

EASTMAN CHEMICAL CO  
Form 10-Q  
October 31, 2006

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

(Mark  
One)

- QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934  
For the quarterly period ended September 30, 2006  
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)

**37660**  
(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  NO

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (check one);

Large accelerated filer  Accelerated filer  Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act) YES  NO

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

<b>Class</b>	<b>Number of Shares Outstanding at September 30, 2006</b>
Common Stock, par value \$0.01 per share (including rights to purchase shares of Common Stock or Participating Preferred Stock)	82,285,145

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**UNAUDITED CONSOLIDATED STATEMENTS OF EARNINGS,  
COMPREHENSIVE INCOME AND RETAINED EARNINGS**

(Dollars in millions, except per share amounts)	<b>Third Quarter</b>		<b>First Nine Months</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
Sales	\$ 1,966	\$ 1,816	\$ 5,698	\$ 5,330
Cost of sales	1,650	1,464	4,701	4,205
Gross profit	316	352	997	1,125
Selling, general and administrative expenses	105	108	316	339
Research and development expenses	40	42	126	120
Asset impairments and restructuring charges, net	13	4	23	23
Other operating income	--	--	--	(2)
Operating earnings	158	198	532	645
Interest expense, net	21	23	62	77
Income from equity investment in Genencor	--	--	--	(173)
Early debt extinguishment costs	--	--	--	46
Other (income) charges, net	1	(2)	(2)	(3)
Earnings before income taxes	136	177	472	698
Provision for income taxes	41	54	158	207
Net earnings	\$ 95	\$ 123	\$ 314	\$ 491
<b>Earnings per share</b>				
Basic	\$ 1.16	\$ 1.51	\$ 3.84	\$ 6.10
Diluted	\$ 1.15	\$ 1.50	\$ 3.79	\$ 6.01
<b>Comprehensive Income</b>				
Net earnings	\$ 95	\$ 123	\$ 314	\$ 491
Other comprehensive income (loss)				
Change in cumulative translation adjustment	(8)	(5)	32	(84)
Change in unrealized gains (losses) on investments, net of tax	--	5	(1)	18
Change in unrealized gains (losses) on derivative instruments, net of tax	(6)	--	5	1
Total other comprehensive income (loss)	(14)	--	36	(65)
Comprehensive income	\$ 81	\$ 123	\$ 350	\$ 426
<b>Retained Earnings</b>				
Retained earnings at beginning of period	\$ 2,070	\$ 1,806	\$ 1,923	\$ 1,509
Net earnings	95	123	314	491
Cash dividends declared	(36)	(36)	(108)	(107)
Retained earnings at end of period	\$ 2,129	\$ 1,893	\$ 2,129	\$ 1,893

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



## CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

(Dollars in millions, except per share amounts)	September 30, 2006 (Unaudited)	December 31, 2005
<b>Assets</b>		
Current assets		
Cash and cash equivalents	\$ 430	\$ 524
Trade receivables, net of allowance of \$16 and \$20	758	575
Miscellaneous receivables	81	81
Inventories	702	671
Other current assets	56	73
Current assets held for sale	132	--
<b>Total current assets</b>	<b>2,159</b>	<b>1,924</b>
Properties		
Properties and equipment at cost	8,763	9,597
Less: Accumulated depreciation	5,707	6,435
<b>Net properties</b>	<b>3,056</b>	<b>3,162</b>
Goodwill	313	312
Other noncurrent assets	358	375
Noncurrent assets held for sale	180	--
<b>Total assets</b>	<b>\$ 6,066</b>	<b>\$ 5,773</b>
<b>Liabilities and Stockholders' Equity</b>		
Current liabilities		
Payables and other current liabilities	\$ 1,041	\$ 1,047
Borrowings due within one year	3	4
Current liabilities related to assets held for sale	15	--
<b>Total current liabilities</b>	<b>1,059</b>	<b>1,051</b>
Long-term borrowings	1,586	1,621
Deferred income tax liabilities	264	317
Post-employment obligations	1,058	1,017
Other long-term liabilities	151	155
Long-term liabilities related to assets held for sale	46	--
<b>Total liabilities</b>	<b>4,164</b>	<b>4,161</b>
Stockholders' equity		
Common stock (\$0.01 par value - 350,000,000 shares authorized; shares issued - 90,214,704 and 89,566,115 for 2006 and 2005, respectively)	1	1
Additional paid-in capital	368	320
Retained earnings	2,129	1,923
Accumulated other comprehensive loss	(164)	(200)
	2,334	2,044

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Less: Treasury stock at cost (8,036,330 shares for 2006 and 8,034,901 shares for 2005)	432	432
Total stockholders' equity	1,902	1,612
Total liabilities and stockholders' equity	\$ 6,066	\$ 5,773

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



## UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in millions)	First Nine Months	
	2006	2005
Cash flows from operating activities		
Net earnings	\$ 314	\$ 491
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Income from equity investment in Genencor	--	(173)
Depreciation and amortization	226	229
Gain on sale of assets	(5)	--
Early debt extinguishment costs	--	46
Asset impairments	20	1
Provision for deferred income taxes	49	130
Changes in operating assets and liabilities:		
(Increase) decrease in receivables	(189)	(35)
(Increase) decrease in inventories	(134)	(141)
Increase (decrease) in trade payables	50	(5)
Increase (decrease) in liabilities for employee benefits and incentive pay	(60)	(108)
Other items, net	(38)	(58)
Net cash provided by operating activities	233	377
Cash flows from investing activities		
Proceeds from sale of equity investment in Genencor, net	--	417
Additions to properties and equipment	(279)	(224)
Proceeds from sale of assets and investments	12	50
Additions to capitalized software	(12)	(8)
Other items, net	--	(5)
Net cash provided by (used in) investing activities	(279)	230
Cash flows from financing activities		
Net increase (decrease) in commercial paper, credit facility and other borrowings	33	(84)
Repayment of borrowings	--	(544)
Dividends paid to stockholders	(108)	(106)
Proceeds from stock option exercises and other items	25	91
Net cash provided by (used in) financing activities	(50)	(643)
Effect of exchange rate changes on cash and cash equivalents	2	(3)
Net change in cash and cash equivalents	(94)	(39)
Cash and cash equivalents at beginning of period	524	325

Cash and cash equivalents at end of period	\$	430	\$	286
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The accompanying notes are an integral part of these consolidated financial statements.

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**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 2005 Annual Report on Form 10-K, except as described in Note 17 to the Company's unaudited financial statements in this Form 10-Q, and should be read in conjunction with the consolidated financial statements in Part II, Item 8 of the Company's 2005 Annual Report on Form 10-K. In the opinion of the Company, all normal recurring adjustments necessary for a fair presentation have been included in the unaudited consolidated financial statements. The unaudited consolidated financial statements are prepared in conformity with accounting principles generally accepted ("GAAP") in the United States 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 in minority-owned companies where it exercises significant influence on the equity basis. Intercompany transactions and balances are eliminated in consolidation. The Company has reclassified certain 2005 amounts to conform to the 2006 presentation including the reclassification of segment sales and operating earnings. For additional information, see Note 18 to the Company's unaudited consolidated financial statements.

**2. INVENTORIES**

(Dollars in millions)	<b>September 30, 2006</b>	<b>December 31, 2005</b>
At FIFO or average cost (approximates current cost)		
Finished goods	\$ 672	\$ 664
Work in process	227	207
Raw materials and supplies	378	247
Total inventories	1,277	1,118
LIFO Reserve	(466)	(447)
Inventories before assets held for sale	811	671
Assets held for sale <sup>(1)</sup>	(109)	--
Total inventories	\$ 702	\$ 671

<sup>(1)</sup> For more information regarding assets held for sale, see Note 5 to the Company's unaudited consolidated financial statements.

Inventories valued on the LIFO method were approximately 60% as of September 30, 2006 and 65% as of December 31, 2005 of total inventories.

**3. OTHER NONCURRENT ASSETS**

The Company has a 50 percent interest in and serves as the operating partner in Primester, a joint venture which manufactures cellulose acetate at Eastman's Kingsport, Tennessee plant. This investment is accounted for under the equity method. During fourth quarter 2005, the Company provided a line of credit to the joint venture of up to \$125 million, which Primester fully utilized to repay the principal amount of the joint venture's third-party borrowings, previously guaranteed by Eastman. The Company holds an interest-bearing note receivable. Eastman's investment in

the joint venture was approximately \$87 million and \$86 million at September 30, 2006 and December 31, 2005, respectively, which was comprised of the recognized portion of the venture's accumulated deficits and the line of credit of \$125 million. Such amount was included in other noncurrent assets.

**NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

Eastman also owns a 50 percent interest in Nanjing Yangzi Eastman Chemical Ltd. ("Nanjing"), a company which manufactures *Eastotac* hydrocarbon tackifying resins for the adhesives market. This joint venture is accounted for under the equity method and is included in other noncurrent assets. At September 30, 2006 and December 31, 2005, the Company's investment in Nanjing was approximately \$5 million.

**4. EQUITY INVESTMENT IN GENENCOR**

On April 21, 2005, the Company completed the sale of its preferred and common stock of Genencor International, Inc. ("Genencor") for cash proceeds of approximately \$417 million, net of \$2 million in fees. The book value of the investment prior to sale was \$246 million, and the Company recorded a pre-tax gain on the sale of \$171 million.

**5. ASSETS HELD FOR SALE**

(Dollars in millions)	<b>September 30, 2006</b>
Current assets	
Trade receivables, net	\$ 23
Inventories	109
Total current assets	132
Non-current assets	
Properties and Equipment, net	174
Other non-current assets	6
Total non-current assets	180
Total assets	\$ 312