EASTMAN CHEMICAL CO
Form 10-Q
August 03, 2010

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549
FORM 10-Q

(Mark One)	
[X]	QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 For the quarterly period ended June 30, 2010 OR
[ ]	TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 For the transition period from ______________ to ______________

Commission file number 1-12626

EASTMAN CHEMICAL COMPANY
(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	62-1539359 (I.R.S. employer identification no.)
200 South Wilcox Drive Kingsport, Tennessee (Address of principal executive offices)	37662 (Zip Code)

Registrant's telephone number, including area code: (423) 229-2000

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES [X] NO [ ]

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

YES [ ] NO [ ]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer [X]	Accelerated filer [ ]
Non-accelerated filer [ ] (Do not check if a smaller reporting company)	Smaller reporting company [ ]

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

YES [ ] NO [X]

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Number of Shares Outstanding at June 30, 2010
Common Stock, par value $0.01 per share	72,242,224

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UNAUDITED CONSOLIDATED STATEMENTS OF EARNINGS,
COMPREHENSIVE INCOME AND RETAINED EARNINGS

(Dollars in millions, except per share amounts)	Second Quarter 2010	Second Quarter 2009	First Six Months 2010	First Six Months 2009
Sales	$ 1,724	$ 1,253	$ 3,288	$ 2,382
Cost of sales	1,320	993	2,563	1,943
Gross profit	404	260	725	439
Selling, general and administrative expenses	108	98	211	192
Research and development expenses	36	34	72	68
Asset impairments and restructuring charges, net	3	(3)	3	23
Operating earnings	257	131	439	156
Net interest expense	25	20	50	39
Other charges (income), net	8	5	14	9
Earnings before income taxes	224	106	375	108
Provision for income taxes	76	41	126	41
Net earnings	$ 148	$ 65	$ 249	$ 67
Earnings per share				
Basic	$ 2.05	$ 0.89	$ 3.44	$ 0.92
Diluted	$ 2.02	$ 0.89	$ 3.38	$ 0.91
Comprehensive Income				
Net earnings	$ 148	$ 65	$ 249	$ 67
Other comprehensive income (loss), net of tax				
Change in cumulative translation adjustment	(9)	25	(21)	15
Change in unrecognized losses and prior service credits for benefit plans	6	(2)	9	(2)
Change in unrealized gains on derivative instruments	2	(8)	8	1
Total other comprehensive income (loss), net of tax	(1)	15	(4)	14
Comprehensive income	$ 147	$ 80	$ 245	$ 81
Retained Earnings				
Retained earnings at beginning of period	$ 2,640	$ 2,533	$ 2,571	$ 2,563
Net earnings	148	65	249	67
Cash dividends declared	(32)	(32)	(64)	(64)
Retained earnings at end of period	$ 2,756	$ 2,566	$ 2,756	$ 2,566

The accompanying notes are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

(Dollars in millions, except per share amounts)	June 30, 2010 (Unaudited)	December 31, 2009
Assets		
Current assets		
Cash and cash equivalents	$ 435	$ 793
Trade receivables, net	721	277
Miscellaneous receivables	88	102
Inventories	635	531
Other current assets	30	32
Total current assets	1,909	1,735
Properties		
Properties and equipment at cost	8,631	8,525
Less: Accumulated depreciation	5,476	5,415
Net properties	3,155	3,110
Goodwill	376	315
Other noncurrent assets	359	355
Total assets	$ 5,799	$ 5,515
Liabilities and Stockholders' Equity		
Current liabilities		
Payables and other current liabilities	$ 880	$ 800
Borrowings due within one year	6	--
Total current liabilities	886	800
Long-term borrowings	1,605	1,604
Deferred income tax liabilities	285	258
Post-employment obligations	1,216	1,221
Other long-term liabilities	130	119
Total liabilities	4,122	4,002
Stockholders' equity		
Common stock ($0.01 par value – 350,000,000 shares authorized; shares issued – 95,417,504 and 94,775,064 for 2010 and 2009, respectively)	1	1
Additional paid-in capital	697	661
Retained earnings	2,756	2,571
Accumulated other comprehensive loss	(389)	(385)
	3,065	2,848
Less: Treasury stock at cost (23,257,954 shares for 2010 and 22,389,696 shares for 2009)	1,388	1,335
Total stockholders' equity	1,677	1,513
Total liabilities and stockholders' equity	$ 5,799	$ 5,515

The accompanying notes are an integral part of these consolidated financial statements.

UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in millions)	First Six Months 2010	2009
Cash flows from operating activities		
Net earnings	$ 249	$ 67
Adjustments to reconcile net earnings to net cash provided by (used in) operating activities:		
Depreciation and amortization	139	134
Provision for deferred income taxes	12	140
Changes in operating assets and liabilities, net of effect of acquisitions and divestitures:		
(Increase) decrease in trade receivables	(433)	(52)
(Increase) decrease in inventories	(90)	191
Increase (decrease) in trade payables	90	(55)
Increase (decrease) in liabilities for employee benefits and incentive pay	(10)	(22)
Other items, net	24	(66)
Net cash provided by (used in) operating activities	(19)	337
Cash flows from investing activities		
Additions to properties and equipment	(76)	(204)
Proceeds from sale of assets and investments	11	25
Acquisitions and investments in joint ventures	(189)	(36)
Additions to capitalized software	(3)	(4)
Other items, net	--	(7)
Net cash used in investing activities	(257)	(226)
Cash flows from financing activities		
Net increase in commercial paper, credit facility, and other borrowings	1	9
Repayment of borrowings	--	(2)
Dividends paid to stockholders	(64)	(64)
Treasury stock purchases	(53)	--
Proceeds from stock option exercises and other items	33	9
Net cash used in financing activities	(83)	(48)
Effect of exchange rate changes on cash and cash equivalents	1	--
Net change in cash and cash equivalents	(358)	63
Cash and cash equivalents at beginning of period	793	387
Cash and cash equivalents at end of period	$ 435	$ 450

The accompanying notes are an integral part of these consolidated financial statements.

NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

1. BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements have been prepared by Eastman Chemical Company (the "Company" or "Eastman") in accordance and consistent with the accounting policies stated in the Company's 2009 Annual Report on Form 10-K and should be read in conjunction with the consolidated financial statements in Part II, Item 8 of the Company's 2009 Annual Report on Form 10-K. The unaudited consolidated financial statements are prepared in conformity with accounting principles generally accepted in the United States ("GAAP") and, of necessity, include some amounts that are based upon management estimates and judgments. Future actual results could differ from such current estimates. The unaudited consolidated financial statements include assets, liabilities, revenues, and expenses of all majority-owned subsidiaries and joint ventures. Eastman accounts for other joint ventures and investments where it exercises significant influence, but does not have control, on the equity basis. Intercompany transactions and balances are eliminated in consolidation. Certain prior period data has been reclassified in the Consolidated Financial Statements and accompanying footnotes to conform to current period presentation.

Effective January 1, 2010, the Company adopted amended accounting guidance on transfers of financial assets. The impact of this guidance is prospective with changes in first six months Statements of Consolidated Financial Position and the Statements of Cash Flows. For additional information, refer to Notes 8, "Borrowings," and 11, "Commitments."

2. ACQUISITIONS

Genovique Specialties Corporation
On April 30, 2010, Eastman completed the stock purchase of Genovique Specialties Corporation ("Genovique"), which has been accounted for as a business combination. Genovique is a global producer of specialty plasticizers, benzoic acid, and sodium benzoate. This acquisition includes Genovique's manufacturing operations in Kohtla-Järve, Estonia, Chestertown, Maryland, and a joint venture in Wuhan, China. Genovique's benzoate ester plasticizers are a strategic addition to Eastman's existing general-purpose and specialty non-phthalate plasticizers. The acquisition adds differentiated, sustainably-advantaged products to Eastman's Performance Chemicals and Intermediates ("PCI") segment and enhances the Company's diversification into emerging geographic regions.

The total purchase price was approximately $160 million, including assumed debt of $5 million. Transaction costs associated with the acquisition were expensed as incurred. The table below shows the preliminary fair value purchase price allocation for the Genovique acquisition:

	Dollars in millions
Current assets	$ 48
Properties and equipment	33
Intangible assets	59
Other noncurrent assets	2
Goodwill	64
Current liabilities	(17)
Long-term liabilities	(29)
Total purchase price	$ 160

Acquired intangible assets consist of $44 million in established customer relationships, $14 million in trade names, and $1 million in developed technology. The customer relationships and developed technology intangible assets have remaining useful lives of 16 and 7 years, respectively. Trade names have been determined to have an indefinite life. Goodwill, which represents the excess of the purchase price over the net tangible and intangible assets acquired and liabilities assumed, is attributed to the synergies between the acquired company and Eastman.

NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Korean Acetate Tow Facility
On March 22, 2010, Eastman Fibers Korea Limited ("EFKL") completed the purchase of the acetate tow facility in Ulsan, Korea from SK Chemicals Co., Ltd. ("SK"), which has been accounted for as a business combination. EFKL is a venture between the Company and SK, in which the Company has controlling ownership and operates the facility. This acquisition established acetate tow manufacturing capacity for the Company in Asia and supports projected long term sales growth for acetate tow in the region.

The fair value of total consideration was $111 million, which was paid in installments beginning first quarter 2009 and completed second quarter 2010. The Company has determined the preliminary fair value of the acquired assets to be as follows: property, plant, and equipment of $101 million, inventory of $5 million, and technology of $5 million.

3. ASSET IMPAIRMENTS AND RESTRUCTURING CHARGES, NET

In second quarter 2010, there were $3 million in restructuring charges primarily for severance associated with the acquisition and integration of Genovique.

In second quarter 2009, there was a $3 million reduction of the first quarter 2009 restructuring charge resulting in a net $23 million charge in first six months 2009. The charges, primarily for severance, resulted from a reduction in force.

Changes in Reserves for Asset Impairments, Restructuring Charges, and Severance Charges

The following table summarizes the beginning reserves, charges to and changes in estimates to the reserves as described above, and the cash and non-cash reductions to the reserves attributable to asset impairments and the cash payments for severance and site closure costs for full year 2009 and first six months 2010:

(Dollars in millions)	Balance at January 1, 2009	Provision/ Adjustments	Non-cash Reductions	Cash Reductions	Balance at December 31, 2009
Non-cash charges	$ --	$ 179	$ (179)	$ --	$ --
Severance costs	5	23	--	(23)	5
Site closure and other restructuring costs	25	(2)	--	(18)	5
Total	$ 30	$ 200	$ (179)	$ (41)	$ 10

	Balance at January 1, 2010	Provision/ Adjustments	Non-cash Reductions	Cash Reductions	Balance at June 30, 2010
Non-cash charges	$ --	$ --	$ --	$ --	$ --
Severance costs	5	3	--	(6)	2
Site closure and other restructuring costs	5	--	--	--	5
Total	$ 10	$ 3	$ --	$ (6)	$ 7

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NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

4. INVENTORIES

(Dollars in millions)	June 30, 2010	December 31, 2009
At FIFO or average cost (approximates current cost)		
Finished goods	$ 612	$ 547
Work in process	189	168
Raw materials and supplies	297	262
Total inventories	1,098	977
LIFO Reserve	(463)	(446)
Total inventories	$ 635	$ 531

Inventories valued on the LIFO method were approximately 70 percent and 75 percent of total inventories as of June 30, 2010 and December 31, 2009, respectively.

5. GOODWILL AND INTANGIBLE ASSETS

Changes in the carrying amount of goodwill are as follows:

(Dollars in millions)	CASPI Segment	PCI Segment	Other Segments	Total
Reported balance at December 31, 2009	$ 309	$ 1	$ 5	$ 315
Additions	--	64	--	64
Currency translation adjustments	(3)	--	--	(3)
Reported balance at June 30, 2010	$ 306	$ 65	$ 5	$ 376

As a result of the purchase of Genovique during second quarter 2010, the Company recorded goodwill of $64 million. The remaining goodwill and indefinite-lived intangibles primarily consist of goodwill in the Coatings, Adhesives, Specialty Polymers and Inks ("CASPI") and PCI segments. Included in the reported balance for goodwill are accumulated impairment losses of $44 million at December 31, 2009 and June 30, 2010.

Intangible assets include developed technology, customer lists, patents and patent licenses, and trademarks with a net book value of $102 million as of June 30, 2010 and $43 million as of December 31, 2009. As a result of the Genovique acquisition, the Company recorded $59 million in customer relationships, technology, and other intangible assets. Intangible assets are included in other noncurrent assets on the balance sheet.

Refer to Note 2, "Acquisitions" for further details regarding the acquisition of Genovique.

6. PAYABLES AND OTHER CURRENT LIABILITIES

(Dollars in millions)	June 30, 2010	December 31, 2009

Trade creditors	$	540	$	433
Accrued payrolls, vacation, and variable-incentive compensation		104		125
Accrued taxes		30		33
Post-employment obligations		63		61
Interest payable		31		32
Other		112		116
Total payables and other current liabilities	$	880	$	800

The current portion of post-employment obligations is an estimate of current year payments.

NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

7. PROVISION FOR INCOME TAXES

(Dollars in millions)	Second Quarter 2010	Second Quarter 2009	First Six Months 2010	First Six Months 2009
Provision for income taxes	$ 76	$ 41	$ 126	$ 41
Effective tax rate	34 %	39 %	33 %	38 %

Excluding discrete items, second quarter and first six months 2010 effective tax rates reflect the Company's expected full year tax rate on reported earnings before income taxes of approximately 33 percent. Second quarter and first six months 2009 effective tax rates reflect a $7 million tax charge associated with a change in accounting method for tax purposes to accelerate timing of deductions for manufacturing repairs expense.

The Company or one of its subsidiaries files tax returns in the U.S. federal jurisdiction, and various states and foreign jurisdictions. With few exceptions, the Company is no longer subject to U.S. federal, state and local, or non-U.S. income tax examinations by tax authorities for years before 2005. It is reasonably possible that within the next 12 months the Company will recognize approximately $2 million of unrecognized tax benefits as a result of the expiration of relevant statutes of limitations.

8. BORROWINGS

(Dollars in millions)	June 30, 2010	December 31, 2009
Borrowings consisted of:		
7% notes due 2012	$ 151	$ 152
6.30% notes due 2018	204	205
5.5% notes due 2019	250	250
7 1/4% debentures due 2024	498	497
7 5/8% debentures due 2024	200	200
7.60% debentures due 2027	298	298
Other	10	2
Total borrowings	1,611	1,604
Borrowings due within one year	(6)	--
Long-term borrowings	$ 1,605	$ 1,604

At June 30, 2010, the Company had a $700 million revolving credit facility ("Credit Facility") in two tranches, with $125 million expiring in 2012 and $575 million expiring in 2013. Borrowings under the Credit Facility are subject to interest at varying spreads above quoted market rates and a facility fee is paid on the total commitment. In addition, the Credit Facility contains a number of customary covenants and events of default, including the maintenance of certain financial ratios. The Company was in compliance with all such covenants for all periods presented. At June 30, 2010 and December 31, 2009, the Company had no outstanding borrowings under the Credit Facility.

The Credit Facility provides liquidity support for commercial paper borrowings and general corporate purposes. Accordingly, any outstanding commercial paper borrowings reduce borrowings available under the Credit

Facility. Given the expiration dates of the Credit Facility, any commercial paper borrowings supported by the Credit Facility are classified as long-term borrowings because the Company has the ability and intent to refinance such borrowings on a long-term basis.

NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

At June 30, 2010, the Company also had a $200 million line of credit under its annually renewable accounts receivable securitization agreement ("A/R Facility"). The A/R Facility was renewed in July 2010. Borrowings under the A/R Facility are subject to interest rates based on a spread over the lender's borrowing costs, and the Company pays a fee to maintain availability of the A/R Facility. In addition, the A/R Facility contains a number of customary covenants and events of default, including the maintenance of certain financial ratios. The Company was in compliance with all such covenants for all periods presented. At June 30, 2010, the Company had no outstanding borrowings under the A/R Facility. Refer to Note 11, "Commitments" for further details regarding the A/R Facility.

9. RETIREMENT PLANS

DEFINED BENFIT PENSION PLANS

Eastman maintains defined benefit pension plans that provide eligible employees with retirement benefits. Costs recognized for these benefits are recorded using estimated amounts, which may change as actual costs derived for the year are determined.

Below is a summary of the components of net periodic benefit cost recognized for Eastman's significant defined benefit pension plans:

Summary of Components of Net Periodic Benefit Costs

	Second Quarter		First Six Months	
(Dollars in millions)	2010	2009	2010	2009
Service cost	$ 11	$ 10	$ 22	$ 21
Interest cost	21	22	42	43
Expected return on assets	(26)	(25)	(53)	(49)
Amortization of:				
Prior service credit	(4)	(4)	(8)	(8)
Actuarial loss	11	10	22	17
Net periodic benefit cost	$ 13	$ 13	$ 25	$ 24

POSTRETIREMENT WELFARE PLANS

Eastman provides a subsidy toward life insurance and health care and dental benefits for eligible retirees hired prior to January 1, 2007, and a subsidy toward health care benefits for retirees' eligible survivors. In general, Eastman provides those benefits to retirees eligible under the Company's U.S. plans. Similar benefits are also made available to retirees of Holston Defense Corporation, a wholly-owned subsidiary of the Company that, prior to January 1, 1999, operated a government-owned ammunitions plant.

Eligible employees hired on or after January 1, 2007 have access to postretirement health care benefits, but Eastman does not provide a subsidy toward the premium cost of postretirement benefits for those employees.

A few of the Company's non-U.S. operations have supplemental health benefit plans for certain retirees, the cost of which is not significant to the Company.

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NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Costs recognized for benefits for eligible retirees hired prior to January 1, 2007 are recorded using estimated amounts, which may change as actual costs derived for the year are determined. Below is a summary of the components of net periodic benefit cost recognized for the Company's U.S. other post-employment plans:

Summary of Components of Net Periodic Benefit Costs

	Second Quarter		First Six Months	
(Dollars in millions)	2010	2009	2010	2009
Service cost	$ 2	$ 2	$ 5	$ 4
Interest cost	11	11	22	22
Expected return on assets	--	--	(1)	(1)
Amortization of:				
Prior service credit	(6)	(6)	(12)	(12)
Actuarial loss	3	3	6	6
Net periodic benefit cost	$ 10	$ 10	$ 20	$ 19

10. ENVIRONMENTAL MATTERS

Certain Eastman manufacturing sites generate hazardous and nonhazardous wastes, the treatment, storage, transportation, and disposal of which are regulated by various governmental agencies. In connection with the cleanup of various hazardous waste sites, the Company, along with many other entities, has been designated a potentially responsible party ("PRP"), by the U.S. Environmental Protection Agency under the Comprehensive Environmental Response, Compensation and Liability Act, which potentially subjects PRPs to joint and several liability for such cleanup costs. In addition, the Company will be required to incur costs for environmental remediation and closure and postclosure under the federal Resource Conservation and Recovery Act. Reserves for environmental contingencies have been established in accordance with Eastman's policies described in Note 1, "Significant Accounting Policies", to the consolidated financial statements in Part II, Item 8 of the Company's 2009 Annual Report on Form 10-K. Because of expected sharing of costs, the availability of legal defenses, and the Company's preliminary assessment of actions that may be required, management does not believe that the Company's liability for these environmental matters, individually or in the aggregate, will be material to the Company's consolidated financial position, results of operations or cash flows. The Company's total reserve for environmental contingencies was $40 million and $42 million at June 30, 2010 and December 31, 2009, respectively. Estimated future environmental expenditures for remediation costs range from the minimum or best estimate of $10 million to the maximum of $21 million at June 30, 2010, and $10 million to the maximum of $20 million at December 31, 2009. The best estimate accrued to date over the facilities' estimated useful lives for asset retirement obligation costs is $30 million and $32 million at June 30, 2010 and December 31, 2009, respectively.

11. COMMITMENTS

Purchasing Obligations and Lease Commitments

At June 30, 2010, the Company had various purchase obligations totaling approximately $1 billion over a period of approximately 15 years for materials, supplies, and energy incident to the ordinary conduct of business. The Company also had various lease commitments for property and equipment under cancelable, noncancelable, and month-to-month operating leases totaling $85 million over a period of several years. Of the total lease commitments, approximately 15 percent relates to machinery and equipment, including computer and communications equipment and production equipment; approximately 50 percent relates to real property, including office space, storage facilities and land; and approximately 35 percent relates to railcars.

NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Accounts Receivable Securitization Program

Effective January 1, 2010, the Company adopted amended accounting guidance for transfers of financial assets which impacts the financial statement presentation for activity under the Company's $200 million accounts receivable securitization program. Beginning for periods after December 31, 2009, transfers of receivables interests that were previously treated as sold and removed from the balance sheet will be included in trade receivables, net and reflected as secured borrowings on the balance sheet. The Company's Statement of Financial Position at June 30, 2010 reflects an increase in trade receivables, $200 million of which was transferred at December 31, 2009 under the securitization program and reduced cash flows from operating activities by that amount for first six months 2010. As a result of the adoption of this accounting guidance, any amounts drawn on this accounts receivable securitization program would now be reflected as secured borrowings and disclosed in Note 8, "Borrowings." At December 31, 2009 and June 30, 2009 the accounts receivable securitization program was fully drawn.

Guarantees

The Company has operating leases with terms that require the Company to guarantee a portion of the residual value of the leased assets upon termination of the lease. These residual value guarantees at June 30, 2010 totaled $160 million and consisted primarily of leases for railcars and company aircraft. Leases with guarantee amounts totaling $11 million, $139 million, and $10 million will expire in 2011, 2012, and 2014 and beyond, respectively. The Company believes, based on current facts and circumstances, that the likelihood of a material payment pursuant to such guarantees is remote.

Variable Interest Entities

In June 2009, new accounting guidance on the consolidation of Variable Interest Entities ("VIEs") was issued. This guidance is effective for all VIEs or potential VIEs the Company is involved with on or after January 1, 2010. This guidance amends the evaluation criteria to identify which entity has a controlling financial interest of a variable interest entity and requires ongoing reassessments. The Company has evaluated its material contractual relationships under the new guidance and concluded that the entities involved in these relationships are not VIEs or, in the case of Primester, a joint venture that manufactures cellulose acetate at the Company's Kingsport, Tennessee plant, the Company has shared control of the VIE. As such, the Company is not required to consolidate these entities.

12. FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair Value of Borrowings

The fair value for fixed-rate borrowings is based on current interest rates for comparable securities.

	June 30, 2010		December 31, 2009	
(Dollars in millions)	Recorded Amount	Fair Value	Recorded Amount	Fair Value
Long-term borrowings	$ 1,605	$ 1,800	$ 1,604	$ 1,656

The Company's floating-rate borrowings approximate fair value.

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NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Fair Value Measurements

The following chart shows the financial assets and liabilities measured at fair value on a recurring basis.

(Dollars in millions)		Fair Value Measurements at June 30, 2010		
Description	June 30, 2010	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Derivative Assets	$ 139	$ 2	$ 137	$ --
Derivative Liabilities	(93)	(4)	(89)	--
	$ 46	$ (2)	$ 48	$ --

(Dollars in millions)		Fair Value Measurements at December 31, 2009		
Description	December 31, 2009	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Derivative Assets	$ 52	$ --	$ 52	$ --
Derivative Liabilities	(21)	--	(21)	--
	$ 31	$ --	$ 31	$ --

Hedging Programs

The Company is exposed to market risk, such as changes in currency exchange rates, raw material and energy costs and interest rates. The Company uses various derivative financial instruments pursuant to the Company's hedging policies to mitigate these market risk factors and their effect on the cash flows of the underlying transactions. Designation is performed on a specific exposure basis to support hedge accounting. The changes in fair value of these hedging instruments are offset in part or in whole by corresponding changes in the cash flows of the underlying exposures being hedged. The Company does not hold or issue derivative financial instruments for trading purposes. For further information, see Note 9, "Fair Value of Financial Instruments", to the consolidated financial statements in Part II, Item 8 of the Company's 2009 Annual Report on Form 10-K.

Fair Value Hedges
Fair value hedges are derivative or non-derivative instruments designated as and used to hedge the exposure to changes in the fair value of an asset or a liability or an identified portion thereof that is attributable to a particular risk. For derivative instruments that are designated and qualify as a fair value hedge, the gain or loss on the derivative as well as the offsetting loss or gain on the hedged item attributable to the hedged risk are recognized in current earnings.

As of June 30, 2010, the total notional amount of the Company's interest rate swaps was $146 million. The fair value of the derivative of $2 million was recorded in other noncurrent assets.

Cash Flow Hedges

Cash flow hedges are derivative instruments designated as and used to hedge the exposure to variability in expected future cash flows that is attributable to a particular risk. For derivative instruments that are designated and qualify as a cash flow hedge, the effective portion of the gain or loss on the derivative is reported as a component of other comprehensive income, net of income taxes and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. Gains and losses on the derivatives representing either hedge ineffectiveness or hedge components excluded from the assessment of effectiveness are recognized in current earnings.

During the second quarter 2010, the Company entered into forward starting interest rate swaps designated as cash flow hedges to manage interest rate exposure related to the probable future issuance of fixed-rate debt. These forward starting interest rate swaps are based on a total notional amount of $300 million.

As of June 30, 2010, the total amount of the Company's foreign exchange forward and option contracts was a $62 million asset. As of June 30, 2010, the total amount of the Company's feedstock/energy forward and option contracts was a $14 million liability. As of June 30, 2010, the total amount of the Company's forward starting interest rate swaps contracts was a $4 million liability.

NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Fair Value of Derivatives Designated as Cash Flow Hedging Instruments

(Dollars in millions)		Fair Value	
Derivative Assets	Balance Sheet Location	June 30, 2010	December 31, 2009
Commodity contracts	Other current assets	$ --	$ 7
Foreign exchange contracts	Other current assets	33	14
Foreign exchange contracts	Other noncurrent assets	30	11
		$ 63	$ 32

(Dollars in millions)		Fair Value	
Derivative Liabilities	Balance Sheet Location	June 30, 2010	December 31, 2009
Commodity contracts	Payables and other current liabilities	$ 14	$ 1
Foreign exchange contracts	Other noncurrent liabilities	1	--
Forward starting interest rate swap contracts	Other noncurrent liabilities	4	--
		$ 19	$ 1

Derivatives' Cash Flow Hedging Relationships

Second Quarter

(Dollars in millions)

Derivatives' Cash Flow Hedging Relationships	Amount after tax of gain/(loss) recognized in Other Comprehensive Income on derivatives (effective portion)		Location of gain/(loss) reclassified from Accumulated Other Comprehensive Income into income (effective portion)	Pre-tax amount of gain/(loss) reclassified from Accumulated Other Comprehensive Income into income (effective portion)	
	June 30, 2010	June 30, 2009		June 30, 2010	June 30, 2009
Commodity contract	$(8)	$1	Cost of sales	$(1)	$(3)
Foreign exchange contracts	13	(9)	Sales	14	6
Forward starting interest rate swap contracts	(3)	--			
	$2	$(8)		$13	$3

First Six Months

(Dollars in millions)

Derivatives' Cash Flow Hedging Relationships	Amount after tax of gain/(loss) recognized in Other Comprehensive Income on derivatives (effective portion)	Location of gain/(loss) reclassified from Accumulated Other Comprehensive Income into income (effective portion)	Pre-tax amount of gain/(loss) reclassified from Accumulated Other Comprehensive Income into income (effective

				portion)	
	June 30, 2010	June 30, 2009		June 30, 2010	June 30, 2009
Commodity contract	$(12)	$5	Cost of sales	$4	$(9)
Foreign exchange contracts	23	(4)	Sales	23	14
Forward starting interest rate swap contracts	(3)	--			
	$8	$1		$27	$5

For all periods presented, there were no material ineffectiveness with regard to the Company's cash flow hedges.

Nondesignated / Nonqualifying Derivative Instruments

The Company mitigates foreign currency transaction exposure within a quarter from point of recording a sale or purchase transaction to the point of receipt of the currency related to that transaction through its foreign exchange tactical hedging program. The gains or losses on these nonqualifying derivatives or derivatives that are not designated as hedges are marked to market in the line item "Other charges (income), net" of the Statements of Earnings. The Company recognized approximately $12 million net gain on nonqualifying derivatives during the quarter ended June 30, 2010. The Company recognized approximately $15 million net gain on nonqualifying derivatives during the six months ended June 30, 2010.

NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

13. STOCKHOLDERS' EQUITY

A reconciliation of the changes in stockholders' equity for first six months 2010 is provided below:

(Dollars in millions)	Common Stock at Par Value $	Paid-in Capital $	Retained Earnings $	Accumulated Other Comprehensive Income (Loss) $	Treasury Stock at Cost $	Total Stockholders' Equity $
Balance at December 31, 2009	1	661	2,571	(385)	(1,335)	1,513
Net Earnings	--	--	249	--	--	249
Cash Dividends Declared (1)	--	--	(64)	--	--	(64)
Other Comprehensive Income (Loss)	--	--	--	(4)	--	(4)
Share-Based Compensation Expense (2)	--	10	--	--	--	10
Stock Option Exercises	--	26	--	--	--	26
Stock Repurchases	--	--	--	--	(53)	(53)
Balance at June 30, 2010	1	697	2,756	(389)	(1,388)	1,677

(1) Includes cash dividends declared, but unpaid.
(2) Includes the fair value of equity share-based awards recognized for share-based compensation.

ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS), NET OF TAX

(Dollars in millions)	Cumulative Translation Adjustment $	Unrecognized Losses and Prior Service Credits for Benefit Plans $	Unrealized Gains on Derivative Instruments $	Unrealized Losses on Investments $	Accumulated Other Comprehensive Income (Loss) $
Balance at December 31, 2008	60	(414)	20	(1)	(335)
Period change	17	(74)	7	--	(50)
Balance at December 31, 2009	77	(488)	27	(1)	(385)
Period change	(21)	9	8	--	(4)
Balance at June 30, 2010	56	(479)	35	(1)	(389)

Amounts of other comprehensive income (loss) are presented net of applicable taxes. The Company records deferred income taxes on the cumulative translation adjustment related to branch operations and other entities included in the Company's consolidated U.S. tax return. No deferred income taxes are provided on the cumulative translation adjustment of subsidiaries outside the United States, as such cumulative translation adjustment is considered to be a component of permanently invested, unremitted earnings of these foreign subsidiaries.

14. EARNINGS AND DIVIDENDS PER SHARE

	Second Quarter		First Six Months	
	2010	2009	2010	2009
Shares used for earnings per share calculation (in millions):				
Basic	72.3	72.5	72.3	72.5
Diluted	73.5	73.1	73.5	73.0

In second quarter and first six months 2010, common shares underlying options to purchase 594,551 shares of common stock and 709,801 shares of common stock, respectively, were excluded from the computation of diluted earnings per share because the total market value of option exercises for these awards was less than the total proceeds that would be received for these awards. Second quarter and first six months 2010 reflect the impact of share repurchases of 0.9 million shares.

In second quarter and first six months 2009, common shares underlying options to purchase 3,745,729 shares of common stock and 4,031,829 shares of common stock, respectively, were excluded from the computation of diluted earnings per share because the total market value of option exercises for these awards was less than the total proceeds that would be received for these awards. There were no repurchases in first six months 2009.

NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

The Company declared cash dividends of $0.44 per share in second quarter 2010 and 2009 and $0.88 per share in first six months 2010 and 2009.

15. SHARE-BASED COMPENSATION AWARDS

The Company utilizes share-based awards under employee and non-employee director compensation programs. These share-based awards may include restricted and unrestricted stock, restricted stock units, stock options, and performance shares. In both second quarter 2010 and 2009, approximately $5 million of compensation expense before tax were recognized in selling, general and administrative expense in the earnings statement for all share-based awards. The impact on second quarter 2010 and 2009 net earnings of approximately $3 million and $2 million, respectively, is net of deferred tax expense related to share-based award compensation for each period.

In first six months 2010 and 2009, $10 million and $9 million, respectively, of compensation expense before tax were recognized in selling, general and administrative expense in the earnings statement for all share-based awards. The impact on first six months 2010 and 2009 net earnings of $6 million and $5 million, respectively, is net of deferred tax expense related to share-based award compensation.

Additional information regarding share-based compensation plans and awards may be found in Note 15, "Share-Based Compensation Plans and Awards", to the consolidated financial statements in Part II, Item 8 of the Company's 2009 Annual Report on Form 10-K.

16. SUPPLEMENTAL CASH FLOW INFORMATION

Included in the line item "Other items, net" of the "Cash flows from operating activities" section of the Consolidated Statements of Cash Flows are specific changes to certain balance sheet accounts as follows:

(Dollars in millions)	First Six Months	
	2010	2009
Current assets	$ 7	$ (72)
Other assets	(8)	37
Current liabilities	11	(34)
Long-term liabilities and equity	14	3
Total	$ 24	$ (66)

The above changes included transactions such as monetized positions from raw material and energy, currency, and certain interest rate hedges, prepaid insurance, miscellaneous deferrals, accrued taxes, value-added taxes, and other miscellaneous accruals.

17. SEGMENT INFORMATION

The Company's products and operations are managed and reported in five reportable operating segments, consisting of the CASPI segment, the Fibers segment, the PCI segment, the Performance Polymers segment, and the Specialty Plastics segment. For additional information concerning the Company's segments' businesses and products, see Note 22, "Segment Information", to the consolidated financial statements in Part II, Item 8 of the Company's 2009 Annual Report on Form 10-K.

Research and development and other expenses not identifiable to an operating segment are not included in segment operating results for either of the periods presented and are shown in the tables below as "other" operating losses.

NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

In first quarter 2010, the Company transferred certain intermediates product lines from the Performance Polymers segment to the PCI segment to improve optimization of manufacturing assets supporting the three raw material streams that supply the Company's downstream businesses. The revised segment composition reflects how management views and evaluates operations. Accordingly, the amounts for sales, operating earnings, and assets have been adjusted to retrospectively apply these changes to all periods presented.

	Second Quarter	
(Dollars in millions)	2010	2009
Sales		
CASPI	$ 416	$ 302
Fibers	274	263
PCI	541	316
Performance Polymers	222	185
Specialty Plastics	271	187
Total Sales	$ 1,724	$ 1,253

	First Six Months	
(Dollars in millions)	2010	2009
Sales		
CASPI	$ 789	$ 552
Fibers	541	522
PCI	1,023	620
Performance Polymers	416	344
Specialty Plastics	519	344
Total Sales	$ 3,288	2,382

	Second Quarter	
(Dollars in millions)	2010	2009
Operating Earnings (Loss)		
CASPI (1)	$ 94	$ 50
Fibers	83	74
PCI (2)	69	1
Performance Polymers	6	7
Specialty Plastics (1)	21	8
Total Operating Earnings by Segment	273	140
Other	(16)	(9)
Total Operating Earnings	$ 257	$ 131