02 - 06 - 2024

DuPont Specialty Products USA, LLP

4Q 2023 Earnings

DuPont Specialty Products USA, LLP

4Q 2023 Earnings

CORPORATE SPEAKERS:

Chris Mecray
DuPont; VP, Investor Relations
Edward Breen
DuPont; Chief Executive Officer
Lori Koch
DuPont; Chief Financial Officer

PARTICIPANTS:

Scott Davis
Melius Research; Analyst
Michael Leithead
Barclays; Analyst
Joshua Spector
UBS; Analyst
John Roberts
Mizuho; Analyst
David Begleiter
Deutsche Bank; Analyst
John McNulty
BMO Capital Markets; Analyst
Stephen Tusa
JPMorgan; Analyst
Aleksey Yefremov
KeyBanc Capital Markets; Analyst
Patrick Cunningham
Citi; Analyst
Vincent Andrews
Morgan Stanley; Analyst
Frank Mitsch
Fermium Research; Analyst
Arun Viswanathan
RBC Capital Markets; Analyst
Steve Byrne
Bank of America; Analyst
Michael Sison
Wells Fargo; Analyst

PRESENTATION:

DuPont Specialty Products USA, LLP

4Q 2023 Earnings

Operator^ Good morning. And welcome to the DuPont Fourth Quarter 2023 Earnings Call. Please note that this call is being recorded. (Operator Instructions)

I will now turn the call over to Chris Mecray.

You may begin your conference.

Chris Mecray^ Good morning. And thank you for joining us for DuPont's fourth quarter and full year 2023 financial results conference call.

Joining me today are Ed Breen, Chief Executive Officer; and Lori Koch, Chief Financial Officer.

We prepared slides to supplement our remarks, which are posted on DuPont's website under the Investor Relations tab and through the webcast link.

Please read the forward-looking statement disclaimer contained in the slides.

During this call, we'll make forward-looking statements regarding our expectations or predictions about the future. Because these statements are based on current assumptions and factors that involve risks and uncertainties, our actual performance or results may differ materially from our forward-looking statements.

Our Form 10-K as updated by our current and periodic reports, includes detailed discussion of principal risks and uncertainties, which may cause such differences.

Unless otherwise specified, all historical financial measures presented today or on a continuing operations basis and exclude significant items.

We'll also refer to other non-GAAP measures. A reconciliation to the most directly comparable GAAP financial measure is included in our press release and presentation materials and have been posted to DuPont's Investor Relations website.

I'll now turn the call over to Ed.

DuPont Specialty Products USA, LLP

4Q 2023 Earnings

Edward Breen^ Good morning. And thank you for joining our fourth quarter and full year 2023 financial review.

This morning's earnings release is consistent with the preliminary results announced on January 24, and we have added our customary segment detail and end market color while also providing incremental detail on our 2024 financial forecast.

Broadly, we continue to see encouraging stabilization within electronics' markets. Our Semiconductor Technologies business reported sequential sales growth of 2% in the fourth quarter, as expected, as the first sign of getting past the bottom in chip production.

In Interconnect Solutions, we saw a return to year-over-year volume growth, with volumes up 2% versus the prior year after sales bottomed earlier in 2023.

However, as we finish 2023, we did see additional channel inventory destocking within many of our industrial base businesses as well as continued weak demand in China with incremental weakness in our China water business. This resulted in fourth quarter net sales, which declined 7% year-over-year, falling below our guidance expectations.

We have already noted that we see a continuation of similar volume trends into the first quarter. And I will come back to this.

But we are encouraged that we see signs of market stabilization, bottoming of customer inventories and a pickup in orders in the month of January that support a view of recovering sales and earnings through 2024.

Fourth quarter operating EBITDA of $715 million was down 6% year-over-year, reflecting continued pressure across many of our largely short-cycle businesses. We remain very focused on managing what we can control, including discretionary spending levers and also executing the restructuring actions announced last November. This focus helped to contain margin impact in the period despite a 9% drop in volume.

Looking into 2024, we continue to target annualized cost savings of $150 million, which we will begin to realize later in the first quarter and which should further bolster our go-forward margin profile.

I am pleased we finished the year with strong cash generation as we continue to prioritize working capital improvement and discipline following the inventory build seen during the supply challenge 2022 period.

For the full year, adjusted free cash flow was $1.6 billion with conversion at 100% versus our target of greater than 90%. This included fourth quarter adjusted free cash flow of $501 million, which represented 133% conversion.

Adjusted EPS for the year of $3.48 per share increased over last year as benefits from our ongoing capital allocation and share repurchase more than offset substantial volume decrements.

Turning to Slide 4. We continue to execute on our capital allocation priorities.

First, this morning, we announced that we completed the $2 billion accelerated share repurchase transaction launched last September. At the conclusion of the ASR transaction, we retired an additional 6.7 million shares with the true-up, bringing the total to 27.9 million shares retired under the $2 billion ASR.

Completion of this ASR wraps up the $5 billion program that we announced in November 2022, enabling a repurchase of approximately 15% of our outstanding shares over this time period. We also announced that our Board approved a new $1 billion share repurchase program, and we intend to launch a new $500 million ASR transaction imminently. We expect to complete the full $1 billion program by the end of this year.

Finally, today, we also announced an increase in our quarterly dividend of $0.38 per share or a 6% increase. We will continue to target a dividend payout ratio of 35% to 45% over time and expect to increase our dividend annually in line with earnings growth.

We exited 2023 on a favorable balance sheet and liquidity position with an adjusted net leverage ratio of 2.1x and with no long-term bond maturities due until November of

2025. We also repaid $300 million of debt due during the fourth quarter with cash on hand.

Finally, we also continue to invest in innovation and our operational excellence program to support long-term organic growth. In 2024, we expect capital spending at about 5% of sales and target R&D spend at about 4% of sales for total DuPont. Regarding our innovation and growth pipeline, we were pleased during the fourth quarter with our electronics portfolio to be selected by a leading U.S. OEM for our micro fill metallization product, which offers improved plating uniformity for advanced computing. In Water, our team significantly advanced commercialization of the oxy membrane products for waste and water biological treatment.

Within Industrial, our Kalrez business opened a new facility in Delaware to support growth for its global semiconductor products. And finally, within Adhesives, we launched a new structural epoxy adhesive specific for large-scale energy storage system.

Before I turn it over to Lori, let's review our expected demand outlook by business based on active conversations that we have had with customers recently.

For Electronics, our ICS business serving printed circuit boards already bottomed in mid-2023. And continues to gradually recover alongside global electronics demand. We expect utilization for our customers in this area to increase this year into the 60s on a percentage basis from the mid-50s in the first quarter. For semiconductor industry forecast for chip production that were pushed out several times in 2023 are signaling a firmer 2024 recovery. And our outlook assumes chip fab utilization increasing through the year to exit at a run rate around the low 80s on a percentage basis from the low 70s in the first quarter.

This inflection also includes stabilization for end market consumption in smartphone, PC and tablet markets, driven in part by replacement demand as well as improved data center demand bolstered by AI-driven growth. These trends bode well for DuPont's strength within electronics materials and our customers are pointing to improve volume in both semi and ICS during 2024.

Within our industrial based businesses, while inventory destocking impacts have continued into the first quarter, customer feedback indicates a positive order inflection as the year progresses. Let's review specific end markets.

First, Shelter, which saw notable destock in 2023, now sits with inventory back to normal levels and we expect a slight positive volume compare in 2024, beginning in the first quarter.

In Safety, we believe our customers' inventory is also close to normal at this point for Tyvek Medical Packaging, and we expect sales to recover during the second and into the third quarter. Further, we expect reduced destock impact within safety solutions across a couple of industrial end markets in the second half.

In Water, we have communicated with our distributor customers in China, and we expect a sequential pickup in sales towards the end of the second quarter. Distributor inventories have declined substantially from the peak last year. Finally, I would mention that we expect to see order improvement over the next several quarters in our Kalrez business with Industrial Solutions. Our Liveo Biopharma business is anticipated to recover later in the second half.

So we have firm signals from a wide range of businesses within the DuPont portfolio that support a sales bottom in early 2024. This is reflected in stronger orders during the month of January after continued weakness in December. To wrap up, we remain confident that our key end markets are well positioned for long-term growth. and our teams are extremely focused on operating discipline and site-level execution, which positions us well to accelerate growth as inventories normalize.

With that, I'll turn it over to Lori to cover the financial results and outlook in detail.

Lori Koch^ Thanks, Ed. And good morning.

Our financial results in 2023 were clearly impacted by significant destocking and demand pressure in China, but our focus has remained on sound operational execution across the business. I'm very pleased that our team's effort to drive productivity and operational excellence, clearly minimize decremental margins and help drive

substantial cash flow improvement. In 2024, our continued proactive approach to managing the business will yield impactable cost reduction beginning later in the first quarter and building from Bayer from the restructuring actions announced last November. We anticipate yielding at least two-thirds of the total $150 million in restructuring benefits during 2024 with the balance realized next year.

Like Ed, I'm also encouraged by the expected trajectory of demand and volume based on direct customer feedback and data supporting the bottoming of channel inventory in key end markets. Our current forecast assumes the bottom for total company sales and earnings in the first quarter followed by steady recovery as the year progresses with a return to year-over-year growth in the second half. I'll come back to the outlook later, but first, I'll cover our results.

Regarding our fourth quarter financial highlights on Slide 5, net sales of $2.9 billion decreased 7% versus the year ago period as a 10% organic sales decline was partially offset by a 3% portfolio benefit due primarily to the Spectrum acquisition. The organic sales decline reflects a 9% decrease in volume and a 1% decrease in price.

Lower volume included the impact of channel inventory destocking within W&P, Safety Solutions line of business most notably for Tyvek Medical Packaging. We also saw accelerated volume decline within Water Solutions in China, driven primarily by distributor destocking and weaker demand.

On a segment view, W&P and E&I organic sales declined 15% and 7%, respectively, while organic sales and corporate declined 4%. From a regional perspective, DuPont sales decreased on an organic basis globally versus the year ago period, with North America, Asia Pacific and Europe, down 13%, 11% and 9%, respectively. China sales were down 14% versus the prior year.

Fourth quarter operating EBITDA of $715 million decreased 6% versus the year ago period as volume declines and the impact of reduced production rates to better align inventory with demand were partially offset by lower input costs, discrete items, which benefited earnings by about $40 million, and Spectrum earnings contribution. About $25 million of the discrete item benefits were reported within the W&P segment, reflecting a land sale and other credits with the remainder reflected in corporate.

DuPont Specialty Products USA, LLP

4Q 2023 Earnings

Operating EBITDA margin during the quarter of 24.7% increased 30 basis points versus the year ago period. In the fourth quarter, driven by continued challenging construction market conditions coupled with ongoing channel inventory destocking, we recorded a noncash goodwill impairment charge of about $800 million. The charge relates to our protection reporting unit, which consists of the Shelter and Safety Solutions lines of business with W&P and is excluded from our adjusted operating results.

As a reminder, the carrying value of the legacy DuPont assets and liabilities were marked at fair value and significant goodwill and intangible balances were recorded in connection with the Dow DuPont merger. Despite the write-down, we maintain long-term confidence in the protection brand offering and our market-leading positions remain strong. We continue to invest in and expand our application of element expertise in these markets, and we have taken actions to improve our cost structure and to enhance our competitiveness with destocking end. Regarding cash flow, we are very pleased with our continued cash flow improvement as we worked hard in 2023 to optimize working capital performance and especially to rightsize our inventory levels following the supply chain disruptions of 2022.

On a continuing operations basis, cash flow from operations of $646 million less capital expenditures of $145 million resulted in adjusted free cash flow of $501 million in the fourth quarter, a significant increase versus $188 million in the year ago period. Adjusted free cash flow conversion during the quarter was 133%, significantly ahead of last year.

Turning to Slide 6. Adjusted EPS for the quarter of $0.87 per share decreased from $0.89 in the year ago period. Lower segment earnings and certain below-the-line items, including a $0.05 headwind from foreign exchange losses led by devaluation of the Argentinian peso, more than offset an $0.08 benefit from a lower share count and a $0.03 benefit from a lower tax rate. Our tax rate for the quarter was 19.2%, down from 22.2% in the year ago period and lower than our previously communicated modeling guidance, driven by certain discrete tax benefits. Our full year tax rate for 2023 was 22.8%.

And our 2024 outlook assumes a base tax rate of 23% to 24%. Turning to segment results, beginning with E&I on Slide 7. We E&I fourth quarter net sales of $1.4 billion increased 1% as the Spectrum sales contribution of 8% was mostly offset by an organic sales decline of 7%. The organic sales decline reflects a 5% decrease in volume and a 2% decrease in price. At the line of business level, organic sales for semiconductor technologies were down high single digits versus the year ago period resulting from reduced semi fab utilization rates as customers work to reduce finished inventories.

We did see sequential improvement within semi as sales increased 2% in the fourth quarter, signaling stabilization for the business. Our customer interactions and reduced channel inventory levels point to continued recovery expected in semi during 2024 with sequential sales up slightly in the first quarter, an increased lift from the second quarter onwards. Within Interconnect Solutions, organic sales declined mid-single digits as low single-digit volume gains were more than offset by price decreases driven by lower metal pricing. Demand continues to stabilize, and this is the first quarter since the downturn started where we saw year-over-year volume growth. Organic sales for Industrial Solutions were down mid-single digits due primarily to channel inventory destocking within our Liveo product line for biopharma markets, and for products such as Kalrez O-rings, which are primarily used in semiconductor equipment. These declines were partially offset by continued strong demand for OLED display materials. Operating EBITDA for E&I of $378 million was down versus the year ago period due to volume declines and lower operating rates to better align inventory with demand, partially offset by Spectrum earnings contribution.

Turning to Slide 8. W&P fourth quarter net sales of $1.3 billion declined 15% versus the year ago period due to volume decline.

Within Safety Solutions, organic sales were down 20% on lower volumes, driven mainly by channel inventory destocking, most notably for Tyvek Medical Packaging products. Within Water, organic sales were down high teens driven by distributor inventory destocking and lower industrial demand in China. Shelter Solutions sales were down mid-single digits on an organic basis. The year-over-year decline has continued to improve, and we believe channel inventory destocking for construction has been completed based on distributor inventory now being back at normal levels. Operating EBITDA for W&P during the quarter of $314 million decreased 13% due to lower volumes

and reduced production rates, partially offset by lower input costs and certain discrete item benefits of about $25 million.

Turning to Slide 9. I'll review our first quarter 2024 outlook and full year guidance expectations. For the first quarter of 2024, we expect net sales of about $2.8 billion and operating EBITDA of about $610 million. On a volume basis, we are seeing similar inventory destocking trends from fourth quarter continue into 2024, driven by wire solutions in China and in several of our industrial-based businesses. Recovery timing is expected to vary by end market as the year progresses, but we expect first quarter at the bottom on a consolidated basis.

The expected sequential decline in operating EBITDA includes the absence of discrete items, which benefited fourth quarter as outlined earlier. The first quarter outlook also includes certain costs that further impact period margins primarily within W&P related to new capacity and safety as well as the impact of lower volume. For the second quarter, we expect mid-single-digit sequential sales improvement and approximate 10% increase in operating EBITDA from first quarter. This assumes volume improvement driven by reduced inventory destocking impacts in other solutions and medical packaging, continued electronics recovery and favorable seasonality in ICS and Shelter. Sequential EBITDA should benefit from this volume growth and additional realization of restructuring cost savings.

For the full year 2024, we expect net sales to be between $11.9 billion and $12.3 billion with operating EBITDA expected to be between $2.8 billion and $3 billion. Year-over-year sales growth in the second half is expected to be driven by ongoing electronics market recovery, including improvement in semiconductor fab utilization rate and continued utilization improvement for PCB manufacturing within ICS, along with further abatement of channel inventory destocking in our industrial businesses. For second half earnings, drivers include volume improvement outlined above alongside expected mix benefits as well as ongoing realization of cost savings. Our current outlook also includes a neutral net impact from price cost for the year as slight price declines are expected to be offset by the carryover benefit of lower input costs. We expect full year adjusted EPS in the range of $3.25 to $3.65 per share, which assumes the benefit of a lower share count is mostly offset by lower interest income, higher depreciation and a higher tax rate as detailed on our outlook slide.

With that, we are pleased to take your questions.

And I'll turn it back over to the operator to open the Q&A.

Operator^ (Operator Instructions) Your first question comes from Scott Davis with Melius Research.

Scott Davis^ I mean, no huge surprises here, but some of the commentary around kind of price versus cost seemed a little bit incrementally cautious. Is that just a function of kind of weaker demand in general, just sloppy demand that's out there? Is it kind of a mix, just given how weak China is? Just level set, maybe I'm overreading this a little bit so if we can just talk about kind of pricing power versus maybe what you're expecting overall in '24, that would be helpful.

Lori Koch^ Yes. So overall, full year, we have about a 1% price decline in total on the top line, and we expect carryover benefit from further raw material, logistics and energy savings to offset that to be neutral from a spread perspective for a year. So I wouldn't say it's any material change. We had always been in that camp in the raw material side. With the pricing, maybe we're being a little bit cautious just based on where the volumes fit in the first half. But overall, no material change. And I don't know that 1% total prices, all that material to the total company.

Edward Breen^ Scott, I'd also say -- I think we said on the last earnings call, there's a couple of end markets we would probably have to give up a little price to maintain our market position. I don't want to get into the details what they are on the call. But generally speaking, we're -- we have been holding price across the platform, and we continue to hold price across the platform. So really no change there at all.

Scott Davis^ Okay. That's helpful. And I think one change at the margin that we've seen this quarter is just China continues to be really weak and perhaps maybe even outlook for 2024 degrading a bit as we speak. But can you give us a little bit more color on your confidence in your guide as it relates to just the degradation in China being kind of over and perhaps we're at a bottom here?

Edward Breen^ Yes. So Scott, it was very interesting. I'll just kind of give you an overall DuPont comment on quarters and then specifically the water business in China, where we've seen our real significant destock. And by the way, overall, it was really interesting to watch. We were still declining, as we said, in the fourth quarter on our order rates.

But through the month of January, we've had high single-digit growth pretty much across the platform except for Kalrez and Biopharma, which we expect to come back later in the year before they pick up. I'll give you two other data points which are really interesting. And the Water business declined in the fourth quarter, but through the first month of January, our orders were up 13%. And a chunk of that was the water business in China. And interestingly there as you look at the order pattern of that increase, most of that starts May on, which is about what our distributors have been telling us when they bottom out on their inventory.

So -- and just another data point because it was one of the other ones we saw destock as we went through the back half of the fourth quarter was our Safety orders, which include medical packaging, which was another one that had the significant destock. Those orders were up 10% in the month of January. And that, by the way, is a shorter cycle book than water. Water is the only one we kind of get booked out three, four months because people are accustomed to having the book out that far, but most of our other businesses are very short cycle. So the 10% up on the safety orders and medical packaging would bode well for the lift that we're expecting to see from first to second quarter on the top line.

So it was really interesting. We were going still negative going into the end of the year and now pretty broadly positive for the month of January.

Lori Koch^ And I would say on volumes in China specifically, they did -- they are still down on a full year basis, but we did see less of a decline as the year went on and it varied by business. So obviously, E&I was kind of first into the China downturn, and they actually delivered 1% volume growth in China in the fourth quarter. And then as the year went on, we saw primarily the water business in China decelerate per Ed's comment. So it is still a tough market in China, but it looks like E&I is on the upswing, and we expect further improvement in the W&P business in water starting towards the tail line of the second quarter.

Operator^ Your next question comes from Mike Leithead with Barclays.

Michael Leithead^ I just wanted to follow up on the inventory dynamics in W&P. I guess can you maybe help us better understand how the fourth quarter unfolded? Did your customers just stop buying at some point? Or just kind of what caught you still off guard with the declines there? And then around the January improvement, you just talked about Ed. I guess what do you make of it? Does it seem like those just delayed orders from year-end? Or do you think end demand is truly getting better there?

Edward Breen^ Well, I think there was a couple of things. I think we got hit a little harder than we were expecting in the fourth quarter simply because it was most people's fiscal year-end, and they're aggressively trying to work down inventories.

By the way, as DuPont did, we were aggressively doing it. We accelerated it, as you could see from our cash flow and our inventory position even more in the fourth quarter. So I think it was just trended a little more than we expected.

I'd also say I would add to that, remember that in W&P, specifically, 50% of our business goes through distribution. So they can easily tell you just shut it off for two or three months and don't ship [EMEA]. And that's what we saw a little bit more than we were expecting. But very interesting, as I said, it is 1% month. It's not a quarter yet, but most of those and those distributor orders turned around in the month of January.

And again, it was pretty broad-based across the portfolio, ex a couple of these end markets that I talked about. And specifically, by the way, in safety, the distribution orders sort of coming into January, Shelter were very heavy through distribution. And we know we've bottomed that. We actually expect slight growth this quarter and that to build a little bit more as the year goes on. And then I mentioned the water one already, that's 40% globally through distribution, and it was mostly our distributor customers that delayed orders, not our end customers. So that's kind of the dynamic, but very interesting to see this January thing now.

Michael Leithead^ Great. That's super helpful. And then maybe a question --

Edward Breen^ Just an overall comment, we're 90% a short-cycle company. It can go down pretty quickly and it can go up pretty quickly. A lot of this is hangover from COVID excess inventory, people working it off. And so you can see the bounce back also.

Michael Leithead^ Makes a lot of sense. And then second, maybe just a quick question for Lori. Can you talk about your expected cash flow conversion in 2024 you gave us CapEx, but should we expect any material cash needs for restructuring, pension or just some other key items there?

Lori Koch^ Yes. So the pension should be roundly $50 million to $60 million of a cash funding. So no material difference from where it was in 2023. We had noted the CapEx, which also isn't a material change from 2023, we would expect to be, again, around the target of 90% conversion for 2024. We'll see how the timing of the volume lift unfolds, that could create a receivables headwind as you get into the back half of the year as you see that nice volume lift year-over-year.

So I expect it to deliver strong cash flow. We made a lot of progress on one of the areas that we really focused on with respect to inventory in 2023, and we're not going to give back that benefit that we saw and we work to hold on to those gains.

Operator^ Your next question comes from Josh Spector with UBS.

Joshua Spector^ Just on the second half expectations. So obviously, visibility is pretty low. But I mean, at the high end of your guide, you're kind of projecting that you could see EBITDA upsell 15% maybe in the second half. What needs to happen for that to play out? Kind of what's the expectation on the volume or restocking dynamic that would see you get to that end of the range?

Edward Breen^ Yes. So by the way, just a few bullet points on kind of first half, second half ramp there. Obviously, the increased semi fab and PC utilization rates. Remember, semi is a very high-margin business for us. So we see that coming back. And we've already started to see, as we just commented slightly, we're seeing an improvement. It was about 2% in the quarter. So we clearly bottomed out there and we'll now lift.

Destock will be mostly complete in the second half of the year. The only ones that might slip into the fourth quarter and we've taken that into account as biopharma and Kalrez, although many in biopharma think that's going to lift by the inflection point at the middle of the year, we're a little more cautious than it's -- maybe more of a fourth quarter and then clearly improved factory absorption from the hits we've been taking there to keep inventory in line. And then we'll have more of the cost savings from the restructuring program.

So I'd say that's the big items that kind of build first half, second half. And obviously, just volume ramp in general because of destock ending.

Joshua Spector^ Okay. That's helpful. And just to maybe follow-up, just more on the first half. Are there discrete items we should be thinking about first quarter to second quarter so that 10% lift you potentially see, I guess, is there a headwind baked in there in the first quarter because you're taking additional inventory actions that's [ex] or something else that actually absent a material demand improvement improves earnings? Or is this more destocking volume driven?

Lori Koch^ Yes. So sequentially, a lot of it is volume driven. So we see about $150 million of revenue ramp first quarter to second quarter. That's primarily volume. We also see a little bit of a build in the cost savings program.

So we had mentioned it will really kick in at the end of Q1. So you'll see some ramp as you head into Q2. Those are the biggest items. The largest improvement is going to be the volume increase so first quarter to second quarter.

Operator^ Your next question comes from John Roberts with Mizuho.

John Roberts^ Just one for me. In Shelter Solutions now that the channel is destocked, are you expecting a normal seasonal sequential improvement or below normal in that segment?

Lori Koch^ We would expect normal. So normally, 2Q and 3Q are the best quarters for Shelter within 1Q and 4Q being lower than those averages.

Operator^ Your next question comes from David Begleiter with Deutsche Bank.

David Begleiter^ You have a very valuable electronics business as not being valued by the market. What are the options in your mind to unlock or have that value being realized?

Edward Breen^ Well, David, I think, look, we've got -- we're working our way through this destock. And I think the year is going to lift very nicely. I think we just have to be patient to see how it looks as we're kind of exiting 2024. And I think we haven't been in stability here with the destock going on in the short-cycle nature.

But to your point, David, it's a phenomenal franchise. We're in the sweet spot of it. We got a lot of upside coming with the AI opportunity. All these new facilities, fabs we have built are mostly advanced chips, which plays even more to our strength. So when people can really see these numbers cranking again, as we're going through the second half of the year, we'll see how the company is valued.

David Begleiter^ Very good. And just on PFAS, what's your expectation for improvement on that issue this year?

Edward Breen^ Well, we're -- I think we're within days or a couple of weeks of the judge finally getting the whole water district thing done [and] all. I think it was just -- they're probably waiting. I think what's going on is they're just waiting to get an announcement from all the companies have. And I think 3M just last Friday, had their a preliminary hearing. So I think that's very, very close to being finalized here.

And then -- nothing will happen on the personal injury cases most likely this year. However, our kind of takes, we like to settle these things before there's any trial, but they're going through picking some of the -- or who would be the initial ones that would go to trial. I think there's 28 of those on the list right now and the judge and all will narrow that down to a smaller group. But I don't think that's a 2024 issue on that.

Operator^ Your next question comes from John McNulty with BMO Capital Markets.

John McNulty^ So, Ed, we have a lot of new fabs coming on, I mean just kind of looking at kind of high level, it looks like almost double digit coming on this year and then again in '25 and '26. I guess can you help us or remind us when you get those wins, like when you see that? And how much of that cake is baked at this point? And then maybe any commentary on share wins or shifts that you might have seen on some of these fabs that are coming up?

Edward Breen^ Yes, sales process works. We do a lot of application engineering and development directly with the -- really, it's about 10 major customers in the semi side. So it's really the win we get there, where it's processed at a fab is somewhat irrelevant to us. Although we like the fact that these fabs are coming on because the world thinks there's a lot of demand coming over the next cycle here in the semi world, which there should be because everything needs to chip nowadays and more of its advanced chips. So -- but our win rate is really at the design stage with these 10 large customers around the world.

And again, where they make it doesn't really matter that much to us, but still a very good sign. And I'd say, overall, market share does not shift much in this business. There's a couple of key players, especially on the higher-end chips and market share is pretty steady across the board year in and year out.

John McNulty^ Got it. Fair enough. And then on the Shelter Solutions side of the business, can you help us to think about what the utilization rates are now that it looks like you've kind of bottomed out in that business? And then how we should think about the incrementals on that as volume starts to really come back?

Lori Koch^ Yes. So we had mentioned we saw an improvement in volume as the year went on. The volumes in Shelter were kind of down about 4% in the fourth quarter, and we expect them to be slightly up in the first quarter and then build from there to about 4% by the time we close out the year. So the utilization rates will definitely improve. This is not a high fixed cost plant -- fixed cost business.

So when we talked about the absorption headwinds that we saw throughout 2023, that was primarily in the E&I side, and then it started to kick in a little bit on the safety side with the heavy assets in that portfolio. So if there isn't a huge absorption headwind

within Shelter, and -- but we will see some benefit from volume that would have a little bit of benefit absorption as the year goes on.

Operator^ Your next question comes from Steve Tusa with JPMorgan.

Stephen Tusa^ Is there any reason over the course of this recovery, why your business should decouple from broad electronics trends? I mean, are you guys less exposed to what's going on in AI and data center? Have you guys -- do you think you've lost share anywhere because a different technology is required in those applications. I mean it just seems like electronics right now is kind of a multispeed world. And I think I would have expected a little more out of you guys so far, but maybe just some comments on how kind of coupled you're going to be to that recovery?

Edward Breen^ I think we're very coupled to it because the because one of the big demand drivers next year is data center and that's a lot of advanced chip applications. I won't say the customer's name, but there's one that's been out there very steadily that is requiring a lot of advanced chips that is a key customer of ours. So that whole drive towards AI data center and the need for advanced chips plays right to the sweet spot of our portfolio. So no, we won't decouple at all. There's no area that's going to grow faster in the semi side that we will participate in.

That truly is our sweet spot as we go forward here. Remember, in a typical times, we've consistently outgrown the market to 300 basis points because of that dynamic.

Lori Koch^ Yes. I think Steve too, so on the semi -- semi is around a $2 billion business for us, about $700 million of that is data center. So it's a pretty large chunk. If you look at the results and the forecast that the OEMs are providing, it's oftentimes skewed by the price of the chip, which has no impact on our volumes and our revenues.

So that's one thing that we maybe just to clarify to make sure that you're seeing, lift in some of the OEMs, it's probably right now more coming from price especially on the memory side, our portfolio is about 30% memory, 70% logic foundry from a disposition perspective as well.

Stephen Tusa^ Sorry. So you said $700 million of that as to what you can see clearly as being like data center-related customers?

Edward Breen^ Yes.

Lori Koch^ Yes.

Stephen Tusa^ And how fast did that grow in like the fourth quarter? Or did it grow in the fourth quarter?

Lori Koch^ Yes. So overall, semi volumes in the fourth quarter were down in the high single digits as some of the OEMs continue to destock. So that's one other piece too, is they could still be producing and they're producing out of inventory versus buying new materials to add to their inventory. But if you compare our results that happened release year-to-date versus the peers that sell materials in those subsegments they are in line.

Operator^ Your next question comes from Aleksey Yefremov with KeyBanc Capital Markets.

Aleksey Yefremov^ I wanted to come back to water filtration in China. Do you have visibility into the underlying demand? Apparently, you do have destocking, but what data points are you tracking to understand how healthy the actual market is?

Edward Breen^ Yes. So Aleksey, it's a great question.

I would say true demand is down 3% or 4% negative. If you look at our direct customers, we sell to over there, they had a little bit of destocking going on at their end. But by and large, when you look at their demand, again, they're in the 3% to 4%, some of our 5% down somewhere right in that range.

But if you go to our distributor customers, they were down over 30%. And that's where we started to see orders come back through January for deliveries kind of in the May, June, July timeframe. And as I mentioned earlier, the water orders in January were up

13%. And a big part of that was the China orders from the distributors. So the market is definitely down a little bit.

But if we could just get all the destocking to come back, that's a huge swing for us even if the market for a little bit phased down. So the inventory in China on water will bottom in that kind of May, June timeframe. And that's why I think we're starting to, obviously, then see these orders, at least preliminarily in January, come in kind of for that time period.

Lori Koch^ And just from a logistics perspective, Ed mentioned --

Edward Breen^ Go ahead, Lori.

Lori Koch^ Just real quick on the logistics perspective. So Ed had mentioned an expected bottoming of the distributor inventory levels in China in the May-June timeframe. We ship from the U.S. to them primarily. There's about a 60-day lag between when they need the material at their facility versus when we ship it, and then we recognize the revenue when we ship it. So there will be a bit of a favorable impact from our perspective on revenue versus when it arrives at their facilities for use in China.

Aleksey Yefremov^ So what is the sort of 2- to 3-year growth rate for the water business? Will it step down you think because China is slower or this is temporary?

Lori Koch^ Yes. We think it should still be in the mid-single-digit range. So we think that China is just resolving of some higher inventory levels. If you look back at the volumes before we started to see a downturn globally, I'm going to talk about global volumes. Water was up 8% in full year 2022. And then in the first half, it was up 4% in Q1 and 9% in Q2, and then we started to see the downturn in Q3.

So we think it's a temporary dislocation. There's still a lot of confidence and opportunity for outsized growth versus GDP in the water business.

Operator^ Your next question comes from Patrick Cunningham with Citi.

Patrick Cunningham^ I'm just curious on your expectations for the retained businesses in the corporate segment into the year given maybe we're starting to see a challenging auto and EV backdrop into the first half of the year.

Lori Koch^ Yes. So 2023 was very favorable for the auto industry kind of up in that high single-digit range, and we would outperform that in the EV space just by about 25% to 30% of our portfolio is now EV. On a full year basis, though, for 2024, we do see it about flat from a volume perspective in line with where auto builds are. So obviously, China is going to slow down a bit in 2024 off of a really strong 2023, especially tail end of 2023. But longer term, we're still very confident in the EV expansion opportunity and the pace of the growth, and we have a really nice position to continue to benefit from that, not only in the corporate retained businesses primarily with adhesives, but also within the W&P portfolio, Nomex, we've got a really nice opportunity on the e-motor side of the house that's using Nomex as the way it is.

Patrick Cunningham^ Got it. Very helpful. And then just on Spectrum, how is it performing relative to expectations? And has it been hit by any residual destocking or deterioration in primary demand?

Lori Koch^ Yes. It's in line with our expectations. It's ramping nicely with the new customer win that we highlighted when we acquired the business that's going very well. We've actually integrated the business within the company and combined it with our Liveo Healthcare business to further take advantage of those commercial synergies that continues to be a nice opportunity for us.

Operator^ Your next question comes from Vincent Andrews with Morgan Stanley.

Vincent Andrews^ First, can I just clarify on the full year remarks. When you talk about sales and profit growth in the back half, are you talking 3Q and 4Q? Or maybe not 3Q, but definitely 4Q?

Lori Koch^ It starts in 3Q. It's greater in 4Q from a year-over-year perspective.

Vincent Andrews^ Okay. And then, Ed, can I ask you the destocking is what it is and it's going to be what it's going to be. But thereafter, in managing these businesses and

investing in them and presenting them to the investment community, how do you think about shipments versus demand and making sure that we don't get into another situation where the supply chain lines up with more products than it will ultimately want? Or is that not something that you can really have the visibility on to control and that, too, will just be what it's going to be?

Edward Breen^ Vincent, only twice in my like, I think, 26 years now doing this, has this happened. So it's a very rare event. I mean it was obviously look, you know the semi stores, just they overshot so much on inventory. But a lot of this was COVID-driven the craziness of the supply chain. It's just not something that would normally happen.

It really is kind of one of those once in opportunities or dislocations let me say it that way. And by the way, interestingly, it goes down rapidly in a short cycle and can go up rapidly. It happened -- by the way, the little bit of '08, '09 was destocking. It was mostly a true recession where demand was down, but I'd say about a third of that then turned into destocking because of the situation, and so it got worse quicker than people were expecting, but that recovered also fairly quick. So I don't -- I just don't see something like this happening again.

And we are almost, as I said, almost all a short-cycle business so we really saw it across a lot of the portfolio in normal times, you're just not going to overshoot. Semi will overshoot once in a while, but not to the extent of what we saw here the severity of it.

Operator^ Your next question comes from Frank Mitsch with Fermium Research.

Frank Mitsch^ Ed, you indicated that, obviously, you made a proactive decision to work down your inventories. And you've mentioned a couple of times the negative impact effect factory absorption in 4Q and in '23. I was wondering if you could size that for us? And obviously, the expectation is that, that's not necessarily going to continue in '24, so that should be a nice tailwind for you.

Lori Koch^ Yes, Frank, we had a little north of $200 million of absorption headwinds in 2023. Most of that in E&I did kick in a little bit towards the tail end of the year in 2023 for W&P and that will continue in Q1 as well. So we do see absorption headwinds in Q1. Right now, given that our full year midpoint guide of $12.1 billion is about flat with this

year -- is on a year-over-year basis, we don't really see material absorption, tailwinds because volumes aren't materially improving.

There will be improvement first half, second half because the volume story is different first half, second half. But in the guide that we have provided, we didn't take in material benefits. Obviously, if that plays out (inaudible) that could be a change -- a positive change. But initially, that's where we sit.

Frank Mitsch^ Okay. Got you. So perhaps there's some conservatism built in there, which I kind of got the sense when you're talking about price cost for '24 being neutral, I would assume that you saw some benefits from price cost in the fourth quarter, could you size that for us?

Lori Koch^ Yes. We did see benefits in the fourth quarter in the $50 million to $75 million range. We do see some further tailwinds year-over-year in Q1, just really from that carryover benefit of the raws that we were buying that were stuck in inventory and are now coming out. But right now, our view is that we would still see those benefits about $100 million on a full year basis in '24, but we expect about a 1% price give back with -- a lot of it being in the Shelter business as we had kind of been flagging all along. That's where we got the most price to begin with in the 2022, 2023 timeframe.

Operator^ Your next question comes from Arun Viswanathan with RBC Capital Markets.

Arun Viswanathan^ Obviously, a lot of the questions have been answered. But just wanted to reconfirm, so I know that you made the statement that your volumes could snap back quickly. But is that -- are you at all concerned with that happening now with maybe China growing at a slightly lower structural growth rate going forward? Maybe you can just comment on what you're hearing out of China.

Lori Koch^ Yes. I mean even if China potentially is at a lower structural growth rate year-over-year, it's coming off a pretty (inaudible). So full year volumes in China were down in the mid-teens. And so it's not a high hurdle to jump off of as you head into 2024 to deliver growth. We still have a lot of confidence longer term in those markets that are highly rooted in China, especially on the electronics side and on the water side we expect improvement.

Edward Breen^ Yes, just turning to the electronics side. I don't think we're being overly aggressive. We've talked to our large customers when you look at the fab utilizations. We're basically going from the low 70s we said to the low 80s. In really good times, they run in the '90s. So we probably still have more upside that would kick in, in that part of the business even going into 2025. It's not all -- we're not assuming it all snaps back in 2024 to where it had been running.

Arun Viswanathan^ Right. And then given that we have experienced a fair amount of volatility here in cyclicality, one of the transformation kind of strategies was to reduce that peak to trough cyclicality. Do you feel still the same way about the current portfolio as far as lowering that cyclicality post transfer (multiple speakers) other businesses that would qualify for disposition at this point?

Edward Breen^ No. No. I totally feel in normal times, it will be more consistent portfolio and unusual time here with the destock and the inventory build from COVID and all short cycle, but now these are good secular businesses. We've got good market position. So we feel good about where we're at. Just got to get through this period and start lifting.

Operator^ Your next question comes from Steve Byrne with Bank of America.

Steve Byrne^ Your businesses within W&P heavily relying on distributors. I'm curious how much visibility do you have, not just on your own products in inventory at these distributors, but competitor products. And the reason I asked is I'm just wondering whether or not you're seeing the potential for a shift to competitor products perhaps in water in China. Anything that you're seeing there that is a concern on the competitive front?

Edward Breen^ No. Steve -- and we -- by the way, we're tracking -- because of [sources], we're tracking way closer with our distributors. The good news is our distributors in China, there's a handful of really big ones. So if we can get our arms around that. We've asked the competitive issue, and we're very close to them. I don't see any issues there at all.

Steve Byrne^ Okay. And how would you look at your businesses and highlight any opportunities for a new technology or a new application of your products that could really drive growth? Anything that you would highlight an example would be like water moving into lithium extraction. Do you see any meaningful (multiple speakers) --

Edward Breen^ Yes. It's -- I would give you two and you just said the one. The lithium opportunity could be substantial for us because that needs a ton of filtration as you guys know. And the other, I would just say big trend out there that we've already talked to. But has a real good opportunity for us because it's in our sweet spot is the whole AI thing. I would say they would be the two big ones.

Operator^ Our final question comes from Mike Sison with Wells Fargo.

Michael Sison^ Ed, when you think about the earnings power of DuPont, when you look at the second half of '24, the run rate EBITDA is going to be much higher than the first half. So when we think about growing into '25 and beyond, so we take that second half run rate and then -- where do you think the earnings power is longer term, '26, '27 in terms of EBITDA?

Lori Koch^ Yes. I mean we, obviously, exited a higher margin than where we started the year. So our current expectations is we would exit butting up against 26% EBITDA margin in the fourth quarter. We've always said that we think the EBITDA margin profile for the total company should be in that 27%, 28% range, and we don't have a change to that with E&I being in the low 30s and W&P in the kind of mid-20s. So we exit the year, as I had mentioned, butting up against 26% kind of in the low $800 range.

If you look back to our peak earnings in late 2022, they were more in that $850 range, and they didn't have Spectrum in them. There's still a clearly opportunity for us to see to expand beyond that run rate that we'll expect to see at the end of this year.

Edward Breen^ And maybe just to add one for the longer term, and again, stabilized times half this portfolio should outgrow GDP and the other half should grow with GDP, just to give you a feel and that would be the magnitude. One of the things, as I mentioned a minute ago, still has to come back even more in 2025 is the semi industry and the utilization rates still to climb from where we would exit '24.

DuPont Specialty Products USA, LLP

4Q 2023 Earnings

Operator^ This concludes our Q&A session. I will now turn the call back to Chris McCray for any closing remarks.

Chris Mecray^ Well, thank you all for joining the call. For your reference, a copy of the transcript will be posted on our website as usual. This concludes our call. Thank you.

Operator^ This concludes today's conference. You may now disconnect.