

EASTMAN CHEMICAL CO  
Form 10-Q  
August 04, 2017  
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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 June 30, 2017  
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, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	<input checked="" type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/>	(Do not check if a smaller reporting company)	<input type="checkbox"/>

Smaller  
reporting  
company  
Emerging  
growth      [ ]  
company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

YES [ ] NO [ ]

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

YES [ ] NO [X]

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

Class	Number of Shares Outstanding at June 30, 2017
Common Stock, par value \$0.01 per share	144,879,098

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FORWARD-LOOKING STATEMENTS

Certain statements made or incorporated by reference 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 ("Eastman" or the "Company") 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; exposure to, and effects of hedging of, raw material and energy costs; foreign currencies and interest rates; disruption of raw material or energy supply; global and regional economic, political, and business conditions; competition; growth opportunities; supply and demand, volume, price, cost, margin and sales; pending and future legal proceedings; earnings, cash flow, dividends and other expected financial results, events, and conditions; expectations, strategies, and plans for individual assets and products, businesses, and operating 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 "Management's Discussion and Analysis of Financial Condition and Results of Operations - Risk Factors" in Part I, Item 2 of this Quarterly Report. Other factors, risks or uncertainties of which we are not aware, or presently deem immaterial, could also cause actual results to differ materially from those in the forward-looking statements.

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)	Second Quarter		First Six Months			
	2017	2016	2017	2016		
Sales	\$2,419	\$2,297	\$4,722	\$4,533		
Cost of sales	1,768	1,692	3,446	3,294		
Gross profit	651	605	1,276	1,239		
Selling, general and administrative expenses	176	174	350	357		
Research and development expenses	55	55	109	109		
Asset impairments and restructuring gains, net	—	—	—	(2 )		
Operating earnings	420	376	817	775		
Net interest expense	61	63	121	127		
Early debt extinguishment costs	—	9	—	9		
Other (income) charges, net	—	(20 )	(4 )	(8 )		
Earnings before income taxes	359	324	700	647		
Provision for income taxes	65	67	127	139		
Net earnings	294	257	573	508		
Less: Net earnings attributable to noncontrolling interest	2	2	3	2		
Net earnings attributable to Eastman	\$292	\$255	\$570	\$506		
Basic earnings per share attributable to Eastman	\$2.01	\$1.73	\$3.91	\$3.43		
Diluted earnings per share attributable to Eastman	\$2.00	\$1.71	\$3.89	\$3.40		
Comprehensive Income						
Net earnings including noncontrolling interest			\$294	\$257	\$573	\$508
Other comprehensive income (loss), net of tax:						
Change in cumulative translation adjustment			36	(70 )	43	36
Defined benefit pension and other postretirement benefit plans:						
Amortization of unrecognized prior service credits included in net periodic costs			(6 )	(7 )	(13 )	(14 )
Derivatives and hedging:						
Unrealized gain (loss) during period			(18 )	38	(39 )	20
Reclassification adjustment for losses included in net income, net			8	33	4	37
Total other comprehensive income (loss), net of tax			20	(6 )	(5 )	79
Comprehensive income including noncontrolling interest			314	251	568	587
Less: Comprehensive income attributable to noncontrolling interest			2	2	3	2
Comprehensive income attributable to Eastman			\$312	\$249	\$565	\$585
Retained Earnings						
Retained earnings at beginning of period			\$5,925	\$5,330	\$5,721	\$5,146
Net earnings attributable to Eastman			292	255	570	506
Cash dividends declared			(75 )	(68 )	(149 )	(135 )
Retained earnings at end of period			\$6,142	\$5,517	\$6,142	\$5,517

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

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## UNAUDITED CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

	June 30, 2017	December 31, 2016
(Dollars in millions, except per share amounts)		
Assets		
Current assets		
Cash and cash equivalents	\$222	\$ 181
Trade receivables, net of allowance for doubtful accounts	1,018	812
Miscellaneous receivables	419	399
Inventories	1,540	1,404
Other current assets	63	70
Total current assets	3,262	2,866
Properties		
Properties and equipment at cost	11,966	11,699
Less: Accumulated depreciation	6,563	6,423
Net properties	5,403	5,276
Goodwill	4,507	4,461
Intangible assets, net of accumulated amortization	2,433	2,469
Other noncurrent assets	359	385
Total assets	\$15,964	\$ 15,457
Liabilities and Stockholders' Equity		
Current liabilities		
Payables and other current liabilities	\$1,384	\$ 1,512
Borrowings due within one year	212	283
Total current liabilities	1,596	1,795
Long-term borrowings	6,669	6,311
Deferred income tax liabilities	1,286	1,206
Post-employment obligations	1,004	1,018
Other long-term liabilities	519	519
Total liabilities	11,074	10,849
Stockholders' equity		
Common stock (\$0.01 par value – 350,000,000 shares authorized; shares issued – 218,274,450 and 217,707,600 for 2017 and 2016, respectively)	2	2
Additional paid-in capital	1,954	1,915
Retained earnings	6,142	5,721
Accumulated other comprehensive income (loss)	(286)	(281)
	7,812	7,357
Less: Treasury stock at cost (73,446,150 shares for 2017 and 71,269,474 shares for 2016)	3,000	2,825
Total Eastman stockholders' equity	4,812	4,532
Noncontrolling interest	78	76
Total equity	4,890	4,608
Total liabilities and stockholders' equity	\$15,964	\$ 15,457

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

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## UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

	First Six Months	
(Dollars in millions)	2017	2016
Operating activities		
Net earnings	\$ 573	\$ 508
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	292	291
Early debt extinguishment costs	—	9
Gain on sale of equity investment	—	(17 )
Provision for deferred income taxes	36	47
Changes in operating assets and liabilities, net of effect of acquisitions and divestitures:		
(Increase) decrease in trade receivables	(166 )	(151 )
(Increase) decrease in inventories	(108 )	41
Increase (decrease) in trade payables	(28 )	(76 )
Pension and other postretirement contributions (in excess of) less than expenses	(56 )	(51 )
Variable compensation (in excess of) less than expenses	(34 )	(67 )
Other items, net	(26 )	11
Net cash provided by operating activities	483	545
Investing activities		
Additions to properties and equipment	(279 )	(234 )
Proceeds from sale of assets	1	41
Acquisitions, net of cash acquired	(4 )	(22 )
Other items, net	(1 )	3
Net cash used in investing activities	(283 )	(212 )
Financing activities		
	(95 )	(208 )

Net increase (decrease) in commercial paper and other borrowings			
Proceeds from borrowings	500		807
Repayment of borrowings	(250)	)	(807)
Dividends paid to stockholders	(149)	)	(136)
Treasury stock purchases	(175)	)	(45)
Dividends paid to noncontrolling interest	(1)	)	(4)
Proceeds from stock option exercises and other items, net	12		8
Net cash used in financing activities	(158)	)	(385)
Effect of exchange rate changes on cash and cash equivalents		)	(1)
Net change in cash and cash equivalents	41		(53)
Cash and cash equivalents at beginning of period	181		293
Cash and cash equivalents at end of period	\$ 222		\$ 240

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 ("Eastman" or the "Company") in accordance and consistent with the accounting policies stated in the Company's 2016 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 2016 Annual Report on Form 10-K. The December 31, 2016 financial position data included herein was derived from the audited consolidated financial statements included in the 2016 Annual Report on Form 10-K but does not include all disclosures required by accounting principles generally accepted in the United States ("GAAP").

In the opinion of management, the unaudited consolidated financial statements include all normal recurring adjustments necessary for fair presentation of the interim financial information in conformity with GAAP. These statements contain 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 conform to current period presentation.

## 2. INVENTORIES

	June 30, 2017	December 31, 2016
(Dollars in millions)		
Finished goods	\$1,103	\$ 997
Work in process	220	198
Raw materials and supplies	478	473
Total inventories at FIFO or average cost	1,801	1,668
Less: LIFO reserve	261	264
Total inventories	\$1,540	\$ 1,404

Inventories valued on the last-in, first-out ("LIFO") method were approximately 60 percent of total inventories at both June 30, 2017 and December 31, 2016.

## 3. PAYABLES AND OTHER CURRENT LIABILITIES

	June 30, 2017	December 31, 2016
(Dollars in millions)		
Trade creditors	\$675	\$ 704
Accrued payrolls, vacation, and variable-incentive compensation	125	196
Accrued taxes	90	106
Post-employment obligations	84	110
Derivative hedging liability	82	72
Other	328	324
Total payables and other current liabilities	\$1,384	\$ 1,512

The "Other" above consists primarily of accruals for dividends payable, interest payable, the current portion of environmental liabilities, and miscellaneous accruals.

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## NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

## 4. PROVISION FOR INCOME TAXES

(Dollars in millions)	Second Quarter				First Six Months			
	2017		2016		2017		2016	
	\$	%	\$	%	\$	%	\$	%
Provision for income taxes and tax rate	\$65	18%	\$67	21%	\$127	18%	\$139	22%

The second quarter and first six months 2017 effective tax rates include a \$22 million tax benefit to reflect finalization of prior years' income tax returns. The first six months 2017 effective tax rate also reflects a \$22 million tax benefit due to planned amendments to prior years' income tax returns. The second quarter and first six months 2016 effective tax rates include a \$16 million one-time benefit for the restoration of tax basis for which depreciation deductions were previously limited. The first six months 2016 effective tax rate also reflects a \$9 million tax benefit primarily due to adjustments to the tax provision to reflect the finalization of 2014 foreign income tax returns.

## 5. BORROWINGS

(Dollars in millions)	June	December 31,
	30, 2017	2016
Borrowings consisted of:		
5.5% notes due November 2019	\$250	\$ 249
2.7% notes due January 2020	796	796
4.5% notes due January 2021	184	184
3.6% notes due August 2022	739	741
1.50% notes due May 2023 <sup>(1)</sup>	852	786
7 1/4% debentures due January 2024	197	197
7 5/8% debentures due June 2024	43	43
3.8% notes due March 2025	690	689
1.875% notes due November 2026 <sup>(1)</sup>	563	519
7.60% debentures due February 2027	195	195
4.8% notes due September 2042	493	493
4.65% notes due October 2044	871	870
Credit facilities borrowings	799	549
Commercial paper borrowings	200	280
Capital leases and other	9	3
Total borrowings	6,881	6,594
Borrowings due within one year	212	283
Long-term borrowings	\$6,669	\$ 6,311

The carrying value of the euro-denominated 1.50% notes due May 2023 and 1.875% notes due November 2026 will fluctuate with changes in the euro exchange rate. The carrying value of these euro-denominated borrowings have been designated as non-derivative net investment hedges of a portion of the Company's net investments in euro functional-currency denominated subsidiaries to offset foreign currency fluctuations. During the six months ended June 30, 2017 and 2016, pre-tax losses of \$109 million and gains of \$3 million, respectively, were recognized in "Other comprehensive income (loss)" ("OCI") for revaluation of these notes.

(1)



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## NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

## Credit Facility and Commercial Paper Borrowings

In December 2014, Eastman borrowed \$1 billion under a five-year term loan ("2019 Term Loan"). As of June 30, 2017 and December 31, 2016, the 2019 Term Loan agreement balance outstanding was \$250 million with an interest rate of 2.48 percent and 2.02 percent, respectively. In December 2016, the Company borrowed \$300 million under a second five-year term loan ("2021 Term Loan"). As of June 30, 2017 and December 31, 2016, the 2021 Term Loan agreement balance outstanding was \$299 million with an interest rate of 2.48 percent and 1.95 percent, respectively. Borrowings under the 2019 Term Loan and 2021 Term Loan agreements 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 2021. 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. Commercial paper borrowings are classified as short-term. At June 30, 2017 and December 31, 2016, the Company had no outstanding borrowings under the Credit Facility. At June 30, 2017, the Company's commercial paper borrowings were \$200 million with a weighted average interest rate of 1.44 percent. At December 31, 2016, the Company's commercial paper borrowings were \$280 million with a weighted average interest rate of 1.12 percent.

The Company has access to a \$250 million accounts receivable securitization agreement (the "A/R Facility") that expires April 2019. Eastman Chemical Financial Corporation ("ECFC"), a subsidiary of the Company, has an agreement to sell interests in trade receivables under the A/R Facility to a third party purchaser. Third party creditors of ECFC have first priority claims on the assets of ECFC before those assets would be available to satisfy the Company's general obligations. Borrowings under the A/R Facility are subject to interest rates based on a spread over the lender's borrowing costs, and ECFC pays a fee to maintain availability of the A/R Facility. At December 31, 2016, the Company had no borrowings under the A/R Facility. At June 30, 2017, the Company's borrowings under the A/R Facility were \$250 million supported by trade receivables with an interest rate of 1.98%.

The Credit and A/R Facilities and other borrowing arrangements contain customary covenants and events of default, some of which require the Company to maintain certain financial ratios that determine the amounts available and terms of borrowings. The Company was in compliance with all covenants at both June 30, 2017 and December 31, 2016.

## Fair Value of Borrowings

The Company has classified its long-term borrowings at June 30, 2017 and December 31, 2016, 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 2016 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 other borrowings under the Term Loans and the A/R Facility equals the carrying value and is classified as Level 2. The Company had no borrowings classified as Level 3 as of June 30, 2017 and December 31, 2016.

Fair Value Measurements at  
June 30, 2017

(Dollars in millions)	Recorded Amount June 30, 2017	Total Fair Value	Quoted Prices in Active Markets	Significant Other Observable Inputs
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			for (Level 2) Identical Liabilities (Level 1)	
Long-term borrowings	\$ 6,669	\$7,069	\$ 6,273	\$ 796

Fair Value Measurements at  
December 31, 2016

(Dollars in millions)	Recorded Amount December 31, 2016	Total Fair Value	Quoted Prices in Active Markets for Identical Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)
Long-term borrowings	\$ 6,311	\$6,586	\$ 6,036	\$ 550

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NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

6. DERIVATIVE AND NON-DERIVATIVE FINANCIAL INSTRUMENTS

Overview of 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 and investments in foreign subsidiaries, the Company uses various derivative and non-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 Company does not enter into derivative transactions for speculative purposes.

For further information on hedging programs, see Note 10, "Derivative and Non-Derivative Financial Instruments", to the consolidated financial statements in Part II, Item 8 of the Company's 2016 Annual Report on Form 10-K.

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 are attributable to a particular risk. The derivative instruments that are designated and qualify as a cash flow hedge are reported on the balance sheet at fair value and the changes in fair value of these hedging instruments are offset in part or in whole by corresponding changes in the anticipated cash flows of the underlying exposures being hedged. The net of the change in the hedge instrument and item being hedged for qualifying cash flow hedges is reported as a component of "Accumulated other comprehensive income (loss)" ("AOCI") located in the Unaudited Consolidated Statements of Financial Position 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.

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. The derivative instruments that are designated and qualify as fair value hedges are reported on the balance sheet at fair value and the changes in fair value of these hedging instruments are offset in part or in whole by corresponding changes in the anticipated cash flows of the underlying exposures being hedged. The net of the change in the hedge instrument and item being hedged for qualifying fair value hedges is reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. Gains and losses on the derivatives representing hedge ineffectiveness are recognized in current earnings.

In second quarter 2016, the Company entered into a fixed-to-floating interest rate swap on a portion of the 3.8% notes due March 2025 to manage the Company's mix of fixed and variable rate debt.

Net Investment Hedges

Net investment hedges are defined as derivative or non-derivative instruments designated as and used to hedge the foreign currency exposure of net investments in certain foreign operations. The net of the change in the hedge instrument and item being hedged for qualifying net investment hedges is reported as a component of "Change in cumulative translation adjustment" within AOCI located in the Unaudited Consolidated Statements of Earnings,



Comprehensive Income and Retained Earnings. Gains and losses representing either hedge ineffectiveness or hedge components excluded from the assessment of effectiveness are recognized in current earnings. The foreign currency-denominated borrowings designated as net investment hedges are included as part of "Long-term borrowings" within the Unaudited Consolidated Statements of Financial Position.

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## NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

The Company designated the euro-denominated 1.50% notes due May 2023 in the principal amounts of €200 million (\$213 million) in fourth quarter 2016 and €550 million (\$614 million) in second quarter 2016 and the euro-denominated 1.875% notes due November 2026 in the principal amount of €500 million (\$534 million) in fourth quarter 2016 as non-derivative net investment hedges of a portion of the Company's net investments in euro functional currency-denominated subsidiaries to offset foreign currency fluctuations.

## Summary of Financial Position and Financial Performance of Hedging Instruments

The following table shows the notional amounts outstanding at June 30, 2017 and December 31, 2016 associated with the Company's hedging programs.

Notional Outstanding	June 30, 2017	December 31, 2016
----------------------	---------------------	----------------------

## Derivatives designated as cash flow hedges:

## Foreign Exchange Forward and Option Contracts

(in millions)

EUR/USD (in EUR)	€360	€378
EUR/USD (in approximate USD equivalent)	\$411	\$398
JPY/USD (in JPY)	¥900	¥1,800
JPY/USD (in approximate USD equivalent)	\$8	\$15
Commodity Forward and Collar Contracts		
Feedstock (in million barrels)	10	11
Energy (in million million british thermal units)	20	23

## Derivatives designated as fair value hedges:

Fixed-for-floating interest rate swaps (in millions) \$75 \$75

## Non-derivatives designated as net investment hedges:

Foreign Currency Net Investment Hedges (in millions)

EUR/USD (in EUR) €1,239 €1,238

## Fair Value Measurements

All the Company's derivative assets and liabilities are currently classified as Level 2 with fair values 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. The Company diversifies its positions among such counterparties to reduce its exposure to counterparty risk and credit losses and monitors the creditworthiness of its counterparties on an on-going basis. The Company had no credit losses during second quarter and first six months 2017 and 2016.

For additional fair value measurement information, see Note 1, "Significant Accounting Policies", and Note 10, "Derivative and Non-Derivative Financial Instruments", to the consolidated financial statements in Part II, Item 8 of the Company's 2016 Annual Report on Form 10-K.

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## NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

The following table shows the financial assets and liabilities valued on a gross basis as of June 30, 2017 and December 31, 2016. Additionally, the table below indicates where the derivatives are reported on the Unaudited Consolidated Statements of Financial Position. During the periods presented, there were no transfers between fair value hierarchy levels.

The Financial Position and Fair Value Measurements of Hedging Instruments on a Gross Basis  
(Dollars in millions)

Derivative Type	Statements of Financial Position Classification	June	
		30, 2017	December 31, 2016
		Level 2	Level 2
Derivatives designated as cash flow hedges:			
Commodity contracts	Other current assets	\$ 1	\$ 5
Commodity contracts	Other noncurrent assets	—	2
Foreign exchange contracts	Other current assets	35	49
Foreign exchange contracts	Other noncurrent assets	16	47
Derivatives designated as fair value hedges:			
Fixed-for-floating interest rate swap	Other current assets	1	1
Total Derivative Assets		\$ 53	\$ 104
Derivatives designated as cash flow hedges:			
Commodity contracts	Payables and other current liabilities	\$ 75	\$ 62
Commodity contracts	Other long-term liabilities	58	69
Foreign exchange contracts	Payables and other current liabilities	1	—
Foreign exchange contracts	Other long-term liabilities	1	—
Derivatives designated as fair value hedges:			
Fixed-for-floating interest rate swap	Long-term borrowings	3	4
Total Derivative Liabilities		\$ 138	\$ 135
Total Net Derivative Liabilities		\$ 85	\$ 31

In addition to the fair value associated with derivative instruments designated as cash flow hedges and fair value hedges noted in the table above, the Company had a carrying value of \$1.4 billion and \$1.3 billion associated with non-derivative instruments designated as foreign currency net investment hedges at June 30, 2017 and December 31, 2016, respectively. The designated foreign currency-denominated borrowings are included in the "Long-term borrowings" line item of the Unaudited Consolidated Statements of Financial Position.

All 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. The Company has elected to present the derivative contracts on a gross basis in the Unaudited Consolidated Statements of Financial Position. If the Company presented the derivatives contracts on a net basis, there would be no material difference in asset and liability positions. The Company does not have any cash collateral due under such agreements.



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## NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

The tables below present the effect of hedging instruments on OCI and the financial performance for second quarter and first six months 2017 and 2016:

(Dollars in millions)	Change in amount of after tax gain/(loss) recognized in OCI on derivatives (effective portion)		Pre-tax amount of gain/(loss) reclassified from Accumulated OCI into income (effective portion)		Additional pre-tax gain/(loss) recognized in earnings (effective portion)		Income Statement Classification
	Second Quarter 2017	Second Quarter 2016	Second Quarter 2017	Second Quarter 2016	Second Quarter 2017	Second Quarter 2016	
Hedging Relationships							
Derivatives in cash flow hedging relationships:							
Commodity contracts	\$ 9	\$ 79	\$ (20)	\$ (65)	\$ —	\$ —	Cost of sales
Foreign exchange contracts	(20)	1	10	15	—	—	Sales
Forward starting interest rate and treasury lock swap contracts	1	(9)	(1)	(2)	—	—	Net interest expense
Derivatives in fair value hedging relationships:							
Fixed-for-floating interest rate swaps	—	—	—	—	1	3	Net interest expense
Non-derivatives in net investment hedging relationships:							
Net investment hedges (pre-tax)	(91)	3	—	—	—	—	N/A
Derivatives not designated as hedges: <sup>(1)</sup>							
Foreign Exchange Contracts	—	—	—	—	10	23	Other (income) charges, net

<sup>(1)</sup> The gains or losses on derivatives that are not designated as hedges are marked to market and represent foreign exchange derivatives denominated in multiple currencies and are transacted and settled in the same quarter.

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## NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in millions)	Change in amount of after tax gain/(loss) recognized in OCI on derivatives (effective portion)		Pre-tax amount of gain/(loss) reclassified from Accumulated OCI into income (effective portion)		Additional pre-tax gain/(loss) recognized in earnings (effective portion)		Income Statement Classification
	First Six Months	2016	2017	2016	2017	2016	
Hedging Relationships							
Derivatives in cash flow hedging relationships:							
Commodity contracts	\$(7)	\$109	\$(27)	\$(85)	\$ —	\$ —	Cost of sales
Foreign exchange contracts	(30)	(25)	22	30	—	—	Sales
Forward starting interest rate and treasury lock swap contracts	2	(27)	(2)	(4)	—	—	Net interest expense
Derivatives in fair value hedging relationships:							
Fixed-for-floating interest rate swaps	—	—	—	—	2	7	Net interest expense
Non-derivatives in net investment hedging relationships:							
Net investment hedges (pre-tax)	(109)	3	—	—	—	—	N/A
Derivatives not designated as hedges: <sup>(1)</sup>							
Foreign Exchange Contracts	—	—	—	—	4	14	Other (income) charges, net

<sup>(1)</sup> The gains or losses on derivatives that are not designated as hedges are marked to market and represent foreign exchange derivatives denominated in multiple currencies and are transacted and settled in the same quarter.

Pre-tax monetized positions and mark-to-market gains and losses from raw materials and energy, currency, and certain interest rate hedges that were included in AOCI included losses of \$223 million at June 30, 2017 and losses of \$57 million at December 31, 2016. Losses in AOCI increased June 30, 2017 compared to December 31, 2016 primarily as a result of an increase in foreign currency exchange rates, particularly the euro. If realized, approximately \$43 million in pre-tax losses, as of June 30, 2017, will be reclassified into earnings during the next 12 months.

Any ineffectiveness from the hedging programs are immediately recognized in earnings. The Company had no material ineffectiveness from the hedging programs during second quarter and first six months 2017 and 2016.

## 7. 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 life insurance for eligible retirees hired prior to January 1, 2007. Eastman provides a subsidy for pre-Medicare health care and dental benefits to eligible retirees hired prior to January 1, 2007 that will end on

December 31, 2021. Company funding is also provided for eligible Medicare retirees hired prior to January 1, 2007 with a health reimbursement arrangement. Costs recognized for these benefits are 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 2016 Annual Report on Form 10-K.



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## NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

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

	Second Quarter				Other	
	Pension Plans				Postretirement	
					Benefit Plans	
	2017	2016		2017	2016	
(Dollars in millions)	U.S.	Non-U.S.	U.S.	Non-U.S.		
Components of net periodic benefit (credit) cost:						
Service cost	\$9	\$ 4	\$10	\$ 3	\$ 1	\$ 1
Interest cost	16	4	19	6	6	7
Expected return on assets	(35 )	(9 )	(34 )	(8 )	(1 )	(1 )
Amortization of:						
Prior service credit, net	(1 )	—	(1 )	—	(10 )	(10 )
Net periodic benefit (credit) cost	\$(11)	\$ (1 )	\$(6 )	\$ 1	\$ (4 )	\$ (3 )

	First Six Months				Other	
	Pension Plans				Postretirement	
					Benefit Plans	
	2017	2016		2017	2016	
(Dollars in millions)	U.S.	Non-U.S.	U.S.	Non-U.S.		
Components of net periodic benefit (credit) cost:						
Service cost	\$18	\$ 7	\$20	\$ 6	\$ 2	\$ 3
Interest cost	33	9	37	12	12	14
Expected return on assets	(70 )	(17 )	(68 )	(16 )	(3 )	(3 )
Amortization of:						
Prior service credit, net	(2 )	—	(2 )	—	(20 )	(20 )
Net periodic benefit (credit) cost	\$(21)	\$ (1 )	\$(13)	\$ 2	\$ (9 )	\$ (6 )

## 8.COMMITMENTS AND OFF BALANCE SHEET ARRANGEMENTS

## Purchase Obligations and Lease Commitments

The Company had various purchase obligations at June 30, 2017, totaling approximately \$2.9 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 \$295 million over a period of approximately 40 years. Of the total lease commitments, approximately 45 percent relate to real property, including office space, storage facilities, and land; approximately 45 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.

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NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

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 \$71 million at June 30, 2017 and consist primarily of leases for railcars that will expire beginning in third quarter 2018. Residual guarantee payments that become probable and estimable are recognized as 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 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.

Other Off Balance Sheet Arrangements

The Company has rights and obligations under non-recourse factoring facilities that have a combined limit of €150 million (\$171 million) as of June 30, 2017 and are committed until December 2017. These arrangements include receivables in the United States, Belgium, 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 second quarter and first six months 2017, were approximately \$250 million and \$500 million, respectively. The total amounts of cumulative receivables sold in second quarter and first six months 2016, were approximately \$225 million and \$460 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 \$122 million and \$99 million at June 30, 2017 and December 31, 2016, 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

## 9. 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 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 2016 Annual Report on Form 10-K. 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. The Company's total reserve for environmental contingencies was \$318 million and \$321 million at June 30, 2017 and December 31, 2016, respectively. At both June 30, 2017 and December 31, 2016, 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 that management believes to be probable and estimable for environmental contingencies, including remediation costs and asset retirement obligations, is included as part of "Payables and other current liabilities" and "Other long-term liabilities" in the Unaudited Consolidated Statements of Financial Position as follows:

(Dollars in millions)	June 30, December 31,	
	2017	2016
Environmental contingent liabilities, current	\$ 30	\$ 30
Environmental contingent liabilities, long-term	288	291
Total	\$ 318	\$ 321

## Remediation

Estimated future environmental expenditures for undiscounted remediation costs ranged from the best estimate or minimum of \$291 million to the maximum of \$500 million and from the best estimate or minimum of \$295 million to the maximum of \$503 million at June 30, 2017 and December 31, 2016, respectively. The estimated future costs are considered to be reasonably possible and include the amounts recognized at both June 30, 2017 and December 31, 2016.

Reserves for environmental remediation include liabilities expected to be paid within approximately 30 years. The amounts charged to pre-tax earnings for environmental remediation and related charges are included within "Cost of sales" in the Unaudited Consolidated Statements of Earnings, Comprehensive Income and Retained Earnings. Changes in the reserves for environmental remediation liabilities during first six months 2017 are summarized below:

(Dollars in millions)	Environmental Remediation Liabilities
Balance at December 31, 2016	\$ 295

Changes in estimates recognized in earnings and other	5	
Cash reductions	(9	)
Balance at June 30, 2017	\$	291

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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 sites that have environmental asset retirement obligations, the best estimate recognized to date over the sites estimated useful lives for these environmental asset retirement obligation costs was \$27 million and \$26 million at June 30, 2017 and December 31, 2016, respectively.

## Other

The Company 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 recognized non-environmental asset retirement obligations were \$47 million and \$46 million at June 30, 2017 and December 31, 2016, respectively.

## 10. 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.

## 11. STOCKHOLDERS' EQUITY

A reconciliation of the changes in stockholders' equity for first six months 2017 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, 2016	\$ 2	\$1,915	\$5,721	\$ (281 )	\$(2,825)	\$ 4,532	\$ 76	\$ 4,608
Net Earnings	—	—	570	—	—	570	3	573
Cash Dividends Declared <sup>(1)</sup> (\$1.02 per share)	—	—	(149 )	—	—	(149 )	—	(149 )
Other Comprehensive Income	—	—	—	(5 )	—	(5 )	—	(5 )
Share-Based Compensation Expense <sup>(2)</sup>	—	27	—	—	—	27	—	27
Stock Option Exercises	—	17	—	—	—	17	—	17
Other	—	(5 )	—	—	—	(5 )	(1 )	(6 )
Share Repurchases	—	—	—	—	(175 )	(175 )	—	(175 )
Balance at June 30, 2017	\$ 2	\$1,954	\$6,142	\$ (286 )	\$(3,000)	\$ 4,812	\$ 78	\$ 4,890

- (1) Cash dividends declared includes cash dividends paid and dividends declared, but unpaid.
- (2) Share-based compensation expense is the fair value of share-based awards.

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## NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

## 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, 2015	\$ (284 )	\$ 129	\$ (234 )	\$ (1 )	\$ (390 )
Period change	(97 )	34	172	—	109
Balance at December 31, 2016	(381 )	163	(62 )	(1 )	(281 )
Period change	43	(13 )	(35 )	—	(5 )
Balance at June 30, 2017	\$ (338 )	\$ 150	\$ (97 )	\$ (1 )	\$ (286 )

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)	Second Quarter			
	2017	2016	2017	2016
	Before Tax	Net of Tax	Before Tax	Net of Tax
Other comprehensive income (loss)				
Change in cumulative translation adjustment	\$36	\$36	\$(70)	\$(70)
Defined benefit pension and other postretirement benefit plans:				
Amortization of unrecognized prior service credits included in net periodic costs <sup>(1)</sup>	(11 )	(6 )	(11 )	(7 )
Derivatives and hedging: <sup>(2)</sup>				
Unrealized gain (loss) during period	(28 )	(18 )	62	38
Reclassification adjustment for losses included in net income, net	13	8	53	33
Total other comprehensive income (loss)	\$10	\$20	\$34	\$(6 )



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## NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in millions)	First Six Months			
	2017	2016	2017	2016
	Before Tax	Net of Tax	Before Tax	Net of Tax
Other comprehensive income (loss)				
Change in cumulative translation adjustment	\$43	\$43	\$36	\$36
Defined benefit pension and other postretirement benefit plans:				
Amortization of unrecognized prior service credits included in net periodic costs <sup>(1)</sup>	(22 )	(13 )	(22 )	(14 )
Derivatives and hedging: <sup>(2)</sup>				
Unrealized gain (loss) during period	(62 )	(39 )	32	20
Reclassification adjustment for losses included in net income, net	7	4	60	37
Total other comprehensive income (loss)	\$(34)	\$(5)	\$106	\$79

(1) Included in the calculation of net periodic benefit costs for pension and other postretirement benefit plans. See Note 7, "Retirement Plans".

(2) For additional information regarding the impact of reclassifications into earnings, see Note 6, "Derivative and Non-Derivative Financial Instruments".

## 12. 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)	Second Quarter		First Six Months	
	2017	2016	2017	2016
Numerator				
Earnings attributable to Eastman:				
Earnings, net of tax	\$292	\$255	\$570	\$506
Denominator				
Weighted average shares used for basic EPS	145.3	147.8	145.7	147.8
Dilutive effect of stock options and other awards	1.1	1.1	1.1	1.1
Weighted average shares used for diluted EPS	146.4	148.9	146.8	148.9
(Calculated using whole dollars and shares)				
EPS				
Basic	\$2.01	\$1.73	\$3.91	\$3.43
Diluted	\$2.00	\$1.71	\$3.89	\$3.40

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## NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

In second quarter and first six months 2017 options to purchase 850,970 and 1,008,667 shares of common stock, respectively, 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. Second quarter and first six months 2017 reflect the impact of share repurchases of 1,232,977 and 2,176,676, respectively.

In second quarter and first six months 2016, options to purchase 1,056,961 and 1,076,935 shares of common stock, respectively, 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. Second quarter and first six months 2016 reflect the impact of share repurchases of 344,790 and 632,071, respectively.

The Company declared cash dividends of \$0.51 and \$0.46 per share in second quarter 2017 and 2016, respectively, and \$1.02 and \$0.92 per share in first six months 2017 and 2016, respectively.

## 13. ASSET IMPAIRMENTS AND RESTRUCTURING

In second quarter and first six months 2017, there were no asset impairment and restructuring charges. In first six months 2016, there was a gain of \$2 million in the Additives & Functional Products segment for the sale of previously impaired assets at the Crystex<sup>®</sup> insoluble sulfur research and development site in France.

## 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 six months 2017 and full year 2016:

(Dollars in millions)	Balance at January 1, 2017	Provision/ Adjustments	Non-cash Reductions/ Additions	Cash Reductions	Balance at June 30, 2017
Severance costs	\$ 42	\$ —	—\$ —	\$ (22 )	\$ 20
Site closure and restructuring costs	13	—	1	(2 )	12
Total	\$ 55	\$ —	—\$ 1	\$ (24 )	\$ 32

(Dollars in millions)	Balance at January 1, 2016	Provision/ Adjustments	Non-cash Reductions/ Additions	Cash Reductions	Balance at December 31, 2016
Non-cash charges	\$ —	\$ 12	\$ (12 )	\$ —	\$ —
Severance costs	55	32	—	(45 )	42
Site closure and restructuring costs	11	1	4	(3 )	13
Total	\$ 66	\$ 45	\$ (8 )	\$ (48 )	\$ 55

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

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## NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

## 14. 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 second quarter 2017 and 2016, \$13 million and \$7 million, respectively, of compensation expense before tax were recognized in "Selling, general and administrative expenses" in the Unaudited Consolidated Statements of Earnings, Comprehensive Income and Retained Earnings for all share-based awards. The impact on second quarter 2017 and 2016 net earnings of \$8 million and \$4 million, respectively, is net of deferred tax expense related to share-based award compensation for each period.

In first six months 2017 and 2016, \$27 million and \$20 million, respectively, of compensation expense before tax were recognized in "Selling, general and administrative expenses" in the Unaudited Consolidated Statements of Earnings, Comprehensive Income and Retained Earnings for all share-based awards. The impact on first six months 2017 and 2016 net earnings of \$17 million and \$12 million, respectively, is net of deferred tax expense related to share-based award compensation for each period.

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 2016 Annual Report on Form 10-K.

## 15. 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:

(Dollars in millions)	First Six	
	Months	
	2017	2016
Other current assets	\$(3 )	\$(13)
Other noncurrent assets	7	14
Payables and other current liabilities	(30 )	40
Long-term liabilities and equity	—	(30 )
Total	\$(26)	\$11

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

## 16. SEGMENT INFORMATION

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 additional financial and product information for each segment, see Part 1, Item 1, Business -- Business Segments and Part II, Item 8, Note 20, "Segment Information", in the Company's 2016 Annual Report on Form 10-K.

(Dollars in millions)	Second Quarter		First Six Months	
	2017	2016	2017	2016
Sales				
Additives & Functional Products	\$830	\$770	\$1,603	\$1,507
Advanced Materials	657	646	1,291	1,235
Chemical Intermediates	703	633	1,373	1,253
Fibers	215	234	428	514
Total Sales by Segment	2,405	2,283	4,695	4,509
Other	14	14	27	24
Total Sales	\$2,419	\$2,297	\$4,722	\$4,533

(Dollars in millions)	Second Quarter		First Six Months	
	2017	2016	2017	2016
Operating Earnings (Loss)				
Additives & Functional Products	\$159	\$168	\$311	\$321
Advanced Materials	137	132	258	240
Chemical Intermediates	83	15	165	82
Fibers	55	72	107	158
Total Operating Earnings by Segment	434	387	841	801
Other				
Growth initiatives and businesses not allocated to segments	(32 )	(24 )	(60 )	(42 )
Pension and other postretirement benefits income, net not allocated to operating segments	18	13	36	25
Acquisition integration and transaction costs	—	—	—	(9 )
Total Operating Earnings	\$420	\$376	\$817	\$775

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## NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in millions)	June 30, December 31,	
	2017	2016
Assets by Segment <sup>(1)</sup>		
Additives & Functional Products	\$6,497	\$ 6,255
Advanced Materials	4,382	4,247
Chemical Intermediates	2,997	2,927
Fibers	950	920
Total Assets by Segment	14,826	14,349
Corporate Assets	1,138	1,108
Total Assets	\$15,964	\$ 15,457

Segment assets include accounts receivable, inventory, fixed assets, goodwill, and intangible assets. Segment asset <sup>(1)</sup> balances for shared fixed assets within the CI and Fibers segments as of December 31, 2016 have been reclassified to conform to current period allocation methodology.

## 17. RECENTLY ISSUED ACCOUNTING STANDARDS

In May 2014, the Financial Accounting Standards Board ("FASB") and International Accounting Standards Board jointly issued new principles-based accounting guidance for revenue recognition that provides a five-step process to the principles-based guidance. 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. In April 2016, the FASB issued clarifying guidance to the 2014 revenue standard in regard to the identification of performance obligations and licensing. In May 2016, the FASB issued narrow-scope improvements and practical expedients to the new revenue standard that include clarification of the collectability criterion, specification for the measurement of noncash considerations, clarifies a completed contract for transition purposes and clarification in regards to the retrospective application, as well as, policy elections, and other practical expedients. In December 2016, the FASB issued additional corrections and improvements that affect various narrow aspects of the guidance. The effective date for all amendments is the same as that of the revenue standard stated above. Management does not expect that changes in its accounting required by this new guidance will materially impact the Company's financial statements and related disclosures. Management plans to adopt the new guidance January 1, 2018, and anticipates adopting retrospectively to each prior reporting period presented with the election of applicable practical expedients.

In February 2016, the FASB issued guidance on lease accounting. The new guidance establishes two types of leases for lessees: finance and operating. Both finance and operating leases will have associated right-of-use assets and liabilities initially measured at the present value of the lease payments. 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. Management is currently evaluating the impact on the Company's financial statements and related disclosures.

In June 2016, the FASB issued guidance relating to credit losses. The amendments require a financial asset (including trade receivables) to be presented at the net amount expected to be collected through the use of allowances for credit losses valuation account. The income statement will reflect the measurement of credit losses for newly recognized financial assets, as well as the expected increases or decreases of expected credit losses that have taken place during the period. This guidance is effective for annual reporting periods beginning after December 15, 2019, including

interim periods within that reporting period and early adoption is permitted, including adoption in an interim period, beginning after December 15, 2018. The new guidance application is mixed among the various elements that include modified retrospective and prospective transition methods. Management is currently evaluating the impact on the Company's financial statements and related disclosures.

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NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

In October 2016, the FASB issued guidance as a part of its simplification initiative in regards to income tax of intra-entity asset transfers. The release requires an entity to recognize the income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs. Consequently, the amendments eliminate the exception for an intra-entity transfer of an asset other than inventory that prohibited recognizing current and deferred income tax consequences for an intra-entity asset transfer until the asset or assets have been sold to an outside party. This guidance is effective for annual reporting periods beginning after December 15, 2017, including interim periods within those annual reporting periods and early adoption is permitted as of the beginning of an annual reporting period for which financial statements (interim or annual) have not been issued or made available for issuance. The new guidance is to be applied on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption. Management is currently evaluating the impact on the Company's financial statements and related disclosures.

In January 2017, the FASB issued guidance clarifying the definition of a business that provides a two-step analysis in the determination of whether an acquisition or derecognition is a business or an asset. The update removes the evaluation of whether a market participant could replace any missing elements and provides a framework to assist entities in evaluating whether both an input and a substantive process are present. This guidance is effective for annual reporting periods beginning after December 15, 2017, including interim periods within those annual reporting periods and early adoption is permitted for transactions that meet specified criteria. This guidance is to be applied on a prospective basis for transactions that occur after the effective date.

In January 2017, the FASB issued guidance as a part of its simplification initiative that bases the impairment of goodwill on any difference for which the carrying value is greater than the fair value of the reporting unit. This guidance is effective for annual reporting periods, or interim period testing performed, beginning after December 15, 2019. Early adoption is permitted for interim or annual goodwill impairment testing performed after January 1, 2017. This guidance is to be applied on a prospective basis for goodwill testing that occur after the effective date.

In February 2017, the FASB issued guidance that clarifies the scope of nonfinancial asset derecognition and the accounting for partial sales of nonfinancial assets. This guidance is effective at the same time as the amendments in the revenue recognition standard stated above, for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017, and must be applied in conjunction with that standard. Adoption can be applied either on a retrospective or modified retrospective approach. Management is currently evaluating the impact on the Company's financial statements and related disclosures.

In March 2017, the FASB issued guidance to improve the presentation of net periodic pension and postretirement benefit costs that will require the reporting of the service cost component in the same line item or items as other compensation costs arising from services rendered by the pertinent employees during the period. The other components of net benefit cost (interest cost, expected return on plan assets, curtailment gains or losses, amortization of prior service costs or credits, and mark-to-market gains or losses) are to be presented in the income statement separately from the service cost component and outside the subtotal of income from operations. In addition, the amendment prescribes only the service cost component to be eligible for capitalization. This guidance is effective for annual reporting periods beginning after December 15, 2017, including interim periods within those annual reporting periods and early adoption is permitted as of the beginning of an annual period for which financial statements (interim or annual) have not been issued or made available for issuance. The new guidance is to be applied retrospectively for income statement effect and prospectively for balance sheet effects. Management is currently evaluating the impact on the Company's financial statements and related disclosures.

In May 2017, the FASB issued guidance to clarify when changes to the terms or conditions of a share-based payment award would require an entity to apply modification accounting. This guidance is effective for annual reporting periods, and interim periods within those annual periods, beginning after December 15, 2017. Early adoption is permitted, including adoption in any interim period, for reporting periods for which financial statements have not yet been issued. The new guidance is to be applied prospectively to an award modified on or after the adoption date.



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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 2016 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. 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 impairment of long-lived assets, environmental costs, pension and other postretirement benefits, litigation and contingent liabilities, and income taxes. 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 2016 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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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", "Summary by Operating Segment", and "2017 Outlook" in this MD&A.

Company Use of Non-GAAP Financial Measures

Non-Core Items and any Unusual or Non-Recurring Items

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 reductions, growth and profitability improvement initiatives, and other events outside of core business operations (such as asset impairments and restructuring charges and gains, costs of and related to acquisitions, gains and losses from and costs related to dispositions of businesses, financing transaction costs, and mark-to-market losses or gains for pension and other postretirement benefit plans). Because non-core, unusual, 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.

Adjusted Tax Rate and Provision for Income Taxes

In first quarter 2017, the Company began disclosing non-GAAP earnings with an adjusted effective tax rate and a resulting adjusted provision for income taxes using the Company's current forecasted tax rate for the full year. The adjusted effective tax rate and resulting adjusted provision for income taxes are equal to the Company's projected full year effective tax rate and provision for income taxes on earnings excluding non-core items for completed periods. The adjusted effective tax rate and resulting adjusted provision for income taxes may fluctuate during the year for changes in events and circumstances that change the Company's forecasted annual effective tax rate and resulting provision for income taxes excluding non-core items. Management discloses this adjusted effective tax rate, and the related reconciliation to the GAAP effective tax rate, to provide investors more complete and consistent comparisons of the Company's operational performance on a period-over-period interim basis and on the same basis as management evaluates quarterly financial results to provide a better indication of expected full year results. The Company did not forecast a full year effective tax rate or provision for income taxes on this basis in prior periods and, accordingly, is not presenting an adjusted effective tax rate or provision for income taxes for periods prior to first quarter 2017.

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', performances, make resource allocation decisions and evaluate organizational and individual performances 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.

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## Non-GAAP Measures in this Quarterly Report

The non-core items excluded by management in its evaluation of certain results in this Quarterly Report are described, and these non-core items and adjustments to provision for income taxes are quantified, below:

- Asset impairments and restructuring gains, net, of which asset impairments are non-cash transactions impacting profitability;
- Acquisition integration and transaction costs;
- Early debt extinguishment costs resulting from repayment of \$500 million of the 2.4% notes due June 2017;
- Cost of disposition of claims against operations that were discontinued by Solutia, Inc., ("Solutia") prior to the Company's acquisition of Solutia in 2012; and
- Gain from the sale of the Company's 50 percent interest in the Primester joint venture.

## Excluded Non-Core Items and Adjustments to Provision for Income Taxes

(Dollars in millions)	Second Quarter 2017	2016	First Six Months 2017	2016
Non-core items impacting operating earnings:				
Asset impairments and restructuring gains, net	\$—	\$—	\$—	\$(2)
Acquisition integration and transaction costs	—	—	—	9
Total non-core items impacting operating earnings	—	—	—	7
Non-core items impacting earnings before income taxes:				
Early debt extinguishment costs	—	9	—	9
Cost of disposition of claims against discontinued Solutia operations	—	—	—	5
Gain from sale of equity investment in Primester joint venture	—	(17)	—	(17)
Total non-core items impacting earnings before income taxes	—	(8)	—	(3)
Less: Items impacting provision for income taxes:				
Tax effect for non-core items	—	(3)	—	5
Adjustment to tax provision	3	—	12	
Total items impacting provision for income taxes	3	(3)	12	5
Total items impacting net earnings attributable to Eastman	\$(3)	\$(5)	\$(12)	\$(1)

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

- Selling, general and administrative ("SG&A") expenses,
- Operating earnings,
- Other (income) charges, net,
- Provision for income taxes,
- Net earnings attributable to Eastman, 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. 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 because it allows for a more consistent period-over-period presentation of such amounts. In its evaluation, 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. Management believes this is an appropriate metric to assess the Company's ability to fund priorities for uses of cash. The priorities for cash after funding operations include payment of quarterly dividends, additional repayment of debt, inorganic growth opportunities, and from time to time repurchasing shares. 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 financial performance and potential future cash available for various initiatives and assessing organizational performance in determining certain performance-based compensation and because management believes investors and securities analysts often use a similar measure of free cash flow to compare the results, and value, of comparable companies. In addition, Eastman may disclose to investors and securities analysts an alternative non-GAAP measure of "free cash flow yield", which management defines as annual free cash flow divided by the Company's market capitalization. Management believes this metric is useful to investors and securities analysts in comparing cash flow generation with that of peer and other companies.



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Alternative Non-GAAP Earnings Measures

From time to time, Eastman may also disclose to investors and securities analysts the non-GAAP earnings measures "Adjusted EBITDA", "EBITDA Margin", and "Return on Invested Capital" (or "ROIC"). Management defines Adjusted EBITDA as EBITDA (net earnings or net earnings per share before interest, taxes, depreciation and amortization) adjusted to exclude the same non-core, unusual, and non-recurring items as are excluded from the Company's other non-GAAP earnings measures for the same periods. EBITDA Margin is Adjusted EBITDA divided by the GAAP measure sales revenue in the Company's income statement for the same periods. Management defines ROIC as net income plus interest expense after tax divided by average total borrowings plus average stockholders' equity for the periods presented, each derived from the GAAP measures in the Company's financial statements for the periods presented. Management believes that Adjusted EBITDA, EBITDA Margin, and ROIC are useful as supplemental measures in evaluating the performance of and returns from Eastman's operating businesses, and from time to time uses such measures in internal performance calculations. Further, management understands that investors and securities analysts often use similar measures of Adjusted EBITDA, EBITDA Margin, and ROIC to compare the results, returns, and value of the Company with those of other companies.



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## OVERVIEW

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. Eastman is focused on consistent earnings growth through a market-driven approach that takes advantage of the Company's existing technology platforms, global market and manufacturing presence, and leading positions in key end markets such as transportation, building and construction, and consumables. Management believes that the Company's end-market diversity is a source of strength, and that many of the markets into which the Company's products are sold are benefiting from longer-term global trends such as energy efficiency, a rising middle class in emerging economies, and an increased focus on health and wellness. Management believes that these trends, combined with the diversity of the Company's end markets, facilitate more consistent demand for the Company's products over time.

The Company generated sales revenue of \$2.4 billion and \$2.3 billion in second quarter 2017 and 2016, respectively, and sales revenue of \$4.7 billion and \$4.5 billion in first six months 2017 and 2016, respectively. Sales revenue increased \$122 million and \$189 million in second quarter and first six months 2017 compared to second quarter and first six months 2016, respectively, as increases in the CI, AFP, and AM segments were partially offset by a decline in the Fibers segment.

Operating earnings were \$420 million in second quarter 2017 compared with \$376 million in second quarter 2016. Operating earnings increased in second quarter 2017 as increases in the CI and AM segments more than offset a decline in the Fibers and AFP segments.

Operating earnings were \$817 million in first six months 2017 compared with \$775 million in first six months 2016. Excluding the non-core items identified in "Non-GAAP Financial Measures", operating earnings in first six months 2017 and 2016 were \$817 million and \$782 million, respectively. Adjusted operating earnings increased in first six months 2017 as increases in the CI and AM segments more than offset a decline in the Fibers and AFP segments.

Net earnings attributable to Eastman and EPS and adjusted net earnings and EPS were as follows:

	Second Quarter			
	2017		2016	
(Dollars in millions, except diluted EPS)	\$	EPS	\$	EPS
Net earnings attributable to Eastman	\$292	\$2.00	\$255	\$1.71
Total non-core items, net of tax <sup>(1)</sup>	—		(5 )	
Adjustment to tax provision <sup>(1)</sup>	(3 )		—	
Adjusted net earnings	\$289	\$1.98	\$250	\$1.68
	First Six Months			
	2017		2016	
(Dollars in millions, except diluted EPS)	\$	EPS	\$	EPS
Net earnings attributable to Eastman	\$570	\$3.89	\$506	\$3.40
Total non-core items, net of tax <sup>(1)</sup>	—		(1 )	
Adjustment to tax provision <sup>(1)</sup>	(12 )		—	
Adjusted net earnings	\$558	\$3.80	\$505	\$3.39

<sup>(1)</sup> See "Results of Operations - Provision for Income Taxes" for adjusted provision for income taxes for second quarter and first six months 2017 and the tax effected amount of total non-core items for second quarter and first

six months 2016.

The Company generated \$483 million in cash from operating activities in first six months 2017.

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## RESULTS OF OPERATIONS

## Sales

	Second Quarter				First Six Months			
	2017	2016	Change		2017	2016	Change	
(Dollars in millions)			\$	%			\$	%
Sales	\$2,419	\$2,297	\$122	5 %	\$4,722	\$4,533	\$189	4 %
Volume / product mix effect			70	3 %			146	3 %
Price effect			75	3 %			84	2 %
Exchange rate effect			(23 )	(1)%			(41 )	(1)%

Sales revenue increased \$122 million and \$189 million in second quarter and first six months 2017 compared to second quarter and first six months 2016, respectively, as increases in the CI, AFP, and AM segments were partially offset by a decline in the Fibers segment.

## Gross Profit

	Second Quarter			First Six Months		
	2017	2016	Change	2017	2016	Change
(Dollars in millions)						
Gross Profit	\$651	\$605	8 %	\$1,276	\$1,239	3 %

Gross profit increased in second quarter and first six months 2017 compared with second quarter and first six months 2016 as increases in the CI and AM segments more than offset a decline in the Fibers and AFP segments. Gross profit in 2017 includes the benefit of lower labor and manufacturing costs from corporate cost reduction actions taken in 2016.

## Selling, General and Administrative Expenses

	Second Quarter			First Six Months		
	2017	2016	Change	2017	2016	Change
(Dollars in millions)						
Selling, General and Administrative Expenses	\$176	\$174	1 %	\$350	\$357	(2 )%
Acquisition integration and transaction costs	—	—		—	(9 )	
Selling, General and Administrative Expenses excluding non-core items	\$176	\$174	1 %	\$350	\$348	1 %

Included in first six months 2016 SG&A expenses were transaction costs for final resolution of the 2011 Sterling Chemicals, Inc. acquisition purchase price and integration costs for the Commonwealth Laminating & Coating, Inc. ("Commonwealth") business acquired in December 2014.

## Research and Development Expenses

	Second Quarter			First Six Months		
	2017	2016	Change	2017	2016	Change
(Dollars in millions)						
Research and Development Expenses	\$55	\$55	-%	\$109	\$109	-%

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## Asset Impairments and Restructuring

	Second Quarter	First Six Months	2017	2016	2017	2016
(Dollars in millions)						
Gain on sale of assets	\$ —	\$ —	\$ —	\$ (2)		
Total	\$ —	\$ —	\$ —	\$ (2)		

In first six months 2016 there was a gain of \$2 million in the AFP segment for the sale of previously impaired assets at the Crystex® insoluble sulfur research and development ("R&D") site in France.

For more information regarding asset impairments and restructuring charges and gains see Note 13, "Asset Impairments and Restructuring", to the Company's unaudited consolidated financial statements in Part I, Item 1 of this Quarterly Report on Form 10-Q.

## Operating Earnings

	Second Quarter			First Six Months		
(Dollars in millions)	2017	2016	Change	2017	2016	Change
Operating earnings	\$420	\$376	12 %	\$817	\$775	5 %
Asset impairments and restructuring gains, net	—	—		—	(2)	
Acquisition integration and transaction costs	—	—		—	9	
Operating earnings excluding non-core items	\$420	\$376	12 %	\$817	\$782	4 %

## Net Interest Expense

	Second Quarter			First Six Months		
(Dollars in millions)	2017	2016	Change	2017	2016	Change
Gross interest costs	\$70	\$73		\$138	\$146	
Less: Capitalized interest	1	2		3	5	
Interest expense	69	71	(3)%	135	141	(4)%
Less: Interest income	8	8		14	14	
Net interest expense	\$61	\$63	(3)%	\$121	\$127	(5)%

Net interest expense decreased in second quarter and first six months 2017 compared with second quarter and first six months 2016 as a result of the refinancing in 2016 of certain outstanding public debt with proceeds of the sale of new debt securities and term loan borrowings.

## Early Debt Extinguishment Costs

On May 26, 2016, the Company sold euro-denominated 1.50% notes due 2023 in the principal amount of €550 million (\$614 million). Proceeds from the sale of the notes, net of transaction costs, were used for the early repayment of \$500 million of the 2.4% notes due June 2017 and repayment of other borrowings. The early repayment resulted in a charge of \$9 million for early debt extinguishment costs primarily attributable to the early redemption premium and related unamortized costs. For additional information regarding the early extinguishment costs, see Note 9, "Borrowings", to the consolidated financial statements in Part II, Item 8 of the Company's 2016 Annual Report on Form 10-K.



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## Other (Income) Charges, Net

	Second Quarter		First Six Months	
(Dollars in millions)	2017	2016	2017	2016
Foreign exchange transaction (gains) losses, net	\$3	\$3	\$2	\$14
(Income) loss from equity investments and other investment (gains) losses, net	(4)	(4)	(7)	(6)
Gain from sale of equity investment in Primester joint venture	—	(17)	—	(17)
Other, net	1	(2)	1	1
Other (income) charges, net	\$—	\$(20)	\$(4)	\$(8)
Cost of disposition of claims against discontinued Solutia operations	—	—	—	(5)
Gain from sale of equity investment in Primester joint venture	—	17	—	17
Other (income) charges, net excluding non-core item	\$—	\$(3)	\$(4)	\$4

Included in other (income) charges, net are losses or gains on foreign exchange transactions, equity investments, business venture investments, and non-operating assets. First six months 2016 foreign exchange transaction (gains) losses, net, included the revaluation of foreign entity assets and liabilities losses partially offset by gains from certain derivative instruments, both items impacted primarily by the euro. See Note 6, "Derivative and Non-Derivative Financial Instruments", to the Company's unaudited consolidated financial statements in Part I, Item 1 of this Quarterly Report on Form 10-Q.

Second quarter and first six months 2016 other (income) charges, net included a gain of \$17 million from the sale of the Company's interest in the Primester joint venture equity investment. For additional information, see Note 6, "Equity Investments", to the consolidated financial statements in Part II, Item 8 of the Company's 2016 Annual Report on Form 10-K. First six months 2016 other (income) charges, net also included cost of disposition of claims against operations that were discontinued by Solutia prior to the Company's acquisition of Solutia in 2012.

## Provision for Income Taxes

	Second Quarter		First Six Months					
(Dollars in millions)	2017	2016	2017	2016				
	\$	%	\$	%				
Provision for income taxes and effective tax rate	\$65	18%	\$67	21%	\$127	18%	\$139	22%
Tax provision for non-core items <sup>(1)</sup>	—		(3)		—		5	
Adjustment to tax provision <sup>(2) (3)</sup>	3		—		12		—	
Adjusted provision for income taxes and effective tax rate	\$68	19%	\$64	20%	\$139	20%	\$144	22%

(1) Provision for income taxes for non-core items is calculated using the tax rate for the jurisdiction where the gains are taxable and the expenses are deductible.

(2) Second quarter 2017 provision for income taxes was adjusted to reflect the current forecasted full year effective tax rate.

(3) The adjusted provision for income taxes for first six months 2017 is calculated applying the forecasted full year effective tax rate as shown below.

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	First Six Months 2017
Effective tax rate	18 %
Discrete tax items <sup>(1)</sup>	3 %
Forecasted full year impact of expected tax events	(1 )%
Forecasted full year effective tax rate	20 %

"Discrete tax items" are items that are excluded from a company's estimated annual effective tax rate and <sup>(1)</sup> recognized entirely in the quarter in which the item occurs. First six months 2017 discrete items consist of planned amendments to and finalization of prior years' income tax returns.

## Net Earnings and Diluted Earnings per Share

	Second Quarter 2017	First Six Months 2017
(Dollars in millions, except diluted EPS)	\$ EPS	\$ EPS
Net earnings and diluted earnings per share attributable to Eastman	\$292 \$2.00	\$570 \$3.89
Less: Adjustment to tax provision	3	12
Adjusted net earnings and diluted earnings per share	\$289 \$1.98	\$558 \$3.80

  

	Second Quarter 2016	First Six Months 2016
(Dollars in millions, except diluted EPS)	\$ EPS	\$ EPS
Net earnings and diluted earnings per share attributable to Eastman	\$255 \$1.71	\$506 \$3.40
Non-core items:		
Asset impairments and restructuring gains, net	—	(2 )
Acquisition integration and transaction costs	—	9
Early debt extinguishment costs	9	9
Cost of disposition of claims against discontinued Solutia operations	—	5
Gain from sale of equity investment in Primester joint venture	(17 )	(17 )
Total non-core items	(8 )	4
Less: Tax effect for non-core items	(3 )	5
Adjusted net earnings and diluted earnings per share	\$250 \$1.68	\$505 \$3.39

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CONDITION AND RESULTS OF OPERATIONS

## SUMMARY BY OPERATING SEGMENT

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 additional financial and product information for each segment, see Part 1, Item 1, Business - Business Segments and Part II, Item 8, Note 20, "Segment Information", in the Company's 2016 Annual Report on Form 10-K.

## Additives &amp; Functional Products Segment

(Dollars in millions)	Second Quarter				First Six Months			
	2017	2016	Change		2017	2016	Change	
			\$	%			\$	%
Sales	\$830	\$770	\$60	8 %	\$1,603	\$1,507	\$96	6 %
Volume / product mix effect			55	7 %			113	7 %
Price effect			17	2 %			4	— %
Exchange rate effect			(12 )	(1)%			(21 )	(1)%
Operating earnings	\$159	\$168	\$(9 )	(5)%	\$311	\$321	\$(10)	(3)%
Asset impairments and restructuring gains, net	—	—	—		—	(2 )	2	
Operating earnings excluding non-core item	\$159	\$168	\$(9 )	(5)%	\$311	\$319	\$(8 )	(3)%

Sales revenue in second quarter 2017 increased compared to second quarter 2016 due to higher sales volume, primarily of the care chemicals additives, specialty fluids, and tire additives products and higher selling prices, primarily for care chemicals additives and coatings and inks additives products. Sales revenue in first six months 2017 increased compared to first six months 2016 due to higher sales volume across the segment.

Operating earnings in first six months 2016 included a \$2 million gain for the sale of previously impaired assets at the Crystex<sup>®</sup> insoluble sulfur R&D site in France. Operating earnings decreased in second quarter 2017 and first six months 2017 compared to second quarter 2016 and first six months 2016 as higher raw material and energy costs more than offset higher selling prices by \$31 million and \$56 million, respectively. The decrease was partially offset by higher sales volume of \$17 million and \$41 million, respectively.

## Advanced Materials Segment

(Dollars in millions)	Second Quarter				First Six Months			
	2017	2016	Change		2017	2016	Change	
			\$	%			\$	%
Sales	\$657	\$646	\$11	2 %	\$1,291	\$1,235	\$56	5 %
Volume / product mix effect			15	3 %			73	6 %
Price effect			2	— %				