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EDITED TRANSCRIPT

EMN.N - Q4 2023 Eastman Chemical Co Earnings Call

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PRESENTATION

Operator

Good day, everyone, and welcome to the Fourth Quarter Full Year 2023 Eastman Conference Call. Today's conference is being recorded. This call is being broadcast live on the Eastman website, www.eastman.com.

We will now turn the call over to Mr. Greg Riddle of Eastman Investor Relations. Please go ahead.

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

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

Yesterday after market closed, we posted our fourth quarter and full year 2023 financial results news release and SEC 8-K filing, our slides and the related prepared remarks in the Investor Relations section of our website, www.eastman.com.

Before we begin, I'll cover 2 items. First, during this presentation, you will hear 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 fourth quarter and full year 2023 financial results news release during this call, in the preceding slides and prepared remarks and in our filings with the Securities and Exchange Commission, including the Form 10-K filed for full year 2022 and the Form 10-K to be filed for full year 2023.

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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 the description of the excluded and adjusted items are available in the fourth quarter and full year 2023 financial results news release.

I'd like to now turn the call over to Mark for some remarks.

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

Before I jump into the Q&A, I do want to take the opportunity to recognize the team that's been working on the methanolysis plant. There's a huge team out there that's been working tremendously since our last call in October to commission and start up this facility and get us to the point where we're introducing feedstock. And that's a real remarkable accomplishment when you look over this time frame.

They've worked incredibly hard through the holidays. They've made a lot of personal sacrifice, and they've got us to this stage. And it's a real testament to their dedication and belief in the company and the excitement that every owner of this company has around building the circular economy.

And it's also a real great example of the power of our Tennessee site. Its scale and integration has really enabled this start-up process to go this quickly and well. Because we have such a huge vast set of resources and capabilities, it literally allowed us to swing a lot of those people from different parts of the plant into this start-up process and make a significant difference. So I just wanted to express my thanks to all of the people who've been involved in this process. It's been a tremendous program and one that they really did make a lot of sacrifice and we deeply appreciate it.

With that, we'll open it up to Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question for today comes from Josh Spector of UBS.

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

I actually wanted to follow up on the methanolysis facility first -- the methanolysis facility. So you're near getting on-spec product out. But I was wondering if you could talk through kind of the milestones as you go through this year. So when do you get to the point where you say yields are as expected? Do you think you can get to the full operational capacity and the cost structure and therefore, the EBITDA becomes in line with your long-term expectations?

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

It's a question one we're very focused on. And we are very excited to be at the stage we're at right now. As we said in our comments, we're at the point where we've been starting up the facility, completed all the commissioning, introducing feedstock, and that will start to be processed. And the front end of the plant takes a little bit of time to do that, to get the system properly charged and then it starts going through the plant.

So we feel that we're in good shape to be on spec here soon with material recognizing revenue and getting that process going and serving our customers who are very eager to get product from us. And when I say soon, I mean sort of days or weeks in where we sit right now. So we feel like we're on track with starting up the plant and serving customer demand relative to that $75 million.

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Now as you talk about the plant side of this, you don't go from the plants producing on-spec material the full ramp-up rates overnight. It takes a few months to line out the facility, optimize its operations and make sure that everything is working properly as you scale it up. And so we'll be doing that and ramping up the production. But the way this plant works and the way we can get the recycled content out, we should be able to start getting revenue relatively soon.

When it comes to the demand side of things -- and by the way, cost structure will line out over time. Right now, we're still in that pre-production phase. Expenses are a bit higher than when you just are pulling the operating resources back to sort of steady state. So front end of this from a cost point of view is a little loaded as you would expect.

The demand side, I'd say, is actually quite good. So what's different than most plants in this situation is we didn't start selling recycled content when the plant starts, we started it over a year ago. We have a technology called glycolysis, it's a bridging technology where we can use our existing assets. You can use sort of clean, clear bottles, which is what you have to have with glycolysis to then make recycled content.

So long term, it's not a great strategy because it's very high cost to buy those clean bottles and it's not a very efficient process in using your existing assets. But what it did allow us to do is supply recycled content polymer to a number of brands. In fact, the brands that you can see on that slide in the presentation we provided have already been selling our recycled content from that technology into the marketplace.

So we're not trying to ramp them up. They're already ready to go in the market and very anxious to get material from us to sort of accelerate volume build into this year. So that really helps us both know that we can get the price premiums we want to support our economics as well as we have a number of customers that are going to sort of buy the moment we have product coming out of the plant.

And then there are a bunch of other brands we've been working on that we just didn't have the capacity to serve last year that are also very interested in the product, and so we'll be qualifying them and ramping them up. So what you have is a situation where the ramp-up will start to help Q2 relative to Q1, but really sort of make a big difference in the second half relative to the first half of where you see this incremental EBITDA.

The last point I would mention is on the cost side, normally, when you build a big specialty plant, you have a huge headwind in operating costs as you start up. And we certainly have operating costs for this plant. But they are really sort of offset by the pre-production expense of last year and the higher cost of this glycolysis process I just mentioned. So the costs are relatively neutral. And so that helps the revenue be -- flow pretty fast to EBITDA through that sort of year-over-year sort of steady cost structure, if you will.

So that's the sort of key components of it. We're very focused on just keeping the process going right now. And as I said earlier, it's just a tremendous example of teamwork out there who are doing this through winter weather and freezing conditions, et cetera, to get this plant running.

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

And maybe just quickly, so as you go through all that, you made some comments that you wouldn't FID the next plant until this plant is done. I guess, is that just on-spec product? Or is there at some point, production yield or some other metric you're looking at to say we're good, the design is fine, there's -- like we're going to move ahead with that project? Because you seem pretty bullish about getting the customer commitments that second plant soon, so I'm just wondering what's the limiting factor there.

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

Yes. There are a couple of limiting factors. One, obviously, is we want to see the Kingsport plant technology up and running. And as you said, we want to see that the yields and efficiency are what we expect them to be, the plants running operationally well. And as I said, that's in the next couple of months that we'll sort of get those insights and knowledge to feel comfortable about the quality of this plant.

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Because it's important to keep in mind that to minimize capital risk and construction risk, we're going to leverage and build the same plant, right, in France in the second plant. And there's obviously improvements we'll learn through this process. But same scale, same design, so that -- really leveraging all the learning that we've gone through in this plant to do a better job in how we build the second and third plants.

So that, I think, is in the time frame of what we're talking about right now from an FID point of view. The customer contracts are obviously the second component of that -- of making that decision, and the incentives for the project getting finalized is the third part.

We feel good about all those. And we think, again, in the same kind of time frame, in the next several months, we should be in a position to have FID. When construction starts is a little bit different than declaring FID. We're still completing the engineering, we have permitting to do on the environmental side and building permitting that is ongoing as we speak.

So we're not talking about starting actual construction until -- soon as probably late summer with the path that we're on right now. And that gives us all of that time to make sure we believe in how the plant is operating before you start turning dirt on the second and third plants.

Operator

Our next question comes from David Begleiter from Deutsche Bank.

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

Mark, some of your customers and peers this earnings season have noted some modest stabilization, improvement in certain markets, underlying demand. Are you seeing any of that in any of your geographies or key markets?

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

Certainly, David. What I'd say is we are seeing stable -- I mean stabilization, absolutely. So our guidance is built on thinking that primary demand this year is going to be similar to last year in the sort of discretionary markets. And in the stable markets like personal care, water treatment, consumer packaging, et cetera, we would expect sort of modest growth from last year.

Now to be clear, last year's demand -- primary demand was low. We're not predicting an improvement in any meaningful way from those sort of low levels we were at from -- through last year. What I would say is -- and automotive, we actually are -- was growing last year, and we think it's going to be more flattish this year. So that's sort of where we are in the primary demand as we sort of showed on the slide that we supplied to you guys.

The key driver for pretty significant volume increase for us this year versus last year is really the sort of lack of destocking when you think about the sort of volume mix impact of last year, driving earnings down about $450 million. And what we said in October, I think it's still true. You assume about 1/3 of that is destocking, it's probably a bit more than that, but to play it safe, we'll call it 1/3. That's $150 million of a lack of a demand headwind from last year relative to this year. It's like an easy comp. And we can see the evidence of that playing out already in the fourth quarter in some markets and certainly into the first.

So for example, the durables business, which -- consumer durables business, which is the one that was most impacted from a demand drop last year. The second half of last year was 40% higher in volumes than the first half of last year. So you've already seen a lot of the -- into destocking that's occurring there.

We're still not where we want to be, of course, from a market demand point of view, but it's very clear destocking is over. Same is true in a lot of the stable markets, right? Destocking occurred in personal care, water treatment, things like that in the first half of the year. By the tentative back half of the year, we're already getting to sort of some modest market growth. So for the overall year, demand was relatively flat to '22 in some of those markets.

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Building construction, I think, is probably still the most challenged. It was tough last year. The expectation is it's going to be tough this year, maybe even slightly down in primary demand. And -- but again, I think most of the destocking in that market has played out. By the end of the fourth quarter, there may be little pieces and parts into the first quarter, so you still get that lack of destocking lift in coatings and interlayers across AFP and AM.

So I think that, that sort of on a full year basis, sort of how we look at it. And I would note of that $150 million of lack of destocking, 2/3 of it is in Advanced Materials. And the progression, I would say, through the quarter is looking good. So we had a soft start to January, February is already stronger orders in January, and March looks good at this point with what we can see.

So that's another point to keep in mind is the first quarter is a pretty slow start, as you can clearly see in our guide. But there's a lot of upside as you move into the second quarter from seasonal build. So we do expect a normal seasonal pattern to demand this year. So even though -- we're not saying primary demand is going to be a lot better. First quarter is always softer. Second, third quarter, stronger fourth quarter obviously comes off in a normal pattern for us. And that is how we've built our forecast around that. So that helps a lot for why things get better in the second quarter.

And then there's some timing issues as we've identified in Fibers and fluids where -- particularly low orders in Fluids for especially heat transfer fluids. And then Fibers is a customer buying pattern thing. So those orders get a lot better in second quarter. So there's several things come together along with some better spread improvements that make second quarter a lot better than first quarter, because I'm sure a lot of people have questions on that as you look at our forecast.

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

And just briefly on AFP. You mentioned some negative price cost in 2024. Where are you expecting to see the pricing pressure in AFP?

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

So first of all, the spread management last year was great in AFP. So we do have a lot of business on price sort of cost pass-through contracts to give us very stable margins. So it was very helpful in '22 as raw materials were shooting upward, our prices kept track. And then as prices came off last year, raw material prices came off, the price contracts follow, but there's a lag. So we had an improving spread last year for AFP for the year. And so that was a helpful tailwind to offset some of the volume headwinds we had in that segment.

When you look at this year, there's just a bit of that lag problem again. So you've now got prices sort of stabilizing off. And so if you look at spreads this year relative to last year, there's going to be a bit of a headwind just in the way those sort of cost pass-through contracts work. So that's the primary driver of the sort of modest spread compression we expect this year relative to last year on AFP.

Operator

Our next question comes from Frank Mitsch of Fermium Research.

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

And if I could follow up in general on pricing. As you indicated in terms of the cost through, the pass-through contracts, '22, was a very good year. And as we're ending '23 here, pricing has been taking a bit of a hit. So how are you thinking overall about Eastman's pricing ability in 2024 for the overall enterprise?

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

Yes. So first of all, I think it's important to have a little history around pricing because it really is a pretty impressive story. So if you think about 2020 to '22, our company had $2.4 billion of inflation. And so we had sort of CPTs trying to keep up to it, but there was still a lag that creates a compression and the prices catching up to the increases. But overall, we did an excellent job of getting prices to catch up to all that inflation by the end of 2022, but it did create a compression headwind in chasing it in the specialties in particular, in 2022.

So that's sort of how we entered '23 is at a pretty high elevation with that inflation. The accomplice to '22 was compression and we moved into really doing a phenomenally good job. Our teams were just -- really demonstrated great commercial excellence and the real strength of the value proposition of our specialty products and holding prices outside of the cost pass-through contracts in the Specialties.

Not to mention we dramatically improved our pricing in Fibers. So when you think about that $450 million of volume headwind we had in '23 and $50 million of currency, we were able to manage price in '23 in a very difficult economic environment to entirely offset that in improvements in price relative to variable cost.

And a lot of it is structural. So about $300 million of that is in Fibers, based on all the descriptions we've given you around where that industry is at as well as a good portion of that is in Advanced Materials in the interlayer business where we had extraordinarily high raw materials in '22 that we were able to -- those raw material prices dropped off or prices held, and we got a lot of just recovery back to normal margins in that business.

So we feel really good about that, and that basically means there's sort of $200 million of spread expansion beyond the sort of Fibers, interlayers that you're managing. So our expectation this year is on the specialties, Fibers is fully contracted. So the prices there are locked. And as we said, business will do a little bit better in earnings versus '23.

In the specialties, what I'd say is that we expect some modest price reductions reflecting how the raw material and energy environment is -- has improved. But overall, we would say the spreads in AM and AFP will be similar to last year. So we're not going to get a tailwind out of it. Maybe there's a slight compression across those 2 businesses. But we really believe we'll hold on to our margins with what we see so far, certainly will in the first quarter.

And then we expect to have volume and capacity utilization be the key drivers for recovery and earnings which are pretty substantial. The destocking number I just gave you, $100 million of asset utilization tailwind are pretty significant drivers of recovery this year.

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

Got it. All right. And then perhaps if you could -- I took a look year-over-year, Europe actually declined less than the United States. Is that really -- is that just a function of Europe entered the year in a worse position? Or is there anything that you can talk about in terms of perhaps any sort of green shoots or what have you in that part of the world?

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

So part of the reason North America is down as much as it was, it's just all of Chemical Intermediates sits in North America predominantly. So when you look at all the revenue that came off in Chemical Intermediates, it's sort of almost all in this country. When it comes to the rest of the portfolio, I'd say we're more globally diverse, and we saw really demand come off and especially sort of across the globe as well as the destocking across the globe. So that was more evenly dispersed. China has got its challenges, and so does Europe and the U.S., probably a little bit stronger in the economy than the other two.

But from a green shoots point of view, Frank, I wouldn't -- from a -- we have this into destocking, which is our primary focus right now. I think it's way too early to call markets recovering in the consumer discretionary world. So cars, building construction, consumer durables, electronics. There may be some improvement there, but I don't think I have enough data to sort of make that declaration.

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But the stable markets are definitely growing. Medical is probably going to grow 4% to 5%. I mean there's still destocking in the first quarter, but the underlying market is going to grow 5%. Ag is growing, personal care, water treatment. A lot of the packaging sector as a lot of the consumer brands are now pivoting from price to recovering volume, we'll benefit from that. So that's about half of our revenue where you get that modest growth in these markets that are sort of more stable.

Operator

Our next question comes from Patrick Cunningham of Citigroup.

Patrick David Cunningham - *Citigroup Inc. Exchange Research - Research Analyst*

And maybe just first on Advanced Materials. Can you help us understand the $450 million guide there, and maybe the degree of upside beyond that? I think you get $50 million from Kingsport and you're guiding to $100 million for the first quarter. And just given the extremity of the demand decline, utilization headwinds, destocking of 2023, is there a path to $500 million or more, even in just a modestly positive demand environment from here?

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

So first, given sort of the challenges we've had in Advanced Materials with pretty rough demand in the fourth quarter of '22 and the full year '23, we're starting with earning our way in our recovery and getting back above $450 million and then working to make it better than that.

But just to give you the sort of key tailwinds that go with it, the biggest driver for Advanced Materials recovery is volume and mix, as I sort of pointed out. The corporate level, the story is pretty much an AM story. So 2/3 of that $150 million of a lack of destocking is sort of in the outlook for this segment. I told you durables has already had significant recovery.

Medical has great underlying growth. It just had a lot of destocking from a lot of caution in the supply chain crisis that's still finishing itself out in the first quarter here, but we can see that it will be less in the second quarter, and then we'll just have the growth in the back half of the year.

So you've got markets that have done a lot of destocking or stabilizing in the lack of destocking helping. Then you've got the return to seasonality. So even though the first quarter is still in recovery mode, when you look to the second quarter and beyond, you've got this return to normal seasonality to this segment. So Q2, Q3 is always stronger, and we expect that to be there. And that order pattern I was talking about, about January, February, March is very much through in Advanced Materials where you can see that progression getting better.

You've also got the ramp-up of the methanolysis plant, as you noted. So that's going to get you that incremental $50 million of EBITDA that you just mentioned that shows up in Advanced Materials. The other $25 million is a benefit for corporate other, just to be clear which is where the pre-production expenses of last year have been sitting.

And then you've got the automotive market that even though it's going to be flat, we have a tremendous track record of growing above that market with our great strength in HUD going into more and more cars, great strength of other premium products, the acoustics, et cetera.

And then importantly, even though EV is maybe not growing as fast as everyone hoped, they're still growing much faster than ICE cars. And we get over 3x the amount of square meters in an EV than we do in an ICE car, very high-value products because there's a lot of functionality in those products that we sell to them -- so there's a lot of leverage there that goes beyond just destocking where we're creating our own growth through innovation in circular and automotive that will drive it.

And as I said earlier, we expect the sort of price cost relationship to be somewhat neutral to last year. So that won't be a source of a tailwind, but we don't expect it to really be a significant headwind either. But all that volume shows up, and then with that, you get utilization, right? So you've

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got $100 million asset utilization headwind for managing inventory last year, that becomes a $50 million tailwind this year with this segment. So that also will be a driver for how you get above $450 million.

So if you put all that math together, you can get to $450 million, you could get something greater than that. But I'd like to see proof in how the market is recovering and ramps up into the spring before we start getting beyond that.

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

And Mark, the only thing I would add is, as we think about the year-over-year increase and our depreciation expense, a substantial portion of that will go to the Advanced Materials segment.

Patrick David Cunningham - *Citigroup Inc. Exchange Research - Research Analyst*

That's very helpful. And maybe just a follow-up on EVs, how much outperformance relative to the market did you see from EV and premium volume mix impact? And given that we've seen some of that headline deceleration in EVs and maybe sort of looming consumer weakness, do you see potential that, that mix improvement, outperformance is decelerating into 2024?

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

Well, certainly, I think the rate of year-over-year improvement in '24 to '23 will be less than it was in '23 or '24 for the sort of data you're citing around EV growth rate. But I don't think it's significant, right? There's still a lot of applications we're winning. So there's -- okay, there's a primary demand issue that's slowing down, but we're also just starting to penetrate all these EV accounts and win share relative to standard interlayers and ICE cars. So you get this leverage within the market, within the EV segment itself that helps.

So I don't want to oversell it. I mean we expect an overall flat production market, which I think is sort of consistent with what everyone else is saying but the growth we can get in these premium products is very meaningful in helping us grow above that market.

Operator

Our next question comes from Vincent Andrews of Morgan Stanley.

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

Mark, could you talk a little bit about plant 2 and plant 3? There were some comments in the prepared remarks, talking about methanolysis obviously, in the prepared remarks about the teams working to sort of make sure they can stay ahead of inflation. And I'm just kind of curious how you're feeling about the CapEx estimates for those plants.

We all know it's obviously an inflationary environment. We've seen some cost overruns at non-related large-scale projects that other folks are doing. So how are you going to stay on top of that? Is it something that you can do technically? Or is it going to be something you're going to have to do in terms of how you price the product?

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

Yes. So Vincent, you're absolutely right, that's an inflation environment. Certainly, if you go back to Investor Day in December of 2021, the capital estimates we had there for both Kingsport as well as these projects have gone up, which is true for every construction project I've seen in the chemical industry and probably everywhere else. So we're all managing and dealing with that inflation.

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And a lot of what we saw happened in Kingsport went beyond just normal inflation, right? So we had a huge issue with the contractor not having skilled -- properly skilled labor, and that productivity issue was the biggest issue we faced. We also had just an endless series of severe weather events along the way.

And there was a lot of engineering work we were doing in that project, and piloting of how to optimize the design of the project, why we're building it, which is never ideal, but allowed us probably to get 2 years ahead of the market and getting the product online. So we have a lot of learnings from the methanolysis project here that we're incorporating into France and second, U.S. projects, where we're very clear on how to build them a lot more efficiently than this first one.

So what I'd say is, from a CapEx point of view, there is inflation that's occurred. There is some deflation that's now in front of us in materials, even contracts -- contractor. Labor availability is improving, as we sort of are in this sort of more recessionary cycle for the materials industry. They'll help sort of offset or slow down or maybe even decline some of that inflation.

We are building the same plant again. As I said earlier, same scale, same design. Obviously, whatever learnings we have in Kingsport, we'll incorporate into it. But we're not trying to build something new, we're just building the same. And you get a lot of capital efficiency when you're building serial number 2 and number serial 3 at the same plant.

So there will be benefits in controlling capital, both the cost and the predictability from that. Scopes will be completely locked up before we start building, and that will help us control CapEx relative to what I just described in Kingsport. And we're using great firms, Technip, Fluor, for this -- these projects. And they've got access to an excellent set of contractors to do this. So we feel good about controlling the capital cost. They will certainly be a bit higher. And that's why we're also pursuing more incentives in both France and in the U.S. as part of the projects.

So I think we feel good about that. What I would say is when we when we came up with the original economics and talked about returns on these projects, we gave ourselves some room for inflation and other challenges we might encounter. So the Kingsport project is still at 15% return on capital despite the capital increases.

And these projects are still with the proper customer contracts and incentives, above 12% return on capital. So even with inflation, we feel good about the returns and feel that we're on track to get these 2 projects started this year, assuming we hit our requirements that I mentioned earlier, we've got to still get those 3 things, customers, incentives and finalize the capital number.

Operator

Our next question comes from Mike Leithead from Barclays.

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

First question, I wanted to circle back on the EPS outlook. I think the last number of years, the first quarter is roughly 25% of what Eastman's full year EPS turns out to be. This year, 1Q is maybe 18% or so, the full year guide. So can you talk through why this year's 1Q is a bit different? Is it mainly the lingering destocking that gets you a bit better into 2Q there?

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

Yes. I think as Mark has outlined, we expect the traditional curve, right? We're growing earnings through Q1. Traditionally, Q2 and Q3 are best quarters. And then there's a seasonal decline in Q4. Also, as we've highlighted and also on a year-over-year basis, we expect the second half is where we'll pick up most of the utilization benefit as well as the benefits from our Kingsport methanolysis facility.

So there's a combination of factors of the pace that we're seeing in the order books, traditional seasonality as well as the specific items that impact us in '23 that are turning into tailwinds in '24. Those are the key items. Mark?

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

I would just add, there's a couple of unique elements of Q1 beyond just the seasonal pattern where you've got oddly low orders from Fibers customers. No volume risk on the contract. They're just not buying as much in Q1 as they will do in Q2, Q3. And so that's sort of putting some pressure on there that's sort of beyond seasonality. Same is true in just timing of fluid fills, not much going on at all in Q1 but we have more in Q2. So there's a few aspects beyond just sort of normal that's sort of impacting the continued destocking in ag and medical, beyond just the seasonal pattern that mostly will play out in Q1.

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

That's helpful. And then just briefly on methanolysis plants, 2 and 3 again, Mark. If I take some of your commentary about if all goes to plan, hopefully, breaking ground, I think, by later this year, is it fair to say these plants -- obviously, you'll have a little bit of efficiency or a lot of efficiency gains from rebuilding the first plant. But is it fair to say that these plants commercially would be running something like in mid-2026 as a starting point?

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

I know -- with the schedule on now, we're more into '27 than '26 for when these projects will start, if you go back to sort of our original estimates. There's certainly efficiency and timing we're pursuing that will allow us to build these plants more efficiently, but we're also building a lot more plants in this case, right? Because it's not just a methanolysis plant we're building. We're building infrastructure on our greenfield side in France. We've got polymer lines that we're also building all at the same time. So when you put it all together, it just takes a certain amount of time to get it done.

But the key is the markets are certainly very eager for the product. They have very significant deadlines in 2030 that they have to hit. So we're certainly well within making sure that we're ramping up and helping them get to their targets. But we want to make sure we've really learned everything we can from Kingsport before we start the construction. And so that's sort of that 6-, 9-month delay that's sort of occurred from what we were originally thinking.

Operator

Our next question comes from Jeff Zekauskas of JPMorgan.

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

I think in the Advanced Materials discussion, there was some noting of weak fourth quarter's amount. And Asian auto production is always very strong in the fourth quarter, especially EV production. So is it the case that your EV exposure in Advanced Materials is more with domestic in European companies rather than with Chinese companies?

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

So Jeff, when it comes to the fourth quarter, there was a lot of moving parts for AM as a segment involved in that. So on the auto side, we do have good relationships and positions with some of the Chinese EV makers as well as the Western EV makers. That has nothing to do with sort of the quarter.

Auto demand was better. You've got to remember, performance films is a key part of that, not just interlayers, where we're going on both EVs as well as ICE cars and our paint protection film. And so it's only the interlayer part that really applies to your question around sort of the OEM manufacturers from an interlayer point of view.

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So I think that's not a significant factor. The bigger factors were it's just destocking continued longer than we expected in medical and packaging on the Specialty Plastics side that caused volume mix to be a little bit less than what we were projecting in October. That was the entirety of the difference.

I mean overall, the automotive market is sort of moderating a bit, as you can see from the production data in total. That has an impact, but we were still growing above that market in Q4, and we'll continue to grow above that market all year this year.

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

I think in the original idea for the methanolysis project, you were going to spend $250 million for the project itself in Kingsport with an additional $175 million for Tritan. And I don't know if you partly built the Tritan plant or the Tritan plant wasn't built at all. But in the non-Titan piece, the original idea was $250 million. What did you spend?

And in the future plans, I believe the estimate was $600 million to $800 million. What is the estimate now, in that what you say is that you have a good return on capital? Or you think you can work that out with your customer base? But the customer -- you need to have an expectation of what the capital expenditures are in order to negotiate a level of a good return on capital. So I think originally, all of this was supposed to cost $1.8 billion. What's the number now? Can you help us?

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

Jeff, let's start -- the last update that we gave on the all programs was saying that the 3 methanolysis facilities would be approximately $2.25 billion. Obviously, Mark has also highlighted there was quite a bit of inflation since 2021. And I think that estimate is reflective of that. And every project over this time frame, including ours is at that level.

Also, I would say, we've been able to handle the CapEx increases that had been above our estimate from a few years ago within our capital budgets that we've outlined and expenditures over the last couple of years. It was fully incorporated into our '22 and '23 spend. And I referenced earlier that we had roughly $30 million of increased depreciation expense going from 2023 to '24, and a substantial portion of that is related to the Kingsport methanolysis facility. That directionally gives you the magnitude.

We're going to be disciplined as we move forward, as we think about both from generating the cash flow to fund these, but also on the returns. And we believe that Advance Materials, the return to growth will be accelerated by having this methanolysis facility and our renewed brands with our customers.

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

But -- there's no question that the capital numbers -- I'm sorry, just the capital numbers are up. We're also pursuing a lot more incentives to offset some of those capital numbers. So until we get that all finalized, I don't want to just keep updating numbers. So once we have clarity on them and the total economics as well as what we achieved with customers on the pricing premiums, we can get to fund it. We will be able to sort of give you a more clear answer on your questions.

I mean the incremental $30 million of depreciation, a good portion, if not all, but a good portion of that is Kingsport plants, so you guys can work out what the project costs.

I'm sorry, you were saying something, Jeff?

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

Yes. Did you partly build the Tritan facility and the Tritan expansion...

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

Sorry, yes. We started the construction of it, the early -- yes, Jeff, we started the early construction part of the Tritan line and then paused it. And we're going to restart that as we align it with our outlook on Tritan demand which is improving a lot this quarter. So we'll see how we judge the Tritan demand in this next quarter or when we need to get that going again to make sure we don't short the market.

Operator

Our next question comes from John Roberts of Mizuho.

John Roberts

Are the sig tow contracts working as expected in 2024? And do you think you get to a point where the decline in sig tow volume is offset by the new products in Fibers so that the overall segment has flat to up volume?

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

Great question. I'm a big fan of the cellulosic stream these days, John. We've gone through a rough patch for quite some time. It's great to have the structural market of the tow business back to being where it was very stable and at the profit levels that allow us to reliably supply our customers. And they're very focused on security, supply and reliability. And they placed a lot of value on us in this industry being able to provide that.

So our contracts, we're 100% contracted this year for volume and price. And so we feel good about the earnings stability we'll have in that business. This year, as we said, it will be somewhat better than last year. And then we've got 90% of our contracts in place for '25 and close to 70% in '26. So we feel good about how this on a tow business is going to provide stable earnings and cash, a lot of cash out of this business. And then as you just noted on top of that, you now have growth in the Fibers business that's part of that equation that allows us to sort of push our assets and utilization and value.

And then Aventa, which is something we'll probably talk to you more about in the spring is really on a great path. This is where we figured out how to take our cellulose acetate and foam it, where it's a drop in replacement to polystyrene for protein -- chicken and pork trays in the grocery store that you see all the time or other sort of foam, clamshells, et cetera.

And that industry has a serious issue about getting out of polystyrene. We have a great value proposition with a cellulosic material where it's a drop in to their existing equipment and is certified to biodegrade not just in industrial settings, but also in home settings, which is equivalent to landfill. So you really have a biodegradable solution to throw this stuff away with all the sort of meat juice and everything else that's with it that can't be recycled.

So very big market, a lot of opportunity, good margins and something that we think will be commercial and grow this year and build into something meaningful next year. So we'll tell you a lot more about that once we have the customer announcements to go with it.

But when you put all that together, it does turn the cellulosic stream into a growth stream along with the polyester stream, both tied to sustainability and circular economy trends that are presenting a huge amount of volume growth. Like Tritan replacing polycarbonate BPA, we can have much higher growth rate than the underlying markets as we're replacing polystyrene or we're replacing other plastics of the recycled-content-made products that can give us a lot of levered growth.

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And the one thing you know about Advanced Materials on both sides is there's a lot of fixed cost leverage. So you've seen the sort of pain of that in the fourth quarter of '22 and '23, but it looks exactly the same on the way up. So as you get volume coming back, the fixed cost leverage of these very high-margin products across specialty plastics and now some of it inside cellulosics, which also has a lot of fixed cost is very attractive.

Operator

Our next question comes from Mike Sison of Wells Fargo.

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

Nice outlook for '24 so far. Just curious, Mark, your volumes were down mid-single digits in the fourth. It's been quite some time since we've seen volume growth. When do you think AFP and AM will sort of turn the quarter? And what type of volume growth do you think the businesses need to generate to hit the midpoint of your guide?

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

Yes, it's a great question. I think that we'll certainly turn the quarter in Q2 and the back half of this year. It's a much closer call in Q1 because of some of these unique things I've talked about overall. These timing on fills and customer buying and Fibers is a bit bumpy. And you still have some destocking going on in ag and medical, those kind of things that are certainly weighed on Q4, and will weigh on Q1 to some degree.

But we are seeing volumes improve in sort of the core businesses, are the -- ones, especially the ones that all started destocking earlier, whether it's consumer durables, building construction, et cetera. You can definitely see that destocking is over. We just don't have everything done with that topic. I'll be happy to see it. It is extraordinary when you think about it.

We're sort of in the sixth quarter of destocking. 2020 had like 2 quarters and 2009 had like 3 quarters. So we are in unchartered territory on this destocking thing, and we all need to own that. But you can definitely see it's coming to an end, and we're happy to get our production volumes connected back to markets. And that will give us a nice recovery this year.

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

Got it. And then just a quick follow-up on adjusted EBIT margins for AFP and AM, it. Looks like you'll see some improvement in '24 versus '23. But historically, there have been -- both of those have been closer to 20%. Is that sort of where you think margins can get to over time?

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

Mike, this is Willie. As Mark highlighted, as we get the benefits of the fixed cost leverage as well as we get the mix upgrades with our circular solution. We definitely believe both AM and AFP can grow back to those and towards those 20% type margins.

Operator

Our next question comes from Aleksey Yefremov of KeyBanc Capital Markets.

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

Are you likely to stagger construction of methanolysis number 2 and number 3? Or do you think you're in a strong enough capital position and confidence in this business to build the two simultaneously?

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

I would highlight, we would expect that we would stagger these, Aleksey. There is not going to be a significant difference, but they will definitely be staggered with the France project as Mark said, breaking ground in late summer. And then as we make progress on that, we would look to then shortly after that to start our second U.S. project.

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

And staying on the same topic, do you have any significant number of customers who might be on the fence right now telling you they'd like to see the Kingsport plant start up, and then if that works well, there could be a lot more customers willing to sign up for the other two?

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

No, we definitely think so. I mean this industry doesn't have a lot of examples of inventing and having successful environmental technology solutions, whether it's recycled content or carbon efficiency. So customers are cautious about how much they want to sign up and buy until they really have proof that it's going to be available reliably at prices that make sense to them.

And so I think we're already in the market, fortunately, confirming our price expectations with the Pepsi contract, with the specialties that we're already selling. So we feel good about that. But I think there is a lot of potential pent-up demand once the plant is up and running and validated, that will certainly help load this plant. Obviously, that's part of our assumption around the $75 million of incremental EBITDA this year and that will help give us upside to it. The downside, of course, is markets are weak.

And so there's just a limitation at the rate at which customers are going to launch products in a weak market. And so you have to net those together in trying to come up with the appropriate forecast, which we've attempted to do with this $75 million EBITDA guide for the first plant for this year. And then obviously, that will continue to ramp up and be a significant tailwind in '25 relative to '24.

Operator

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

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

Mark, if the methanolysis startup and ramp goes smoothly such that you earn $75 million in EBITDA, as you've indicated, what could that earnings level become in 2025?

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

Kevin, this is Willie. What I would highlight is as we've talked about, roughly $50 million of EBITDA will come in the Advanced Materials segment. That's primarily in the second half. So as I think about where we'll be, effectively we'll be at greater than a $75 million EBITDA run rate within that business.

We've got a strong pathway to exiting 2025 as we think about brands and being able to connect them to even more brand launches in '25. That will be at roughly a $150 million run rate as we exit '25. And then ultimately, we expect greater than $150 million of EBITDA from this facility on an annual basis.

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

Perfect. I appreciate that. And secondly, if I may, Mark, I want to come back to the Fibers discussion. I think it's interesting that you've got so much under contract through 2026. When we talk about a lot of the output being under contract, can you speak to -- does that just mean the volume is committed? Or can you speak to the degree to which you've got visibility into both pricing and cost? Just trying to get a sense for kind of the confidence intervals around the economics through '26.

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

Yes. So the sort of the commitments we have in '25 and '26 with the market is both on price and cost. It covers both. Now there's ranges in the volume side, right, so they have a min and a max on volume. But the pricing formula, which in most cases include -- these prices will then adjust based on changes in energy and raw material. So it's sort of cost pass-through, if you will, to some degree.

So these margins, if we get a tailwind, we'll share that with the customers. If costs go up, we'll raise our prices formulaically. But that is the nature of most of these contracts, not all, but most have some version of pricing it, a lot of it includes the CPT. So no, that's -- but there's always a little bit of potential volume decline in the market that we have to accommodate with them. So that part has room for sort of changes in market demand.

Operator

Our next question comes from Laurence Alexander of Jefferies.

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

Can you -- on the renewable side, can you discuss how the policy landscape is shifting in terms of the potential incentives you may receive for this second and third plant compared to what you had initially expected or broader policy shifts that might be incentivizing customers?

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

Sure. So two different sets of topics there. On the incentives, the European Union and the governments within it have certain prescribed methodologies around how they do incentives, and we are working to get the higher end of what's allowed in the European Union. We're in the middle of finalizing that, so I can't talk about it right now. But there are some improvements we expect to get as the inflationary environment has impacted the CapEx cost. So we feel good about where we're at on that.

When it comes to the U.S., the Inflation Reduction Act is out there. As I think we discussed in the third quarter call, we do have an application in to them. We have not yet been notified about whether or not we'll get that reward and what the level of the reward will be. We've asked for a substantial amount of capital because it would support some very impressive environmental investments around the plant that allow that plant to be carbon neutral which would be extremely attractive.

There are two things customers want right now, 100% recycled content. They don't want anything less, because they want to have a bold claim. And they want to be carbon neutral or as close to that as possible. And so the second and third plants are both capable of being carbon neutral, and they are obviously capable of delivering 100% recycled content. So there's a lot of interest and attraction to making sure these kind of plants get built. But it's a political process, and I never want to guess politics until I know what the incentives are. We'll just wait and see what they do.

When it comes to the policy for the circular economy, the European policy in place that they're finalizing the rules on as we speak, is very attractive for driving demand of the product. So it's a -- it requires circularity in certain percentage targets for like beverages, 25% by next year. And the industry only probably has half of the capacity mechanically to serve that. So there's a lot of demand and market need in that space.

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And then all packaging needs to be 30% by recycled content. As I mentioned earlier, no one wants 25% or 30%, every customer we're talking to wants 100%. So the demand is probably in excess of the regulatory requirements, but there's definitely requirements that will force people to start getting recycle content. It also requires the content to be made from packaging place in the European market. So it allows that to be a regional circular business. So we're still waiting for all of that to be finalized, but that's sort of where it's headed at this point as we understand it.

The U.S. is a patchwork. So every state is developing a different point of view around circular economy and how they want it to play out. Half the country that is the more conservative states are all passing. They're very sort of favorable circle economy language. The other half, it's a patchwork. But so far, everything we've seen, our technology fits within the definitions of being a solution to the plastic waste crisis.

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

And then just as we start looking towards 2025 and 2026, to what extent have you pulled forward productivity that would make it more difficult to get sort of incremental productivity gains over the next few years?

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

Are you talking about sort of total company or product -- I'm sorry, I just -- I'm not sure I understand the question. Are you talking about just general productivity in the company or...

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

Yes, the kind of structural productivity gains you've been delivering kind of fairly consistently. I guess my impression is that effort ramps up in the more recent period. And so I'm just curious as to have you pulled things forward? Or should we be thinking about there's another leg of structural productivity getting over the next couple of years? Just what's the next piece of that story?

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

Yes. So I think what I'd say happened to us and every company is we had extraordinary inflation in '21 and '22, and we lost productivity through COVID and work at home and everything else that I think every company, including us, is working our way through.

So we aggressively went after it last year, where we got $200 million of productivity above inflation to start addressing some of that sort of extraordinary inflation and get our cost structure where it should be. This year, as you saw, we're just getting enough productivity to offset inflation. So $100 million of productivity offsetting total inflation of labor and external spend.

And so that's more normal is what I'd say. We have to have productivity every year, where we're offsetting inflation so that we have the ability to invest in growth, deliver earnings growth and cash to the shareholders all at the same time. And so that's sort of where we're at.

And so you should expect continued productivity, but it's more in the offsetting inflation category going forward than some big additional step-up, right? The leverage for our company right now is volume recovery, especially in the specialties where the value per product is much higher than the company average. So you get volume, you get mix lift, you get fixed cost leverage, which is how we've demonstrated a lot of success in our past and certainly, the strategy we're going to be on this year and leveraging into next year with innovation.

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

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

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Operator

Our final question for today comes from Salvator Tiano from Bank of America.

Salvator Tiano - *BofA Securities, Research Division - Analyst*

I just want to ask about the M&A landscape. What are you seeing here? And now that it looks like things are finally improving, are you more incentivized to go out and look for specific targets?

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

Yes, Salvator, this is Willie. What I would highlight is, I think we've shown that we're disciplined with our portfolio overall. As we think about priorities for bolt-ons, which we're always looking for those bolt-ons, would be within our Additives & Functional Products and Advanced Materials segment. But our key focus that we have right now is continuing to execute on our organic growth program. But to your point, there's probably better deal space coming as there's both a recovery from a business standpoint and the rate environment is changing.

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

All right. Thank you, everybody, for joining us. I hope you have a great day.

Operator

Thank you for joining today's call. You may now disconnect your lines.

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