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EMN.N - Q2 2022 Eastman Chemical Co Earnings Call

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PRESENTATION

Operator

Good day, everyone, and welcome to the Second Quarter 2022 Eastman Chemical 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*

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

Yesterday after market closed, we posted our second quarter 2022 financial results news release and SEC 8-K filing, our slides and the related prepared remarks in the Investors Section of our website, www.eastman.com.

Before we begin, I'll cover 2 items. First, during this presentation, you will hear certain forward-looking statements concerning our plans and expectations. Actual events or results could differ materially. Certain factors related to future expectations are or will be detailed in our second 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 second quarter 2022.

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Second, earnings referenced in this presentation exclude certain non-core 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 second 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. Tracy, please let's start with our first question.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) We will now take our first question from Alex Yefremov from KeyBanc.

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

Can you just discuss the reduction in price cost expectations for Advanced Materials? Is this -- do you view this as more of a timing issue or relatively more permanent reset of expectations?

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

I'm sorry, I just want to make sure I understand the question. You're talking about how the raw material trends are going to play out and whether it's sort of temporary or long term. Is that correct?

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

Yes, correct.

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

Yes. So as we look at the raw material situation in Advanced Materials, we view it more temporary than long-term structural. You can already see that where paraxylene prices popped up and have already sort of come down a considerable amount. Obviously, the price of oil drives everything. But when you think about the sort of margin above oil, if you will, I think that we view the short-term spike really around the driving season this summer as something that doesn't continue going into the future.

When it comes to PVOH and VAM, which was the real issue from a spread point of view, we also don't think that's a long-term structural trend either. The spike-up that we've seen in PVOH and VAM is really a supply-driven event more than a demand-driven event, particular VAM production in the U.S. in the second quarter, about 2/3 of the capacity was off-line, which is just an extraordinary number of unplanned outages. And a lot of that VAM doesn't just go to the U.S., it also goes to the U.S., and that VAM is also made into PVOH, which are the 2 key raw materials that we buy for making the interlayers. And those prices went up dramatically and even more uniquely for us because it was not just a price spike, it was a supply shortage that was quite severe.

So we had to go by spot material out of China at very high prices, combined with antidumping duties and higher logistics costs. So that's how you end up with VAM, PVOH price that's 90% higher year-over-year, that's not remotely sustainable. You can already see VAM prices dropping in Asia in the recent month. And you can see that some people are finally getting some of their capacity back online, but that's still a process ongoing through the third quarter as far as we can see.

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So we do expect that to be a headwind, not just in the second quarter, but in the back half of the year, but expect the trend to get a little bit better in the fourth quarter and certainly better next year. And as you all know, that's the one business where if you have a kind of extreme spike, it's more challenging to manage. We have these long-term annual contracts. We did a great job of getting the prices up in those contracts to cover all the raw material increases from last year, that raw material prices, of course, increased with just inflation through the first quarter and then all the supply outages in the second quarter.

And while we have some flexibility in the contracts, they don't give you this much flexibility in how you manage price. And so we had spread compression in the second, and what we expect in the third quarter for that business. But overall, this is all about market tightness in commodity markets, whether it's VAM, PVOH or PX and in these commodities when the market softened up, whether it's demand softening a little bit in coatings for VAM or just the overall tightness coming off a bit in PX, you've already seen the benefits of prices starting to come off.

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

And as a second question, you talked about signing a deal with baseload customer for your third project in the U.S. Is this large enough to kind of be confident that this project will go forward? Can you provide us any kind of frame of reference how big is this baseload customer relative to the project?

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

So the answer is yes. This is -- when we say baseload, we mean baseload. So it is a big customer and a very high quality, incredible customer. And we are encouraged by all the progress we've made with them in defining a structure that meets our needs around margin stability to make this investment and long-term commitment on their part with that margin stability. So yes, we feel good about it.

We know letters of intent are just that, intent. So until a contract is signed, we're not going to sort of talk about that customer and whether it's quantity or the structure of what we achieved but we feel good about it. And I think we're making really good progress. And hopefully, you'll hear sometime soon in the next quarter or so that we've sort of got that done.

The -- and it's not just that customer. We have a series of other customers who also need this material and are engaged with us, and we're making great progress with them. So when we put that all together, we feel that if we achieve that milestone, that's the key that we need to sort of move forward on that project.

And it's just a great testament that even in an uncertain economic environment, all these customers are very committed to sustainability in the long term. They know they need to deal with recycled plastic. They need to get waste out of the environment. They need to reduce their Scope 3 carbon emissions, and our project allows them to do both of those objectives at the same time, and they know the mechanical recycling is not enough to serve the market. And so what we have is molecular recycling is a perfect complement or partnership with the mechanical guys to solve that challenge. So I feel really good about how it's going.

Operator

We will now take our next question from John Roberts from Credit Suisse.

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

John, we can't hear you.

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

I'm sorry, I was on mute. Mark, are you still ramping up mixed waste plastic into the gasifier? And how far do you think you can take that? What are the theoretical limits?

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

So John, yes, we still are ramping up that project, and thank you for reminding everyone that it's not just methanolysis, which is incredibly exciting and has a huge amount of economic potential as well as impact on improving the environment. Our cellulosic opportunities are also quite strong in this marketplace, and that's where we go with this gasifier.

So we have multiple options on how to ramp up the feed. And we -- as we look at the demand curve in front of us for the next 3 years, we believe we can ramp it up to serve all that demand growth. We're not going to talk about the technical details of this, but we're very confident that there's no constraint in our ability to grow with the market.

The -- and the market is really expanding and growing really incredibly well. So you've got the Naia textile fibers that even in a down textile market today is actually demand exceeding supply, and we're working hard on how to expand capacity, the value -- the sustainable value proposition of a biopolymer where the microfibers that might break off in the ocean biodegrade is just very compelling. And then you add in recycled plastic, and it's a trifecta win on the environmental with bio recycled and biodegradable.

We've got great progress going on the micro beads, that are the biodegradable additives for cosmetic applications that we told you about Innovation Day, and the event of program is also making tremendous progress in the marketplace around how we can sort of replace polystyrene in food service and some of their applications.

So we're really excited. The growth expectations are sort of honestly exceeding what we imagine. So we're working hard on how we're going to evolve in that capacity to keep pace with it all on the polymer side as well as how we take in the waste plastic. So it's all going really well.

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

Okay. And then did you finish the ethylene-to-propylene conversion project that you were working on? It sounded like that in the release, but I thought that was still yet to come?

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

No, John, it's yet to come. We did the RGP project, as you know, a couple of years ago that allowed us to reduce a good portion of our ethylene production and switch it to propylene through our crackers as we change the mix to use RGP instead of ethane. So that's on full tilt right now.

You can do the math and see that ethylene prices are pretty much down to cash cost in the second quarter as well as we go forward in the third. So we're pushing that as much as we possibly can. But the E-to-P is an investment we need to make going forward. And it is a great investment. It's just a timing question of getting it done, but it would remove the entirety of our bulk ethylene exposure in the marketplace and switch it to the propylene whenever we want to. It has flexibility to go back and forth. So if ethylene is great, we can sell it. But in times like this, we could completely eliminate any bulk ethylene, and that would take a lot of volatility out of the business.

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

And when does that actually get done then?

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

It takes about 2 years to get billed, John. So it's not really going to have an impact until you look out and say it's like 2024, '25 time frame from where we are today.

Operator

We will now take our next question from Josh Spector from UBS.

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

I just wanted to dig into some of the sequential outlook for AM. You're forecasting up 10% sequentially. Your full year comments kind of impact 4Q could be flattish sequentially. Typically, there's a pretty big step down in 4Q and then it's followed by a pretty big step up into the first quarter next year. So wondering if you could walk through that 4Q thought versus 1Q? What drives 4Q flattish? And what should we expect 1Q up into next year off of that level?

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

So in the back half of the year, as we look at the trend rates that we had in the first half of the year, obviously, first quarter was disrupted by about $100 million earnings in AM for the steam line events. So you sort of have to add that back, if you will, just to look at the underlying quality of the quarter.

And so when you look at it that way, we had a very solid second quarter and the trends remained good. So when you look into the second quarter, we made good progress and starting to recover some of the spread compression that we faced last year with our pricing. And we had some limitations on the markets that we could serve. So automotive is obviously down, which was not what we expected.

And then from 1Q to 2Q and with logistics constraints on how much of the durables demand we could serve, that was well in excess of logistics and our production capacity in the second quarter given the limited production we had in the first quarter.

So as you roll into the third quarter, you've got continued improvement in pricing and continued capture in recovery of spreads as you move into the back half of the year versus the first half of the year, that's a tailwind. You've also got pretty stable markets. It's important to keep in mind that while there is some softness in durables, there's a lot of the market that's quite stable. So about 40% of the demand in Advanced Materials is very stable in medical, consumer packaging, cosmetics. And in Advanced Materials, B&C is actually stable. It's commercial demand that's actually holding up fairly well.

And then you've got automotive that's going to have some amount of recovery in the back half of the year versus the first half. obviously, a little bit less than we expected, but still recovering. So you've got that as a sequential tailwind going into the second half of the year.

And then the consumer durables, which is sort of the biggest exposure to what you're seeing from Walmart and Target and all of those companies, demand is coming off, but a good portion of that demand, frankly, we couldn't meet with our production and logistics limitations. So it's not all impacting our outlook for the demand in the back half of the year.

So we're not expecting that much of a net hit of how demand drops relative to what we can produce, especially since we're trying to catch up with so many customers from the production limitations in the first quarter. So overall, the demand, obviously, is a little bit less than we expected. That's why we sort of reduced our outlook for AM in the back half of the year, but not that much. So all those are sort of the key trends, continue to improve spread, continue to improve volume mix on a trend basis versus sort of the limitations that we had in the second quarter.

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

Okay. I mean that's helpful. I understand asking about '23 is obviously a bit early, but I think if I consider that demand kind of stabilizes, your 4Q levels maybe $170 million in EBIT. Are there one-time catch-up items in there that then remove that typical $30 million, $20 million step-up into the early part of next year? Or is that a normalized base that we should be growing off of?

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

Well, if you look at the performance we're going to have in the back half of the year and what we guided and annualize it, it's a pretty good earnings number that you would carry into next year. You'd have continued volume mix growth. You've got to remember, we have a lot of innovation, especially in durables. That's why our demand is holding up so well.

Tritan is winning all over the place, especially with recycled content, especially as you go into next year when the methanolysis plant starts up, and that will really benefit the back half of the year, in particular, of accelerating growth in the sort of durables area as well as cosmetics.

We continue the cellulosics that John just asked about a lot of that Aventa growth that we're talking about, that's the food service products on cellulosics or wins we just told you about in our prepared remarks, in the eyewear market, et cetera, all those are sort of building to grow faster than underlying markets on the sustainability trends in both polyester and cellulosics.

You've got continued automotive growth next year in that recovery phase. You've got these markets that are stable, that will continue to grow like medical and consumable packaging, et cetera, cosmetics, another market heavily levered to circular. So demand looks really good.

I'm not going to pretend to guess at the net of the outcome relative to the economy next year. No one knows whether it's going to be slow growth, mild recession, something worse, so we're not going to start giving any kind of guidance on total basis, but we certainly will have a lot of vectors to grow.

And then you got continued spread recovery, as I just talked about, VAM and PVOH prices are going to come off of these exceptionally extreme highs due to all these supply outages. And so you've got tailwinds there, probably tailwinds as well in PX and so spread also a tailwind for next year. So there's a lot of different reasons that AM should have a good year, and you're going to have an easy comp in the first quarter relative to this year.

Operator

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

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

Mark, in CI, you talk about structurally improved segment earnings quality. Given that, what do you think the new normalized earnings level here is in CI going forward?

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

Well, Dave, thanks for the question. And we're still trying to work our way through the math on that. You have to sort of look at the long-term energy cost structure implications of what's going on. Clearly, right now, with what's going on in the Ukraine war, with the shift towards more green energy and the lack of progress on that front in the short term, that means that things like natural gas are even a more need around the world than anyone ever imagined.

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You've got a shift from the cost structure on a global basis where the European, the Asians are going to be paying a lot more natural gas relative to the U.S., even though our prices are really high right now in the U.S., they're exceptionally high everywhere else. And so that's an advantage that's going to help us going into the future, but I'm not about ready to quantify what that means, but certainly better than what we were talking about in the Innovation Day in December and when we build that guidance.

And it's important to remember that before we even get to that topic, there's a lot of actions we have taken to structurally improve this business. 40% of the revenue in this business is in really actually high quality, good margin, higher-margin businesses than the segment average on a normal basis. So you've got functional means, which is the biggest part of that 40% going into ag and they have cost pass-through contracts with stable margins. You've got a nice specialty plasticizer business in the benzoic acid area that has nice stable margins, good growth curves around sustainability. And then you've got the acetyl business.

And for us, it's focused on the acetic anhydride and some other derivatives that are pretty stable and actually tied to demand growth in food, feed pharma which are all, again, stable, attractive businesses. And then, of course, we've made the investments we just talked about on RGP. We shut down our Singapore plant that was the biggest source of earnings volatility we had in the company when it came to olefins given the dynamics of the Asian market and then the future of E2P I mentioned.

So a lot of different things going on there that give us confidence in the back half of this year is going to hold up a little bit better than we expected 3 months ago. And as we go into next year, should also hold up better than we expect. But I'm not going to quantify anything about next year with all the macroeconomic uncertainty.

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

And just lastly, on your implied Q3 guidance, you don't talk about solid EPS growth year-over-year. What do you think solid really means? Is it up 5%? Is it up 10% year-over-year? Anything in that range?

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

I'll let Willie take that one.

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

David, I think as you look at what we've seen to date, if you look at year-over-year being roughly 2.45 last year, we were 2.83 in Q2, you can look at, I'll call it, approaching the middle of that range.

Operator

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

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

In general, do you think your domestic pricing of all kinds of products has benefited from the difficulty of imports coming into the United States? And do you think that if logistics are improved globally, that might make pricing tougher for your products in 2023?

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

So when I think about that, Jeff, I think that's mostly a question for CI than anything else. And certainly, logistics constraints out of Asia have limited some of those products' ability to come into the U.S., and that's contributed to some of the market tightness that all chemical intermediate companies around the globe, especially North American ones are benefiting from.

On the specialty side, I don't think that's really a factor. Jeff, we haven't really seen logistics constraints that Asian competitors be a limiting factor whatsoever on the specialties. And the specialties have enough value and margin for anyone, that's not a limiting factor. So it's really just a CI question.

Operator

we will now take our next question from Vincent Andrews from Morgan Stanley.

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

On the Kingsport facility that's going to start up in '23, you note that you have 1,000 sales opportunities, which is more than the capacity of the plant. I was just wondering how are you thinking about allocating that volume from a customer perspective, if demand is indeed in excess of supply? Are there ways that you can leverage your existing relationships to improve contract structures or other things in Advanced Materials? Or how are you thinking about marketing the material?

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

So one, it's been tremendous to see such strong engagement across so many iconic brands interested in the recycled content and how that can play a role in their sustainability goals and their positioning relative composition in the marketplace.

And as we said, we've got over 1,000 sales opportunities that's in excess of the capacity of the plant. So we are in that approach of figuring out how we align with the most strategic customers that provide us a long -- the best long-term growth.

And we have relationships visit with a lot of companies that have been sort of loyal dedicated customers to us for a long time with our current products and now they want to add recycle content. So obviously, they get preferential treatment versus someone who's new. And so we're trying to balance all that out.

And when we look at some of the -- and we look at the quality end markets that drive a lot of where we want to go. So markets like hydration, which is in the trends of sustainability, reduce reuse and then recycle, right? So the trends moving towards hydration water bottles, for example, is a great market. It's going to grow incredibly well going in the future as people become more conscious about plastics, single-use products.

And when you look at these high-end brands like Williams Sonoma and Cuisinart and Ninja and all these other products where they're the leaders in the marketplace and they're winning share and growing in the markets, you want to align with those winners.

So same thing on cosmetics. We've got great relationships with all the top main luxury brands, LVMH, L'Oreal, Chanel, et cetera, that allow us to sort of help them, truly be sustainability leaders and especially for our future French project, not just our current project, those brands are very focused on their products being made in France, being global leaders in sustainability and highly engaged, not just in buying from Kingsport, but buying our specialty products that we'll make in our French plant. So it's aligning with the winners, and the leaders is how we are approaching it.

Operator

We will now take our next question from Mike Leithead from Barclays.

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

First question is just on fibers. One of your competitors in acetate tow last night, kind of called out what they phrased the sort of untenable situation in the tow market today, needing a bit of an overhaul to increase the value proposition. Obviously, Eastman's previously made a bit of a pivot towards textiles and nonwovens. But just curious how you're thinking about the filter tow market today or just the overall situation with your acetate assets?

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

Sure. So tow market from a demand point of view has been actually quite stable. The market is not actually declining quite as fast as we expected. A lot of it's benefited from things like the heat-not-burn cigarettes that also use tow. And so you've got traditional cigarettes declining, our burden growing, sort of that offset some of that market dynamics.

And as you noted, our textile business is doing incredibly well, right? So we put that in motion several years ago to say, to some degree, the cigarette market is going to decline. And the textile market is incredibly attractive where we've got a very compelling sustainability offer for the market and what we can offer, as I mentioned earlier, and great customer engagement in a way to sort of replace any decline in tow, and we're definitely at that stage where that's going on. So we feel good about where we are from a volume point of view.

From a margin point of view, you've seen us increase prices in a pretty meaningful way for this segment because the raw material costs are higher, pulp costs are higher, energy costs are higher, operating costs are higher. And so we need to improve our pricing and improve our margins back to a reasonable level because they currently are not at a reasonable level.

And so yes, we need to work with our customers to help recover those costs. So we continue to invest and support this business and in what they need to do. So we're looking for all those opportunities to partner and have those kind of conversations with our customers to find a path that makes sense and recover those margins to keep supporting this business.

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

Great. Perfect. And then just quickly, can you just remind us on the Tennessee methanolysis facility, if you do hit that mechanical completion target at the end of 1Q '23, just when should we expect to see commercial production rates and sort of see it run through your P&L then?

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

Yes. So it's going to take a period of time like it does in every plant to start it up. So we complete the end of first quarter, the second quarter is going to be a process of starting it up and you're going to see the benefit in the second half of next year. It's not going to be a huge benefit as you're ramping up when it comes to bottom line earnings because you're going to have all the costs showing up as well of the plan, but it will certainly start helping and really make a difference in a pretty significant way in 2024.

Operator

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

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

Nice quarter. In terms of AFP volume growth in the first half is pretty impressive. Do you see a similar level in the second half in terms of growth?

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

So Mike, it's good to hear from you. So we do see volume trends continuing, probably not as strong as the first half. So first half had just tremendous growth across the board for animal nutrition, specialty fluids, care chemicals, even B&C in some of the restocking efforts that are going on. So growth was quite good. Obviously, automotive wasn't where we wanted it to be, as everyone knows.

When we look at the back half of the year, we still expect strong volume growth continuing in a lot of stable markets. And so we'll see that benefit in animal nutrition, specialty fluids, both the aviation recovery as well as heat transfer fluids for LNG, care chemicals continuing. We also expect some recovery in the automotive OEM side, maybe some softness on the auto refinish side.

So I'm not quite sure how that's going to net out. B&C will certainly be a bit softer, and you can just see that when it comes to architectural paint with our customers. And so we'll see that be a little bit softer. So overall, volume mix will definitely be better. Spreads will be better as we continue to recover our spreads relative to some of the compression that we faced last year where prices were chasing raws, but it was much less of an issue.

You have to remember in AFP last year, right? So the pricing actions we took were much swifter given the contractual contracts we had there to sort of keep up with the raws. So we have a tailwind, but it's not nearly the same scale as Advanced Materials.

So all that's going along, but then that's going to be offset by several factors to mitigate how much we're up year-over-year. You've got an FX headwind, which is pretty meaningful in AFP. You've got higher gross spend, and we have a higher shutdown schedule in the back half of this year versus last year. So all that sort of nets out -- some of that. So that's why you're going to see some decline.

And you need to remember, there's just a natural seasonal sequential decline in AFP when you go from first half to second half. with ag markets and B&C markets, things like that just less busy in the back half of the year versus the first half. So great strong start to the year, but not as much on a year-over-year basis in the back half for those combined factors.

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

Got it. And in terms of the outlook for AM, I think you outlined a pretty good portion of why in the prepared remarks. But when you think about the segments, is the shortfall similar between Tritan and interlayers? And how do we start to get that back? I mean, is that earnings power that is still there, that should come back maybe in '23 if everything -- if the headwinds kind of subside?

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

Yes. So just to step back for a second around the segment from an end market point of view before I get to product real. When you think about the demand portfolio across AM, we'd say about 40% of the revenue is stable. That's medical, consumable packaging, cosmetics, B&C, right? That's going to continue to be stable, continue to have some growth.

You've got segments like medical that are still restocking to get to a safe supply level. And then you've got the auto, which has some upside versus last year or the first half of this year, however you want to look at, and that's about 30% of the revenue in the segment.

And then you got a consumer durables, which is about 25% that obviously has some risk, as I discussed. So from an end market point of view, A good portion of this that's pretty stable or actually improving. And then that gets offset by sort of this durables question in particular and how that backlog of demand sort of reduces relative to our production capability.

And we think probably is a bit below that in our sort of revised outlook, then you get this innovation that drives growth across the segment. So when you think about the end markets, specialty plastics is on track to have a really good year, both in the first half of the year once we got past the first quarter, and they're certainly going to continue to have a good year on the demand side on a net basis from the back half of the year. And

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they have a significant amount of spread recovery in the back half of the year relative to last year. That's quite meaningful. So SP is on track to having a really good year.

Performance films is also doing incredibly well. It's amazing to see how they kept earnings sort of stable to last year in such a difficult market. And so they've got a lot of programs allowing them in a great set of new channel programs to grow with our dealers and auto dealers. Tremendous ingenuity that they've demonstrated in China, which is a big market there with no COVID. Heroic agile acts of figuring out how to completely redo our logistics system out of Shanghai, which was shut down to another one of our locations that wasn't -- with everyone's sleeping in the place and making sure we kept our customers supported. So just a tremendous business, and that will -- and we see that continuing into the back half of the year.

Interlayers is a business that has the challenge. And I think I already covered it. Demand will get a little bit better than the back half of the year, obviously, but the spread challenge is pretty significant. And so that's the one part of the portfolio. We don't think this continues at all into next year, as I mentioned earlier, where ROIC will, I think, improve for that business. But certainly, an issue there.

And so you got all those great things going, but it's important to remember, we got groth spend, and we've got global energy costs. They're going up, especially in Europe that impact all of the business. That's true probably for every company. And so that's a headwind that sort of gets netted into the math, too.

Operator

We will now take our next question from Kevin McCarthy from Vertical Research Partners.

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

Mark, with regard to your Advanced Materials segment, I think there was some verbiage in your prepared remarks last night, whereby you indicated, you now see less improvement in global auto production versus the prior expectation in April. What is the current outlook for global builds that you're kind of building, no pun intended, into your outlook for the back half? Some of the companies that paint cars are talking about $80 million plus global builds. Is that consistent with your view? Or are you starting to see anything more cautionary there?

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

No, I think that's consistent with our view. Certainly, our customers drive our demand. So as they're talking about their view on the market, it's important to pay attention to that. But no, I think it's going to get better sequentially from where we were in the first half of the year. but certainly not as much as we expected, I'd say. But I think that number is fine.

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

Okay. And secondly, I appreciate any updated thoughts on paraxylene procurement and whether or not we should anticipate any relief there in coming months? It looks like maybe it's starting to soften a little in Europe. Not sure how you view the flow-through for the U.S. market that you have?

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

So PX, obviously, in June, really spiked up and into parts of July as well. But it's already come off quite a bit if you look at where it was versus where it is now.

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From an exposure point of view, we produce and consume the PX here in the U.S. But our exposure and how we pay for it, we've diversified quite a bit away from U.S. PX. And so that mitigates a little bit of that volatility, which was more extreme here. But we did see a spike in the last 2 months without a doubt. That's flowing through our COGS.

And our pricing model isn't an instantaneous pricing model in our specialties. So there's a lump there of higher PX costs occurred relative to our pricing strategy that we had in place with the increases that we were able to achieve. And so there will be a little bit of that sort of flowing through that will have some impact on the third quarter. I don't think it's a significant impact, Kevin, but there's a bit of that.

But when you look at it on a total basis, whether it's in the first half or the second half, for the year, we're making really good progress in improving our spreads in this business relative to last year. It may not be quite as much as we intended, but it's still quite significant improvement relative to where we were to get our margins back to where they should be. So we continue to feel great about investing in this business. And so it's a business where the team has done a great job in managing price and having good discipline on how to do it.

Operator

Will now take our next question from Frank Mitsch from Fermium Research.

Frank Joseph Mitsch - *Fermium Research, LLC - President*

That's actually Frank, but we'll take it. Nice results, gentlemen. Frank Costa or Mark Mitsch, I don't know. In the release, you obviously mentioned the 75% asset base in the U.S. and obviously, you also mentioned logistics having an impact on your business.

How do you look at the impact that you've seen so far? And what's your expectations in terms of getting to a more normalized logistics that you don't have to call that out anymore having an impact on your business? What's going on in that area?

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

I'll let Willie take that.

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

Yes, Frank, to your point, I think Mark's described as we look at our asset position, we look at that as a position of strength as we serve the global markets with our specialty products. Obviously, earlier in the year, with our operational challenges, we're not achieving the year-over-year reductions in logistics costs that we had expected, and that's been compounded by the continued inflation and continued high demand in the first half of the year.

So as we think about the markets that we serve, actually, some level of softening will actually all improve the supply chains and allow us to better serve and achieve the volumes in the back half of the year. But it has been continued inflation on that front, and we've had to continue to use, I'll call it, modes of transportation and logistics that aren't completely optimized, and we look to get back to a more optimized business operations in the back half of the year.

Frank Joseph Mitsch - *Fermium Research, LLC - President*

Okay, back half of the year. And Willie, sticking with you, congrats on executing the $750 million ASR. The guidance is to get to $1 billion plus buybacks for the year, so not a lot left. So how do we think about the pace of buybacks for the balance of this year?

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

Yes, Frank, I think what you can do is we'll continue to be disciplined and you can basically spread that evenly across the last half of the year. And I guess people remain committed to greater than $1 billion, and I appreciate that.

Operator

We will now take our next question from Duffy Fischer from Goldman Sachs.

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

Maybe a 4-parter just around the PVOH, VAM. So one, did that disproportionately hit you where it might be causing market share loss? Two, the price that you're using to offset that? Is that structural or are you using surcharges? And then third would be you obviously have some acetyls products yourselves. Are you seeing some benefit in other geographies on the acetyls that you sell that might be offsetting that? And then just the last one is how do you see the acetyls chain normalizing kind of from now through 2023, maybe?

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

Sure, Duffy. There's a lot of questions embedded in that 1 question. So good to hear from you. So on the competitive side, the VAM situation is shared by all of us. There were some unique aspects in how that price spiked up for our European asset, as I explained, where we had to buy some spot material that our competitors may not have bought as much.

And so that's why we had some spread compression there as there was limitations on how we can move pricing relative to our contracts and competitive dynamics. So I don't think we have a significant share loss issue. Instead, we just had some spread compression that we're going through in the second and third quarter.

In regards to how we're managing pricing, I think that we've used a combination of contract terms that allow us with pricing and some surcharges to try to relieve some of the extremity of what we're facing right now. It's important to keep in mind that from a long-term point of view in this business, there's just tremendous growth in front of us.

There's the auto recovery. But beyond that, the EVs, as we told you, have about 3.5x more value in them than combustion engine car and the way those cars are designed and the way they're using glass in a different way. So there's a tremendous amount of volume upside and mix upside, right? So as we sell more HUD, more advanced complicated windows, which is why EVs are so attractive. Those are very differentiated products, and we are launching the most innovative products in the market, both on HUD, on solar and very complicated integrated functionality that also includes solar rejection to take air conditioning load off the car in an EV.

So we're really excited about the innovation portfolio that's got a tremendous engagement at the auto OEM level to drive this business forward. We just need to get past the sort of supply issues that were so extensive.

So that -- so the business we feel great about. And the -- when it comes to the broader acetyl chain, there's someone coming up in a couple of hours, you can ask that question, too, on the broader acetyl chain. What I'd say is we're not in VAM and PVOH. So obviously, we're not seeing the posing benefit in Chemical Intermediates.

The overall acetyl chain is holding up really well, but we're very small in acetic acid, so I can't comment on that in any meaningful way. The acetic anhydridebusiness, which is where we're the largest player in the world, and that business has always been a little bit more stable. It doesn't have fly up as much in market tightness, but it also doesn't go down as much.

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So we're feeling like we've got a good sort of stability in that acetyl business, both in sort of what it was last year, what it is this year and what it will be next year. So it's not going through as much supply-demand dynamics.

Operator

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

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

In your prepared comments, you talked about slowing consumer durables and construction-related end markets. Can you give us some color on durables and is it appliances, home-related stuff in construction, residential, commercial? Because downstream customers like Sherwin-Williams have already warned and seeing a slowdown. Can you characterize your slowdown? And how do you see that playing out?

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

Sure. So just to step back for a second, and then I'll come to the durable question. When we look at the overall portfolio, durables is an important part of the portfolio, but it's not a huge part of the portfolio. And as you think about Eastman and its overall exposure from this sort of recession question, we've dramatically improved our portfolio. You can go all the way back to 10 years ago and how much $3 billion of divested businesses that were commodities and $3.5 billion of specialty as added and all the innovation that we've been talking about for the last 8 years and how we've improved the portfolio or divesting $1 billion of revenue in AFP that was in businesses that are not performing well.

And so that gets us now to an end market portfolio that's quite improved. So when you look at stable markets, we think about 45% of our revenue is in what we call stable as like medical, personal care, consumables, animal nutrition, cigarettes, water treatment, et cetera.

Then you got about 20% in transportation and energy, which actually has upside going into this year and next. And then you get to B&C and consumer durables where we have sort of this sort of market demand sensitivity and risk. And about half of that is durables, right? So we're talking about 15% of the total corporate revenue.

And that is a place where it's predominantly 2 places where we go into consumer durables, mostly specialty plastics. That's our Tritan that would be going into a Cuisinart or a Ninja Blender or any of those sort of typical appliances that you would think about as well as electronics, where we have some of our cellulosics. So it's high-value business, but it's also a place where we have tremendous innovation, creating our own growth, especially as we go into next year with all the new content, the recycled content that we're adding.

So you've got to sort of -- for sure, we're seeing demand come off in those markets. As you can hear, Walmart, Target, et cetera, are destocking. But I already hit that the demand was well in excess of our capabilities, so some of that's actually not lost volume in the forecast. It's just the backlogs going away, if you will. But there will be some moderation in that business.

And then there's some of it in the Coatings business, where we have coatings that go into all those different types of products as well, and we'll see some softness in that business. And so that's where we see some sensitivity. B&C also has some risk to it.

I think another important thing to keep in mind about what happens in the back half of this year isn't just about primary demand or innovation and how you offset it, but it's also this question around how much destocking is going to occur. And we don't think that there is going to be the same kind of bullwhip would normally have going into a recession because supply chain constraints have really limited how much inventory could be built through the chain, getting to the retailer, especially in markets like auto, where clearly, they have no inventory at the retail at the dealer level. And B&C's also had its own challenges.

And as I said, you've got markets rebuilding inventory like medical and aviation as well as having upside growth. And then you're back to historical question. So when we put it all together, there's certainly some demand risk and uncertainty.

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We're trying to factor that into our outlook. And we're really just trying to focus on what we control, continue to drive innovation, keep driving the pricing on specialties, but be conscious about maintaining a good competitive position while you do that. And that will certainly improve spreads to last year and give us a tailwind for next year and manage our costs as always and stay focused on circular platforms and how we return cash to shareholders.

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

Great. And then I have a quick question on cash flow, in the first half was down significantly. Looking at some of your competitors that reported last night or even earlier in the week, many of them had flat to up operating cash flow. Can you talk about your weaker free cash -- or operating cash flow? And is it maybe due to some seasonality like ag and you have big ag end market exposure, maybe that comes back in second half? Can you just, either you or Willie can go through that?

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

P.J., I'm happy to go through that. Obviously, as we think about the situation that we're in with the highest inflation in 40 years and actually that gained momentum. So as we looked at the beginning of the year, versus where we are now, the raw materials and energy that we are seeing is about $0.5 billion higher. And obviously, that $0.5 billion translates here in the near term into an impact on working capital.

So you're seeing about $100 million on a year-over-year basis, negative impact of higher working capital consumption through the first 6 months. Additionally, the payout of the variable comp from last year. You can see that on the cash flow is about $140 million.

We're taking actions on our cash conversion cycle, whether it's inventory managing our receivable programs as well as looking at and continuing to look at our terms. As we look into the back half and traditionally at Eastman, we have been more back half loaded on operating cash flow from a seasonality standpoint.

And you can look at over the last 5 to 6 years when we generated the robust operating cash flow of $1.5 billion or $1.6 billion. Typically, that has about $1.1 billion to $1.2 billion of operating cash in the back half. So we have headwinds in this environment, and they acknowledge those, but we're still focused on delivering that approximately $1.5 billion even in the face of that.

Operator

We will now take our next question from Matthew DeYoe from Bank of America.

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

Do you have any patents or competitive advantages beyond just like the first mover advantage that would protect you from an entrant in textiles over time? I'm thinking maybe you have a competitor in tow?

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

So we don't have a lot of specific patents on the textile side. We have a significant market position advantage where we are the vast majority of the market when it comes to textile filament, which is different technology than making a tow fiber. And so -- and there's a pretty high capital intensity with that business. So the position we have is pretty solid in developing and producing that product, but we don't have any patents on it.

You can -- in the staple side of things where you can use the tow assets, that's a more competitive market. But again, there's a big advantage we have in the sort of market relationships that we currently have.

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

And Mark, if I may add that other highlight thatI would add is we produce textiles at our Kingsport, Tennessee site, which is highly integrated. And we have the lowest cost position from producing flake at this site in the world. So as you think about the integration and the power of our acetyl streams and cellulosics differentiate us versus our competitors.

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

And one of the great things about this business is the size of the market relative to our capacity or anyone else who wants to join in, is just far greater than what we can make. So we view it as a great business for us. And if there's some amount of competition, there's plenty of room.

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

Understood. And this one might be a little long, so I apologize. But looking at animal nutrition and crop protection right, it did something like $330 million, $350 million in sales in '15 and '16 and then went all the way up to the mid-500s. And as of the end of last year, I guess, we were back in the mid-330 level.

Is this business COVID-sensitive? And why, if it is? And then it seems like it's doing pretty well right now. So is that mid-$500 in revenue number kind of the right target in the medium term again?

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

So what I can tell you about the animal nutrition business is it is growing really well. It's very stable and benefited obviously a bit of some more foods consumption, I guess, you could argue through COVID, but you had more home consumption, less restaurants, so those sort of net each other out. So it's just -- from an end market point of view, it's pretty steady.

Now prices go up and down that impact some of the revenue story just based on the market dynamics that we've been going through in many products. And the profitability of this business has materially improved. The key that we're doing in this business is focusing on how we value up the business, right?

So we have one of the broadest organic asset portfolios to replace antibiotics and nutrition, which is driving our growth. But historically, we've mostly just sold them as individual acids, organic acids. And as we have been moving forward in creating more formulated solutions, that combine the acids and other elements of product performance together, you step up the value 2 to 4x as much as what we get currently today.

And this 3F acquisition we did last year also brought in a lot of capability to sort of not just grow their business, but really value up our portfolio and the synergies on that have been fantastic. So all that has really drive -- driven a lot of improvement in the performance of this business. So it's pretty steady.

I'll let Willie sort of try and respond to the numbers that you're quoting.

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

Well, what I would say, Matt, is -- sorry, is as I look at the last couple of years, it's been around $300 million, and then there's a pretty good jump up here in 2022, and that is related to the 3F acquisition in addition to overall growth, as Mark just referenced.

So not seeing the big spike that you're talking about in a year, and then it coming back, it's more been steady, at least over the last several years.

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

Operator

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

Daniel Dalton Rizzo - *Jefferies LLC, Research Division - Equity Analyst*

It's Dan Rizzo on for Laurence. I was just thinking about energy curtailment in Europe, and I don't know if I missed this, but I was just wondering if you're thinking about how that might affect you guys towards the winter or late this year and early next year?

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

So like everyone, we're working hard on making sure we've got supply positions in place to manage any sort of risk on the curtailment side and are doing everything we can on that front.

Our exposure in Europe has been reduced pretty significantly. So the largest plants we had in Europe were in the adhesives and tires business, which we have recently divested. So the 2 businesses that really have exposure to this in a meaningful way is our amines plant in Belgium and our interlayers plant in Belgium.

Interlayers is more electricity-driven than natural gas-driven in what it's sort of exposed to. But that cost exposure is there. I mean the energy prices are already incredibly high and embedded in our sort of outlook and forecasting. But from a curtailment point of view, we're doing everything we can to minimize that risk.

Daniel Dalton Rizzo - *Jefferies LLC, Research Division - Equity Analyst*

And what about your customers, I mean, have they said anything?

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

I think every customer around Europe is doing the same thing. There's a lot of uncertainty. I don't think anyone really knows what's going to happen, right? The governments across Europe are working hard on trying to come up with a plan. They realize it's shutting down industrial facilities that don't shut down very well or come back up very well. It's not a great idea because it creates a lot of economic and job risk and safety risk in some cases.

And so I think they're trying to be very thoughtful about how they're going to manage this problem going into the winter and then it's anyone's guess on what Putin will do between now and winter. So we're all working to manage that issue together.

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

Thanks again, everyone, for joining us today. We appreciate your interest in Eastman. And I hope that you have a great day.

Operator

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

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