EASTMAN CHEMICAL CO
Form 10-Q
July 30, 2008

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 June 30, 2008
	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, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

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

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

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

Class	Number of Shares Outstanding at June 30, 2008
Common Stock, par value $0.01 per share	76,392,765

PAGE 1 OF 52 TOTAL SEQUENTIALLY NUMBERED PAGES
EXHIBIT INDEX ON PAGE 51

1

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	46
4.	Controls and Procedures	46
	PART II. OTHER INFORMATION	
1.	Legal Proceedings	47
1A.	Risk Factors	48
2.	Unregistered Sales of Equity Securities and Use of Proceeds	48
4.	Submission of Matters to a Vote of Security Holders	48
6.	Exhibits	49
	SIGNATURES	
	Signatures	5001

UNAUDITED CONSOLIDATED STATEMENTS OF EARNINGS,
COMPREHENSIVE INCOME AND RETAINED EARNINGS

(Dollars in millions, except per share amounts)	Second Quarter 2008	Second Quarter 2007	First Six Months 2008	First Six Months 2007
Sales	$ 1,834	$ 1,764	$ 3,561	$ 3,401
Cost of sales	1,513	1,455	2,903	2,806
Gross profit	321	309	658	595
Selling, general and administrative expenses	107	109	217	207
Research and development expenses	39	38	81	72
Asset impairments and restructuring charges, net	3	2	20	2
Operating earnings	172	160	340	314
Interest expense, net	18	14	34	31
Other (income) charges, net	1	(5)	--	(8)
Earnings from continuing operations before income taxes	153	151	306	291
Provision for income taxes from continuing operations	38	49	76	96
Earnings from continuing operations	115	102	230	195
Earnings (loss) from discontinued operations, net of tax	--	1	--	(2)
Gain (loss) from disposal of discontinued operations, net of tax	--	2	18	(11)
Net earnings	$ 115	$ 105	$ 248	$ 182
Basic earnings per share				
Earnings from continuing operations	$ 1.51	$ 1.21	$ 2.98	$ 2.32
Earnings (loss) from discontinued operations	--	0.03	0.23	(0.16)
Basic earnings per share	$ 1.51	$ 1.24	$ 3.21	$ 2.16
Diluted earnings per share				
Earnings from continuing operations	$ 1.48	$ 1.19	$ 2.94	$ 2.29
Earnings (loss) from discontinued operations	--	0.03	0.22	(0.16)
Diluted earnings per share	$ 1.48	$ 1.22	$ 3.16	$ 2.13
Comprehensive Income				
Net earnings	$ 115	$ 105	$ 248	$ 182
Other comprehensive income (loss)				
Change in cumulative translation adjustment, net of tax	(4)	12	(41)	9
Change in pension liability, net of tax	--	(6)	8	(4)
Change in unrealized gains (losses) on derivative instruments, net of tax	29	(4)	3	3
Change in unrealized gains (losses) on investments, net of tax	--	2	--	1

Total other comprehensive income (loss)		25		4		(30)		9
Comprehensive income	$	140	$	109	$	218	$	191
Retained Earnings								
Retained earnings at beginning of period	$	2,448	$	2,234	$	2,349	$	2,186
Net earnings		115		105		248		182
Cash dividends declared		(34)		(37)		(68)		(74)
Adoption of accounting standard		--		--		--		8
Retained earnings at end of period	$	2,529	$	2,302	$	2,529	$	2,302

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

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

(Dollars in millions, except per share amounts)	June 30, 2008 (Unaudited)	December 31, 2007
Assets		
Current assets		
Cash and cash equivalents	$ 562	$ 888
Trade receivables, net of allowance of $4 and $6	644	546
Miscellaneous receivables	155	112
Inventories	669	539
Other current assets	102	74
Current assets related to discontinued operations	--	134
Total current assets	2,132	2,293
Properties and equipment		
Properties and equipment at cost	8,376	8,152
Less: Accumulated depreciation	5,341	5,306
Net properties and equipment	3,035	2,846
Goodwill	328	316
Other noncurrent assets	335	313
Noncurrent assets related to discontinued operations	--	241
Total assets	$ 5,830	$ 6,009
Liabilities and Stockholders' Equity		
Current liabilities		
Payables and other current liabilities	$ 1,107	$ 1,013
Borrowings due within one year	--	72
Current liabilities related to discontinued operations	--	37
Total current liabilities	1,107	1,122
Long-term borrowings	1,440	1,535
Deferred income tax liabilities	286	300
Post-employment obligations	858	852
Other long-term liabilities	127	118
Total liabilities	3,818	3,927
Stockholders' equity		
Common stock ($0.01 par value – 350,000,000 shares authorized; shares issued – 94,472,428 and 93,630,292 for 2008 and 2007, respectively)	1	1
Additional paid-in capital	623	573
Retained earnings	2,529	2,349
Accumulated other comprehensive loss	(58)	(28)
	3,095	2,895
Less: Treasury stock at cost (18,162,337 shares for 2008 and 13,959,951 shares for 2007)	1,083	813

Total stockholders’ equity		2,012		2,082
Total liabilities and stockholders’ equity	$	5,830	$	6,009

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

4

UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in millions)	First Six Months 2008	2007
Cash flows from operating activities		
Net earnings	$ 248	$ 182
Adjustments to reconcile net earnings to net cash provided by (used in) operating activities:		
Depreciation and amortization	132	169
Asset impairments	1	22
Gains on sale of assets	(13)	--
Provision (benefit) for deferred income taxes	(59)	(18)
Changes in operating assets and liabilities:		
(Increase) decrease in receivables	(88)	(59)
(Increase) decrease in inventories	(115)	(18)
Increase (decrease) in trade payables	10	(63)
Increase (decrease) in liabilities for employee benefits and incentive pay	(29)	(121)
Other items, net	(8)	5
Net cash provided by operating activities	79	99
Cash flows from investing activities		
Additions to properties and equipment	(278)	(198)
Proceeds from sale of assets and investments	329	43
Investments in and acquisitions of joint ventures	(38)	(13)
Additions to capitalized software	(6)	(5)
Other items, net	(1)	27
Net cash provided by (used in) investing activities	6	(146)
Cash flows from financing activities		
Net increase (decrease) in commercial paper, credit facility and other borrowings	(40)	75
Repayment of borrowings	(72)	--
Dividends paid to stockholders	(69)	(75)
Treasury stock purchases	(270)	(86)
Proceeds from stock option exercises and other items	39	88
Net cash provided by (used in) financing activities	(412)	2
Effect of exchange rate changes on cash and cash equivalents	1	(3)
Net change in cash and cash equivalents	(326)	(48)
Cash and cash equivalents at beginning of period	888	939

Cash and cash equivalents at end of period	$	562	$	891

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	9
Note 4.	Acquisition and Divestiture of Industrial Gasification Interests	9
Note 5.	Payables and Other Current Liabilities	9
Note 6.	Provision for Income Taxes	10
Note 7.	Borrowings	10
Note 8.	Asset Impairments and Restructuring Charges, Net	11
Note 9.	Retirement Plans	12
Note 10.	Environmental Matters	13
Note 11.	Commitments	13
Note 12.	Fair Value of Financial Instruments	14
Note 13.	Stockholders' Equity	14
Note 14.	Earnings and Dividends per Share	15
Note 15.	Share-Based Compensation Awards	16
Note 16.	Segment Information	16
Note 17.	Legal Matters	18
Note 18.	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 2007 Annual Report on Form 10-K, except as described below with respect to the adoption of Statement of Financial Accounting Standards ("SFAS") No. 157, "Fair Value Measurements," ("SFAS No. 157"), and should be read in conjunction with the consolidated financial statements in Part II, Item 8 of the Company's 2007 Annual Report on Form 10-K. The unaudited consolidated financial statements are prepared in conformity with generally accepted accounting principles ("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 on the equity basis. Intercompany transactions and balances are eliminated in consolidation.

The Company adopted SFAS No. 157 as of January 1, 2008, with the exception of the application of the statement to non-recurring nonfinancial assets and nonfinancial liabilities, which has been deferred until January 1, 2009. The standard establishes a valuation hierarchy for disclosure of the inputs to the valuation used to measure fair value. This hierarchy prioritizes the inputs into 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. A financial asset or liability's classification within the hierarchy is determined based on the lowest level input that is significant to the fair value measurement. The following chart shows the securities valued on a recurring basis.

(Dollars in millions)	Fair Value Measurements at June 30, 2008			
Description	June 30, 2008	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Derivative Assets	$ 48	$ --	$ 48	$ --
Derivative Liabilities	(56)	--	(56)	--
	$ (8)	$ --	$ (8)	$ --

The Company will be required to measure the assets of its defined benefit pension and post-retirement welfare plans pursuant to SFAS No. 157 at the next measurement date, which will be December 31, 2008.

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 $340 million, subject to working capital adjustments and retained approximately $10 million of working capital. The Company recognized a gain of $18 million, net of tax, related to the sale of these businesses which includes 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. As of December 31, 2007, the Company had definitive agreements to sell assets and liabilities related to these businesses, resulting in them being classified as assets held for sale at December 31, 2007. The Company also entered into contracts with the buyer for transition services to supply raw materials for a period of less than one year. During first quarter 2007, the Company recorded asset impairments and restructuring charges of $21 million for its PET polymers manufacturing facility in Spain, which it sold in second quarter 2007. Net proceeds from the sale of the San Roque site were approximately $42 million. In addition, the Company indemnified the buyer against certain liabilities primarily related to taxes, legal matters, environmental matters, and other representations and warranties.

NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

The manufacturing facilities in the Netherlands, United Kingdom, and Spain, and related businesses represent the Company's European PET business and qualify as a component of an entity under SFAS No. 144, "Accounting 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 all periods 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 are 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.

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

	Second Quarter		First Six Months	
(Dollars in millions)	2008	2007	2008	2007
Sales	$ --	$ 131	$ 169	$ 289
Earnings before income taxes	--	3	2	1
Earnings (loss) from discontinued operations, net of tax	--	1	--	(2)
Gain (loss) on disposal, net of tax	--	2	18	(11)

Assets and liabilities of the discontinued operations classified as held for sale as of December 31, 2007 are summarized below:

(Dollars in millions)	December 31, 2007
Current assets	
Trade receivables	$ 85
Inventories	49
Total current assets held for sale	134
Non-current assets	
Properties and equipment, net	236
Other non-current assets	5
Total non-current assets held for sale	241
Total assets	$ 375
Current liabilities	
Payables and other current liabilities, net	$ 37
Total current liabilities held for sale	37
Total liabilities	$ 37

NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

3. INVENTORIES

(Dollars in millions)	June 30, 2008	December 31, 2007
At FIFO or average cost (approximates current cost)		
Finished goods	$ 672	$ 607
Work in process	218	195
Raw materials and supplies	329	247
Total inventories	1,219	1,049
LIFO Reserve	(550)	(510)
Total inventories	$ 669	$ 539

Inventories valued on the LIFO method were approximately 80 percent as of June 30, 2008 and 70 percent as of December 31, 2007 of total inventories.

4. ACQUISITION AND DIVESTITURE OF INDUSTRIAL GASIFICATION INTERESTS

In October 2007, the Company entered into an agreement with Green Rock Energy, L.L.C. ("Green Rock") to jointly develop an industrial gasification facility in Beaumont, Texas through TX Energy, L.L.C. ("TX Energy"). In June 2008, the Company acquired Green Rock's 50 percent ownership interest in TX Energy for approximately $35 million, which is primarily allocated to properties and equipment.

The results of operations of TX Energy for the period subsequent to the acquisition have been included in Eastman's consolidated financial statements for the second quarter of 2008. If TX Energy had been consolidated for the periods prior to the acquisition, the Company's consolidated revenue, net income and earnings per share would not have been materially different than reported. With this acquisition, the Company became the sole owner and developer of the industrial gasification facility in Beaumont, Texas, which is expected to be operational in 2011 and will produce intermediate chemicals, such as hydrogen, methanol, and ammonia from petroleum coke or coal.

Eastman had also begun to participate in an industrial gasification project in St. James Parish, Louisiana sponsored by Faustina Hydrogen Products, L.L.C. ("Faustina"). Through May 2008, the Company had invested approximately $11 million in Faustina. In June 2008, the Company sold its ownership interest in Faustina for approximately $11 million and will no longer participate in the project.

5. PAYABLES AND OTHER CURRENT LIABILITIES

(Dollars in millions)	June 30, 2008	December 31, 2007
Trade creditors	$ 620	$ 578
Accrued payrolls, vacation, and variable-incentive compensation	96	138
Accrued taxes	51	36
Post-employment obligations	55	60
Interest payable	29	31
Bank overdrafts	73	6

Other		183		164
Total payables and other current liabilities	$	1,107	$	1,013

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

NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

6. PROVISION FOR INCOME TAXES

	Second Quarter		First Six Months	
(Dollars in millions)	2008	2007	2008	2007
Provision for income taxes	$ 38	$ 49	$ 76	$ 96
Effective tax rate	25 %	33 %	25 %	33 %

The second quarter 2008 effective tax rate reflects an estimated benefit resulting from a federal gasification investment tax credit associated with the Company's expected capital spending in 2008 on the Beaumont, Texas industrial gasification project. Excluding discrete items, the second quarter 2008 and 2007 effective tax rates reflect the Company's expected full year tax rate on reported operating earnings from continuing operations before income tax, of approximately 30 percent and 33 percent, respectively.

Excluding discrete items, the first six months 2008 and 2007 effective tax rates reflect the Company's expected full year rate on reported operating earnings before income tax of approximately 30 percent and 33 percent, respectively.

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 2002. 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.

7. BORROWINGS

(Dollars in millions)	June 30, 2008	December 31, 2007
Borrowings consisted of:		
3 1/4% notes due 2008	$ --	$ 72
7% notes due 2012	147	148
6.30% notes due 2018	187	188
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	95	188
Other	16	16
Total borrowings	1,440	1,607
Borrowings due within one year	--	(72)
Long-term borrowings	$ 1,440	$ 1,535

At June 30, 2008, the Company has credit facilities with various U.S. and non-U.S. banks totaling approximately $800 million. These credit facilities consist of a $700 million revolving credit facility (the "Credit Facility") and a 60 million euro credit facility. These credit facilities will expire in 2012 and 2013. 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 June 30, 2008, the Company's credit facility borrowings totaled $95 million at an effective interest rate of 4.82 percent. At December 31, 2007, the Company's credit facility borrowings were $188 million at an effective interest rate of 4.79 percent.

The Credit Facility provides liquidity support for general corporate purposes.

NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

At June 30, 2008 and December 31, 2007, the Company had outstanding interest rate swaps associated with the entire outstanding principal of the 7% notes due in 2012 and $150 million of the outstanding principal of the 6.30% notes due in 2018. The average variable interest rate on the 7% notes was 5.65 percent and 7.12 percent for June 30, 2008 and December 31, 2007, respectively. The average variable interest rate on the 6.30% notes was 4.05 percent and 5.52 percent for June 30, 2008 and December 31, 2007, respectively. See the table in Note 1, "Basis of Presentation" for the fair value of the interest rate swaps.

8. ASSET IMPAIRMENTS AND RESTRUCTURING CHARGES, NET

In the second quarter and first six months 2008, asset impairments and restructuring charges, net totaled $3 million and $20 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.

In the second quarter and first six months 2007, asset impairments and restructuring charges, net totaled $2 million, related primarily to the dismantlement charges 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 2007 and the first six months 2008:

(Dollars in millions)	Balance at January 1, 2007	Provision/ Adjustments	Non-cash Reductions	Cash Reductions	Balance at December 31, 2007
Non-cash charges	$ --	$ 122	$ (122)	$ --	$ --
Severance costs	34	(9)	--	(18)	7
Site closure and other restructuring costs	14	(1)	--	(2)	11
Total	$ 48	$ 112	$ (122)	$ (20)	$ 18

	Balance at January 1, 2008	Provision/ Adjustments	Non-cash Reductions	Cash Reductions	Balance at June 30, 2008
Non-cash charges	$ --	$ 9	$ (9)	$ --	$ --
Severance costs	7	5	--	(7)	5
Site closure and other restructuring costs	11	6	--	(9)	8
Total	$ 18	$ 20	$ (9)	$ (16)	$ 13

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

11

NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

9. RETIREMENT PLANS

DEFINED BENFIT PENSION PLANS

Eastman maintains defined benefit pension plans that provide eligible employees hired prior to January 1, 2007, 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)	Second Quarter 2008	Second Quarter 2007	First Six Months 2008	First Six Months 2007
Service cost	$ 11	$ 13	$ 23	$ 24
Interest cost	23	24	44	45
Expected return on assets	(27)	(27)	(53)	(52)
Curtailment charge	--	--	9	--
Amortization of:				
Prior service credit	(4)	(2)	(7)	(4)
Actuarial loss	8	8	14	17
Net periodic benefit cost	$ 11	$ 16	$ 30	$ 30

The Company contributed $100 million to its U.S. defined benefit pension plan in first quarter 2007.

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

POSTRETIREMENT WELFARE PLANS

Eastman provides a subsidy toward life insurance and 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.

Employees hired on or after January 1, 2007 will have access to post-retirement health care benefits only, but Eastman will not provide a subsidy toward the premium cost of post-retirement 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

(Dollars in millions)	Second Quarter 2008	Second Quarter 2007	First Six Months 2008	First Six Months 2007
Service cost	$ 1	$ 2	$ 3	$ 4
Interest cost	11	10	22	21
Expected return on assets	(1)	--	(2)	(1)
Amortization of:				
Prior service credit	(5)	(5)	(11)	(11)
Actuarial loss	3	3	5	6
Net periodic benefit cost	$ 9	$ 10	$ 17	$ 19

NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

10. 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", to the consolidated financial statements in Part II, Item 8 of the Company's 2007 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 $40 million and $42 million at June 30, 2008 and December 31, 2007, 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 $11 million to the maximum of $16 million at June 30, 2008 and $13 million to the maximum of $17 million at December 31, 2007.

11. COMMITMENTS

Purchasing Obligations and Lease Commitments

At June 30, 2008, the Company had various purchase obligations totaling approximately $2.1 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 $125 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 35 percent relate to real property, including office space, storage facilities and land; and approximately 50 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 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 June 30, 2008 and December 31, 2007. 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 $341 million and $312 million in the second quarter 2008 and 2007, respectively, and $335 million and $302 million for the first six months of 2008 and 2007, respectively.

Guarantees

Financial Accounting Standards Board, ("FASB") Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others", 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 June 30, 2008 totaled $152 million and consisted primarily of leases for railcars, aircraft, and other equipment. Leases with guarantee amounts totaling $2 million, $11 million, and $139 million will expire in 2008, 2011, 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.

NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

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 FASB Interpretation Number 46, "Consolidation of Variable Interest Entities", 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 June 30, 2008. This potential VIE is a joint venture from which the Company has purchased raw materials and utilities for several years and purchases approximately $60 million of raw materials and utilities on an annual basis. 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.

12. FAIR VALUE OF FINANCIAL INSTRUMENTS

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 to the consolidated financial statements in Part II, Item 8 of the Company's 2007 Annual Report on Form 10-K.

At June 30, 2008, net mark-to-market gains from raw material and energy, currency and certain interest rate hedges that were included in accumulated other comprehensive income totaled less than $1 million. If realized, approximately $10 million in gains 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 second quarter of 2008.

13. STOCKHOLDERS' EQUITY

A reconciliation of the changes in stockholders' equity for the first six months 2008 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, 2007	1	573	2,349	(28)	(813)	2,082
Net Earnings	--	--	248	--	--	248
Cash Dividends Declared (1)	--	--	(68)	--	--	(68)

Other Comprehensive Income	--	--	--	(30)	--	(30)
Stock-Based Compensation and Other Items (2)(3)	--	50	--	--	--	50
Share Repurchases	--	--	--	--	(270)	(270)
Balance at June 30, 2008	1	623	2,529	(58)	(1,083)	2,012

(1) Includes dividends declared but unpaid.

(2) The tax benefits relating to the difference between the amounts deductible for federal income taxes over the amounts charged to income for book value purposes have been credited to paid-in capital.

(3) Includes the fair value of equity share-based awards recognized under SFAS No. 123 Revised December 2004 , "Share-Based Payment".

NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS), NET OF TAX

(Dollars in millions)	Cumulative Translation Adjustment $	Unfunded Additional Minimum Pension Liability $	Unrecognized Loss and Prior Service Cost $	Unrealized Gains (Losses) on Derivative Instruments $	Unrealized Gains (Losses) on Investments $	Accumulated Other Comprehensive Income (Loss) $
Pre-SFAS No. 158 (1) balance at December 31, 2006	121	(207)	--	(6)	(1)	(93)
Adjustments to apply SFAS No. 158	--	207	(288)	--	--	(81)
Balance at December 31, 2006	121	--	(288)	(6)	(1)	(174)
Period change	36	--	106	3	1	146
Balance at December 31, 2007	157	--	(182)	(3)	--	(28)
Period change	(41)	--	8	3	--	(30)
Balance at June 30, 2008	116	--	(174)	--	--	(58)

(1) SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans" ("SFAS No. 158")

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

14. EARNINGS AND DIVIDENDS PER SHARE

	Second Quarter		First Six Months	
	2008	2007	2008	2007
Shares used for earnings per share calculation (in millions):				
Basic	76.1	84.2	77.1	84.1
Diluted	77.4	85.5	78.3	85.3

In second quarter and the first six months 2008, common shares underlying options to purchase 171,500 shares of common stock and 237,050 shares of common stock, respectively, were excluded from the computation of diluted earnings per share, because the total market value of option exercises for these awards was less than the total proceeds that would be received for these awards. Additionally, the basic and diluted shares were reduced in second quarter and the first six months 2008 as a result of the Company's share repurchase programs. For second quarter and the first six months 2008, a total of 383,600 shares and 4,198,178 shares, respectively, were repurchased under the current

$700 million share repurchase authorization.

In second quarter and the first six months 2007, common shares underlying options to purchase 674,134 shares of common stock and 673,593 shares of common stock, respectively, were excluded from the computation of diluted earnings per share, because the total market value of option exercises for these awards was less than the total proceeds that would be received for these awards. Additionally, the basic and diluted shares were reduced in second quarter and the first six months 2007 as a result of the Company's share repurchase programs. For the second quarter and first six months 2007, a total of 810,000 shares and 1,370,100 shares, respectively were repurchased under a prior $300 million share repurchase authorization.

The Company declared cash dividends of $0.44 per share in second quarters 2008 and 2007 and $0.88 per share in the first six months 2008 and 2007.

NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

15. SHARE-BASED COMPENSATION AWARDS

The Company utilizes share-based awards under employee and non-employee director compensation programs. These share-based awards may include restricted and unrestricted stock grants, restricted stock units, stock options and performance shares. In the second quarter 2008 and 2007, approximately $5 million and $7 million, respectively, of compensation expense before tax were recognized in selling, general and administrative expense in the earnings statement for all share-based awards. The impact on second quarter 2008 and 2007 net earnings of $3 million and $4 million, respectively, is net of deferred tax expense related to share-based award compensation for each period. In the first six months 2008 and 2007, approximately $13 million for each period of compensation expense before tax were recognized in selling, general and administrative expense in the earnings statement for all share-based awards. The impact on first six months 2008 and 2007 net earnings of $8 million for each period is net of deferred tax expense related to share-based award compensation for each period.

Additional information regarding share-based compensation plans and awards may be found in Note 16 to the consolidated financial statements in Part II, Item 8 of the Company's 2007 Annual Report on Form 10-K.

16. SEGMENT INFORMATION

The Company's products and operations are managed and reported in five reportable operating segments, consisting of the Coatings, Adhesives, Specialty Polymers, and Inks ("CASPI") segment, the Fibers segment, the PCI segment, the Performance Polymers segment, and the Specialty Plastics ("SP") segment. For additional information concerning the Company's segments' businesses and products, refer to Note 23 to the consolidated financial statements in Part II, Item 8 of the Company's 2007 Annual Report on Form 10-K.

Research and development and other expenses not identifiable to an operating segment are not included in segment operating results for either of the periods presented and are shown in the tables below as "other" operating losses.

	Second Quarter	
(Dollars in millions)	2008	2007
Sales by Segment		
CASPI	$ 414	$ 376
Fibers	260	239
PCI	618	552
Performance Polymers	289	382
SP	253	215
Total Sales	$ 1,834	$ 1,764

	First Six Months	
(Dollars in millions)	2008	2007
Sales by Segment		
CASPI	$ 803	$ 721
Fibers	514	473
PCI	1,174	1,050
Performance Polymers	593	730
SP	477	427
Total Sales	$ 3,561	$ 3,401

NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in millions)	Second Quarter 2008		Second Quarter 2007	
Operating Earnings (Loss)				
CASPI (1)	$	53	$	66
Fibers		62		51
PCI (2)		54		57
Performance Polymers (3)		2		(21)
SP (4)		13		18
Total Operating Earnings by Segment		184		171
Other		(12)		(11)
Total Operating Earnings	$	172	$	160

(1) CASPI includes $2 million in second quarter 2008 gains for an adjustment to a reserve for asset impairments and restructuring costs for the first quarter divestiture of certain product lines.

(2) PCI includes $1 million and $7 million in second quarter 2008 and second quarter 2007, respectively, in accelerated depreciation costs related to cracking units at the Company's Longview, Texas facility and $3 million in second quarter 2008 in asset impairments and restructuring charges, net, primarily related to severance and pension costs from the decision to close a previously impaired site in the United Kingdom.

(3) Performance Polymers includes $2 million and $6 million in second quarter 2008 and second quarter 2007, respectively, in accelerated depreciation costs related to assets in Columbia, South Carolina and asset impairments and restructuring charges, net of $2 million in second quarter 2008 related to restructuring at the South Carolina facility using IntegRexTM technology and $1 million in second quarter 2007 primarily related to the divested PET manufacturing facilities in Mexico and Argentina.

(4) SP includes $1 million in second quarter 2007 in accelerated depreciation costs related to assets in Columbia, South Carolina and $1 million in second quarter 2007 in asset impairments and restructuring charges, net related to the discontinued production of cyclohexane dimethanol ("CHDM") at the San Roque, Spain facility.

(Dollars in millions)	First Six Months 2008		First Six Months 2007	
Operating Earnings (Loss)				
CASPI(1)	$	112	$	131
Fibers		130		110
PCI (2)		98		111
Performance Polymers (3)		(4)		(53)
SP (4)		30		36
Total Operating Earnings by Segment		366		335
Other		(26)		(21)
Total Operating Earnings	$	340	$	314

(1) CASPI includes $2 million in the first six months 2008 gains for an adjustment to a reserve for asset impairments and restructuring costs for the first quarter divestiture of certain product lines.

(2)

PCI includes $2 million and $14 million in the first six months 2008 and the first six months 2007, respectively, in accelerated depreciation costs related to cracking units at the Company's Longview, Texas facility and $19 million in the first six months 2008 in asset impairments and restructuring charges, net, primarily related to severance and pension costs from the decision to close a previously impaired site in the United Kingdom.

(3) Performance Polymers includes $3 million and $13 million in the first six months 2008 and the first six months 2007, respectively, in accelerated depreciation costs related to assets in Columbia, South Carolina and asset impairments and restructuring charges, net of $3 million in the first six months 2008 related to restructuring at the South Carolina facility using IntegRexTM technology and $1 million in the first six months 2007 primarily related to the divested PET manufacturing facilities in Mexico and Argentina.

(4) SP includes $1 million in the first six months 2007 in accelerated depreciation costs related to assets in Columbia, South Carolina and $1 million in the first six months 2007 in asset impairments and restructuring charges, net related to the discontinued production of CHDM at the San Roque, Spain facility.

NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in millions)	June 30, 2008	December 31, 2007
Assets by Segment (1)		
CASPI	$ 1,247	$ 1,114
Fibers	778	692
PCI	969	1,062
Performance Polymers	659	727
SP	807	622
Total Assets by Segment	4,460	4,217
Corporate Assets	1,370	1,417
Total Assets Before Assets Related to Discontinued Operations	5,830	5,634
Assets Related to Discontinued Operations (2)	--	375
Total Assets	$ 5,830	$ 6,009

(1) Assets managed by segment are accounts receivable, inventory, fixed assets, and goodwill.

(2) For more information regarding assets related to discontinued operations, see Note 2, “Discontinued Operations”.

17. LEGAL MATTERS

General

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, including the asbestos litigation described below, will have a material adverse effect on its overall financial condition, results of operations or cash flows. However, adverse developments could negatively impact earnings or cash flows in a particular future period.

Asbestos Litigation

Over the years, Eastman has been named as a defendant, along with numerous other defendants, in lawsuits in various state courts in which plaintiffs have alleged injury due to exposure to asbestos at Eastman’s manufacturing sites. More recently, certain plaintiffs have claimed exposure to an asbestos-containing plastic, which Eastman manufactured in limited amounts between the mid-1960’s and the early 1970’s.

To date, the Company has obtained dismissals or settlements of its asbestos-related lawsuits with no material effect on its financial condition, results of operations or cash flows, and over the past several years, has substantially reduced its

number of pending asbestos-related claims. The Company has also obtained insurance coverage that applies to a portion of certain of the Company's defense costs and payments of settlements or judgments in connection with asbestos-related lawsuits.

Based on an ongoing evaluation, the Company believes that the resolution of its pending asbestos claims will not have a material impact on the Company's financial condition, results of operations, or cash flows, although these matters could result in the Company being subject to monetary damages, costs or expenses, and charges against earnings in particular periods.

NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

18. RECENTLY ISSUED ACCOUNTING STANDARDS

Effective first quarter 2008, the Company adopted SFAS No. 157, except as it applies to those nonfinancial assets and nonfinancial liabilities addressed in FASB Staff Position FAS 157-2 ("FSP FAS 157-2"). The FASB issued FSP FAS 157-2 which delays the effective date of SFAS No. 157 to fiscal years beginning after November 15, 2008 for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). The Company is currently evaluating the effect FSP FAS 157-2 will have on its consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141 (revised 2007) "Business Combinations" ("SFAS No. 141R") which replaces SFAS No. 141 "Business Combinations" ("SFAS No. 141"). SFAS No. 141R retains the fundamental requirements of SFAS No. 141 that the acquisition method of accounting be used for all business combinations. However, SFAS No. 141R provides for the following changes from SFAS No. 141: an acquirer will record 100% of assets and liabilities of acquired business, including goodwill, at fair value, regardless of the level of interest acquired; certain contingent assets and liabilities will be recognized at fair value at the acquisition date; contingent consideration will be recognized at fair value on the acquisition date with changes in fair value to be recognized in earnings upon settlement; acquisition-related transaction and restructuring costs will be expensed as incurred; reversals of valuation allowances related to acquired deferred tax assets and changes to acquired income tax uncertainties will be recognized in earnings; and when making adjustments to finalize preliminary accounting, acquirers will revise any previously issued post-acquisition financial information in future financial statements to reflect any adjustments as if they occurred on the acquisition date. SFAS No. 141R applies prospectively to business combinations for which the acquisition date is on or after January 1, 2009. SFAS No. 141R will not have an impact on the Company's consolidated financial statements when effective, but the nature and magnitude of the specific effects will depend upon the nature, terms, and size of the acquisitions consummated after the effective date.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements—an amendment of ARB No. 51" ("SFAS No. 160"), which establishes accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. SFAS No. 160 provides that accounting and reporting for minority interests be recharacterized as noncontrolling interests and classified as a component of equity. This Statement also establishes reporting requirements that provide sufficient disclosures that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. SFAS No. 160 applies to all entities that prepare consolidated financial statements but will affect only those entities that have an outstanding noncontrolling interest in one or more subsidiaries or that deconsolidate a subsidiary. This Statement is effective as of the beginning of an entity’s first fiscal year beginning after December 15, 2008. The Company has concluded that SFAS No. 160 will not have a material impact on the Company’s consolidated financial statements.

In March 2008, the FASB issued SFAS Statement No. 161 "Disclosures about Derivative Instruments and Hedging Activities" ("SFAS No. 161"). The new standard is intended to improve financial reporting about derivative instruments and hedging activities by requiring enhanced disclosures to enable investors to better understand their effects on an entity’s financial position, financial performance, and cash flows. It is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. The new standard also improves transparency about the location and amounts of derivative instruments in an entity’s financial statements; how derivative instruments and related hedged items are accounted for under SFAS No. 133 "Accounting for Derivative Instruments and Hedging Activities"; and how derivative instruments and related hedged items affect its financial position, financial performance, and cash flows. The Company has concluded that SFAS No.

161 will not have a material impact on the Company's consolidated financial statements.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

ITEM	Page
Critical Accounting Estimates	21
Strategic Actions and Related Presentation of Non-GAAP Financial Measures	21
Overview	22
Results of Operations	24
Summary by Operating Segment	28
Summary by Customer Location	34
Liquidity, Capital Resources, and Other Financial Information	36
Recently Issued Accounting Standards	40
Outlook	41
Forward-Looking Statements and Risk Factors	43

This Management's Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with Eastman Chemical Company's (the "Company" or "Eastman") audited consolidated financial statements, including related notes, and Management’s Discussion and Analysis of Financial Condition and Results of Operations contained in the Company's 2007 Annual Report on Form 10-K, and the Company's unaudited consolidated financial statements, including related notes, included elsewhere in this report. All references to earnings per share contained in this report are diluted earnings per share unless otherwise noted.

As described below in "Strategic Actions and Related Presentation of Non-GAAP Financial Measures", the Company sold its polyethylene terephthalate ("PET") manufacturing facility in Spain in the second quarter 2007 and sold its PET polymers and purified terephthalic acid ("PTA") manufacturing facilities in the Netherlands and its PET manufacturing facility in the United Kingdom and the related businesses in first quarter 2008. Because the Company has exited the PET business in the European region, results from sales of PET products manufactured at the Spain, the Netherlands, and the United Kingdom sites, including impairments and restructuring charges of those operations, and gains and losses from disposal of those assets and businesses, are presented as discontinued operations for all periods presented and are therefore not included in results from continuing operations under generally accepted accounting principles ("GAAP"). For additional information, see Note 2, "Discontinued Operations ", to the Company's unaudited consolidated financial statements in Part I, Item 1 of this quarterly report on Form 10-Q. Also in 2007, the Company sold its Mexico and Argentina PET manufacturing sites. Sales and results from these sites are not presented as discontinued operations due to the Performance Polymers segment's continuing involvement in the Latin American region and polymer intermediates sales to the divested facilities.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION
AND RESULTS OF OPERATIONS

CRITICAL ACCOUNTING ESTIMATES

In preparing the consolidated financial statements in conformity with GAAP in the United States, 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, revenues 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 assets, environmental costs, U.S. pension and other post-employment 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 listed and described in Part II, Item 7 of the Company's 2007 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.

STRATEGIC ACTIONS AND RELATED PRESENTATION OF NON-GAAP FINANCIAL MEASURES

During 2007 and 2008, the Company took strategic actions in its Performance Polymers segment to address its underperforming PET manufacturing facilities outside the United States. In second quarter 2007, the Company completed the sale of its PET manufacturing facility in Spain and in first quarter 2008, the Company completed the sale of its PET polymers and PTA manufacturing facilities in the Netherlands and the PET manufacturing facility in the United Kingdom and related businesses. Results from, charges related to, and gains and losses from disposal of the Spain, the Netherlands, and the United Kingdom assets and businesses are presented as discontinued operations. In fourth quarter 2007, the Company completed the sale of its Mexico and Argentina manufacturing facilities. As part of this divestiture, the Company entered into transition supply agreements for polymer intermediates. In order to provide a better understanding of the impact on Performance Polymers segment results of the divested Latin American PET assets, this Management's Discussion and Analysis includes certain financial measures with and without sales and operating results in Latin America from PET manufacturing facilities and related businesses in Mexico and Argentina and with and without contract polymer intermediates sales.

In fourth quarter 2006, the Company sold its polyethylene ("PE") and EpoleneTM polymer businesses and related assets of the Performance Polymers and Coatings, Adhesives, Specialty Polymers, and Inks ("CASPI") segments. As part of the PE divestiture, the Company entered into a transition supply agreement for contract ethylene sales, from which sales revenue and operating earnings are included in the Performance Chemicals and Intermediates ("PCI") segment results in 2008 and 2007.

Also in the fourth quarter 2006, the Company made strategic decisions relating to the scheduled shutdown of cracking units in Longview, Texas and a planned shutdown of higher cost PET assets in Columbia, South Carolina. Accelerated depreciation costs resulting from these decisions were $3 million and $14 million in second quarter 2008 and second quarter 2007, respectively, and $5 million and $28 million in the first six months 2008 and first six months 2007, respectively. For more information on accelerated depreciation costs, see "Gross Profit" in the "Results of Operations" section of this Management's Discussion and Analysis.

This Management's Discussion and Analysis includes the following non-GAAP financial measures and accompanying reconciliations to the most directly comparable GAAP financial measures:

- Company sales and segment sales and results from continuing operations excluding sales revenue and results from continuing operations from sales in Latin America of PET products manufactured at the divested Mexico and Argentina PET manufacturing sites;
- Company and segment sales excluding contract ethylene sales under a transition agreement related to the divestiture of the PE product lines;
- Company and segment sales excluding contract polymer intermediates sales under a transition supply agreement related to the divestiture of the PET manufacturing facilities and related businesses in Mexico and Argentina;

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION
AND RESULTS OF OPERATIONS

- Company and segment gross profit, operating earnings and earnings from continuing operations excluding accelerated depreciation costs and asset impairments and restructuring charges; and
- Company earnings from continuing operations excluding net deferred tax benefits related to the previous divestiture of businesses.

Eastman's management believes that contract ethylene sales under the transition agreement related to the divestiture of the PE product lines and the contract polymer intermediates sales under the transition supply agreement related to the divestiture of the PET manufacturing facilities and related businesses in Mexico and Argentina do not reflect the continuing and expected future business of the PCI and Performance Polymers segments. In addition, for evaluation and analysis of ongoing business results and of the impact on the Company and segments of strategic decisions and actions to reduce costs and to improve the profitability of the Company, management believes that Company and segment earnings from continuing operations should be considered both with and without accelerated depreciation costs, asset impairments and restructuring charges, and deferred tax benefits related to the previous divestiture of businesses, and that Company and segment sales and results from continuing operations should be considered both with and without sales revenue and results from continuing operations from sales in Latin America of PET products manufactured at the divested Mexico and Argentina manufacturing facilities. Management believes that investors can better evaluate and analyze historical and future business trends if they also consider the reported Company and segment results, respectively, without the identified items. Management utilizes Company and segment results including and excluding the identified items in the measures it uses to evaluate business performance and in determining certain performance-based compensation. These measures, excluding the identified items, are not recognized in accordance with GAAP and should not be viewed as alternatives to the GAAP measures of performance.

OVERVIEW

The Company generated sales revenue of $1.8 billion for both the second quarter 2008 and the second quarter 2007. Excluding the results of contract ethylene sales, contract polymer intermediates sales, and sales from divested PET facilities in Mexico and Argentina, sales revenue increased by 8 percent. The Company generated sales revenue of $3.6 billion for the first six months 2008 compared to $3.4 billion for the first six months 2007. Excluding the results of contract ethylene sales, contract polymer intermediates sales, and sales from divested PET facilities in Mexico and Argentina, sales revenue increased by 9 percent. Sales revenue increases for both second quarter and first six months 2008 compared to comparable periods 2007 were due to increased selling prices in response to higher raw material and energy costs more than offsetting lower sales volume.

Operating earnings were $172 million in second quarter 2008, an 8 percent increase compared with second quarter 2007. Excluding accelerated depreciation costs and asset impairments and restructuring charges from both the second quarter 2008 and 2007, operating earnings were $178 million in second quarter 2008 compared with $176 million in second quarter 2007. Operating earnings were $340 million in first six months 2008, an 8 percent increase compared with first six months 2007. Excluding accelerated depreciation costs and asset impairments and restructuring charges from both the first six months 2008 and 2007, operating earnings were $365 million in the first six months 2008 compared with $344 million in the first six months 2007. The Company's broad base of businesses continues to have strong results, despite the difficulty to fully offset increased raw material and energy costs. The Performance Polymers segment had significant improvement due primarily to improved operation of the South Carolina PET facility based on the IntegRexTM technology.

Primarily as a result of strategic decisions related to the Performance Polymers and PCI segments, operating earnings in second quarter 2008 were negatively impacted by $3 million of accelerated depreciation costs and $3 million in asset impairments and restructuring charges. Operating earnings in second quarter 2007 were negatively impacted by $14 million of accelerated depreciation costs and $2 million in asset impairments and restructuring charges. Operating earnings in first six months 2008 were negatively impacted by $5 million of accelerated depreciation costs and $20 million in asset impairments and restructuring charges. Operating earnings in first six months 2007 were negatively impacted by $28 million of accelerated depreciation costs and $2 million in asset impairments and restructuring charges.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION
AND RESULTS OF OPERATIONS

Earnings from continuing operations increased by $13 million for second quarter 2008 as compared to second quarter 2007. Excluding accelerated depreciation costs and asset impairments and restructuring charges, net, earnings from continuing operations were $119 million and $111 million, respectively. Earnings from continuing operations increased by $35 million for the first six months 2008 compared to the first six months 2007. Excluding accelerated depreciation costs, asset impairments and restructuring charges, net, and net deferred tax benefits related to the previous divestiture of businesses, earnings from continuing operations were $236 million and $214 million, respectively. Earnings from continuing operations for second quarter and first six months 2008 compared to second quarter and first six months 2007 included a reduction in the provision for income taxes resulting from an estimated benefit from a federal gasification investment tax credit associated with the Company’s expected capital spending in 2008 on the Beaumont, Texas industrial gasification project.

The Company generated $79 million in cash from operating activities during the first six months 2008 compared to $99 million provided by operating activities in the first six months 2007. The difference was primarily due to a greater increase in working capital in 2008 largely resulting from an increase in inventory attributable to higher raw material costs, which was partially offset by lower pension contributions. In first six months 2007, the Company contributed $100 million to its U.S. defined benefit pension plan and does not plan to make any contributions in 2008. In first six months 2008, the Company received proceeds from sales of assets and investments of $329 million, repurchased shares totaling $270 million, and repaid $175 million of borrowings.

In addition to the completion of the sale of its PET polymers and PTA manufacturing facilities in the Netherlands and the PET manufacturing facility in the United Kingdom in first quarter 2008, Eastman continued to progress on its overall growth objectives including the industrial gasification project in the U.S. Gulf Coast and actions to improve the performance of its Performance Polymers segment including the transformation at the South Carolina facility. In June 2008, the Company acquired the remaining ownership interest in TX Energy, LLC (“TX Energy”) for approximately $35 million. With this acquisition, the Company became the sole owner and developer of the industrial gasification facility in Beaumont, Texas, which is expected to be operational in 2011. Additionally, the Company sold its ownership interest in the St. James Parish, Louisiana industrial gasification project for approximately $11 million and will no longer participate in the project.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION
AND RESULTS OF OPERATIONS

RESULTS OF OPERATIONS

	Second Quarter					Product	Exchange
(Dollars in millions)	2008	2007	Change	Volume Effect	Price Effect	Mix Effect	Rate Effect
Sales	$ 1,834	$ 1,764	4 %	(9) %	11 %	1 %	1 %
Sales from Mexico and Argentina PET manufacturing facilities (1)	--	110					
Sales - contract polymer intermediates sales (2)	26	--					
Sales - contract ethylene sales (3)	102	74					
Sales – excluding listed items	1,706	1,580	8 %	(4) %	10 %	1 %	1 %

	First Six Months					Product	Exchange
(Dollars in millions)	2008	2007	Change	Volume Effect	Price Effect	Mix Effect	Rate Effect
Sales	$ 3,561	$ 3,401	5 %	(8) %	11 %	1 %	1 %
Sales from Mexico and Argentina PET manufacturing facilities (1)	--	235					
Sales - contract polymer intermediates sales (2)	82	--					
Sales - contract ethylene sales (3)	194	144					
Sales – excluding listed items	3,285	3,022	9 %	(3) %	10 %	1 %	1 %

(1) Sales revenue for 2007 include sales revenue from PET manufacturing facilities and related businesses in Cosoleacaque, Mexico and Zarate, Argentina divested in fourth quarter 2007.

(2) Included in 2008 sales revenue are contract polymer intermediates sales under the transition supply agreement related to the divestiture of the PET manufacturing facilities and related businesses in Mexico and Argentina in fourth quarter 2007.

(3) Included in 2008 and 2007 sales revenue are contract ethylene sales under the transition supply agreement related to the divestiture of the PE businesses.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION
AND RESULTS OF OPERATIONS

Sales revenue in second quarter and first six months 2008 compared to second quarter and first six months 2007 increased $70 million and $160 million, respectively. Excluding revenue from the contract ethylene and polymer intermediates sales and the sales from Mexico and Argentina PET manufacturing facilities, sales revenues increased $126 million and $263 million for second quarter and first six months 2008 compared to second quarter and first six months 2007, respectively. The increase was primarily due to higher selling prices in all segments in response to higher raw material and energy costs partially offset by lower sales volume. Lower sales volume for the PCI and Performance Polymers segments was partially offset by higher sales volume in the Specialty Plastics ("SP") segment.

	Second Quarter			First Six Months		
(Dollars in millions)	2008	2007	Change	2008	2007	Change
Gross Profit	$ 321	$ 309	4 %	$ 658	$ 595	11 %
As a percentage of sales	18 %	18 %		18 %	17 %	
Accelerated depreciation costs included in cost of goods sold	3	14		5	28	
Gross Profit excluding accelerated depreciation costs	324	323	-- %	663	623	6 %
As a percentage of sales	18 %	18 %		19 %	18 %	

Gross profit for second quarter 2008 increased compared to second quarter 2007 as higher selling prices were partially offset by higher raw material and energy costs. Second quarter 2008 and 2007 included accelerated depreciation costs of $3 million and $14 million, respectively, resulting from the previously reported shutdown of the cracking units in Longview, Texas and of higher cost PET polymer assets in Columbia, South Carolina. The Company's second quarter 2008 raw material and energy costs increased by approximately $200 million compared with second quarter 2007.

Gross profit and gross profit as a percentage of sales for the first six months 2008 increased compared to the first six months 2007 primarily in the Performance Polymers and Fibers segments. In addition, the first six months 2008 and 2007 included accelerated depreciation costs of $5 million and $28 million, respectively, resulting from the previously reported shutdown of the cracking units in Longview, Texas and of higher cost PET polymer assets in Columbia, South Carolina. T