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EMN - Eastman Chemical Co at JPMorgan Industrials Conference

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PRESENTATION

Operator

Welcome, and thank you all for standing by. (Operator Instructions) Today's call is also being recorded. If anyone has any objections, you may disconnect at this time.

And I would now like to turn the conference over to Mr. Jeff Zekauskas. Sir, you may begin. .

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

Thanks very much. I'd like to welcome everyone this afternoon to the JPMorgan Virtual Industrials Conference. We changed our format of the 2020 conference to a virtual one in the interest of health and safety, and thank you for attending.

It's my pleasure this afternoon to introduce Willie McLain, the new Chief Financial Officer of Eastman Chemical. Willie is a 20-year veteran at Eastman, having held positions in finance and strategy in Eastman's Asian, European and U.S. operations. Willie will make a presentation, and then Willie and I will conduct a brief fireside chat. Willie?

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

Thank you, Jeff, and thank you to JPMorgan for the flexibility in pursuing the virtual conference format. I'd like to say good afternoon to everyone, and thanks for your interest in Eastman.

I'd like to take some time and emphasize a few actions we're taking in this challenging environment before jumping into my presentation. Between the virus, the volatility in oil and financial markets we're seeing, we're certainly operating under a lot of uncertainty, and that's why we're not standing still at Eastman. If you'll recall from our year-end conference call, we are focused on the things that are under our control, driving new business revenue through innovation, managing our cost structures effectively, and we're taking a few other steps to deliver value in the near term, including leveraging our sites, licensing and portfolio optimization. Let me add a little more color on these value drivers as well as cover our strong balance sheet and our free cash flow during the presentation and Q&A. And of course, I would encourage you to read the cautionary language on Slide 2.

With that, let me start on Slide 3 and new business revenue from innovation.

For those of you that follow Eastman, this won't be a new concept. We've made great progress over the last 3 years. Key to our success has been our innovation-driven growth model, and in particular, the investments that we've made in application development capabilities. In 2017, our new business revenue was approximately $300 million. And in 2019, we had increased that to almost $400 million. And in 2020, we expect new business revenue to approach $500 million, depending on the impact of the coronavirus.

Advanced Materials is leading the way, Tritan copolyesters and the BPA-free copolyester is showing strong growth in medical, consumer durables and hydration. Also, Saflex acoustic interlayers are enabling lighter cars and growth beyond the windshield. Heads-up display is adding another safety component to the higher-end markets, and paint protection film has strong growth within the segment.

And with our 2 commercial chemical recycling technologies, we have enhanced our offering in specialty plastics for several applications, such as cosmetics, ophthalmics, toys and much more, and this is an exciting new vector that we're adding to the growth of an already strong innovation platform within Advanced Materials.

Additives & Functional Products is also making progress. We're getting commercial orders in a large number of innovation platforms, including Tetrashield for BPA non-intent food packaging, which adds BPA-free linings to soda cans as well as canned goods and auto coatings; specialty keystones for sustainable coating solutions; and our next-generation Crystex for tires. We will also be talking about new platforms as we go throughout the year within Additives & Functional Products.

Lastly, we've made great progress within Naia cellulosic yarns in targeted textile markets, particularly in womenswear and fast fashion. The offering of a bio-based yarn that uses cellulosics from certified, sustainably, managed forest has been compelling in the marketplace, where sustainability is driving consumer behavior. And now, with our circular economy technologies, we will commercialize Naia with recycled content which makes the customer proposition even more compelling. This has made our results more resilient in the current and difficult economy, as demonstrated in 2019, within our focused market segments and our new vectors that we are creating with circular economy, and it positions us well for strong growth as the economy rebounds, which we all know it will.

The next area I'll cover on Slide 4 is about our investments in building a more capable and efficient organization. To execute our strategy, we are making great progress on our commercial capabilities. We have implemented an improved business operating model, that is improving decision-making to deliver growth, and manage cost and cash flows within our cross-functional business teams. We are seeing significant improvement with our CRM investment, and we're making several other digital investments. And application development investments are helping accelerate commercialization rates on our innovation programs.

At the same time, we are also driving efficiency. It is how we offset inflation and the cost of these investments. Note the bar graph on the right-hand side of the slide. We are disciplined in how we manage our costs, [SGA + R&D are] (added by company after the call) approximately 10% of revenue, relative to our peers, especially with our level of innovation efforts. In uncertain times like we have now, we are stepping up our productivity efforts significantly. We have developed a program to reduce our cost structure, net of inflation, by greater than $100 million over the next 3 years in 3 focus areas: site optimizations, digital and productivity investments as well as supply chain optimization.

First, site optimizations will allow us to adjust our footprint to these new market conditions. One example is our Singapore plant that makes olefin derivatives. We have made the difficult decision to exit our raw material supply contract by the end of 2020, giving us options to realize $25 million of earnings benefit in 2021.

Second, we have digital and other productivity investments. Building on the efforts and productivity from 2019, we are on track for $20 million to $40 million of cost structure improvements this year, net of inflation, to the bottom line. We have a wide range of productivity initiatives across maintenance, energy efficiencies, improving yields and business process improvements.

Third, we are driving supply chain optimization as we look at opportunities across the globe to adjust to changes in customer and geographic mix. In addition to building more capable and efficient organizations, on Slide 5, I will highlight additional actions that we are taking to improve our performance. First, leveraging our sites could yield $30 million to $60 million in earnings improvement over the next 3 years. For example, we recently welcomed 2 new strategic tenants to our Texas City site, Gulf Coast ammonia and air products. At our site in St. Gabriel , Louisiana, we are building a new asset, leveraging our integration in alkylamines to support Corteva's innovative growth of their Enlist system. And we have several additional opportunities that are in development for leveraging our sites. Second, we also have an opportunity to step up the level of licensing. That could contribute another $25 million to $50 million to our results in the next 3 years.

We have developed, as an example, a new ethylene glycol technology that produces mono ethylene glycol, or MEG, from a variety of raw materials, including coal, natural gas or biomass. Unlike the majority of the world's MEG, which is currently made from ethylene, this is the first of a number of agreements in the works. We continue to expect meaningful benefit in 2020.

Lastly, we remain fully committed to taking actions in the 1/3 of AFP that has demonstrated more volatility than we expected in this challenging economic environment. The actions could include restructuring partnerships and potential divestment. We are actively looking at all of these options, recognizing the need to be sensitive to the current market conditions. These actions, better leveraging our sites, stepping up licensing and portfolio optimization will continue to create value for Eastman and are important contributor to our success in 2020 and for the next few years.

On Slide 6, you can see a chart of our debt maturities, which is, in my view, very manageable, especially given the strong cash generation of the Eastman. We remain committed to an investment-grade credit rating, and you can see some of the actions we're taking. We expect to delever more than $400 million in 2020, which is a priority for us. We think this is prudent, especially given the uncertainty in the macro environment. This further delevering and our strong cash flow will improve our already strong balance sheet. We also have sufficient liquidity through our various financing programs, including our revolving credit facility and working capital program, such as supply chain financing and AR programs. The combination of cash flow generation, balance sheet strength and liquidity provides us lots of flexibility and gives us confidence during this period of uncertainty.

On Slide 7, I'd like to highlight that Eastman had another year of very attractive free cash flow in 2019. This was our third consecutive year of greater than $1 billion. And we continue to expect free cash flow to be between $1 billion and $1.1 billion again in 2020. Beyond our excellent free cash flow, we've shown a great track record of being disciplined with the cash we generate. We completed several years of capital investment to support growth initiatives across the company, focused on Advanced Materials and Additives & Functional Products. We also remain committed to a healthy investment-grade balance sheet, and put our cash to work to pay down debt as necessary. In 2019, we increased our dividend for the tenth consecutive year. After funding our attractive dividend, which is yielding 5%, and paying down debt, we used cash to repurchase shares or bolt-on M&A. And you should always assume that we will fully deploy the cash we generate.

Finally, on Slide 8, let me finish up with our innovation-driven growth model, which I have a high degree of confidence in. I've just shared with you our multi-year plan of the actions we will take to improve performance in the coming years, and when.

We've got hard evidence that our strategy works. As an example, our advanced materials business growth over the last 10 years. And we're taking steps to control what we can control in this uncertain environment, including addressing challenges and the 1/3 of AFP, and when the macro challenges reverse, we know they will, it's our innovation-driven growth model that will allow us to be poised to create even more growth. I'll also highlight that through the first 2 months, we're actually on pace to be ahead of 2019 performance for the first 2 months, and you'll recall in 2019, we had the challenge of destocking and the headwind of higher cost raw materials that were flowing through. So those in balance, the impact of the coronavirus and other factors that we've seen year-to-date haven't been as significant as the headwinds we saw in early '19. So a very good start. With the orders that look okay in March, what we have seen is a propensity for customers to either push out orders or cancel orders later in the month. And with 2.5 weeks left, we'll see how that unfolds here in March, but we would say that the significant impact, if there is one, is probably more of an April of Q2 at this point, primarily due to supply chain.

QUESTIONS AND ANSWERS

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

Have you have your business has improved in China? And are they holding up in Europe right now?

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

So great question. So let me just give you a broader update on Asia Pacific and China specifically. First and foremost, we're worried about the safety of our employees and staying in compliance with the direction within China. We have 9 manufacturing sites and 2 offices within China. All but one of those manufacturing sites are back up and operational at this point with the one site that's down being, I'll call it, a small entity that's within the Wuhan area. So those are back up and operational, I'll call it, primarily by the end of February and increasing production through March. So at this point, I would say the year-over-year comps relative to the destocking, we haven't seen a significant decline through the first 2 months. And honestly, we wouldn't have expected that. We would expect the first Chinese New Year that March is typically the month that makes Q1, and we would see any impacts actually here this month. And at this point, no significant impacts that I would highlight.

Within Europe, I would say the first 2 months have been strong. In the focused areas like Italy, we do not have manufacturing operations. It's, typically, I'll call it, small sales force. And I would say, at this point, we have not seen any material impacts within Europe.

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

So the energy markets have really shifted and that we began the year with oil at $65 a barrel, and maybe now in rough terms, it's at $35 a barrel after the controversies at OPEC. When oil falls so sharply, is that good for Eastman or bad for Eastman? Or there's no simple read across?

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

So I would say it's not simple, but I would also give maybe 2 or 3 points to that question. The other side I'd point out that our portfolio has significantly been upgraded over the last 5 to 10 years and through that, both organically and inorganically. So for instance, Advanced Materials and Additives & Functional Products have grown over $600 million on a combined basis. And these 2 segments are a larger percentage [of the company] (added by company after the call) today. Obviously, they were impacted by the trade war and how that impacted specialty demand but they will come back. And these specialty businesses are priced more on functionality with some [cost] (added by company after the call) pass-through contracts. Therefore, they should benefit from a lower raw material cost environment depending on the duration.

And the second, the segment that we've typically most discussed being impacted by the drop of oil is Chemical Intermediates. It is now much smaller. I would actually say it's below 15% of our EBIT as a company. And our exposure to oil relative to the stranded natural gas and NGLs is significantly reduced and we felt many of those effects in the period from '14 now to 2017 as propane connected more on a global basis to oil and less of an impact there. Our primary oil from raw material is propane. And with the export capacity that I mentioned, that's connected back to Brent. So propylene and propane spread shouldn't be significantly impacted by the drop. And also remind you our RGP investment has further reduced our oil export, and the RGP to PGP spread is more stable and has even been more stable here in the short term. While we do have smaller exposures to stranded ethane, it's limited in comparison to other companies that are focused on their ethane crackers. Also, for our amines and acetyls, on the amine side, we're not as exposed to compression because of methanol margins from stranded natural gas because of its predominantly [cost] (added by company after the call) pass-through contracts.

And one more point I would just highlight is since we're focused on cash and free cash flow at Eastman, the drop in oil should result in reduced working capital and being a net source of cash in 2020, and I remain confident in the free cash flow, as I highlighted in my prepared comments.

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

So that's a complex answer, which I would expect from Eastman. So if I can reinterpret what you said to me, is it the case that oil prices have come down quite far from where they were a few years ago $100 a barrel? And it's also the case that the price of natural gas liquids have really come down over the last few years and more recently. And so what you're saying is that you've already borne the brunt of much of the effect of the oil price decrease and you're being assisted by some of the fall in natural gas liquids prices. And so on balance, it may not be a large raw material effect in 2020 even if oil stays at $35. Is that a fair paraphrase?

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

I think it's a fair paraphrase, as we think about, one, the materiality that this will have almost given the size of our Chemical Intermediates business. And also, it depends on does the pricing stay at this level versus continuing the volatility? But from a cash flow standpoint, we believe it's positive. Also from -- as we talked about in our press release, over time, we typically -- in some of the raw materials back with our, I'll call it, partnerships that we have and our applications development with those key customers. So net-net, in the short term, we do not see it as a major driver for 2020 at this level.

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

Earlier in the call, I think you said that your intention was to pay down your debt by about $400 million this year. Now the Eastman share price has suffered as many chemical company share prices have suffered. And so it's now at roughly 50, and as you say, it's a 5% dividend yield. And your cash flows have been pretty consistent and maybe your interest expense is only a couple of hundred million. So does it make sense to rethink the amount of money you want to allocate to share repurchase versus the amount of money that you want to allocate to debt paydown? Or are there other considerations that really make debt pay down a better choice for Eastman?

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

Well, again, what I would say is we view debt paydown to be prudent in an uncertain environment. Obviously, we have tried to keep a focus on, one, in the near term being below 3x. We finished the year at 2.9x. Our objective would be to get back to the, I'll call it, the 2.5x and grow into numbers that could be below that in this uncertain environment. Also, what we said is we would offset the dilution here in the first half and that we would evaluate our cash flow forecast and our business forecast and could potentially use our other $250 million to $300 million of cash flows for share repurchases if we do not have bolt-on M&A ideas in the near-term horizon. So we think both are prudent. We think both create shareholder value given the fact that we finished the year at 2.9x and our view of enterprise value to EBITDA.

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

I think your capital expenditures in 2019 were about $425 million, and those CapEx numbers are down from maybe a little bit more than $600 million a few years ago. And we've gone through a period where volume growth for Eastman and for many chemical companies has been very, very slow. Is it the case that you really need to spend much more capital than you're spending now in 2020 or '21? And is it possible that, that also might be a source of greater cash that is reducing your capital expenditures?

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

Great point and good question. On what we said and the way I see it is right now, our capital expenditures are going to be similar to 2019, with the exception of leveraging some of our site capabilities. And in those cases, what's happening is on the CapEx line, you'll see expenditures related to those projects that will be reimbursed through our operating cash flow. So you'll see some growth in the CapEx line, but that cash is being reimbursed throughout the year. To your point, if we were in a more difficult environment, we could actually take the number below 4, the 425, the 475 type of that mark. But right now, we're -- I will call it, wait and see on how the impacts of the coronavirus as well as, I'll call it, the old chart that you've highlighted, and the financial markets play out here in the near term before we make a true pivot. So we're running scenario analysis for different environments, and we'll be more prepared to speak to that probably in April.

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

I think Eastman and Air Liquide has applied for tax abatements related to the building of a gasification unit and oxygen units at Longview? Can you explain what that's about? Is this a large project or a small project? Is it a refurbishment of capacity or an expansion of capacity?

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

So what I would comment there is, obviously, we're looking at the site reliability and efficient debottlenecks of our assets in Longview. And we look at, I'll call it, less core for us to operate versus third parties. And I think that's what you're seeing there. It's not a large investment from an Eastman standpoint in that side, but it's a core capability of delivering from an ASU and a POX standpoint.

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

If I understand what you said, is this primarily a project for Eastman or a project for Air Liquide?

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

It's a project -- a supply project for Eastman.

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

Yes. In the old days, I think you had one of these, maybe in the 2000, 2002 period, where Air Liquide built some syngas assets for Eastman. I don't know if you remember what the outlays were at that time. It is to just get a sense of the size of this capital project.

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

I do not recall the capital requirements for that, Jeff, but we can follow up.

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

Of course. When you look across the Eastman business portfolio, do you wish to acquire to build on the assets that you have? Or do you wish to find more businesses to bring in that have the kind of specialty financial characteristics that you desire? That is, are you still in a search mode? Or are you now more in a build mode?

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

What I would say is we've built capacities, as you've highlighted from 2016 to 2018 timeframe. And those investments were basically to support our innovation-driven growth model with capacity expansions in Tritan as well as our acoustic and heads-up display interlayers and also for some of our Additives & Functional Products, like our next-generation Crystex. So what I would say is there, we've got the capacities that we need in the near term, and we will continue to look at high-return debottlenecks within those areas. Also, we're actively focused on looking at bolt-ons where it makes sense. As we previously talked about in our transformation of our portfolio, we've done some very good bolt-on acquisitions. Last year, we did 2, and we continue to challenge our businesses on how do they either extend the product line or create the optionality to use our products to integrate into the specialty segments that we're focused on.

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

In Advanced Materials, it seems that the strongest performer over time has been the performance films business, and interlayers and specialty plastics has had slower growth over time. Is that the case? I know that there are currency effects that are different in each segment. And is the growth in performance films really the place where margins are lifting? And is that the positive margin for us in that business over time?

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

Well, I think, actually, the response that I would have is, we're seeing very strong growth across premium products within each of those areas. So you're seeing the strong growth in Tritan. You're also seeing very good growth in the paint protection films, which we acquired in our bolt-on acquisition in 2014. Also, you're seeing growth in heads up display. And I would also acoustic in layer. So part of this thing is what's the level of performance within the core products across each of those. So we're upgrading mix, and we're upgrading that mix in the transportation and auto market that's faced some pretty challenging headwinds in 2019. And we also expect to grow in 2020 in each of those key end markets with the growth headwind. Also, performance films is a smaller base. So you would also expect that some of those growth rates would be at a higher percentage, but we're seeing strong growth across the board in our premiums and different headwinds within the pool as we trade up for that mix.

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

In your adhesives and functional products, 2019, I think, was a difficult year for adhesive resins and tire additives and maybe even for care chemicals. Is it the case that the AFP business is sort of a set of products that are growing and a set of products that are shrinking? And what you try to do is to, I guess, ring-fence the product lines that are shrinking. Is the case that tire additives had such a weak performance in 2019 that they're poised to grow again in 2020? Or is that true for adhesives? Or are these businesses likely to still be under pressure in 2020?

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

Okay. I think as we highlighted at year-end, we do continue to expect some pressure in both adhesives and tires. I would also say that some of the market uncertainty with the coronavirus, in China specifically, has resulted in some opportunities for share shifting here as we began 2020, and that's true in both tires as well as adhesives. So that could mitigate some of the headwinds that we talked about on our year-end conference call.

One point I'd like to highlight or maybe correct is the fact that our Care Chemicals business had extremely strong performance in 2019 and in the prior year. So we see that in some of the trends in water treatment and other areas of being very solid tailwinds for that business as well as our aviation and fluids businesses. Those businesses had very good growth in 2019 and offset some of the transportation automotive headwinds that we had in our coating space. But to transition back to adhesives and tires, the market uncertainty is offsetting some of that as we start the year. We'll have to see how things continue to unfold for the full year performance. But if demand improves overall, then we could actually see less of a a decline. If ultimately, this plays out and impacts demand more negatively on a full-year basis, it could be a little bit more of a downside.

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

In the fibers area, Eastman is very good about disclosing its subsegment revenue. And so what we can see is that acetate tow decreased in revenues by about 20% year-over-year. What happened in acetate? So I know it's a business that's often under some pressure, but it seems that the revenue decline this year was larger than one might expect given the rate of shrinkage in the cigarette market.

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

Yes. So I would say there were a couple of drivers. First, we'll follow up, but our view is that the revenue declined roughly 7% to 8% in 2019 for tow. That was predominantly customer buying patterns and contract patterns as we then discussed our long-term contracts. And obviously, that's why it's a little bit above the rate of decline that we have talked about in that 3% area. We've also talked about offsetting the declines and tow with growth in the textiles, and specifically, our Naia products. Textile demand overall in our core lines also faced headwinds in the tow segment during 2019.

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

Okay. Thank you for a very comprehensive summary of the Eastman's prospects this year, and we look forward to having you back at our conference live and in person next year.

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

Sounds great, Jeff. Thank you.

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

Okay. Thank you, Will. All right. Thank you very much for attending.

Operator

Thank you. That does conclude today's conference. Thank you all for participating. You may now disconnect.
