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## EMN - Q4 2019 Eastman Chemical Co Earnings Call

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**OVERVIEW:**

Co. reported 4Q19 results. Expects 2020 adjusted EPS to be $7.20-7.60.

## CORPORATE PARTICIPANTS

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

## PRESENTATION

**Operator**

Good day, everyone, and welcome to the Eastman Chemical Fourth Quarter Full Year 2019 Conference Call. This conference is being recorded. This call is being broadcast live on the Eastman's website, www.eastman.com.

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

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

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

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 results or events concerning our plans and expectations could change. Certain factors related to future expectations are or will be detailed in the company's fourth quarter and full year 2019 financial results news release during this call and in the accompanying slides and in our filings with the Securities and Exchange Commission, including the Form 10-Q filed for third quarter 2019 and the Form 10-K to be filed for full year 2019.

Second, earnings referenced in this presentation exclude certain noncore and unusual items. Reconciliations to the most directly comparable GAAP financial measures and other associated disclosures, including a description of the excluded and adjusted items, are available in the fourth quarter and full year 2019 financial results in this release, which can be found on our website, www.eastman.com, in the Investors section. Projections of future earnings exclude any noncore, unusual or nonrecurring items.

With that, I'll turn the call over to Mark.

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

Thanks, Greg, and good morning, everyone. I'll begin with the full year 2019 highlights on Page 3.

2019 was a significant year of macroeconomic challenges that continue to get tougher through the year. I'm incredibly proud of how Eastman employees around the world responded to these challenges and stepped up to the plate to deliver almost $400 million in new business revenue closes from innovation, led by Advanced Materials, which has achieved a decade of EBIT growth in 2019. We delivered on our cost management targets while we continue to make progress on our innovation programs. I'm also proud of how our cash engine generated free cash flow at a record level of almost $1.1 billion for the third consecutive year.

Although we aren't satisfied with our earnings performance and it was a difficult environment, we're well positioned for earnings growth in 2020 and going forward.

Here are a few highlights from 2019. First, we're celebrating Eastman's centennial this year. Our 100-year history is filled with many successes and meaningful innovations that have enhanced the quality of life in a material way. The segment that best demonstrates this innovative spirit is Advanced Materials, which delivered impressive results considering the challenging macroenvironment. Advanced Materials greatly outperformed its underlying markets despite its exposure to transportation plus several other consumer discretionary markets. And as our free cash flow results demonstrate, we can consistently deliver in any environment.

We continue to push our cash to work in a disciplined way, including significant delevering, which will remain a priority for us in 2020; bolt-on M&A like you saw with Marlotherm and INACSA this year, 2 great businesses opening up new markets for our technologies; and capital returns through a combination of share repurchases and dividends, which have increased for 10 consecutive years.

Finally on a personal note, I want to highlight that Curt Espeland, our CFO of 11 years, has elected to retire in 2020 after nearly 1/4 century of service. Curt's a hugely talented financial professional and has had an extraordinary career. I'm personally very grateful for his pragmatic leadership and the vital role he has played in the portfolio transformation, which has been a foundational element of our strategy to become a leading specialty materials company.

I'd also like to share that I have every confidence in Curt's successor, Willie McLain. Willie has been a key player at Eastman for 20 years and has worked closely with Curt as part of our long-term succession planning process. He's a proven experienced leader with deep knowledge of Eastman's financial organization, businesses and capital markets, which will be integral as we continue the company's transformation.

With that, I'll hand the call over to Curt to review some financial results, his final quarterly review as he closes this chapter and opens another.

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**Curtis E. Espeland** - *Eastman Chemical Company - Executive VP & CFO*

Thanks, Mark, and good morning, everyone. First of all, I appreciate the kind words, Mark, and I want to thank you, the Board and all men and women at Eastman for allowing me to serve as the CFO since 2008. It has been a real honor.

I'd also like to reiterate that Willie is absolutely the right CFO to take Eastman forward and is supported by a very talented and motivated team in Eastman. Now we are in good hands.

With that said, let me start on Slide 4. For the full year, revenue, EBIT and EPS all declined as global growth decelerated and trade disputes created uncertainty for Eastman and our customers. At a corporate level, lower volumes due to destocking and a reduced primary demand, alongside a strong dollar, contributed the most to the year-over-year decline in earnings. The lower volume resulted in lower utilization rates. Variable margin spreads were flat at a corporate level for the year. Despite a difficult economic environment, we delivered strong growth across many of our innovative products, particularly in Advanced Materials.

Similar with the trends for the full year, fourth quarter results were impacted by a slowdown in the global economy on top of normal seasonality. Revenue decreased mostly due to lower selling prices as a result of lower raw material prices. EBIT increased slightly due to lower raw material costs and improved product mix. In an environment like we are in now, we remain focused on what we can control, closing new business revenue, reducing costs and generating strong free cash flow.

Moving now to segment results and starting with Advanced Materials. Considering the business environment in 2019, full year performance was solid with EBIT growing over 3%. While Advanced Materials had challenges in the early part of the 2019, once destocking had largely played out in the supply chain between the U.S. and China, volumes returned to a more normal level, and the segment's innovation programs drove growth. The results in Advanced Materials are a great example of the importance of innovation. The core business is not immune to the challenges with global trade uncertainty and transportation, but premium products provided resilience. We were also able to realize spread expansion in the second half as lower-cost raws flowed through and we remained disciplined on pricing.

Looking at the fourth quarter, revenue and EBIT increased due to strong volume and more favorable product mix. Ahead in 2020, we expect to deliver another year of EBIT growth in this segment as we benefit from both continued progress growing new business revenue from innovation and a smaller headwind on foreign currency exchange rates. As a result, we expect Advanced Materials' EBIT to be up mid-single digits in 2020.

Now moving to Additives & Functional Products on Slide 6. Unlike Advanced Materials, AFP was impacted more gradually with destocking picking up through 2019 while primary demand in many of the geographies we serve was decelerating, particularly in China and Europe. I'm encouraged that 2/3 of AFP delivered solid results in this environment, including strong growth in Care Chemicals, water treatment and specialty fluids as well as spread expansion across the portfolio. We also had some challenges in this part of the segment, including slow demand in China for autos and disruptions in the ag market in China. All in, the bulk of AFP's businesses are performing how a specialty business should perform in this environment.

The remaining 1/3 of the business, adhesives, tires and formic acid that we previously called out in our third quarter call, contributed the significant majority of the earnings decline for the year. We are continuing to actively work on solutions for this part of the segment.

Looking ahead to 2020, we expect solid growth in the 2/3, offset by continued challenges in the 1/3 impacting both spreads and volumes. Putting it all together, we expect AFP's EBIT to be flat to slightly down compared to 2019.

Turning now to Slide 7 in Chemical Intermediates. For the full year and the fourth quarter, sales revenue decreased for the reasons summarized on the slide. In the fourth quarter, EBIT decreased mostly due to increased planned shutdown costs. As 2019 progressed and industry activity slowed, spreads in many of our derivative product lines declined, but we now think we're seeing signs of stabilization at this point. We expect to carry the lower level of spreads in the back half of 2019 into 2020, which will be a headwind in the first half of the year. But we also expect to see higher volumes in ag as North America gets back to a more normal planting season, and we're expecting to see the benefits of our cost management programs and other stabilizing actions. All in, we think Chemical Intermediates' EBIT in 2020 will be lower than 2019.

Finishing up the segment reviews with Fibers on Slide 8. Revenue and EBIT declined in full year 2019 due to general market decline for acetate tow and some chunkiness related to customer volume patterns. Fourth quarter EBIT was up due to increased tow volumes in China. In the textiles market, we continue to make progress with our key initiatives, including growth in womenswear, which was up approximately 20% this year. This progress was offset by softness in the global market for more traditional textile applications. In 2020, we expect acetate tow to be down slightly, consistent with the market. For textiles, we expect continued strong growth in key end markets, such as womenswear, to be offset by a softer overall textile market, impacting our more traditional textile applications. Putting it together, we expect Fiber segment EBIT in 2020 to be slightly lower than 2019, consistent with the market.

I'll finish with some financial highlights on Slide 9. Free cash flow was strong at almost $1.1 billion, sustaining the record level we achieved in 2018, another great result delivered by a variety of B.A. teams across Eastman. We also continued our track record of returning cash to owners and reducing debt, which both create value for our stockholders. Reducing debt will remain a top priority in 2020, and we expect to delever greater than $400 million this upcoming year, further improving the strength of our balance sheet.

Our tax rate was approximately 15.5% for the full year, and I expect the 2020 tax rate to be similar to 2019 in that 15% to 16% range.

Capital expenditures for the year are expected to be $450 million to $475 million in 2020. The main driver behind the planned increase in capital spending is associated with site tenant projects, which will be reimbursed across other lines of the cash flow statement over a number of periods.

Finally, don't miss the modeling slide in the appendix as well as our manufacturing shutdown scheduled for this year.

One final comment on the appendix. In 2020, we project that depreciation and amortization will decline approximately $50 million as part of the Taminco acquisition, Eastman marked-to-market an advantaged methanol contract and certain other assets with a 5-year life. With the expiration of this advantaged contract at the end of 2019, market-based methanol purchases in 2020 will substantially offset the $30 million reduced amortization of the Taminco methanol contract.

With that, I'll turn it back to Mark.

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

Thanks, Curt. Now turning to our 2020 outlook on Slide 10.

As we all know, we are currently in a dynamic and uncertain macro environment. Despite this uncertainty, we needed to make a series of assumptions for our outlook.

First, we expect modest volume growth and mix improvement from 3 factors. We're assuming global industrial production growth to be similar to '19.

Second, we are expecting that destocking is predominantly behind us, although there may be some pockets where there's more to go such as North American ag.

Third, we expect to create our own growth through market development and innovation.

In 2020, we have a number of additional items that are tailwinds. We expect our operating costs will be lower by $20 million to $40 million for the year, reflecting continued progress on productivity. And this is above offsetting normal inflation, which is between $75 million and $100 million annually. We expect pension costs will be lower by about $25 million. And we also expect lower depreciation expense to be about a $20 million net benefit to EBIT, as Curt mentioned in his remarks. All in, these tailwinds total approximately $75 million.

And we have a few headwinds for the year, such as higher variable comp and increased benefit comps as we return to target levels and a somewhat stronger U.S. dollar compared to the euro with an assumption the exchange rate averages $1.10 for the year. Together with a few other small items, we expect a headwind of $85 million.

In addition, we're expecting spreads to be lower primarily in Chemical Intermediates and the 1/3 of AFP. This reflects the fact that these spreads in 2019 declined through the year, especially as the trade war escalated, and therefore, we entered this year at a low level relative to the first half of '19.

Lastly, you should expect that we continue to be disciplined as we allocate capital, including delevering, share repurchases and bolt-on acquisitions where they make sense.

Putting this all together, we expect our 2020 EPS will be between $7.20 and $7.60, with the first quarter EPS coming in flat to slightly down from the year-ago quarter. We also expect our full year free cash flow to be between $1 billion and $1.1 billion. Of course, there are macroeconomic factors that can move us above or below this range. As we get through this short-term uncertainty, we expect we'll have a more informed view in April and will adjust as necessary at that time.

Next, I'm going to discuss actions we're taking to increase performance in 2020 and for the next 3 years.

First, on Slide 11. New business revenue from innovation. For those that follow Eastman, this won't be a new concept as we make great progress. Key to our success has been our innovation-driven growth model and particularly the investment we've made in application development capability. In 2017, our new business revenue was approximately $300 million. By '19, we had increased it to $400 million. And in '20, we expect new business revenue to approach $500 million. The segment leading the way is Advanced Materials, which has numerous examples of innovative products driving new business revenues. They include Tritan copolyester, Saflex acoustic interlayers, heads-up display interlayers and paint protection films. And with our 2 new commercial chemical recycling technologies, we have enhanced our offer in specialty plastics for several applications such as cosmetics, ophthalmics, toys and more. And while Advanced materials has made the most progress, Additives & Functional Products is poised to make significant contribution in the coming years. We're getting commercial orders in a large number of innovation platforms, including Tetrashield for BPA non-intent food packaging and auto coatings, specialty ketones for sustainable coating solutions, next-generation Crystex for tires, and we have several new platforms we'll discuss with you throughout the year.

Lastly I'd add that we have made great progress with Naia cellulosic yarn in the textiles markets, where we're particularly excited about our growth in womenswear. The offering of a bio-based yarn that uses cellulosics from certified sustainably managed forests is compelling in a market where sustainability is a driving consumer behavior. And now with our circular economy technology, we will commercialize Naia with recycled content, which makes the consumer even more excited and more compelled to buy our product.

Overall, we've made outstanding progress in driving new business revenue. This has made our results more resilient in the current difficult environment. And it positions us for strong growth as the economy rebounds.

The next area I'll cover is on Slide 12, and it's about our investments in building an even more capable and efficient organization to execute our strategy.

We're making great progress in our commercial capability. We implemented an improved business operating model that is dramatically enhancing our decision-making to deliver growth and manage costs. We're also seeing significant improvement with our CRM investments and are making several other digital investments. And application development investments are helping accelerate our commercialization rate of our innovation programs.

At the same time, we're also driving efficiency in how we offset inflation and these investment costs. As you can see with our graph, we are a disciplined operator in how we manage our costs relative to our peers, especially with this level of innovation efforts in our portfolio. And in these uncertain times, we're going to step up productivity significantly, as I mentioned on the third quarter call. We have developed a program to reduce our cost structure, net of inflation, by greater than $100 million. And as I said, we will get $20 million to $40 million of it in 2020.

We'll achieve these results in 3 areas. First, site optimization will allow us to adjust our footprint to these new market conditions. One example is our Singapore plant that makes olefins. We've made the difficult decision to not renew our raw material supply contract by the end of 2020, giving us options to realize $25 million of benefits. We also have a few other sites under consideration in the 1/3 of AFP.

Second, we have digital and other productivity investments. We have a wide range of productivity initiatives across maintenance, energy efficiency, improving yield and business process improvements.

Third, we're driving supply chain optimization as we look at opportunities across the globe to adjust to changes in customer and geographic mix. In today's world, we must build our capability, continue to improve our safety performance and, at the same time, improve our cost structure to win.

On Slide 13, in addition to building an even more capable and efficient organization, there are additional actions we are taking to improve our performance. First, better leveraging our sites could yield $30 million to $60 million in recurring EBIT by the end of 3 years. For example, we recently welcomed 2 new strategic tenants to our site in Texas City: Gulf Coast Ammonia and Air Products. At our site in St. Gabriel, Louisiana, we are building a new asset leveraging integration in alkylamines to support Corteva's innovative growth of their Enlist system. And we have several additional opportunities in development.

Second, we also see an opportunity to step up our level of licensing that could contribute another $25 million to $50 million in EBIT to our results in the next 3 years. Eastman has a rich portfolio of innovative technologies that have significant value, such as olefins and acetyls, and a strong history of licensing. We expect to step up this value creation with a partnership we have had with JM Davy Technologies, which is expected to create a meaningful benefit in 2020. We developed a new mono ethylene glycol technology that could use 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.

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

Finally on Slide 14, let me bring everything together. I just shared with you our multiyear plan of actions we will take to improve performance in the coming years and win. Yet none of this happens without the dedication and persistence of the people of Eastman, who continue to rise to the occasion and prove every day that they're a get-it-done team and bring to life our commitment of enhancing the quality of life in a material way. When the macroeconomic challenges reverse, and we know they will, it's our innovative-driven growth model that will allow us to be poised to create even more of our own growth through innovation and leadership in specialty markets. In the meantime, big picture, we will continue to focus on what we can control and remain committed to long-term, attractive earnings growth and sustainable value creation for our owners and for all of our stakeholders.

With that, I'll turn it back to Greg.

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

All right. Thanks, Mark. As usual, we've got a lot of people on the line this morning, and we'd like to get to as many questions as possible. (Operator Instructions)

With that, Diana, we are ready for questions.

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## QUESTIONS AND ANSWERS

**Operator**

(Operator Instructions) We will now take our first question from Vincent Andrews from Morgan Stanley.

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

Mark, maybe you could just talk about the volume growth in Advanced Materials, which continues to be impressive on an absolute and relative basis versus what we're hearing elsewhere. Can you maybe just talk about how inflated or how much of a moat you have around that volume?

We're hearing sort of generically a pickup in competitive behavior and decreases in pricing and pricing still holding up well. So how are you staying so differentiated there in an obviously difficult environment?

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

Thanks, Vince. Yes, great question, and it's really the heart of the whole company strategy around having an innovation-driven growth model as the way you create your own growth in tough environments as well as defend your margins. Across the entire segment, we've been investing in innovation, and 2019 is sort of our decade of continued earnings growth through it.

The differentiation really comes from innovating differentiated and sustainable products that are important to the marketplace. So our Tritan success, which is a patented proprietary product being the only solution that's BPA free for polycarbonate replacement, continues to have tremendous success in housewares and durables and now growing in medical. And that's just a story that continues to deliver performance.

It's the same thing with heads-up display interlayers and acoustic interlayers, where you can significantly enhance the driver experience and enable light-weighting in a car and where we have not just this generation but are now launching the next generation of even better HUD and acoustic, as we speak, in this year to continue to drive differentiation and growth in that space.

Same thing with paint protection films, where we've launched the best product in the marketplace last year; rolled out new software, where we have the best cutting software support for the dealers. So it's always about enhancing and developing new features and growing these businesses at much higher rates than the underlying market.

This segment has a lot of consumer discretionary exposure, whether it's autos or appliances or electronics, that the underlying markets are down, and we felt that some in our core interlayers or some of the core copolyesters. But it's that innovation that allows you to continue to grow and why our model works so well.

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

Okay. And as a follow-up, can I just ask you -- I believe you said you plan on paying down more debt this year versus last year with a similar amount of free cash flow. So I'm just curious what's driving that decision versus share repurchases. And congrats to Curt.

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**Curtis E. Espeland** - *Eastman Chemical Company - Executive VP & CFO*

Thanks, Vince, for the question and the comment as well. And so as you know, we are always disciplined with our capital allocation across those buckets of share repurchases, bolt-on acquisitions and the paydown of debt, and we consider all 3 of them as very viable ways to create value for our stockholders.

So as we finish 2019, we ended up shifting our capital allocation of that excess cash towards more further delevering as a priority. And as Mark mentioned, that's going to continue in 2020. So the result was that we used $370 million of our free cash flow for paydown versus the original $300 million that we promised.

So what we're looking at now for -- if you look at 2020, that kind of discipline is going to be maintained. So we're kind of looking at -- if you think about that $1 billion to $1.1 billion, let's just take the midpoint of $1.050 billion, so $350 million of it will go kind of towards that increasing dividend that we're very proud of; greater than $400 million will be used to reduce debt at a minimum; and then, we'll repurchase shares to offset dilution, which is roughly $50 million. So that remaining $200 million to $300 million of free cash flow is going to be applied for acquisitions, additional share repurchases or further debt paydown. And really, that's going to depend how the macroenvironment plays out. And we'll probably kind of hold that extra choices until the second half of this year just so we have more time to see how it plays out.

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**Operator**

And we will now take our next question -- and next question comes from David Begleiter from Deutsche Bank.

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

Mark, on the 1/3 of AFP that you've identified for a potential action here, have you -- how much more clarity do you have on the potential options today than you did 3 months ago? And are outright sales possible or even likely for some of these businesses?

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

Thanks, David. So we are looking at all the options. This environment requires us to be thoughtful about what options make sense. Certainly, we're looking at everything we can do on the restructuring front and driving both innovation as well as how to optimize our cost structure in this environment. And then we're looking at partnering and divestment options as things we consider. A divestment is certainly in the consideration set, but we've got to make sure we don't overreact to short-term challenges in the marketplace and make sure we understand the impact of the restructuring activities for understanding both the quality of these businesses as well as how we'd position them to potential new owners. So we're going to keep driving it forward, and we'll update you when we have more clarity.

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

And Mark, just on -- in the businesses that saw destocking over the last 3 to 5 quarters, et cetera, is all that, do you think, done? And where do we stand with supply chains and inventory levels heading into 2020 across your businesses? Any customers?

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

Yes. I'd say across the entire company, in most places, I think we've seen channels destock. In Advanced Materials, I think the destocking has run its course and even maybe a little bit of stabilization in inventory management in a few of those businesses.

In AFP, I'd say it's mostly destocked in the channels, and we're more looking at where primary demand goes at this point. As I mentioned, ag and functional amines and CI is one place where you could see some additional destocking here in the first quarter. We do believe in net volume growth for that business, assuming a normal weather pattern here in North America, but it may not be as dramatic because they still have a bit of inventory to work off. But I would say in North America, where the economy has been stronger, there are probably people sitting on a bit more inventory than where Asian and European customers are. So there's always a risk if the U.S. economy slows down, you could see a bit of destocking there. And so we'll just have to see how it plays out. But I do think, net-net, the vast majority of the destocking is behind us and that lack of it will provide some volume growth this year versus last year, assuming similar economic growth between the 2 years.

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**Operator**

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

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**P.J. Juvekar** - *Citigroup Inc, Research Division - Global Head of Chemicals and Agriculture and MD*

Yes. First of all, Curt, congratulations on your retirement.

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**Curtis E. Espeland** - *Eastman Chemical Company - Executive VP & CFO*

Thank you, P.J.

**P.J. Juvekar** - *Citigroup Inc, Research Division - Global Head of Chemicals and Agriculture and MD*

And congrats to Eastman as well for your centennial year. I know it's not easy to survive for 100 years through all the depressions and wars and all that, so congratulations.

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

Thank you. We're proud of it.

**P.J. Juvekar** - *Citigroup Inc, Research Division - Global Head of Chemicals and Agriculture and MD*

So a question on some of Taminco's assets. Care Chemicals, I think they have a lot of pass-through pricing. Feed additives, I know last quarter you had mentioned about Asian swine flu. So can you just update on some of those intermediate products?

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

Yes. Overall, the Taminco businesses are doing great across the portfolio with the exception of the formic acid business that we called out in the third quarter, which was a small acquisition Taminco had done just ahead of us buying Taminco. But when we look at the core alkylamine platform, which is what we're set on acquiring, Care Chemicals has delivered really strong growth and very stable margins, as you just highlighted, with cost pass-through contracts. Water treatment is having really great growth in this environment with the environmental trends out there and, again, doing quite well, stable margins. And then as you look at the functional amines going into ag, those, again, very stable margins given the market structures and the contracts we have in place. Obviously, there's demand that goes up and down with the seasons, but overall, the whole portfolio has really been great. The management team has been great. We've had phenomenal retention of the talent, and the cost structure has been well managed.

**P.J. Juvekar** - *Citigroup Inc, Research Division - Global Head of Chemicals and Agriculture and MD*

And then for my follow-up, I have a sort of a big-picture question. You've done some bolt-on acquisitions over the years but stayed away from any major M&As since Solutia deal. So in this slow environment, why not use low rates to get some growth? One company in Wilmington has some businesses for sale, especially in transportation. I know these are large deals, but would you have risk appetite in looking at a deal of that size?

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

And so P.J., I think we've been really proud of the portfolio transformation way ahead of what people are doing in the industry now where we divested $3.5 billion in revenue of underperforming businesses and did great acquisitions with Solutia and Taminco and some bolt-ons to add $4.2 billion of great, attractive businesses. So I think we have a very impressive track record of not just doing good acquisitions at good prices, where we paid 9x EBITDA for the things that we bought and have delivered very attractive returns with the synergies that we delivered. So we're very much open to portfolio management both in and out of the portfolio. But when we look at the market conditions right now, they seem to be very expensive. And so we don't see that there's opportunities out there, especially large ones, that are financially attractive.

More importantly, we like the portfolio that we have. And we're -- we've been focused on making sure we deliver return to our shareholders for the money that we spent on these acquisitions up through 14 and deliver growth, and I think we've done that quite well. And if you look at the 2 specialty businesses we've had before the trade war started, over $600 million of EBITDA growth from '14 to '18, 1/3 of that was acquisition, but 2/3 of it was organic growth that came from these acquisitions as well as the core Eastman businesses. So we feel good about how we can integrate acquisitions. So I'm not saying we'll never do anything, but large ones right now don't seem necessary or financially prudent.

**Curtis E. Espeland** - *Eastman Chemical Company - Executive VP & CFO*

And P.J., if I could add. I'm still a traditionalist. And since Willie and I both went to the same M.B.A. school, I think it will continue. And that is, when we look at investments, whether it's acquisitions or organic growth, we look at things on an unlevered basis. So that way, we make sure we're driving good value without considering the leverage. And then once we find good opportunities and/or growth programs, we find great ways to finance it. So we'll continue to look at things in a disciplined, unlevered basis.

**Operator**

Our next question comes from Matthew DeYoe from Bank of America. .

**Matthew Porter DeYoe** - *BofA Merrill Lynch, Research Division - VP*

So by my numbers, raw materials in Advanced Materials were maybe something like a $50 million tailwind to the second half of '19. And you had mentioned giving some of that back with lower prices, but I think things get fairly sticky with Tritan, and you did absorb a lot of inflation in 2018. So when it comes to 2020, what should we think about annualization of those second half tailwinds? Should there be more giveback? Is there more opportunity? Yes, if you can expand on that.

**Curtis E. Espeland** - *Eastman Chemical Company - Executive VP & CFO*

Yes. If you look at Advanced Materials, the main driver of their growth continues to be innovation and volume growth. And then there's an opportunity to really keep pricing off of what we'd call the product performance. There is some input costs that do vary, and they did have some tailwind in 2019. I think some of that will moderate, but it will still be there. And I think they've shown good discipline on pricing of their products relative to the performance It provides. And so that's why we think this business will grow in that mid-single-digits EBIT in 2020.

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

We do -- I mean, we do expect prices to come down a little bit as you share some of that raw material value. We've had thorough conversations with investors on previous calls on this topic. But we expect to hold on to a good portion of it. More importantly, we're going to have volume and mix growth. That is the heart of our strategy across the company as well as the fixed cost leverage and other cost management activities that sort of flow into the segment.

**Matthew Porter DeYoe** - *BofA Merrill Lynch, Research Division - VP*

Okay. And then I know you plan on divulging a little bit more of this to come. But opportunities at Crystex, you doubled capacity in Malaysia, and the market has been under pressure since. I got to think that some are older cats and dogs out there, legacy facilities. Do you imagine opportunities for footprint rationalization there?

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

Yes. So that's one of the areas where we've added advantaged technology with the capacity that we added that produces a far better product, which we call Cure Pro, relative to their current product we make as well as our competitors' so we can help customers improve their tire mixing efficiency by 10% to 20% in their tire plants. And so the new capacity is also differentiated and advantaged. And we are now looking at the overall footprint in this business, just look at where demand is, where we expect demand to grow, what sort of assets really make sense in that, and then we'll make some decisions on what's appropriate as we go forward.

**Operator**

Next question comes from Kevin McCarthy from Vertical Research Partners. .

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

Mark, I'm intrigued by your program to leverage your sites. I think you indicated $30 million to $60 million of benefit on the EBIT line over the next 3 years. Can you talk a little bit about which sites are in play? Are there any beyond the GCA and Air Products project at Texas City? How will that flow through over the next 3 years? And which segments might be affected?

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

So we did an acquisition of Sterling at the Texas City site, which is just a phenomenal site when you look at the scale, infrastructure, ports, rail, everything. It's just a great opportunity to leverage. And this is a great example, one of, I think, several that we'll have at Texas City, on how we can sort of provide that site opportunity. And the Gulf Coast Ammonia and the Air Products projects is a great example of what several other opportunities could look like. The -- so I see multiple things there. I'd say what we're doing in St. Gabriel is more unique to supporting Corteva; we'll offer our alkylamine platform. But there are other sites around the world we're looking at. But I do think it can be substantial and very reliably and predictable earnings.

**William McLain**

Yes. Kevin, this is Willie. I'll -- if I may add. I would also highlight the fact that on a segment basis, that we would see that primarily benefiting CI and the Additives & Functional Products businesses today. But as we think about further integration beyond those 2 projects, they could benefit other assets as well.

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

Okay. And then a financial question for Curt or Willie, perhaps. You've raised your dividend for 10 years in a row. Would you expect that streak to continue notwithstanding the current choppy industrial production environment? What is the level of commitment to long-term growth there, recognizing that it's ultimately a Board decision?

**William McLain**

Well, Kevin, to your point, it is definitely -- we collaborate with the Board on that decision. I think you will also see that we moderated our dividend as our dividend payout ratio has, I'll call it, gotten back in line with where we would expect it to be post the Solutia and Taminco acquisition. And as we think about future growth, we will continue to grow it, but it will be based on the long-term expectations, consistent with how we have in the past.

**Operator**

Our next question comes from Jim Sheehan from SunTrust Robinson Humphrey.

**James Michael Sheehan** - *SunTrust Robinson Humphrey, Inc., Research Division - Research Analyst*

Curious about your comments on an advantaged methanol contract that's expiring. Are you going to be exposed to a lot more methanol price volatility? And in which segments would that occur? And how would you expect to deal with it?

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**William McLain**

Yes. This is Willie. What I would say is we're diversified across our methanol exposure as we think about we produce methanol here in our Kingsport site as well as we purchase some methanol, market based as well as other benchmark. So I think we've diversified our exposure as we think about going forward, and that exposure is primarily in our Chemical Intermediates and Additives & Functional Products segments.

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**James Michael Sheehan** - *SunTrust Robinson Humphrey, Inc., Research Division - Research Analyst*

And can you give us your thoughts on the coronavirus impacts in China? What's embedded in your guidance for post Chinese New Year demand?

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

So as I said in our outlook statement, our outlook statement does not include the impact of the coronavirus. I think we can all agree it's a little too early to call what those impacts are going to be. But most importantly, we're focused on safety and health of the people in China as well as around the world, including our employees, and making sure we're taking the right set of actions, which we've implemented around controlling travel within China, travel in and out of China and making sure people are as safe as possible.

We do have 9 plants in China and 2 offices, so we're focused on those. And there's obviously going to be a delay based on the Chinese extending the new year out by 1 to 2 weeks depending on where you look at the location. So we'll have to sort of factor that into our thinking.

I don't think it's a simple conclusion, though, where you just look at the impact of what's going to happen to demand in China, which obviously will occur. So our customers will be shut down, but it's important to keep in mind that our competitors are going to be shut down as well both in China as well as how they compete around the world. So there's probably some opportunities for us to see some volume improvement outside of China as a lot of customers have become dependent on some Chinese sources and we want to make sure we're there to help them when those sources may not be available and help them be a reliable supplier that we're proud of our more global and diverse and reliable footprint.

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**Operator**

Our next question comes from Duffy Fischer from Barclays.

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

I think most of us know we had ag issues here in North America. Curt mentioned some ag issues, it sounds like, in China. So can you just kind of size the headwind that you saw in your ag business last year? And do you think you get all of that back this year to a normalization level?

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

The ag is actually animal nutrition. So it's mostly in China. So it's mostly about the pig population that was hit by the African swine flu. It's hard to get exact numbers, but somewhere around 30% or 50% reduction in that population, which is a huge consumer of these organic assets that we and some others sell. So we saw a volume hit associated with that that's also contributed to some of the pricing challenges in formic acid and a couple of other products. So it's really that dynamic. Obviously, they've got the flu under control; this is the swine flu. And they're rebuilding their population. So we'll start to see it recover this year and next, but it doesn't snap back like the North American ag market could this year.

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

Okay. And then on the licensing effort, is that kind of a proactive effort on your side where there'll be a lot of little projects? Or is that kind of reverse inquiries where 1 or 2 big guys are coming to you for some of your technology and we'll see 1 or 2 big lumpy contracts signed?

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

Well, our historical program is more of the former where we get some inbound inquiries around acetyls and olefins, which we always do. But what we're identifying here and calling out is this value is a more substantial, proactive approach. So a number of years ago, we had developed a breakthrough technology to make MEG through an alternate process than ethylene to leverage coal gasification. And we sort of turned down that effort internally as we focused more on specialty growth. So we partnered with JM Davy to work with us and finish off that technology and take it to market and leveraging their strength as a licensing organization. So we've been in the background working that with them, and they're close to success on the first license. These licenses are quite large and significant in the scale of what plants will be built. MEG is a critical product, and this technology is a lot better than the oxalate technology they've been trying to use, which has some quality problems. So we think it's a great opportunity for sort of multiple licenses as we go forward. Important to remember these licenses show up in chunky ways, and so it's a little hard to predict exactly when they're going to hit and you register the value.

**Operator**

And we will now take our next question from Frank Mitsch from Fermium Research.

**Frank Joseph Mitsch** - *Fermium Research, LLC - Senior MD*

And best wishes, Mr. Espeland. I hope our paths continue to cross.

**Curtis E. Espeland** - *Eastman Chemical Company - Executive VP & CFO*

Thank you, Frank.

**Frank Joseph Mitsch** - *Fermium Research, LLC - Senior MD*

Mark, I apologize, I didn't quite catch what you were talking about with respect to Singapore and the raw material contract and the order of magnitude there. Can you give a little more detail there?

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

Sure. I'll start and I'll let Willie finish off. But the contract there was a long-term supply contract that we've had in place for a number of years, and it's finally coming up for expiration at the end of this year. And it allows us to terminate it and then consider other options. I'll let Willie cover what those options are.

**William McLain**

As we consider those other options, obviously we look at our existing footprint and our integrated facilities in Texas to support the Chemical Intermediates business. Obviously, this gives us the ability to use that footprint to serve the market and the regions where we are best leveraged to compete based on the cost curve in that business. But you can think about probably in 2021 that we would have an improvement of $25 million versus our current run rate.

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**Frank Joseph Mitsch** - *Fermium Research, LLC - Senior MD*

All right. Terrific. That's what I thought I heard, but I wanted to clarify that. And you also discussed some of the -- in the AFP business, the part that was doing well. You mentioned specialty fluids. And I know that, that business can be chunky from time to time. Is there -- can you expand upon what might have been the benefit that we saw in 4Q? And is that going to recur in 1Q, in your opinion?

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

Yes. The fluids business has been great and developed a much more robust portfolio of end market applications. So historically, it was very dependent on PET applications. For example, on the heat transfer fluids, we've now diversified into LNG facilities and some other things. So we've diversified our market exposure, which is helpful. And we continue to have a very strong competitive position in this business relative to a couple of other small players. So we see that business continuing on. There's always capital construction cycles, Frank, as you pointed out, where this business will moderate up and down. You have the solar fills; sometimes, they can be fairly chunky in how they show up.

It's also important to mention that a good portion of this business is the aviation fluids business that is actually very steady. This is our hydraulic fluids and turbine oil fluids that go into aircraft and have a much more stable, continuous revenue stream where we've had great growth in revenue as well as margin improvement. And that's just been a great acquisition that we've done as well.

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**Operator**

And our next question comes from Bob Koort from Goldman Sachs.

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**Robert Andrew Koort** - *Goldman Sachs Group Inc., Research Division - MD*

A couple of questions. First, Mark, on Slide 12, you showed some interesting metrics around R&D and admin to profitability in -- to revenue base. I guess I'm sort of struck. It would seem like that would be more favorable for commodity companies than specialties. I mean what are the metrics do you look at from a benchmarking standpoint that can help us sort of dimensionalize your business relative to those peers?

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

Yes. So Bob, I think the point we're trying to make there is we're a very lean organization that are good stewards of our shareholders' money and trying to make sure every dollar we spend delivers a return. And I'm incredibly proud of how our Chief Technology Officer has, within the budget, transformed our technology organization in a dramatic way. So we had a lot of projects going on around process development, new technologies that we're going to have a payback for a very long time. And he put those to a stop, reoriented the organization much more towards application development and product development. But this AD capability we built is really the key to our success, and we've doubled the amount of resources and capability we've had in that business since 2014 to where we are now within that mix of spend. And that AD, as we explained in our Innovation Day in '18, is how we can do what our customers do. We can make a tire. We can make a shield. We can make thermoplastic final products. We can make a coating. And so we can accelerate our innovation, accelerate the value we understand in those formulations and accelerate how we go to market not just for our direct customers but downstream to drive specification through the market by showing what we can do. So that is really the real test of it. And we're, of course, adding the commercial resources as we gear that side up and find efficiency in the support functions.

The metrics, I think, or the one that we shared with you, the new business revenue from innovation, is the real test. It's -- the revenue we're getting every year, that metric is "year 1". So it's really about the next year. When you see that $400 million last year, that's about helping this year. The

$500 million we're aiming for this year will help next year. But we keep very careful track of that, and that's the most important metric to sort of say, are you getting results from this portfolio.

We have a bunch of internal stage gate project metrics and milestones and everything else to have good discipline to manage our portfolio on a very disciplined way, and we're constantly optimizing and focusing and shifting resources where we see the best value.

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**Robert Andrew Koort** - *Goldman Sachs Group Inc., Research Division - MD*

Got it. That's helpful. And then out of your third quarter call that seemed you're putting the brakes down a little bit off your working capital and production levels, trying to lean out into the end of the year, do you have any sense or can you help us quantify what that fixed cost absorption pain might have been and when that might release as you go through '20? Is there a recovery of that, an advantage to that as you go through the year?

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**Curtis E. Espeland** - *Eastman Chemical Company - Executive VP & CFO*

Yes. Bob, the way I'd characterize it is where you're seeing that right now is kind of in the margins. So while we were able to implement the cost reduction actions, those cost reduction actions are harder to see in COGS and our margins is because we had to slow down our plants. We don't give our specific utilization rates, et cetera. But when you get our 10-K, you'll see that our finished goods and our intermediate products in inventory declined 5%. Some of that is value, but also some of it is some of the slowdown within our production rates.

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

And Bob, I'd just add that we're going to be careful about how we run our plants as we go into the first half of this year so that volume growth is a way to sort of move inventory down and continue making progress on that. It's a great opportunity for us to release a lot of cash as we go forward.

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**Operator**

And the next question comes from Laurence Alexander from Jefferies.

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

Can you give a sense for the recycling technologies, what commodity environments it would not be competitive? And secondly, I may have missed this, the -- in terms of the spreads stabilizing in the middle to back half of the year, are you seeing competitor shutdowns helping improve the prospect for the spreads? Or is it purely tied to your perspective on end market demand?

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

Okay. Good questions. So the first one is circular economy. At this point, with the trends in the marketplace, it's not as much about competing against the price of oil or fossil fuel feedstocks. The train has left the station, right? You've got legislation in Europe and coming in multiple other jurisdictions of banning single-use plastics or putting what they call EPRS, Enhanced Producer Responsibility (sic) [Extended Producer Responsibility], which is basically taxes, on single-use plastics. So the drive for recycling and the value that it's putting on it is creating a real cost choice, not just a consumer preference choice, for brands around the world. Even China now is banning plastic bags in all major cities by the end of this year for groceries and things like that. So the recycled content part we're really excited about what we're doing is a critical differentiator for us. Fortunately, we got out of the single-use plastic business, so we're not trying to defend it. When we got rid of the PET business in 2011, we're more focused on how we provide solutions to customers around the actual recycled content as well as put our recycle content in finished products and durables. So a whole another differentiation, back to Vince's questions earlier, is not only do we have a lot of product differentiation in the performance of the product, we now have a whole new vector of growth in specialty plastics as well as over in textiles and Fibers by putting recycled content in these products, which is a very significant demand. And we do think that we will get a premium relative to fossil, fuel-based products for providing these solutions to the marketplace. You can look at rPET. Through last year in Europe, they traded at roughly a 60% premium to PET in the marketplace. I think that's a bit high, but we do think on a long-term basis. And we do think our technologies provide real solutions because we can access feedstock that's going to a landfill, not compete against some mechanical recycle streams. So the cost structure for us will be more advantaged for our feedstock because it has no alternative value, and that's an important differentiator for what we're doing. So we feel really good about that. We feel like we're in a good differentiated position to sort of move those programs forward in both AM and Fibers.

The second question...

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**Curtis E. Espeland** - *Eastman Chemical Company - Executive VP & CFO*

Spreads.

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

Was on spread in the back half of last year. As we said, spreads declined through the back half relative to the first half of '19 as people realized that the economy was not going to improve with the settlement of the trade war. And so that elongated economic stress led to more competitive behaviors in particular in CI and that 1/3 of AFP. In CI, we do see prices pretty much stabilizing out relative to competitors who are hitting their cash costs in Asia. So we have seen that. And we are seeing people start moderating run rates or have potentially shut down plants temporarily. I'm not sure, I think, any of these plants are going to shut down permanently. So when the market recovers, some of these people will come back in the marketplace, which is why we've been cautious on how we think about spreads this year, and we're assuming spreads do not improve this year. And so I think we're in a good place there.

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**Operator**

And our next question comes from John Roberts from UBS.

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**John Ezekiel E. Roberts** - *UBS Investment Bank, Research Division - Executive Director and Equity Research Analyst, Chemicals*

Yes. And best wishes, Curt, and welcome, Willie. I assume most of the lower raw materials for the overall company are purchased paraxylene and glycols, but could you talk a little bit about acetyls and propylene? Did the Advanced Materials and Fiber segment benefit from the lower acetyls prices? And how does lower propylene play out between CI and AFP?

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

So you're correct, polyester benefited from lower paraxylene prices. The olefins benefited from lower ethane and propane prices as well as a propylene supply contract that's a formula to propane. So we saw raw material benefits in the olefin chain.

On the acetyl chain, we're coal based in how we make our acetyls with our gasifier. Coal prices have been relatively stable, so there wasn't any tailwind there.

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**Operator**

And our next question comes from Matthew Blair from Tudor, Pickering, Holt.

**Matthew Robert Lovseth Blair** - *Tudor, Pickering, Holt & Co. Securities, Inc., Research Division - MD of Refining and Chemicals Research*

Willie, could you quantify the currency impact on EPS in 2019?

**William McLain**

Yes. It's basically consistent with what we were saying in Q3, which is about $0.30 a share, so it was slightly up. I'd also remind you that about 85% of that's in our Advanced Materials and is in the functional products businesses.

**Matthew Robert Lovseth Blair** - *Tudor, Pickering, Holt & Co. Securities, Inc., Research Division - MD of Refining and Chemicals Research*

Great. And then could you provide any color on the overall trajectory of the business during Q4? You did come in a little bit above the midpoint guidance provided in October. Does that imply that things were picking up a little bit in December?

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

They did. So we had a good October. We had a weak November. That gave us some concern about what might happen in December. And then volume came in better than expected. And costs came in quite a bit better than expected on the raw materials side.

**Operator**

So the last question comes from Michael Sison from Wells Fargo.

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

Curt, congrats and it was great working with you. In terms of your outlook for AFP, I just want to make sure I understood. Flat to down for EBIT. Does the specialty side, the 2/3, grow pretty -- does it grow next year to maybe mid-single digits, and the 1/3 that's more challenged down double digits or something? Can you just give us a little bit of color on each of the pieces?

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

Yes. So first of all, through '19, the 2/3 did quite well. As Curt laid out, prices were relatively flat outside of their cost pass-through contracts, and we expect that to continue this year where prices will be stable. And we saw raw material benefits as a result. We saw volume growth. And we had this headwind, especially in these high-value additives for automotive, in China, net out to being modestly down for last year. So as we look at this year, we see volume, we see raws stable as well as pricing. So that's going to deliver some growth as well as some cost reductions. So you do see some earnings growth in the 2/3 side of the portfolio. And you're correct, the potential for down net earnings for the AFP segment is in the 1/3 segment as we've taken those lower spreads from the back half of last year. We do regain some volume. So as we had good discipline in pricing for the first half of '19, we lost some volume in adhesives and tires, regaining that with some pricing in the fourth quarter, so we'll have a volume improvement. But some pricing down, net, in the 1/3 as well as -- but you're going to have some earnings challenges there just given where spreads are at this point. And so I think you're directionally correct.

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

Great. And then one quick one on Tritan. It's been a good growth business for several years. How are you on capacity? Do you need to add capacity? Or do you have enough to sort of support the growth that you're seeing?

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

We're well positioned on capacity. We had doubled the capacity in 2018 because we had run our capacity because the volume growth had been so strong. This was one of several plants that we brought online in 2018 where volume was really great across AFP and with the growth we've been having until the trade war hit. And so we're well positioned to support growth there.

**Curtis E. Espeland** - *Eastman Chemical Company - Executive VP & CFO*

And if I could add, Mike, that's an example for this business. Not only you get volume growth, you get mix upgrade, now you get fixed cost leverage as well.

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

Thanks, everyone.

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

Thanks, again, everyone, for joining us this morning. Appreciate your time. Have a great day. There'll be a replay of this available on our website later this morning. Thanks again.

**Operator**

Ladies and gentlemen, this concludes today's conference call. Thank you for your participation. You may now disconnect.