

EASTMAN CHEMICAL CO
Form 10-Q
May 05, 2016
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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 March 31, 2016
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 62-1539359
(State or other jurisdiction of (I.R.S. employer
incorporation or organization) identification no.)

200 South Wilcox Drive
Kingsport, Tennessee 37662
(Address of principal executive offices) (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 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

Accelerated
filer

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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

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 March 31, 2016
Common Stock, par value \$0.01 per share	147,836,635

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FORWARD-LOOKING STATEMENTS

Certain statements made in this Quarterly Report are "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act, Section 27A of the Securities Act of 1933, as amended and Section 21E of the Securities and Exchange Act of 1934, as amended. Forward-looking statements are all statements, other than statements of historical fact, that may be made by Eastman Chemical Company (the "Company" or "Eastman") from time to time. In some cases, you can identify forward-looking statements by terminology such as "anticipates," "believes," "estimates," "expects," "intends," "may," "plans," "projects," "will," "would," and similar expressions or expressions of the negative of these terms. Forward-looking statements may relate to, among other things, such matters as planned and expected capacity increases and utilization; anticipated capital spending; expected depreciation and amortization; environmental matters; pending and future legal proceedings; exposure to, and effects of hedging of, raw material and energy costs or disruption of raw material or energy supply, foreign currencies and interest rates; global and regional economic, political, and business conditions; competition; growth opportunities; supply and demand, volume, price, cost, margin and sales; earnings, cash flow, dividends and other expected financial results, events, and conditions; expectations, strategies, and plans for individual assets and products, businesses, and segments, as well as for the whole of Eastman; cash requirements and uses of available cash; financing plans and activities; pension expenses and funding; credit ratings; anticipated and other future restructuring, acquisition, divestiture, and consolidation activities; cost reduction and control efforts and targets; the timing and costs of, and benefits from, the integration of, and expected business and financial performance of, acquired businesses; strategic initiatives and development, production, commercialization and acceptance of new products, services and technologies and related costs; asset, business, and product portfolio changes; and expected tax rates and net interest costs.

Forward-looking statements are based upon certain underlying assumptions as of the date such statements were made. Such assumptions are based upon internal estimates and other analyses of current market conditions and trends, management expectations, plans, and strategies, economic conditions, and other factors. Forward-looking statements and the assumptions underlying them are necessarily subject to risks and uncertainties inherent in projecting future conditions and results. Actual results could differ materially from expectations expressed in the forward-looking statements if one or more of the underlying assumptions and expectations proves to be inaccurate or is unrealized. The most significant known factors, risks, and uncertainties that could cause actual results to differ materially from those in the forward-looking statements are identified and discussed under "Risk Factors" in "Management's Discussion and Analysis of Financial Condition and Results of Operations" in Part I, Item 2 of this Quarterly Report.

The Company cautions you not to place undue reliance on forward-looking statements, which speak only as of the date such statements are made. Except as may be required by law, the Company undertakes no obligation to update or alter these forward-looking statements, whether as a result of new information, future events, or otherwise.

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COMPREHENSIVE INCOME AND RETAINED EARNINGS

(Dollars in millions, except per share amounts)	First Quarter	
	2016	2015
Sales	\$2,236	\$2,443
Cost of sales	1,602	1,787
Gross profit	634	656
Selling, general and administrative expenses	183	180
Research and development expenses	54	56
Asset impairments and restructuring (gains) charges, net	(2)	109
Operating earnings	399	311
Net interest expense	64	66
Other charges (income), net	12	(11)
Earnings before income taxes	323	256
Provision for income taxes	72	84
Net earnings	251	172
Less: Net earnings attributable to noncontrolling interest	—	1
Net earnings attributable to Eastman	\$251	\$171
Basic earnings per share attributable to Eastman	\$1.70	\$1.15
Diluted earnings per share attributable to Eastman	\$1.69	\$1.14
Comprehensive Income		
Net earnings including noncontrolling interest		\$251 \$172
Other comprehensive income (loss), net of tax:		
Change in cumulative translation adjustment		106 (212)
Defined benefit pension and other postretirement benefit plans:		
Amortization of unrecognized prior service credits included in net periodic costs	(7)	(4)
Derivatives and hedging:		
Unrealized (loss) gain during period	(18)	55
Reclassification adjustment for losses (gains) included in net income, net	4	(3)
Total other comprehensive income (loss), net of tax	85	(164)
Comprehensive income including noncontrolling interest	336	8
Less: Comprehensive income attributable to noncontrolling interest	—	1
Comprehensive income attributable to Eastman	\$336	\$7
Retained Earnings		
Retained earnings at beginning of period	\$5,146	\$4,545
Net earnings attributable to Eastman	251	171
Cash dividends declared	(67)	(60)
Retained earnings at end of period	\$5,330	\$4,656

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

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UNAUDITED CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

	March 31, 2016	December 31, 2015
(Dollars in millions, except per share amounts)		
Assets		
Current assets		
Cash and cash equivalents	\$202	\$ 293
Trade receivables, net of allowance for doubtful accounts	951	792
Miscellaneous receivables	155	246
Inventories	1,493	1,479
Other current assets	62	68
Total current assets	2,863	2,878
Properties		
Properties and equipment at cost	11,395	11,234
Less: Accumulated depreciation	6,210	6,104
Net properties	5,185	5,130
Goodwill	4,527	4,518
Intangible assets, net of accumulated amortization	2,637	2,650
Other noncurrent assets	404	404
Total assets	\$15,616	\$ 15,580
Liabilities and Stockholders' Equity		
Current liabilities		
Payables and other current liabilities	\$1,334	\$ 1,625
Borrowings due within one year	513	431
Total current liabilities	1,847	2,056
Long-term borrowings	6,565	6,577
Deferred income tax liabilities	939	928
Post-employment obligations	1,294	1,297
Other long-term liabilities	686	701
Total liabilities	11,331	11,559
Stockholders' equity		
Common stock (\$0.01 par value – 350,000,000 shares authorized; shares issued – 217,211,091 ₂ and 216,899,964 for 2016 and 2015, respectively)	2	2
Additional paid-in capital	1,877	1,863
Retained earnings	5,330	5,146
Accumulated other comprehensive loss	(305)	(390)
	6,904	6,621
Less: Treasury stock at cost (69,425,254 shares for 2016 and 69,137,973 shares for 2015)	2,700	2,680
Total Eastman stockholders' equity	4,204	3,941
Noncontrolling interest	81	80
Total equity	4,285	4,021
Total liabilities and stockholders' equity	\$15,616	\$ 15,580

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

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UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in millions)	First Three Months	
	2016	2015
Operating activities		
Net earnings	\$251	\$172
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	147	145
Asset impairment charges	—	89
Provision for deferred income taxes	9	16
Changes in operating assets and liabilities, net of effect of acquisitions and divestitures:		
Increase in trade receivables	(144)	(91)
(Increase) decrease in inventories	(2)	21
Decrease in trade payables	(62)	(108)
Pension and other postretirement contributions in excess of expenses	(19)	(23)
Variable compensation in excess of expenses	(109)	(80)
Other items, net	(24)	(50)
Net cash provided by operating activities	47	91
Investing activities		
Additions to properties and equipment	(110)	(125)
Proceeds from sale of assets	6	4
Acquisitions, net of cash acquired	(21)	—
Other items, net	(1)	(1)
Net cash used in investing activities	(126)	(122)
Financing activities		
Net increase in commercial paper borrowings	82	93
Repayment of borrowings	(10)	—
Dividends paid to stockholders	(68)	(59)
Treasury stock purchases	(20)	(26)
Dividends paid to noncontrolling interest	—	(2)
Proceeds from stock option exercises and other items, net	4	11
Net cash (used in) provided by financing activities	(12)	17
Effect of exchange rate changes on cash and cash equivalents	—	(4)
Net change in cash and cash equivalents	(91)	(18)
Cash and cash equivalents at beginning of period	293	214
Cash and cash equivalents at end of period	\$202	\$196

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 2015 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 2015 Annual Report on Form 10-K. The December 31, 2015 financial position data included herein was derived from the audited consolidated financial statements included in the 2015 Annual Report on Form 10-K but does not include all disclosures required by accounting principles generally accepted in the United States ("GAAP"). The unaudited consolidated financial statements are prepared in conformity with 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, sales revenue, and expenses of all majority-owned subsidiaries and joint ventures in which a controlling interest is maintained. Eastman accounts for other joint ventures and investments where it exercises significant influence 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 confirm to current period presentation.

In April 2015, the Financial Accounting Standards Board ("FASB") issued new guidance for debt issuance costs as a part of the simplification and productivity initiative. Under this guidance, debt issuance costs will be presented as a direct reduction from the carrying amount of the debt liability, consistent with the presentation of debt discounts. The amortization of debt issuance costs will be reported as interest expense. The recognition and measurement guidance for debt issuance costs is not affected by the amendment. As of March 31, 2016, the new guidance has been applied on a retrospective basis which resulted in a reclassification of \$31 million from "Other noncurrent assets" to "Long-term borrowings" line items in the Unaudited Consolidated Statement of Financial Position at December 31, 2015. See Note 6, "Borrowings".

In January 2016, Eastman changed its organizational and management structure following completion of the integration of recently acquired businesses to better align similar strategies and business models. As a result, beginning first quarter 2016, the Company's products and operations are managed and reported in four operating segments: Additives & Functional Products ("AFP"), Advanced Materials ("AM"), Chemical Intermediates ("CI"), and Fibers. For further information, see Note 3, "Goodwill" and Note 17, "Segment Information".

Off Balance Sheet Financing Arrangements

The Company has rights and obligations under non-recourse factoring facilities that have a combined limit of \$180 million (the U.S. Dollar equivalent of the €158 million limit amount as of March 31, 2016) and are committed until December 2017. These arrangements include receivables in the United States, Belgium, Germany, and Finland, and are subject to various eligibility requirements. The Company sells the receivables at face value but receives funding (approximately 85 percent) net of a deposit amount until collections are received from customers for the receivables sold. The total amounts of cumulative receivables sold in first three months 2016 and 2015 were approximately \$235 million and \$280 million, respectively. As part of the program, the Company continues to service the sold receivables at market rates with no servicing assets or liabilities recognized. The amounts of sold receivables outstanding under the non-recourse factoring facilities were \$104 million and \$106 million at March 31, 2016 and December 31, 2015, respectively. The fair value of the receivables sold equals the carrying value at the time of the sale, and no gain or loss is recognized. The Company is exposed to a credit loss of up to 10 percent on sold receivables.

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NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

2. INVENTORIES

(Dollars in millions)	March 31, 2016	December 31, 2015
At FIFO or average cost (approximates current cost)		
Finished goods	\$1,090	\$ 1,063
Work in process	213	212
Raw materials and supplies	486	500
Total inventories	1,789	1,775
Less: LIFO Reserve	296	296
Total inventories	\$1,493	\$ 1,479

Inventories valued on the last-in, first-out ("LIFO") method were approximately 60 percent at both March 31, 2016 and December 31, 2015.

3. GOODWILL

In January 2016, as a result of the changes in Eastman's organizational and management structure, goodwill was reassigned to segments using a relative fair value allocation. In conjunction with the organizational changes and in accordance with GAAP, during first quarter 2016 Eastman performed an impairment assessment and concluded that no indication of an impairment existed. For further information on the organizational changes, see Note 1, "Basis of Presentation" and Note 17, "Segment Information".

Changes to the carrying value of goodwill follow:

(Dollars in millions)	Additives & Functional Products	Adhesives & Plasticizers	Advanced Chemical Materials	Chemical Intermediates	Other Segments	Total
Balance at December 31, 2015	\$ 1,865	\$ 111	\$ 1,293	\$ 1,239	\$ 10	\$4,518
Adjustments to net goodwill resulting from reorganization	583	(111)	—	(472)	—	—
Currency translation adjustments	5	—	—	4	—	9
Balance at March 31, 2016	\$ 2,453	\$ —	\$ 1,293	\$ 771	\$ 10	\$4,527

As of March 31, 2016, the reported balance of goodwill included accumulated impairment losses of \$23 million, \$12 million, and \$14 million in the AFP segment, CI segment, and other segments, respectively. As of December 31, 2015, the reported balance of goodwill included accumulated impairment losses of \$35 million and \$14 million in the Adhesives & Plasticizers segment and other segments, respectively.

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NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

4. PAYABLES AND OTHER CURRENT LIABILITIES

(Dollars in millions)	March 31, 2016	December 31, 2015
Trade creditors	\$633	\$ 699
Derivative hedging liability	170	218
Accrued payrolls, vacation, and variable-incentive compensation	125	227
Post-employment obligations	107	120
Other	299	361
Total payables and other current liabilities	\$1,334	\$ 1,625

"Other" consists primarily of accruals for dividends payable, interest payable, accrued taxes, and the current portion of environmental liabilities.

5. PROVISION FOR INCOME TAXES

(Dollars in millions)	First Quarter	
	2016	2015
Provision for income taxes	\$72	\$84
Effective tax rate	22 %	33 %

The first quarter 2016 effective tax rate reflects a \$9 million tax benefit primarily due to adjustments to the tax provision to reflect the finalization of 2014 foreign income tax returns. The first quarter 2016 effective tax rate also reflects a benefit from the timing of the extension of favorable U.S. federal tax provisions, primarily research and development ("R&D") tax credits and deferral of certain earnings of foreign subsidiaries from U.S. income taxes. The first quarter 2015 effective tax rate was negatively impacted by limited deductibility of costs for shutdown of the Workington, UK acetate tow manufacturing facility.

6. BORROWINGS

(Dollars in millions)	March 31, 2016	December 31, 2015
Borrowings consisted of:		
2.4% notes due June 2017	\$998	\$ 998
6.30% notes due November 2018	165	166
5.5% notes due November 2019	249	249
2.7% notes due January 2020	795	794
4.5% notes due January 2021	249	249
3.6% notes due August 2022	894	896
7 1/4% debentures due January 2024	244	244
7 5/8% debentures due June 2024	54	54
3.8% notes due March 2025	791	791
7.60% debentures due February 2027	222	222
4.8% notes due September 2042	492	492
4.65% notes due October 2044	869	869
Credit facilities and commercial paper borrowings	1,052	980
Capital leases	4	4
Total borrowings	7,078	7,008

Borrowings due within one year	513	431
Long-term borrowings	\$6,565	\$ 6,577

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NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Credit Facility and Commercial Paper Borrowings

In connection with the 2014 acquisition of Taminco Corporation, Eastman borrowed \$1 billion under a five-year Term Loan. As of March 31, 2016, the Term Loan balance outstanding was \$350 million with an interest rate of 1.68 percent. As of December 31, 2015, the Term Loan balance outstanding was \$350 million with an interest rate of 1.67 percent. Borrowings under the Term Loan are subject to interest at varying spreads above quoted market rates.

The Company has access to a \$1.25 billion revolving credit agreement (the "Credit Facility") that expires October 2020. Borrowings under the Credit Facility are subject to interest at varying spreads above quoted market rates and a commitment fee is paid on the total unused commitment. The Credit Facility provides liquidity support for commercial paper borrowings and general corporate purposes. Accordingly, any outstanding commercial paper borrowings reduce capacity for borrowings available under the Credit Facility. Commercial paper borrowings are classified as short-term. At March 31, 2016 and December 31, 2015, the Company had no outstanding borrowings under the Credit Facility. At March 31, 2016, the Company's commercial paper borrowings were \$512 million with a weighted average interest rate of 0.81 percent. At December 31, 2015, the Company's commercial paper borrowings were \$430 million with a weighted average interest rate of 0.80 percent.

The \$250 million accounts receivable securitization agreement (the "A/R Facility") expires April 2018. 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. At March 31, 2016, the Company's borrowings under the A/R Facility were \$190 million supported by trade receivables with an interest rate of 1.25 percent. In first quarter 2016, \$10 million of the Company's borrowings under the A/R Facility were repaid using available cash. At December 31, 2015, the Company's borrowings under the A/R Facility were \$200 million supported by trade receivables with an interest rate of 1.11 percent.

The Credit Facility and the A/R Facility, and the Term Loan, contain 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. Total available borrowings under the Credit Facility and A/R Facility were \$769 million and \$842 million as of March 31, 2016 and December 31, 2015, respectively. Changes in available borrowings were due primarily to an increase in commercial paper borrowings. The Company would not have violated applicable covenants for these periods if the total available amounts of the facilities had been borrowed.

Fair Value of Borrowings

The Company has classified its long-term borrowings at March 31, 2016, and December 31, 2015, under the fair value hierarchy as defined in the accounting policies in Note 1, "Significant Accounting Policies", to the consolidated financial statements in Part II, Item 8 of the Company's 2015 Annual Report on Form 10-K. The fair value for fixed-rate debt securities is based on current market prices and is classified as Level 1. The fair value for the Company's floating-rate borrowings, which relate to the Term Loan, the A/R Facility, and capital leases, equals the carrying value and is classified as Level 2.

Fair Value Measurements at March 31, 2016

(Dollars in millions)	Recorded Amount	Total Fair Value	Quoted Prices in Active Markets for	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
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			Identical Assets (Level 1)			
Long-term borrowings	\$ 6,565	\$6,854	\$ 6,311	\$ 543	\$	—

Fair Value Measurements at December 31,
2015

(Dollars in millions)	Recorded Amount December 31, 2015	Total Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Long-term borrowings	\$ 6,577	\$6,647	\$ 6,094	\$ 553	\$ —

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NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

7. DERIVATIVES

Hedging Programs

The Company is exposed to market risks, such as changes in foreign currency exchange rates, commodity prices, and interest rates. To mitigate these market risks and their effects on the cash flows of the underlying transactions, the Company uses various derivative financial instruments when appropriate in accordance with the Company's hedging strategy and policies. Designation is performed on a specific exposure basis to support hedge accounting. The changes in fair value of these hedging instruments are offset in whole or in part by corresponding changes in the anticipated cash flows of the underlying exposures being hedged. The Company does not enter into derivative transactions for speculative purposes.

For further information on hedging programs, see Note 10, "Derivatives", to the consolidated financial statements in Part II, Item 8 of the Company's 2015 Annual Report on Form 10-K.

Fair Value Hedges

Fair value hedges are defined as 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 fair value hedges, 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 March 31, 2016 and December 31, 2015, there are no outstanding interest rate swap hedges.

Derivatives' Fair Value Hedging Relationships

(Dollars in millions)	First Quarter Consolidated Statement of Earnings Location of Gain/(Loss) Recognized in Income on Derivatives	Amount of Gain/(Loss) Recognized in Income on Derivatives	
		March 31, 2016	March 31, 2015
Derivatives in Fair Value Hedging Relationships			
Interest rate swaps	Net interest expense	\$ 3	\$ 4

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.

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NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Total Notional Amounts

	March 31, 2016	December 31, 2015
Foreign Exchange Forward and Option Contracts (in millions):		
EUR/USD (in EUR)	€558	€618
EUR/USD (in approximate USD equivalent)	\$650	\$689
JPY/USD (in JPY)	¥2,100	¥2,400
JPY/USD (in approximate USD equivalent)	\$19	\$20
Commodity Forward and Collar Contracts:		
Feedstock (in million barrels)	19	22
Energy (in million million British thermal units)	33	32
Interest rate swaps for the future issuance of debt (in millions)	\$500	\$500

Fair Value Measurement of Derivatives Designated as Cash Flow Hedging Instruments

		Fair Value Measurements Significant Other Observable Inputs	
(Dollars in millions)		March 31, 2016	December 31, 2015
Derivative Assets	Statement of Financial Position Location		
Commodity contracts	Other noncurrent assets	\$ 1	\$ —
Foreign exchange contracts	Other current assets	48	65
Foreign exchange contracts	Other noncurrent assets	54	79
		\$ 103	\$ 144
(Dollars in millions)			
Derivative Liabilities	Statement of Financial Position Location		
Commodity contracts	Payables and other current liabilities	\$ 154	\$ 194
Commodity contracts	Other long-term liabilities	196	242
Forward starting interest rate swap contracts	Other long-term liabilities	61	30
		\$ 411	\$ 466

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NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Derivatives' Hedging Relationships

(Dollars in millions)	First Quarter		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)	
	Change in amount after tax of gain/(loss) recognized in	Other Comprehensive Income on derivatives (effective portion)		March 31, 2016	March 31, 2015
Derivatives' Cash Flow Hedging Relationships	March 2016	March 2015		March 2016	March 2015
Commodity contracts	\$30	\$ 5	Sales Cost of Sales	\$ — (20)	\$ 2 (16)
Foreign exchange contracts	(26)	55	Sales	15	21
Forward starting interest rate swap contracts	(18)	(8)	Net interest expense	(2)	(2)
	\$(14)	\$ 52		\$ (7)	\$ 5

Hedging Summary

Monetized positions and mark-to-market gains and losses from raw materials and energy, currency, and certain interest rate hedges that were included in accumulated other comprehensive income before taxes totaled losses of \$400 million at March 31, 2016 and \$348 million at March 31, 2015. If realized, \$133 million net losses as of March 31, 2016 will be reclassified into earnings during the next 12 months. Ineffective portions of hedges are immediately recognized in cost of sales or other charges (income), net. The Company recognized pre-tax losses for ineffectiveness of the commodity hedging portfolio of \$2 million and \$1 million during first quarter 2016 and 2015, respectively.

The gains or losses on nonqualifying derivatives or derivatives that are not designated as hedges are marked to market and reported in the line item "Other charges (income), net" of the Unaudited Consolidated Statements of Earnings, and, in all periods presented, represent foreign exchange derivatives denominated in multiple currencies and are transacted and settled in the same quarter. The Company recognized \$9 million net gains and \$11 million net losses on nonqualifying derivatives during first quarter of 2016 and 2015, respectively.

Fair Value Measurements

For additional information on fair value measurement, see Note 1, "Significant Accounting Policies", to the consolidated financial statements in Part II, Item 8 of the Company's 2015 Annual Report on Form 10-K.

The following chart shows the gross financial assets and liabilities valued on a recurring basis.

Description	Fair Value Measurements at		
	March 31, 2016	Quasi-Significant	Significant Unobservable
	March 31, 2016	Other	Other

		in Observable Inputs (Level 1)	in Observable Inputs (Level 2)	in Unobservable Inputs (Level 3)	
Derivative Assets	\$ 103	\$—	\$ 103	\$	—
Derivative Liabilities	(411)	—	(411)	—	—
	\$ (308)	\$—	\$ (308)	\$	—

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NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Description	December 31, 2015	Fair Value Measurements at December 31, 2015	
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)
Derivative Assets	\$ 144	\$ —	\$ 144
Derivative Liabilities	(466)	—	(466)
	\$ (322)	\$ —	\$ (322)

All of the Company's derivative assets and liabilities are currently classified as Level 2. Level 2 fair value is based on estimates using standard pricing models. These standard pricing models use inputs which are derived from or corroborated by observable market data such as interest rate yield curves and currency spot and forward rates. The fair value of commodity contracts is derived using forward curves supplied by an industry recognized and unrelated third party. In addition, on an ongoing basis, the Company tests a subset of its valuations against valuations received from the transaction's counterparty to validate the accuracy of its standard pricing models. Counterparties to these derivative contracts are highly rated financial institutions which the Company believes carry minimal risk of nonperformance.

All of the Company's derivative contracts are subject to master netting arrangements, or similar agreements, which provide for the option to settle contracts on a net basis when they settle on the same day and in the same currency. In addition, these arrangements provide for a net settlement of all contracts with a given counterparty in the event that the arrangement is terminated due to the occurrence of default or a termination event. Management has elected to present the derivative contracts on a gross basis in the Unaudited Consolidated Statements of Financial Position. Had it chosen to present the derivatives contracts on a net basis, it would have a derivative in a net asset position of \$102 million and a derivative in a net liability position of \$410 million as of March 31, 2016. The Company does not have any cash collateral due under such agreements.

8. RETIREMENT PLANS**Defined Benefit Pension Plans and Other Postretirement Benefit Plans**

Eastman maintains defined benefit pension plans that provide eligible employees with retirement benefits. In addition, Eastman provides a subsidy for life insurance, health care, and dental benefits to eligible retirees hired prior to January 1, 2007, and a subsidy for health care and dental benefits to retirees' eligible survivors. Costs recognized for these benefits are recorded using estimated amounts, which may change as actual costs derived for the year are determined.

For additional information regarding retirement plans, see Note 11, "Retirement Plans", to the consolidated financial statements in Part II, Item 8 of the Company's 2015 Annual Report on Form 10-K.

Components of net periodic benefit (credit) cost were as follows:

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	First Quarter				Other	
	Pension Plans				Postretirement	
	2016		2015		2016	2015
(Dollars in millions)	U.S.	Non-U.S.	U.S.	Non-U.S.		
Components of net periodic benefit (credit) cost:						
Service cost	\$10	\$ 3	\$9	\$ 4	\$ 2	\$ 2
Interest cost	18	6	22	6	7	10
Expected return on assets	(34)	(8)	(36)	(9)	(2)	(2)
Amortization of:						
Prior service credit, net	(1)	—	(1)	—	(10)	(6)
Net periodic benefit (credit) cost	\$(7)	\$ 1	\$(6)	\$ 1	\$ (3)	\$ 4

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NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

The Company did not make any contributions to its U.S. defined benefit pension plans in first three months 2016 or 2015.

In first quarter 2016, the Company changed the approach used to calculate service and interest cost components of net periodic benefit costs for its significant defined benefit pension and other postretirement benefit plans. The Company elected to calculate service and interest costs by applying the specific spot rates along the yield curve to the plans' projected cash flows. The change does not affect the measurement of the total benefit obligation or the annual net periodic benefit cost or credit of the plans because the change in the service and interest costs will be offset in the mark-to-market actuarial gain or loss which typically is recognized in the fourth quarter of each year or in any other quarters in which an interim remeasurement is triggered.

9.COMMITMENTS

Purchase Obligations and Lease Commitments

The Company had various purchase obligations at March 31, 2016, totaling \$1.6 billion over a period of approximately 30 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 \$274 million over a period of approximately 40 years. Of the total lease commitments, approximately 50 percent relate to real property, including office space, storage facilities, and land; approximately 40 percent relate to railcars; and approximately 10 percent relate to machinery and equipment, including computer and communications equipment and production equipment.

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 as well as other guarantees. Disclosures about each group of similar guarantees are provided below.

Residual Value 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 totaled \$122 million at March 31, 2016 and consist primarily of leases for railcars and the company aircraft mostly expiring in 2016 and 2017. Residual guarantee payments that become probable and estimable are accrued to rent expense over the remaining life of the applicable lease. Management's current expectation is that the likelihood of material residual guarantee payments is remote.

Other Guarantees

Guarantees and claims also arise during the ordinary course of business from relationships with customers, suppliers, joint venture partners, and other parties when the Company undertakes an obligation to guarantee the performance of others, if specified triggering events occur. Non-performance under a contract could trigger an obligation of the Company. The Company's current other guarantees include guarantees relating primarily to intellectual property, environmental matters, and other indemnifications and have arisen through the normal course of business. The ultimate effect on future financial results is not subject to reasonable estimation because considerable uncertainty exists as to the final outcome of these claims, if they were to occur. These other guarantees have terms up to 30 years

with maximum potential future payments of approximately \$35 million in the aggregate, with none of these guarantees being individually significant to the Company's operating results, financial position, or liquidity. Management's current expectation is that future payment or performance related to non-performance under other guarantees is remote.

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NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

10. ENVIRONMENTAL MATTERS AND ASSET RETIREMENT OBLIGATIONS

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 post-closure 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 2015 Annual Report on Form 10-K. The Company's total reserve for environmental contingencies was \$332 million and \$336 million at March 31, 2016 and December 31, 2015, respectively. At both March 31, 2016 and December 31, 2015, this reserve included \$8 million related to sites previously closed and impaired by Eastman and sites that have been divested by Eastman but for which the Company retains the environmental liability related to these sites. The Company's total environmental reserve for environmental contingencies, including remediation costs and asset retirement obligations, is included in the Unaudited Consolidated Statements of Financial Position as follows:

(Dollars in millions)	March 31, December 31,	
	2016	2015
Environmental contingent liabilities, current	\$ 30	\$ 35
Environmental contingent liabilities, long-term	302	301
Total	\$ 332	\$ 336

Remediation

Estimated future environmental expenditures for remediation costs ranged from the minimum or best estimate of \$305 million to the maximum of \$507 million and from the minimum or best estimate of \$308 million to the maximum of \$516 million at March 31, 2016 and December 31, 2015, respectively. The maximum estimated future costs are considered to be reasonably possible and include the amounts accrued at both March 31, 2016 and December 31, 2015. Although the resolution of uncertainties related to these environmental matters may have a material adverse effect on the Company's consolidated results of operations in the period recognized, because of the availability of legal defenses, the Company's preliminary assessment of actions that may be required, and if applicable, the expected sharing of costs, 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 or cash flows.

Reserves for environmental remediation that management believes to be probable and estimable are recognized as current and long-term liabilities in the Unaudited Consolidated Statements of Financial Position. These reserves include liabilities expected to be paid within 30 years. The amounts charged to pre-tax earnings for environmental remediation and related charges are included in cost of sales and other charges (income), net. Changes in the reserves for environmental remediation liabilities during first three months 2016 are summarized below:

(Dollars in millions)	Environmental Remediation Liabilities
Balance at December 31, 2015	\$ 308
Changes in estimates recognized in earnings and other	3
Cash reductions	(6)
Balance at March 31, 2016	\$ 305

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NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Closure/Post-Closure

An asset retirement obligation is an obligation for the retirement of a tangible long-lived asset that is incurred upon the acquisition, construction, development, or normal operation of that long-lived asset. The Company recognizes asset retirement obligations in the period in which they are incurred if a reasonable estimate of fair value can be made. The asset retirement obligations are discounted to expected present value and subsequently adjusted for changes in fair value. The associated estimated asset retirement costs are capitalized as part of the carrying value of the long-lived assets and depreciated over their useful life. Environmental asset retirement obligations consist primarily of closure and post-closure costs. For facilities that have environmental asset retirement obligations, the best estimate accrued to date over the facilities' estimated useful lives for these environmental asset retirement obligation costs was \$27 million and \$28 million at March 31, 2016 and December 31, 2015, respectively.

Other

The Company also has contractual asset retirement obligations not associated with environmental liabilities. Eastman's non-environmental asset retirement obligations are primarily associated with the future closure of leased manufacturing assets at Pace, Florida and Oulu, Finland. These accrued non-environmental asset retirement obligations were \$45 million and \$46 million as of March 31, 2016 and December 31, 2015, respectively.

11. LEGAL MATTERS

From time to time, the Company and its operations are parties to, or targets of, lawsuits, claims, investigations and proceedings, including product liability, personal injury, asbestos, patent and intellectual property, commercial, contract, environmental, antitrust, health and safety, and employment matters, which are being handled and defended in the ordinary course of business. While the Company is unable to predict the outcome of these matters, it does not believe, based upon currently available facts, that the ultimate resolution of any such pending matters will have a material adverse effect on its overall financial condition, results of operations, or cash flows.

12. STOCKHOLDERS' EQUITY

A reconciliation of the changes in stockholders' equity for first three months 2016 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 Attributed to Eastman	Noncontrolling Interest	Total Stockholders' Equity
Balance at December 31, 2015	\$ 2	\$ 1,863	\$ 5,146	\$ (390)	\$(2,680)	\$ 3,941	\$ 80	\$ 4,021
Net Earnings	—	—	251	—	—	251	—	251
Cash Dividends Declared ⁽¹⁾ (\$0.46 per share)	—	—	(67)	—	—	(67)	—	(67)
Other Comprehensive Income	—	—	—	85	—	85	—	85
Share-Based Compensation Expense ⁽²⁾	—	13	—	—	—	13	—	13
Stock Option Exercises	—	5	—	—	—	5	—	5
Other ⁽³⁾	—	(4)	—	—	—	(4)	1	(3)
Share Repurchase	—	—	—	—	(20)	(20)	—	(20)
Balance at March 31, 2016	\$ 2	\$ 1,877	\$ 5,330	\$ (305)	\$(2,700)	\$ 4,204	\$ 81	\$ 4,285

(1) Includes cash dividends paid and dividends declared, but unpaid.

(2) Fair value of share-based awards.

Paid in capital includes tax benefits/charges relating to the differences between the amounts deductible for federal

(3) income taxes over the amounts charged to income for book value purposes and other items. Equity attributable to noncontrolling interest includes adjustments for currency revaluation.

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Accumulated Other Comprehensive Income (Loss), Net of Tax

(Dollars in millions)	Cumulative Translation Adjustment	Benefit Plans Unrecognized Prior Service Credits	Unrealized Gains (Losses) on Derivative Instruments	Unrealized Losses on Investments	Accumulated Other Comprehensive Income (Loss)
Balance at December 31, 2014	\$ (68)	\$ 61	\$ (269)	\$ (1)	\$ (277)
Period change	(216)	68	35	—	(113)
Balance at December 31, 2015	(284)	129	(234)	(1)	(390)
Period change	106	(7)	(14)	—	85
Balance at March 31, 2016	\$ (178)	\$ 122	\$ (248)	\$ (1)	\$ (305)

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

Components of other comprehensive income recognized in the Unaudited Consolidated Statements of Earnings, Comprehensive Income and Retained Earnings are presented below, before tax and net of tax effects:

(Dollars in millions)	First Quarter			
	2016	2015	2016	2015
	Before Tax	Net of Tax	Before Tax	Net of Tax
Other comprehensive income (loss)				
Change in cumulative translation adjustment	\$106	\$106	\$(212)	\$(212)
Defined benefit pension and other postretirement benefit plans:				
Amortization of unrecognized prior service credits included in net periodic costs ⁽¹⁾	(11)	(7)	(7)	(4)
Derivatives and hedging: ⁽²⁾				
Unrealized (loss) gain during period	(30)	(18)	89	55
Reclassification adjustment for losses (gains) included in net income, net	7	4	(5)	(3)
Change in derivatives and hedging	(23)	(14)	84	52
Total other comprehensive income (loss)	\$72	\$85	\$(135)	\$(164)

⁽¹⁾ Included in the calculation of net periodic benefit costs for pension and other postretirement benefit plans. See Note 8, "Retirement Plans".

⁽²⁾ For additional information regarding the impact of reclassifications into earnings, refer to Note 7, "Derivatives".

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NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

13. EARNINGS AND DIVIDENDS PER SHARE

The following table sets forth the computation of basic and diluted earnings per share ("EPS"):

(In millions, except per share amounts)	First Quarter	
	2016	2015
Numerator		
Earnings attributable to Eastman:		
Earnings, net of tax	\$251	\$171
Denominator		
Weighted average shares used for basic EPS	147.8	148.7
Dilutive effect of stock options and other awards	1.0	1.0
Weighted average shares used for diluted EPS	148.8	149.7
EPS ⁽¹⁾		
Basic	\$1.70	\$1.15
Diluted	\$1.69	\$1.14

⁽¹⁾ Earnings per share are calculated using whole dollars and shares.

In first quarter 2016 and 2015, common shares underlying options to purchase 1,081,423 and 784,890 shares, respectively, of common stock were excluded from the shares treated as outstanding for computation of diluted earnings per share because the total market value of option exercises for these awards was less than the total cash proceeds that would be received for these exercises. First quarter 2016 and 2015 reflect the impact of share repurchases of 287,281 and 370,000, respectively.

The Company declared cash dividends of \$0.46 and \$0.40 per share in first quarter 2016 and 2015, respectively.

14. ASSET IMPAIRMENTS AND RESTRUCTURING

In first quarter 2016, there were net asset impairments and restructuring gains of \$2 million in the AFP segment for the sale of previously impaired assets at the Crystex[®] R&D facility in France.

In first quarter 2015 there were net asset impairments and restructuring charges of \$109 million. Net asset impairments and restructuring charges included \$81 million of asset impairments and \$16 million of restructuring charges, including severance, in the Fibers segment due to the closure of the Workington, UK acetate tow manufacturing facility which was substantially completed in 2015. Additionally, in first quarter 2015, management decided not to continue a growth initiative that was reported in "Other". This resulted in the Company recognizing asset impairments of \$8 million and restructuring charges of \$4 million.

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

The following table summarizes the changes in asset impairments and restructuring charges and gains, the non-cash reductions attributable to asset impairments, and the cash reductions in restructuring reserves for severance costs and site closure costs paid in first three months 2016 and full year 2015:

(Dollars in millions)	Balance at January 1, 2016	Provision/ Adjustments	Non-cash Reductions	Cash Reductions	Balance at March 31, 2016
Non-cash charges	\$ —	\$ —	\$ —	\$ —	\$ —
Severance costs	55	—	—	(8)	47
Site closure and restructuring costs	11	(2)	1	—	10
Total	\$ 66	\$ (2)	\$ 1	\$ (8)	\$ 57

(Dollars in millions)	Balance at January 1, 2015	Provision/ Adjustments	Non-cash Reductions	Cash Reductions	Balance at December 31, 2015
Non-cash charges	\$ —	\$ 107	\$ (107)	\$ —	\$ —
Severance costs	13	67	1	(26)	55
Site closure and restructuring costs	15	9	3	(16)	11
Total	\$ 28	\$ 183	\$ (103)	\$ (42)	\$ 66

Substantially all severance costs remaining are expected to be applied to the reserves within one year.

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 first quarter 2016 and 2015, \$13 million and \$11 million, respectively, of compensation expense before tax were recognized in "Selling, general and administrative expense" in the Unaudited Consolidated Statements of Earnings for all share-based awards of which \$3 million in both periods related to stock options. The compensation expense is recognized over the substantive vesting period, which may be a shorter time period than the stated vesting period for qualifying termination eligible employees as defined in the forms of award notice. For both first quarter 2016 and 2015, \$2 million of stock option compensation expense was recognized due to qualifying termination eligibility preceding the requisite vesting period. The impact on first quarter 2016 and 2015 net earnings of \$8 million and \$7 million, respectively, is net of deferred tax expense related to share-based award compensation for each period.

Stock Option Grants

In first quarter 2016 and 2015, the number of stock options granted under the 2012 Omnibus Stock Compensation Plan were approximately 550,000 and 500,000, respectively. Options have an exercise price equal to the closing price of the Company's stock on the date of grant. The term of options is 10 years with vesting periods that vary up to three years. Vesting usually occurs ratably over the vesting period or at the end of the vesting period. The Company utilizes the Black Scholes Merton option valuation model which relies on certain assumptions to estimate an option's fair value.

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The assumptions used in the determination of fair value for stock options granted in first quarter 2016 and 2015 are provided in the table below:

Assumptions	First Quarter	
	2016	2015
Expected volatility rate	23.71%	24.11%
Expected dividend yield	2.31%	1.75%
Average risk-free interest rate	1.23%	1.45%
Expected forfeiture rate	0.75%	0.75%
Expected term years	5.0	4.8

The grant date exercise price and fair value of options granted during first quarter 2016 were \$65.16 and \$10.97, respectively, and during first quarter 2015 were \$74.46 and \$13.89, respectively.

For options unvested at March 31, 2016, \$6 million in compensation expense will be recognized over the next three years.

Other Share-Based Compensation Awards

In addition to stock option grants, the Company has awarded long-term performance share awards, restricted stock and restricted stock unit awards, and stock appreciation rights. The long-term performance share awards are based upon actual return on capital compared to a target return on capital and total stockholder return compared to a peer group ranking by total stockholder return over a three year performance period. The awards are valued using a Monte Carlo Simulation based model and vest pro-ratably over the three year performance period. The number of long-term performance share target awards during first quarter 2016 and 2015 for the 2016-2018 and 2015-2017 periods were approximately 400,000 and 300,000, respectively. The target shares awarded are assumed to be 100 percent. At the end of the three-year performance period, the actual number of shares awarded can range from zero percent to 250 percent of the target shares based on the award notice. The number of restricted stock unit awards during first quarter 2016 and 2015 were approximately 160,000 and 200,000, respectively. The fair value of a restricted stock unit award is equal to the closing stock price of the Company's stock on the award date and normally vests over a period of three years. In first quarter 2016 and 2015, \$10 million and \$8 million, respectively, was recognized as compensation expense before tax for these other share-based awards and was included in the total compensation expense noted above for all share-based awards. The unrecognized compensation expense before tax for these same type awards at March 31, 2016 was \$73 million and will be recognized primarily over a period of three years.

For additional information regarding share-based compensation plans and awards, see Note 18, "Share-Based Compensation Plans and Awards", to the consolidated financial statements in Part II, Item 8 of the Company's 2015 Annual Report on Form 10-K.

16. SUPPLEMENTAL CASH FLOW INFORMATION

Included in the line item "Other items, net" of the "Operating activities" section of the Unaudited Consolidated Statements of Cash Flows are the following changes to Unaudited Consolidated Statement of Financial Position line items:

(Dollars in millions)	First Three Months	
	2016	2015
Other current assets	\$—	\$15

Other noncurrent assets	38	5
Payables and other current liabilities	24	(17)
Long-term liabilities and equity	(86)	(53)
Total	\$(24)	\$(50)

The above changes resulted primarily from accrued taxes, deferred taxes, environmental liabilities, monetized positions from raw material and energy, currency, and certain interest rate hedges, prepaid insurance, miscellaneous deferrals, value-added taxes, and other miscellaneous accruals.

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NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

17. SEGMENT INFORMATION

As reported in the 2015 Annual Report on Form 10-K, the Company's products and operations were managed and reported in five operating segments: Additives & Functional Products ("AFP"), Adhesives & Plasticizers ("A&P"), Advanced Materials ("AM"), Fibers, and Specialty Fluids & Intermediates ("SFI"). Beginning first quarter 2016, as a result of changes in the Company's organizational structure and management, the Company's products and operations are managed and reported in four operating segments: AFP, AM, Chemical Intermediates ("CI"), and Fibers. The new structure supports the Company's strategy to transform towards a specialty portfolio by better aligning similar businesses in a more streamlined structure.

Under the new structure, the adhesives resins product line of the former A&P segment is moved to the AFP segment, the specialty fluids product line of the former SFI segment is moved to the AFP segment, and the plasticizers product line of the former A&P segment is moved to the new CI segment. In addition to the product line changes, there were shifts in products among product lines in different segments. Acetyl and olefin products with animal nutrition and food ingredient applications of the former SFI segment are moved to the AFP segment as part of the care chemicals and animal nutrition product lines. Distribution solvents, ethylene oxide derivatives, and ethyl acetate products are moved from the AFP segment to the new CI segment in the other intermediates product line.

For additional financial and product information concerning each segment, see Note 20, "Segment Information", to the consolidated financial statements in Part II, Item 8 of the Company's 2015 Annual Report on Form 10-K.

(Dollars in millions)	First Quarter	
	2016	2015
Sales		
Additives & Functional Products	\$737	\$804
Advanced Materials	589	561
Chemical Intermediates	620	782
Fibers	280	284
Total Sales by Segment	2,226	2,431
Other	10	12
Total Sales	\$2,236	\$2,443

(Dollars in millions)	First Quarter	
	2016	2015
Operating Earnings (Loss)		
Additives & Functional Products	\$153	\$157
Advanced Materials	108	68
Chemical Intermediates	67	118
Fibers	86	(7)
Total Operating Earnings by Segment	414	336
Other:		
Growth initiatives and businesses not allocated to segments	(18)	(26)
Pension and other postretirement benefits income, net not allocated to operating segments	12	9
Acquisition integration, transaction, and restructuring costs	(9)	(8)
Total Operating Earnings	\$399	\$311

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NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in millions)	March 31, 2016	December 31, 2015
Assets by Segment ⁽¹⁾		
Additives & Functional Products	\$6,471	\$ 6,370
Advanced Materials	4,338	4,227
Chemical Intermediates	3,147	2,930
Fibers	768	969
Total Assets by Segment	14,724	14,496
Corporate Assets	892	1,084
Total Assets	\$15,616	\$ 15,580

(1) The chief operating decision maker holds segment management accountable for accounts receivable, inventory, fixed assets, goodwill, and intangible assets.

18. RECENTLY ISSUED ACCOUNTING STANDARDS

In May 2014, the FASB and International Accounting Standards Board jointly issued new principles-based accounting guidance for revenue recognition that will supersede virtually all existing revenue guidance. The core principle of this guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods and services. To achieve the core principle, the guidance establishes the following five steps: 1) identify the contract(s) with a customer, 2) identify the performance obligation in the contract, 3) determine the transaction price, 4) allocate the transaction price to the performance obligations in the contract, and 5) recognize revenue when (or as) the entity satisfies a performance obligation. The guidance also details the accounting treatment for costs to obtain or fulfill a contract. Lastly, disclosure requirements have been enhanced to provide sufficient information to enable users of financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. In August 2015, the FASB issued new guidance to delay the effective date of the new revenue standard by one year. The deferral results in the new revenue standard being effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. Early application is permitted under the original effective date of fiscal years, and interim periods within those fiscal years, beginning after December 15, 2016. The Company is currently evaluating the impact on the Company's financial position and results of operations and related disclosures.

In January 2016, the FASB issued targeted improvements in regards to the recognition and measurement of financial assets and financial liabilities. The changes are as follows: requires equity investments (except equity method and consolidated investments) to be measured at fair value with changes in fair value recognized in net income; simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment, when a qualitative assessment indicates that impairment exists, an entity is required to measure the investment at fair value; eliminates the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet; requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; requires an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments; and requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (that is, securities or loans and

receivables) on the balance sheet or the accompanying notes to the financial statements. This guidance is effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period and early adoption is permitted but limited. The new guidance is to be applied by means of a cumulative-effect adjustment to the balance sheet as of the beginning of the fiscal year of adoption and for equity securities without readily determinable fair values, applied prospectively to equity investments that exist as of the date of adoption. The Company has concluded that changes in its accounting required by this new guidance will not materially impact the Company's financial position or results of operations and related disclosures.

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NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

In February 2016, the FASB issued guidance on lease accounting. The new guidance establishes two types of leases for lessees: finance or operating. The guidance for lessors is largely unchanged. Under the guidance, a lessee is to recognize a right-of-use asset and lease liability that arises from a lease. A lessee can make a policy election, by asset class, to not recognize lease assets or liabilities for leases with a term of 12 months or less. Both finance and operating leases will have associated right-of-use assets and liabilities initially measured at the present value of the lease payments. Current and noncurrent balance sheet classification will apply. Finance leases will have another reported element for interest associated with the principal lease liability. The component concept from the 2014 revenue recognition standard has been included in the new lease standard which will guide identification of individual assets and non-lease components. As with current GAAP, the guidance does not apply to the following leases: intangible assets to explore for or use minerals, oil, natural gas, and similar nonregenerative resources, biological assets (includes timber), inventory, or assets under construction. This guidance is effective for annual reporting periods beginning after December 15, 2018, including interim periods within that reporting period and early adoption is permitted. The new guidance is to be applied under a modified retrospective approach wherein practical expedients have been allowed that will not require reassessment of current leases at the effective date. The Company is currently evaluating the impact on the Company's financial position and results of operations and related disclosures.

In March 2016, the FASB issued guidance for derivatives and hedging given lack of specific guidance and diversity in practice. The guidance clarifies that a change in the counterparty to a derivative instrument under Topic 815 treatment does not, in and of itself, require dedesignation of that hedge accounting relationship provided all other hedge accounting criteria continues to be met (specifically points to counterparty credit worthiness). This guidance is effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period and early adoption is permitted, including adoption in an interim period. The new guidance is to be applied under the prospective method or modified retrospective approach. The Company has concluded that changes in its accounting required by this new guidance will not materially impact the Company's financial position or results of operations and related disclosures.

In March 2016, the FASB issued guidance in regards to stock compensation as a part of the simplification initiative that covers related tax accounting, cash flow presentation, and forfeitures. The two tax accounting related amendments are as follows: all excess tax benefits and tax deficiencies (including tax benefits of dividends on share-based payment awards) should be recognized as income tax expense or benefit in the income statement, the tax effects of exercised or vested awards should be treated as discrete items in the reporting period in which they occur, an entity also should recognize excess tax benefits regardless of whether the benefit reduces taxes payable in the current period; and the threshold to qualify for equity classification permits withholding up to the maximum statutory tax rates in the applicable jurisdictions. The cash flow presentation items sets forth that excess tax benefits should be classified along with other income tax cash flows as an operating activity and cash paid by an employer when directly withholding shares for tax withholding purposes should be classified as a financing activity. For forfeitures, an entity can make an entity-wide accounting policy election to either estimate the number of awards that are expected to vest (current GAAP) or account for forfeitures when they occur. This guidance is effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period and early adoption is permitted, including adoption in an interim period. The new guidance application is mixed among the various elements that include, retrospective, prospective, and modified retrospective transition methods. The Company is currently evaluating the impact on the Company's financial position and results of operations and related disclosures.

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This Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") is based upon the consolidated financial statements of Eastman Chemical Company ("Eastman" or the "Company"), which have been prepared in accordance with accounting principles generally accepted ("GAAP") in the United States, and should be read in conjunction with the Company's audited consolidated financial statements, including related notes, and MD&A contained in the Company's 2015 Annual Report on Form 10-K, the Company's unaudited consolidated financial statements, including related notes, included elsewhere in this Quarterly Report on Form 10-Q, and the Current Report on Form 8-K filed with the Securities and Exchange Commission ("SEC") on April 18, 2016. All references to earnings per share ("EPS") contained in this report are diluted EPS unless otherwise noted.

CRITICAL ACCOUNTING ESTIMATES

In preparing the consolidated financial statements in conformity with GAAP, the Company's management must make decisions which impact the reported amounts and the related disclosures. Such decisions include the selection of the appropriate accounting principles to be applied and assumptions on which to base estimates and judgments that affect the reported amounts of assets, liabilities, sales revenue and expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, the Company evaluates its estimates, including those related to allowances for doubtful accounts, impairment of long-lived assets, environmental costs, pension and other postretirement benefits, litigation and contingent liabilities, income taxes, and purchase accounting. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. The Company's management believes the critical accounting estimates described in Part II, Item 7 of the Company's 2015 Annual Report on Form 10-K are the most important to the fair presentation of the Company's

financial condition and results. These estimates require management's most significant judgments in the preparation of the Company's consolidated financial statements.

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MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL
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NON-GAAP FINANCIAL MEASURES

Non-GAAP financial measures, and the accompanying reconciliations of the non-GAAP financial measures to the most comparable GAAP measures, are presented in "Overview", "Results of Operations", and "Summary by Operating Segment" in this MD&A.

Company Use of Non-GAAP Financial Measures

In addition to evaluating the Company's financial condition, results of operations, liquidity, and cash flows as reported in accordance with GAAP, Eastman management also evaluates Company and operating segment performance, and makes resource allocation and performance evaluation decisions, excluding the effect of transactions, costs, and losses or gains that do not directly arise from Eastman's normal, or "core", business and operations, or are otherwise of an unusual or non-recurring nature. These transactions, costs, and losses or gains relate to, among other things, cost reduction, growth and profitability improvement initiatives, and other events outside of core business operations (such as asset impairments and restructuring gains and charges, costs of and related to acquisition or disposition of businesses, and mark-to-market ("MTM") losses or gains for pension and other postretirement benefit plans). Because non-core or non-recurring transactions, costs, and losses or gains may materially affect the Company's, or any particular operating segment's, financial condition or results in a specific period in which they are recognized, Eastman believes it is appropriate to evaluate both the financial measures prepared and calculated in accordance with GAAP and the related non-GAAP financial measures excluding the effect on our results of these non-core, unusual, or non-recurring items. In addition to using such measures to evaluate results in a specific period, management evaluates such non-GAAP measures, and believes that investors may also evaluate such measures, because such measures may provide more complete and consistent comparisons of the Company's, and its segments', operational performance on a period-over-period historical basis and, as a result, provide a better indication of expected future trends. Management discloses these non-GAAP measures, and the related reconciliations to the most comparable GAAP financial measures, because it believes investors use these metrics in evaluating longer term period-over-period performance, and to allow investors to better understand and evaluate the information used by management to assess the Company's, and its operating segments', performance, make resource allocation decisions and evaluate organizational and individual performance in determining certain performance-based compensation. Non-GAAP measures do not have definitions under GAAP, and may be defined differently by, and not be comparable to, similarly titled measures used by other companies. As a result, management cautions investors not to place undue reliance on any non-GAAP measure, but to consider such measures with the most directly comparable GAAP measure.

Non-GAAP Measures in this Quarterly Report

The following non-core items are excluded by management in its evaluation of certain results in this Quarterly Report, in each case for the periods and in the amounts in the table below:

- Asset impairments and restructuring (gains) charges, net, of which asset impairments are non-cash transactions impacting profitability;
- Acquisition integration and transaction costs;
- Costs resulting from the sale of acquired inventories at fair value, net of the last-in, first-out ("LIFO") impact for certain of these inventories (as required by purchase accounting, these inventories were marked to fair value); and
- Cost to Company of disposition of claims against operations that were discontinued by Solutia Inc., ("Solutia") prior to the Company's acquisition of Solutia in 2012.

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Non-GAAP Financial Measures -- Excluded Non-Core Items

(Dollars in millions)	First Quarter	
	2016	2015
Non-core items impacting operating earnings:		
Asset impairments and restructuring (gains) charges, net	\$(2)	\$109
Acquisition integration and transaction costs	9	8
Additional costs of acquired inventories	—	7
Non-core items impacting earnings before income taxes:		
Cost of disposition of claims against discontinued Solutia operations	5	—

This MD&A includes the effect of the foregoing on the following financial measures:

- Gross profit,
- Selling, general and administrative ("SG&A") expenses,
- Operating earnings,
- Other charges (income), net,
- Net earnings, and
 - Diluted earnings per share.

Other Non-GAAP Financial Measures

Alternative Non-GAAP Cash Flow Measures

In addition to the non-GAAP measures presented in this Quarterly Report and other periodic reports, from time to time management evaluates and discloses to investors and securities analysts the non-GAAP measure cash provided by operating activities excluding certain non-core, unusual, or non-recurring items ("cash provided by operating activities, as adjusted") when analyzing, among other things, business performance, liquidity and financial position, and performance-based compensation. Eastman management uses this non-GAAP measure in conjunction with the GAAP measure cash provided by operating activities because it believes it is a more appropriate metric to evaluate the cash flows from Eastman's core operations that are available for organic and inorganic growth initiatives and create stockholder value, and because it allows for a more consistent period-over-period presentation of such amounts. In its evaluation, Eastman management generally excludes the impact of certain non-core activities and decisions of management because such activities and decisions are not considered core, ongoing components of operations and the decisions to undertake or not to undertake such activities may be made irrespective of the cash generated from operations. From time to time, management discloses this non-GAAP measure and the related reconciliation to investors and securities analysts to allow them to better understand and evaluate the information used by management in its decision making processes and because management believes investors and securities analysts use similar measures to assess Company performance, liquidity, and financial position over multiple periods and to compare these with other companies.

Similarly, from time to time, Eastman may disclose to investors and securities analysts an alternative non-GAAP measure of "free cash flow", which management defines as cash provided by operating activities, as adjusted, described above, less the amount of capital expenditures. Management believes such items are generally funded from

available cash and, as such, should be considered in determining free cash flow. Eastman management believes this is an appropriate metric to use to evaluate the Company's overall ability to generate cash to fund future operations, inorganic growth opportunities, and to meet the Company's debt repayment obligations. Management believes this metric is useful to investors and securities analysts in order to provide them with information similar to that used by management in evaluating potential future cash available for various initiatives and because management believes investors and securities analysts