don't think there's going to be a significant delay in the start-up of the facility for serving customers. So by summertime, you're making recycled content off of this facility and supplying the market and building to full run rates by the end of the year, and you'll get a full year effect as you get into 2024.

You got to remember, this is different than a specialty plant in how it ramps up and fills out because, while the specialties will grow like they normally do and not be a light switch in how you fill out the plant, we have the ability to take all the excess monomer from this methanolysis plant and make PET or textiles for packaging in the clothing market and sort of ramp the plant full pretty quickly as the operations come up to full levels in those markets. And then we just mix, upgrade as we grow the specialties relative to serving those markets from this plant.

So a much faster ROIC in this kind of facility with that flex than what you would normally get in a specialty plant.

Operator

We'll take our next question from Aleksey Yefremov with KeyBanc.

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

As we get closer to the start-up of this methanolysis plant, Mark, I was just trying to understand how economics might work in the real world. For example, crude jumped year-to-date. Would it have been a tailwind for your methanolysis margins? Or a headwind? Or not a factor? So in other words, when oil moves like this, is the cost of your feedstock changing? And if so, are you able to kind of promptly raise prices?

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

Yes. So higher oil prices is very good for methanolysis, all right? So the competitive material in the marketplace, which is virgin PET based on fossil feedstocks, is connected to oil. So the price that's in the marketplace for those products goes up pretty consistently every day with the price of oil. So that raises their alternate product on the marketplace.

The reality though is our product, both its feedstock and its -- and our final price, is not really that connected to the virgin PET market anymore because they're buying it on the value proposition of recycled content. And right now, what we're seeing is those prices, both historically and in this environment, are holding up to be substantially higher than the sort of fossil-based polymer. If you look at Europe, roughly about a 50% premium for that recycled content, value proposition of creating a circular economy versus perpetuating a fossil-based linear economy. So the market's changed and structurally so.

When it comes to the value of our feedstock, there may be sort of a modest increase in the prices, but the reality is it's going to landfill, right? The price of landfill isn't changing with the price of oil. It's being incinerated, same thing, not really changing dramatically. Or these low-value applications, like park benches or strapping, and where this product -- this sort of waste feedstock is going that the mechanical recyclers can't upcycle into applications.

So we're not seeing a significant increase in feedstocks just because the price of oil is up.

Operator

We'll take our next question from David Begleiter with Deutsche Bank.

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

Mark, just on the Q2 guidance in terms of the earnings bridge, you think about the $0.80 impact from the Kingsport incident and the $2.06 base. You look at the midpoint of Q2 guidance is $2.75. How do you -- what are the offsets to that sort of bridge from Q1 to Q2 with the Kingsport incident layered in?

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

Yes. Great question, Dave. And that's exactly how we look at it. We had a phenomenally strong first quarter, when you back out the steam line event, at $2.85. It's just tremendous success, well above how we guided in January for the first quarter. Unfortunately, the event happened. But the demand for those products is very much there, so that $125 million hit which easily shown up in the quarter.

So we do start looking at it and saying, "Okay. From $2.85, which is the run rate now that the event is behind us, what's the up and down relative to that number in the second quarter?"

So on the upside, we expect continued strong demand that we saw in the first quarter and the significant mix improvement that comes with that, that's part of our story in our specialties. The pricing actions are doing a phenomenally good job of keeping pace real time with inflation that occurred through the first quarter. So spread sequentially will improve from first quarter to second quarter in AM and Fibers. And then CI is holding up and being stronger than expected. So that will be quite stable sequentially from first to second quarter.

And so all of that leads to a higher number, right? So then what -- why is it? Why are we guiding to something a little bit less than first quarter?

First of all, the $50 million of accelerated cost accounting doesn't repeat. So that's a pure tailwind, Q1 to Q2. But the $75 million in the steam line event that's related to production, that doesn't catch up in a quarter. So it takes some time to get production back up, to get it on ships and trains and get it delivered through this quarter. And there's only so much excess capacity that we have to make up that lost production. So that's going

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to take the whole year to sort of recover that. And we're only expecting to recover about half of it through the year. So you've got a bit of a headwind from the event on the production side.

Then you've got an AFP -- remember, a good portion of their pricing is connected to cost pass-through contracts. We had a lot of inflation in the first quarter. The way those contracts work, it doesn't really catch up until July 1. So there's just a lag in that part of AFP and how prices catch it up. They will. You saw the benefit of that in the first quarter, based on catching up to fourth quarter raw materials. And this will happen as we go into the third quarter. So there's a bit of a headwind from that. So AFP will be slightly down relative to first quarter.

And then you've got a step up in growth spend as we start ramping up the circular investments. And then there's just macro uncertainty, right? So we've adjusted our outlook, as I said earlier, about auto just being a little bit softer sequentially. As well as China and the COVID lockdowns is certainly having an impact on some of our businesses, like performance films, and in general, how we bring product into the country to get it delivered with all the different various lockdowns. So there's some sort of headwind there that we're trying to estimate, but highly uncertain on how that's going to play out for the quarter.

Overall though, put it together, it's still a 10% increase year-over-year. So it's great momentum to building towards our full year guidance.

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

Got it. And just on the CI spread normalization in the back half of the year. Is that more supply-driven or demand-driven? And which products in particular are you looking for the spreads to normalize first?

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

Yes. So in the spread normalization, we've obviously been in very tight market conditions since the second quarter, really since the beginning of the first quarter of last year. And CI has benefited from that, like many other companies in these intermediates. And the markets remain tight, and that's demand-driven. Demand is incredibly strong for all of the products, or customers that we're serving with those intermediates. And that's obviously holding up in the first quarter, expected to hold up in the second quarter.

And there's also supply-driven issues that are creating constraints across both olefins and acetyls, as you can see in the many announcements of operational issues across the planet.

And the third issue that's new now that we're still thinking through, is the U.S. has just picked up a new advantaged cost structure relative to the energy costs now in Europe and Asia. So that structural cost improvement is not yet factored into sort of how that's going to play out for the back half of the year or years ahead. But that's probably, I would call it an upside if that continues to be true, to how we're looking at our forecast.

So it's really a combination of both, right? And we're assuming that the economy start to slow down a bit with all the inflation out there, the China issues, Ukraine-Russia issues, so market softened a little bit. We assume people will get around to running their plants more reliably, so supply will start to improve, and that creates some softness.

But I think we all know that it's hard to call when this normalization is going to occur. And so we've put in something to estimate that there's some normalization back to sort of what we called sort of normal margins. But it's, frankly, anyone's guess when that's actually going to occur. There's no specific data any of us have to make that call.

Operator

We'll take our next question from P.J. Juvekar with Citi.

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

Mark, there's a lot of discussion about inflation in the economy and all that. Where you sit, from your vantage point, do you think 1Q was the peak inflation? Inflation could be raw materials, trucking, logistics, truck drivers, all that stuff. Or do you think inflation has peaked when you look at the second derivative of your businesses and you talk to your own people? Or do you think inflation will continue to go higher?

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

Well, I think inflation is certainly going higher as you go into the second quarter. When you look at just all the price increases that we had to implement in April to catch up to the inflation that occurred through the first quarter in our raw materials and energy costs, that's now higher prices in the second quarter flowing into our customers. And they're going to take all those higher prices and they're going to have to flow it into their products, which will go through this quarter into the third quarter. So I don't think we're close to how inflation is going to peak downstream of us because this has all got multiple steps to be passed on through multiple quarters to get to the consumer.

When you think about the inflation of our raw materials and energy costs, what we're assuming right now is we are sort of peaking out in the second quarter, and that it doesn't get worse as we go into the third quarter and the fourth quarter. In fact, maybe raw materials stabilize and come off a little bit in the back half of the year from the second quarter. So that's what's embedded in our forecast on our cost side.

But if you're asking downstream, we've got, I think, multiple quarters before inflation reaches the consumer, all of what's happening to our part of the industry, because we're just so far up the value system.

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

Right. So consumer inflation would continue for the next couple of quarters is what you're saying.

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

For customers and consumers, yes. For us, we think second quarter is peak.

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

Right. And just you mentioned on methanolysis, you're putting together these contracts to buy raw materials. How do these contracts -- how are they structured? Is it fixed price or the price goes up with energy?

And the same thing on the other side. When you sell your product, I would presume that you would sell it at a premium because it has lower carbon footprint. And so how does those contracts look like? Can you just sort of give us the terms in how these contracts are structured?

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

Sure. So there's a spectrum of contracts that we're securing when it comes to feedstock based on the source of the material. So there are some contracts that are exactly what you said, where they're going to -- the alternative value is landfill. And so the pricing of that is set in a very stable manner that doesn't have an alternative value to drive the price and value that material up or down. And we're getting long-term contracts with sources of waste on that front.

There are other products where you're competing maybe against a park bench or strapping. So down-cycled applications that perpetuate the linear economy, and so we have to look at the alternative values of those applications and how that might change. So there will be some connection

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to where the price of oil goes, where alternative market values go, that we have to compare our pricing to sort of secure that. So it will be connected to some either cost- or price-based index.

So there's a lot of different sources. But all of them, when you look at what drives them up or down, they're actually relatively stable compared to where the price of oil goes every day on the sort of fossil feedstock-based market.

And then you have to keep in mind that -- on the customer side of things, there's 2 models we have in our pricing. So in our specialty business, pricing is going to be based, as always, on value. As I said earlier, the value of recycled content is quite high, right? So it's not a speculation. You can look at just for PET for packaging, which is a relatively low-value application compared to our specialties, is trading, on average, 50% premium to the fossil-based feedstocks.

So plenty of premium there to create the circular economy and get waste out of the environment and lower the carbon footprint impact of our operations and the Scope 3 of our customers when they think about improving their overall carbon footprint. So they are paying a premium for that already. That's not speculation, that's just a fact.

But you have to remember that -- and the specialty pricing will just be based on that value and we'll do it like we do pricing today. But for the PET and the textile applications -- the packaging and textile applications, as we said, we're not taking risk on the difference between our feedstock costs and market price, we're doing cost pass-through contracts that give us predictable, stable margins. Otherwise, we won't build these plants and invest them because I don't want to get caught in trying to speculate where the feedstock costs are going to go relative to market prices. That's the Airgas model that we're taking for those applications. So we're not trying to exploit the spread expansion or take a spread contraction risk on those high-volume applications that baseload the second and third plants.

Operator

We'll take our next question from Matthew DeYoe with Bank of America.

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

So as we look at the year-over-year bridge to 2023, maybe it's early, but it seems like -- particularly for AM, it seems like the add-back of $50 million on the accounting side is maybe a starting point. But you won't recover the full $100 million maybe -- or the $75 million of additional, I think you said, so maybe half. But you're also going to get that back through the course of the year. So I guess what -- where do we -- where should we start think about building a bridge for next year?

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

I think that with AM, you start with the bridge that occurs every year. So when you look at Advanced Materials as a segment, its value creation starts with strong volume growth. Prediction: When we look at the markets that we serve, automotive, I think odds are, I hope, good, that supply chain issues get resolved and automotive demand will be better next year than this year. The demand we have in the other end markets, like durables, medical, all those have continued strength that we see going forward, especially medical. So the end markets, we expect to be relatively strong.

Then we have the innovation that creates our own growth above these end markets. We've proven that extensively over the last decade. So even in a softer economy, we're still going to create growth over those end markets.

And then you've got production catch-up, right? There's certain amount of production volume, because of the steam line event, we're not going to realize this year even though the demand is there for it. So that will be upside in volume next year. And there's the cost accounting issue really isn't a year-over-year tailwind because, well, it's a headwind the first quarter, it sort of comes back, if you will, to the rest of the year. So that's not something I would include in the bridge for '23.

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But tremendous amount of volume, and then importantly, mix upgrade across all these volumes that we're talking about that have high growth or very high value relative to the segment average in AM, and certainly well above company average. So that creates a lot of mix leverage, as always.

So you've got all those drivers that are going to sort of increase success. And then on top of all that, you've got to start the circular plant that gives you a whole another growth driver and value up on mix because the margins are attractive there. That's going to occur in 2023 relative to '22.

So that's how we create value every year, is control our cost structure, drive volume and mix. Spreads, my guess, are not a source of headwind or tailwind next year because we're getting our margins back to pre-pandemic levels this year. So it's a volume mix story, as it always has been, to deliver pretty attractive growth in '23 versus this year. This year is going to be a very attractive growth number relative to last year when you think about $650 million to $700 million. That's tremendous growth relative to '21.

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

And I guess it looked like corporate expense was 0 for 1Q. Part of that looked like insurance proceeds and stuff like that. Does any of that flow into 2Q? Or do we see a more normal rate of corporate cost in 2Q in the rest of the year?

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

Thanks for the question. For the rest of the year, we see roughly about an $85 million expense. Obviously, with the steam line incident, we stayed focused and, I'll call it, paced or level of investment in growth and projects.

Also, I'll remind you that we had the Adhesives business still part of Eastman, and it was -- the earnings were part of Other during Q1. So as we ramp up the circular, as we also look at the startup of the -- and completion of the first methanolysis facility, the cost incurred and related to those initiatives will be paced through the back half of the year.

Operator

We'll take our next question from Jeff Zekauskas with JPMorgan.

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

So when you talk about the methanolysis project and producing packaging material, is what you're referring to disposable PET bottles? In other words, water bottles? And what you have is essentially a more circular route to making the PET bottles. Is that -- that's the essence of it?

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

Jeff, that's it. So it's not disposable water bottles, it's now circular water bottles, right? So we were in the business of making PET. Obviously, got out of it because it became incredibly competitive, if you want to go back to 2011.

And with the first plant, just to be clear, it's all specialties. The Kingsport plant we're building is feeding over specialties. But when we're talking about the plant in France or the second plant in the U.S., we are bringing back into our product portfolio making PET or polyester for textiles. Both of those end markets have a phenomenal waste problem, as we all know, in the bottles being thrown away. And frankly, right after packaging waste, textile waste is the second hugest -- second-largest problem going to landfill or incineration across the planet. Both of those issues need to be solved in significant ways.

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That's why we're taking this act to sort of bring the circular economy in the linear economy and eliminate fossil-based feedstocks. But the model is going to be very different in how we get back into it, Jeff, versus where we were before. So it was market-based transactions, compete against China every day, in the traditional PET business.

In this business, we're not building a plant unless we have long-term cost pass-through contracts that give us stable margins relative to wherever feedstock costs go, and not connecting it whatsoever to the sort of traditional PET market pricing. So we get much more predictable and reliable returns on these investments. So that's basically the heart of what we're trying to do in the model, is to make sure it's different than what we did in the past.

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

Okay. I get that. And so in terms of the non-packaging applications, what you're doing is you're making a more specialized PET that's more capital-intensive in the end rather than people who use, I don't know, recycled polypropylene. So what is it about the applications for your specialty PET that makes the customers want to buy a more expensive material? Is there some engineering characteristic that they've got so that they want to use specialty PET rather than less capital-intensive and cheaper polypropylene?

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

Yes. Jeff, I just want to make sure we're keeping sort of different -- conversation clear. So when you're saying specialty, are you talking about our specialty copolyesters and our Tritan? Or are you talking about...

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

Yes, that's what I'm talking about. Yes.

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

Yes. So if you look at our sort of first plant that's going into Tritan and our other copolyesters, it's the same issue, right? So Innovation Day, we told you a great story about Black & Decker, right? It's a drill, but they want to be part of the circular economy, they want to address their Scope 3 emissions, the emissions that are occurring in their supply base, to improve their impact on climate. And they want to make a -- they want to be using something that is getting waste out of the environment, right?

It's part of how they're marketing their product. And they're getting a premium on their products, whether it's a Tritan water bottle for hydration that's a reusable bottle instead of using a PET bottle that you throw away, right? So reuse in the 3Rs. Or it's a drill. Or it's a phone case where they want to make it out of recycled content to, again, improve their impact on climate as well as the branding positioning they get about using recycled content.

And all these brands are getting meaningful premiums, well above the price, way, way above the prices that we're charging for the polymer in their final products. So it's a value up for them. And so we get a better price for this recycled content, so there's better spread for us as we sell this versus our current products. And we're getting significant accelerated growth, not just in applications that we've been in, like water -- in those reusable water bottles, but also into new applications, like phone cases, where we weren't before. And there's other electronic applications, automotive applications. So it's opening up, accelerated market growth that we can tap into as well.

It's actually been tremendously exciting because it's the scope and strength of interest in this has well exceeded our expectations. So we're rushing as hard as we can to get this plant up and running.

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Operator

We'll take our next question from Mike Sison with Wells Fargo.

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

In Advanced Materials, you -- in the first -- in the January quarter, you gave a $700 million EBITDA -- or EBIT outlook, and you added sort of a lower part of the range this quarter, $650 million. Is that largely related to the Kingsport shutdown? And if it is, what's the impact in maybe 2Q in that outlook?

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

So Mike, this is Willie. What I would highlight is, yes, it is a key component of, I'll call it, adding a lower end of the range for $650 million to $700 million. As we've highlighted, the impact in Q1 related to the steam line incident for Advanced Materials is approximately $100 million. Also, we've highlighted that it will take us some time. We expect to get roughly half of the volume mix impact, which is for Advanced Materials, about $60 million. So as you think about pacing that into the back half of the year.

So as Mark has highlighted, we remain confident in this business. And ultimately, it will put us on a strong pace in the back half of the year as we recover the $100 million of spreads on a year-over-year basis and get our volume mix back to more normalized levels, which sets us up for more growth as we go into '23.

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

Yes. Just to add one thing to that. There are really sort of 3 parts of this as we think about it versus where we were in the beginning of the year, where we said we were going to be greater than $700 million. We obviously had the impact of the steam line incident that Willie just described. We also have expectations in the automotive market being a little bit weaker. And then we have the China COVID kind of underlying risk here that we're realizing in the moment.

But the spreads are actually -- the spread improvement relative to last year is very much on track relative to where we were in January. So that has held up, and we believe, consistent with where we were in January.

So we went from greater than $700 million to this sort of adjusted range now to reflect these headwinds.

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

Got it. And then just a quick follow-up in Chemical Intermediates. I think you've had 5 quarters now above $100 million in just the EBIT. I mean, in the event that oil stays high, demand stays good. And when I talk to some of the commodity folks, I don't think a lot of them are seeing sort of this normalization in the second half of the year. But if all that sort of plays out, would you stay above $100 million? Because I think if I model out the segment, you would be below in the second half.

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

Yes. So when you think about CI, you have to keep in mind, there are sort of 3 factors that cause the second half to be lower than the first half, right?

So one, we have just normal seasonal volume trend off and functional means in the ag market. So there's some of that, that occurs every year and certainly will happen this year, we believe.

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Second is just shutdown schedules. So last year, shutdown schedule was sort of loaded to the front half. This year, the shutdown schedule is loaded into the back half with a big cracker turnaround in the fourth quarter. So there's just that sort of shift in maintenance expense that's going to occur.

So those 2 will moderate the second half to be lower than the first half even if the spreads stayed the same in the back half of the year to the front half.

So then you get into this question about sort of markets softening and going back towards normal versus where the margins are today. If you go do the math, you can see there are some headwinds already in the cracking spreads that creates a bit of a headwind that you can start seeing here in the second quarter. So some of this is likely to happen. But again, we don't sell ethylene and propylene nor do we sell derivatives, and those markets continue to be really tight. So we're not going to see much of an impact on the sort of cracker spreads in the second quarter from what we can see. But we expect this will eventually start finding its way into the market as we get into the second half and some amount of normalization is going to occur.

But we've all been guessing at when and how much it's going to occur. And as I said earlier, I think we've taken a reasonable or conservative approach to say we're going to normalize. And if we turn out to be wrong about that and it stays stronger into the second half, that will be upside.

Operator

We'll take our next question from Laurence Alexander with Jefferies.

Maria Milina - *Jefferies LLC, Research Division - Equity Associate*

This is Maria Milina for Laurence Alexander. I have a question on the impact of China lockdown and COVID that you mentioned a couple of minutes ago. Do you expect to recapture the earnings after these lockdowns? Or how do you see it playing out?

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

That's a good question. So I would say China lockdowns is probably the biggest uncertainty that we can think of at this stage, especially in the second quarter. We've assumed that the lockdowns are continuing through this month and will start to get resolved in May. So who knows what's going to happen? But just that's sort of what we've assumed into our forecast.

It's impacting us in a couple of ways. One, our ability to impact -- import products into China, which is important for all of our segments, including Advanced Materials, where a lot of products are made from our Tritan and then shipped around the world. And then you've got the impact on just demand in the country, where you've got people buying cars and appliances and everything else and the impact that it has on our business from a direct demand point of view.

So we're keeping an eye on all those factors. Automotive seems to be the market most impacted at this stage, especially for performance films business at the point of sale for those films in paint protection and window films.

But I think that overall, what we think is, it is still underlying pent-up demand, especially on the export business that is still strong in Europe and the U.S. So we do expect that there could be a rebound in demand when we get past how they're managing COVID. But it's anyone's guess on how managing COVID in China is going to go and sort of the pace and breadth of that impact.

Operator

And we'll take our next question from Arun Viswanathan with RBC Capital Markets.

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

I guess I wanted to revisit the outlook for '23 you kind of laid out earlier. So if you think about your own inflation potentially peaking in Q2. And then you look into the rest of the year, you laid out the 5% increase. When you look into next year, I guess, you will see potentially a moderating feedstock environment, as you just noted. But do you still expect kind of 8% to 12% EPS growth in that? And if so, maybe what will be some of the drivers that would get you there? Would you see it like a still a $0.45 buyback opportunity? Or how should we think about that as well?

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

Yes. So 2023 bridge, I have to admit, that's a first for me in a first quarter call. But look, when we look at it for '23, as I said earlier, strong demand growth in AFP and AM will deliver earnings growth next year relative to this year. And we'll have a tailwind because of the sort of capacity production disruptions we had this year that enable that volume recovery also to be a tailwind for next year.

It's a little hard to predict where spreads are going to be next year in the specialties. But if inflation -- if raw materials come off, that will create a tailwind relative to pricing for next year relative to this year, I think that's correct. Then you've got normalization of CI. So how those 2 net out at the corporate level could be, to some degree, neutralized as a tailwind relative to this year. So really a volume mix story as the key drivers.

As always, we'll manage our cost structure to make sure there's not a headwind there outside of some gross spend. And so we're set up, I think, for improving EBITDA in a meaningful way. Obviously, we have a very strong cash flow, and that will continue to be both reinvested in organic investments that we're doing for specialty as well as our circular plants. And as we said at Innovation Day, there will still be money left over for share repurchases on top of that as we go through next year to create that EPS growth on top of the EBITDA growth relative to this year.

So we feel good about the 8% to 12%, but it's a little early to start calling numbers.

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

Okay. Fair enough. And then, I guess, I just wanted to ask as a follow-up, back to the strategy on methanolysis. It sounds like, initially, the plan is to roll out more of the specialty applications, but over time potentially progress towards replacing some of the, as you said, circular water bottles. Is that really the strategy that Eastman wants to pursue? Maybe longer term, do you see this company as kind of 50% specialties and then maybe 50% replacing some of these more commoditized applications? Or how do you think about strategy? And the strategy you guys have been following for many years of trying to go more downstream and more specialty and squaring that with the needs to replace some of these commoditized items with circular solutions.

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

Yes. So from a total company point of view, obviously, our strategy is very much focused on specialties and AM, AFP as well as textiles, with our very differentiated biopolymers and new applications that we're creating for the biopolymers like microbeads and food service packaging, et cetera. So when we think about specialty, let's just be clear what specialty means to us.

It's attractive, high, stable margins over time, where we have good pricing power because of the value our products create in the marketplace. To manage our pricing relative to our sort of raw material and energy costs. And creating value for shareholders, not by expanding spread over time, because the spreads are already very attractive to start off with, but by growing volume quickly. And because that is high margins, that translates into a significant mix upgrade at the corporate level.

And whether that's -- especially copolyesters or Tritan or coating additives or personal care additives or circular PET or circular textiles at very attractive margins that are very stable in cost pass-through contracts, that's all in our category of specialty, where we're bringing very attractive high-margin growth, right?

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And you think of the circular platform, we've told you we're going to deploy $2 billion of capital across these first 3 plants, the first one being focused on specialty; France being a hybrid of specialty and PET and textiles; and the third being predominantly packaging and textiles with, I'll call it, specialty circular polymers.

But that $2 billion translates into $450 million of EBITDA. So when you look at the ROIC and the value creation from those 3 projects, I call it special.

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

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

Operator

Okay. Our final question is from Jaideep Pandya with On Field Research.

Jaideep Mukesh Pandya - *On Field Investment Research LLP - Analyst*

Your first question is really around the circular plastic product you have, to your point. And if you take France as an example, you want to invest $1 billion for 160 kt plant. So if I just go by the returns numbers that you sort of said, I mean, sort of back of the envelope, it feels like there will be -- all else equal, you would need almost 3x the price of recycled polymer versus a virgin polymer. So if that is not the case, then what is the inherent cost advantages in the cost structure which make returns attractive and prices not ridiculously different from virgin polymer? That's my first question.

And the second question is just around cash flow. Sorry to ask this, but I suppose, is it really just the raw material inflation, why you have changed your wording on the cash flow? Or is there something else to it as well?

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

Yes. Let me start with the cash flow question first. So yes, obviously, we're -- we've seen a pretty significant inflation here in the first quarter. As Mark highlighted, we expect that to peak in the second quarter. So as we think about that, that's at least $100 million of headwind that we see. And what we're highlighting is a change in guidance.

I would say our first quarter cash flow was probably pretty normal compared to pre-COVID. If you look back at the '17 to '19 time frame, our Q1 is pretty representative. We had a couple of headwinds this year in Q1, which one is a higher than normal, I'll call it, variable compensation payout, as well as the impact of the steam line incident and the divested EBITDA year-over-year combining for about $100 million. So as we go into the back half of the year, it will be more traditional.

And we'll use all the levers. We've made investments in integrated business planning to effectively and efficiently manage our inventories. As well as, again, we look at our net 90 programs and terms and accounts payable as well as other avenues on the accounts receivable side.

So again, we've been able to demonstrate and deliver cash flow in multiple environments over the last several years and remain confident in robust cash flow this year.

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

So the first question, I'm not quite sure how you did the math, but it's wrong. So when you look at this plant in France, First of all, we've said that the first phase of the plant is going to be $600 million to $800 million, not $1 billion. The second phase, where we're adding more specialty capability down the road, is what gets you to the $1 billion. So capital number is a bit lower than what you assumed.

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Second, when we look at the pricing, you got to remember that the value that we're capturing is the price in the marketplace relative to the cost of our feedstock, right? It's a 2-step investment, right? We're building methanolysis and we're building PET and selling PET revenue, right? That $600 million to $800 million is to build the methanolysis and the PET plant. So the margins you're generating are a lot more substantial when you're going all the way to the cost of plastic waste, which is quite low relative to the price you get in the markets.

So when you do that math and say, "Okay, what premium do I have to get above the sort of fossil-based feedstock market?" It's not all that different than the premiums that exist in the market today for mechanical-grade feedstock.

And remember, our material is much higher quality, in it's clarity, it's performance reliability and safety, than mechanical-grade feedstocks. So it is a high-value product and it is a long-term solution because we can infinitely recycle plastic waste, we don't degrade sort of after 5 laps like mechanical does.

By the way, that makes us also a necessary complement to mechanical to keep it a viable stream in the long term because we can revitalize what is degrading through our technology. So a lot of value we bring to the marketplace, not just in what we provide, but enabling mechanical recycling to exist in the future, which it will not do without molecular recycling.

So there's a lot of value we can get, but we're taking a pretty reasonable pricing approach relative to the market and generating the sort of $450 million EBITDA to $2 billion of capital. So good returns.

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

All right. Thanks, everyone, for joining us today. Very much appreciate that. And I hope you have a great day. This concludes our call.

Operator

Ladies and gentlemen, this does conclude today's conference. We appreciate your participation. You may now disconnect.

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