Eastman Chemical Company (EMN) Earnings Report: Q1 2015 Conference Call Transcript

The following Eastman Chemical Company conference call took place on May 1, 2015, 08:00 AM ET. This is a transcript of that earnings call:

Company Participants

- Greg Riddle; Eastman Chemical Company; VP - IR and Communications
- Mark Costa; Eastman Chemical Company; CEO
- Curt Espeland; Eastman Chemical Company; CFO

Other Participants

- David Begleiter; Deutsche Bank; Analyst
- P.J. Juvekar; Citigroup; Analyst
- Vincent Andrews; Morgan Stanley; Analyst
- Frank Mitsch; Wells Fargo Securities; Analyst
- Kevin McCarthy; Bank of America Merrill Lynch; Analyst
- James Sheehan; SunTrust Robinson Humphrey; Analyst
- John Roberts; UBS; Analyst
- Mike Sison; KeyBanc Capital Markets; Analyst
- Ryan Berney; Goldman Sachs; Analyst
- Jeff Zekauskas; JPMorgan; Analyst
- Dan Rizzo; Jefferies & Company; Analyst
- Alex Yefremov; Jefferies & Company; Analyst
- Nils Wallin; CLSA; Analyst

MANAGEMENT DISCUSSION SECTION

Operator:

Good day, everyone, and welcome to the Eastman Chemical Company's first quarter 2015 earnings conference call. Today's conference is being recorded. This call is being broadcast live on Eastman's Web site, www.Eastman.com.

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

Greg Riddle (VP - IR and Communications):

OK. Thank you, Mara. And good morning, everyone, and thanks very much for joining us. On the call with me today are Mark Costa, Chairman and CEO; Curt Espeland, Executive Vice President and CFO; and Louis Reavis, Manager Investor relations.

Before we begin, I will cover two items. First, during this presentation you will hear certain forward-looking statements concerning our plans and expectations. Actual events or results could differ materially. Certain factors related to future expectations are or will be detailed in the Company's first quarter 2015 financial results news release and in our filings with the Securities and Exchange Commission including the Form 10-Q filed for 2014 and the Form 10-Q to be filed for the first quarter 2015.

Second, earnings per share, operating earnings and EBITDA referenced in this presentation exclude certain non-core or nonrecurring costs, charges and gains. A reconciliation to the most directly comparable GAAP financial measure and other associated disclosures including a description of excluded items are available in the first quarter 2015 financial results news release and in the appendix to the slides that accompany our remarks this morning, both of which can be found on our Web site, www.Eastman.com in the investor section.

Projections of future earnings in the presentation also exclude such items as described in the first quarter financial results news release.

With that I will turn the call over to Mark.

Mark Costa (CEO):

Good morning, everyone. It is a beautiful day in Kingsport. We are putting another tough winter behind us and we can see everything blooming. I will start on page three.

We had a strong start to the year with our first quarter results. We made solid progress in executing our strategy to become a leading specialty chemical company. This progress is the result of a number of actions we have taken to upgrade the quality of our portfolio. Today we have a portfolio of world-class technology platforms we are leveraging to be a market leader, an innovation leader and a cost leader.

In our first quarter, EPS increased 14% year-over-year and our first quarter adjusted EBITDA margin was 24% which ranks in the top quartile among our chemical peers. We did a great job of holding onto value for the first quarter as we increased our operating margin by 120 basis points to almost 18%. This also reflects our continued ability to upgrade the quality of our product mix by growing high-margin specialty product lines. We're also doing a good job of creating value in both earnings and cash flow from our acquisitions including Taminco and Commonwealth.

Disciplined cost management has also been a focus and we are doing an excellent job as we hold costs flat via productivity efforts while at the same time shifting more resources to our innovation efforts. Our SG&A as a percentage of sales is in the lower quartile of our peers which is a function of our scale and integration and the great discipline of our employees. We've also made good progress in reducing manufacturing costs. Productivity is in the DNA of Eastman.

Beyond the numbers we've also been the recipient of numerous awards over the past several months that highlight many of the qualities our stakeholders have come to expect from Eastman. We were honored for the second consecutive with year Glassdoor Employees' Choice Award honoring the best places to work. What I value most about this award is that it is based solely on the input of employees.

We were also recognized for outstanding corporate ethics and corporate responsibility with the words from both Ethisphere and Corporate Responsibility magazine. And we were recognized by the EPA as an Energy Star Sustained Excellence Partner of the Year becoming the only chemical company to have received this recognition for four consecutive years.

Our excellent first quarter results and the recognition we are receiving are a direct result from the great work being done by all of our Eastman employees.

I will now move to slide four. I want to emphasize the great progress we are making in delivering strong growth in our innovative specialty products which is a key driver of earnings growth this year and in the long term. At our Investor Day we described that a key element of our strategy was improving our product mix by growing our high-margin specialty products and by not growing or investing in our commodities, a strategy that is differentiated from many of our peers.

We are very much on track with this strategy. For this year we expect strong growth in a number of products across Advanced Materials, Additives and Functional Products and Adhesives and Plasticizers. We have several growth programs delivering results now. For example, we expect record volumes in Saflex window interlayers this year driven by auto market adoption of laminated glass inside windows and a much higher use of acoustics.

We had strong growth in North America and China performance films including our new paint protection film from our Commonwealth acquisition, high growth in our tackifying resins in tires as a performance additive to improve traction and high growth in our differentiated hydrogenated tackifying resins especially in hygiene markets.

We also see another wave of specialty product growth coming. For example, new differentiated polyesters for a wide range of coatings in AFP, leveraging our proprietary monomer that has enabled our Tritan success in thermoplastics; next generation of Crystex that will enable a 20% to 30% improvement in our costs and a more differentiated product set; and microfibers in both nonwoven and woven applications.

Bottom line, we are walking the talk to transform our portfolio to a set of high-quality specialty businesses.

On slide five, we have provided an update on the Taminco acquisition as this is the first quarter results as part of Eastman. I am pleased with the solid performance of this business that was in line with our expectations. Volume was driven by good growth in the home and personal care and water treatment markets as well as the benefit of the Taminco formic acid acquisition which demonstrates the diversity of markets in which our Taminco businesses participate.

In our high-margin crop protection business which goes into perishable high-value fruit, vegetables and flowers, we realized a stronger than expected performance in Europe and North America. In functional means which go into herbicides for row crops, we saw some decline in demand in the first quarter as expected and sequentially we are seeing improved demand across a number of fronts. We expect the overall Taminco margins to remain stable due to the quality of their market positions and high level of cost pass-through contracts.

On synergies we remain on track. We are seeing good opportunities in procurement, operational capabilities and supply chain optimization and are aggressively working these. Although we are still in early days we have already had some operational improvement successes in combining Eastman's deep fundamental operational expertise from our large integrated sites, with Taminco's [aiming] manufacturing expertise resulting in higher capacity utilization rates in several Taminco sites.

We are also very encouraged about Taminco's product development pipeline and see opportunities to help them accelerate their success similar to what we have done to the Solutia businesses.

We continue to expect synergies of approximately $60 million over the next couple of years. One of the key elements of a successful acquisition is the retention of key talent and we are doing very well in this area. I have been very pleased with the engagement of the Taminco team and the success of the combination of Eastman and Taminco.

On a full-year basis, we expect volume growth to be greater than GDP for all of Taminco and earnings accretion on track with our expectations of greater than $0.35 per share in 2015 and greater than $0.60 per share in 2016. Given the strategic fit of Taminco into Eastman, the consistency of their earnings growth in a variety of business climates and the strength of their cash flow, we remain very pleased to have Taminco as part of the Eastman portfolio.

Now I will turn it over to Curt to discuss the corporate and segment results.

Curt Espeland (CFO):

Okay. Thanks, Mark, and good morning, everyone. I will start with our first quarter results on slide six.

Overall sales revenue increased primarily due to revenue from the businesses we acquired in 2014. This was partially offset by lower selling prices which largely reflected lower raw material and energy costs and to a lesser extent, foreign exchange rates. Our operating earnings increased as we largely were able to hold onto value in the quarter reflecting the specialty and special position nature of a significant portion of our portfolio.

Earnings from acquired businesses were also key contributors. These were partially offset by lower earnings in our Fibers segment, an unfavorable shift in foreign exchange rates and propane hedges that we discussed previously. As Mark mentioned, our operating margin increased by 120 basis points which is an excellent result despite difficult business conditions.

Earnings per share increased 14% year-over-year primarily reflecting higher earnings and lower share count, overall a very strong quarter where we delivered earnings growth.

Moving next to the segment results starting with Additives and Functional Products on slide seven. Revenue increased due to sales of the acquired Taminco businesses partially offset by lower selling prices due to lower raw material and energy costs. Operating earnings increased due to earnings from acquired businesses partially offset by the impact of currency and propane hedges.

As we look at second quarter, we expect strong volume growth sequentially due to normal seasonality, an improving building and construction market particularly in the US, and improving demand for tires as their anticipated growth particularly in Europe and North America.

We also expect solid growth for the full year especially in our transportation, building and Construction and personal care markets. We therefore continue to expect strong full-year earnings growth for Additives and Functional Products due to earnings from acquired businesses with the earnings and heritage Eastman businesses relatively flat as solid volume growth offsets the currency effects and hedges.

Next is Adhesives and Plasticizers on slide eight. Sales revenue declined 7% primarily driven by currency and slightly lower selling prices due to lower raw material costs. Operating earnings increased primarily in adhesive resins as an increase in spread was partially offset by currency.

Operating margins for the quarter were 17%, up 300 basis points year-over-year. For full-year 2015, we are expecting to continue to make progress improving our product mix. We expect strong growth in hydrogenated hydrocarbon resins as the hygiene market grows in Asia-Pacific and we see solid growth in the packaging market. We are also seeing continued good adoption of non-phthalate plasticizers.

We are also expecting the adhesives resins market to remain tight due to the lack of available raw materials such as piperylene. Offsetting some of these benefits will be the impact of currency and volatile oil prices. Taken together we expect Adhesives and Plasticizers will deliver strong earnings growth for the year.

Now to Advanced Materials on slide nine which delivered a very solid quarter. Sales revenue declined somewhat as sales from the acquired performance film business were more than offset by currency and lower selling prices particularly for coal polyesters reflecting lower raw material and energy costs. Earnings increased primarily due to earnings from the acquired Commonwealth business, an excellent bolt-on acquisitions. These earnings were partially offset by the unfavorable impact of currency. Looking at the full-year, we continue to expect strong results from Advanced Materials as they make progress on our strategy for this business of volume growth, mix improvement and fixed cost leverage.

Sequentially we expect volume will increase as destocking by our copolyester customers in the beginning of the first quarter has subsided. We had strong volumes in March and that has continued into April. Interlayer volumes are picking up as OEM auto builds remain solid. Acoustic growth continues and the overall building and construction market in Europe is stabilizing and as a result, we expect interlayers volumes in 2015 will be at record levels.

And film volumes are picking up sequentially as we have seen strong growth in North America and Asia from normal seasonality and share gains and as the destocking we have seen in Southeast Asia seems to be behind us. As a result, for the year we expect good volume growth.

One thing I do want to mention though that affects this business, there is core volume that is -- this core volume is somewhat offset by an ethyl acetate product that is a low margin product line that was previously sold in both AFP and Advanced Materials in 2014. Going forward this product line will be sold solely by Additives and Functional Products.

In addition to the good volume growth, we expect continued mix improvement as high-margin product lines such as Tritan copolyester, acoustic interlayers and Visualize, our film product used in displays for smartphones, delivered strong growth.

As we continue to fill out existing capacity we benefit from fixed cost leverage. We expect all of these factors will result in strong earnings growth for Advanced Materials in 2015 offset in part by the impact of currency.

Now to Fibers on slide 10. Performance in this segment is about as expected. In the quarter, sales revenue declined year-over-year primarily due to lower acetate tow and acetyl intermediate sales volume. We attribute this to customer inventory destocking which we discussed back in January. Earnings declined due to lower revenue -- I'm sorry -- lower volume and I would add that the operating margin was about 32% in the quarter, down slightly from year-ago levels.

As we look at full-year 2015, we are pretty much on track with our previous guidance. Based on conversations with customers about their plans and expectations, we continue to expect that the inventory destocking will be more pronounced in the first half of the year and tow demand will improve in the second half of the year. And we are benefiting from lower raw material energy costs particularly for wood pulp.

Regarding our UK facility as previously announced we discontinued production and expect site closure would be completed in the third quarter. As a result, we continue to expect earnings will be down between $40 million and $60 million for the year albeit probably closer to the $60 million sitting here today. We expect to see earnings of this segment improve as we progress through the year.

I will finish up the segment review with Specialty Fluids and Intermediates on slide 11. During the first quarter, we did a great job of holding onto value. Sales revenue increased due to the sales of acquired businesses partially offset by lower selling prices particularly for olefin-based intermediates. Operating earnings increased due to improved spreads and earnings from acquired businesses partially offset by propane hedges.

Looking at the full year, we have a number of factors impacting results. We expect to continue to benefit from strong volume growth and earnings in the acquired businesses. Sales volume for the heritage Eastman business is expected to be about flat as solid end market demand growth is being offset by increasing internal consumption of intermediates for both backward integration with Taminco businesses and growth in heritage Eastman businesses and lower polymer intermediates volumes.

We are projecting lower propylene and ethylene prices for the remainder of the year as experienced in April and expect lower prices to continue for the rest of the year negatively impacting olefin margins.

We also expect the impact of propane hedges to be more significant for this segment for the balance of the year as the cost of the hedge flows through inventories. We therefore expect overall earnings in 2015 to be lower than 2014 earnings.

On slide 12, I will transition to an overview of our cash flow and other financial highlights. We continue to do an excellent job of generating cash with the first quarter operating cash flow of $91 million in which is typically our seasonally lowest quarter. Net earnings were solid and our normal beginning of the year working capital build was tempered somewhat by lower raw material energy costs.

Free cash flow is negative $34 million for the quarter. Capital expenditures totaled $125 million and we are on track for full-year capital expenditures of between $700 million and $725 million. Our first quarter dividend was $60 million.

Our effective tax rate for the quarter was 27%. We continue to expect our full-year tax rate will be between 26% and 27%, reflecting the continued benefits of our improved business operations. We continue to do what we can to be at the lower end of that range.

As a whole I am pleased with the earnings and cash flow performance to start the year, there is good things happening at Eastman Chemical and I thank everyone that is involved in making it happen.

With that, I will turn it back over to Mark.

Mark Costa (CEO):

Thank you, Curt. I will close on slide 13 with comments on our full-year 2015 outlook and I'm quite happy to say our outlook has improved through the actions we have taken. We continue to have strong growth drivers across the Company. This starts with our portfolio specialty businesses that leverage our world-class technology platforms. These specialty businesses are positioned to grow this year. We will benefit from growth in a diverse set of end markets including transportation, building construction, consumables and food, feed and ag.

We also expect high growth from some of our most innovative high-margin specialty growth programs improving our mix. We will benefit from low oil in many of our specialty and special position businesses where pricing is more determined on the functionality and value to customers and you can see that in our first quarter results and we expect it will continue for the remainder of the year.

We have done an excellent job in managing costs over the years and I expect this to continue. And as I mentioned, we expect significant accretion from the businesses we acquired in 2014.

We are all about focus and execution this year and driving value through organic growth and creating value for the integration of our highly accretive acquisitions. Of course we also have some short-term headwinds and uncertainties in the global economy, volatile oil and a strengthening dollar.

Given our excellent start to the year, expectations for solid growth in our specialty businesses, earnings from the recently acquired businesses and continued cost discipline, we are now well-positioned to deliver our sixth consecutive year of earnings growth in 2015, something only a very small percentage of S&P 500 companies have been able to do in the last 10 years.

Lastly, these solid earnings are translating to strong free cash flow generation. We now expect to generate approximately $900 million of free cash flow at the top end of the guidance we gave you in January which represents a free cash flow yield of approximately 8%.

This puts us in a great position to continue to pay a strong dividend, invest and grow through capital expenditures and achieve the appropriate level of deleveraging. So I am very excited about our performance so far this year, our expectations for the full year and for what we can deliver over the coming years.

With that I will turn it over to Greg.

Greg Riddle (VP - IR and Communications):

Thanks, Mark. We have a lot of people on the line this morning and we would like to get to as many questions as possible so I ask everybody that is on the line to limit yourself to one question and one follow-up question. With that, [Mara], we are ready for questions.

Questions and Answers

QUESTIONS & ANSWERS

Operator:

(Operator Instructions). David Begleiter, Deutsche Bank.

David Begleiter (Analyst - Deutsche Bank):

Thank you. Good morning. Mark, very strong earnings in SFI. Can you help us think about first, how much did the spread contribute in Q1 versus Q4? And thinking about Q2 versus Q1, how much will the spread hurt you sequentially in Q2 versus Q1?

Mark Costa (CEO):

Thanks, David. Certainly spread was a factor in the growth in Q1 relative to Q4 as Curt mentioned. We saw good discipline in holding onto prices as raw materials came down and the inventory turns are quite fast in that business and we were able to sort of improve our spread. And as also Curt mentioned, the hedge which predominantly goes into SFI flows through COGS. You don't see much of that hit in the first quarter as that will increase into the second quarter and the hedge will really be the big driver in compressing some of the margins on first quarter to second quarter.

Curt Espeland (CFO):

If I could add, Mark, on top of that, so as I mentioned in SFI, you are seeing that margin compression in April, that will be felt mostly in the segment plus that impact of the hedges. Quite honestly if I think about just shaping of the year as well, that is going to impact the quarters as they progress a little differently than what you have seen in the past so I think our full-year is going to be more balanced first half of the year, second half of the year and the second quarter is really going to be probably one of the more challenging quarters we have on our year-over-year comparable basis in part due to that SFI factor we discussed as well as the timing of tow demand.

David Begleiter (Analyst - Deutsche Bank):

Thank you. Very helpful. Just on Fibers, Mark, when do you think the destocking will end and do think we will see normalized demand at any point during the back half of the year and what is that normalized demand in our view?

Mark Costa (CEO):

Sure. So we do certainly think that destocking will abates in the first half of the year and

things will improve in the second half. And the way I think about this, Dave, is primary demand story hasn't changed at all really in the last 12 months. So what we see is outside of China demand for cigarettes is trending as it always has. In China, the primary demand is expected to be flat to slightly up but let's call it flattish. So the primary demand situation is unchanged. What is really going on this year is what is the story in tow demand and there are really three components to that.

The first is the Chinese National Tobacco Company has added capacity in joint ventures with us last year and [Dicell] this year and that removes a certain amount of demand available to the tow suppliers because if you are backward integrated you are going to run your assets full. So there is a certain chunk of markets that just leaves the market.

Then the rest of it is a destocking story and it is two different stories. So in China, CNTC produces cigarettes and collects tax revenue at the production level. And over 2013, 2014 they got ahead of themselves in production relative to primary demand and built up more inventory than they needed and they finally took actions to sort of correct that inventory which is what you are seeing in the first half of this year. And they continue to tell us that should clear itself the first half of the year and that is all the data we have to go on but it makes sense.

With the multinationals, they also are doing some destocking around the globe for a different reason. Capacity utilization was incredibly tight in the 2010 to 2013 timeframe and so they were concerned about making sure they had safety stock in place because they never want to run out of filter tow because it is a very small percentage of their total cost and so they were carrying excess inventory. And as the Chinese added capacity, that made the capacity utilization a little bit looser, they felt less at risk at that.

And there was also a significant large customer changing out their product line and destocking in the first half of the year and restocking for their new product line in the second half of the year. So all of that combines to make the destocking story make sense to us. I would also note that with all of our large customers we have annual contracts of both price and volume and they generally honor those contracts and that also would confirm a recovery in demand in the back half of the year.

David Begleiter (Analyst - Deutsche Bank):

Thank you very much.

Operator:

P.J. Juvekar, Citi.

P.J. Juvekar (Analyst - Citigroup):

Mark, you talked about demand growth in tires. That seems like a changing tone from your last quarter especially in Europe. So can you just talk about what you are seeing in the tire demand globally?

Mark Costa (CEO):

Sure. Tire demand globally is very moderate in its growth rate if you look at what our customers like Michelin and others are saying in the marketplace. But there is really two stories inside that. Europe and North America tire growth is actually quite solid and getting better year-over-year. The issue is China and the Chinese are struggling through two things and reducing tire production right now to destock their situation because the tariffs in the US have pushed those sales back out of the US towards China or other markets and they have massively overbuilt tire production capacity in China. And the economy is clearly slowing down especially commercial activity in China where we are leveraged with Crystex and that has resulted in some decline in demand there in the first quarter.

But we have seen a strong improvement in demand going into the second quarter from the first. But overall I would say the tire market is going to have very modest growth globally when you add it all together.

P.J. Juvekar (Analyst - Citigroup):

Okay, thank you. And then SFI, as propylene prices came down, can you talk about what you are seeing in the (dedodi) pricing like oxos. And also you talked about sort of in your other question you talked about propane to propylene spread, sort of hinted at that. Can you talk about propylene to (dedodi) spread? Thank you.

Mark Costa (CEO):

Sure. On the market price situation, what we see is -- we saw a fairly large drop in propylene prices in April and the more commoditized products that we have are going to follow that down. The specialties are going to hold onto value as best as they can with that change in the marketplace conditions. And I think that is all playing out in the way you would expect. Fortunately the commodities are a very small percentage of our total earnings portfolio but it is the dynamic that is going on right now.

I'm going to let Curt answer the olefin spread hedge question.

Curt Espeland (CFO):

Sure and maybe the best way to think about this, P.J., let me just kind of give an update on that $0.40 to $0.60 impact we talked about on olefins. And so it is important when we talk about the producing versus buying olefins and let me highlight a couple of things.

First, the makeup of our olefin needs are changing as we grow. So for example now we produce about 55% of the propylene we need and we now purchase the rest so that is impacting some of this.

The benefits of producing versus purchasing olefins we do expect to be volatile and you see that as it goes through this April. And so as we see these decline in ethylene and propylene prices so that is going to be a little bit more of a challenge than we originally anticipated.

On our propane hedges we put in place last year, that is an additional headwind for us where we have kind of hedged about two-thirds of our propane purchases in 2015 and just over 50% in 2016. So when I think about the propane hedges themselves there has been no material change in the expected impact of these hedges on the 2015 results so a lot of it is just right now coming down to those cracking spreads.

Finally, when we have though taken a variety of actions trying to mitigate these margin pressures including improved operations and a shift to a more advantaged feedstock mix I think is probably around 70% propane today. So putting it all together with the current market conditions, we are probably now at the high-end of that $0.40 to $0.60 range we provided earlier in the year. As a reminder though, that impact does not include the impact of prices of our derivatives or changes in other raw materials and so we try to factor those into our overall corporate guidance. But again, the business teams are doing a great job trying to hold onto value and you see that being done in our first quarter results.

P.J. Juvekar (Analyst - Citigroup):

Thank you very much.

Operator:

Vincent Andrews, Morgan Stanley .

Vincent Andrews (Analyst - Morgan Stanley):

Thank you and good morning everyone. Could you just -- you said tow was going to be probably at the low end of your operating profit forecast for the year in terms of the impact year-over-year. Why is that? Is that just because the volume is going to come in a little worse than you thought or was there a difference on price or what is the dynamic?

Mark Costa (CEO):

Yes, there are two parts of it, both volume related. So as the final contract settled there was a slight drop in tow demand when we added it all together. The other part was we sell acetyl intermediates into our joint venture with Solvay for producing product and they also reduced their demand need on that joint venture so we had lower acetyl intermediate sales.

Vincent Andrews (Analyst - Morgan Stanley):

Okay, on Adhesives and Plasticizers, it seems like some of the issues that you were having last year have settled out, so what is the update there?

Mark Costa (CEO):

Adhesives and Plasticizers, great story, improvement in the industry structure. What has happened in Adhesives is the volumes have continued in the market to grow quite solidly in hygiene, hot metal adhesive packaging so strong growth in the market. As we continue to move to lighter feedstock slates, the amount of raw materials available for hydrocarbon resins has become more limited and you have got a tightening market situation that is giving us a lot of value and pricing power in the marketplace.

I would also note that the rosin question that we have discussed in the past is also quite stable. Prices in rosins are low and the availability is sort of typical this year and the low prices of rosins this year would suggest that those won't significantly increase into next year either so we see a nice, stable situation there in Adhesives.

Vincent Andrews (Analyst - Morgan Stanley):

Okay, thank you very much.

Operator:

Frank Mitsch, Wells Fargo Securities.

Frank Mitsch (Analyst - Wells Fargo Securities):

Good morning and nice start to the year. I wanted to follow up on some of the comments Curt made on the Taminco acquisition. I think when you were talking about the functional means in the ag business you saw sequential improvement. Now of course we would expect sequential improvement in Q2 but were you also referring to Q1? Did you see sequential improvement in that business there?

Also just in general, it sounded to me that the tone was a bit more positive on Taminco on this call and if you could talk about what you are seeing now that you have owned it for a little bit longer that would be great.

Mark Costa (CEO):

We view Taminco as a great acquisition, great add to the portfolio, very much on track in delivering the results and doing a great job in performing including finding ways to offset their own FX headwinds.

On the specific ag question, Frank, the ag demand on a year-over-year basis is the way I think about came off a bit when it comes to the functional means going into sort of the row crop herbicides consistent with what you might expect in the marketplace. But we have seen strong indications and improvements of volumes sequentially from the first quarter into the second quarter. In particular the customers we serve, they are doing a bit better this year than last year. We also saw burn downs start this year which did not occur last year so some additional demand as a result of that.

As we all know, the winter ag season last year was a pretty tough comp. So things are going really well there on the row crop but also remind everyone that the ag business related to row crops is only about 10% of the total revenue of Taminco so while we pay attention to it, it is not a significant part of the portfolio. One of the great things about Taminco, like Eastman, is it has a very diverse set of end markets.

Then the other part is crop protection is doing better than expected. The nice thing about perishable products is you can't build up inventory and those crop products are having a good demand this year.

Frank Mitsch (Analyst - Wells Fargo Securities):

That is great because I do know that some of the other crop protection chemical companies are not as optimistic on the early part of the year here so that is good to hear from your perspective. In terms of the $900 million of free cash flow, can you talk about your priorities for that money?

Mark Costa (CEO):

Sure. Capital allocation is always a critical and important debate we among ourselves, with our Board and we are committed to the approach we've always taken. So when I think about capital allocation, the priority starts with great attractive organic growth opportunities that are important in leveraging our world-scale platforms. It allows us to grow and sustain the performance of those platforms so organic is always going to take a priority assuming they have attractive returns.

We are fortunate that our operating cash flow is so strong that we can meet those needs and still have quite a bit of free cash flow. We have one of the best yields in the industry so there is a fair question which is what do you do with all of that free cash flow and we will continue to have a very disciplined and balanced approach to that in looking at both acquisitions and returning cash to shareholders and making sure we do which creates the most value for our shareholders at that time from a long-term value creation point of view.

Curt Espeland (CFO):

If I could, Frank, if you look at about 2015, nothing has changed in our commitment though. We also have to take a fair bit of that free cash flow and complete the deleveraging we have committed to.

Mark Costa (CEO):

Yes, my comments were long-term.

Frank Mitsch (Analyst - Wells Fargo Securities):

Understood. So debt paydown is probably the near-term priority and Curt's comments are more longer-term?

Mark Costa (CEO):

Other way around. So Curt just made the short-term comment about delevering and I made the long-term capital allocation philosophy.

Frank Mitsch (Analyst - Wells Fargo Securities):

Got you. Thank you.

Operator:

Kevin McCarthy, Bank of America Merrill Lynch.

Kevin McCarthy (Analyst - Bank of America Merrill Lynch):

Good morning. Mark, I was wondering if you could provide an update on Crystex. I think you were planning to take some capacity off-line in France, expand in Malaysia and retrofit technology at some sites. Can you update us on where you stand in that evolution?

Mark Costa (CEO):

Sure, Kevin. We are very much on track with our Crystex strategy, continue to be very excited about this new technology we developed. As you mentioned, we shuttered the set business down last year to take out some fixed cost and the reason we could do that is we have done such a great job in working with the Crystex manufacturing guys combined with our operational experts at our large integrated sites we have found ways to improve the performance of the existing plants so that out of six plants we are producing much more than we ever could in seven. And that is why we could shut set down which is just a great operational synergy story.

The new technology will be both retrofits which we have already started in our Germany plant and then of course, we are gearing up to start construction of our Kuantan plant to double capacity in that site. So the overall Crystex story is moving along quite nicely.

I would also mentioned that while the overall market is not growing that fast in tires, we are having great success with some of our new growth products that we are selling into tires and growing those quite fast. So our tackifying resins, our performance for traction are seeing significant growth this year over last year so the overall portfolio has ways to grow beyond just the primary end market.

Kevin McCarthy (Analyst - Bank of America Merrill Lynch):

And second question if I may, how would you describe activity or lack thereof as it relates to your efforts to monetize crackers at Longview? Second piece if I may, do you have any propane hedges in place for 2017?

Curt Espeland (CFO):

Kevin, this is Curt. Nothing new to report on our efforts around our olefins in Texas. We will continue to evaluate options with excess ethylene and/or our crackers in normal course. On the propane, we do have some hedges going into 2017 but they are moderate compared to what I described in 2015 and 2016.

Kevin McCarthy (Analyst - Bank of America Merrill Lynch):

Thank you very much.

Operator:

James Sheehan, SunTrust Robinson Humphrey.

James Sheehan (Analyst - SunTrust Robinson Humphrey):

Could you please elaborate on some of the improving business trends that you are seeing in Europe?

Mark Costa (CEO):

Sure. The businesses are actually improving quite nicely in Europe. The overall economy is obviously sluggish but improving from a GDP point of view but in markets like transportation we are seeing nice recovery in volumes. Even in building construction there is some improvements that we are starting to see. So Europe is expected to be sort of a nice story for us this year.

James Sheehan (Analyst - SunTrust Robinson Humphrey):

And to follow up on your comments on the tire market, could you just differentiate between what you are seeing on the passenger side versus truck tires?

Mark Costa (CEO):

Sure. Passenger tires are doing sort of reasonably well across the globe. Truck tires are doing well in North America, slow in Europe and challenged in China at the moment because of the economic deceleration going on in China. That is a short-term comment. While they are destocking, we expect that to sort of improve as we go into the year.

James Sheehan (Analyst - SunTrust Robinson Humphrey):

Thank you.

Operator:

John Roberts, UBS.

John Roberts (Analyst - UBS):

Good morning. You mentioned you don't have any propane hedging beyond next year. What is the go-forward strategy around propane? Do you have any opinion on whether it is going to be more volatile, less volatile and how do you intend to manage that?

Mark Costa (CEO):

From a hedging point of view, we are continuing to review our hedging strategy and decide what is the most appropriate thing to do. Obviously there is a tremendous amount of volatility today around where oil is going to go and the associated raw materials from oil. So we are making sure that we think about it carefully and step forward carefully.

John Roberts (Analyst - UBS):

It doesn't sound like you have a strategy. Is that it?

Mark Costa (CEO):

We have a strategy of making sure that we protect our volatility and our earnings but we are trying to understand what the structural implications are to the change in the market places because clearly no one saw oil going from $100 to $50 including us and when that kind of structural change happens in the marketplace, it is appropriate to step back and rethink your strategy and make sure what you are doing is appropriate.

John Roberts (Analyst - UBS):

And is the dispute with Westlake completely resolved at this point?

Curt Espeland (CFO):

This is Curt. There is nothing new to update on Westlake.

John Roberts (Analyst - UBS):

But there was a lingering piece there so that is unresolved still?

Curt Espeland (CFO):

I have nothing new to report.

John Roberts (Analyst - UBS):

Thank you.

Operator:

Mike Sisson, KeyBanc.

Mike Sison (Analyst - KeyBanc Capital Markets):

Nice start to the year. When you think about specialty fluids intermediates, you did operating income of $102 million versus $64 million last year. Is the improvement primarily all Taminco? And if I did the math, that would suggest that given the sales that margins really expanded versus last year and just curious if that math works then how much of the improvement would have been the pricing power of raw materials?

Curt Espeland (CFO):

Again, the benefit is partially the acquisitions. If you recall we said Taminco if you think about specialty means and crop protection going to Additives and Functional Products and the functional means going to SFI, it was about a 75% going to AFP, 25% going to SFI so that we give you some way to think about the order of magnitude of Taminco.

Yes, as Mark mentioned, the margins did expand in the first quarter but as we talked about we think that margin expansion is going to come off in the second quarter for SFI in part because of the decline in propylene and ethylene margins and in part because of the flow of the hedge.

Mike Sison (Analyst - KeyBanc Capital Markets):

Okay, great. And then, Mark, I think you described AFP to be up strong and Adhesives to be up strong, Advanced Materials to be up strong and Fibers and your thoughts on Specialty Fluids and Intermediates and given that the first quarter EPS growth was double digits, is that the type of growth you can do every quarter? Is there a little bit kind of changes because of the hedges and I just want to better understand kind of the growth potential as the quarters unfold this year.

Mark Costa (CEO):

Mike, great question. Been waiting for it. We see a great opportunity for us to continue delivering earnings growth this year over last year as well as into 2016 and I think the first quarter is great evidence about the quality of our specialty portfolio and the transitions we have been making to be more of a specialty company. When you look at the earnings performance in the first quarter, it was really quite good in our specialty businesses.

We held onto value and we were quite disappointed how we held onto value in those businesses and were able to offset the vast majority of the headwinds we had in currency and hedging and we did it without volume. And there is an important point in that which is we were being disciplined and as a result customers held off on ordering waiting for the best price and then we saw when we got those all negotiated, we saw volumes recover in the March timeframe into April.

It is also important to note when you think about that story that the COGS flow through on specialty businesses is quite slow, three to six months versus commodities being in that shorter one- to two- month range. Therefore when you really look at the story of the specialty businesses in the first quarter, it is quite good.

So as we go from that into the rest of the year, what we see is continued strong improvement in volumes in those specialty businesses as we go into the first quarter -- I'm mean sorry, into the second quarter and we expect volume growth to continue through the year.

In addition to those end markets delivering volume growth, we also expect high growth of these high-margin products that we have that are selling especially in Advanced Materials that are giving us quite an earnings uplift within that volume growth. So we feel good about that but of course you've always got some of the offsets we have mentioned currency strengthened, the propylene and ethylene prices are lower today than what we expected in January and so there is a netting effect of all of that.

But if you took current market conditions that we have today associated with oil, currency, etc. and looked forward you would, we feel very confident that we are going to deliver earnings growth year-over-year.

As I think about it, this is not a 2015 story, it is a 2016 story too. So you've got all these strong growth drivers that continue into 2016. You've got oil hopefully one day showing up as an economic stimulus further improving demand and then you've got the headwinds that we have this year that are more short-term headwinds when you think about 2016 and not likely to repeat. So hedge starts coming off, oil price is likely to be higher, Fibers demand stable to better next year all give us additional room for earnings growth year-over-year. And then of course I think that all of that is much stronger than some margins this year that we captured in particular on the first quarter that would be difficult to repeat next year with prices falling relative to rosins. A small part of our portfolio is commodity.

So I think our overall earnings story is very much intact on a year-over-year basis for 2015 as well as 2016.

Mike Sison (Analyst - KeyBanc Capital Markets):

Great, thank you.

Operator:

Bob Koort, Goldman Sachs .

Ryan Berney (Analyst - Goldman Sachs):

Good morning. This is Ryan Berney on for Bob. Just had a question within the Adhesives and Plasticizers business. I was hoping you could maybe elaborate a little bit more on the lower selling prices that you are seeing in Plasticizers. It seems like maybe that piece of the business overwhelmed a little bit of the positive you are getting from the Adhesives side. So I was hoping you could provide a little more color there.

Mark Costa (CEO):

Sure. It is a story related to oil so raw material prices dropped dramatically associated with oil and plasticizers like other olefins and so what you are seeing is prices come down with those raw materials in the plasticizers side of that business. There is also continued competitive pressure in that business as Asians have been trying to reposition towards North America. Europe is obviously not attractive for them on a relative currency basis for some of them as well as looking to place that product because economic growth in China has not been very good.

Ryan Berney (Analyst - Goldman Sachs):

And to elaborate on that economic growth in China kind of just based on what you are seeing in your businesses, do you expect the kind of deceleration we have seen in the early part of the year to accelerate from where we are, meaning the pace of the slowdown to speed up so of speak for the remainder of the year?

Mark Costa (CEO):

That would be the big question for the world about what is China economy going to do. My personal view is they are not growing at 7% GDP, not close to it and there are certainly lots of articles out there right now talking about that. How it accelerates or decelerates from where it is today is a question beyond my pay grade. But I do think that the important part for us is our volume story is actually quite strong in Plasticizers. While we have had some headwinds on margin which will start to abate this year, the volume story about our non-phthalates is great.

We are seeing very strong growth in non-phthalates we are primary focused on selling these products in North America where we have the best net back and we recently had another factor come into drive non-phthalates change where Home Depot has now told all of its suppliers that it doesn't want phthalates in its flooring so the pressure to sort of switch to non-phthalates just keeps on increasing.

So we feel good about this business long-term. It is going to have very strong growth, there is lots of addressable market left to penetrate in the switch from phthalate to non-phthalates. We just need to get this margin pressure situation to clear and then that will then turn into earnings growth.

Ryan Berney (Analyst - Goldman Sachs):

Great, thank you very much.

Operator:

Jeff Zekauskas, JPMorgan .

Jeff Zekauskas (Analyst - JPMorgan):

Good morning. In your earlier remarks I think you said that your propane was hedged by 50% in 2016. My recollection was that in the old days it was maybe hedged to 90%. So did you alter your hedged positions or were there various steps that you have taken to change your exposure or your purchases in propane for next year?

Curt Espeland (CFO):

So, Jeff, this is Curt. A couple of perspectives. First of all, there has been no change to our propane hedging program as we defined it last year so you know we have moved from that instead of a short-term hedging program to a multi-year hedging program. So there has been no change there. We had talked in the past about it being substantially hedged in 2015 and 2016. I just wanted to provide some more clarity for people to understand what that order of magnitude is so it is about two-thirds in 2015 and just over half in 2016.

Mark Costa (CEO):

But part of that story is we have taken actions to improve our total production rate of olefins. So we are improving the quality of how we are running our crackers. We have shifted our mix toward more propane from ethane because propane currently is quite advantaged as you know. So there are some actions we have taken but we also were concerned that people are over interpreting our substantial comment. I wanted to make sure people knew where our hedged positions were.

Jeff Zekauskas (Analyst - JPMorgan):

Okay. And then for my follow-up, I remember that Taminco had an aircraft deicing business, was quite depressed last year because of good weather. And so I would imagine that might have helped the Taminco earnings overall and there are some synergies. Order of magnitude, is Taminco EBITDA up $15 million or $20 million or $12 million? Can you size it?

Curt Espeland (CFO):

This is Curt, Jeff. First of all on your deicing, the deicing was up year-over-year, that was a contributing factor. There are some offsets to it within a diversified portfolio you have like within our specialty means business and that is the formic acid aspect of it there.

On the EBITDA for Taminco, I would characterize it as we look at it right now I think if you take all the factors the EBITDA of Taminco would be equal or slightly above where they were last year.

Jeff Zekauskas (Analyst - JPMorgan):

Okay, great. Thank you so much.

Mark Costa (CEO):

Jeff, that includes an FX affect too.

Jeff Zekauskas (Analyst - JPMorgan):

And FX effect. Okay, great.

Mark Costa (CEO):

They are facing that FX headwind so they are helping offset some of that in that comment.

Operator:

Laurence Alexander, Jefferies.

Dan Rizzo (Analyst - Jefferies & Company):

This is Dan Rizzo in for Laurence. Just in regards to the acetyl tow, you say the destocking is going to continue through the second half of the year -- I mean until the second half of this year. Do you mean it is going to spike in this quarter or is it moderating as you go forward or just sequentially from the first quarter to the second, is it kind of the same or is it getting better or worse and then getting better? Just a little more color.

Mark Costa (CEO):

If I could let me just clarify. I think you are referring to my comment about second-quarter being more of a challenge year-over-year and that is truly part of the factors is tow demand on a year-over-year comparison basis. So as you think about overall tow demand just so we are clear, the destocking is occurring in the first half of the year, we expect recovery in demand in the second half of the year as that destocking abates.

In regards to the second quarter versus the first quarter, I would describe the volume as similar to maybe a little bit better on a sequential basis from the first quarter to second quarter.

Dan Rizzo (Analyst - Jefferies & Company):

Okay, thanks. Just given all the moves you made in the past year, so what does the M&A pipeline look like? Are you guys kind of done for a while or do you still see a lot of opportunities out there?

Mark Costa (CEO):

Right now we are very much focused on execution. We have done some great acquisitions, four of them last year. We've got a tremendous portfolio of organic growth projects and we are all about delivering results right now and focusing on how we do all of that incredibly well. That is and will continue to be our priority.

Dan Rizzo (Analyst - Jefferies & Company):

Thank you, guys.

Operator:

Alex Yefremov, Nomura.

Alex Yefremov (Analyst - Jefferies & Company):

Good morning, everyone. How would you characterize industry-wide operating rates in (filter) tow. Any (carlee) and also after capacity costs that you are undergoing and that your competitor has announced and also could you comment on Eastman specific operating rates in (filter) tow?

Mark Costa (CEO):

So I will comment on the industry side. What we are seeing is as I mentioned, we added some capacity and Dicell is adding some capacity with CNTC and fortunately what we are also seeing is that the three out of four tow suppliers in this industry are also rationalizing capacity right now that is high cost and not necessary and so we have taken our Workington site down.

You have seen announcements from Celanese and Solvay about taking some capacity out. When you add that all together and you look at different demand scenarios for 2016, it would imply industry utilization rates in the low 90% range which is a nice stable place to be and importantly should indicate ability for us to maintain stable margins just like we have already done this year maintaining stable margins in the face of this destocking.

Alex Yefremov (Analyst - Jefferies & Company):

Great, thank you. Also could you comment on your foreign exchange hedges. What is the magnitude of any potential benefit that you expect this year and also how could this progress into 2016?

Thank you.

Curt Espeland (CFO):

Well if you think about, this is Curt, the impact of the exchanges, the strengthening dollar and for us it is specifically the euro, we have talked about that change being a $0.25 to $0.30 headwind per share. That is reflecting net of some of the hedges we have in place. We have hedged roughly half of our currency. As you see currency sitting there today around $1.10, $1.11, that impact is going to be a little greater than that $0.25 to $0.30 and that is what we are expecting in our outlook.

I would say similarly we have a hedge going into next year that will help mitigate that, just not to the same magnitude of 50% we had this year.

Alex Yefremov (Analyst - Jefferies & Company):

Thank you very much.

Operator:

Nils Wallin CLSA.

Nils Wallin (Analyst - CLSA):

Good morning and thanks for taking my question. You have spoken a lot about the specialty aspect of your portfolio holding price and capturing value but your year-over-year price comparisons were down 6%. So would you be able to parse the price realizations you had in the specialty and special position versus commodity?

Mark Costa (CEO):

Sure. I will take part of this question and I wouldn't be surprised if Curt piles in. So first of all, when you look at the overall price performance of our Company compared to our diversified peers, we actually did a great job of holding price and I think that is a good proxy for the quality of our portfolio. But no matter what you are specialty or commodity, raw material prices came down considerably and some of our pricing especially in our core copolyesters was going to follow raw materials downward to some extent and that is the price effect that we are feeling.

So in Advanced Materials and the same logic would apply to the olefin products in AFP and the Plasticizers and A&P. So but spreads did not compress and so I think that portfolio in fact expanded in most cases. But there is a limit. You have to treat your customers with respect to make sure you pass on value to them too when the raw materials come down.

So I think that we did a nice job of finding the appropriate balance with our customers for the value that we create for them and we will continue to do so going forward. So it is also important to keep in mind that raw material flow through issue being three to six months on the specialty so when you look at the margins you don't have that rapid flow through that you saw in SFI.

Curt Espeland (CFO):

This is Curt. As you make your evaluation analysis, you can see some of that in the pricing changes so you look at Additives and Functional Products, Adhesives and Plasticizers, Advanced Materials, you see their prices only coming down 2% to 5% versus 16% in SFI. So that is the sum of the factors that Mark described.

I would also remind people as they evaluate Additives and Functional Products and SFI, keep in mind as they bring the Taminco businesses into those, that does have a weighting effect on the operating margins for those businesses so for Additives and Functional Products, they will have a slightly lower operating margin now just because of the mix of Taminco versus the (Herchuchichman) businesses.

Nils Wallin (Analyst - CLSA):

Thanks. That is really helpful. And then would you have an estimate -- you obviously had a lot of new assets in the portfolio year-over-year. Would you have an estimate of total accretion from all these new businesses?

Curt Espeland (CFO):

I would say right now it has been factored in our guidance. We look at all of the moving parts and so from an as it relates to organic growth, we factor that into that aspect. From the acquisition standpoint, we talked about greater than a $0.35 accretion this year and greater than $0.60 accretion next year.

Mark Costa (CEO):

For Taminco.

Curt Espeland (CFO):

Taminco.

Mark Costa (CEO):

So when you add it all together, it is more like $0.50.

Nils Wallin (Analyst - CLSA):

Understood. Sorry, I meant for this quarter.

Mark Costa (CEO):

For the quarter, we are not breaking that out by quarter.

Curt Espeland (CFO):

Its earnings profile is pretty constant during the course of the year so that is how I think would about it.

Unidentified Company Representative:

I mean the way to think about it though is they are on track on a corporate basis for that $0.50 or greater than $0.50 accretion on an annual basis. So just think of it that way. We are on track with that accretion expectation.

Mark Costa (CEO):

As you think about the benefits of the synergies, that is probably weighted more toward the second half of the year.

Nils Wallin (Analyst - CLSA):

Understood. Thanks for the help.

Operator:

And that concludes our question-and-answer session. Mr. Riddle, I would like to turn the conference back over to you for any additional or closing remarks.

Greg Riddle (VP - IR and Communications):

Thanks, (Mara), and thanks everyone for joining us this morning. We will have a Web replay and a replay and downloadable MP3 format available on our Web site probably later this morning. Thanks a lot and have a great day.

Operator:

And that concludes our conference for today. Again, we thank everyone for joining us.