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)

[X]	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 incorporation or organization)	(I.R.S. employer 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 [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 [X] 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 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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UNAUDITED CONSOLIDATED STATEMENTS OF EARNINGS,
COMPREHENSIVE INCOME AND RETAINED EARNINGS

	First Quarter	
(Dollars in millions, except per share amounts)	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

(Dollars in millions, except per share amounts)	March 31, 2016	December 31, 2015
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 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

	First Three Months	
(Dollars in millions)	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

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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 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

	March 31,	December 31,
(Dollars in millions)	2016	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

	First Quarter	
(Dollars in millions)	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

	March 31,	December 31,
(Dollars in millions)	2016	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

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 March 31, 2016	Total Fair Value	Quoted Prices in Active Markets for	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)

			Identical Assets (Level 1)		
Long-term borrowings	$ 6,565	$6,854	$ 6,311	$ 543	$ —

(Dollars in millions)	Recorded Amount December 31, 2015	Fair Value Measurements at 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

	First Quarter		
(Dollars in millions)	Consolidated Statement of Earnings Location of Gain/(Loss) Recognized in Income on Derivatives	Amount of Gain/(Loss) Recognized in Income on Derivatives	
Derivatives in Fair Value Hedging Relationships		March 31, 2016	March 31, 2015
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)		