EASTMAN CHEMICAL CO
Form 10-Q
October 23, 2009

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 September 30, 2009
OR
[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from ______________ to ______________

Commission file number 1-12626

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

Delaware (State or other jurisdiction of incorporation or organization)	62-1539359 (I.R.S. employer identification no.)
200 South Wilcox Drive Kingsport, Tennessee (Address of principal executive offices)	37662 (Zip Code)

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
YES [X] NO [ ]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.
Large accelerated filer [X] Accelerated filer [ ]

Non-accelerated filer [ ] Smaller reporting company [ ]
(Do not check if a smaller reporting company)

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

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

Class	Number of Shares Outstanding at September 30, 2009
Common Stock, par value $0.01 per share	72,707,237

PAGE 1 OF 50 TOTAL SEQUENTIALLY NUMBERED PAGES
EXHIBIT INDEX ON PAGE 49

TABLE OF CONTENTS

ITEM		PAGE
	PART I. FINANCIAL INFORMATION	
1.	Financial Statements	
	Unaudited Consolidated Statements of Earnings, Comprehensive Income and Retained Earnings	3
	Consolidated Statements of Financial Position	4
	Unaudited Consolidated Statements of Cash Flows	5
	Notes to the Unaudited Consolidated Financial Statements	6
2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	20
3.	Quantitative and Qualitative Disclosures About Market Risk	45
4.	Controls and Procedures	45
	PART II. OTHER INFORMATION	
1.	Legal Proceedings	46
1A.	Risk Factors	46
2.	Unregistered Sales of Equity Securities and Use of Proceeds	47
6.	Exhibits	47
	SIGNATURES	
	Signatures	48

UNAUDITED CONSOLIDATED STATEMENTS OF EARNINGS,
COMPREHENSIVE INCOME AND RETAINED EARNINGS

	Third Quarter		First Nine Months	
(Dollars in millions, except per share amounts)	2009	2008	2009	2008
Sales	$ 1,337	$ 1,819	$ 3,719	$ 5,380
Cost of sales	1,009	1,497	2,952	4,400
Gross profit	328	322	767	980
Selling, general and administrative expenses	104	107	296	324
Research and development expenses	33	39	101	120
Asset impairments and restructuring charges, net	--	2	23	22
Operating earnings	191	174	347	514
Net interest expense	19	19	58	53
Other charges (income), net	2	7	11	7
Earnings from continuing operations before income taxes	170	148	278	454
Provision for income taxes from continuing operations	69	48	110	124
Earnings from continuing operations	101	100	168	330
Earnings from disposal of discontinued operations, net of tax	--	--	--	18
Net earnings	$ 101	$ 100	$ 168	$ 348
Basic earnings per share				
Earnings from continuing operations	$ 1.40	$ 1.35	$ 2.31	$ 4.34
Earnings from discontinued operations	--	--	--	0.23
Basic earnings per share	$ 1.40	$ 1.35	$ 2.31	$ 4.57
Diluted earnings per share				
Earnings from continuing operations	$ 1.38	$ 1.33	$ 2.29	$ 4.27
Earnings from discontinued operations	--	--	--	0.23
Diluted earnings per share	$ 1.38	$ 1.33	$ 2.29	$ 4.50
Comprehensive Income				
Net earnings	$ 101	$ 100	$ 168	$ 348
Other comprehensive income (loss)				
Change in cumulative translation adjustment, net of tax	2	(27)	17	(68)
Change in pension plans, net of tax	--	(1)	(2)	7
Change in unrealized gains (losses) on derivative instruments, net of tax	(7)	(6)	(6)	(3)
Total other comprehensive income (loss)	(5)	(34)	9	(64)
Comprehensive income	$ 96	$ 66	$ 177	$ 284

Retained Earnings				
Retained earnings at beginning of period	$ 2,566	$ 2,529	$ 2,563	$ 2,349
Net earnings	101	100	168	348
Cash dividends declared	(32)	(31)	(96)	(99)
Retained earnings at end of period	$ 2,635	$ 2,598	$ 2,635	$ 2,598

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

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

(Dollars in millions, except per share amounts)	September 30, 2009 (Unaudited)	December 31, 2008
Assets		
Current assets		
Cash and cash equivalents	$ 668	$ 387
Trade receivables, net	316	275
Miscellaneous receivables	68	79
Inventories	495	637
Other current assets	33	45
Total current assets	1,580	1,423
Properties and equipment		
Properties and equipment at cost	8,636	8,527
Less: Accumulated depreciation	5,363	5,329
Net properties and equipment	3,273	3,198
Goodwill	326	325
Other noncurrent assets	375	335
Total assets	$ 5,554	$ 5,281
Liabilities and Stockholders' Equity		
Current liabilities		
Payables and other current liabilities	$ 827	$ 819
Borrowings due within one year	1	13
Total current liabilities	828	832
Long-term borrowings	1,440	1,442
Deferred income tax liabilities	274	106
Post-employment obligations	1,250	1,246
Other long-term liabilities	117	102
Total liabilities	3,909	3,728
Stockholders' equity		
Common stock ($0.01 par value – 350,000,000 shares authorized; shares issued – 94,659,859 and 94,495,860 for 2009 and 2008, respectively)	1	1
Additional paid-in capital	649	638
Retained earnings	2,635	2,563
Accumulated other comprehensive loss	(326)	(335)
	2,959	2,867
Less: Treasury stock at cost (22,035,296 shares for 2009 and 22,031,357 shares for 2008)	1,314	1,314
Total stockholders' equity	1,645	1,553

Total liabilities and stockholders' equity	$	5,554	$	5,281

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

4

UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in millions)	First Nine Months 2009	2008
Cash flows from operating activities		
Net earnings	$ 168	$ 348
Adjustments to reconcile net earnings to net cash provided by (used in) operating activities:		
Depreciation and amortization	203	199
Asset impairments charges	--	1
Gains on sale of assets	--	(13)
Provision (benefit) for deferred income taxes	165	(56)
Changes in operating assets and liabilities, net of effect of acquisitions and divestitures:		
(Increase) decrease in trade receivables	(35)	(16)
(Increase) decrease in inventories	141	(170)
Increase (decrease) in trade payables	(8)	(49)
Increase (decrease) in liabilities for employee benefits and incentive pay	(14)	(6)
Other items, net	48	55
Net cash provided by operating activities	668	293
Cash flows from investing activities		
Additions to properties and equipment	(268)	(430)
Proceeds from sale of assets	25	333
Acquisitions of and investments in joint ventures	--	(38)
Additions to capitalized software	(6)	(8)
Other items, net	(64)	(2)
Net cash used in investing activities	(313)	(145)
Cash flows from financing activities		
Net increase in commercial paper, credit facility and other borrowings	23	42
Repayment of borrowings	(16)	(175)
Dividends paid to stockholders	(96)	(103)
Treasury stock purchases	--	(501)
Proceeds from stock option exercises and other items	15	38
Net cash used in financing activities	(74)	(699)
Effect of exchange rate changes on cash and cash equivalents	--	--
Net change in cash and cash equivalents	281	(551)
Cash and cash equivalents at beginning of period	387	888

Cash and cash equivalents at end of period	$	668	$	337

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

ITEM		Page
Note 1.	Basis of Presentation	7
Note 2.	Discontinued Operations	7
Note 3.	Inventories	8
Note 4.	Payables and Other Current Liabilities	8
Note 5.	Provision for Income Taxes	8
Note 6.	Borrowings	9
Note 7.	Asset Impairments and Restructuring Charges, Net	9
Note 8.	Retirement Plans	10
Note 9.	Environmental Matters	11
Note 10.	Commitments	12
Note 11.	Fair Value of Financial Instruments	13
Note 12.	Stockholders' Equity	15
Note 13.	Earnings and Dividends per Share	16
Note 14.	Share-Based Compensation Awards	16
Note 15.	Segment Information	17
Note 16.	Legal Matters	18
Note 17.	Recently Issued Accounting Standards	19

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 2008 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 2008 Annual Report on Form 10-K. The unaudited consolidated financial statements are prepared in conformity with accounting principles generally accepted in the United States ("GAAP") and, of necessity, include some amounts that are based upon management estimates and judgments. Future actual results could differ from such current estimates. The unaudited consolidated financial statements include assets, liabilities, 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, but does not have control, 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.

The Company has evaluated the period from September 30, 2009, the date of the financial statements, through October 23, 2009, the date of the issuance and filing of the financial statements and has determined that no material subsequent events have occurred that would affect the information presented in these financial statements or require additional disclosure.

2. DISCONTINUED OPERATIONS

In first quarter 2008, the Company sold its polyethylene terephthalate ("PET") polymers and purified terephthalic acid ("PTA") production facilities in the Netherlands and its PET production facility in the United Kingdom and related businesses for approximately $329 million. The Company recognized a gain of $18 million, net of tax, related to the sale of these businesses which included the recognition of deferred currency translation adjustments of approximately $40 million, net of tax. In addition, the Company indemnified the buyer against certain liabilities primarily related to taxes, legal matters, environmental matters, and other representations and warranties.

The sale of the manufacturing facilities in the Netherlands and United Kingdom, and related businesses completed the Company's exit from the European PET business and qualified as a component of an entity under GAAP for the impairment or disposal of long-lived assets, and accordingly their results are presented as discontinued operations and are not included in the results from continuing operations for the effected period presented in the Company's unaudited consolidated financial statements.

In fourth quarter 2007, the Company sold its PET polymers production facilities in Mexico and Argentina and the related businesses. The results related to the Mexico and Argentina facilities were not presented as discontinued operations due to continuing involvement of the Company's Performance Polymers segment in the region including contract polymer intermediates sales under a transition supply agreement to the divested sites through 2008.

Operating results of the discontinued operations which were formerly included in the Performance Polymers segment are summarized below:

First
Nine

(Dollars in millions)	Months 2008
Sales	$ 169
Earnings before income taxes	2
Gain on disposal, net of tax	18

NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

3. INVENTORIES

(Dollars in millions)	September 30, 2009	December 31, 2008
At FIFO or average cost (approximates current cost)		
Finished goods	$ 535	$ 634
Work in process	161	200
Raw materials and supplies	259	328
Total inventories	955	1,162
LIFO Reserve	(460)	(525)
Total inventories	$ 495	$ 637

Inventories valued on the LIFO method were approximately 70 percent as of September 30, 2009 and 75 percent as of December 31, 2008 of total inventories.

4. PAYABLES AND OTHER CURRENT LIABILITIES

(Dollars in millions)	September 30, 2009	December 31, 2008
Trade creditors	$ 403	$ 390
Accrued payrolls, vacation, and variable-incentive compensation	110	129
Accrued taxes	60	41
Post-employment obligations	62	60
Interest payable	25	30
Bank overdrafts	25	4
Other	142	165
Total payables and other current liabilities	$ 827	$ 819

The current portion of post-employment obligations is an estimate of current year payments in excess of plan assets.

5. PROVISION FOR INCOME TAXES

	Third Quarter		First Nine Months	
(Dollars in millions)	2009	2008	2009	2008
Provision for income taxes	$ 69	$ 48	$ 110	$ 124
Effective tax rate	40 %	33 %	39 %	27 %

Third quarter 2009 effective tax rate reflects a $12 million tax charge associated with the recapture of gasification investment tax credits. Third quarter 2008 effective tax rate reflected an $8 million benefit from the reversal of a U.S. capital loss valuation allowance associated with the sale of businesses, and a $6 million benefit from the settlement of

a non-U.S. income tax audit.

First nine months 2009 effective tax rate reflects a $12 million tax charge associated with the recapture of gasification investment tax credits and a $7 million tax charge associated with a change in accounting method for tax purposes to accelerate timing of deductions for manufacturing repairs expense. First nine months 2008 effective tax rate reflected the estimated benefit resulting from the gasification investment tax credit, an $8 million benefit from the reversal of a U.S. capital loss valuation allowance associated with the sale of businesses, and a $6 million benefit from the settlement of a non-U.S. income tax audit. Including the above items, first nine months 2009 and 2008 effective tax rates reflect the Company's expected full year tax rate on reported earnings from continuing operations before income tax, of approximately 38 and 28 percent, respectively.

NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

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 income tax examinations by tax authorities for years before 2004, or non-U.S. income tax examinations by tax authorities for years before 2003.

6. BORROWINGS

(Dollars in millions)	September 30, 2009	December 31, 2008
Borrowings consisted of:		
7% notes due 2012	$ 152	$ 154
6.30% notes due 2018	206	207
7 1/4% debentures due 2024	497	497
7 5/8% debentures due 2024	200	200
7.60% debentures due 2027	298	298
Credit facilities borrowings	85	84
Other	3	15
Total borrowings	1,441	1,455
Borrowings due within one year	(1)	(13)
Long-term borrowings	$ 1,440	$ 1,442

At September 30, 2009, the Company had credit facilities with various U.S. and foreign banks totaling approximately $800 million. These credit facilities consist of a $700 million revolving credit facility (the "Credit Facility"), as well as a 58 million euro credit facility ("Euro Facility"). The Credit Facility has two tranches, with $125 million expiring in 2012 and $575 million expiring in 2013. The Euro Facility expires in 2012. Borrowings under these credit facilities are subject to interest at varying spreads above quoted market rates. The Credit Facility requires a facility fee on the total commitment. In addition, these credit facilities contain a number of customary covenants and events of default, including the maintenance of certain financial ratios. The Company was in compliance with all such covenants for all periods presented. At September 30, 2009, the Company's credit facility borrowings totaled $85 million at an effective interest rate of 0.79 percent. At December 31, 2008, the Company's credit facility borrowings totaled $84 million at an effective interest rate of 3.74 percent.

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. Given the expiration dates of the Credit Facility, any commercial paper borrowings supported by the Credit Facility are classified as long-term borrowings because the Company has the ability and intent to refinance such borrowings on a long-term basis.

7. ASSET IMPAIRMENTS AND RESTRUCTURING CHARGES, NET

In first nine months 2009, restructuring charges were $23 million, net. The charges, primarily for severance, resulted from a reduction in force.

In third quarter and first nine months 2008, asset impairments and restructuring charges, net totaled $2 million and $22 million, respectively, primarily for severance, pension charges, and site closure costs in the Performance Chemicals and Intermediates ("PCI") segment resulting from the decision to close a previously impaired site in the United Kingdom, and in the Performance Polymers segment for restructuring at the South Carolina facility and the divestiture of the PET manufacturing facilities in Mexico and Argentina.

NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

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 full year 2008 and first nine months 2009:

(Dollars in millions)	Balance at January 1, 2008	Provision/ Adjustments	Non-cash Reductions	Cash Reductions	Balance at December 31, 2008
Non-cash charges	$ --	$ 2	$ (2)	$ --	$ --
Severance costs	7	10	--	(12)	5
Site closure and other restructuring costs	11	34	--	(20)	25
Total	$ 18	$ 46	$ (2)	$ (32)	$ 30

	Balance at January 1, 2009	Provision/ Adjustments	Non-cash Reductions	Cash Reductions	Balance at September 30, 2009
Non-cash charges	$ --	$ --	$ --	$ --	$ --
Severance costs	5	24	--	(18)	11
Site closure and other restructuring costs	25	(1)	--	--	24
Total	$ 30	$ 23	$ --	$ (18)	$ 35

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

8. RETIREMENT PLANS

DEFINED BENEFIT PENSION PLANS

Eastman maintains defined benefit pension 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

	Third Quarter		First Nine Months	
(Dollars in millions)	2009	2008	2009	2008

Service cost	$	10	$	11	$	31	$	34
Interest cost		22		22		65		66
Expected return on assets		(25)		(26)		(74)		(79)
Curtailment charge		--		--		--		9
Amortization of:								
Prior service credit		(4)		(5)		(12)		(12)
Actuarial loss		8		7		25		21
Net periodic benefit cost	$	11	$	9	$	35	$	39

The Company contributed $30 million to its U.S. defined benefit pension plan in third quarter 2009.

The curtailment charge in 2008 was primarily related to the decision to close a previously impaired site in the United Kingdom.

NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

POSTRETIREMENT WELFARE PLANS

Eastman provides a subsidy toward life insurance, health care, and dental benefits for eligible retirees hired prior to January 1, 2007, and a subsidy toward health care benefits for retirees' eligible survivors. In general, Eastman provides those benefits to retirees eligible under the Company's U.S. plans. Similar benefits are also made available to retirees of Holston Defense Corporation, a wholly-owned subsidiary of the Company that, prior to January 1, 1999, operated a government-owned ammunitions plant.

Eligible employees hired on or after January 1, 2007 have access to postretirement health care benefits, but Eastman does not provide a subsidy toward the premium cost of postretirement health care benefits for those employees.

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 benefits for eligible retirees hired prior to January 1, 2007 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:

Summary of Components of Net Periodic Benefit Costs

	Third Quarter		First Nine Months	
(Dollars in millions)	2009	2008	2009	2008
Service cost	$ 2	$ 2	$ 6	$ 5
Interest cost	12	11	34	33
Expected return on assets	(1)	(1)	(2)	(3)
Amortization of:				
Prior service credit	(5)	(6)	(17)	(17)
Actuarial loss	4	2	10	7
Net periodic benefit cost	$ 12	$ 8	$ 31	$ 25

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 could 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", to the consolidated financial statements in Part II, Item 8 of the Company's 2008 Annual Report on Form 10-K. 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 $42 million and $41 million at September 30, 2009 and December 31, 2008, 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 $10 million to the maximum of $21 million at September 30, 2009, and $11 million to the maximum of $21 million at December 31, 2008.

NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

10. COMMITMENTS

Purchasing Obligations and Lease Commitments

At September 30, 2009, the Company had various purchase obligations totaling approximately $1.3 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, noncancelable, and month-to-month operating leases totaling $103 million over a period of several years. Of the total lease commitments, approximately 17 percent relate to machinery and equipment, including computer and communications equipment and production equipment; approximately 41 percent relate to real property, including office space, storage facilities and land; and approximately 42 percent relate to vehicles, primarily railcars.

Accounts Receivable Securitization Program

In 1999, the Company entered into an agreement that allows the Company to sell certain trade receivables on a non-recourse basis to a consolidated special purpose entity which in turn may sell interests in those receivables to a third party purchaser which generally funds its purchases via the issuance of commercial paper backed by the receivables interests. The annually renewable agreement permits the sale of undivided interests in domestic trade accounts receivable. The assets of the special purpose entity are not available to satisfy the Company's general obligations. Receivables sold to the third party totaled $200 million at September 30, 2009 and December 31, 2008. 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 $245 million and $370 million in third quarter 2009 and 2008, respectively, and $225 million and $345 million in first nine months 2009 and 2008, respectively. The securitization program was fully drawn at September 30, 2009 and renewed in July 2009.

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 at September 30, 2009 totaled $159 million and consisted of leases for railcars and aircraft. Leases with guarantee amounts totaling $11 million, $138 million, and $10 million will expire in 2011, 2012, and 2014 and beyond, 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 its material contractual relationships and has concluded that the entities involved in these relationships are not Variable Interest Entities ("VIEs") or, in the case of Primester, a joint venture that manufactures cellulose acetate at the Company's Kingsport, Tennessee plant, the Company is not the primary beneficiary of the VIE. As such, in accordance with consolidations rules included in GAAP, the Company is not required to consolidate these entities. In addition, the Company has evaluated long-term purchase obligations with an entity that may be a VIE at September 30, 2009. This potential VIE is a joint venture from which the Company has purchased raw materials and utilities for several years. The Company purchased approximately $50 million of raw materials and utilities during 2008 and expects to purchase approximately $35 million during 2009. The Company has no equity interest in this entity and has confirmed that one party to this joint venture 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 entity is a VIE, and whether or not the Company is the primary beneficiary.

NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

11. FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair Value of Borrowings

GAAP requires public companies to disclose the fair value of financial assets and liabilities whenever summarizing financial information for interim reporting periods. The fair value for fixed-rate borrowings is based on current interest rates for comparable securities. The Company's floating-rate borrowings approximate fair value.

(Dollars in millions)	September 30, 2009		December 31, 2008	
	Recorded Amount	Fair Value	Recorded Amount	Fair Value
Long-term borrowings	$ 1,440	$ 1,484	$ 1,442	$ 1,369

Fair Value Measurements

On January 1, 2008, the Company began recording financial assets and liabilities subject to recurring fair value measurement at the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. On January 1, 2009 the Company began recording non-recurring financial as well as all non-financial assets and liabilities subject to fair value measurement under the same principles. These fair value principles prioritize valuation inputs across three broad levels. Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities. Level 2 inputs are quoted prices for similar assets and liabilities in active markets or inputs that are observable for the asset or liability, either directly or indirectly through market corroboration, for substantially the full term of the financial instrument. Level 3 inputs are unobservable inputs based on the Company's assumptions used to measure assets and liabilities at fair value. An asset or liability's classification within the various levels is determined based on the lowest level input that is significant to the fair value measurement.

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

(Dollars in millions)	Fair Value Measurements at September 30, 2009			
Description	September 30, 2009	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Derivative Assets	$ 12	$ --	$ 12	$ --
Derivative Liabilities	(6)	--	(6)	--

	$ 6	$ --	$ 6	$ --

(Dollars in millions)	Fair Value Measurements at December 31, 2008			
Description	December 31, 2008	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Derivative Assets	$ 16	$ --	$ 16	$ --
Derivative Liabilities	(14)	--	(14)	--
	$ 2	$ --	$ 2	$ --

Hedging Programs

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 10, "Fair Value of Financial Instruments", to the consolidated financial statements in Part II, Item 8 of the Company's 2008 Annual Report on Form 10-K.

NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Fair Value Hedges

Fair value hedges are defined by GAAP as derivative or non-derivative instruments designated as and used to hedge the exposure to changes in the fair value of an asset or a liability or an identified portion thereof that is attributable to a particular risk. For derivative instruments that are designated and qualify as a fair value hedge, the gain or loss on the derivative as well as the offsetting loss or gain on the hedged item attributable to the hedged risk are recognized in current earnings.

As of September 30, 2009, the Company had no active fair value hedges.

Cash Flow Hedges

Cash flow hedges are defined by GAAP as derivative instruments designated as and used to hedge the exposure to variability in expected future cash flows that is attributable to a particular risk. For derivative instruments that are designated and qualify as a cash flow hedge, the effective portion of the gain or loss on the derivative is reported as a component of other comprehensive income, net of income taxes and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. Gains and losses on the derivatives representing either hedge ineffectiveness or hedge components excluded from the assessment of effectiveness are recognized in current earnings.

As of September 30, 2009, the total amount of the Company's foreign exchange forward and option contracts was a $5 million asset. As of September 30, 2009, the total amount of the Company's feedstock/energy forward and option contracts was a $1 million asset.

Fair Value of Derivatives Designated as Cash Flow Hedging Instruments

(Dollars in millions)	September 30, 2009		
Asset Derivatives	Balance Sheet Location		Fair Value
Commodity contract	Other current assets	$	2
Foreign exchange contracts	Other current assets		6
		$	8

(Dollars in millions)	September 30, 2009		
Liability Derivatives	Balance Sheet Location		Fair Value
Commodity contract	Payables and other current liabilities	$	1
Foreign exchange contacts	Other noncurrent liabilities		1
		$	2

NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Derivatives' Cash Flow Hedging Relationships

(Dollars in millions) Third Quarter 2009

Derivatives Cash Flow Hedging Relationships		Amount after tax of gain/ (loss) recognized in Other Comprehensive Income on derivatives (effective portion) September 30, 2009	Location of gain/(loss) reclassified from Accumulated Other Comprehensive Income into income (effective portion)		Pre-tax amount of gain/(loss) reclassified from Accumulated Other Comprehensive Income into income (effective portion) September 30, 2009
Commodity contract	$	1	Cost of sales	$	--
Foreign exchange contracts		(8)	Sales		5
	$	(7)		$	5

(Dollars in millions) First Nine Months 2009

Derivatives Cash Flow Hedging Relationships		Amount after tax of gain/ (loss) recognized in Other Comprehensive Income on derivatives (effective portion) September 30, 2009	Location of gain/(loss) reclassified from Accumulated Other Comprehensive Income into income (effective portion)		Pre-tax amount of gain/(loss) reclassified from Accumulated Other Comprehensive Income into income (effective portion) September 30, 2009
Commodity contract	$	6	Cost of sales	$	(9)
Foreign exchange contracts		(12)	Sales		19
	$	(6)		$	10

For third quarter and nine months ended September 30, 2009, there was no material ineffectiveness with regard to the Company's cash flow hedges.

Nondesignated / Nonqualifying Derivative Instruments
The gains or losses on nonqualifying derivatives or derivatives that are not designated as hedges are marked to market in the line item "Other charges (income), net" of the Statements of Earnings. The Company recognized approximately $4 million net loss on nonqualifying derivatives during the quarter ended September 30, 2009. The Company recognized less than $3 million net loss on nonqualifying derivatives during the nine months ended September 30, 2009.