EASTMAN CHEMICAL CO
Form 10-Q
May 01, 2007

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

(Mark One)

[X]	QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
	For the quarterly period ended March 31, 2007
	OR
[ ]	TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
	For the transition period from ______________ to ______________

Commission file number 1-12626

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

Delaware	**62-1539359**
(State or other jurisdiction of incorporation or organization)	(I.R.S. employer identification no.)
200 South Wilcox Drive **Kingsport, Tennessee**	**37660**
(Address of principal executive offices)	(Zip Code)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
YES [X] NO [ ]

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

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

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

Class	Number of Shares Outstanding at March 31, 2007
Common Stock, par value $0.01 per share	84,128,383

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UNAUDITED CONSOLIDATED STATEMENTS OF EARNINGS, COMPREHENSIVE INCOME AND RETAINED EARNINGS

(Dollars in millions, except per share amounts)	First Three Months 2007	2006
Sales	$ 1,795	$ 1,803
Cost of sales	1,502	1,472
Gross profit	293	331
Selling, general and administrative expenses	101	98
Research and development expenses	36	42
Asset impairments and restructuring charges, net	21	7
Operating earnings	135	184
Interest expense, net	18	20
Other (income) charges, net	(3)	(1)
Earnings before income taxes	120	165
Provision for income taxes	43	60
Net earnings	$ 77	$ 105
Earnings per share		
Basic	$ 0.92	$ 1.28
Diluted	$ 0.91	$ 1.27
Comprehensive Income		
Net earnings	$ 77	$ 105
Other comprehensive income (loss)		
Change in cumulative translation adjustment	(3)	17
Change in unrecognized loss and prior service cost, net of tax	2	--
Change in unrealized gains (losses) on investments, net of tax	(1)	--
Change in unrealized gains (losses) on derivative instruments, net of tax	7	3
Total other comprehensive income (loss)	5	20
Comprehensive income	$ 82	$ 125
Retained Earnings		
Retained earnings at beginning of period	$ 2,186	$ 1,923
Net earnings	77	105
Cash dividends declared	(37)	(36)
Adoption of accounting standards	8	--
Retained earnings at end of period	$ 2,234	$ 1,992

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

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

(Dollars in millions, except per share amounts)		March 31, 2007 (Unaudited)		December 31, 2006
Assets				
Current assets				
Cash and cash equivalents	$	833	$	939
Trade receivables, net of allowance of $16 and $20		704		682
Miscellaneous receivables		84		72
Inventories		665		682
Other current assets		75		47
Current assets held for sale		21		--
Total current assets		2,382		2,422
Properties				
Properties and equipment at cost		8,733		8,844
Less: Accumulated depreciation		5,739		5,775
Net properties		2,994		3,069
Goodwill		314		314
Other noncurrent assets		380		368
Noncurrent assets held for sale		46		--
Total assets	$	6,116	$	6,173
Liabilities and Stockholders' Equity				
Current liabilities				
Payables and other current liabilities	$	991	$	1,056
Borrowings due within one year		--		3
Current liabilities related to assets held for sale		2		--
Total current liabilities		993		1,059
Long-term borrowings		1,595		1,589
Deferred income tax liabilities		291		269
Post-employment obligations		977		1,084
Other long-term liabilities		145		143
Long-term liabilities related to assets held for sale		10		--
Total liabilities		4,011		4,144
Stockholders' equity				
Common stock ($0.01 par value - 350,000,000 shares authorized; shares issued - 92,631,025 and 91,579,294 for 2007 and 2006, respectively)		1		1
Additional paid-in capital		504		448
Retained earnings		2,234		2,186
Accumulated other comprehensive loss		(169)		(174)
		2,570		2,461
Less: Treasury stock at cost (8,609,413 shares for 2007 and 8,048,442 shares for 2006)		465		432

Total stockholders' equity		2,105		2,029
Total liabilities and stockholders' equity	$	6,116	$	6,173

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

UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in millions)	First Three Months 2007	2006
Cash flows from operating activities		
Net earnings	$ 77	$ 105
Adjustments to reconcile net earnings to net cash provided by (used in) operating activities:		
Depreciation and amortization	84	74
Asset impairments	22	6
Provision (benefit) for deferred income taxes	(15)	22
Changes in operating assets and liabilities:		
(Increase) decrease in receivables	(29)	(55)
(Increase) decrease in inventories	15	(9)
Increase (decrease) in trade payables	(80)	(36)
Increase (decrease) in liabilities for employee benefits and incentive pay	(165)	(82)
Other items, net	25	12
Net cash provided by (used in) operating activities	(66)	37
Cash flows from investing activities		
Additions to properties and equipment	(86)	(78)
Proceeds from sale of assets and investments	(2)	7
Additions to capitalized software	(3)	(4)
Other items, net	--	(1)
Net cash provided by (used in) investing activities	(91)	(76)
Cash flows from financing activities		
Net increase (decrease) in commercial paper, credit facility and other borrowings	73	35
Dividends paid to stockholders	(38)	(36)
Treasury stock purchases	(33)	--
Proceeds from stock option exercises and other items	49	1
Net cash provided by (used in) financing activities	51	--
Effect of exchange rate changes on cash and cash equivalents	--	--
Net change in cash and cash equivalents	(106)	(39)
Cash and cash equivalents at beginning of period	939	524
Cash and cash equivalents at end of period	$ 833	$ 485

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

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NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

1. BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements have been prepared by Eastman Chemical Company (the "Company" or "Eastman") in accordance and consistent with the accounting policies stated in the Company's 2006 Annual Report on Form 10-K, except as described in Note 5 to the Company's unaudited financial statements in this Form 10-Q, and should be read in conjunction with the consolidated financial statements in Part II, Item 8 of the Company’s 2006 Annual Report on Form 10-K. The Company adopted the provisions of Financial Accounting Standards Board ("FASB") Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* ("FIN 48"), on January 1, 2007. In the opinion of the Company, all normal recurring adjustments necessary for a fair presentation have been included in the unaudited consolidated financial statements. The unaudited consolidated financial statements are prepared in conformity with generally accepted accounting principles ("GAAP") in the United States and, of necessity, include some amounts that are based upon management estimates and judgments. Future actual results could differ from such current estimates. The unaudited consolidated financial statements include assets, liabilities, revenues and expenses of all majority-owned subsidiaries and joint ventures. Eastman accounts for other joint ventures and investments in minority-owned companies where it exercises significant influence on the equity basis. Intercompany transactions and balances are eliminated in consolidation.

The Company has reclassified certain 2006 amounts to conform to the 2007 presentation including the reclassification of segment sales and operating earnings. For additional information, see Note 15 to the Company's unaudited consolidated financial statements.

2. ASSETS HELD FOR SALE

During the first quarter 2007, Eastman entered into an agreement for the sale of Eastman Chemical Iberia, S.A., located in San Roque, Spain. The sale includes Eastman's polyethylene terephthalate ("PET") polymers manufacturing assets in Spain and the related polyester resins business. The terms of the sales agreement have been met and the Company expects the sale to be completed in the second quarter of 2007. The Company also recorded an impairment charge and site closure costs of $21 million resulting from the expected sale. See Note 7 to the Company's unaudited consolidated financial statements for additional information.

(Dollars in millions)		March 31, 2007
Current assets		
Miscellaneous receivables	$	2
Trade receivables, net		10
Inventories		9
Total current assets		21
Non-current assets		
Properties and Equipment, net		40
Deferred tax asset		4
Other non-current assets		2
Total non-current assets		46
Total assets	$	67
Current liabilities		
Payables and other current liabilities, net	$	2
Total current liabilities		2

Long-term liabilities		
Deferred income tax liabilities		7
Other long term liabilities		3
Total long-term liabilities		10
Total liabilities	$	12

NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

The migration of certain customer sales to other Eastman operating facilities precludes the Company from reporting the assets, businesses and product lines as discontinued operations per Statement of Financial Accounting Standards ("SFAS") No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets."

3. INVENTORIES

(Dollars in millions)	March 31, 2007	December 31, 2006
At FIFO or average cost (approximates current cost)		
Finished goods	$ 635	$ 660
Work in process	197	206
Raw materials and supplies	306	280
Total inventories	1,138	1,146
LIFO Reserve	(464)	(464)
Inventories before assets held for sale	674	682
Inventories related to assets held for sale [1]	(9)	--
Total inventories	$ 665	$ 682

[1] For more information regarding assets held for sale, see Note 2 to the Company's unaudited consolidated financial statements.

Inventories valued on the LIFO method were approximately 70% as of March 31, 2007 and 65% as of December 31, 2006 of total inventories.

4. PAYABLES AND OTHER CURRENT LIABILITIES

(Dollars in millions)	March 31, 2007	December 31, 2006
Trade creditors	$ 502	$ 581
Accrued payrolls, vacation, and variable-incentive compensation	83	126
Accrued taxes	85	59
Post-employment obligations	55	63
Interest payable	26	31
Bank overdrafts	85	11
Other	157	185
Payables and other current liabilities before assets held for sale	993	1,056
Current liabilities related to assets held for sale [1]	(2)	--
Total payables and other current liabilities	$ 991	$ 1,056

[1] For more information regarding assets held for sale, see Note 2 to the Company's unaudited consolidated financial statements.

NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

5. PROVISION FOR INCOME TAXES

	First Quarter		
(Dollars in millions)	2007	2006	Change
Provision for income taxes	$ 43	$ 60	(28)%
Effective tax rate	36 %	36 %	

The first quarter 2007 and 2006 effective tax rates reflect the Company's expected tax rate on reported operating earnings before income tax, excluding discrete items, of approximately 35 percent.

The Company adopted the provisions of FIN 48 on January 1, 2007. As a result of the implementation of FIN 48 and reliance on the proposed FASB Staff Position No. FIN 48-a, "*Definition of Settlement in FASB Interpretation No. 48*," the Company recognized an approximately $3 million decrease in the liability for unrecognized tax benefits, which was accounted for as a $8 million increase to the January 1, 2007 balance of retained earnings and a $5 million decrease in long-term deferred tax liabilities. After the above decrease, the liability for unrecognized tax benefits was approximately $31 million, of which $26 million would, if recognized, impact the Company's effective tax rate.

Interest and penalties, net, related to unrecognized tax benefits are recorded as a component of income tax expense. As of January 1, 2007 the company had accrued approximately $3 million for interest, net of tax benefit and had no accrual for tax penalties. During the quarter ending March 31, 2007 the Company recognized an immaterial amount of interest associated with unrecognized tax benefits.

The Company or one of its subsidiaries files tax returns in the U.S. federal jurisdiction, and various states and foreign jurisdictions. With few exceptions, the Company is no longer subject to U.S. federal, state and local, or non-U.S. income tax examinations by tax authorities for years before 2001. It is reasonably possible that within the next 12 months the Company will recognize approximately $2 million of unrecognized tax benefits as a result of the expiration of the relevant statute of limitations.

6. BORROWINGS

(Dollars in millions)	March 31, 2007	December 31, 2006
Borrowings consisted of:		
3 1/4% notes due 2008	$ 72	$ 72
7% notes due 2012	142	141
6.30% notes due 2018	182	182
7 1/4% debentures due 2024	497	497
7 5/8% debentures due 2024	200	200
7.60% debentures due 2027	297	297
Credit facility borrowings	187	185
Other	18	18
Total borrowings	1,595	1,592
Borrowings due within one year	--	(3)
Long-term borrowings	$ 1,595	$ 1,589

At March 31, 2007, the Company has credit facilities with various U.S. and non-U.S. banks totaling approximately $890 million. These credit facilities consist of a $700 million revolving credit facility (the "Credit Facility"), expiring in April 2012, and a 140 million euro credit facility which expires in December 2011. Both of these credit facilities have options for a one year extension. Borrowings under these credit facilities are subject to interest at varying spreads above quoted market rates. These credit facilities require facility fees on the total commitment that are based on Eastman's credit rating. In addition, these credit facilities contain a number of covenants and events of default, including the maintenance of certain financial ratios. The Company's combined credit facility borrowings at March 31, 2007 and December 31, 2006 were $187 million and $185 million at weighted average interest rates of 4.21 percent and 4.00 percent, respectively.

NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

The Credit Facility provides liquidity support for commercial paper borrowings and general corporate purposes. Accordingly, any outstanding commercial paper borrowings reduce borrowings available under the Credit Facility. Since the Credit Facility expires in April 2012, any commercial paper borrowings supported by the Credit Facility are classified as long-term borrowings because the Company has the ability to refinance such borrowings on a long-term basis.

At March 31, 2007 and December 31, 2006, the Company had outstanding interest rate swaps associated with the entire outstanding principle of the 7% notes due in 2012 and $150 million of the outstanding principle of the 6.30% notes due in 2018. The average variable interest rate on the 7% notes was 7.84 percent and 7.89 percent for March 31, 2007 and December 31, 2006, respectively. The average variable interest rate on the 6.30% notes was 6.25 percent and 6.30 percent for March 31, 2007 and December 31, 2006, respectively.

7. ASSET IMPAIRMENTS AND RESTRUCTURING CHARGES, NET

In the first quarter 2007, asset impairments and restructuring charges totaled $21million, relating primarily to the impairment of assets of the San Roque, Spain PET manufacturing facility which are currently reported as held for sale. See Note 2 to the Company's unaudited consolidated financial statements for additional information.

The Company has impaired the assets of the PET manufacturing facility to adjust the asset values to the sales amounts less cost to sell. This impairment is partially offset by the reversal of the $5 million severance accrual related to the fourth quarter 2006 shut down of the cyclohexane dimethanol ("CHDM") manufacturing facility, located adjacent to the PET manufacturing facility. This severance accural was assumed by the buyer as part of the sale of the San Roque, Spain PET manufacturing facility, relieving the company of the severance liability.

In the first quarter 2006, asset impairments and restructuring charges totaled $7 million, relating primarily to the divestiture of a previously closed manufacturing facility.

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

The following table summarizes the beginning reserves, charges to and changes in estimates to the reserves as described above, and the cash and non-cash reductions to the reserves attributable to asset impairments and the cash payments for severance and site closure costs for the full year 2006 and the first quarter 2007:

(Dollars in millions)	**Balance at January 1, 2006**	**Provision/ Adjustments**	**Non-cash Reductions**	**Cash Reductions**	**Balance at December 31, 2006**
Non-cash charges	$ --	$ 62	$ (62)	$ --	$ --
Severance costs	3	32	--	(1)	34
Site closure and other restructuring costs	7	7	--	--	14
Total	$ 10	$ 101	$ (62)	$ (1)	$ 48

	Balance at	**Provision/ Adjustments**	**Non-cash Reductions**	**Cash Reductions**	**Balance at**

	January 1, 2007				March 31, 2007
Non-cash charges	$ --	$ 22	$ (22)	$ --	$ --
Severance costs	34	(5)	--	(2)	27
Site closure and other restructuring costs	14	4	--	--	18
Total	$ 48	$ 21	$ (22)	$ (2)	$ 45

A majority of the remaining severance and site closure costs is expected to be applied to the reserves within one year.

NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

8. PENSION AND OTHER POST-EMPLOYMENT BENEFITS

DEFINED BENEFIT PENSION PLANS

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

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

Summary of Components of Net Periodic Benefit Costs

(Dollars in millions)	First Quarter 2007	First Quarter 2006
Service cost	$ 11	$ 11
Interest cost	21	20
Expected return on assets	(25)	(21)
Amortization of:		
Prior service credit	(2)	(2)
Actuarial loss	9	9
Net periodic benefit cost	$ 14	$ 17

In July 2006, the Company announced plans to change the U.S. defined benefit plans such that employees hired on or after January 1, 2007 will not be eligible for those plans. This change did not impact net periodic benefit cost in 2006 and had minimal impact on the financial statements in first quarter 2007.

The Company has contributed $100 million to its U.S. defined benefit plans during first quarter 2007.

POSTRETIREMENT WELFARE PLANS

Eastman provides life insurance and health care benefits for eligible retirees, and health care benefits for retirees' eligible survivors. In general, Eastman provides those benefits to retirees eligible under the Company's U.S. pension plans. Similar benefits are also provided to retirees of Holston Defense Corporation (“HDC”), a wholly-owned subsidiary of the Company that, prior to January 1, 1999, operated a government-owned ammunitions plant. HDC’s contract with the Department of Army (“DOA”) provided for reimbursement of allowable costs incurred by HDC including certain postretirement welfare costs, for as long as HDC operated the plant. After the contract was terminated at the end of 1998, the DOA did not contribute further to these costs. The Company pursued extraordinary relief from the DOA and was granted an award effective in the fourth quarter 2006 in the amount of $95 million. This award was for reimbursement of the described costs and other previously expensed post-retirement benefit costs. The Company began recognizing the impact of the reimbursement in fourth quarter 2006 by recording an unrecognized gain and amortizing the gain into earnings over a period of time.

In general, Eastman provides those benefits to retirees eligible under the Company's U.S. defined benefit pension plans. A few of the Company's non-U.S. operations have supplemental health benefit plans for certain retirees, the cost of which is not significant to the Company. Costs recognized for these benefits are recorded using estimated amounts, which may change as actual costs derived for the year are determined. Below is a summary of the components of net periodic benefit cost recognized for the Company's U.S. plans:

NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Summary of Components of Net Periodic Benefit Costs

(Dollars in millions)	First Quarter 2007	First Quarter 2006
Service cost	$ 2	$ 2
Interest cost	11	11
Expected return on assets	(1)	--
Amortization of:		
Prior service credit	(6)	(6)
Actuarial loss	3	4
Net periodic benefit cost	$ 9	$ 11

In July 2006, the Company announced plans to change its U.S. life insurance and health care benefit plans such that employees hired on or after January 1, 2007 will have access to post-retirement health care benefits only, while Eastman will not provide a company contribution toward the premium cost of post-retirement benefits for those employees. This change had minimal impact on the financial statements in first quarter 2007.

9. ENVIRONMENTAL MATTERS

Certain Eastman manufacturing sites generate hazardous and nonhazardous wastes, the treatment, storage, transportation, and disposal of which are regulated by various governmental agencies. In connection with the cleanup of various hazardous waste sites, the Company, along with many other entities, has been designated a potentially responsible party ("PRP"), by the U.S. Environmental Protection Agency under the Comprehensive Environmental Response, Compensation and Liability Act, which potentially subjects PRPs to joint and several liability for such cleanup costs. In addition, the Company will be required to incur costs for environmental remediation and closure and postclosure under the federal Resource Conservation and Recovery Act. Reserves for environmental contingencies have been established in accordance with Eastman's policies described in Note 1, "Significant Accounting Policies". Because of expected sharing of costs, the availability of legal defenses, and the Company's preliminary assessment of actions that may be required, management does not believe that the Company's liability for these environmental matters, individually or in the aggregate, will be material to the Company's consolidated financial position, results of operations or cash flows. The Company's reserve for environmental contingencies was $46 million and $47 million at March 31, 2007 and December 31, 2006, respectively, representing the minimum or best estimate for remediation costs and the best estimate accrued to date over the facilities' estimated useful lives for asset retirement obligation costs. Estimated future environmental expenditures for remediation costs range from the minimum or best estimate of $18 million to the maximum of $32 million at March 31, 2007 and December 31, 2006.

10. COMMITMENTS

Purchasing Obligations and Lease Commitments

At March 31, 2007, the Company had various purchase obligations totaling approximately $2.2 billion over a period of approximately 15 years for materials, supplies, and energy incident to the ordinary conduct of business. The Company also had various lease commitments for property and equipment under cancelable, non-cancelable, and month-to-month operating leases totaling approximately $200 million over a period of several years. Of the total lease commitments, approximately 15 percent relate to machinery and equipment, including computer and communications equipment and production equipment; approximately 50 percent relate to real property, including office space, storage facilities and land; and approximately 35 percent relate to vehicles, primarily railcars.

NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Accounts Receivable Securitization Program

In 1999, the Company entered into an agreement that allows the Company to sell certain domestic accounts receivable under a planned continuous sale program to a third party. The agreement permits the sale of undivided interests in domestic trade accounts receivable. Receivables sold to the third party totaled $200 million at March 31, 2007 and December 31, 2006. Undivided interests in designated receivable pools were sold to the purchaser with recourse limited to the purchased interest in the receivable pools. Average monthly proceeds from collections reinvested in the continuous sale program were approximately $293 million and $320 million in the first quarter 2007 and 2006, respectively.

Guarantees

Interpretation No. 45, “Guarantor’s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" ("FIN 45"), clarifies the requirements of SFAS No. 5, “Accounting for Contingencies,” relating to the guarantor’s accounting for, and disclosure of, the issuance of certain types of guarantees. If certain operating leases are terminated by the Company, it guarantees a portion of the residual value loss, if any, incurred by the lessors in disposing of the related assets. Under these operating leases, the residual value guarantees at March 31, 2007 totaled $122 million and consisted primarily of leases for railcars, aircraft, and other equipment. The Company believes, based on current facts and circumstances, that a material payment pursuant to such guarantees is remote. Leases with guarantee amounts totaling $3 million, $27 million, and $92 million will expire in 2007, 2008, and 2012, respectively. The Company believes, based on current facts and circumstances, that the likelihood of a material payment pursuant to such guarantees is remote.

Variable Interest Entities

The Company has evaluated material relationships and has concluded that the legal entities involved with these material relationships are not Variable Interest Entities ("VIEs") or, in the case of Primester, a joint venture that manufactures cellulose acetate at its Kingsport, Tennessee plant, the Company is not the primary beneficiary of the VIE. As such, in accordance with Interpretation No. 46R "Consolidation of Variable Interest Entities" ("FIN 46R"), the Company is not required to consolidate these entities. In addition, the Company has evaluated long-term purchase obligations with two entities that may be VIEs at March 31, 2007. These potential VIEs are joint ventures from which the Company has purchased raw materials and utilities for several years and purchases approximately $70 million of raw materials and utilities on an annual basis. The Company has no equity interest in these entities and has confirmed that one party to each of these joint ventures does consolidate the potential VIE. However, due to competitive and other reasons, the Company has not been able to obtain the necessary financial information to determine whether the entities are VIEs, and if one or both are VIEs, whether or not the Company is the primary beneficiary.

11. DERIVATIVE FINANCIAL INSTRUMENTS HELD OR ISSUED FOR PURPOSES OTHER THAN TRADING

Hedging Programs

Financial instruments held as part of the hedging programs discussed below are recorded at fair value based upon comparable market transactions as quoted by brokers.

The Company is exposed to market risk, such as changes in currency exchange rates, raw material and energy costs and interest rates. The Company uses various derivative financial instruments pursuant to the Company's hedging policies to mitigate these market risk factors and their effect on the cash flows of the underlying transactions.

Designation is performed on a specific exposure basis to support hedge accounting. The changes in fair value of these hedging instruments are offset in part or in whole by corresponding changes in the cash flows of the underlying exposures being hedged. The Company does not hold or issue derivative financial instruments for trading purposes. For further information, see Note 9 to the consolidated financial statements in Part II, Item 8 of the Company's 2006 Annual Report on Form 10-K.

NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

At March 31, 2007, mark-to-market gains from raw material and energy, currency and certain interest rate hedges that were included in accumulated other comprehensive income totaled approximately $1 million. If realized, approximately $1 million in losses will be reclassified into earnings during the next 12 months. The mark-to-market gains or losses on non-qualifying, excluded and ineffective portions of hedges are immediately recognized in cost of sales or other income and charges. Such amounts did not have a material impact on earnings during the first quarter of 2007.

12. STOCKHOLDERS' EQUITY

A reconciliation of the changes in stockholders' equity for the first three months 2007 is provided below:

(Dollars in millions)	Common Stock at Par Value $	Paid-in Capital $	Retained Earnings $	Accumulated Other Comprehensive Income (Loss) $	Treasury Stock at Cost $	Total Stockholders' Equity $
Balance at December 31, 2006	1	448	2,186	(174)	(432)	2,029
Net Earnings	--	--	77	--	--	77
Cash Dividends Declared [2]	--	--	(37)	--	--	(37)
Effect of FIN 48 Adoption	--	--				