COMPETITIVE TECHNOLOGIES INC
Form S-1
March 19, 2004

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As filed with the Securities and Exchange Commission on March 19, 2004.

Registration No.

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM S-1

**REGISTRATION STATEMENT
UNDER
THE SECURITIES ACT OF 1933**

COMPETITIVE TECHNOLOGIES, INC.

(Exact name of Registrant as specified in its charter)

Delaware	**6794**	**36-2664428**
(State or Other Jurisdiction of Incorporation or Organization)	(Primary Standard Industrial Classification Code Number)	(I.R.S. Employer Identification No.)

**1960 Bronson Road
Fairfield, Connecticut 06824
(203) 255-6044**

(Address, Including Zip Code, and Telephone Number, Including Area Code, of Registrant's Principal Executive Offices)

**John B. Nano
President, Chief Executive Officer and Chief Financial Officer
Competitive Technologies, Inc.
1960 Bronson Road
Fairfield, Connecticut 06824
(203) 255-6044**

(Name, address including zip code, and telephone number, including area code, of agent for service)

With a copy to:

**Allan J. Reich, Esq.
Seyfarth Shaw LLP
55 East Monroe Street, Suite 4200
Chicago, Illinois 60603-5803
Telephone: (312) 346-8000
Facsimile: (312) 269-8869**

Approximate date of commencement of proposed sale to the public: From time to time after this Registration Statement becomes effective.

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, check the following box: ý

If this form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If this form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If this form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If delivery of the prospectus is expected to be made pursuant to Rule 434, please check the following box. o

CALCULATION OF REGISTRATION FEE

Title of Each Class of Securities To be Registered	Amount to be Registered	Proposed Maximum Offering Price Per Share(1)	Proposed Maximum Aggregate Offering Price(1)	Amount of Registration Fee
Common Stock, par value $0.01 per share	1,248,115	$3.98	$4,967,498	$630

(1) Estimated pursuant to Rule 457(c), solely for the purpose of calculating the registration fee based on the average of the high and low prices for the common stock, as reported on the American Stock Exchange on March 17, 2004. Under the common stock purchase agreement, Fusion Capital has agreed to purchase up to $5.0 million of newly issued CTT common stock.

THE REGISTRANT HEREBY AMENDS THIS REGISTRATION STATEMENT ON SUCH DATE OR DATES AS MAY BE NECESSARY TO DELAY ITS EFFECTIVE DATE UNTIL THE REGISTRANT HAS FILED A FURTHER AMENDMENT THAT SPECIFICALLY STATES THAT THIS REGISTRATION STATEMENT SHALL THEREAFTER BECOME EFFECTIVE IN ACCORDANCE WITH SECTION 8(A) OF THE SECURITIES ACT OF 1933 OR UNTIL THE REGISTRATION STATEMENT SHALL BECOME EFFECTIVE ON SUCH DATE AS THE COMMISSION ACTING PURSUANT TO SAID SECTION 8(A), MAY DETERMINE.

The information in this Prospectus is not complete and may be changed. These securities may not be sold until the registration statement filed with the Securities and Exchange Commission is effective. This Prospectus is not an offer to sell these securities and it is not soliciting offers to buy these securities in any state where the offer or sale is not permitted.

SUBJECT TO COMPLETION, DATED MARCH 19, 2004.

PROSPECTUS

Competitive Technologies, Inc.
1,248,115 Shares of Common Stock

This Prospectus relates to the sale of up to 1,248,115 shares of our common stock by Fusion Capital Fund II, LLC. Fusion Capital is sometimes referred to in this Prospectus as the selling stockholder. The prices at which Fusion Capital may sell the shares will be determined by the prevailing market price for the shares or in negotiated transactions. We will not receive any proceeds from the sale of our shares by Fusion Capital.

Our common stock is traded on the American Stock Exchange under the symbol "CTT." On March 17, 2004 the last reported sale price for our common stock as reported on the American Stock Exchange was $3.88 per share.

Investing in our common stock involves a high degree of risk. You should consider carefully the "Risk Factors" beginning on page 2 for a discussion of these risks.

The selling stockholder is an "underwriter" within the meaning of the Securities Act of 1933, as amended.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this Prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

The date of this Prospectus is , 2004.

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You may rely only on the information provided or incorporated by reference in this Prospectus. Neither we nor the selling stockholder have authorized anyone to provide information different from that contained in this Prospectus. Neither the delivery of this Prospectus nor the sale of the securities means that the information contained in this Prospectus is correct after the date of this Prospectus. This Prospectus is not an offer to sell or solicitation to buy the securities in any circumstances under which the offer or solicitation is unlawful.

Prospectus Summary

The following summary highlights information contained elsewhere in this Prospectus. It may not contain all of the information that is important to you. You should read the entire Prospectus carefully, especially the discussion regarding the risks of investing in CTT common stock under the heading "Risk Factors," before investing in CTT common stock. In this Prospectus, "CTT," "we," "us," and "our" refer to Competitive Technologies, Inc.

Business

CTT is a Delaware corporation incorporated in 1971 to succeed an Illinois business corporation incorporated in 1968. We provide technology transfer and licensing services focused on the technology needs of our customers and matching those requirements with commercially viable solutions. We identify, develop, and commercialize innovative technologies in life, digital, nano and physical sciences developed by universities, companies, independent research institutions and individual inventors.

We seek to maximize the value of intellectual property for the benefit of our customers, clients and stockholders by selling, licensing or otherwise commercializing technologies from our clients' or our portfolio of intellectual property rights. We obtain customers' technology requirements and match them with effective technology solutions, bridging the gap between market demand and raw innovation. In a few cases, we are enforcing our clients' and our patent rights with respect to certain of our technologies.

Our customers (licensees) pay license and royalty fees for licensed rights to use our clients' and our technologies. We also realize revenues from court awarded judgments and settlements of patent enforcement actions. We share these fees, judgments and settlements with our clients under our respective agreements with them.

Our life science portfolio includes pharmaceuticals, biotechnologies, and medical devices. We include communications, semiconductors, Internet, e-commerce and consumer electronics technologies in our digital portfolio. Our physical science portfolio targets display, environmental and nano-technologies and smart/novel materials.

Corporate Information

CTT is incorporated under the laws of the State of Delaware. Our executive offices are located at 1960 Bronson Road, Fairfield, Connecticut 06824, and our telephone number is (203) 255-6044. The address of our website is ***www.competitivetech.net***. Information on our web site is not part of this Prospectus.

CTT Common Stock

CTT common stock trades on the American Stock Exchange under the symbol "CTT."

The Offering

On February 25, 2004, we entered into a common stock purchase agreement with Fusion Capital Fund II, LLC, pursuant to which Fusion Capital has agreed to purchase, subject to CTT's rights to reduce or suspend these purchases and terminate the agreement with Fusion Capital at any time, on each trading day, $12,500 of our common stock up to an aggregate purchase price of $5.0 million. The $5.0 million of common stock is to be purchased over a twenty (20) month period, subject to a six (6) month extension or earlier termination at our discretion. Pursuant to the common stock purchase agreement, we can control the size and timing of any sales of our common stock to Fusion Capital.

Fusion Capital, the selling stockholder under this Prospectus, is offering for sale up to 1,248,115 shares of our common stock. As of March 10, 2004, there were 6,243,697 shares outstanding, excluding the initial 53,138 shares issuable to Fusion Capital, the additional 35,425 shares issuable to Fusion Capital as compensation for its purchase commitment, and the additional 1,159,552 shares offered by

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Fusion Capital pursuant to this Prospectus. The number of shares offered by this Prospectus represents approximately 19.9% of the total common stock outstanding as of March 10, 2004. The number of shares ultimately offered for sale by Fusion Capital is dependent upon the number of shares purchased by Fusion Capital under the common stock purchase agreement. This number may be affected by other factors more fully described under the heading "The Fusion Capital Transaction."

Risk Factors

An investment in CTT common stock involves a high degree of risk. You should carefully consider the following risk factors and other information in this Prospectus before deciding to invest in shares of CTT common stock. Our most significant risks and uncertainties are described below; however, they are not the only risks that we face. If any of the following risks actually occurs, our business, financial condition, liquidity, results of operations and prospects for growth could be materially adversely affected, the trading of our common stock could decline, and you may lose all or part of your investment. You should acquire shares of our common stock only if you can afford to lose your entire investment. We make various statements in this section which constitute "forward-looking statements" under Section 27A of the Securities Act of 1933. See "Forward-Looking Statements."

We cannot assure you that we will be successful in reducing cash expenses or increasing cash resources sufficiently to sustain us until we obtain additional cash from revenues, potential litigation awards or other funding. Our auditor's opinion with respect to our financial statements as of and for the year ended July 31, 2003 included an explanatory paragraph with respect to our ability to continue operating as a going concern.

We have incurred substantial operating and net losses in the three years ended July 31, 2003. Net patent enforcement expenses related to the Fujitsu and LabCorp litigations have been substantial. In addition, we have incurred $534,000 cumulatively through January 31, 2004 for professional advice relating to the ongoing Securities and Exchange Commission (SEC) investigation.

Management has and continues to take actions to improve our results. These actions include aggressively pursuing new license agreements, reducing cash operating expenses, deferring payment of certain liabilities, structuring payment obligations contingent upon revenues, selling portions of our share of the potential Materna award, and collecting amounts previously written off.

The amounts and timing of our future cash requirements will depend on many factors, including the results of our marketing efforts, the Materna award, Fujitsu and LabCorp lawsuits, the SEC investigation, and our fund raising efforts. To achieve profitability, we must successfully license technologies with current and long-term revenue streams greater than our operating expenses. To sustain profitability, we must continually add such licenses. However, royalty revenues, obtaining rights to new technologies, granting licenses, and enforcing intellectual property rights are subject to many factors outside our control or that we cannot currently anticipate. Although we cannot assure you that we will be successful in these efforts, management believes its plan would sustain CTT at least through fiscal 2005.

We will require additional financing to sustain our operations, and our ability to secure additional financing is uncertain.

We will need additional funds to fully implement our business, operating and development plans. We only have the right to receive up to $12,500 per trading day under our agreement with Fusion Capital unless our stock price exceeds $4.50, in which case the daily amount may be increased under certain conditions as the price of our common stock increases. However, we may elect to reduce or suspend our sales of common stock to Fusion Capital if we feel that the share price of our common stock is too low and due to our desire to keep dilution to a minimum. Fusion Capital does not have the right or the obligation to purchase any shares of our common stock on any trading days that the

market price of our common stock is less than $1.00. We are initially registering 1,248,115 shares of our common stock for sale by Fusion Capital pursuant to this Prospectus. The selling price of the 1,159,552 shares of our common stock to be purchased by Fusion Capital will have to average at least $4.32 per share for us to receive the maximum proceeds of $5.0 million without registering additional shares of common stock. Assuming a purchase price of $3.87 per share (the closing sale price of the common stock on March 10, 2004) and the purchase by Fusion Capital of the full 1,159,552 shares under the common stock purchase agreement, gross proceeds to us would only be $4,487,466 unless we choose to register more than 1,159,552 shares, which we have the right, but not the obligation, to do. In addition, Fusion Capital has the right to terminate the common stock purchase agreement if an event of default under the agreement occurs. See "The Fusion Capital Transaction Events of Default."

The extent to which we intend to rely on Fusion Capital as a source of financing will depend on a number of factors, including the prevailing market price of our common stock and the extent to which we are able to secure working capital from other sources, such as through obtaining substantial up-front license fees in potential new licenses, collecting additional amounts we believe are due to us and by selling future royalty streams from our portfolio. Even if we are able to access the full $5.0 million under the common stock purchase agreement with Fusion Capital, we may still need additional capital to fully implement our business and operating plans. Should the financing we require to sustain our working capital needs be unavailable or prohibitively expensive when we require it, the consequences would have a material adverse effect on our business, operating results, financial condition and prospects. Our agreement with Fusion Capital expires in October 2005 unless terminated sooner. If we are unable to obtain other debt and/or equity funding or generate significant additional revenue, we would need to significantly curtail our operations.

The sale of our common stock to Fusion Capital could cause the price of our common stock to decline. If our stock price declines, we may be unable to raise additional funds through the sale of our common stock to others. If we are able to sell shares of our common stock to others, the sales could result in significant dilution to our current stockholders.

The American Stock Exchange may delist our common stock.

On November 12, 2003, the American Stock Exchange notified us that we did not meet certain American Stock Exchange listing standards and that we must submit a plan for returning to compliance with those standards to maintain our listing on the American Stock Exchange. On

December 12, 2003, we submitted our plan and on January 23, 2004, the American Stock Exchange notified us that it had accepted our plan to regain compliance with the American Stock Exchange continued listing standards and that the American Stock Exchange was continuing our listing pursuant to an extension. To maintain our listing, we are required to make progress consistent with our plan during the extension period and to regain compliance with the American Stock Exchange listing standards by May 12, 2005. We cannot assure you if or when we will again meet the American Stock Exchange's listing requirements.

We have received and responded to written "Wells Notices" dated June 12, 2003 from the staff of the Securities and Exchange Commission. However, until this matter is resolved, our ability to obtain debt or equity financing is restricted.

On June 12, 2003, the staff of the SEC sent written "Wells Notices" indicating that the staff intended to recommend that the SEC bring a civil action against us and certain individuals (including our then Chief Financial Officer, a director and a former director) in the matter of trading in our stock. The individuals and we have responded in writing to our respective "Wells Notices." We continue to cooperate with the staff of the SEC in this matter and await the staff's formal recommendation of what action, if any, might be brought against us by the SEC. While this matter is pending, we have found our efforts to obtain debt or equity financing severely restricted and our operations and expenses negatively affected.

Our common stock may be subject to "low price stock" rules, limiting the market for our common stock.

If our common stock is delisted by the American Stock Exchange and if the market price of our common stock is less than $5.00 per share, our common stock will be deemed to be "penny stock" as that term is defined in Rule 3a51-1 promulgated under the Securities Exchange Act of 1934, as amended. Under these rules, broker-dealers who recommend such securities to persons other than institutional accredited investors must:

- make a special written suitability determination for the purchaser;
- receive the purchaser's written agreement to a transaction prior to sale;
- provide the purchaser with risk disclosure documents which identify certain risks associated with investing in "penny stocks" and which describe the market for these "penny stocks" as well as a purchaser's legal remedies; and
- obtain a signed and dated acknowledgment from the purchaser demonstrating that the purchaser has actually received the required risk disclosure document before a transaction in a "penny stock" can be completed.

If our common stock becomes subject to these rules, broker-dealers may find it difficult to effectuate consumer transactions and trading activity in our securities may be adversely affected. As a result, the market price of our securities may be depressed, and stockholders may find it more difficult to sell our securities.

The sale of our common stock to Fusion Capital will cause dilution and the sale of the shares of common stock acquired by Fusion Capital could cause the price of our common stock to decline.

The purchase price for the common stock to be issued to Fusion Capital pursuant to the common stock purchase agreement will fluctuate based on the price of our common stock. The purchase price per share will be equal to the lesser of: (i) the lowest sale price of our common stock on the purchase date or (ii) the average of the three (3) lowest closing sale prices of our common stock, during the twelve (12) consecutive trading days prior to the date of a purchase by Fusion Capital. All shares in this offering are freely tradable.

Fusion Capital may sell none, some or all of the shares of common stock purchased from us at any time. We expect that any shares offered by this Prospectus that are purchased by Fusion Capital will be sold over a period of up to twenty (20) months from the date of this Prospectus. Depending upon market liquidity at the time, a sale of shares under this offering at any given time could cause the trading price of our common stock to decline. The sale of a substantial number of shares of our common stock under this offering, or anticipation of such sales, could make it more difficult for us to sell equity or equity-related securities in the future at a time and at a price at which we might otherwise wish to effect sales.

There are 1,159,552 shares of our common stock that are registered for sale by Fusion Capital pursuant to this Prospectus (excluding the commitment shares that have been issued or are issuable to Fusion Capital under the common stock purchase agreement). Should we elect to sell shares to Fusion Capital under the common stock purchase agreement, which we have the right, but not the obligation to do, these shares would be issued by us in connection with purchases by Fusion Capital. Under our agreement with Fusion Capital, Fusion Capital does not have the right or the obligation to purchase any shares of our common stock in the event that the per share purchase price is less than $1.00. Assuming the issuance of these shares, the remaining 1,159,552 shares registered for sale by Fusion Capital pursuant to this Prospectus represent 18.6% of our outstanding shares of common stock as of March 10, 2004 and proceeds from the sale of these shares to Fusion Capital would be $4,487,466 based on the closing sale price of our common stock of $3.87 on March 10, 2004. In addition, 53,138

shares are issuable to Fusion Capital as an initial commitment fee and an additional 35,425 shares are issuable to Fusion Capital as an additional commitment fee on a pro rata basis during the twenty (20) month period as purchases are made.

The issuance of these shares would result in significant dilution to the ownership interests of other holders of our common stock. The amount of dilution would be higher if the market price of our common stock is lower at the time Fusion Capital purchases shares under the common stock purchase agreement, as a lower market price would cause more shares of our common stock to be issuable to Fusion Capital. Subsequent sales of these shares in the open market by Fusion Capital may also have the effect of lowering our stock price, thereby increasing the number of shares issuable under the common stock purchase agreement and consequently further diluting our outstanding shares. Although we have the right to reduce or suspend Fusion Capital purchases at any time, our financial condition at the time may require us to waive our right to suspend purchases even if there is a decline in the market price.

Employee stock options and warrants have the potential for dilution and could adversely affect the market price of our common stock.

As of March 10, 2004, an aggregate of 1,113,717 employee stock options were outstanding. We have granted to Brooks, Houghton & Company, Inc., our financial advisor who assisted us in arranging the transaction with Fusion Capital, five-year warrants to purchase 57,537 shares of our common stock (approximately 5% of 1,159,552 shares, the maximum number of shares that may be sold to Fusion Capital). Further, we may issue additional warrants and options in the future. For the life of all such warrants and options, the holders of such options and warrants will have the opportunity to profit from a rise in the market price of our common stock, with a resulting dilution in the interest of holders of our common stock. The terms on which we will be able to obtain additional capital during the life of such warrants and options may be adversely affected.

The existence of the agreement with Fusion Capital to purchase shares of CTT common stock could cause downward pressure on the market price of CTT common stock.

Both the actual dilution and the potential for dilution resulting from sales of CTT common stock to Fusion Capital could cause holders to elect to sell their shares of CTT common stock, which could cause the trading price of the CTT common stock to decrease. In addition, prospective investors anticipating the downward pressure on the price of the CTT common stock due to the shares available for sale by Fusion Capital could refrain from purchases or cause sales or short sales in anticipation of a decline of the market price, which may itself cause the price of our stock to decline.

In the first two quarters of fiscal year 2004 we received 83% of our retained royalties or revenues from three technologies.

In the first two quarters of fiscal year 2004, $1,850,000 (83%) of our revenues were from three technologies: $1,150,000 (52%) from the sales of portions of our potential award in the Materna lawsuit, $401,000 (18%) from the homocysteine assay, and $300,000 (13%) from Ethyol. Such a concentration of revenues makes our operation vulnerable to changes in any one of them, particularly to one time, nonrecurring transactions such as the sales of portions of our potential award in the Materna lawsuit.

Certain of our licensed patents have recently expired or will expire in the near future and we may not be able to replace their royalty revenues.

In fiscal 2003, we received royalties from licenses on thirty-three (33) patented technologies, excluding the sale for $600,000 of the first $1,290,000 of our potential share from a judgment in the Materna lawsuit. We expect royalties from nineteen (19) of those patented technologies to expire in the next five years. Those patented technologies represented approximately 44% of our revenue in fiscal

2003 (29% of our revenue in first half 2004). Fiscal 2003 revenues of approximately $191,000 (6%), $359,000 (11%), and $891,000 (27%) were from patents expiring in fiscal 2003, 2004 and 2007, respectively. First half 2004 revenues of approximately $127,000 (6%) and $506,000 (23%) were from licenses expiring in fiscal 2004 and 2007, respectively. Loss of these royalties may adversely affect our operating results if we are unable to replace them with revenue from other licenses or other sources.

We are currently involved in lawsuits that could have a material adverse affect on our business, results of operations and financial condition.

We have incurred significant legal expenses in lawsuits. If the courts in these suits decide against us, this could have a materially adverse affect on our business, results of operations and financial condition. See the heading "Legal Proceedings" in this Prospectus.

Our revenue growth depends on our ability to understand the technology requirements of our customers in the context of their markets. If we fail to understand their technology needs or markets, we limit our ability to meet those needs and to generate revenues.

We believe that by focusing on the technology needs of our customers, we are better positioned to generate revenues by providing them technology solutions. In this way, our revenues are driven by the market demands of our customers. The better we understand their markets and requirements, the better we are able to identify and obtain effective technology solutions for our customers. We currently primarily rely on our professional staff to understand the technical, commercial and market demands, requirements and constraints of our customers and to identify and obtain effective technology solutions for them.

Our success depends on our ability to attract and retain key personnel.

Our success depends on the knowledge, efforts and abilities of a small number of key personnel. John B. Nano, is our President, Chief Executive Officer and Chief Financial Officer, and Donald J. Freed is our Executive Vice President and Chief Technology Officer. We primarily rely on our professional staff to identify intellectual property opportunities and technology solutions and to negotiate and close license agreements. Competition for these personnel is intense and we cannot assure you that we will be able to continue to attract and retain qualified personnel. If we are unable to hire and retain highly qualified professional employees and consultants, our revenues, prospects, financial condition and future activities could be materially adversely affected.

We depend on our relationships with inventors to gain access to new technologies and inventions. If we fail to maintain existing relationships or to develop new relationships, we may reduce the number of technologies and inventions available to generate revenues.

We do not invent new technologies and products ourselves. We depend on relationships with universities, corporations, governmental agencies, research institutions, inventors, and others to provide us technology-based opportunities we can develop into profitable royalty-bearing licenses. Our failure to maintain our relationships with them or to develop new relationships could adversely affect our business, operating results and financial condition. If we are unable to forge new relationships or to maintain our current relationships, we may be unable to identify new technology-based opportunities.

Further, we cannot be certain that our current or new relationships will provide the volume or quality of available new technologies necessary to sustain our business. In some cases, universities and other sources of new technologies seek to develop and commercialize these technologies themselves or through entities they develop, finance and/or control. In other cases, universities receive financing for basic research from companies in exchange for the exclusive right to commercialize resulting inventions. These and other strategies may reduce the number of technology sources (potential clients) to whom we can market our services. If we are unable to secure new sources of technology, this could have a material adverse effect on our business, operating results and financial condition.

We receive most of our revenues from licensees over whom we have no control.

We rely on royalties received from our licensees for revenues. The royalties we receive from our licensees depend on their efforts and expenditures and we have no control over their efforts or expenditures. Additionally, our licensees' development of new products involves great risk since many new technologies do not become commercially profitable products despite extensive development efforts. Our license agreements do not require licensees to advise us of problems they may encounter in attempting to develop commercial products, and licensees usually treat such information as confidential. You should expect that licensees will encounter problems frequently. Our licensees' failure to resolve such problems may result in a material adverse effect on our operating results.

Our licensees, and therefore we, depend on receiving government approvals to exploit certain licensed products commercially.

Commercial exploitation of some licensed patents may require the approval of governmental regulatory agencies and there is no assurance that those agencies will grant such approvals. In the United States, the principal governmental agency involved is the U.S. Food and Drug Administration (FDA). The FDA's approval process is rigorous, time consuming and costly. Unless and until a licensee obtains approval for a product requiring such approval, the licensee may not sell the product in the U.S.A. and therefore, we will not receive royalty income based on U.S. sales of the product.

If our clients and we are unable to protect the intellectual property underlying our licenses or to enforce our patents adequately, we may be unable to exploit such licensed patents or technology successfully.

Our success in earning revenues from licenses is subject to the risk that issued patents may be declared invalid, that patents may not issue on patent applications, or that competitors may circumvent our licensed patents and thereby render our licensed patents uncommercial. In addition, when all patents underlying a license expire, our royalties from that license cease, and there can be no assurance that we will be able to replace those royalties with royalty revenues from other licenses.

Patent litigation has increased; it can be expensive and may delay or prevent our licensees' products from entering the market.

Our clients and/or we may pursue patent infringement litigation or interference proceedings against sellers of products that we believe infringe our patent rights. Holders of conflicting patents or sellers of competing products may also challenge our patents in patent infringement litigation or interference proceedings. We cannot assure you that our clients and/or we will be successful in any such litigation or proceeding, and the results and costs of such litigation or proceeding may materially adversely affect our business, operating results and financial condition.

In the markets for our licensees' products, technology can change rapidly and industry standards are continually evolving. This often makes products obsolete or results in short product lifecycles. Our profitability depends on our licensees' ability to adapt to such changes.

Therefore, our profitability will depend in large part on our clients', our licensees' and our abilities to:

introduce products in a timely manner;

maintain a pipeline of new technologies;

enhance and improve existing products continually;

maintain development capabilities;

anticipate or adapt to technological changes and advances in relevant industries; and

ensure continuing compatibility with evolving industry standards.

Developing new products, creating effective commercialization strategies for technologies and enhancing those products and strategies are subject to inherent risks. These risks include unanticipated delays, unrecoverable expenses, technical problems or difficulties, as well as the possibility that development funds will be insufficient. Any one of these could make us abandon or substantially change our technology commercialization strategy.

Our success will depend upon, among other things, products meeting targeted cost and performance objectives for large-scale production, our licensees' ability to adapt technologies to satisfy industry standards, satisfy consumer expectations and needs and bring their products to market before the market is saturated. They may encounter unanticipated technical or other problems that result in increased costs or substantial delays in introducing and marketing new products. Current and future products may not be reliable or durable under actual operating conditions or otherwise commercially viable and competitive. New products may not satisfy price or other performance objectives when introduced in the marketplace. Any of these events could adversely affect our realization of royalties from such new products.

Strong competition within our industry may reduce our client base.

We compete with universities, law firms, venture capital firms and other technology commercialization firms for technology licensing opportunities. Many organizations offer some aspect of technology transfer services. This market is highly fragmented and participants are frequently focused on a specific technology area. Some of our competitors are well established and have more financial and human resources than we do.

Forward-Looking Statements

This Prospectus contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Such forward-looking statements include statements regarding, among other things, (a) our expectations about product development activities, (b) our growth strategies, (c) anticipated trends in our industry, (d) our future financing plans, and (e) our anticipated needs for working capital. Forward-looking statements, which involve assumptions and describe our future plans, strategies, and expectations, are generally identifiable by use of the words "may," "will," "should," "expect," "anticipate," "estimate," "believe," "intend," or "project" or the negative of these words or other variations on these words or comparable terminology. This information may involve known and unknown risks, uncertainties, and other factors that may cause our actual results, performance, or achievements to be materially different from the future results, performance, or achievements expressed or implied by any forward-looking statements. These statements may be found under "Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Business," as well as in this Prospectus generally. Actual events or results may differ materially from those discussed in forward-looking statements as a result of various factors, including, without limitation, the risks outlined under "Risk Factors" and matters described in this Prospectus generally. In light of these risks and uncertainties, the events anticipated in the forward-looking statements may not occur. These statements are based on current expectations and speak only as of the date of such statements. We undertake no obligation to publicly update or revise any forward-looking statement, whether as a result of future events, new information or otherwise.

The information contained in this Prospectus, as well as in our SEC filings, identifies important factors that could adversely affect actual results and performance. Prospective investors are urged to carefully consider such factors.

All forward-looking statements attributable to CTT are expressly qualified in their entirety by the foregoing cautionary statements.

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Use of Proceeds

This Prospectus relates to shares of our common stock that may be offered and sold from time to time by Fusion Capital, the selling stockholder. We will receive no proceeds from the sale of shares of common stock in this offering. However, we may receive up to $5.0 million in proceeds from the sale of our common stock to Fusion Capital under the common stock purchase agreement. The proceeds, if any, we receive from Fusion Capital under the common stock purchase agreement, net of our costs incurred in connection with the offering, will be used to implement our strategic business plan, including for working capital and other general corporate purposes.

Market Price of our Common Equity

Our common stock is quoted on the American Stock Exchange under the symbol "CTT." The following table presents, for the periods indicated, the high and low sales prices per share of our common stock as reported by the American Stock Exchange.

Fiscal Year Ended July 31, 2002	**High**	**Low**
First Quarter	$ 6.25	$ 2.60
Second Quarter	$ 4.45	$ 2.30
Third Quarter	$ 3.60	$ 2.37
Fourth Quarter	$ 3.00	$ 1.82

Fiscal Year Ended July 31, 2003	**High**	**Low**

Fiscal Year Ended July 31, 2002	High	Low
First Quarter	$ 3.84	$ 1.82
Second Quarter	$ 3.50	$ 1.80
Third Quarter	$ 2.40	$ 1.76
Fourth Quarter	$ 2.12	$ 1.49

Fiscal Year Ended July 31, 2004	High	Low
First Quarter	$ 2.10	$ 1.53
Second Quarter	$ 6.36	$ 1.97

On March 17, 2004, the closing price of our stock as reported on the American Stock Exchange was $3.88. As of March 17, 2004, there were 686 record holders of our common stock.

Dividend Policy

Since 1981, we have not paid cash dividends on our common stock and we do not expect to declare or pay cash dividends in the foreseeable future. We presently expect to retain any future earnings to fund continuing development and growth of our business. Any payment of dividends on our common stock in the future is subject to the discretion of our Board of Directors and will depend on our earnings, financial condition, capital requirements and other relevant factors. Furthermore, any payment of dividends on our common stock is subject to the rights of the holders of preferred stock to receive preferential non-cumulative dividends.

Equity Compensation Plan Information

The table below summarizes the status of our equity compensation plans as of July 31, 2003, the end of our most recent fiscal year.

Plan category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity compensation plans approved by security holders	943,267	$5.08	590,331
Equity compensation plans not approved by security holders	None	Not applicable	None
Total	943,267	$5.08	590,331

Selected Financial Data

The selected financial data as of July 31, 2003, 2002, 2001, 2000 and 1999 and for each of the five years in the period ended July 31, 2003, that are set forth below have been derived from our audited consolidated financial statements. The audit report of BDO Seidman, LLP covering the July 31, 2003 financial statements contains an explanatory paragraph that states that CTT's recurring losses and negative cash flow from operations raises substantial doubt about CTT's ability to continue as a going concern. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

On September 2, 2003, PricewaterhouseCoopers LLP notified us by letter that it viewed its dismissal to have occurred. It is our understanding that PricewaterhouseCoopers LLP views its dismissal to have occurred on August 25, 2003. However, we disagree with PricewaterhouseCoopers LLP's opinion as to the date of their dismissal, which was not intended to occur until the retention of new auditors was completed on September 16, 2003. However, we accept that September 2, 2003 may be viewed as the dismissal date of PricewaterhouseCoopers

LLP. On September 16, 2003, we engaged BDO Seidman, LLP as our independent certified public accountant.

The selected financial data below as of January 31, 2004 and for the six months ended January 31, 2004 and 2003 have been derived from our unaudited consolidated financial statements and in the opinion of management, all adjustments that are necessary to present the financial statements fairly in conformity with accounting principles generally accepted in the United States of America, consisting only of normal recurring adjustments, have been made.

The following selected financial data should be read in conjunction with the consolidated financial statements and related notes, and 'Management's Discussion and Analysis of Financial Condition and Results of Operations' appearing elsewhere in this Prospectus.

STATEMENTS OF OPERATIONS DATA(1)

	Six Months ended January 31,		Years ended July 31,				
	2004	**2003**	**2003**	**2002**	**2001**	**2000**	**1999**
	(unaudited)	**(unaudited)**					
Revenue:							
Retained royalties	$ 1,084,954	$ 1,214,762	$ 2,692,933	$ 2,570,931	$ 3,637,764	$ 3,202,194	$ 3,463,176
Retained royalty settlements	1,150,000		600,000			736,375	
Other revenues				25,000	3,520	174,298	176,148
Total revenues	$ 2,234,954	$ 1,214,762	$ 3,292,933	$ 2,595,931	$ 3,641,284	$ 4,112,867	$ 3,639,324
Operating income (loss)(2)	$ 243,722	$ 294,253	$ (1,017,973)	$ (3,278,885)	$ (2,232,361)	$ 774,038	$ 421,533
Net income (loss)(3)	$ 409,580	$ (631,116)	$ (1,935,301)	$ (4,016,428)	$ (2,500,749)	$ 1,300,937	$ 2,919,384
Net income (loss) per share							
Basic and diluted	$ 0.07	$ (0.10)	$ (0.31)	$ (0.65)	$ (0.41)	$ 0.21	$ 0.49
Weighted average number of common shares outstanding:							
Basic	6,204,488	6,166,284	6,182,657	6,148,022	6,135,486	6,079,211	5,982,112
Diluted	6,300,036	6,166,284	6,182,657	6,148,022	6,135,486	6,187,407	6,009,701

BALANCE SHEETS

	January 31,	July 31,				
	2004	**2003**	**2002**	**2001**	**2000**	**1999**
	(unaudited)					
Cash, cash equivalents and short term investments	$ 1,597,310	$ 1,504,295	$ 2,887,295	$ 5,017,877	$ 6,716,429	$ 5,498,486
Total assets	$ 2,823,233	$ 2,952,501	$ 6,399,783	$ 10,640,873	$ 12,093,965	$ 8,959,021
Current liabilities	$ 1,086,046	$ 1,783,074	$ 3,407,140	$ 3,673,127	$ 2,165,853	$ 1,778,735
Long-term obligations	$	$	$	$	$	$
Shareholders' interest	$ 1,737,187	$ 1,169,427	$ 2,992,643	$ 6,967,746	$ 9,928,112	$ 7,180,286

SELECTED QUARTERLY FINANCIAL DATA
(Unaudited)

	2004		2003			
	1st Quarter	2nd Quarter	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
Revenues(4)	$ 1,286,899	$ 948,055	$ 381,758	$ 833,004	$ 659,455	$ 1,418,716
Patent enforcement expenses, net of reimbursements	$ 32,837	$ 14,174	$ 35,143	$ 118,362	$ 193,948	$ 78,337
Personnel and other direct expenses relating to revenue	$ 558,809	$ 588,085	$ 739,996	$ 670,672	$ 707,358	$ 1,299,883
General and administrative expenses	$ 426,170	$ 371,157	$ 423,994	$ 515,787	$ 307,862	$ 803,009
Reversal of accounts payable exchanged for contingent note payable	$	$	$ (1,583,445)	$	$	$
Total operating expenses (2)	$ 1,017,816	$ 973,416	$ (384,312)	$ 1,304,821	$ 1,209,168	$ 2,181,229
Operating income (loss)(2)	$ 269,083	$ (25,361)	$ 766,070	$ (471,817)	$ (549,713)	$ (762,513)
Net income (loss)(3)	$ 345,293	$ 64,287	$ 778,907	$ (1,410,023)	$ (545,729)	$ (758,456)
Net income (loss) per share (basic and diluted)	$ 0.06	$ 0.01	$ 0.13	$ (0.23)	$ (0.09)	$ (0.12)
Weighted average number of common shares outstanding:						
Basic	6,201,345	6,207,631	6,154,351	6,174,196	6,201,345	6,201,345
Diluted	6,201,345	6,398,726	6,200,084	6,174,196	6,201,345	6,201,345

	2002			
	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
Revenues	$ 409,739	$ 797,189	$ 547,278	$ 841,725
Patent enforcement expenses, net of reimbursements(2)	$ 631,615	$ 553,022	$ 602,345	$ 345,108
Personnel and other direct expenses relating to revenue	$ 451,529	$ 594,383	$ 542,435	$ 653,092
General and administrative expenses	$ 410,639	$ 296,929	$ 419,844	$ 373,875
Total operating expenses(2)	$ 1,493,783	$ 1,444,334	$ 1,564,624	$ 1,372,075
Operating loss	$ (1,084,044)	$ (647,145)	$ (1,017,346)	$ (530,350)
Net loss(3)	$ (1,039,040)	$ (1,167,059)	$ (1,031,879)	$ (778,450)
Net loss per share (basic and diluted)	$ (0.17)	$ (0.19)	$ (0.17)	$ (0.13)
Weighted average number of common shares outstanding:				
Basic	6,139,351	6,144,242	6,154,351	6,154,351
Diluted	6,139,351	6,144,242	6,154,351	6,154,351

(1) Please read in conjunction with respective consolidated financial statements and notes thereto.

(2) 1st quarter fiscal 2003 includes reversal of $1,583,000 charged to patent enforcement expense in fiscal 2002. 4th quarter fiscal 2003 includes $482,000 impairment charges on intangible assets acquired (in personnel and other direct expenses relating to revenue) and $196,000 financing costs expensed (in general and administrative expenses). 4th quarter fiscal 2002 includes $156,000 impairment charges on intangible assets acquired (in personnel and other direct expenses relating to revenue). Fiscal 2003 includes $341,000 of legal expenses directly related to the SEC Investigation (in general and administrative expenses).

(3) 2nd quarter fiscal 2003 includes $944,000 impairment loss on investment in NTRU Cryptosystems, Inc. 2nd and 4th quarters fiscal 2002 include $519,000 and $263,000, respectively, impairment losses on loans to E.L. Specialists, Inc. Fiscal 2001 includes $600,000 investment and loan impairment loss on Micro-ASI, Inc. Fiscal 1999 includes $2,313,000 gain on sale of investment in NovaNET Learning, Inc.

(4)

Includes sales of CTT's share of potential award in the Materna lawsuit of $900,000 in 1st quarter fiscal 2004, $250,000 in 2nd quarter fiscal 2004 and $600,000 in 4th quarter fiscal 2003.

Management's Discussion and Analysis of
Financial Condition and Results of Operations

You should read the following discussion together with our financial statements and the notes appearing elsewhere in this Prospectus. The following discussion contains forward-looking statements. Our actual results may differ materially from those projected in the forward-looking statements. Factors that might cause future results to differ materially from those projected in the forward-looking statements include those discussed in "Risk Factors" and elsewhere in this Prospectus.

We have rounded all amounts in Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) to the nearest thousand dollars. In addition, all periods discussed in MD&A relate to our fiscal years ending July 31 (first, second, third and fourth quarters ending October 31, January 31, April 30 and July 31, respectively).

Overview

CTT is a full service technology transfer and licensing provider focused on the technology needs of its customers and transforming those requirements into commercially viable solutions. We identify, develop and commercialize innovative technologies in life, digital, nano, and physical sciences developed by universities, companies and inventors. Our goal is to maximize the value of intellectual assets for the benefit of our customers, clients and shareholders.

Global market opportunities for technology transfer services are estimated at $150 billion annually and driven by factors that we believe are favorable to CTT's business strategy. The key market drivers are:

- Significant increase in the number of new patents
- Time to market competitive advantage by licensing
- High cost of R&D
- Limited availability of R&D talent

CTT has experienced net losses in each of the last three (3) fiscal years. We believe that this resulted primarily from CTT's failure during that period to best utilize its financial resources and to capitalize on new business opportunities in the following areas:

- Failure to develop new business/royalty streams as existing patents expired and royalty streams ceased.
- Investing an aggregate of $2.7 million in start-up companies with unproven technologies in fiscal 2000, 2001 and 2002, of which $2.4 million had to be written off in impairment losses in fiscal 2001, 2002 and 2003.
- Incurring significant legal costs in pursuing patent infringement litigation against major corporations, which resulted in legal fees of approximately $5.0 million during the three-year period ended July 31, 2003, of which $1.6 million in accounts payable was subsequently negotiated into a contingent note payable.
- Incurring aggregate legal costs of approximately $534,000 since May 2001 in connection with the SEC's private investigation captioned "In the Matter of Trading in the Securities of Competitive Technologies, Inc."

CTT has taken the following steps to address these financial matters:

Changed CTT's focus to proactively identify the market and customers' technology needs and deliver the appropriate technology to meet those needs

Employed four experienced technology marketers to lead CTT's business development efforts

Discontinued investing in start-up companies as a technology commercialization strategy

Changed CTT's approach to legal fees for patent infringement litigation, by having clients take the lead and incur the costs in litigation, by renegotiating $1.6 million of invoiced but unpaid legal fees into a contingent note payable, and by making contingency-based arrangements with law firms

Sold on a non-recourse basis $2.7 million of CTT's expected $6.0 million share of the potential award in the Materna litigation

Filed a complaint to enforce CTT's claim for reimbursement of legal fees in connection with the SEC investigation that exceed our directors' and officers' liability insurance policy deductible

Entered into an agreement to obtain up to $5 million in equity financing from Fusion Capital Fund II, LLC

Results of Operations Six Months Ended January 31, 2004 (First Half 2004) vs. Six Months Ended January 31, 2003 (First Half 2003)

Summary Results

Net income for our first half 2004 was $410,000 compared with a loss of $631,000 for our first half 2003, an improvement of $1,041,000.

Revenues

In our first half 2004, $1,850,000 (83%) of our revenues were from three technologies: $1,150,000 (52%) from sales of portions of our potential award in the Materna lawsuit, $401,000 (18%) from the homocysteine assay, and $300,000 (13%) from Ethyol.

Total revenues in our first half 2004 were $2,235,000, which was $1,020,000 (84%) higher than in our first half 2003, principally because of retained royalty settlement revenues of $1,150,000 in our first half 2004 from sales of portions of our potential award in the Materna lawsuit discussed under the sub-heading "Materna " under the heading "Legal Proceedings" in this Prospectus. Royalty revenues from Ethyol increased $153,000 due to increasing sales and their effect on when we record these royalties, up to our $500,000 per calendar year maximum. In our first half 2004, we recorded $300,000 of Ethyol royalties in the second quarter and none in the first quarter. In our first half 2003, we recorded $147,000 of Ethyol royalties in the first quarter and none in the second quarter. We expect to record the remaining $200,000 of our calendar year 2004 Ethyol royalties in our third quarter 2004. CTT received $140,000 homocysteine revenues from settlement of a royalty audit in our first half 2004. Recurring royalty revenues from homocysteine assays increased $101,000 (63%).

Partially offsetting these increases were a $200,000 reduction in gallium arsenide revenues, a $163,000 reduction because of other expiring licenses and $162,000 of nonrecurring first half 2003 revenues. Lower sales of licensed products, timing differences and expiring licenses caused the reduction in gallium arsenide revenues.

Operating expenses

Patent enforcement expenses, net of reimbursements, of $47,000 in first half 2004 were $106,000 (69%) lower than in first half 2003. The level of patent enforcement expenses varies depending on the stage of the litigation. We have included details of progress and status in these cases under the heading "Legal Proceedings" in this Prospectus.

Personnel and other direct expenses relating to revenue were $1,147,000 for first half 2004, which was $264,000 (19%) lower than the $1,411,000 in first half 2003. Personnel expenses (which include costs of consultants engaged to assist us in developing specific revenue opportunities and strategic alliances and relationships) were $250,000 lower in first half 2004. In first half 2004, we had approximately 14 full-time equivalents compared with approximately 16 in first half 2003.

General and administrative expenses for first half 2004 were $797,000, which was $142,000 (15%) lower than the $940,000 for first half 2003. We reduced proxy and annual report expenses by $83,000, audit and tax expenses by $45,000 and legal expenses directly related to the SEC investigation by $36,000 (see sub-heading "SEC Investigation" under the heading "Legal Proceedings" in this Prospectus) in first half 2004. Financing expenses increased $65,000.

Reversal of accounts payable exchanged for contingent note payable

In first quarter 2003, we reversed from accounts payable $1,583,000 that was accrued at July 31, 2002. This one-time reversal constituted other operating income (see heading "Legal Proceedings" in this Prospectus).

Other income, net

Other income, net, for first half 2004 included $203,000 of installments received from Unilens Corp. USA pursuant to a settlement agreement effective October 17, 2003, partially offset by related and other expenses. Due to Unilens's financial condition and the uncertainty of its payments on this receivable ($1,047,000 at January 31, 2004), CTT will record other income as it receives payments from Unilens.

We recorded an impairment charge of $944,000 on our investment in NTRU Cryptosystems, Inc. (NTRU) in our second quarter 2003.

CTT has substantial net operating and capital loss carryforwards for Federal income tax purposes.

Results of Operations 2003 vs. 2002

Financial Results

Our net loss for 2003 was $1,935,000 compared with $4,016,000 for 2002, an improvement of $2,081,000. Our operating results improved $2,261,000 from a loss of $3,279,000 for 2002 to $1,018,000 for 2003 as discussed below.

Revenues

Our total revenues for 2003 were $3,293,000, which was $697,000 (27%) higher than in 2002. Retained royalty settlement revenues of $600,000 in 2003 were from the sale of $1,290,000 of our potential award in the Materna lawsuit. (See sub-heading "Materna " under the heading "Legal Proceedings" in this Prospectus.) Excluding this $600,000, revenues increased 4% over 2002.

In 2003, $2,339,000 (71%) of our revenues were from four technologies: $647,000 (20%) from Ethyol, $600,000 (18%) from the sale of a portion of our potential award in the Materna lawsuit, $584,000 (18%) from the homocysteine assay, and $508,000 (15%) from gallium arsenide semiconductors.

Ethyol's royalty base is higher since October 2001 when the licensee began selling Ethyol directly in the United States rather than through a distributor. Our retained royalties from Ethyol reached our $500,000 per calendar year maximum for calendar 2003 in fiscal 2003. In the future, we expect to receive and record our total $500,000 per calendar year Ethyol retained royalties in our third and fourth fiscal quarters.

Effective May 19, 2003, CTT sold to LawFinance Group, Inc. (LFG) a portion of its potential $6 million from the patent infringement judgment against American Cyanamid Company (Defendant) in the Materna lawsuit. CTT received $600,000 cash (recognized in retained royalty settlement revenue) in exchange for the first $1,290,000 (plus court awarded interest thereon from May 19, 2003) of CTT's share of the potential award. CTT has no financial obligation to repay LFG or to return any portion of the $600,000 received from LFG; accordingly, CTT recorded this amount as revenue. If CTT's share of a final award is less than the amount sold to LFG, the entire amount received would be paid to LFG and LFG would be deemed paid in full. CTT granted LFG a security interest in CTT's share of the potential award. At July 31, 2003, CTT retained the remaining anticipated approximately $4,710,000 proceeds from this potential award in addition to the $600,000 already received.

The increase in homocysteine assay royalties includes amounts for assays performed in several quarters by LabCorp ($294,000 under a stipulated order in the LabCorp litigation) and other clinical laboratories ($132,000 under license agreements made in the second quarter of 2003). LabCorp has appealed the judgment in favor of CTT. If the judgment is reversed on appeal, LabCorp's ability to recover amounts paid to CTT will depend on the extent of and reason for the reversal. CTT's

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management believes the probability that LabCorp will recover such amounts is very unlikely. See sub-heading "LabCorp" under the heading "Legal Proceedings" in this Prospectus.

The exclusive licensee terminated its license for the electrochromic display during the third quarter of fiscal 2003. As a result, we recognized $107,000 previously deferred revenue on this license and $50,000 in license termination fees.

The last vitamin B12 patent expired in November 2002. As a result, our 2003 revenues (which include final royalty payments under these licenses) declined $149,000 from our 2002 royalties.

Our 2003 royalties from gallium arsenide semiconductors were $504,000 (50%) lower than in 2002 due to expiring licenses and licensees' much lower sales.

Operating expenses

Patent enforcement expenses, net of reimbursements, in 2003 were $426,000, which was $1,706,000 (80%) lower than in 2002. Our July 23, 2002, agreement with the University of Illinois, our client, (for the University to take the lead and assume the cost of new lead counsel in the litigation against Fujitsu) substantially reduced our net patent enforcement expenses in 2003. The level of patent enforcement expenses varies depending on the stage of the litigation. We have included details of progress and status in these cases under the heading "Legal Proceedings" in this Prospectus.

Personnel and other direct expenses relating to revenue were $3,418,000 for 2003, which was $1,176,000 (52%) higher than in 2002. A reduction of $118,000 in recruiting expense partially offset increases of $774,000 in expenses for salaries and benefits and for consultants we engaged to assist us in developing specific revenue opportunities and strategic alliances and relationships. In 2003 we had approximately 16 full-time equivalents compared with approximately 13 in 2002. In the fourth quarter of 2003, we recorded $482,000 of impairment charges related to intangible assets principally due to the uncertainty of future revenues from the ribozyme technology. In the fourth quarter of 2002, we recorded $156,000 of impairment charges related to intangible assets.

General and administrative expenses for 2003 were $2,051,000, which was $549,000 (37%) higher than in 2002. Expenses that increased were corporate legal expenses directly related to the SEC investigation (increased $252,000) (see sub-heading "SEC Investigation" under the heading "Legal Proceedings" in this Prospectus), financing (increased $192,000) and investor relations (increased $107,000). We had expected to charge $196,000 of financing costs incurred since October 2002 against the proceeds of a debt or equity financing in 2003. We expensed them in the fourth quarter of 2003 since the placement memorandum was no longer current and we have not yet obtained funding.

Reversal of accounts payable exchanged for contingent note payable

On October 28, 2002, CTT signed an agreement making future payments to our former patent litigation counsel in the Fujitsu matter completely contingent on future receipts from Fujitsu. This contingent promissory note payable is for $1,683,000 plus simple interest at the annual rate of 11% from the agreement date ($139,000 at July 31, 2003) payable only from future receipts in a settlement or other favorable outcome of the litigation against Fujitsu, if any. Accordingly, in the first quarter of 2003, we reversed from accounts payable $1,583,000 that was accrued at July 31, 2002. This one-time reversal constituted other operating income in the first quarter of 2003 and increased shareholders' interest. (See sub-heading "Fujitsu" under the heading "Legal Proceedings" in this Prospectus).

Other expense

Impairment loss on investment in NTRU Cryptosystems, Inc. (NTRU)

In April 2003, NTRU redeemed all outstanding shares of its Series A and Series B Preferred Stock (NTRU Preferred Stock) in exchange for cash or NTRU common stock.

CTT is a minority investor in NTRU and currently owns 3,129,509 shares of NTRU common stock, including 76,509 shares received in April 2003 (approximately 10% of NTRU's outstanding common stock). CTT exchanged its NTRU Preferred Stock for $90,741 in cash ($88,377 received in May 2003 and $2,364 received in September 2003), and 76,509 shares of NTRU common stock.

CTT recorded other expense of $944,000 in its second quarter ended January 31, 2003 due to the uncertain timing and amount of CTT's expected future cash flows from its investment in NTRU's common stock after its recapitalization.

In the past, CTT held a seat and participated actively on NTRU's Board of Directors. CTT's management continues to believe NTRU's encryption technology has value and these actions provide NTRU an opportunity to allow applications to evolve to meet customer's needs for strong encryption, a small footprint and low processing requirements.

Interest income of $27,000 for 2003 was $71,000 (73%) lower than in 2002. Our average invested balance was approximately 49% lower and our weighted average interest rate was approximately 1.2% per annum compared with approximately 2.2% per annum in 2002.

CTT has substantial net operating and capital loss carryforwards for Federal income tax purposes.

Results of Operations 2002 vs. 2001

Our total revenues for fiscal 2002 were $2,596,000, which was $1,045,000 (29%) lower than for fiscal 2001.

For fiscal 2002, retained royalties were $2,571,000, which was $1,067,000 (29%) lower than for fiscal 2001. In fiscal 2002, approximately $1,838,000 (71%) of our retained royalties were from four technologies: $1,012,000 (39%) from gallium arsenide patents (including a laser diode technology used in optoelectronic storage devices and another technology that improves semiconductor operating characteristics); $391,000 (15%) from Ethyol (a chemotherapeutic mitigation agent); $264,000 (10%) from the vitamin B12 assay; and $171,000 (7%) from the homocysteine assay.

Retained royalties from the gallium arsenide semiconductor inventions (which include laser diode applications) for fiscal 2002 were approximately $1,012,000 compared with approximately $2,190,000 for fiscal 2001, a decline of approximately $1,178,000 (54%). This reflects lower telecom industry sales partially offset by higher DVD product sales. Most of our royalties from these inventions are reported semi-annually in the second and fourth fiscal quarters.

Retained royalties were also lower because a licensee (which had previously been paying $100,000 minimum pre-market annual retained royalties in prior fiscal years) terminated its license and therefore paid no minimum in fiscal 2002. Also lower were retained royalties from homocysteine and expiring vitamin B12 assay patents (our last vitamin B12 assay patent expired in November 2002). A homocysteine licensee that had been paying certain royalties in fiscal 2001 began withholding those royalties in fiscal 2002, taking a position similar to LabCorp's position.

Retained royalty increases from other technologies partially offset these reductions. Royalties from Ethyol in fiscal 2002 increased approximately $163,000 (71%) over fiscal 2001. Other increases included higher minimum royalties on licenses of our sunless tanning technology and a treatment for sexual dysfunction, one-time royalties from a Retin-A royalty audit and earned royalties from a new license in 2002.

Licensees of our endoscopic ligator have withheld royalties since the third quarter of fiscal 2000. (Our retained royalties from the endoscopic ligator were approximately $138,000 for fiscal 2000.) We believe we are entitled to all withheld and future royalties for use of our patented technology. However, we cannot predict when, if ever, licensees will resume remitting royalties for this technology.

Other changes in retained royalty revenues reflect changes in the timing of royalties reported by licensees and in licensees' sales of licensed products. Historically, CTT's royalty revenues in its second and fourth fiscal quarters have been higher than in its first and third fiscal quarters.

In fiscal 2002 we employed 13 people (full-time equivalents) compared with 11 in fiscal 2001. We increased our professional staff and reduced consultants compared with fiscal 2001. Recruiting expenses in fiscal 2002 (to search for a new President and Chief Executive Officer) were higher than those for professional staff hired in fiscal 2001. Corporate legal expenses were higher due in part to legal expenses related to an SEC investigation, (see sub-heading "SEC Investigation" under the heading "Legal Proceedings" in this Prospectus) and increased legal services related to certain contractual matters with a client.

Patent enforcement expenses, net of reimbursements, in fiscal 2002 were $2,132,000, which was $342,000 (14%) lower than in fiscal 2001. Patent enforcement expenses were principally for outside litigation counsels' services in the three patent litigations (Fujitsu, LabCorp and Materna, two of which were active in fiscal 2002) in which our clients and/or we have sued to enforce their and our patent rights. The level of activity in these two cases was lower in fiscal 2002 than in fiscal 2001.

In fiscal 2002 we paid a client $201,000 as reimbursement of certain of our previously deducted patent enforcement expenses. We included this charge in patent enforcement expenses in fiscal 2002. If and when the related enforcement action is settled, we are entitled to reimbursement of these and additional litigation expenses we have then incurred from any recovery we receive as a result of the litigation and from subsequent income from the related patents.

Personnel and other direct expenses relating to revenue were $2,241,000 for 2002, which was $398,000 (22%) higher than in 2001. This increase principally reflects increased costs for salaries and recruiting expenses. It also includes approximately $156,000 of intangible asset impairment charges in fiscal 2002.

General and administrative expenses for 2002 were $1,501,000, which was $55,000 (4%) lower than in 2001. Reductions in acquisition costs, audit and tax fees, directors' fees and expenses and depreciation were partially offset by increases in legal expenses directly related to the SEC investigation (see subheading "SEC Investigation" under the heading "Legal Proceedings" in this Prospectus).

Other expense, net

Effective August 5, 2002, CTT sold and transferred all its interests related to E. L. Specialists, Inc. (ELS) to MRM Acquisitions, LLC for $200,000 cash. As a result of this transaction, CTT wrote down its $1,056,300 notes receivable from ELS to their fair value of $200,000, which it collected on August 5, 2002. In fiscal 2002, CTT incurred a total $782,000 impairment loss on loans to ELS ($519,000 and $263,000 in the second and fourth quarters, respectively) and charged against other revenues approximately $75,000 deemed uncollectible.

Because of Digital Ink, Inc.'s (DII) inability to arrange financial support to continue its operations, CTT recorded an impairment loss of $50,000 in other expense to write off 100% of our equity investment in DII in the third quarter of fiscal 2002. In fiscal 1999 and 2000, CTT provided patenting, marketing and accounting services in exchange for its $50,000 equity in DII.

In the third quarter of fiscal 2002, CTT recorded a recovery of $22,000 of its secured bridge financing advances to Micro-ASI, Inc. (Micro-ASI). At July 31, 2001, CTT reduced its carrying value

for all its investments and advances to Micro-ASI to zero because of Micro-ASI's bankruptcy filing in August 2001. We are unable to predict the timing or amount of CTT's potential future recoveries of our advances to Micro-ASI, if any.

Interest income of $97,000 for fiscal 2002 was $303,000 (76%) lower than in fiscal 2001. Our average invested balance was approximately 37% lower and our weighted average interest rate was approximately 2.2% per annum compared with approximately 5.6% per annum in fiscal 2001.

Other expenses in fiscal 2001 were legal expenses incurred in connection with a suit brought against CTT and others involving the sale by a subsidiary of CTT of substantially all of its assets to Unilens Corp. USA. The suit was dismissed on May 16, 2003.

Financial Condition and Liquidity

Condition at January 31, 2004

At January 31, 2004, CTT had net working capital of $1,561,000 (which was $607,000 more than at July 31, 2003) and no outstanding debt or available credit facility. However, see the discussion of the "Fusion Capital Transaction" below.

At January 31, 2004, cash, cash equivalents and short-term investments of $1,597,000 were $93,000 higher than at July 31, 2003 and were available to support our current operating needs. Operating activities in first half 2004 used $97,000 of cash: $600,000 for paying accounts payable and accrued liabilities partially offset by $410,000 from net income, $123,000 from prepaid expenses and other current assets and $60,000 from collecting receivables. Investing activities provided $162,000 of cash primarily from the payment by Unilens. Financing activities provided $27,000 from exercise of stock options.

In addition to fluctuations in the amounts of royalties reported, changes in royalties receivable and payable reflect CTT's normal cycle of royalty collections and payments.

Funding and Capital Requirements

Fusion Capital Transaction

On February 25, 2004, we entered into a common stock purchase agreement with Fusion Capital to obtain up to $5.0 million in equity financing from Fusion Capital. Under the agreement, Fusion Capital agreed to purchase up to $5.0 million of newly issued CTT common stock over a period of time up to twenty (20) months. CTT has the right to control the timing and the amount of stock sold, if any, to Fusion Capital.

In this agreement, CTT agreed to initially issue to Fusion Capital 53,138 commitment shares of CTT common stock and an additional 35,425 commitment shares of CTT common stock on a pro rata basis as CTT obtains funds from selling common stock to Fusion Capital. CTT will pay no cash commitment fee to Fusion Capital to obtain this agreed funding.

Under this agreement, funding of the initial $5.0 million would occur over a period of time commencing upon fulfillment of certain conditions, including the SEC declaring effective a registration statement covering the sale by Fusion Capital of the shares issued under the common stock purchase agreement. Upon completion of this funding, at our sole discretion, we have the right to enter into a new agreement with Fusion Capital covering the sale of up to an additional $5.0 million of common stock.

Under our agreement with Fusion Capital we have the right to sell to Fusion Capital on each trading day during the term of the agreement $12,500 of our common stock. The purchase price per share will be equal to the lesser of (i) the lowest sale price of our common stock on the purchase date;

or (ii) the average of the three (3) lowest closing sale prices during the twelve (12) consecutive trading days prior to the date of purchase. We may, subject to certain provisions, set a minimum purchase price from time to time (currently $3.00 per share). Fusion Capital does not have the right or obligation to purchase our common stock in the event that the price of our common stock is less than $1.00 per share.

We presently estimate that the maximum number of shares we will sell to Fusion Capital (exclusive of commitment fee shares) will be 1,159,552 shares. Therefore, the selling price of our common stock to Fusion Capital will have to average at least $4.32 per share for us to receive the maximum proceeds of $5.0 million. For further details see the section entitled "The Fusion Capital Transaction" in this Prospectus.

Under our agreement with Brooks, Houghton & Company, Inc., our financial advisor who assisted in arranging the transaction with Fusion Capital, we will pay the advisor a cash fee of $50,000 plus up to $200,000 in installments as we receive amounts from Fusion Capital (5% of $5 million in the aggregate). In addition, we will grant to the advisor five-year warrants to purchase 57,537 shares of our common stock (approximately 5% of 1,159,552 shares, the maximum number of shares that may be sold to Fusion Capital) at an exercise price of $4.345 per share (110% of the $3.95 average closing price of our common stock for a ten (10) day trading period ended January 21, 2004 that was used to determine the 88,563 commitment shares issuable to Fusion Capital).

Capital Requirements

At January 31, 2004, CTT's accumulated deficit was $25,290,910. At January 31, 2004 our cash, cash equivalents and short-term investments were $1,597,310.

CTT has incurred substantial operating and net losses in the three years ended July 31, 2003. Net patent enforcement expenses related to the Fujitsu and LabCorp litigations and investment losses have been substantial. In addition, CTT has incurred $534,000 cumulatively through January 31, 2004 for professional advice related to the ongoing SEC investigation (see sub-heading "SEC Investigation" under the heading "Legal Proceedings" in this Prospectus). Accordingly, our auditor's opinion with respect to our financial statements as of and for the year ended July 31, 2003 included an explanatory paragraph with respect to our ability to continue as a going concern.

Management has and continues to take actions to improve CTT's results. These actions include aggressively pursuing new license agreements, reducing cash operating expenses, deferring payment of certain liabilities, structuring payment obligations contingent upon revenues, selling portions of CTT's share of the potential Materna award, and collecting amounts previously written off. At January 31, 2004, we retained the remaining anticipated a) $3,272,500, b) $2,237,500, or c) $2,997,500 proceeds from this expected award (plus court awarded interest thereon) in addition to the $1,750,000 already received from LFG and a CTT shareholder. (See the sub-heading "Materna " under the heading "Legal Proceedings" in this Prospectus).

Also see the heading "The Fusion Capital Transaction" in this Prospectus.

The amounts and timing of CTT's future cash requirements will depend on many factors, including the results of CTT's marketing efforts, the Materna award, Fujitsu and LabCorp lawsuits (see the heading "Legal Proceedings" in this Prospectus), the SEC investigation, and CTT's fund raising efforts. To achieve profitability, CTT must successfully license technologies with current and long-term revenue streams greater than its operating expenses. To sustain profitability, CTT must continually add such licenses. However, royalty revenues, obtaining rights to new technologies, granting licenses, and enforcing intellectual property rights are subject to many factors outside our control or that we cannot currently anticipate. Although we cannot assure you that we will be successful in these efforts, management believes its plan would sustain CTT at least through fiscal 2005.

Compliance with American Stock Exchange listing standards

At July 31, 2003, CTT's shareholders' interest was $1,169,000. On November 12, 2003 the American Stock Exchange (AMEX) notified CTT that it did not meet certain AMEX listing standards and that CTT must submit a plan for returning to compliance with those standards to maintain our AMEX listing. On December 12, 2003, we submitted our plan and on January 23, 2004, AMEX notified us that it had accepted our plan to regain compliance with AMEX continued listing standards and that AMEX was continuing our listing pursuant to an extension. To maintain our listing, we are required to make progress consistent with our plan during the extension period and to regain compliance with AMEX continued listing standards by May 12, 2005. We cannot assure you if or when we will again meet AMEX listing requirements.

Installment Receivable from Unilens Corp. USA and Unilens Vision Inc. (Unilens)

In 1989, CTT sold substantially all of the assets of University Optical Products Co. (UOP) to Unilens Corp. USA for $6 million dollars, including a $5.5 million installment receivable. Due to uncertainties related to its collection, CTT wrote off the entire installment receivable in fiscal 1989 and 1990. CTT deemed the receivable balance of $4.7 million uncollectible.

Effective October 17, 2003, Unilens agreed to pay CTT an aggregate of $1,250,000 in quarterly installments of the greater of $100,000 or an amount equal to 50% of the royalties received by Unilens from one licensee. CTT and Unilens also agreed to settle all prior claims and to terminate all prior agreements between them. At January 31, 2004, Unilens has paid aggregate installments of $203,000. Installments are due each March 31, June 30, September 30 and December 31 beginning December 31, 2003. Unilens granted CTT a security interest in all Unilens real and personal property that is subordinate to a security interest held by UNIINVEST Holding AG in respect of $450,000 plus interest owed by Unilens to UNIINVEST Holding AG.

Due to Unilens' financial condition and the uncertainty of its payments on our installment receivable ($1,047,000 at January 31, 2004), CTT will record other income as it receives payments from Unilens.

Commitments

In addition to liabilities recorded at January 31, 2004, CTT's commitments were:

At January 31, 2004 Contractual Obligations	Payments Due by Period Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Operating lease obligations	$ 735,000	$ 294,000	$ 441,000	$	$
Other obligations	$ 19,000	$ 4,000	$ 15,000	$	$
	$ 754,000	$ 298,000	$ 456,000	$	$

CTT's other commitments are either contingent upon a future event or terminable on less than thirty days' (30) notice.

Our directors, officers, employees and agents may claim indemnification in certain circumstances. We are currently exposed to potential indemnification claims in connection with the SEC investigation and with complaints filed by certain former employees alleging discriminatory employment practices in violation of Section 806 of the Corporate and Criminal Fraud Accountability Act of 2002 (see sub-headings "SEC Investigation" and "Other" under the heading "Legal Proceedings" in this Prospectus). We seek to limit and reduce our potential financial obligations for indemnification by carrying directors' and officers' liability insurance (subject to deductibles).

CTT has several agreements with third parties to assist it in licensing specific technologies or to audit licensees' royalty reports. Under these agreements, the third parties are compensated only from the new revenues generated by their efforts.

In one of CTT's agreements (which CTT may terminate on ninety days' (90) written notice), it has committed to pay minimum annual license fees of $10,000 on each January 1, beginning January 1, 2004. In another agreement (which CTT may also terminate on ninety days' (90) written notice), it has committed to pay $4,000 in June 2004 and a $15,000 termination fee if the agreement is terminated in certain circumstances before January 31, 2006. In addition, CTT has agreed to reimburse patent expenses ($59,000 as of January 31, 2004) from future royalty receipts before retaining any revenue.

Under another agreement, CTT has agreed to pay $25,000 per technology portfolio when a candidate transferee demonstrates firm interest in two technology portfolios.

CTT and Vector Vision, Inc. (VVI), a CTT consolidated subsidiary, have contingent obligations to repay up to $209,067 and $224,127, respectively, (three times total grant funds received) in consideration of grant funding received in 1994 and 1995. CTT is obligated to pay at the rate of 7.5% of its revenues, if any, from transferring rights to inventions supported by the grant funds. VVI is obligated to pay at rates of 1.5% of its net sales of supported products or 15% of its revenues from licensing supported products, if any. These obligations are recognized when any such revenues are recognized. During fiscal 2003 and 2002, respectively, CTT charged $563 and $3,018 in related royalty expenses to operations. CTT's and VVI's remaining contingent obligations were $199,569 and $224,127, respectively, at January 31, 2004 to repay grant funding.

Other Matters

CTT carries liability insurance, directors' and officers' liability insurance and casualty insurance for owned or leased tangible assets.

CTT is involved in several lawsuits all of which are detailed under the heading "Legal Proceedings" in this Prospectus.

Critical Accounting Policies

Preparation of our consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires that we make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements, the reported amounts of revenues and expenses for the reporting period, and related disclosures. We base our estimates on the information available at the time and assumptions we believe are reasonable.

We believe that significant estimates, assumptions and judgments affect the following critical accounting policies used in preparing our consolidated financial statements. Our audit committee has reviewed their selection, application and disclosure.

Revenue Recognition

We derive revenues primarily from patent and technology license and royalty fees. Since these revenues result from our representation agreements with owners and assignees of intellectual property rights, we record revenues net of the owners' and assignees' shares of license and royalty fees. We stipulate the terms of our licensing arrangements in written agreements with the owners, assignees and licensees.

Single element arrangements

Since we usually have no significant obligations after we execute license agreements, they are generally single element arrangements. Under the terms of our license agreements, we generally receive an upfront license fee and a royalty stream based on the licensee's sales of products applying the licensed technology.

License fees under single element arrangements

We recognize upfront, nonrefundable license fees when our licensee executes the license agreement and pays the license fee. When these two events occur, we have persuasive evidence of an arrangement, no continuing obligations, completed delivery, and assurance of collection.

Royalty fees under single element arrangements

Although we fix the royalty rate (e.g., percentage of sales or rate per unit sold) in the license agreement, the amount of earned royalties is contingent upon the amount of licensed product the licensee sells. Royalties earned in each reporting period are contingent on the outcome of events (i.e., the licensee's sales of licensed products) occurring within that period that are not within our control and are not directly tied to our providing services. Therefore, we recognize this royalty revenue when the contingency is resolved and we can estimate the amount of royalty fees earned, which is upon our receipt of the licensee's royalty report.

Royalty settlements

We recognize royalty settlement revenue when our rights to litigation awards related to our patent and license rights are final and unappealable and we have assurance of collecting those awards. We also recognize royalty settlement revenue when we have collected litigation awards in cash (from the adverse party or by sale of our rights to another party without recourse) and we have no obligation or are very unlikely to be obligated to repay such collected amounts. We include royalty settlement revenue in operating revenue. Although final litigation awards may be infrequent, they are an integral aspect of our patent and technology licensing and commercialization business.

Other arrangements

In limited instances, we enter into multiple element arrangements with continuing service obligations. Based upon the limited verifiable objective evidence available, we generally defer all revenue from such multiple element arrangements until we deliver all elements.

We evaluate milestone billing arrangements on a case-by-case basis. Generally we recognize upfront fees ratably over the entire arrangement and milestone payments as we achieve milestones.

Impairment of Intangible Assets and Long-Term Investments

We review intangible assets and investments in equity securities that do not have readily determinable fair values for impairment when events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable. If the sum of expected future undiscounted cash flows is less than the carrying amount of the asset, we recognize an impairment loss measured by the amount the asset's carrying value exceeds its fair value and re-evaluate the remaining useful life of the asset. If a quoted market price is available for the asset or a similar asset, we use it in determining fair value. If not, we determine fair value as the present value of estimated cash flows based on reasonable and supportable assumptions.

We regularly apply this policy to our equity investments in privately held companies. We consider the investee's financial health (including cash position), business outlook (including product stage and viability to continue operations), recent funding activities, and business plan (including historical and forecast financial information). These investments are not readily transferable and our opportunities to liquidate them are limited and subject to many factors beyond our control, including circumstances internal to the investee and broader economic conditions.

We also apply this policy to all acquired intangible assets.

Recently Issued Accounting Pronouncements

In June 2002, the FASB issued Statement No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." This statement addresses financial accounting and reporting for costs associated with exit or disposal activities and nullifies Emerging Issues Task Force Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." The provisions of this statement are effective for exit or disposal activities initiated after December 31, 2002. CTT's adoption of this statement did not have a material effect on its financial condition or results of operations.

In December 2002, the FASB issued Statement No. 148, "Accounting for Stock-Based Compensation Transition and Disclosure." This statement amends Statement No. 123, "Accounting for Stock-Based Compensation," to provide alternative transition methods for a voluntary change to the fair value method of accounting for stock-based employee compensation. This statement also requires prominent disclosures in annual and interim financial statements about the method of accounting for stock-based employee compensation and its effect on reported results. The disclosure provisions of this statement were effective for and CTT made these disclosures beginning in CTT's third quarter ended April 30, 2003.

Related Party Transactions

In connection with the SEC's private investigation captioned "In the Matter of Trading in the Securities of Competitive Technologies, Inc." we have agreed, pursuant to Article IV of our bylaws, to advance to Mr. Samuel Fodale his expenses incurred in connection with this investigation, and Mr. Fodale has agreed to repay amounts so advanced if it is ultimately determined that he is not entitled to be indemnified by us as authorized by Article IV of our bylaws. As of January 31, 2004, we have advanced $101,000 to Mr. Fodale pursuant to this agreement. As of January 31, 2004, we have also paid $356,000 and accrued an additional $77,000 for our and several current and former directors' (excluding Mr. Fodale) related legal fees in the matter, which were in the aggregate approximately $433,000 to January 31, 2004. Except for Mr. Fodale, no individual current or former director's cumulative fees exceeded $60,000 at January 31, 2004.

We are a party to a service and representation agreement with Mega Concentrate, LLC for the representation of certain chemical compounds owned by Mega Concentrate, LLC. One of the principals of Mega Concentrate, LLC is Aris Despo, who is a Vice-President of CTT. No payments have been made by or received by CTT under this agreement as of March 16, 2004.

CTT incurred charges (reported in personnel and other direct expenses relating to revenue) of $5,300 and $6,000 related to consulting services provided by one director in the first half of fiscal 2004 and 2003, respectively.

CTT's board of directors determined that when a director's services were outside the normal duties of a director, CTT should compensate the director at the rate of $1,000 per day plus expenses (which is the same amount it pays a director for attending a one-day Board meeting).

Business

Technology Commercialization Services

CTT is a Delaware corporation incorporated in 1971 to succeed an Illinois business corporation incorporated in 1968. We provide technology transfer and licensing services focused on the technology needs of our customers and matching those requirements with commercially viable solutions. We identify, develop, and commercialize innovative technologies in life, digital, nano and physical sciences developed by universities, companies, independent research institutions and individual inventors.

We seek to maximize the value of intellectual property for the benefit of our customers, clients and stockholders by selling, licensing or otherwise commercializing technologies from our clients' or our portfolio of intellectual property rights. We obtain customers' technology requirements and match them with effective technology solutions, bridging the gap between market demand and raw innovation. In a few cases, we are enforcing our clients' and our patent rights with respect to certain of our technologies.

Our customers (licensees) pay license and royalty fees for licensed rights to use our clients' and our technologies. We also realize revenues from court awarded judgments and settlements of patent enforcement actions. We share these fees, judgments and settlements with our clients under our respective agreements with them.

Our life science portfolio includes pharmaceuticals, biotechnologies, and medical devices. We include communications, semiconductors, Internet, e-commerce and consumer electronics technologies in our digital portfolio. Our physical science portfolio targets display, environmental and nano-technologies and smart/novel materials.

The technologies that produced revenues equal to or exceeding 15% of our consolidated revenue for 2003, 2002 or 2001 were:

	2003	2002	2001
Ethyol	$ 647,000	$ 391,000	$ 228,000
Materna	$ 600,000	*	*
Homocysteine assay	$ 584,000	*	*
Gallium arsenide, including laser diode	$ 508,000	$ 1,012,000	$ 2,190,000

* Amounts were less than 15% of revenues in these years.

As a percentage of retained royalties, they represented:

	2003	2002	2001
Ethyol	20%	15%	*
Materna	18%	*	*
Homocysteine assay	18%	*	*
Gallium arsenide, including laser diode	15%	39%	60%

* Amounts were less than 15% of revenues in these years.

Ethyol is a chemotherapeutic mitigation agent licensed by Southern Research Institute (SRI) exclusively to MedImmune, Inc. (formerly U.S. BioScience, Inc.). Pursuant to an agreement between CTT and SRI, SRI pays CTT a share of Ethyol license income it receives, which payments are limited to $500,000 maximum in any calendar year. According to information reported by MedImmune, U.S. patents for Ethyol expire between July 2012 and June 2019. Since October 2001, when MedImmune began selling Ethyol directly in the United States, the underlying royalty base has been higher than

when it sold Ethyol through a distributor. Our retained royalties from Ethyol in fiscal 2003 exceeded $500,000 because fiscal year 2003 included $500,000 for calendar 2003 and $147,000 for calendar 2002.

The homocysteine assay is used to determine homocysteine levels and a corresponding deficiency of folate or vitamin B12. Studies suggest that high levels of homocysteine are a primary risk factor for cardiovascular, vascular and Alzheimer's diseases, and rheumatoid arthritis. Our U.S. patent that covers this homocysteine assay expires in 2007. In the second quarter of fiscal year 2003, we licensed this assay to two additional clinical laboratories and LabCorp began paying us under the terms of a January 2003 Stipulated Order. Before that, we had ten homocysteine licenses (including one sublicense), which provided $171,000 and $203,000 of revenues in fiscal 2002 and 2001, respectively.

Based on information we have obtained, we believe that the number of homocysteine assays performed is growing substantially. We continue our accelerated program to license laboratories performing homocysteine assays and manufacturers and distributors of automated homocysteine assays. We cannot predict if or when we will succeed in closing these additional license agreements or how the growth in volume will affect assay prices.

Inventions employing gallium arsenide to improve semiconductor operating characteristics were developed at the University of Illinois. U.S. patents have issued from March 1983 to May 1989 and expire from May 2001 to September 2006. These patents include a laser diode technology used in optoelectronic storage devices and another technology that improves semiconductor operating characteristics. We have licensed these inventions to Mitsubishi Electric Corporation, NEC Corporation, Semiconductor Company, Matsushita Electric Industrial Co., Ltd., SDL, Inc., Hitachi Ltd., Tottori Sanyo Electric Co., Ltd. and Toshiba Corporation. These inventions are in current use according to information received from licensees and other sources. Approximately $156,000, $417,000 and $1,715,000 of retained royalties in fiscal 2003, 2002 and 2001, respectively, were from one U.S. licensee's sales of licensed product; the remaining $351,000, $595,000 and $475,000, respectively, were from several foreign licenses.

Retained Royalties from Foreign Sources

We are developing relationships with Asian companies seeking technology solutions. Currently, our foreign operations are principally royalties received from foreign licensees. Retained royalties for 2003, 2002 and 2001, include $657,194, $878,894, and $682,011, respectively, from foreign licensees, including $351,000, $595,000 and $475,000, respectively, from the gallium arsenide portfolio. Retained royalties from Japanese licenses were $486,000, $730,000 and $577,000, respectively in 2003, 2002 and 2001.

Investments

From time to time in the past, in addition to providing other forms of assistance, we have funded certain development-stage companies to exploit specific technologies. In view of our financial condition, we discontinued that practice during the fourth quarter of fiscal year 2002.

NTRU Cryptosystems, Inc.

In April 2003, NTRU Cryptosystems, Inc. (NTRU) redeemed all outstanding shares of its Series A and Series B Preferred Stock (NTRU Preferred Stock) in exchange for cash or NTRU common stock.

CTT is a minority investor in NTRU and currently owns 3,129,509 shares of NTRU common stock, including 76,509 shares received in April 2003 (approximately 10% of NTRU's outstanding common stock). CTT exchanged its NTRU Preferred Stock for $90,741 in cash ($88,377 received in May 2003 and $2,364 received in September 2003), and 76,509 shares of NTRU common stock.

CTT recorded in other expense a charge of approximately $944,000 in its second quarter ended January 31, 2003 due to the uncertain timing and amount of CTT's expected future cash flows from its investment in NTRU's common stock after its recapitalization.

In the past, CTT held a seat and participated actively on NTRU's Board of Directors. CTT's management continues to believe NTRU's encryption technology has value and these actions provide NTRU an opportunity to allow applications to evolve to meet customer's needs for strong encryption, a small footprint and low processing requirements.

E. L. Specialists, Inc.

Effective August 5, 2002, CTT sold and transferred all its interests related to E. L. Specialists, Inc. (ELS) to MRM Acquisitions, LLC (MRM) for $200,000 cash. CTT recorded an impairment loss in other expense on its loans to ELS of $781,924 in fiscal year 2002 ($519,200 in the second quarter and $262,724 in the fourth quarter). (In addition, CTT previously charged against other revenues from ELS approximately $75,000 deemed uncollectible in fiscal year 2002.) The transferred interests included CTT's notes receivable in the face amount of $1,056,300 (plus interest) from ELS, its related security interest in ELS's intellectual property, all its other interests under agreements in connection with its notes receivable from ELS and CTT's interest in a technology servicing agreement related to ELS's intellectual property.

NovaNet Learning, Inc.

In May 1999, we sold our remaining 14.5% interest in NovaNET Learning, Inc. (NLI) and recorded a gain of $2,313,227 on the sale. In February 1995, we sold the then majority of our shares of NLI common stock to Barden Companies, Inc. and recorded a $2,534,505 gain on the sale. We formed University Communications, Inc., later renamed NovaNET Learning, Inc., in June 1986 to commercialize an interactive education and communication network developed at the University of Illinois. At various times since starting NLI, we had invested an aggregate of $1,997,000 in NLI equity. During NLI's first five years, we provided custom incubation services, including interim business management and initial capital sourcing services.

Employees

As of March 10, 2004, we had fourteen (14) full-time employees and two (2) part-time employees. On January 1, 2004, we hired as employees four (4) consultants who had previously provided business development services under contracts with us until December 31, 2003. In addition to the diverse technical, intellectual property, legal, financial, marketing and business expertise of our professional team, we rely on advice from technical and professional specialists to satisfy our clients' unique technology needs.

Properties

Our principal executive office is approximately 9,000 square feet of leased space in an office building in Fairfield, Connecticut. The office lease expires December 31, 2006, and provides for annual base rent of $225,000. We have an option to renew the lease through December 31, 2011. We believe that our facilities are adequate for our current and near-term operations.

Legal Proceedings

Fujitsu

In December 2000, (coincident with filing a complaint with the United States International Trade Commission (ITC) that was withdrawn in August 2001) CTT and the University of Illinois filed a complaint against Fujitsu Limited, Fujitsu General Limited, Fujitsu General America, Fujitsu Microelectronics, Inc. and Fujitsu Hitachi Plasma Display Ltd. (Fujitsu et al.) in the United States District Court for the Central District of Illinois seeking damages for past infringements and an injunction against future sales of plasma display panels (PDPs) that infringe two U.S. patents held by our client, the University of Illinois. The two patents cover energy recovery in flat plasma display panels. In July 2001, we reactivated this complaint to pursue legal remedies (damages for past infringing sales and possibly damages for willfulness) that are not available at the ITC. In May 2002, the District Court granted defendants' motion to transfer this case to the Northern District of California. On July 31, 2003, the judge in this case issued his Markman decision to determine the scope of and the interpretation of terms in the underlying patent claims. The Court has since stayed all issues in both the underlying case and the counterclaims except issues relating to summary judgment. Currently, no trial is scheduled pending the outcome of summary judgment motions and possible appeal options.

Since July 23, 2002, the University of Illinois has taken the lead in this litigation and assumed the cost of new lead counsel. Before that, we bore the entire cost of lead counsel in this litigation. In December 2002, we were dismissed as co-plaintiff from this litigation but we retain our economic interest in any potential favorable outcome.

In September 2001, Fujitsu et al. filed suit against us and Plasmaco, Inc. in the United States District Court for the District of Delaware (subsequently dismissed and reinstituted in the Northern District of California). This lawsuit alleged, among other things, that we misappropriated confidential information and trade secrets supplied by Fujitsu during the course of the ITC action. It also alleged that, with Plasmaco's assistance, we abused the ITC process to obtain information to which we otherwise would not have been entitled and which we will use in the action against Fujitsu in the United States District Court for the Northern District of California. On February 3, 2004, the U.S. Court of Appeals for the Federal Circuit heard oral arguments on appeal by the University of Illinois (now a defendant in this suit) of the District Court ruling that sovereign immunity does not attach to certain of the counterclaims.

We are unable to estimate the legal expenses or the loss we may incur or the possible damages we may recover in these suits, if any, and have recorded no potential judgment proceeds in our financial statements to date. We record expenses in connection with this suit as they are incurred.

LabCorp

On May 4, 1999, Metabolite Laboratories, Inc. (MLI) and CTT (collectively plaintiffs) filed a complaint and jury demand against Laboratory Corporation of America Holdings d/b/a LabCorp (LabCorp) in the United States District Court for the District of Colorado. The complaint alleged, among other things, that LabCorp owes plaintiffs royalties for homocysteine assays performed beginning in the summer of 1998, using methods falling within the claims of a patent owned by us. We

licensed the patent non-exclusively to MLI and MLI sublicensed it to LabCorp. Plaintiffs claimed LabCorp's actions constitute breach of contract and patent infringement. The claim sought an injunction ordering LabCorp to perform all its obligations under its agreement, to cure past breaches, to provide an accounting of wrongfully withheld royalties and to refrain from infringing the patent. Plaintiffs also sought unspecified money and exemplary damages and attorneys' fees, among other things. LabCorp filed an answer and counterclaims alleging noninfringement, patent invalidity and patent misuse.

The jury that heard this case in November 2001 confirmed the validity of our patent rights and found that LabCorp willfully contributed to and induced infringement and breached its contract. In December 2001, the Court entered judgment affirming the jury's verdict.

In November 2002, the Court confirmed its judgment in favor of MLI and us. The Court's amended judgment awarded us approximately $1,019,000 damages, $1,019,000 enhanced damages, $560,000 attorneys' fees and $132,000 prejudgment interest. If the Court's judgment is upheld on appeal, we will retain approximately $1,100,000 of damages awarded plus post-judgment interest at the statutory rate. The U.S. Court of Appeals for the Federal Circuit heard oral arguments in this case on November 5, 2003 and we await its decision.

We are unable to estimate the legal expenses we may incur or the possible damages we may ultimately recover in this suit, if any. We have not recorded revenue in our financial statements to date for awarded damages, awarded enhanced damages, awarded attorneys' fees or awarded interest from the Court's November 2002 judgment. We will record these revenues, if any, when the awards are final and collectible. We record expenses in connection with this suit as they are incurred.

In a January 2003 Stipulated Order, LabCorp agreed to post a bond for all damages awarded in the November 2002 judgment and to pay us a percentage of sales of homocysteine tests performed since November 1, 2002 through final disposition of this case. In addition, pursuant to this order, LabCorp paid $250,000 for homocysteine assays performed from November 1, 2001 through October 31, 2002. In exchange, this Stipulated Order stayed execution of the monetary judgment and the permanent injunction against LabCorp in the Court's November 2002 judgment. This Stipulated Order is without prejudice to any party's position on appeal. Since January 2003, we have received cumulative royalties of $1,003,029 (revenues of $401,211 (of which $99,954 relate to assays performed from November 1, 2001 through October 31, 2002) and royalties paid or payable of $601,818 to our clients) from LabCorp pursuant to this January 2003 Stipulated Order. If the November 2002 judgment in our favor is reversed on appeal, LabCorp's ability to recover amounts paid to us, if at all, may depend on the extent and reason for the reversal. Our management believes the probability that LabCorp will recover such amounts is very unlikely.

Materna

The University of Colorado Foundation, Inc., the University of Colorado, the Board of Regents of the University of Colorado, Robert H. Allen and Paul A. Seligman, plaintiffs, previously filed a lawsuit against American Cyanamid Company (now a subsidiary of Wyeth), defendant, in the United States District Court for the District of Colorado. This case involved a patent for an improved formulation of Materna, a prenatal vitamin compound sold by defendant. While we were not and are not a party to this case, we had a contract with the University of Colorado to license University of Colorado inventions to third parties. As a result of this contract, we are entitled to share 18.2% of damages awarded to the University of Colorado, if any, after deducting the expenses of this suit.

On July 7, 2000, the District Court concluded that Robert H. Allen and Paul A. Seligman were the sole inventors of the reformulation of Materna that was the subject of the patent and that defendant is liable to them and the other plaintiffs on their claims for fraud and unjust enrichment.

On August 13, 2002, the District Court judge awarded approximately $54 million, plus certain interest from January 1, 2002, to the plaintiffs. The defendant has posted a $59 million bond.

On September 3, 2003, a three-judge panel of the U.S. Court of Appeals for the Federal Circuit (CAFC) unanimously affirmed the August 13, 2002 judgment. In November 2003, the CAFC denied the defendant's appeal requesting a rehearing en banc. On February 12, 2004, the defendant filed petition for certiorari (a request that the U.S. Supreme Court hear its appeal) to the U.S. Supreme Court.

Based on the language of the September 3, 2003 judgment, our management believes there is a very reasonable possibility that we will receive our share of damages finally awarded, plus our proportionate share of interest. We have recorded no potential judgment proceeds in our financial statements to date. We will record revenue for judgment proceeds when we receive them.

Sales of portions of expected Materna award

Effective May 19, 2003, CTT sold to LawFinance Group, Inc. (LFG) the first $1,290,000 (plus court awarded interest from May 19, 2003) of its potential share from the judgment in the Materna lawsuit for $600,000 cash. CTT granted LFG a security interest in CTT's share of the potential award.

Effective October 30, 2003, we sold to LFG a second portion of our expected judgment in the Materna lawsuit. On October 31, 2003, we received $900,000 cash in exchange for an Assigned Portion (plus court awarded interest thereon from October 31, 2003) of CTT's share of the potential award and recorded $900,000 in retained royalty settlement revenue in first quarter 2004. In management's opinion, it is most likely that the Assigned Portion will be $1,125,000.

According to this LFG agreement, the Assigned Portion relating to the above transaction will be:

a) $1,125,000 if, in the current Appeal, Defendant does not file a petition for certiorari with the United States Supreme Court (Supreme Court) or the Supreme Court denies Defendant's petition for certiorari during the current 2003-2004 Term and LFG receives full payment within 7 days of our receiving payment from Defendant, or

b) $2,160,000 if, in the current Appeal, Defendant files a petition for certiorari with the Supreme Court and the Supreme Court grants Defendant's petition and LFG receives full payment within 7 days of our receiving payment from Defendant, or

c) $1,400,000 in any circumstance that does not meet the conditions of a) or b).

We have no financial obligation to repay LFG or to return any portion of the aggregate $1,500,000 received from LFG as of January 31, 2004. If our share of the potential award is less than the total amount sold to LFG, the entire amount would be paid to LFG and LFG would be deemed paid in full. We granted LFG a first security interest in our share of the potential award.

Effective November 17, 2003, we sold to one of our shareholders $312,500 (plus court awarded interest thereon from November 14, 2003) of our expected judgment in the Materna lawsuit in exchange for $250,000 in cash. We granted this shareholder a security interest subordinate to that of LFG in our share of the potential award.

If the judgment in the Materna lawsuit is reversed in an unappealable decision by the appropriate court, or if there are no litigation proceeds to be distributed, we have no financial obligation to repay this shareholder in either cash or shares of our common stock. If the award remaining after all amounts due to LFG is less than $312,500, we shall pay this shareholder the difference in shares of our common stock valued at its market value on the day of distribution, after which he would be deemed paid in full.

Depending on the conditions described in a), b) and c) above relative to LFG, at January 31, 2004, we retained the remaining anticipated a) $3,272,500, b) $2,237,500, or c) $2,997,500 proceeds from this expected award (plus court awarded interest thereon) in addition to the $1,750,000 already received from LFG and this shareholder.

SEC Investigation

By letter of May 17, 2001, we received a subpoena from the SEC seeking certain documents in connection with the SEC's private investigation captioned "In the Matter of Trading in the Securities of Competitive Technologies, Inc."

On June 12, 2003, the staff of the SEC sent written "Wells Notices" to us, Frank R. McPike, Jr., (then CTT's Executive Vice President and Chief Financial Officer), Samuel M. Fodale (a director of CTT) and George C. J. Bigar (a former director of CTT). The "Wells Notices" indicated that the staff intended to recommend that the SEC bring a civil action against us and the individuals in the matter of trading in our stock, which we believe relates to our stock repurchase program under which we repurchased shares of our stock from time to time during the period from October 28, 1998 to March 22, 2001.

CTT, Mr. McPike, Mr. Fodale and Mr. Bigar have responded in writing to their respective "Wells Notices." We continue to cooperate with the SEC staff in this matter and await notice of the staff's formal recommendation of what action, if any, the SEC might take against us.

Suit under our Directors and Officers Policy

We filed a claim under our directors' and officers' liability insurance with Federal Insurance Company of Warren, New Jersey (Federal) for reimbursement of fees related to the SEC investigation in excess of the policy deductible. Federal denied our claim. As a result, on February 3, 2004, we filed a complaint in the U.S. District Court for the District of Connecticut against Federal to enforce our claims. We will record any reimbursement for these expenses when we receive them.

Other

By letter dated October 7, 2003, the U.S. Department of Labor notified us that certain former employees had filed complaints alleging discriminatory employment practices in violation of Section 806 of the Corporate and Criminal Fraud Accountability Act of 2002, 18 U.S.C. 1514A, also known as the Sarbanes-Oxley Act. The complainants request that the Occupational Safety and Health Administration (OSHA) investigate and, if appropriate, prosecute such violations and request OSHA assistance in obtaining fair and reasonable reimbursement and compensation for damages. Management believes these claims are without merit and we have responded to the complaints. We cannot estimate the final outcome of these complaints or the related legal or other expenses we may incur.

Management

Executive Officers and Directors

The following table sets forth information regarding CTT's executive officers and directors:

Name	Age	Position
Richard E. Carver	66	Director and Chairman of the Board of Directors
George W. Dunbar, Jr.	57	Director
Samuel M. Fodale	60	Director
Donald J. Freed	61	Executive Vice President and Chief Technology Officer
John B. Nano	59	President, Chief Executive Officer, Chief Financial Officer and Director
Charles J. Philippin	53	Director
John M. Sabin	49	Director

Richard E. Carver. Mr. Carver has served as a Director and Chairman of the Board of Directors of CTT since January 2000. Currently, Mr. Carver serves as the President and Chief Executive Officer of MST America, an international business strategies consultancy company. He has served as its President and Chief Executive Officer since January 1995. Prior thereto, he served as the President and Chief Executive Officer of RPP America, a company that sells solid waste wrapping systems, from November 1998 to April 2000. From May 1988 to December 1999, he was the Chairman and Chief Executive Officer of Carver Lumber Company, a provider of building materials for new home construction and prefabrications.

George W. Dunbar. Mr. Dunbar has been a Director of CTT since November 1999. Currently, Mr. Dunbar serves as the Chief Executive Officer and as a Director of Quantum Dot Corporation, a privately held bioscience company commercializing proprietary labeling and detection nanotechnology with commercial applications throughout life science research and medicine. He has served in such capacities since February 2004. Since February 2003, he has also served as the Chief Executive Officer, President and Director of Targesome, Inc., an early stage, targeted drug delivery technology start up. Prior thereto, he served as the Chief Executive Officer of EPIC Therapeutics, Inc., a drug delivery technology company from September 2000 to November 2002. From February 2000 to January 2001, he was the Acting President and Chief Executive Officer of StemCells, Inc. (previously known as CytoTherapeutics, Inc.). From November 1999 to January 2001, he served as the Acting President of StemCells California, Inc., a wholly owned subsidiary of StemCells, Inc. Prior thereto, he served as the President and

Chief Executive Officer of Metra BioSystems, Inc., a developer of products to detect and manage bone and joint diseases from 1991 to August 1999. Mr. Dunbar also serves as a Director of Sonus Pharmaceuticals, Inc.

Samuel M. Fodale. Mr. Fodale has been a Director of CTT since October 1998. Mr. Fodale is the President of Central Maintenance Services, Inc., a service and warehousing corporation serving the automobile industry.

Donald J. Freed. Dr. Freed has served as Executive Vice President and Chief Technology Officer of CTT since January 2004. Prior thereto, he consulted for CTT from April 2003 to December 2003. From November 1998 through March 2003, he served as Vice President, Business Development, and prior thereto, as Vice President of Marketing of Nanophase Technologies Corporation, a publicly held nanomaterials company.

John B. Nano. Mr. Nano has served as President, Chief Executive Officer and a Director of CTT since June 2002. He has also served as CTT's Chief Financial Officer since August 2003. From 2000 to 2001, he served as a Principal reporting to the Chairman of Stonehenge Networks Holdings, N.V., a global virtual private network provider, with respect to certain operating, strategic planning and finance functions. Prior thereto, he served as the Executive Vice President and Chief Financial Officer of ConAgra Trade Group, Inc., an international food company from 1998 to 1999. From 1993 to 1998, he served as the Executive Vice President, Chief Financial Officer and President of the Internet Startup Division of Sunkyong America, a subsidiary of Sunkyong Group, a Korean conglomerate.

Charles J. Philippin. Mr. Philippin has been a Director of CTT since June 1999. Currently, he is a Partner of Garmark Advisors, a mezzanine investment fund. He also serves as the Chief Executive Officer of Accordia, Inc., formerly On-Line Retail Partners, a provider of management and technology resources for branded e-commerce businesses. He has served as its Chief Executive Officer since June 2000. From July 1994 to May 2000, he served as a member of the management committee of Investcorp International, Inc., a global investment group that acts as a principal and intermediary in international investment transactions. Mr. Philippin also serves as a Director of Samsonite Corp. and CSK Auto Corp.

John M. Sabin. Mr. Sabin has served as a Director of CTT since December 1996. Currently, he serves as the Chief Financial Officer and General Counsel of NovaScreen Biosciences Corporation, a developer of biotechnology-based tools to accelerate drug discovery and development. He has served as its Chief Financial Officer and General Counsel since January 2000. Prior thereto, he was a business consultant from September 1999 to January 2000. From May 1998 to September 1999, he served as the Executive Vice President and Chief Financial Officer of Hudson Hotels Corporation, a limited service hotel development and management company. From February 1997 to May 1998, he served as the Senior Vice President and Treasurer of Vistana, Inc., a developer of vacation timeshares. Mr. Sabin also serves as a Trustee of Hersha Hospitality Trust.

Executive Compensation

The following table summarizes the total compensation awarded to, earned by or paid by us for services rendered during each of the fiscal years ended July 31, 2003, 2002 and 2001 to the two individuals who served as our executive officers during the fiscal year ended July 31, 2003.

Summary Compensation Table

		Annual Compensation		Long-Term Compensation Awards	
Name and Principal Position	**Year**	**Salary ($)**	**Bonus ($)**	**Securities Underlying Options (#)**	**All Other Compensation ($) (1)**
					(2)

				Long-Term Compensation	
John B. Nano	2003	250,000			5,942
President and Chief Executive	2002	28,846		300,000	
Officer since June 17, 2002					
Frank R. McPike, Jr.	2003	242,308	10,000		7,067(3)
Executive Vice President and	2002	233,654		12,500	19,240(3)
Chief Financial Officer;	2001	217,500	25,000	25,000	23,773(3)
formerly President, Chief					
Executive Officer, and Chief					
Operating Officer(4)					

(1) The aggregate amount of any perquisites or other personal benefits was less than 10% of the total of annual salary and bonus and is not included in the above table.

(2) Consists of personal use of CTT auto.

(3) Consists principally of amounts contributed for Mr. McPike to Competitive Technologies, Inc.'s 401(k) plan in 2002 and Employees' Common Stock Retirement Plan in 2001. CTT contributed shares of its common stock valued at the means between its high and low prices on the American Stock Exchange on December 18, 2002 and July 31, 2001, respectively. Also includes premiums of $1,065 in 2003 and 2002 and $460 in 2001 paid for $250,000 term life insurance policy and personal use of CTT auto.

(4) Mr. McPike was on unpaid leave of absence effective July 1, 2003, and his resignation from CTT was effective November 1, 2003.

Option Grants in Last Fiscal Year

CTT granted no stock options during the fiscal year ended July 31, 2003 to the executive officers named in the Summary Compensation Table.

Aggregated Option Exercises in Last Fiscal Year and Fiscal Year-End Option Values

For the executives officers named in the Summary Compensation Table, the following table summarizes the stock options held at July 31, 2003. The executive officers named in the Summary Compensation Table exercised no stock options during the fiscal year ended July 31, 2003.

			Number of securities underlying unexercised options at fiscal year end (#)		Value of unexercised in-the-money options at fiscal year end ($)	
Name	**Shares acquired on exercise (#)**	**Value Realized ($)**	**Exercisable**	**Unexercisable**	**Exercisable**	**Unexercisable**
John B. Nano	0	$ 0	75,000	225,000	$ 0	$ 0
Frank R. McPike, Jr.	0	$ 0	164,315	0	$ 0	$ 0

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Compensation of Directors

CTT pays each director who is not an employee of CTT or a subsidiary $1,000 for each Board meeting attended and $500 for each committee meeting attended ($250 when the committee meeting coincides with a Board meeting). CTT pays directors who participate in telephonic board and/or committee meetings one half the fee for attending such meetings. CTT reimburses directors for out-of-pocket expenses incurred to attend Board and committee meetings.

Prior to January 1, 2004, when a director of CTT represented CTT as a director of an investee company, CTT paid the director for attending investee board meetings the difference, if any, between (a) the amount the investee company pays and (b) the amount CTT pays for attendance at such meetings. During fiscal year 2003, CTT paid Mr. Sabin $6,000 for his attendance at investee board meetings. No other director received any such fees.

In addition to meeting fees, CTT pays outside directors an annual cash retainer of $7,500 payable in quarterly installments.

Under CTT's 1996 Directors' Stock Participation Plan, on the first business day of January from January 1997 through January 2006, CTT issues to each non-employee director who has been elected by the stockholders and has served at least one full year a number of shares of CTT's common stock equal to the lesser of (i) $15,000 divided by the per share fair market value of such stock on the issuance date, or (ii) 2,500 shares. If a non-employee director were to leave the Board after serving at least one full year but prior to the January issuance date, CTT would pay the annual stock compensation described above on a pro-rata basis up to the termination date. In January 2003, CTT issued an aggregate of 15,000 shares under the plan (2,500 each to Messrs. George C. J. Bigar (who did not stand for re-election in January 2003), Carver, Dunbar, Fodale, Philippin and Sabin). In January 2004, CTT issued an aggregate of 12,500 shares under the plan (2,500 each to Messrs. Carver, Dunbar, Fodale, Philippin and Sabin).

Effective January 27, 2000, CTT adopted the Competitive Technologies, Inc. 2000 Directors Stock Option Plan (the Directors Option Plan) with respect to its common stock. Directors who are not employees of CTT or a subsidiary are eligible for options granted pursuant to this plan. This plan provides that CTT grant an option for 10,000 shares to each new director elected during the term of this plan on the date he or she is first elected to office, whether by the stockholders or by the Board. This plan also provides that CTT grant an additional option for 10,000 shares to each director holding office on the first business day in each subsequent January. Options under this plan will be non-statutory options, have an exercise price not less than 100% of the fair market value at the grant date, have a term of ten years from the grant date, and fully vest on the grant date. If a person's directorship is terminated because of death or permanent disability, options may be exercised within one year after termination. If the termination is for any other reason, options may be exercised within 180 days after termination. However, the Board has discretion to amend options previously granted to provide that such options may continue to be exercisable for specified additional periods following termination. In no event may an option be exercised after expiration of its ten-year term. CTT may not grant options under the Directors Option Plan after the first business day of January 2010. On January 2, 2004, CTT granted 50,000 options under this plan (10,000 each to Messrs. Carver, Dunbar, Fodale, Philippin and Sabin) at an exercise price of $2.50 per share, the market price on the grant date. On January 24, 2003, the Board extended the exercisability of 40,000 options previously granted to Mr. Bigar to January 24, 2006 (3 years after termination of his services as a director).

Employment Agreements

We have entered into an employment agreement with John B. Nano which provides for his employment as our President and Chief Executive Officer at a base compensation of $250,000 per year, subject to reviews and increases in the sole discretion of our Board of Directors. Mr. Nano's

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employment is at will and can be terminated by either party at any time and for any reason. The agreement also provides that from the date of Mr. Nano's employment through July 31, 2003, and in each following fiscal year, Mr. Nano will be eligible to receive a bonus of up to $100,000, based on our performance and Mr. Nano's performance of objectives to be established by our Board of Directors. No bonus was awarded to Mr. Nano in fiscal year 2003. After fiscal year 2003, we may adopt an executive bonus plan in lieu of the bonus. The agreement also granted Mr. Nano ten-year options under our 1997 Employees' Stock Option Plan for the purchase of 300,000 shares of our common stock at an exercise price of $2.15 per share, vesting 25% on each of the first four anniversaries of his employment date. If the agreement is terminated as a result of Mr. Nano's death or disability, any unvested options granted under the agreement will immediately become fully vested. If Mr. Nano terminates his employment for good reason or we terminate it without cause, Mr. Nano will be entitled to receive a severance benefit continuing his base compensation and certain other benefits for a period of six months and continued vesting of stock options for the longer of a period of six months or until the next anniversary of his employment date. If Mr. Nano's employment is terminated without cause in conjunction with a change in control of CTT, Mr. Nano will be entitled to receive his base compensation and certain other benefits for one year, and any unvested options granted under the agreement will immediately become fully vested. The agreement also contains a one-year period of non-competition with us in certain circumstances.

Donald J. Freed's employment with us is at will and can be terminated by either party at any time with or without cause. There is no written employment agreement with Dr. Freed.

Frank R. McPike, Jr.'s employment with us was at will and could be terminated by either party at any time with or without cause. Our December 7, 1999, employment agreement with Mr. McPike expired on December 7, 2002. Effective July 1, 2003, we placed Mr. McPike on unpaid leave of absence and he ceased to act as our chief financial officer. On November 1, 2003, we entered into a severance agreement and general release with Mr. McPike. The agreement provides that Mr. McPike's last day of employment with us was November 1, 2003. The agreement also provides that we will pay to Mr. McPike a sum not to exceed $112,500, within fourteen (14) days after we have received our share of the award in the Materna lawsuit in an amount sufficient to make such payment to Mr. McPike. However, in the event that we continue to assign portions of the Materna lawsuit to third party purchasers, we must pay to Mr. McPike 3.237% of any such future amounts that we assign and 3.237% of any balance due to us from the Materna award, within fourteen (14) days after we receive our share of funds, provided that the total amounts paid to Mr. McPike will not exceed $112,500. The agreement also provides that we will extend the expiration date on stock options granted to Mr. McPike to the earlier of ten (10) years from the date of the grant or three (3) years from November 1, 2003. The agreement also provides that Mr. McPike will release all claims he has or may have against us, provided that such release does not affect his rights, if any, with respect to (i) any options granted to Mr. McPike under the 1997 Employees' Stock Option Plan, (ii) the Competitive Technologies, Inc. 401(k) Plan, or (iii) Mr. McPike's rights pursuant to the indemnification provisions under our bylaws. The agreement also provides that for six (6) months after November 1, 2003, Mr. McPike cannot solicit the business of any of our customers or prospective customers and perform work for any of our customers or prospective customers whose needs became known to Mr. McPike during his employment with us or with whom Mr. McPike had any dealings as a result of his employment with us at any time during the two (2) years immediately preceding November 1, 2003, wherein such solicitation or work involves any service or product that is similar or in competition with any of our services or products either existing or in the process of being developed at the time of his termination of his employment with us on November 1, 2003.

Other Arrangements

401(k) Plan

Effective January 1, 1997, we established the Competitive Technologies, Inc. 401(k) Plan (the 401(k) plan), a defined contribution plan for all employees meeting certain service requirements. All our employees who have attained the age of 21 are eligible to participate in the 401(k) plan.

Under the 401(k) plan, an eligible employee may elect a salary reduction of his or her compensation as defined in the 401(k) plan to be contributed by us to the 401(k) plan. Employee contributions for any calendar year are limited to a specific dollar amount determined by the Internal Revenue Service ($12,000, plus an additional $2,000 for participants over age 50 for 2003, $11,000, plus an additional $1,000 for participants over age 50 for 2002 and the lesser of 15% of compensation or $10,500 for 2001). Employee contributions are fully vested when made.

We may also make discretionary contributions subject to limitations set forth in the Internal Revenue Code. Before an employee has completed four years of service, our contributions generally vest over time based on an employee's years of service. After an employee has completed four years of service, our contributions are fully vested when they are made. The 401(k) plan defines a year of service as twelve (12) consecutive months during which an employee has at least 1,000 hours of service. Discretionary contributions may be allocated based on compensation, based on a per capita allocation or on a combination of per capita and compensation bases.

For the fiscal years ended July 31, 2003 and 2002, our directors authorized discretionary contributions of $100,000 and $80,000, respectively, payable in our common stock. We charged these amounts to expense in fiscal years 2003 and 2002, respectively. We contributed shares of our common stock valued at $80,000 to the 401(k) plan in December 2002. Mr. McPike's portion of the fiscal year 2002 allocation was $12,094. Mr. Nano was not eligible to participate in the fiscal 2002 allocation. We contributed shares of our common stock valued at $100,000 to the 401(k) plan on January 31, 2004. Mr. Nano's portion of the January 31, 2004 allocation was $26,324.

Employees' Common Stock Retirement Plan

Effective August 1, 1990, we adopted the Competitive Technologies, Inc. Employees' Common Stock Retirement Plan. For the fiscal year ended July 31, 2001, our Board of Directors authorized a contribution of 14,814 shares valued at approximately $80,000, based on the fiscal 2001 year-end closing price. We charged this amount to expense in 2001. The Competitive Technologies, Inc. Employees' Common Stock Retirement Plan was merged into our 401(k) Plan effective January 31, 2003.

Annual Incentive Compensation Plan

On March 28, 2003, our Board of Directors approved the Competitive Technologies, Inc. Annual Incentive Compensation Plan and terminated its previous incentive compensation plan.

The Compensation Committee, composed of not less than two independent directors of CTT, administers the Annual Incentive Compensation Plan. Our Board of Directors may suspend, amend or terminate this plan at any time or from time to time. This plan provides that the greater of annual bonus incentive or commission awards be paid in cash.

Annual bonus incentive awards are tied up to 70% to our financial performance and up to 30% to individual performance. If our financial performance is less than 80% of our goal, there may be no award for the 70% portion. If our financial performance is more than 115% of our goal, the award may increase to 150% of the 70% portion of the award. If a participant meets his or her individual goals, the 30% portion may be paid regardless of whether we achieve our financial performance goal. The targeted incentive award is a percentage of the participant's salary as of December 31 of each plan

year, 10% for administrative staff, 30% for professional staff and 50% for the President and CEO. Special awards may also be made in the discretion of the Compensation Committee. For the fiscal year ended July 31, 2003, we charged $50,000 to expense for annual bonus incentive awards to administrative and professional staff. We will pay these bonuses upon receipt of the potential Materna award.

This plan includes our Commission Plan for professional and support staff and consultants, which sets aside up to 10% of new business revenue (less direct costs other than personnel costs). The commission from each new business revenue source shall be paid for a maximum of five years and be allocated among those who participated in generating that revenue. No commissions were paid or accrued under this plan in fiscal year 2003.

1997 Employees' Stock Option Plan

We have in effect a 1997 Employees' Stock Option Plan (the Option Plan) with respect to our Common Stock, which provides for granting either incentive stock options under Section 422 of the Internal Revenue Code or nonqualified options. Incentive options and non-qualified options granted under the Option Plan must be granted at not less than 100% of fair market value on the grant date. In certain instances stock options, which are vested or become vested upon the happening of an event or events specified by our Stock Option Committee, may continue to be exercisable through up to 10 years after the date granted, irrespective of the termination of the optionee's employment with us.

Compensation Committee Interlocks and Insider Participation

During the twelve months ended July 31, 2003, Charles J. Philippin, Richard E. Carver and George W. Dunbar, Jr. were members of the Compensation and Stock Option Committee.

Principal Stockholders

The following table sets forth the beneficial ownership of shares of CTT's common stock as of March 1, 2004 by each director, by the executive officers of CTT, and by each person known to CTT to be the beneficial owner of more than 5% of CTT's outstanding common stock. Unless otherwise indicated in the footnotes, all of such interests are owned directly, and the indicated person or entity has sole voting and investment power.

Name (and Address if more than 5%) of Beneficial Owners	Amount Beneficially Owned	Percent of Class (1)
Directors and executive officers		
Richard E. Carver	59,720(2)	
George W. Dunbar, Jr.	60,025(3)	
Samuel M. Fodale	168,408(4)	2.7%
Donald J. Freed	7,250(5)	
Frank R. McPike, Jr.	215,815(6)	3.4%
John B. Nano	180,000(7)	2.8%
Charles J. Philippin	94,269(8)	1.5%

Name (and Address if more than 5%) of Beneficial Owners	Amount Beneficially Owned	Percent of Class (1)
John M. Sabin	62,226(9)	
All directors and executives officers as a group	847,713(10)	12.4%
Additional 5% Owner		
Richard D. Corley 416 St. Mark Court Peoria, Illinois 61603	440,400(11)	7.1%

(1)
Percentage of less than 1% are not shown.

(2)
Consists of 15,720 shares of common stock plus 44,000 stock options deemed exercised solely for purposes of showing total shares owned by Mr. Carver. Mr. Carver holds 6,500 shares of common stock jointly with his spouse.

(3)
Consists of 10,025 shares of common stock and 50,000 stock options deemed exercised solely for purposes of showing total shares owned by Mr. Dunbar.

(4)
Consists of 118,408 shares of common stock plus 50,000 stock options deemed exercised solely for purposes of showing total shares owned by Mr. Fodale. Includes 70,300 shares of common stock held by Central Maintenance Services, Inc., 9,000 shares of common stock held by Missouri Recycling St. Louis, Inc., 3,200 shares of common stock held by his children and 2,000 shares of common stock held by his spouse.

(5)
Consists of 1,000 shares of common stock and 6,250 stock options deemed exercised solely for purposes of showing total shares owned by Dr. Freed.

(6)
Consists of 43,689 shares of common stock and 172,126 stock options deemed exercised solely for purposes of showing total shares owned by Mr. McPike. Mr. McPike ceased being an executive officer of CTT on July 1, 2003.

(7)
Consists of 5,000 shares of common stock and 175,000 stock options deemed exercised solely for purposes of showing total shares owned by Mr. Nano. Includes 5,000 shares of common stock held by his spouse in Uniform Gifts to Minors account for his son.

(8)
Consists of 44,269 shares of common stock plus 50,000 stock options deemed exercised solely for purposes of showing total shares owned by Mr. Philippin.

(9)
Consists of 12,226 shares of common stock plus 50,000 stock options deemed exercised solely for purposes of showing total shares owned by Mr. Sabin.

(10)
Consists of 250,337 shares of common stock plus 597,376 stock options to purchase shares of common stock deemed exercised solely for purposes of showing total shares owned by such group, including Mr. McPike because he was a named executive officer in fiscal year 2003. If Mr. McPike were excluded, the total would be 631,898 (9.5%) and consist of 206,648 shares of common stock plus 425,250 stock options to purchase shares of common stock deemed exercised solely for purposes of showing total shares owned by such group.

(11)

Information from Schedule 13D/A dated and filed on December 22, 2003.

At March 10, 2004, the stock transfer records maintained by CTT with respect to its preferred stock showed that the largest holder of preferred stock owned 500 shares.

Certain Relationships and Related Transactions

In connection with the SEC's private investigation captioned "In the Matter of Trading in the Securities of Competitive Technologies, Inc." as of January 31, 2004, CTT has advanced $101,000 in legal fees for Samuel M. Fodale. As of January 31, 2004, we have also paid $356,000 and accrued an additional $77,000 for our and several current and former directors' (excluding Mr. Fodale, addressed above) related legal fees in the matter, which were in the aggregate approximately $433,000 to January 31, 2004. Except for Mr. Fodale, no individual current or former director's cumulative fees exceeded $60,000 at January 31, 2004. CTT may receive reimbursement of certain of these fees in excess of the deductible from its directors' and officers' liability insurance policy.

Beginning August 2000, CTT compensated George C.J. Bigar, a former director of CTT, at the rate of $8,000 per month for consulting services related to CTT's investments and potential investments in development-stage companies. Mr. Bigar received $346,000 for these services from August 2000 through June 2002.

Description of Capital Stock

Our authorized capital stock consists of 20,000,000 shares of common stock, par value of $0.01 per share, and 35,920 shares of preferred stock, par value of $25.00 per share.

Common Stock

As of March 10, 2004, 6,243,697 common shares were outstanding. Our common stock is traded on the American Stock Exchange under the trading symbol "CTT." Each holder of common stock is entitled to one vote for each share on all matters submitted to a vote of the stockholders. There are no cumulative voting rights, which means that the holders of more than 50% of the aggregate outstanding shares of common and preferred stock can elect all of the directors to our Board of Directors, in which event the holders of the remaining shares will not be able to elect any directors. Subject to the rights of the holders of preferred stock to receive preferential non-cumulative dividends, the holders of the common stock are entitled to receive dividends on such shares, if, as and when declared payable by our Board of Directors from funds legally available for that purpose. There are no restrictions in our certificate of incorporation on our ability to repurchase or redeem shares from funds legally available for that purpose while there is any arrearage in the payment of dividends on preferred stock. The common stock has no preemptive, conversion, sinking fund or redemption rights. All outstanding shares of common stock are fully paid and non-assessable. Upon our liquidation, dissolution or winding up, the holders of common stock are entitled to share ratably in assets remaining available for distribution after payment of all debts and payment of the preferential liquidation rights of shares of preferred stock then outstanding.

Preferred Stock

As of March 10, 2004, 2,427 preferred shares were issued and outstanding. Each holder of preferred stock is entitled to one vote for each share on all matters submitted to a vote of the stockholders. The holders of preferred stock are entitled to receive, if, as and when declared by our Board of Directors, out of funds legally available therefor, preferential non-cumulative dividends at the rate of $1.25 per share per annum, payable quarterly, before any dividends may be declared or paid upon or other distribution made in respect of any share of common stock. The preferred stock is redeemable in whole at any time or in part from time to time on 30 days' notice, at our option, at a redemption price of $25.00 per share. Upon our liquidation, dissolution or winding up, the holders of preferred stock are entitled to $25.00 a share in cash before any distribution of assets can be made to the holders of the common stock. The preferred stock has no preemptive, sinking fund or conversion rights.

Limitation on Liability

Our Restated Certificate of Incorporation provides that none of our directors shall be personally liable to us or our stockholders for monetary damages for breach of fiduciary duty by such director as a director, provided, however, that to the extent provided by applicable law, the liability of a director will not be eliminated or limited (i) for any breach of the director's duty of loyalty to us or our stockholders, (ii) for acts or omissions not in good faith or which involved intentional misconduct or a knowing violation of law, (iii) for the payment of dividends or approval of stock repurchases or redemptions that are unlawful under Delaware law, or (iv) for any transaction from which the director derived an improper personal benefit.

Transfer Agent

The transfer agent for our common stock is American Stock Transfer & Trust Company, 59 Maiden Lane, New York, New York 10038, Telephone (800) 937-5449.

The Fusion Capital Transaction

General

On February 25, 2004, we entered into a common stock purchase agreement with Fusion Capital Fund II, LLC under which Fusion Capital agreed to purchase, subject to our right to reduce or suspend these purchases and our right to terminate the agreement with Fusion Capital at any time, on each trading day during the term of the agreement, $12,500 of our common stock up to an aggregate of $5.0 million. The $5.0 million of common stock is to be purchased over a twenty (20) month period, subject to a six (6) month extension or earlier termination at our discretion. The purchase price of our common stock will be based upon the future market price of the common stock without any fixed discount to the market price. We have the right to set a minimum purchase price at any time as described below. Fusion Capital does not have the right or the obligation to purchase shares of our common stock in the event that the price of our common stock is less than $1.00 per share.

We have authorized the sale and issuance of up to 1,248,115 shares of our common stock to Fusion Capital under the common stock purchase agreement. We estimate that the maximum number of shares we will sell to Fusion Capital under the common stock purchase agreement will be 1,159,552 shares (exclusive of the 53,138 shares issuable to Fusion Capital as the initial commitment fee and the 35,425 shares that are issuable to Fusion Capital as the additional commitment fee). Therefore, the selling price of our common stock to Fusion Capital will have to average at least $4.32 per share for us to receive the maximum proceeds of $5.0 million without registering additional shares of common stock. We have the right, but not the obligation, to register additional shares of our common stock. Assuming a purchase price of $3.87 per share (the closing sale price of the common stock on March 10, 2004) and the purchase by Fusion Capital of the full 1,159,552 shares under the common stock purchase agreement, proceeds to us would be $4,487,466. If we decided to sell and issue more than the 1,248,115 shares to Fusion Capital (19.99% of our outstanding shares as of February 25, 2004, the date of the common stock purchase agreement), we would first be required to seek stockholder approval of the common stock purchase agreement in order to be in compliance with the American Stock Exchange rules. We may, but shall be under no obligation to, request our stockholders to approve the transaction contemplated by the common stock purchase agreement.

Purchase of Shares Under the Common Stock Purchase Agreement

Under the common stock purchase agreement, on each trading day, Fusion Capital is obligated to purchase a specified dollar amount of our common stock. Subject to our right to suspend such purchases at any time, and our right to terminate the agreement with Fusion Capital at any time, each as described below, Fusion Capital will purchase on each trading day during the term of the agreement $12,500 of our common stock. This daily purchase amount may be decreased by us at any time. We also have the right to increase the daily purchase amount at any time, provided however, we may not increase the daily purchase above $12,500 unless our stock price is above $4.50 per share for 10 consecutive trading days and provided that the closing sale price of our stock remains at least $4.50. The purchase price per share is equal to the lesser of:

- the lowest sale price of our common stock on the purchase date; or

- the average of the three (3) lowest closing sale prices of our common stock, during the twelve (12) consecutive trading days prior to the date of a purchase by Fusion Capital.

The purchase price will be adjusted for any reorganization, recapitalization, non-cash dividend, stock split, or other similar transaction occurring during the trading days in which the closing sales price is used to compute the purchase price. Fusion Capital may not purchase shares of our common stock under the common stock purchase agreement if Fusion Capital, together with its affiliates, would beneficially own more than 9.9% of our common stock outstanding at the time of purchase by Fusion

Capital. However, even though Fusion Capital may not receive additional shares of our common stock in the event that the 9.9% limitation is ever reached, Fusion Capital is still obligated to pay up to $12,500 on each trading day, unless the common stock purchase agreement is suspended, an event of default occurs or the agreement is terminated. Under these circumstances, Fusion Capital would have the right to acquire additional shares in the future should its ownership subsequently become less than 9.9%. Fusion Capital has the right at any time to sell any shares purchased under the common stock purchase agreement which would allow it to avoid the 9.9% limitation. Therefore, we do not believe that the percentage of our outstanding common stock owned by Fusion Capital will ever reach the 9.9% limitation.

The following table sets forth the amount of proceeds we would receive from Fusion Capital from the sale of shares of our common stock offered by this Prospectus:

Assumed Average Purchase Price	Number of Shares to be Issued if Full Amount Purchased	Percentage Outstanding After Giving Effect to the Issuance to Fusion Capital(1)	Proceeds from the Sale of Shares to Fusion Capital
$ 1.50	1,159,552	15.5%	$ 1,739,328
$ 3.87(2)	1,159,552	15.5%	$ 4,487,466
$ 5.00	1,000,000	13.6%	$ 5,000,000
$ 10.00	500,000	7.3%	$ 5,000,000

(1) Based on 6,332,260 shares outstanding as of March 10, 2004. Includes 53,138 shares of common stock issuable to Fusion Capital as a commitment fee, the 35,425 shares of common stock that will be issued to Fusion Capital as a commitment fee and the number of shares issuable at the corresponding assumed purchase price set forth in the adjacent column.

(2) Closing sale price of our common stock on March 10, 2004.

We estimate that we will issue no more than 1,248,115 shares to Fusion Capital under the common stock purchase agreement, including the shares issuable as a commitment fee, all of which are included in this offering. We have the right to terminate the agreement without any payment or liability to Fusion Capital at any time, including in the event that more than 1,248,115 shares are issuable to Fusion Capital under the common stock purchase agreement.

Minimum Purchase Price

We have the right to set a minimum purchase price ("floor price") at any time. Currently, the floor price is set at $3.00. We can increase or decrease the floor price at any time upon one trading day prior notice to Fusion Capital. However, the floor price may not be less than $1.00. Fusion Capital does not have the right or the obligation to purchase any shares of our common stock in the event that the purchase price is less than the then applicable floor price.

Our Right to Suspend Purchases

We have the unconditional right to suspend purchases at any time for any reason effective upon one trading day's notice. Any suspension would remain in effect until our revocation of the suspension. To the extent we need to use the cash proceeds of the sales of common stock under the common stock purchase agreement for working capital purposes or other business purposes, we do not intend to restrict purchases under the common stock purchase agreement.

Our Right to Increase and Decrease the Daily Purchase Amount

Under the common stock purchase agreement Fusion Capital has agreed to purchase on each trading day during the 20 month term of the agreement, $12,500 of our common stock, or an aggregate of $5.0 million of our common stock. We have the unconditional right to decrease the daily amount to be purchased by Fusion Capital at any time for any reason effective upon one trading day's notice. We also have the right to increase the daily purchase amount at any time for any reason as the market price of our common stock increases. Specifically, for every $0.25 increase in Threshold Price above $4.50 (subject to equitable adjustment for any reorganization, recapitalization, non-cash dividend, stock split or other similar transaction), we have the right to increase the daily purchase amount by up to an additional $2,500. For example, if the Threshold Price is $5.00 we would have the right to increase the daily purchase amount up to an aggregate of $17,500. By way of another example, if the Threshold Price is $5.50, we would have the right to increase the daily purchase amount up to an aggregate of $22,500. The "Threshold Price" is the lowest sale price of our common stock during the five (5) trading days immediately preceding our notice to Fusion Capital to increase the daily purchase amount. This notice becomes effective five (5) trading days after receipt by Fusion Capital. If at any time during any trading day the sale price of our common stock is below the Threshold Price, the applicable increase in the daily purchase amount will be void and Fusion Capital's obligations to purchase shares of our common stock in excess of the applicable daily purchase amount will be terminated.

Our Termination Rights

We have the unconditional right at any time for any reason to give notice to Fusion Capital terminating the common stock purchase agreement. This notice shall be effective one trading day after Fusion Capital receives such notice.

Effect of Performance of the Common Stock Purchase Agreement on our Stockholders

All shares registered in this offering will be freely tradable. It is anticipated that shares registered in this offering will be sold over a period of up to 20 months from the date of this Prospectus. The sale of a significant amount of shares registered in this offering at any given time could cause the trading price of our common stock to decline and to be highly volatile. Fusion Capital may ultimately purchase all of the shares of common stock issuable under the common stock purchase agreement, and it may sell some, none or all of the shares of common stock it acquires upon purchase. Therefore, the purchases under the common stock purchase agreement may result in substantial dilution to the interests of other holders of our common stock. However, we have the right at any time for any reason to: (1) reduce the daily purchase amount, (2) suspend purchases of the common stock by Fusion Capital and (3) terminate the common stock purchase agreement.

Principal Market Requirements

In order to satisfy any principal securities or market requirements, we cannot without the approval of our stockholders, issue shares of our common stock to Fusion Capital under the common stock purchase agreement in excess of 19.99% of the outstanding shares of our common stock as of the date of the common stock purchase agreement.

No Short-Selling or Hedging by Fusion Capital

Fusion Capital has agreed that neither it nor any of its affiliates, agents or representatives will cause or engage in any direct or indirect short-selling or hedging of our common stock during any time prior to the termination of the common stock purchase agreement.

Events of Default

Fusion Capital may terminate the common stock purchase agreement without any liability or payment to us upon the occurrence of any of the following events of default:

- the effectiveness of the registration statement of which this Prospectus is a part lapses for any reason (including, without limitation, the issuance of a stop order) or is unavailable to Fusion Capital for sale of our common stock offered hereby and such lapse or unavailability continues for a period of (ten) 10 consecutive trading days or for more than an aggregate of thirty (30) trading days in any 365-day period;

suspension by our principal market, the American Stock Exchange, of our common stock from trading for a period of three consecutive trading days;

our common stock is delisted from the American Stock Exchange, our principal market, and is not immediately thereafter trading on the New York Stock Exchange, the Nasdaq National Market, the Nasdaq Small Cap Market or the Nasdaq OTC Bulletin Board;

the transfer agent's failure for five (5) trading days to issue to Fusion Capital shares of our common stock which Fusion Capital is entitled to under the common stock purchase agreement;

if at any time the issuance of shares of our common stock to Fusion Capital would exceed the number of shares of our common stock that we may issue without breaching the rules or regulations of our principal market;

any breach of the representations or warranties or covenants contained in the common stock purchase agreement or any related agreements which has or which could have a material adverse affect on us, Fusion Capital or the value of our common shares subject to a cure period of ten (10) days;

a default by us of any payment obligation in excess of $1.0 million; or

our insolvency or our participation or threatened participation in any insolvency or bankruptcy proceedings by or against us.

Commitment Shares Issued to Fusion Capital

Under the terms of the common stock purchase agreement Fusion Capital is entitled to receive 88,563 shares of our common stock as a commitment fee. 53,138 shares are issuable to Fusion Capital as the initial commitment fee and the remaining 35,425 shares will be issued on a pro rata basis during the twenty (20) month period as purchases are made. Unless an event of default occurs, Fusion Capital must hold these shares until twenty (20) months from the date of the common stock purchase agreement or the date the common stock purchase agreement is terminated.

No Variable Priced Financings

Until the termination of the common stock purchase agreement, we have agreed not to issue, or enter into any agreement with respect to the issuance of, any floating conversion rate or variable priced equity or floating conversion rate or variable priced equity-like securities.

Expense Reimbursement

We have paid Fusion Capital $35,000 as the full and complete expense reimbursement of Fusion Capital's expenses in connection with entering into the transaction. Such amount included payment of Fusion Capital's due diligence expenses and legal fees.

Our Option for a Second Tranche

Under the common stock purchase agreement, we may in our sole discretion, twenty (20) days after the completion of the purchase of an aggregate of $5.0 million in shares of our common stock by Fusion Capital, deliver an irrevocable written notice to Fusion Capital to enter into an additional common stock purchase agreement with Fusion Capital for the purchase of $5.0 million of additional shares of our common stock. The terms and conditions of the second common stock purchase agreement shall be in form and substance identical in all respects to the initial agreement provided that the second common stock purchase agreement will not have an option for an additional tranche.

Selling Stockholder

The following table presents information regarding the selling stockholder. Neither the selling stockholder nor any of its affiliates has held a position or office, or had any other material relationship, with us.

Selling Stockholder	Shares Beneficially Owned Before Offering	Percentage of Outstanding Shares Beneficially Owned Before Offering(1)	Shares to be Sold in the Offering	Percentage of Outstanding Shares Beneficially Owned After Offering
Fusion Capital Fund II, LLC(1)(2)	53,138	0.84%	1,248,115	0%

(1) As of the date hereof, 53,138 shares of our common stock are issuable to Fusion Capital as the initial commitment fee and Fusion Capital has the right to acquire an additional 35,425 shares of our common stock as an additional commitment fee under the common stock purchase agreement. Fusion Capital may acquire up to an additional 1,159,552 shares under the common stock purchase agreement. Percentage of outstanding shares is based on 6,296,835 shares of common stock outstanding as of March 10, 2004, including such initial commitment fee, but excluding the additional 1,194,927 shares of common stock that may be acquired by Fusion Capital from us under the common stock purchase agreement after the date hereof. Fusion Capital may not purchase shares of our common stock under the common stock purchase agreement if Fusion Capital, together with its affiliates, would beneficially own more than 9.9% of our common stock outstanding at the time of the purchase by Fusion Capital; provided, however, that this limitation does not affect Fusion Capital's obligation to purchase shares in accordance with the terms of the common stock purchase agreement. Fusion Capital has the right at any time to sell any shares purchased under the common stock purchase agreement which would allow it to avoid the 9.9% limitation. Therefore, we do not believe that the percentage of our outstanding common stock owned by Fusion Capital will ever reach the 9.9% limitation.

(2) Steven G. Martin and Joshua B. Scheinfeld, the principals of Fusion Capital, are deemed to be beneficial owners of all of the shares of common stock owned by Fusion Capital. Messrs. Martin and Scheinfeld have shared voting and dispositive power over the shares being offered under this Prospectus.

Plan of Distribution

The common stock offered by this Prospectus is being offered by Fusion Capital Fund II, LLC, the selling stockholder. The common stock may be sold or distributed from time to time by the selling stockholder directly to one or more purchasers or through brokers, dealers, or underwriters who may act solely as agents at market prices prevailing at the time of sale, at prices related to the prevailing

market prices, at negotiated prices, or at fixed prices, which may be changed. The sale of the common stock offered by this Prospectus may be effected in one or more of the following methods:

- ordinary brokers' transactions;
- transactions involving cross or block trades;
- through brokers, dealers, or underwriters who may act solely as agents;
- "at the market" into an existing market for the common stock;
- in other ways not involving market makers or established trading markets, including direct sales to purchasers or sales effected through agents;

in privately negotiated transactions; or

any combination of the foregoing.

In order to comply with the securities laws of certain states, if applicable, the shares may be sold only through registered or licensed brokers or dealers. In addition, in certain states, the shares may not be sold unless they have been registered or qualified for sale in the state or an exemption from the registration or qualification requirement is available and complied with.

Brokers, dealers, underwriters, or agents participating in the distribution of the shares as agents may receive compensation in the form of commissions, discounts, or concessions from the selling stockholder and/or purchasers of the common stock for whom the broker-dealers may act as agent. The compensation paid to a particular broker-dealer may be less than or in excess of customary commissions.

Fusion Capital is an "underwriter" within the meaning of the Securities Act.

Neither we nor Fusion Capital can presently estimate the amount of compensation that any agent will receive. We know of no existing arrangements between Fusion Capital, any other stockholder, broker, dealer, underwriter, or agent relating to the sale or distribution of the shares offered by this Prospectus. At the time a particular offer of shares is made, a prospectus supplement, if required, will be distributed that will set forth the names of any agents, underwriters, or dealers and any compensation from the selling stockholder and any other required information.

We will pay all of the expenses incident to the registration, offering, and sale of the shares to the public other than commissions or discounts of underwriters, broker-dealers, or agents. We have also agreed to indemnify Fusion Capital and related persons against specified liabilities, including liabilities under the Securities Act.

Insofar as indemnification for liabilities arising under the Securities Act may be permitted to our directors, officers, and controlling persons, we have been advised that in the opinion of the SEC this indemnification is against public policy as expressed in the Securities Act and is therefore, unenforceable.

Fusion Capital and its affiliates have agreed not to engage in any direct or indirect short selling or hedging of our common stock during the term of the common stock purchase agreement.

We have advised Fusion Capital that while it is engaged in a distribution of the shares included in this Prospectus it is required to comply with Regulation M promulgated under the Securities Exchange Act of 1934, as amended. With certain exceptions, Regulation M precludes the selling stockholder, any affiliated purchasers, and any broker-dealer or other person who participates in the distribution from bidding for or purchasing, or attempting to induce any person to bid for or purchase any security which is the subject of the distribution until the entire distribution is complete. Regulation M also prohibits any bids or purchases made in order to stabilize the price of a security in connection with the

distribution of that security. All of the foregoing may affect the marketability of the shares offered by this Prospectus.

This offering will terminate on the date that all shares offered by this Prospectus have been sold by Fusion Capital.

Legal Matters

The validity of the common stock offered by this Prospectus will be passed upon for us by Seyfarth Shaw LLP, Chicago, Illinois. Allan J. Reich, one of the partners of the law firm of Seyfarth Shaw LLP is the owner of 15,000 shares of our common stock. The interests in our common stock of the other attorneys at Seyfarth Shaw LLP participating in such matter are immaterial.

Experts

The financial statements of Competitive Technologies, Inc. as of July 31, 2003 and for the year ended July 31, 2003, included in this Prospectus have been so included in reliance on the report of BDO Seidman, LLP, independent certified public accountants, given on the authority of said firm as experts in auditing and accounting. The audit report of BDO Seidman, LLP covering the July 31, 2003 financial statements contains an explanatory paragraph that states that CTT's recurring losses and negative cash flow from operations raise substantial doubt about CTT's ability to continue as a going concern. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

The financial statements of Competitive Technologies, Inc. as of July 31, 2002 and for the years ended July 31, 2002 and 2001 included in this prospectus have been so included in reliance on the reports of PricewaterhouseCoopers LLP, independent accountants, given on the authority of said firm as experts in auditing and accounting.

Where You Can Find More Information

CTT has filed a Registration Statement on Form S-1 with the SEC. This Prospectus, which forms a part of the Registration Statement, does not contain all of the information included in the Registration Statement. Some information is omitted from this Prospectus in accordance with the rules of the SEC and you should refer to the Registration Statement and its exhibits for additional information. Our internet website address is *www.competitivetech.net*. The contents of our website are not part of this Registration and our Internet address is included in this document as an inactive textual reference only. Our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, any amendments to those reports filed by us with the SEC pursuant to Sections 13(a) and 15(d) of the Securities Exchange Act of 1934, as amended, are accessible free of charge through our website as soon as reasonably practicable after we electronically file those documents with, or otherwise furnish them to, the SEC. The public may read and copy any materials we file with the SEC at the SEC's Public Reference Room at 450 Fifth Street, N.W., Washington, D.C. 20549 and at the SEC's regional offices in Chicago, Illinois and New York, New York. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. Our filings with the SEC are also available to the public on the SEC's Internet web site at *http://www.sec.gov*.

You should rely only on the information contained in this Prospectus. Neither CTT nor the selling shareholder has authorized anyone to provide you with any information that is different from that contained in this Prospectus. The information contained in this Prospectus is accurate as of the date of this Prospectus. You should not assume that there have been no changes in the affairs of CTT since the date of this Prospectus or that the information in this Prospectus is correct as of any time after the date of this Prospectus, regardless of the time that this Prospectus is delivered or any sale of the common stock offered by this Prospectus is made. This Prospectus is not an offer to sell or a solicitation of an offer to buy the shares covered by this Prospectus in any jurisdiction where the offer or solicitation is unlawful.

Competitive Technologies, Inc.
Index to Financial Statements

Report of Independent Certified Public Accountants

To the Board of Directors and Stockholders of
Competitive Technologies, Inc.
Fairfield, Connecticut

We have audited the accompanying consolidated balance sheet of Competitive Technologies, Inc. and Subsidiaries as of July 31, 2003 and the related consolidated statements of operations, changes in shareholders' interest and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatements. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Competitive Technologies, Inc. and Subsidiaries as of July 31, 2003, and the results of their operations and their cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 1 to the financial statements, the Company has suffered recurring losses and negative cash flow from operations that raise substantial doubt about its ability to continue as a going concern. Management's plans in regard to these matters are also described in Note 1. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

/s/ BDO SEIDMAN, LLP

BDO Seidman, LLP

Valhalla, New York
October 10, 2003, except for
Note 18, for which the date is
October 27, 2003

REPORT OF INDEPENDENT AUDITORS

To the Board of Directors and Shareholders
of Competitive Technologies, Inc.:

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of Competitive Technologies, Inc. and its Subsidiaries (the "Company") at July 31, 2002 and the results of their operations and their cash flows for each of the two years in the period ended July 31, 2002 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

/s/ PRICEWATERHOUSECOOPERS LLP
Stamford, Connecticut
October 28, 2002

COMPETITIVE TECHNOLOGIES, INC. AND SUBSIDIARIES
Consolidated Balance Sheets
July 31, 2003 and 2002

	2003	2002
ASSETS		
Current assets:		
Cash and cash equivalents	$ 1,404,615	$ 750,421
Short-term investments	99,680	2,136,874
Accounts receivable	957,275	1,199,483
Notes receivable E. L. Specialists, Inc.		200,000
Prepaid expenses and other current assets	275,019	261,198
Total current assets	2,736,589	4,547,976
Property and equipment, at cost, net	29,834	42,877
Investments, at cost	43,356	1,075,684
Intangible assets acquired, net	142,722	733,246
TOTAL ASSETS	$ 2,952,501	$ 6,399,783
LIABILITIES AND SHAREHOLDERS' INTEREST		
Current liabilities:		
Accounts payable	$ 501,655	$ 1,726,237
Accrued liabilities	1,281,419	1,680,903
Total current liabilities	1,783,074	3,407,140
Commitments and contingencies		
Shareholders' interest:		
5% preferred stock, $25 par value; 35,920 shares authorized; 2,427 shares issued and outstanding	60,675	60,675
Common stock, $.01 par value; 20,000,000 shares authorized; 6,201,345 and 6,190,785 shares issued in 2003 and 2002, respectively, and 6,201,345 and 6,154,351 shares outstanding in 2003 and 2002, respectively	62,013	61,907
Capital in excess of par value	26,747,229	26,893,287
Treasury stock, at cost; 36,434 shares in 2002		(258,037)
Accumulated deficit	(25,700,490)	(23,765,189)
Total shareholders' interest	1,169,427	2,992,643
TOTAL LIABILITIES AND SHAREHOLDERS' INTEREST	$ 2,952,501	$ 6,399,783

See accompanying notes

COMPETITIVE TECHNOLOGIES, INC. AND SUBSIDIARIES
Consolidated Statements of Operations
For the years ended July 31, 2003, 2002 and 2001

	2003	2002	2001
Revenues:			
Retained royalties	$ 2,692,933	$ 2,570,931	$ 3,637,764
Retained royalty settlement	600,000		
Other revenues		25,000	3,520
	3,292,933	2,595,931	3,641,284
Patent enforcement expenses, net of reimbursements	425,790	2,132,090	2,474,017
Personnel and other direct expenses relating to revenue, of which $6,122, $124,073 and $145,673 were to related parties in 2003, 2002 and 2001, respectively	3,417,909	2,241,439	1,842,998
General and administrative expenses	2,050,652	1,501,287	1,556,630
Reversal of accounts payable exchanged for contingent note payable	(1,583,445)		
	4,310,906	5,874,816	5,873,645
Operating loss	(1,017,973)	(3,278,885)	(2,232,361)
Other expense, net	(917,328)	(737,543)	(268,388)
Net loss	$ (1,935,301)	$ (4,016,428)	$ (2,500,749)
Net loss per share:			
Basic and diluted	$ (0.31)	$ (0.65)	$ (0.41)
Weighted average number of common shares outstanding:			
Basic and diluted	6,182,657	6,148,022	6,135,486

See accompanying notes

COMPETITIVE TECHNOLOGIES, INC. AND SUBSIDIARIES
Consolidated Statements of Changes in Shareholders' Interest
For the years ended July 31, 2003, 2002 and 2001

	Preferred Stock		Common Stock			Treasury Stock		
	Shares issued and outstanding	Amount	Shares issued	Amount	Capital in excess of par value	Shares held	Amount	Accumulated Deficit

	Preferred Stock		Common Stock			Treasury Stock		
Balance July 31, 2000	2,427	$ 60,675	6,190,785	$ 61,907	$ 27,053,542		$	$ (17,248,012)
Exercise of common stock options					(5,208)	3,250	26,333	
Stock issued under 1996 Directors' Stock Participation Plan					(25,849)	11,540	100,849	
Stock issued to directors					(2,073)	2,898	25,620	
Stock issued under Employees' Common Stock Retirement Plan					(42,138)	14,814	122,138	
Stock issued to employee in lieu of cash compensation					(3,096)	2,564	23,096	
Purchase of treasury stock						(86,500)	(679,289)	
Net loss								(2,500,749)
Balance July 31, 2001	2,427	60,675	6,190,785	61,907	26,975,178	(51,434)	(381,253)	(19,748,761)
Stock issued under 1996 Directors' Stock Participation Plan					(81,891)	15,000	123,216	
Net loss								(4,016,428)
Balance July 31, 2002	2,427	60,675	6,190,785	61,907	26,893,287	(36,434)	(258,037)	(23,765,189)
Stock issued under 1996 Directors' Stock Participation Plan			10,560	106	1,814	4,440	30,181	
Stock issued under 401(k) Plan					(147,872)	31,994	227,856	
Net loss								(1,935,301)
Balance July 31, 2003	2,427	$ 60,675	6,201,345	$ 62,013	$ 26,747,229		$	$ (25,700,490)

See accompanying notes

COMPETITIVE TECHNOLOGIES, INC. AND SUBSIDIARIES
Consolidated Statements of Cash Flows
For the years ended July 31, 2003, 2002 and 2001

	2003	2002	2001
Cash flows from operating activities:			
Net loss	$ (1,935,301)	$ (4,016,428)	$ (2,500,749)
Noncash items included in net loss:			
Reversal of accounts payable exchanged for contingent note payable	(1,583,445)		
Depreciation and amortization	187,787	193,775	214,768
Impairment of intangible assets	482,247	156,080	
Minority interest		26,936	15,982
Stock compensation	123,350	121,325	207,298
Other, net	311	(25,624)	
Impairment losses on investments and advances	943,640	810,326	600,000
Net changes in operating accounts:			
Accounts receivable	242,208	1,604,391	(362,096)

	2003	2002	2001
Prepaid expenses and other current assets	(13,821)	(191,154)	79,439
Accounts payable and accrued liabilities	(51,886)	(345,987)	1,498,524
Net cash flows from operating activities	(1,604,910)	(1,666,360)	(246,834)

(continued)
See accompanying notes

COMPETITIVE TECHNOLOGIES, INC. AND SUBSIDIARIES
Consolidated Statements of Cash Flows
For the years ended July 31, 2003, 2002 and 2001
(Continued)

	2003	2002	2001
Cash flows from investing activities:			
Purchases of property and equipment, net	(16,467)	(30,986)	(27,572)
Purchase of intangible assets	(50,000)		
Proceeds from NTRU Cryptosystems, Inc. preferred stock	88,377		
Investments in cost-method affiliates		(100,000)	(100,000)
Proceeds from (advances to) E. L. Specialists, Inc.	200,000	(306,300)	(650,000)
Sales of short-term investments	2,037,194	2,656,567	206,613
Other		(26,936)	(15,982)
Net cash flows from investing activities	2,259,104	2,192,345	(586,941)
Cash flows from financing activities:			
Proceeds from exercise of stock options and warrants			21,125
Purchases of treasury stock			(679,289)
Net cash flows from financing activities			(658,164)
Net increase (decrease) in cash and cash equivalents	654,194	525,985	(1,491,939)
Cash and cash equivalents, beginning of year	750,421	224,436	1,716,375
Cash and cash equivalents, end of year	$ 1,404,615	$ 750,421	$ 224,436

See accompanying notes

COMPETITIVE TECHNOLOGIES, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements

1.
BUSINESS

Competitive Technologies, Inc. (CTT) and its majority owned subsidiaries (the Company) provide patent and technology licensing and commercialization services throughout the world (with concentrations in U.S.A., Europe and Asia) with respect to a broad range of life, digital, physical, and nano science technologies originally invented by various individuals, corporations and universities. The Company is compensated for its services primarily by sharing in the license and royalty fees generated from its successful licensing of technologies.

Capital Requirements, Management's Plans and Basis of Presentation

The accompanying consolidated financial statements have been prepared on a going concern basis, which contemplates continuity of operations, realization of assets and liquidation of liabilities in the ordinary course of business. The Company incurred a net loss of $1,935,301 and negative cash flows from operations of $1,604,910 for the fiscal year ended July 31, 2003 and has an accumulated deficit of $25,700,490 at July 31, 2003. The Company's net working capital declined $187,321 in fiscal 2003. At July 31, 2003, the Company's cash, cash equivalents and short-term investments of $1,504,295 were $1,383,000 lower than at July 31, 2002.

The Company has incurred substantial operating and net losses in the three years ending July 31, 2003. Net patent enforcement expenses related to the Fujitsu and LabCorp litigations have been substantial. During fiscal 2003, the Company has focused its efforts and resources on increasing revenues to replace revenues from expiring licenses; however, these efforts and resources have not yet increased revenues sufficiently. In addition, the Company has incurred $494,000 cumulatively through July 31, 2003 for professional advice related to the ongoing SEC investigation (see Note 16 to Consolidated Financial Statements).

The amounts and timing of the Company's future capital requirements will depend on many factors, including the results of the Materna , Fujitsu and LabCorp lawsuits (see Note 16 to Consolidated Financial Statements), the Company's marketing efforts, the SEC investigation and the Company's fund raising efforts. To achieve profitability, the Company must successfully license technologies with current and long-term revenue streams substantially greater than its operating expenses. To sustain profitability, the Company must continually add such licenses. The time required to reach profitability is highly uncertain and we cannot assure you that the Company will be able to achieve profitability on a sustained basis, if at all.

Management has taken certain steps to reduce ongoing cash operating expenses (including fourth quarter fiscal 2003 staff reductions), to defer payment of certain liabilities, to make payment of certain obligations contingent upon receipt of revenues, and to sell additional portions of its share of the potential Materna award. In addition to seeking debt and/or equity funding, we also seek to increase our cash resources by obtaining substantial up-front license fees in potential new licenses, by collecting additional amounts we believe are due to us and by selling future royalty streams from our portfolio. We cannot predict when we might receive our anticipated approximately $4,710,000 potential award (which is net of the $1,290,000 sold to LawFinance). While receipt of that award would satisfy our cash requirements and fund our current level of operations until we believe we could generate revenues to sustain our operations, we cannot rely on it for our current cash requirements.

If we do not obtain sufficient additional cash resources in the next several months, management plans additional cash expense reductions sufficient to sustain the Company until it obtains additional cash from revenues, potential litigation awards or other funding sources. Under this plan, the Company will implement further cost reductions and cost containment actions to reduce operating costs.

However, royalty revenues, obtaining rights to new technologies, granting licenses, and enforcing intellectual property rights are subject to many factors outside our control or that we cannot currently anticipate. If these reductions are insufficient or if our efforts do not generate sufficient cash, management would make further necessary reductions that could affect our ability to achieve our growth strategy. Although we cannot assure you that we will be successful in these efforts, management believes that its plan will sustain the Company at least into fiscal 2005. If the Company is unsuccessful at its plans to raise funding as described above, it is unlikely we will continue as a going concern.

2. *SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES*

Principles of Consolidation

The consolidated financial statements include the accounts of the Company. CTT's majority-owned subsidiaries are Digital Acorns, Inc., University Optical Products Co. (UOP), Genetic Technology Management, Inc. (GTM) and Vector Vision, Inc. (VVI). Intercompany accounts and transactions have been eliminated in consolidation.

Management Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The Company's more significant estimates include the future cash flows used in evaluating intangible assets for potential impairment and the remaining useful lives of long-lived and intangible assets. Actual results could differ from those estimates.

Reclassifications

Certain amounts, including operating expenses, have been reclassified to conform with the presentation in financial statements for fiscal 2003.

Revenue Recognition

The Company derives revenues primarily from patent and technology license and royalty fees. Since these revenues result from the Company's representation agreements with owners and assignees of intellectual property rights, the Company records revenues net of the owners' and assignees' shares of license and royalty fees. The Company stipulates the terms of its licensing arrangements in its written agreements with the owners, assignees and licensees. Generally these arrangements are single element arrangements since the Company has no significant obligations after executing the license agreements.

Under the terms of the Company's license arrangements, the Company generally receives an upfront license fee and a royalty stream based on the licensee's sales of the licensed technology.

License Fees

The Company recognizes upfront, nonrefundable license fees upon execution of the license arrangement and collection of the license fee. Upon the occurrence of these two events, the Company has persuasive evidence of an arrangement, delivery is complete, collectibility is assured and there are no continuing obligations.

Royalty Fees

Although the royalty rate is fixed in the license agreement, the amount of earned royalties is contingent upon the amount of product the licensee sells. Royalties earned in each reporting period are contingent on the outcome of events occurring within that period and such events are not within the control of the Company and are not directly tied to the Company's providing service. Therefore, the Company recognizes royalty fee revenue when the contingency is resolved and it can estimate the amount of royalty fees, which is upon receipt of licensees' royalty reports.

In limited instances, the Company enters into multiple element arrangements with continuing service obligations or milestone billing arrangements. Based upon the limited verifiable objective evidence available, the Company generally defers all revenue from such multiple element arrangements until it delivers all elements. The Company evaluates milestone billing arrangements on a case by case basis. Generally, the Company recognizes these revenues under the milestone payment method. Under this method, the Company recognizes upfront fees ratably over the entire arrangement and milestone payments as it achieves milestones.

Expenses

The Company recognizes expenses related to evaluating, patenting and licensing inventions and enforcing intellectual property rights in the period incurred.

Patent enforcement expenses include direct costs incurred to enforce the Company's patent rights but exclude personnel costs.

Personnel and other direct expenses relating to revenue include: employee salaries and benefits; marketing and consulting expenses related to technologies and specific revenue initiatives; domestic and foreign patent legal filing, prosecution and maintenance expenses (net of reimbursements); amortization and impairment of intangible assets acquired; and commissions and other direct costs relating to revenue.

General and administrative expenses include directors' fees and expenses, public company expenses, professional service expenses (including corporate legal, litigation, financing and audit), rent and other general business and operating expenses.

Cash Equivalents and Short-Term Investments

The Company classifies overnight bank deposits as cash equivalents. The Company classifies all highly liquid investments other than overnight deposits as short-term investments. Cash equivalents and short-term investments are carried at fair value. The Company's bank and investment accounts are maintained with one financial institution; amounts on deposit exceed the FDIC insurance limit. The Company's policy is to monitor the financial strength of this institution on an ongoing basis.

Property and Equipment

The costs of depreciable assets are charged to operations on a straight-line basis over their estimated useful lives (3 to 5 years for equipment) or the terms of the related lease for leasehold improvements. The cost and related accumulated depreciation or amortization of property and equipment are removed from the accounts upon retirement or other disposition; any resulting gain or loss is reflected in earnings.

Intangible Assets Acquired

Intangible assets acquired comprise certain licenses and patented technologies acquired in 1996 and 2003 and recorded at the lower of cost or fair value. That value is amortized on a straight-line basis over their estimated remaining lives.

Income Taxes

Deferred income taxes are recognized for future tax consequences of differences between the tax bases of assets and liabilities and their financial reporting amounts at each balance sheet date based on enacted tax laws and statutory tax rates applicable to the periods in which the differences are expected to affect taxable income. Valuation allowances are established when necessary to reduce deferred tax assets to the amount expected to be realized. Provision for income taxes is the tax payable for the year and the change during the year in deferred tax assets and liabilities.

Net Income (Loss) Per Share

Basic earnings per share is computed based on the weighted average number of common shares outstanding without giving any effect to potentially dilutive securities. Diluted earnings per share is computed giving effect to all potentially dilutive securities outstanding during the period.

Stock-Based Compensation

The Company accounts for its stock-based compensation at its intrinsic value under Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," and related Interpretations. Accordingly, the Company has recognized no compensation expense for options granted under its employees and directors stock option plans since the exercise price of all options granted under those plans was at least the market value of the underlying common stock on the grant date.

If CTT had determined compensation expense for its option grants under its employees and directors stock option plans using the fair value method of Financial Accounting Standards Board Statement No. 123, "Accounting for Stock-Based Compensation," the Company's results would have been:

	For the years ended July 31,		
	2003	**2002**	**2001**
Net loss, as reported	$ (1,935,301)	$ (4,016,428)	$ (2,500,749)
Deduct total stock-based compensation determined under the fair value method, net of related tax effects	$ (222,855)	$ (135,373)	$ (303,058)

	For the years ended July 31,		
Pro forma net loss	$ (2,158,156)	$ (4,151,801)	$ (2,803,807)
Basic and fully diluted losses per share:			
As reported	$ (0.31)	$ (0.65)	$ (0.41)
Pro forma	$ (0.35)	$ (0.68)	$ (0.46)

The fair value of each option grant was estimated on the grant date using the Black-Scholes option pricing model with the following weighted average assumptions:

	For the years ended July 31,		
	2003	2002	2001
Dividend yield	0.0%	0.0%	0.0%
Expected volatility	78.8%	79.1%	79.5%
Risk-free interest rates	3.8%	4.1%	5.2%
Expected lives	4 years	3 years	3 years

The pro forma information above may not be representative of pro forma fair value compensation effects in future years.

Impairment of Long-lived and Intangible Assets

The Company reviews long-lived and intangible assets for impairment when events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable. If the sum of expected future undiscounted cash flows is less than the carrying amount of the asset, the Company recognizes an impairment loss measured by the amount the asset's carrying value exceeds its fair value and re-evaluates the remaining useful life of the asset. If a quoted market price is available for the asset or a similar asset, the Company uses it in determining fair value. If not, the Company determines fair value as the present value of estimated cash flows based on reasonable and supportable assumptions.

Segment Information

The Company operates in a single reportable segment determined on the basis management uses to make operating decisions and assess performance.

Recently Issued Accounting Pronouncements

In June 2001, the Financial Accounting Standards Board (FASB) issued Statement No. 142, "Goodwill and Other Intangible Assets." This statement establishes financial accounting and reporting for acquired goodwill and other intangible assets acquired individually or with a group of other assets but not acquired in a business combination. The Company's adoption of this statement on August 1, 2002, did not have a material effect on its financial condition or results of operations.

In August 2001, the FASB issued Statement No. 144, "Accounting for the Impairment or Disposal of Long-lived Assets." This statement establishes a single accounting model for the impairment of long-lived assets. The Company has recognized impairment charges on investments in fiscal 2003 and 2002. However, the Company's adoption of this statement on August 1, 2002, did not affect the amount or timing of those impairment charges.

In June 2002, the FASB issued Statement No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." This statement addresses financial accounting and reporting for costs associated with exit or disposal activities and nullifies Emerging Issues Task Force Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." The provisions of this statement are effective for exit or disposal activities initiated after December 31, 2002. The Company's adoption of this Statement did not have a material effect on its financial condition or results of operations.

In December 2002, the FASB issued Statement No. 148, "Accounting for Stock-Based Compensation Transition and Disclosure." This statement amends Statement No. 123, "Accounting for Stock-Based Compensation," to provide alternative transition methods for a voluntary change to the fair value method of accounting for stock-based employee compensation. This statement also requires prominent disclosures in annual and interim financial statements about the method of accounting for stock-based employee compensation and its effect on reported results. The disclosure provisions of this statement were effective for the Company's third quarter ended April 30, 2003; the Company made these disclosures in "Stock Based Compensation" above.

3. *INVESTMENTS AND NOTES RECEIVABLE*

NTRU Cryptosystems, Inc.

In fiscal 2000, CTT acquired 3,172,881 shares of NTRU Cryptosystems, Inc. (NTRU) common and preferred stock in exchange for reducing its future royalty participation on NTRU's sales of CTT licensed products and $198,006 in cash. CTT recorded the exchange of its future royalty participation at the estimated fair value of 2,945,500 shares of NTRU common stock, $0.25 per share, as retained royalty settlement of $736,375. In August 2001, CTT acquired additional shares of NTRU Series B convertible preferred stock for $100,000 in cash.

CTT recorded an impairment of this investment in other expense of approximately $944,000 in its second quarter ended January 31, 2003 due to the uncertain timing and amount of CTT's expected future cash flows from its investment in NTRU's common stock after NTRU's recapitalization.

In April 2003, NTRU redeemed all outstanding shares of its Series A and Series B Preferred Stock (NTRU Preferred Stock) in exchange for cash or NTRU common stock. CTT exchanged its NTRU Preferred Stock for $88,377 in cash and 76,509 shares of NTRU common stock.

CTT currently owns 3,129,509 shares of NTRU common stock, including 76,509 shares received in April 2003 (approximately 10% of NTRU's outstanding common stock.)

At July 31, 2003 and 2002, CTT's carrying value for this investment was $2,364 and $1,034,381, respectively. CTT accounts for this investment on the cost method.

CTT continues to hold a seat and participate actively on NTRU's Board of Directors. CTT's management continues to believe NTRU's encryption technology has value and these actions provide NTRU an opportunity to allow applications to evolve to meet its customers' needs.

Micro-ASI, Inc.

In April 2000, CTT paid $500,000 for 500,000 shares of convertible preferred stock and warrants to purchase 300,000 shares of common stock at $1.00 per share of Micro-ASI, Inc. (Micro-ASI). In May 2001, CTT advanced $100,000 of secured bridge financing to Micro-ASI. Based on Micro-ASI's bankruptcy filing in August 2001, management determined that CTT's investment in and advance to Micro-ASI were impaired as of July 31, 2001, and recorded a $600,000 impairment charge in other expense. During fiscal 2002, CTT recovered $21,598 of its advance. CTT cannot predict the timing or amounts of additional potential recoveries; therefore CTT will record further recoveries, if any, when it can estimate their timing and amounts.

E. L. Specialists, Inc.

Through a series of bridge financing agreements, the Company loaned $1,056,300 ($956,300 in cash and $100,000 in services) to E. L. Specialists, Inc. (ELS).

The Company recorded an impairment loss in other expense on its loans to ELS of $781,924 in fiscal 2002 ($519,200 in the second quarter and $262,724 in the fourth quarter). (In addition, CTT previously charged against other revenues from ELS approximately $75,000 deemed uncollectible in fiscal 2002.)

Effective August 5, 2002, CTT sold and transferred all its interests related to ELS to MRM Acquisitions, LLC (MRM) for $200,000 cash. The transferred interests included CTT's notes receivable in the face amount of $1,056,300 (plus interest) from ELS, its related security interest in ELS's intellectual property, all its other interests under agreements in connection with its notes receivable from ELS and CTT's interest in a technology servicing agreement related to ELS's intellectual property.

4.
ACCOUNTS RECEIVABLE

Accounts receivable were:

	July 31, 2003	July 31, 2002
Royalties	$ 905,654	$ 1,158,685
Other	51,621	40,798
	$ 957,275	$ 1,199,483

5.
PREPAID EXPENSES AND OTHER CURRENT ASSETS

Prepaid expenses and other current assets were:

	July 31, 2003	July 31, 2002
Prepaid insurance	$ 184,950	$ 155,662
Other prepaid expenses and other current assets	90,069	105,536
	$ 275,019	$ 261,198

6.
PROPERTY AND EQUIPMENT

Property and equipment were:

	July 31, 2003	July 31, 2002
Equipment and furnishings	$ 170,160	$ 269,253
Leasehold improvements	59,860	59,860
	230,020	329,113
Accumulated depreciation and amortization	(200,186)	(286,236)
	$ 29,834	$ 42,877

Depreciation expense was $29,510, $55,103 and $76,096 in 2003, 2002 and 2001, respectively.

7.
INTANGIBLE ASSETS ACQUIRED

The Company purchased additional patent rights during fiscal 2003 for $50,000. These patent rights are being amortized on a straight line basis over their estimated remaining lives, approximately 17 years.

Certain of the Company's acquired licenses stopped producing revenues and certain of its acquired patents are no longer expected to generate revenues in the future. The Company reviewed all acquired intangible assets for impairment at each quarter end in fiscal 2003 and at July 31, 2002. For each technology, the Company compared the estimated future revenues with the then current carrying value. For those technologies with a carrying value greater than estimated future revenues, the Company recorded an impairment charge. The Company reported total impairment charges of $482,247 and $156,080 in personnel and other direct expenses relating to revenue in the fourth quarters of fiscal 2003 and 2002, respectively. The Company adjusted the amortization period after each impairment charge based upon the weighted average life of the remaining technologies, 2.5 years at July 31, 2003.

The Company reported amortization expense of $158,000 for fiscal 2003 and $139,000 for fiscal 2002 and 2001; it expects to record annual amortization expense of approximately $41,000 for fiscal 2004 and 2005, $22,000 for fiscal 2006 and $3,000 for fiscal 2007 and 2008.

	July 31, 2003	July 31, 2002
Intangible assets acquired, principally licenses and patented technologies, at cost	$ 1,687,067	$ 1,793,147
Impairment charge	(482,247)	(156,080)
	1,204,820	1,637,067
Accumulated amortization	(1,062,098)	(903,821)
	$ 142,722	$ 733,246

8.
ACCRUED LIABILITIES

Accrued liabilities were:

	July 31, 2003	July 31, 2002
Royalties payable	$ 854,616	$ 1,308,381
Accrued professional fees	156,840	65,162
Accrued compensation	217,952	157,416
Deferred revenues		106,667
Other	52,011	43,277
	$ 1,281,419	$ 1,680,903

9.
INCOME TAXES

The income tax provision of $0 for each of 2003, 2002 and 2001 resulted from operating and capital loss carryforwards and providing a full valuation allowance against the Company's net deferred tax asset.

Components of the Company's net deferred tax assets were:

	July 31, 2003	July 31, 2002
Net operating loss carryforwards	$ 3,512,000	$ 2,670,000
Net capital loss carryforwards	567,000	586,000
Installment receivable from sale of discontinued operation	341,000	1,449,000
Impairment of investments	380,000	227,000

	July 31, 2003	July 31, 2002
Accounts payable		618,000
Impairment of receivables		305,000
Other, net	271,000	(13,000)
Deferred tax assets	5,071,000	5,842,000
Valuation allowance	(5,071,000)	(5,842,000)
Net deferred tax asset	$	$

At July 31, 2003, the Company had Federal net operating loss carryforwards of approximately $9,827,000, which expire from 2004 through 2023 ($157,000 in 2004, $57,000 in 2005, $2,000 in 2006, $767,000 in 2007, $65,000 in 2008, $459,000 in 2009, $182,000 in 2010, $677,000 in 2011, $1,171,000 in 2012, $618,000 in 2013, $2,000 in 2014, $1,891,000 in 2021, $1,262,000 in 2022 and $2,517,000 in 2023).

Changes in the valuation allowance were:

	2003	2002	2001
Balance, beginning of year	$ 5,842,000	$ 5,613,000	$ 6,078,000
Change in temporary differences	(1,593,000)	1,281,000	40,000
Change in net operating and capital losses	822,000	(1,052,000)	(505,000)
Balance, end of year	$ 5,071,000	$ 5,842,000	$ 5,613,000

The Company's ability to derive future tax benefits from the net deferred tax assets is uncertain and therefore it provided a full valuation allowance.

10.
SHAREHOLDERS' INTEREST

Preferred Stock

Dividends on preferred stock are noncumulative and preferred stock is redeemable at par value at CTT's option.

Treasury Stock

In October 1998, the Board of Directors authorized CTT to repurchase up to 250,000 shares of CTT's common stock. CTT could repurchase shares on the open market or in privately negotiated transactions at times and in amounts determined by management based on its evaluation of market and economic conditions. CTT repurchased 161,300 shares of its common stock for $1,065,214 during 1999, 2000 and 2001.

11.
STOCK-BASED COMPENSATION PLANS

Employee Stock Option Plans

CTT has a stock option plan that expired December 31, 2000. Under this plan both incentive stock options and nonqualified stock options were granted to key employees. Incentive stock options could be granted at an exercise price not less than the fair market value of the optioned stock on the grant date. Nonqualified stock options could be granted at an exercise price not less than 85% of the fair market value of the optioned stock on the grant date. Options generally vested over a period of up to three years after the grant date and expire ten years after the grant date if not terminated earlier. No option may be granted under this plan after December 31, 2000. The following information relates to this stock option plan.

	July 31, 2003	July 31, 2002
Common shares reserved for issuance on exercise of options	368,838	368,838
Shares available for future option grants	0	0

CTT may grant either incentive stock options or nonqualified options to employees under its 1997 Employees' Stock Option Plan as amended in January 2003. They may be granted at an option price not less than 100% of the fair market value of the stock at grant date. The Compensation Committee or the Board of Directors determines vesting provisions when options are granted. The maximum term

of any option under the 1997 option plan is ten years from the grant date. No options may be granted after September 30, 2007. The following information relates to the 1997 Employees' Stock Option Plan.

	July 31, 2003	July 31, 2002
Common shares reserved for issuance on exercise of options	975,777	825,777
Shares available for future option grants	406,752	244,252

2000 Directors Stock Option Plan

Under the 2000 Directors Stock Option Plan, CTT grants each non-employee director 10,000 fully vested nonqualified options when he or she is first elected as a director and on each January 1 he or she is a director. All such options are granted at an option price not less than 100% of the fair market value of the stock at grant date. The maximum term of any option under the 2000 option plan is ten years from the grant date. No options may be granted after January 1, 2010. The following information relates to the 2000 Directors Stock Option Plan.

	July 31, 2003	July 31, 2002
Common shares reserved for issuance on exercise of options	394,000	244,000
Shares available for future option grants	160,000	70,000

1996 Directors' Stock Participation Plan

Under the terms of the 1996 Directors' Stock Participation Plan which expires January 2, 2006, on the first business day of January each year, CTT shall issue to each outside director who has been elected by shareholders and served at least one year as a director the lesser of 2,500 shares of CTT's common stock or shares of CTT's common stock equal to $15,000 on the date such shares are issued. Should an eligible director terminate as a director before January 2, CTT shall issue such director a number of shares equal to the proportion of the year served by that director.

In 2003, 2002 and 2001, CTT issued 15,000, 15,000 and 11,540 shares of common stock, respectively, to eligible directors. (In 2001 CTT issued 2,898 additional shares to directors outside the 1996 Directors' Stock Participation Plan.) In 2003, 2002 and 2001, CTT charged to expense $23,350, $41,325 and $75,000, respectively, over the directors' respective periods of service. The following information relates to the

1996 Directors' Stock Participation Plan.

	July 31, 2003	July 31, 2002
Common shares reserved for future share issuances	23,579	38,579

Summary of Common Stock Options and Warrants

A summary of the status of all CTT's common stock options and warrants as of July 31, 2003, 2002 and 2001 and changes during the years then ended is presented below.

	For the years ended July 31,					
	2003		2002		2001	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding, beginning of year	940,267	$ 5.44	500,767	$ 7.48	480,517	$ 9.14
Granted	60,000	$ 2.14	452,500	$ 3.35	212,000	$ 7.29
Forfeited	(9,375)	$ 5.00		$	(1,750)	$ 7.22
Exercised				$	(3,250)	$ 6.50
Expired or terminated	(47,625)	$ 8.42	(13,000)	$ 11.41	(186,750)	$ 9.08
Outstanding, end of year	943,267	$ 5.08	940,267	$ 5.44	500,767	$ 7.48
Exercisable at year-end	646,092	$ 6.00	485,929	$ 7.22	377,704	$ 7.51
Weighted average fair value per share of grants during the year:						
At market		$ 0.72		$ 2.89		$ 2.49
Above market		$		$ 0.27		$

The following table summarizes information about all common stock options outstanding at July 31, 2003.

Range of Exercise Prices	Number Outstanding	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
$ 2.140-$ 2.150	360,000	8.79 years	$ 2.15	135,000	$ 2.15
$ 4.220-$ 6.875	337,567	5.97 years	$ 5.84	287,582	$ 5.95
$ 7.300-$ 8.813	188,000	5.42 years	$ 7.83	165,810	$ 7.83
$ 9.063-$11.094	57,700	3.14 years	$ 10.03	57,700	$ 10.03

Employees' Common Stock Retirement Plan

Effective August 1, 1990, CTT adopted an Employees' Common Stock Retirement Plan. For the fiscal year ended July 31, 2001, the Board authorized a contribution of 14,814 shares valued at approximately $80,000, based on the year-end closing price. CTT charged this amount to expense in 2001. The Employees' Common Stock Retirement Plan was merged into the Company's 401 (k) Plan effective January 31, 2003.

12. *401(k) PLAN*

Effective January 1, 1997, the Company established a 401(k) defined contribution plan for all employees meeting certain service requirements. All employees who have attained the age of 21 are eligible to participate in the 401(k) plan. Employee contributions for any calendar year are limited to a specific dollar amount determined by the Internal Revenue Service ($12,000 plus an additional $2,000 for participants over age 50 for 2003, $11,000 plus an additional $1,000 for participants over age 50 for 2002, and the lesser of 15% of their annual compensation or $10,500 for 2001). The Company may also make discretionary contributions. For the fiscal years ended July 31, 2003 and 2002, CTT's directors authorized discretionary contributions of $100,000 and $80,000, respectively, payable in the Company's common stock. CTT charged these amounts to expense in fiscal 2003 and 2002, respectively. CTT

contributed shares of Company common stock valued at $80,000 to the 401 (k) plan in December 2002. CTT expects to contribute shares of Company common stock valued at $100,000 to the 401 (k) plan during the second quarter of fiscal 2004. The Company has made no matching contributions.

13. *CONCENTRATIONS OF REVENUES*

All of the Company's royalty revenues derive from its patent rights to various technologies. Although patents may be declared invalid, may not issue on patent applications, or may be rendered uncommercial by new or alternative technologies, the Company is not aware of any such circumstances specific to its portfolio of licensed technologies. In addition, licensees may not develop products incorporating the Company's patented technologies or they may be unsuccessful in obtaining governmental approvals required to sell such products. In such cases, except for minimum fees provided in certain license agreements, royalty revenues generally would not accrue to the Company.

Approximately $2,339,000 (71%) of the Company's 2003 revenues were from four technologies: $647,000 (20%) from Ethyol(TM) (a chemotherapeutic mitigation agent); $600,000 (18%) exchanged for the first $1,290,000 of CTT's share of the potential award in the Materna(TM) lawsuit; $584,000 (18%) from the homocysteine assay; and $508,000 (15%) from gallium arsenide patents (including a laser diode technology used in optoelectronic storage devices and another technology that improves semiconductor operating characteristics).

Certain of the Company's patents have expired recently or will soon expire. The vitamin B_{12} assay patents expired between April 1998 and November 2002. The gallium arsenide patents expire between May 2001 and September 2006. Fiscal 2003 revenues of approximately $191,000 (6%), $359,000 (11%), and $891,000 (27%) were from patents expiring in fiscal 2003, 2004 and 2007, respectively. In addition, CTT's $600,000 revenue from selling $1,290,000 of its potential award in the Materna lawsuit is an infrequent transaction.

Retained royalties for 2003, 2002 and 2001, include $657,194, $878,894, and $682,011, respectively, from foreign licensees, including $351,000, $595,000 and $475,000, respectively, from the gallium arsenide portfolio. Retained royalties from Japanese licenses were $486,000, $730,000 and $577,000, respectively in 2003, 2002 and 2001.

14. *OTHER EXPENSE, NET*

Other income (expense), net, comprised:

	For the years ended July 31,		
	2003	**2002**	**2001**
Impairment loss on investment in:			
NTRU Cryptosystems, Inc.	$ (943,640)	$	$
Digital Ink, Inc.		(50,000)	
Impairment loss (recovery) on loans and advances to:			
E. L. Specialists, Inc.		(781,924)	
Micro-ASI, Inc.		21,598	(600,000)
Interest income	26,623	97,335	400,054
Other, net	(311)	2,384	(52,460)
Minority interest		(26,936)	(15,982)
	$ (917,328)	$ (737,543)	$ (268,388)

	For the years ended July 31,		

15. *NET LOSS PER SHARE*

At July 31, 2003, 2002 and 2001, respectively, options and warrants to purchase 943,267, 940,267 and 500,767 shares of common stock were outstanding but were not included in the computation of earnings per share because they were anti-dilutive.

16. *COMMITMENTS AND CONTINGENCIES*

Operating Leases

CTT occupies its executive office in Fairfield, Connecticut under a lease that expires December 31, 2006. CTT has an option to renew this lease for an additional five years.

At July 31, 2003, future minimum rental payments required under operating leases with initial or remaining noncancelable lease terms in excess of one year were:

For the years ending July 31:

2004	$ 245,097
2005	243,303
2006	226,590
2007	93,750
2008	
Total minimum payments required	$ 808,740

Total rental expense for all operating leases was:

	For the years ended July 31,		
	2003	2002	2001
Minimum rentals	$ 233,390	$ 223,613	$ 209,828
Less: Sublease rentals	(9,600)	(6,665)	(18,500)
	$ 223,790	$ 216,948	$ 191,328

Other Obligations

The Company has an employment agreement with Mr. Nano that provides for his employment as the Company's President and Chief Executive Officer at a base compensation of $250,000 per year, subject to reviews and increases in the sole discretion of the Company's Board of Directors. His employment is at will and can be terminated by either party at any time and for any reason. Certain obligations under this agreement survive the end of Mr. Nano's employment.

The Company has four contracts (two of which have expired by their terms, but continue on a month to month basis) with consultants for business development services. Three agreements are terminable on seven days' written notice and one is terminable on thirty days' written notice. Compensation to the consultand>

Less: Net earnings attributable to noncontrolling interest
7

7

1

2

5

Net earnings attributable to Eastman
$
1,165

$
437

$
646

$
425

$
89

Amounts attributable to Eastman stockholders

Earnings from continuing operations, net of tax
$
1,165

$
436

$
606

$
416

$
111

Earnings (loss) from discontinued operations, net of tax
—

1

40

9

(22
)
Net earnings attributable to Eastman stockholders
$
1,165

$
437

$
646

$
425

$
89

Basic earnings per share attributable to Eastman

Earnings from continuing operations
$
7.57

$
2.99

$
4.34

$
2.88

$
0.77

Earnings (loss) from discontinued operations
—

0.01

0.29

0.07

(0.16
)
Net earnings
$
7.57

$
3.00

$
4.63

$
2.95

$
0.61

Diluted earnings per share attributable to Eastman

Earnings from continuing operations
$
7.44

$
2.92

$
4.24

$
2.81

$
0.76

Earnings (loss) from discontinued operations
—

0.01

0.28

0.07

(0.15
)
Net earnings
$
7.44

$
2.93

$
4.52

$
2.88

$
0.61

Statement of Financial Position Data

Current assets
$
2,840

$
2,699

$
2,302

$
2,047

$
1,735

Net properties
4,290

4,181

3,107

3,219

3,110

Goodwill
2,637

2,644

406

375

315

Other intangibles
1,761

1,849

101

92

43

Total assets
11,845

11,710

6,184

5,986

5,515

Current liabilities
1,470

1,364

1,114

1,070

800

Long-term borrowings
4,254

4,779

1,445

1,598

1,604

Total liabilities
7,970

8,682

4,283

4,327

3,975

Total Eastman stockholders' equity
3,796

2,943

1,870

1,627

1,513

Dividends declared per share
1.250

1.080

0.990

0.895

0.880

On July 2, 2012, the Company completed its acquisition of Solutia Inc. ("Solutia"), a global leader in performance materials and specialty chemicals. The fair value of total consideration transferred was $4.8 billion, consisting of cash of $2.6 billion, net of cash acquired; equity in the form of Eastman stock of approximately $700 million; and the assumption and subsequent repayment of Solutia's debt at fair value of $1.5 billion. For additional information see Note 2, "Acquisitions and Investments in Joint Ventures", to the Company's consolidated financial statements in Part II, Item 8 of this Annual Report on Form 10-K (this "Annual Report"). As of the date of acquisition, results of the acquired Solutia businesses are included in Eastman results.

In third quarter 2011, the Company completed three acquisitions. Eastman acquired Sterling Chemicals, Inc. ("Sterling"), a single site North American petrochemical producer, to produce non-phthalate plasticizers in the Adhesives & Plasticizers segment, including Eastman 168™ non-phthalate plasticizers, and acetic acid in the Specialty Fluids & Intermediates segment, and Eastman also acquired Scandiflex do Brasil S.A. Indústrias Químicas ("Scandiflex"), a manufacturer of plasticizers located in São Paulo, Brazil, which is reported in the Adhesives & Plasticizers segment. In addition, the Company acquired Dynaloy, LLC ("Dynaloy"), a producer of formulated solvents, which is reported in the Additives & Functional Products segment. The acquisitions were accounted for as business combinations. For additional information see Part II, Item 8 – "Notes to the Audited Consolidated Financial Statements" – Note 2, "Acquisitions and Investments in Joint Ventures" and Note 16, "Asset Impairments and Restructuring Charges (Gains), Net" of this Annual Report.

In 2011, the Company completed the sale of the polyethylene terephthalate ("PET") business, related assets at the Columbia, South Carolina site, and technology of its Performance Polymers segment. The PET business, assets, and technology sold were substantially all of the Performance Polymers segment. Performance Polymers segment operating results are presented as discontinued operations for all periods presented and are therefore not included in results from continuing operations in accordance with accounting principles generally accepted ("GAAP") in the United States. For additional information, see Note 20, "Discontinued Operations", to the Company's consolidated financial statements in Part II, Item 8 of this Annual Report.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") is based upon the consolidated financial statements for Eastman Chemical Company ("Eastman" or the "Company"), which have been prepared in accordance with accounting principles generally accepted ("GAAP") in the United States, and should be read in conjunction with the Company's consolidated financial statements and related notes included elsewhere in this 2013 Annual Report on Form 10-K (this "Annual Report"). All references to earnings per share ("EPS") contained in this report are diluted earnings per share unless otherwise noted.

On July 2, 2012, the Company completed its acquisition of Solutia Inc. ("Solutia"), a global leader in performance materials and specialty chemicals. The fair value of total consideration transferred was $4.8 billion, consisting of cash of $2.6 billion, net of cash acquired; equity in the form of Eastman stock of approximately $700 million; and the assumption and subsequent repayment of Solutia's debt at fair value of $1.5 billion. For additional information, see Note 2, "Acquisitions and Investments in Joint Ventures", to the Company's consolidated financial statements in Part II, Item 8 of this Annual Report. As of the date of acquisition, results of the acquired Solutia businesses are included in Eastman results.

CRITICAL ACCOUNTING ESTIMATES

In preparing the consolidated financial statements in conformity with GAAP, the Company's management must make decisions which impact the reported amounts and the related disclosures. Such decisions include the selection of the appropriate accounting principles to be applied and assumptions on which to base estimates and judgments that affect the reported amounts of assets, liabilities, sales revenue and expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, the Company evaluates its estimates, including those related to allowances for doubtful accounts, impairment of long-lived assets, environmental costs, pension and other postretirement benefits, litigation and contingent liabilities, income taxes, and purchase accounting. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. The Company's management believes the critical accounting estimates described below 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.

Allowances for Doubtful Accounts

The Company maintains allowances for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments. The Company believes, based on historical results, the likelihood of actual write-offs having a material impact on financial results is low. However, if one of the Company's key customers was to file for bankruptcy, or otherwise be unwilling or unable to make its required payments, or there was a significant slow-down in the economy, the Company could increase its allowances. This could result in a material charge to earnings. The Company's allowance for doubtful accounts was $12 million and $8 million at December 31, 2013 and 2012, respectively.

Impairment of Long-Lived Assets

Definite-lived Assets

Properties and equipment and definite-lived intangible assets to be held and used by the Company are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. The review of these long-lived assets is performed at the asset group level, which is the lowest level for which identifiable cash flows are largely independent of the cash flows of other assets and liabilities. If the carrying amount is not considered to be recoverable, an analysis of fair value is triggered. An impairment is recorded for the excess of the carrying amount of the asset over the fair value.

Goodwill

The Company conducts testing of goodwill annually in third quarter of each year or when impairment indicators arise, whichever comes first. The testing of goodwill is performed at the reporting unit level which the Company has determined to be its components. Components are defined as one level below an operating segment, and in order to be a reporting unit, the component must 1) be a "business" as defined by applicable accounting standards (an integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing a return in the form of dividends, lower costs, or other economic benefits directly to the investors or other owners, member, or participants); 2) have discrete financial information available; and 3) be reviewed regularly by Company operating segment management. The Company aggregates certain components into reporting units based on economic similarities. During 2013 testing, the Company did not evaluate the acquired Solutia components for aggregation, instead testing each component as a separate reporting unit. Management will continue to review further aggregation as those components become integrated with Eastman.

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

The Company uses an income approach and applies a fair value methodology based on discounted cash flows in testing the carrying value of goodwill for each reporting unit. The key assumptions and estimates used in the Company's 2013 goodwill impairment testing included a long-term projection of revenues, expenses, and cash flows, the estimated discount rate, and the estimated tax rate. The Company believes these assumptions are consistent with those a hypothetical market participant would use given circumstances that were present at the time the estimates were made. However, actual results and amounts may be significantly different from the Company's estimates. In addition, the use of different estimates or assumptions could result in materially different determinations. If the estimated fair value of a reporting unit is determined to be less than the carrying value of the net assets of the reporting unit including goodwill, additional steps, including an allocation of the estimated fair value to the assets and liabilities of the reporting unit, would be necessary to determine the amount, if any, of goodwill impairment.

As a result of the tests performed during 2013, there was no impairment of the Company's goodwill. Fair values substantially exceeded the carrying values for each reporting unit tested, except for the performance films (a part of the Advanced Materials operating segment) and rubber chemicals (a part of the Additives & Functional Products operating segment) reporting units acquired from Solutia. As anticipated, because of the recent acquisition of Solutia, the fair value of these two reporting units was not substantially in excess of the carrying value.

Goodwill of $743 million is allocated to the rubber chemicals reporting unit, whose fair value exceeded its carrying value by 16 percent. Two of the most critical assumptions used in the calculation of the fair value of the rubber chemicals reporting unit are the long-term growth rate and the discount rate. The Company performed a sensitivity analysis on both of those assumptions. The fair value exceeds the carrying value with either a 1 percent decrease in the long-term growth rate or a 1 percent increase in the discount rate.

Goodwill of $532 million is allocated to the performance films reporting unit, whose fair value exceeded its carry value by 11 percent. Two of the most critical assumptions used in the calculation of the fair value of the performance films reporting unit are the long-term growth rate and the discount rate. The Company performed a sensitivity analysis on both of those assumptions. The fair value exceeds the carrying value with a 1 percent decrease in the long-term growth rate; however, with a 1 percent increase in the discount rate, the fair value was 2 percent less than the carrying value.

In order to determine the discount rate, the Company uses a market perspective weighted average cost of capital ("WACC") approach. The WACC is calculated incorporating weighted average returns on debt and equity from market participants. Therefore, changes in the market, which are beyond the control of the Company, may have an impact on future calculations of estimated fair value.

Indefinite-lived Intangible Assets

The Company conducts testing of indefinite-lived intangible assets annually in third quarter of each year or when impairment indicators arise, whichever comes first. The carrying value of indefinite-lived intangible assets is considered to be impaired when the fair value, as established by appraisal or based on discounted future cash flows of certain related products, is less than their respective carrying values.

Indefinite-lived intangible assets, consisting of various trademarks, are tested for potential impairment by comparing the estimated fair value to the carrying amount. The Company uses an income approach, specifically the relief from royalty method, to test indefinite-lived intangible assets. The estimated fair value of the trademarks is determined based on an assumed royalty rate savings, discounted by the calculated market participant WACC plus a 1 percent risk premium. The carrying value of indefinite-lived intangible assets is considered to be impaired when the estimated fair value is less than the carrying value of the trademarks.

As of July 1, 2013, the testing date, the Company had $568 million in indefinite-lived intangible assets. There was no impairment of the Company's indefinite-lived intangible assets as a result of the tests performed during third quarter 2013.

The Company will continue to monitor both goodwill and indefinite-lived intangible assets for any indication of triggering events which might require additional testing before the next required annual impairment test.

As the Company's assumptions related to long-lived assets are subject to change, write-downs may be required in the future. If estimates of fair value less costs to sell are revised, the carrying amount of the related asset is adjusted, resulting in a charge to earnings.

Environmental Costs

The Company accrues environmental remediation costs when it is probable that the Company has incurred a liability at a contaminated site and the amount can be reasonably estimated. When a single amount cannot be reasonably estimated but the cost can be estimated within a range, the Company accrues the minimum amount. This undiscounted accrued amount reflects liabilities expected to be paid out within 30 years and the Company's assumptions about remediation requirements at the contaminated site, the nature of the remedy, the outcome of discussions with regulatory agencies and other potentially responsible parties at multi-party sites, and the number and financial viability of other potentially responsible parties. Changes in the estimates on which the accruals are based, unanticipated government enforcement action, or changes in health, safety, environmental, and chemical control regulations and testing requirements could result in higher or lower costs. Estimated future environmental expenditures for remediation costs ranged from the minimum or best estimate of $341 million to the maximum of $581 million at December 31, 2013. The maximum estimated future costs are considered to be reasonably possible and are inclusive of the amounts accrued at December 31, 2013.

In accordance with GAAP, the Company also establishes reserves for closure/postclosure costs associated with the environmental and other assets it maintains. Environmental assets, as defined by GAAP, include but are not limited to waste management units, such as landfills, water treatment facilities, and ash ponds. When these types of assets are constructed or installed, a reserve is established for the future costs anticipated to be associated with the retirement or closure of the asset based on an expected life of the environmental assets and the applicable regulatory closure requirements. These future estimated costs are charged against earnings over the estimated useful life of the assets. Currently, the Company estimates the useful life of each individual asset is up to 50 years. If the Company changes its estimate of the environmental asset retirement obligation costs or its estimate of the useful lives of these assets, expenses charged against earnings could increase or decrease.

In accordance with GAAP, the Company also monitors conditional obligations and will record reserves associated with them when and to the extent that more detailed information becomes available concerning applicable retirement costs.

The Company's reserve, including the above remediation, was $368 million at December 31, 2013 and $394 million at December 31, 2012, representing the minimum or best estimate for remediation costs and the best estimate of the amount accrued to date over the regulated assets' estimated useful lives for asset retirement obligation costs.

Pension and Other Postretirement Benefits

The Company maintains defined benefit pension plans that provide eligible employees with retirement benefits. Additionally, Eastman subsidizes life insurance, health care, and dental benefits for eligible retirees, and health care and dental benefits for retirees' eligible survivors. The costs and obligations related to these benefits reflect the Company's assumptions related to general economic conditions (particularly interest rates) and expected return on plan assets. In July 2012, as part of its acquisition of Solutia, the Company assumed Solutia's U.S. and non-U.S. defined benefit pension and other postretirement benefit plans. Prior to the acquisition, the Solutia U.S. pension plans had been closed to new participants and were no longer accruing additional benefits. In 2011, as part of its acquisition of Sterling Chemicals, Inc. ("Sterling"), the Company assumed Sterling's U.S. pension plans. For valuing the obligations and assets of the Company's U.S. and non-U.S. defined benefit pension plans, the Company assumed weighted average discount rates of 4.59 percent and 4.18 percent, respectively, and a weighted average expected return on plan assets of 7.83 percent and 5.78 percent, respectively, at December 31, 2013. The Company assumed a weighted average discount rate of 4.75 percent for its other postretirement benefit plans and an expected return on plan assets of 3.75 percent for its voluntary employees' beneficiary association retiree trust at December 31, 2013. The cost of providing plan benefits also depends on demographic assumptions including retirements, mortality, turnover, and plan participation.

The December 31, 2013 projected benefit obligation and 2014 expense are affected by year-end 2013 assumptions. The following table illustrates the sensitivity to changes in the Company's long-term assumptions in the expected return on assets and assumed discount rate for all pension plans and other postretirement benefit plans. The sensitivities below are specific to the time periods noted. They also may not be additive, so the impact of changing multiple factors simultaneously cannot be calculated by combining the individual sensitivities shown.

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

Change in Assumption	Impact on 2014 Pre-tax Benefits Expense (Excludes mark-to-market impact) for Pension Plans	Impact on December 31, 2013 Projected Benefit Obligation for Pension Plans		Impact on 2014 Pre-tax Benefits Expense (Excludes mark-to-market impact) for Other Postretirement Benefit Plans	Impact on December 31, 2013 Benefit Obligation for Other Postretirement Benefit Plans
		U.S.	Non-U.S.		
25 basis point decrease in discount rate	-$2 Million	+$57 Million	+$32 Million	-$1 Million	+$26 Million
25 basis point increase in discount rate	+$2 Million	-$55 Million	-$31 Million	+$1 Million	-$24 Million
25 basis point decrease in expected return on assets	+$7 Million	No Impact	No Impact	+$1 Million	No Impact
25 basis point increase in expected return on assets	-$7 Million	No Impact	No Impact	-$1 Million	No Impact

The expected return on assets and assumed discount rate used to calculate the Company's pension and other postretirement benefit obligations are established each December 31. The expected return on assets is based upon the long-term expected returns in the markets in which the trusts invest their funds, primarily in the following markets: U.S. and non-U.S. fixed income, U.S. and non-U.S. public equity, private equity, and real estate markets. Historically, over approximately a ten year period, the Company's average achieved actual return has been near the expected return on assets. The assumed discount rate is based upon a portfolio of high-grade corporate bonds, which are used to develop a yield curve. This yield curve is applied to the expected durations of the pension and other postretirement benefit obligations. As future health care benefits under the U.S. benefit plan have been fixed at a certain contribution amount, changes in the health care cost trend assumptions do not have a material impact on the results of operations.

The Company uses fair value accounting for plan assets. If actual experience differs from long-term assumptions for asset returns and discount rates which were used in determining the current year expense, the difference is recognized immediately as part of the mark-to-market ("MTM") net gain or loss in the fourth quarter of each year, and any other quarter in which an interim remeasurement is triggered. The MTM net gain or loss applied to earnings from continuing operations in 2013, 2012, and 2011 due to the actual experience versus assumptions of returns on plan assets and discount rates for the defined benefit pension and other postretirement benefit plans were net gain of $383 million, net loss of $276 million, and net loss of $144 million, respectively. The 2013 net MTM gain included an $86 million gain triggered by an other postretirement benefit plan amendment. At December 31, 2013, the Company's weighted-average assumed discount rate was 4.55 percent, up significantly from the prior year, resulting in an actuarial gain of approximately $280 million. In addition, overall there were significant increases in pension asset values of approximately $105 million due to asset values appreciating in excess of the assumed weighted-average rate of return. The actual return of approximately $275 million or 11 percent less the expected return of approximately $170 million or 7.13 percent results in the approximately $105 million increase.

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

The Company does not anticipate that a change in pension and other postretirement benefit obligations caused by a change in the assumed discount rate during 2014 will impact the cash contributions to be made to the pension plans during 2014. While the amount of the change in these obligations does not correspond directly to cash funding requirements, it is an indication of the amount the Company will be required to contribute to the plans in future years. The amount and timing of such cash contributions is dependent upon interest rates, actual returns on plan assets, retirement, attrition rates of employees, and other factors. For further information regarding pension and other postretirement benefit obligations, see Note 11, "Retirement Plans", to the Company's consolidated financial statements in Part II, Item 8 of this Annual Report.

Litigation and Contingent Liabilities

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 handled and defended in the ordinary course of business. The Company accrues a liability for such matters when it is probable that a liability has been incurred and the amount can be reasonably estimated. When a single amount cannot be reasonably estimated but the cost can be estimated within a range, the Company accrues the minimum amount. The Company expenses legal costs, including those expected to be incurred in connection with a loss contingency, as incurred. Based upon facts and information currently available, the Company believes the amounts reserved are adequate for such pending matters; however, results of operations could be affected by monetary damages, costs or expenses, and charges against earnings in particular periods.

Income Taxes

The Company records deferred tax assets and liabilities based on temporary differences between the financial reporting and tax bases of assets and liabilities, applying enacted tax rates expected to be in effect for the year in which the differences are expected to reverse. The ability to realize deferred tax assets is evaluated through the forecasting of taxable income using historical and projected future operating results, the reversal of existing temporary differences, and the availability of tax planning strategies. Valuation allowances are recorded to reduce deferred tax assets when it is more likely than not that a tax benefit will not be realized. In the event that the actual outcome from future tax consequences differs from management estimates and assumptions, the resulting change to the provision for income taxes could have a material adverse impact on the consolidated results of operations and statement of financial position. As of December 31, 2013, a valuation allowance of $204 million has been provided against the deferred tax assets.

The Company recognizes income tax positions that meet the more likely than not threshold and accrues interest related to unrecognized income tax positions, which is recorded as a component of the income tax provision.

Purchase Accounting

In general, the acquisition method of accounting requires companies to record assets acquired and liabilities assumed at their respective fair values at the date of acquisition. The Company estimates fair value using the exit price approach which is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly market. An exit price is determined from the viewpoint of unrelated market participants as a whole, in the principal or most advantageous market, and may result in the Company valuing assets or liabilities at a fair value that is not reflective of the Company's intended use of the assets or liabilities. Any amount of the purchase price paid that is in excess of the estimated fair values of net assets acquired or liabilities assumed is recorded in the line item goodwill on the Company's consolidated balance sheets. Management's judgment is used to determine the estimated fair values assigned to assets acquired and liabilities assumed, as well as asset lives for property, plant and equipment and amortization periods for intangible assets, and can materially affect the Company's results of operations.

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

NON-GAAP AND PRO FORMA COMBINED FINANCIAL MEASURES

In addition to evaluating the Company's financial condition, results of operations, liquidity and cash flows as reported in accordance with GAAP, Eastman management also evaluates Company and operating segment performance, and makes resource allocation and performance evaluation decisions, excluding the effect of transactions, costs, and losses or gains that do not directly arise from Eastman's normal, or "core", business and operations, or are otherwise of an unusual or non-recurring nature. These transactions, costs, and losses or gains relate to, among other things, cost reduction, growth and profitability improvement initiatives, and other events outside of core business operations (such as MTM losses or gains for pension and other postretirement benefit plans, typically in the fourth quarter of each year and any quarters in which an interim remeasurement is triggered). Because non-core or non-recurring transactions, costs, and losses or gains may materially affect the Company's, or any particular operating segment's, financial condition or results in a specific period in which they are recognized, Eastman believes it is appropriate to evaluate both the financial measures prepared and calculated in accordance with GAAP and the related non-GAAP financial measures excluding the effect on our results of these non-core or non-recurring items. In addition to using such measures to evaluate results in a specific period, management evaluates such non-GAAP measures, and believes that investors may also evaluate such measures, because such measures may provide more complete and consistent comparisons of the Company's, and its segments', operational performance on a period-over-period historical basis and, as a result, provide a better indication of expected future trends. Management discloses these non-GAAP measures, and the related reconciliations to the most comparable GAAP financial measures, because it believes investors use these metrics in evaluating longer term period-over-period performance, and to allow investors to better understand and evaluate the information used by management to assess the Company's, and its operating segments', performance, make resource allocation decisions and evaluate organizational and individual performance in determining certain performance-based compensation. Non-GAAP measures do not have definitions under GAAP, and may be defined differently by, and not be comparable to, similarly titled measures used by other companies. As a result, management cautions investors not to place undue reliance on any non-GAAP measure, but to consider such measures with the most directly comparable GAAP measure.

The non-core or non-recurring items excluded by management in its evaluation of certain results in this Annual Report are:

- Costs resulting from the sale of acquired Solutia inventories at fair value, net of the last-in, first-out ("LIFO") impact of these inventories (as required by purchase accounting, these inventories were marked to fair value, and were sold in 2012);
- Solutia acquisition, financing, transaction, and integration costs, including the costs and fees for borrowings used to complete the Solutia acquisition and pre-acquisition interest expense for acquisition-related borrowings, which resulted from non-core transactions not expected to impact Eastman's results consistently;
- MTM pension and other postretirement benefit plans gains and losses, net, which are actuarial gains and losses measured as the changes in discount rates and other actuarial assumptions and the difference between actual and expected returns on plan assets during the period. These actuarial gains and losses were primarily due to changes in discount rates reflective of changes in global financial market conditions and interest rates on high-grade corporate bonds and changes in other postretirement benefit plan obligations resulting from a plan amendment, and did not directly arise from Eastman's core business and operations; and
- Asset impairments and restructuring charges and gains, net, which, other than certain severance costs, are not cash transactions impacting profitability,

in each case for the periods and in the amounts in the table below.

Non - GAAP Financial Measures -- Excluded Non-Core or Non-Recurring Items

(Dollars in millions)	2013	2012	2011
Non-core or non-recurring items impacting operating earnings:			
Additional costs of acquired Solutia inventories	$—	$79	$—
Transaction costs related to the acquisition of Solutia	—	28	—
Integration costs related to the acquisition of Solutia	36	16	—
Mark-to-market pension and other postretirement benefit (gains) losses, net	(383)	276	144
Asset impairments and restructuring charges (gains), net	76	120	(8)
Non-core or non-recurring items impacting earnings before income taxes:			
Financing costs related to the acquisition of Solutia	—	32	—

MANAGEMENT'S DISCUSSION AND ANALYSIS OF
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This MD&A includes the effect of the foregoing on the following financial measures:

- Gross profit,
- Selling, general, and administrative ("SG&A") expenses,
- Research and development ("R&D") expenses,
- Operating earnings,
- Net interest expense,
- Other charges (income), net,
- Provision for income taxes,
- Earnings from continuing operations, and
- Diluted earnings per share.

For more detail about MTM pension and other postretirement benefit plans gains and losses, net, including actual and expected return on plan assets and the components of the net gains or loss, see "CRITICAL ACCOUNTING ESTIMATES -- Pension and Other Postretirement Benefits" above and "Note 11, Retirement Plans - Summary of Changes and - Summary of Benefit Costs and Other Amounts Recognized in Other Comprehensive Income" to the Company's consolidated financial statements in Part II, Item 8 of this Annual Report.

In addition to the above, in order to provide the most meaningful comparison of results, some of the following corporate and segment discussion and analysis includes both actual results for all periods presented and results on a "pro forma combined" basis. The unaudited pro forma combined information is based on the historical consolidated financial statements of both Eastman and Solutia and has been prepared to illustrate the effects of the Company's acquisition of Solutia, assuming the acquisition of Solutia had been consummated January 1, 2011, the beginning of the earliest period presented. The accompanying pro forma combined financial information does not give pro forma effect to any other transactions or events. For 2012, pro forma combined results reflect actual results for third and fourth quarter 2012 plus pro forma combined results for the first six months 2012. Pro forma combined sales revenue, operating earnings, and discussion include pro forma combined for the first six months of 2012 and all of 2011.

The unaudited pro forma combined information is not necessarily indicative of the results of operations, or the financial position, that would have actually occurred had the acquisition been completed as of the dates indicated, nor is it indicative of the future operating results, or financial position, of Eastman. The unaudited pro forma combined information does not reflect future events that may have occurred or may still occur after the acquisition of Solutia, including the potential realization of any future operating cost savings (synergies) or restructuring activities or other costs related to the planned integration of Solutia and yet to be incurred, and does not consider potential impacts of current market conditions on revenues or expense efficiencies.

The unaudited pro forma combined information reflects only the combination of Eastman and Solutia. The unaudited pro forma combined financial results include certain adjustments for additional depreciation and amortization expense based upon the fair value step-up and estimated useful lives of Solutia depreciable fixed assets and limited-life amortizable assets acquired in the transaction. Additionally, in the preparation of unaudited pro forma combined sales and earnings from continuing operations, Solutia's historical consolidated results have been retrospectively adjusted for the change in accounting methodology for pension and other postretirement benefit plans actuarial losses and gains adopted by Eastman during first quarter 2012. The information also includes adjustments to Solutia exclusions from operating earnings in order to be consistent with Eastman's non-GAAP presentation.

These non-GAAP and pro forma combined financial measures, and the accompanying reconciliations of the non-GAAP financial measures to the most comparable GAAP measures, are presented in "2013 Overview", "Results of Operations", and "Summary by Operating Segment" in this MD&A.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF
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In addition to the non-GAAP measures presented in this Annual Report and other periodic reports, from time to time management evaluates and discloses to investors and securities analysts the non-GAAP measure cash provided by operating activities excluding certain non-core or non-recurring items ("cash provided by operating activities, as adjusted") when analyzing, among other things, business performance, liquidity and financial position, and performance-based compensation. Eastman management uses this non-GAAP measure in conjunction with the GAAP measure cash provided by operating activities because it believes it is a more appropriate metric to evaluate the cash flows from Eastman's core operations that are available to grow the business and create stockholder value, and because it allows for a more consistent period-over-period presentation of such amounts. In its evaluation, Eastman management generally excludes the impact of certain non-core activities and decisions of management because such activities and decisions are not considered core, ongoing components of continuing operations and the decisions to undertake or not to undertake such activities may be made irrespective of the cash generated from continuing operations. From time to time, management discloses this non-GAAP measure and the related reconciliation to investors and securities analysts to allow them to better understand and evaluate the information used by management in its decision making processes and because management believes investors and securities analysts use similar measures to assess Company performance, liquidity, and financial position over multiple periods and to compare these with other companies.

Similarly, from time to time, Eastman discloses to investors and securities analysts a non-GAAP measure of free cash flow, which management defines as cash provided by operating activities, as adjusted, described above, less the amounts of capital expenditures and dividends, as management believes such items are generally funded from available cash and, as such, should be considered in determining free cash flow. Eastman management believes this is the appropriate metric to use to evaluate the Company's overall ability to generate cash to fund future operations, inorganic growth opportunities, and to meet the Company's debt repayment obligations. Management believes this metric is useful to investors and securities analysts in order to provide them with information similar to that used by management in evaluating potential future cash available for various initiatives and because management believes investors and securities analysts often use a similar measure of free cash flow to compare the results, and value, of comparable companies.

2013 OVERVIEW

Eastman's portfolio of specialty businesses holds leading market positions and manufactures products that enhance performance in a variety of end markets such as transportation, building and construction, and consumables. Management believes that despite ongoing economic uncertainty, certain of the Company's key end markets, including transportation and building and construction, benefited during 2013 from continued economic growth in Asia and modest economic growth in the United States. The Additives & Functional Products ("AFP") segment had higher sales volume in solvents product lines, attributed to strengthened coatings demand in the building and construction market. The Advanced Materials ("AM") segment had higher sales volume for Eastman Tritan™ copolyester in the durable goods market and in interlayers product lines, attributed to strengthened demand in transportation markets. While the Adhesives & Plasticizers ("A&P") segment experienced weakened demand for adhesives resins used in the consumables market, particularly tapes, labels, and packaging, the segment continued to benefit from the substitution of phthalate plasticizers with non-phthalate plasticizers, particularly in the building and construction market. Management expects continued challenges in the A&P segment. Eastman management believes that the Company's global market and manufacturing presence, combined with global trends such as energy efficiency, a rising middle class in emerging economies, and increased focus on health and wellness, will continue to support the Company's achievement of its growth objectives in the long term.

The Company generated sales revenue of $9.4 billion and $8.1 billion for 2013 and 2012, respectively. Sales revenue in 2013 increased compared with 2012 primarily due to sales volume in first six months 2013 from the acquired

Solutia product lines in the AM, AFP, and Specialty Fluids & Intermediates ("SFI") segments. Sales volume also increased as a result of higher sales volume in solvents product lines in the AFP segment and higher sales volume for Eastman Tritan™ copolyester in the AM segment, partially offset by weakened demand for adhesives resins in the A&P segment.

On a pro forma combined basis, sales revenue was $9.4 billion and $9.1 billion in 2013 and 2012, respectively. Sales revenue increased compared with 2012 primarily due to higher sales volume in all other operating segments more than offsetting lower sales volume in the A&P segment.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF
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Operating earnings were $1.9 billion in 2013 compared to $800 million in 2012. Excluding the non-core or non-recurring items referenced in "Non-GAAP and Pro Forma Combined Financial Measures", operating earnings were $1.6 billion in 2013 and $1.3 billion in 2012. Operating earnings increased primarily due to earnings from acquired Solutia product lines, higher volumes and higher capacity utilization resulting in lower unit costs, and lower raw material and energy costs more than offsetting slightly lower selling prices. These increases were partially offset by higher SG&A expense. Operating earnings increased in all operating segments, with the exception of A&P which had both lower sales volume and selling prices. Operating earnings also benefited from decreased "Other" loss primarily due to lower operating costs for the Perennial Wood™ growth initiative which the Company has decided not to continue.

On a pro forma combined basis, operating earnings were $1.9 billion in 2013 compared to $940 million in 2012. In addition to the non-core or non-recurring items referenced in "Non-GAAP and Pro Forma Combined Financial Measures", pro forma combined operating earnings in 2012 also included $5 million for restructuring charges related to Solutia's acquisition of Southwall Technologies Inc. ("Southwall"). Excluding these non-core or non-recurring items, operating earnings increased primarily due to higher sales volume and higher capacity utilization, and lower raw material and energy costs more than offsetting lower selling prices. Operating earnings increased particularly in the Fibers and AM segments, partially offset by lower operating earnings in the A&P segment. These increases were partially offset by higher SG&A. Pro forma combined operating earnings also increased due to lower operating costs for the Perennial Wood™ growth initiative.

Earnings from continuing operations were $1.2 billion in 2013 compared to $436 million in 2012. Earnings from continuing operations per diluted share were $7.44 in 2013 compared to $2.92 in 2012. Excluding the non-core or non-recurring items referenced in "Non-GAAP and Pro Forma Combined Financial Measures", earnings from continuing operations in 2013 and 2012 were $1.0 billion and $802 million, respectively. Excluding these items, earnings from continuing operations per diluted share for 2013 and 2012 were $6.44 and $5.38, respectively.

Eastman generated $1.3 billion in cash from operating activities in 2013, compared to $1.1 billion cash generated from operating activities during 2012. The increase was primarily due to increased cash earnings from the Company's businesses and the absence of one-time payments related to the July 2, 2012 acquisition of Solutia partially offset by an increase in working capital requirements, higher income tax payments, and higher interest payments. The Company reduced long-term borrowings by $525 million in 2013.

In 2013, the Company progressed on both inorganic (external growth through joint ventures and acquisitions) and organic (internal) growth initiatives, including:

- substantially completing the integration of Solutia, which:
  - broadened Eastman's global presence;
  - established a combined platform with extensive organic growth opportunities through complementary technologies and business capabilities, and an overlap of key end markets; and
  - expanded Eastman's portfolio of sustainable products and products with leading market positions;
- in the AFP segment, completing an expansion of ethylene oxide derivative capacity in Longview, Texas in second quarter 2013 to meet demand in the coatings markets;
- in the AM segment, beginning the expansion of Eastman Tritan™ copolyester capacity at the Kingsport, Tennessee manufacturing facility which is expected to be operational in the second half of 2014 to meet demand for Eastman Tritan™ copolyester;
- in the Fibers segment, completing a new 30,000 metric ton acetate tow manufacturing facility in Hefei, China during third quarter 2013 in a joint venture with China National Tobacco Corporation to meet customer growth; and
- in the SFI segment:

debottlenecking its largest olefins cracking unit in Longview, Texas in first quarter 2013, primarily to produce additional ethylene to improve Eastman's olefin cost position; and
beginning a Therminol® heat transfer fluid capacity expansion in Newport, Wales, which is expected to be operational in the second half of 2014 to support expected demand in the industrial chemicals and processing market.

In addition, in January 2014 the Company entered into a definitive agreement to acquire the assets of BP plc's global aviation turbine engine oil business. The acquisition is expected to be completed in the second quarter of 2014, and the acquired business will become a part of the SFI segment.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF
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RESULTS OF OPERATIONS

The Company's results of operations as presented in the Company's consolidated financial statements in Part II, Item 8 of this Annual Report are summarized and analyzed below.

SUMMARY OF CONSOLIDATED RESULTS

	2013 Compared to 2012				2012 Compared to 2011			
(Dollars in millions)	2013	2012	%		2012	2011	%	
Sales	$9,350	$8,102	15	%	$8,102	$7,178	13	%
Volume effect			15	%			14	%
Price effect			—	%			(1	)%
Exchange rate effect			—				—	
Pro Forma Combined Sales	$9,350	$9,120	3	%	$9,120	$9,275	(2	)%
Volume effect			3	%			—	%
Price effect			—	%			(1	)%
Exchange rate effect			—	%			(1	)%

2013 Compared to 2012

Sales revenue increased $1,248 million in 2013 compared to 2012. Sales revenue increased primarily due to volume in first six months 2013 from the acquired Solutia product lines in the AM, AFP, and SFI segments. Sales volume also increased as a result of higher sales volume in solvents product lines in the AFP segment and higher sales volume for Eastman Tritan™ copolyester in the AM segment partially offset by weakened demand for adhesives resins in the A&P segment.

On a pro forma combined basis, sales revenue increased slightly in 2013 compared to 2012 primarily due to higher sales volume in all other operating segments more than offsetting lower sales volume in the A&P segment.

2012 Compared to 2011

Sales revenue increased $924 million in 2012 compared to 2011. Sales revenue increased primarily due to volume from acquired Solutia product lines in the AM, AFP, and SFI segments. Sales volume also increased in the A&P segment, particularly in the plasticizers product lines, and in the AFP segment for the solvents product lines. Sales volume for the specialty materials product lines decreased in the AM segment. Higher selling prices in the Fibers and AM segments were more than offset by lower selling prices in the SFI and AFP segments.

On a pro forma combined basis, sales revenue decreased slightly in 2012 compared to 2011.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF
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	2013 Compared to 2012			2012 Compared to 2011		
(Dollars in millions)	2013	2012	Change	2012	2011	Change
Gross Profit	$2,776	$1,762	58 %	$1,762	$1,569	12 %
Additional costs of acquired Solutia inventories	—	79		79	—	
Mark-to-market pension and other postretirement benefit (gains) loss, net	(297)	208		208	119	
Gross Profit excluding non-core or non-recurring items	$2,479	$2,049	21 %	$2,049	$1,688	21 %

2013 Compared to 2012

Gross profit increased $1.0 billion in 2013 compared with 2012 with increases in all segments except the A&P segment. Gross profit in 2013 included a $297 million MTM gain due to pension and other postretirement benefit adjustments. The $297 million MTM gain included a $68 million MTM gain triggered by an other postretirement benefit plan amendment. Gross profit in 2012 included a $208 million MTM loss due to pension and other postretirement benefit adjustments and $79 million of additional costs of acquired Solutia inventories. Excluding these non-core or non-recurring items, higher gross profit was primarily due to gross profit of the acquired Solutia businesses during first six months 2013 of $284 million and higher sales volume of $83 million in all segments except the A&P segment which had lower sales volume of $25 million. Gross profit also increased due to higher selling prices more than offsetting higher raw material and energy costs by $69 million in the Fibers segment and lower raw material and energy costs more than offsetting lower selling prices by $22 million in the AM segment partially offset by lower selling prices and higher raw material and energy costs of $49 million in the A&P segment. Gross profit also benefited from decreased "Other" loss primarily for lower operating costs for the Perennial Wood™ growth initiative.

2012 Compared to 2011

Gross profit increased $193 million in 2012 compared with 2011 with increases in all segments. Gross profit in 2012 included $208 million MTM loss due to pension and other postretirement benefit adjustments and $79 million of additional costs of acquired Solutia inventories. Gross profit in 2011 included a $119 million MTM loss due to pension and other postretirement benefit adjustments. The $119 million MTM loss included a $12 million MTM gain due to an interim remeasurement of the other postretirement benefit plan obligation under the current method of accounting for actuarial gains and losses for pension and other postretirement benefit plans, triggered by the exit of employees associated with the sale of the polyethylene terephthalate ("PET") business. Excluding these items, higher gross profit was primarily due to $234 million from acquired Solutia product lines in 2012 and lower raw material and energy costs partially offset by lower selling prices by $226 million. These increases were partially offset by $103 million of higher operating costs, particularly for increased maintenance for olefins cracking unit assets in the SFI segment, capacity expansions in the A&P and AM segments, and higher unit costs resulting from lower capacity utilization rates in the AM segment.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF
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	2013 Compared to 2012			2012 Compared to 2011		
(Dollars in millions)	2013	2012	Change	2012	2011	Change
Selling, General & Administrative Expenses	$645	$644	— %	$644	$481	34 %
Transaction costs related to the acquisition of Solutia	—	(28)		(28)	—	
Integration costs related to the acquisition of Solutia	(36)	(16)		(16)	—	
Mark-to-market pension and other postretirement benefit gains (loss), net	76	(58)		(58)	(21)	
Selling, General, and Administrative Expenses excluding non-core or non-recurring items	$685	$542	26 %	$542	$460	18 %

2013 Compared to 2012

SG&A expenses in 2013 were higher compared to 2012. SG&A in 2013 included a $76 million MTM gain due to pension and other postretirement benefit adjustments. SG&A in 2012 included a $58 million MTM loss due to pension and other postretirement benefit adjustments. SG&A also increased due to SG&A costs of the acquired Solutia businesses during first six months 2013 of $101 million, and higher expense for employee compensation, primarily annual performance-based compensation, higher expense for share-based compensation, and higher costs of growth initiatives for existing businesses and the related supporting functions partially offset by Solutia acquisition cost reduction synergies.

Excluding non-core or non-recurring items, SG&A expenses in 2013 were higher compared to 2012 primarily due to SG&A expenses of the acquired Solutia businesses during first six months 2013 of $101 million, higher expense for employee compensation, primarily annual performance-based compensation, higher expense for share-based compensation, and higher costs of growth initiatives for existing businesses and the related supporting functions partially offset by Solutia acquisition cost reduction synergies.

2012 Compared to 2011

SG&A expenses in 2012 were higher compared to 2011 primarily due to SG&A costs of the acquired Solutia businesses of $80 million in the second half of 2012 and higher costs of growth and business development initiatives, including transaction and integration costs related to the acquisition of Solutia.

Excluding non-core or non-recurring items, SG&A expenses in 2012 were higher compared to 2011 primarily due to SG&A expenses of the acquired Solutia businesses during last six months 2012 of $80 million and higher costs of growth and business development initiatives.

	2013 Compared to 2012			2012 Compared to 2011		
(Dollars in millions)	2013	2012	Change	2012	2011	Change
Research & Development Expenses	$193	$198	(3)%	$198	$159	25 %
Mark-to-market pension and other postretirement benefit gains (loss), net	10	(10)		(10)	(4)	
	$203	$188	8 %	$188	$155	21 %

Research & Development Expenses excluding non-core or non-recurring items

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MANAGEMENT'S DISCUSSION AND ANALYSIS OF
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2013 Compared to 2012

R&D expenses were slightly higher for 2013 compared to 2012. R&D in 2013 included a $10 million MTM gain due to pension and other postretirement benefit adjustments. R&D in 2012 included a $10 million MTM loss due to pension and other postretirement benefit adjustments. R&D also increased due to R&D costs of the acquired Solutia businesses of $26 million during first six months 2013.

2012 Compared to 2011

R&D expenses were higher for 2012 compared to 2011 primarily due to R&D costs of the acquired Solutia businesses of $20 million in the second half of 2012 and higher R&D expenses for growth initiatives.

Asset Impairments and Restructuring Charges (Gains), Net

2013

In 2013, there were $76 million of net asset impairments and restructuring charges, including $23 million of restructuring charges primarily for severance associated with the continued integration of Solutia.

During fourth quarter 2013, management decided not to continue its Perennial Wood™ growth initiative. This resulted in asset impairment charges of $16 million and restructuring charges of $14 million primarily for inventory and contract termination costs. Also during fourth quarter 2013, management decided to terminate efforts to develop a continuous resin process in Kuantan, Malaysia and Antwerp, Belgium. This resulted in asset impairment charges of $4 million.

During 2013, management decided to shut-down the Photovoltaics product line, including the primary production facility in Germany. This resulted in the Company recognizing asset impairments of $8 million and restructuring charges of $6 million including charges for severance.

During 2013, management also approved a voluntary separation plan for certain employees, resulting in recognition of severance charges of $6 million.

In addition, during 2013, a change in estimate for certain costs for the fourth quarter 2012 termination of the operating agreement for the Sao Jose dos Campos, Brazil site resulted in a reduction of $4 million to previously recognized asset impairments and restructuring charges. Analysis of total Brazil site shutdown costs is ongoing and is subject to the finalization of certain aspects of the operating agreement termination.

2012

In 2012, there were $120 million in asset impairments and restructuring charges and gains, net.

In fourth quarter 2012, the Company terminated an operating agreement at the acquired Solutia facility in Sao Jose dos Campos, Brazil. This resulted in asset impairments and restructuring charges of $35 million. Restructuring charges for the shutdown of manufacturing activities at this site included contract termination costs for severance and other required costs under the operating agreement and impairment of the long-lived assets at the site.

In fourth quarter 2012, management approved the closure of a production facility in China. Based on business analyses completed in fourth quarter 2012, management concluded that production of the related product lines would be more efficiently performed at the Kingsport, Tennessee facility. This resulted in asset impairment and restructuring charges of $6 million.

During 2012, acquisition related restructuring charges of $32 million were recognized primarily for severance costs associated with the acquisition and integration of Solutia.

During 2012, the Company ceased research and development activities for renewable chemicals at a site it acquired in 2011, resulting in asset impairments and restructuring charges of $4 million.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF
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In fourth quarter 2012, the Company recognized asset impairments of $17 million due to a change in approach to address recently finalized boiler air emissions regulations. The Company had incurred engineering costs associated with required modifications for its existing steam and electric generation capacity. However, based on the current availability of natural gas and the lower cost of operation, management determined that conversion to natural gas fueled boilers was more cost efficient. The Company entered into long-term natural gas supply agreements with a third party in fourth quarter 2012, triggering the impairment of the project.

During fourth quarter 2012, management decided to cease production of certain products in its Perennial Wood™ growth initiative. As a result, a restructuring charge of $17 million was recognized in fourth quarter for inventory costs in excess of recoverable value on these product lines and to accrue for losses on take-or-pay contracts with third parties. An analysis was performed to determine what, if any, impairment may be required for the associated fixed assets. Based on the expected life of the assets and intended uses within the Company's continuing acetylation initiatives, there was no impairment.

During 2012, the Company also recognized asset impairments related to land retained from the previously discontinued industrial gasification project. Based on fair value indicators, the carrying value of the Beaumont land was reduced by $6 million.

2011

In 2011, asset impairments and restructuring charges and gains were net gains of $8 million. A gain of $15 million was recognized from the sale of the previously impaired methanol and ammonia assets related to the terminated Beaumont, Texas industrial gasification project and restructuring charges of $7 million were primarily for severance associated with the acquisition and integration of Sterling.

For more information regarding asset impairments and restructuring charges and gains, primarily related to recent strategic decisions and actions, see Note 16, "Asset Impairments and Restructuring Charges (Gains), Net", to the Company's consolidated financial statements in Part II, Item 8 of this Annual Report.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF
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Operating Earnings

	2013 Compared to 2012			2012 Compared to 2011		
(Dollars in millions)	2013	2012	Change	2012	2011	Change
Operating earnings	$1,862	$800	133 %	$800	$937	(15)%
Additional costs of acquired Solutia inventories	—	79		79	—	
Transaction and integration costs related to the acquisition of Solutia	36	44		44	—	
Mark-to-market pension and other postretirement benefit (gains) loss, net	(383)	276		276	144	
Asset impairments and restructuring charges (gains), net	76	120		120	(8)	
Operating earnings excluding non-core or non-recurring items	$1,591	$1,319	21 %	$1,319	$1,073	23 %

Pro Forma Combined Operating Earnings

	2013 Compared to 2012			2012 Compared to 2011		
(Dollars in millions)	2013	2012	Change	2012	2011	Change
Operating earnings	$1,862	$940	98 %	$940	$1,254	(25)%
Additional costs of acquired Solutia inventories (1)	—	79		79	—	
Transaction and integration costs related to the acquisition of Solutia	36	69		69	—	
Mark-to-market pension and other postretirement benefit (gains) loss, net	(383)	276		276	209	
Asset impairments and restructuring charges (gains), net (1)(2)(3)	76	125		125	11	
Other operating expense (income)(4)(5)	—	—		—	(46)	
Operating earnings excluding non-core or non-recurring items	$1,591	$1,489	7 %	$1,489	$1,428	4 %

(1) 2012 included acquisition related expenses of $5 million for the Solutia Southwall acquisition.

(2) 2011 included severance, pension settlement, and other charges of $14 million related to the relocation of Solutia's European regional headquarters.

(3) 2011 included Solutia's severance of $3 million and share-based compensation costs for executive officer separation of $2 million.

(4) 2011 included a gain of $29 million for the sale of Solutia's remaining ownership interest in Ascend Performance Materials Holdings Inc.

(5) 2011 included a gain of $17 million for Solutia's certain other rubber chemicals divestitures.

On a pro forma combined basis, operating earnings increased in 2013 compared to 2012. Excluding non-core or non-recurring items, operating earnings increased primarily due to higher sales volume and higher capacity utilization of approximately $96 million and lower raw material and energy costs more than offsetting lower selling prices by approximately $16 million. Pro forma combined operating earnings also increased due to lower costs for "Other", including lower operating costs of the Perennial Wood™ growth initiative.

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Net Interest Expense

	2013 Compared to 2012			2012 Compared to 2011		
(Dollars in millions)	2013	2012	Change	2012	2011	Change
Gross interest costs	$190	$152		$152	$92	
Less: Capitalized interest	4	4		4	9	
Interest expense	186	148	26 %	148	83	78 %
Interest income	6	5		5	7	
Net interest expense	180	143		143	76	
Financing costs related to the acquisition of Solutia	—	(9)		(9)	—	
Net interest expense excluding financing costs related to the acquisition of Solutia	$180	$134	34 %	$134	$76	76 %

2013 Compared to 2012

Net interest expense increased $37 million in 2013 compared to 2012. The increase was primarily due to a full year of interest on borrowings incurred to finance the acquisition of Solutia. The financing costs in 2012 reflected pre-acquisition interest expense for acquisition borrowing.

For 2014, the Company expects net interest expense to decrease primarily due to repayment in 2013 of the five-year term loan agreement (the "Term Loan") used to finance part of the Solutia acquisition.

2012 Compared to 2011

Net interest expense increased $67 million in 2012 compared to 2011 primarily due to increased borrowing to finance the acquisition of Solutia, including $9 million of financing costs due to pre-acquisition interest expense for acquisition borrowing.

Other Charges (Income), Net

(Dollars in millions)	2013	2012	2011
Foreign exchange transaction (gains) losses, net	$7	$(4)	$(2)
Financing costs related to the acquisition of Solutia	—	23	—
Investment (gains) losses, net	(5)	(9)	(16)
Other, net	1	(2)	(2)
Other charges (income), net	3	8	(20)
Financing costs related to the acquisition of Solutia	—	(23)	—
Other charges (income), net excluding financing costs related to the acquisition of Solutia	$3	$(15)	$(20)

Included in other charges (income), net are gains or losses on foreign exchange transactions, gains and losses from equity investments, gains or losses on business venture investments, gains from the sale of non-operating assets, certain litigation costs, fees for securitized receivables, acquisition financing costs, and other miscellaneous items. Financing costs in "Other Charges (Income), Net" in 2012 were primarily fees for Solutia acquisition borrowings. Investment gains in 2011 included sales of business venture investments.

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Provision for Income Taxes from Continuing Operations

	2013 Compared to 2012			2012 Compared to 2011		
(Dollars in millions)	2013	2012	Change	2012	2011	Change
Provision for income taxes from continuing operations	$507	$206	146 %	$206	$274	(25)%
Effective tax rate	30 %	32 %		32 %	31 %	

The 2013 effective tax rate reflects the positive impacts of integrating the Eastman and Solutia tax structures, a $14 million benefit primarily due to adjustments to the tax provision to reflect the finalization of the 2012 consolidated U.S. Federal income tax return, a $14 million benefit for finalization of foreign tax audits, and the enactment of the American Taxpayer Relief Act of 2012 in January 2013 which resulted in a $10 million benefit primarily from an R&D tax credit.

The 2012 effective tax rate reflected a $12 million tax benefit for favorable audit settlements and the expiration of the relevant statute of limitations, a $9 million tax benefit for additional state tax credits, and a $5 million tax charge for nondeductible transaction costs.

The 2011 effective tax rate reflected an $8 million tax benefit recognized due to an increased level of capital investment which qualified for additional state tax credits.

Other factors impacting the effective tax rate for financial reporting purposes include changes in enacted statutory tax rates, changes in the composition of taxable income from the countries in which Eastman has operations, ability to use net operating loss and tax credit carryforwards, and changes in unrecognized tax benefits. The Company expects its effective tax rate in 2014 will be approximately 29 percent, reflecting the positive impact of integrating the Eastman and Solutia tax structures.

Earnings from Continuing Operations and Diluted Earnings per Share

	2013		2012		2011	
(Dollars in millions, except per share amounts)	$	EPS	$	EPS	$	EPS
Earnings from continuing operations	$1,165	$7.44	$436	$2.92	$606	$4.24
Additional costs of acquired Solutia inventories, net of tax	—	—	56	0.37	—	—
Solutia transaction and integration costs, net of tax	23	0.15	52	0.35	—	—
Asset impairments and restructuring charges (gains), net of tax	53	0.34	80	0.54	(5)	(0.03)
Mark-to-market pension and other postretirement benefit (gains) losses, net of tax	(233)	(1.49)	178	1.20	88	0.60
Earnings from continuing operations excluding non-core or non-recurring items	$1,008	$6.44	$802	$5.38	$689	$4.81

Net Earnings and Diluted Earnings per Share

	2013	2012	2011

(Dollars in millions, except per share amounts)	$	EPS	$	EPS	$	EPS
Earnings from continuing operations	$1,165	$7.44	$436	$2.92	$606	$4.24
Earnings from discontinued operations, net of tax	—	—	—	—	9	0.07
Gain from disposal of discontinued operations, net of tax	—	—	1	0.01	31	0.21
Net earnings	$1,165	$7.44	$437	$2.93	$646	$4.52

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Earnings of $9 million, net of tax in 2011 were from discontinued operations of the PET business of the Performance Polymers segment. Corporate costs which were allocated to the former PET business were reallocated to other of the Company's operating segments in the Company's financial statements. For additional information, see Note 20, "Discontinued Operations", to the Company's consolidated financial statements in Part II, Item 8 of this Annual Report.

SUMMARY BY OPERATING SEGMENT

Eastman has five reporting segments: Additives & Functional Products ("AFP"), Adhesives & Plasticizers ("A&P"), Advanced Materials ("AM"), Fibers, and Specialty Fluids & Intermediates ("SFI"). For additional information concerning the products, see Note 21, "Segment Information", to the Company's consolidated financial statements in Part II, Item 8 of this Annual Report.

Additives & Functional Products Segment

	2013 Compared to 2012				2012 Compared to 2011			
			Change				Change	
(Dollars in millions)	2013	2012	$	%	2012	2011	$	%
Sales	$ 1,719	$ 1,332	$ 387	29 %	$ 1,332	$ 1,067	$ 265	25 %
Volume effect			393	29 %			312	29 %
Price effect			(5)	— %			(43)	(4)%
Exchange rate effect			(1)	— %			(4)	— %
Operating earnings	405	285	120	42 %	285	215	70	33 %
Additional costs of acquired Solutia inventories	—	21	(21)		21	—	21	
Asset impairments and restructuring charges (gains), net	1	17	(16)		17	—	17	
Operating earnings excluding non-core or non-recurring items	406	323	83	26 %	323	215	108	50 %
Pro forma combined sales	$ 1,719	$ 1,613	$ 106	7 %	$ 1,613	$ 1,677	$ (64)	(4)%
Volume effect			122	8 %			3	— %
Price effect			(13)	(1)%			(52)	(3)%
Exchange rate effect			(3)	— %			(15)	(1)%
Pro forma combined operating earnings	405	357	48	13 %	357	382	(25)	(7)%
Additional costs of acquired Solutia inventories	—	21	(21)		21	—	21	
	1	17	(16)		17	(17)	34	

Pro forma combined asset impairments and restructuring charges (gains), net										
Pro forma combined operating earnings excluding non-core or non-recurring items	406	395	11	3	%	395	365	30	8	%

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2013 Compared to 2012

Sales revenue in 2013 increased compared to 2012 primarily due to $276 million in sales volume in first six months 2013 from the Solutia product lines acquired in third quarter 2012. Sales revenue also increased due to higher sales volume of solvents product lines attributed to strengthened coatings demand in the building and construction market supported by capacity additions at the Longview, Texas facility. Sales volume for Crystex® insoluble sulfur, particularly in Asia Pacific, and cellulosic polymers also increased attributed to increased demand in the transportation market. Sales revenue in 2013 for the polymers product lines included sales revenue of certain products sold primarily into the tires market which were previously reported in the A&P segment. These products had sales revenue of $49 million in 2012.

Pro forma combined sales revenue in 2013 increased compared to 2012 primarily due to higher sales volume of solvents product lines, Crystex® insoluble sulfur, and cellulosic polymers. Sales revenue in 2013 for the polymers product lines included sales revenue of certain products sold primarily into the tires market which were previously reported in the A&P segment. These products had sales revenue of $49 million in 2012.

Operating earnings in 2013 increased compared to 2012 primarily due to $52 million of operating earnings in first six months 2013 from the acquired Solutia product lines. In addition, operating earnings increased due to higher sales volume. Operating earnings in 2012 included $21 million of additional costs of acquired Solutia inventories. Operating earnings in 2012 also included $17 million of asset impairments and restructuring charges including $8 million for termination of an operating agreement at the acquired Solutia manufacturing facility in San Jose Dos Campos, Brazil and related manufacturing facility closure costs, and $6 million for the closure of a production facility in China.

Pro forma combined operating earnings in 2013 increased slightly compared to 2012. Operating earnings increased due to higher sales volume of $38 million. This increase was partially offset by $12 million due to lower selling prices and higher raw material and energy costs for antidegradants rubber additives product lines attributed to competitive conditions in a relatively weak tire market, and $5 million of higher costs of growth initiatives for existing businesses. Operating earnings were also negatively impacted by $8 million for lower capacity utilization of the rubber additives manufacturing facilities in 2013 compared to higher capacity utilization to build inventory in 2012. Operating earnings in 2012 included $21 million of additional costs of acquired Solutia inventories. Operating earnings in 2012 also included $17 million of asset impairments and restructuring charges including $8 million for termination of an operating agreement at the acquired Solutia manufacturing facility in San Jose Dos Campos, Brazil and related manufacturing facility closure costs; and $6 million for the closure of a production facility in China.

2012 Compared to 2011

Sales revenue in 2012 compared to 2011 increased primarily due to $265 million in sales volume from the Solutia rubber materials product lines acquired in third quarter 2012 and higher sales volume in the solvents product lines attributed to strengthened coatings demand in the U.S. These increases were partially offset by lower selling prices in response to lower raw material and energy costs, primarily in the solvents product lines and particularly for propane.

Pro forma combined sales revenue in 2012 compared to 2011 decreased primarily due to lower selling prices in response to lower raw material and energy costs in the solvents product lines and lower selling prices in rubber materials antidegradant product lines attributed to competitive conditions in a relatively weak tires market, primarily in Europe. Higher sales volume in the solvents product lines attributed to strengthened coatings demand in the U.S. was mostly offset by lower sales volume in the rubber additives product lines resulting from the challenging economic environment in Europe.

Operating earnings increased in 2012 compared to 2011 primarily due to lower raw material and energy costs more than offsetting lower selling prices by $53 million; $33 million related to operating earnings of the acquired Solutia rubber materials product lines, including $21 million of additional costs of acquired Solutia inventories in 2012; and higher sales volume primarily in coatings industry sales of $19 million. Operating earnings in 2012 included asset impairments and restructuring charges of $17 million including $8 million for termination of an operating agreement at the acquired Solutia manufacturing facility in San Jose Dos Campos, Brazil and related manufacturing facility closure costs, $6 million for the closure of a production facility in China, and $2 million due to a change in approach to address recently finalized boiler air emissions regulations.

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Pro forma combined operating earnings in 2012 included $21 million of additional costs of acquired Solutia inventories and the $17 million of asset impairments and restructuring charges described above. Pro forma combined operating earnings in 2011 included other operating income of $17 million for a gain from Solutia's divestiture of certain rubber chemicals operations. Excluding these items, operating earnings increased $30 million in 2012 compared to 2011 primarily due to lower raw material and energy costs more than offsetting slightly lower selling prices by $36 million, particularly in the solvents product lines.

Growth Initiatives

In second quarter 2013, the Company completed an expansion of ethylene oxide derivative capacity in Longview, Texas. In addition, the Company continues to make progress in the refinement and enhancement of its technology for the manufacture of Crystex® insoluble sulfur in order to improve its cost position and introduce a higher performance product into the tires industry. In the first half of 2014, management plans to complete evaluation of the timing of incorporating this technology into a capacity expansion at the Kuantan, Malaysia manufacturing facility to capitalize on expected high industrial growth rates in the Asia Pacific region.

Adhesives & Plasticizers Segment

	2013 Compared to 2012				2012 Compared to 2011			
			Change				Change	
(Dollars in millions)	2013	2012	$	%	2012	2011	$	%
Sales	$ 1,326	$ 1,432	$ (106)	(7)%	$ 1,432	$ 1,381	$ 51	4 %
Volume effect			(69)	(5)%			71	5 %
Price effect			(30)	(2)%			(5)	— %
Exchange rate effect			(7)	— %			(15)	(1)%
Operating earnings	172	260	(88)	(34)%	260	250	10	4 %
Asset impairments and restructuring charges (gains), net	1	3	(2)		3	—	3	
Operating earnings excluding non-core or non-recurring items	173	263	(90)	(34)%	263	250	13	5 %

2013 Compared to 2012

Sales revenue in 2013 decreased compared to 2012 primarily due to lower selling prices for both adhesives resins and plasticizers product lines and lower sales volume of adhesives resins product lines. Lower adhesives resins selling prices were primarily in response to increased competitive pressure due to greater industry supply attributed to increased availability of key raw materials and additional competitor capacity. Lower selling prices for plasticizers were primarily in response to competitive pressures resulting from continued weakened demand in Asia Pacific and Europe. Lower sales volume of adhesives resins product lines was primarily attributed to weakened demand in certain end markets including tapes, labels, and packaging, and customer inventory destocking occurring mainly in the first half of 2013. The decreased sales volume in adhesives resins was partially offset by continued substitution of phthalate plasticizers with non-phthalate plasticizers. Sales revenue in 2012 included $49 million of revenue from sales of certain products sold primarily into the tires market which are in 2013 reported in the AFP segment to combine the tires growth platforms of Solutia and Eastman.

Operating earnings in 2013 decreased compared to 2012 primarily due to $49 million of lower selling prices and higher raw material and energy costs and $24 million of lower sales volume of adhesives resins.

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2012 Compared to 2011

Sales revenue in 2012 compared to 2011 increased primarily due to higher sales volume in the plasticizers product lines attributed to continued substitution of primary non-phthalate plasticizers and niche non-phthalate plasticizers for phthalate plasticizers.

Operating earnings increased in 2012 compared to 2011, primarily due to higher sales volume of $31 million, partially offset by higher operating costs of $19 million primarily associated with the mid-year start up the Texas City, Texas plasticizer assets. Operating earnings in 2012 included asset impairments of $3 million due to a change in approach to address recently finalized boiler air emissions regulations.

Growth Initiatives

In third quarter 2011, the Company acquired Sterling, a single site North American petrochemical producer. The acquisition of Sterling allowed an idled plasticizer unit to be retrofitted to produce non-phthalate plasticizers in two phases, serving growing global demand for these products. The first phase was operational in second quarter 2012. In October 2013, the Company announced the second phase, a capacity expansion of its Eastman 168™ non-phthalate plasticizers at its manufacturing facility in Texas City, Texas. The expansion is expected to be operational mid-2014.

In third quarter 2012, the Company announced a joint venture to build a hydrogenated hydrocarbon resin plant in Nanjing, China. The venture will be equally owned by Eastman and Sinopec Yangzi Petrochemical Company Limited and is expected to be operational in late 2015. The facility is expected to produce 50,000 metric tons of the A&P segment's Regalite™ hydrocarbon resins upon completion, increasing Eastman's total capacity for hydrogenated resins by 50 percent, making Eastman the largest global supplier of hydrogenated hydrocarbon resins, and supporting expected demand growth for its products in hygiene and packaging applications.

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Advanced Materials Segment

	2013 Compared to 2012				2012 Compared to 2011			
			Change				Change	
(Dollars in millions)	2013	2012	$	%	2012	2011	$	%
Sales	$ 2,349	$ 1,694	$ 655	39 %	$ 1,694	$ 1,195	$ 499	42 %
Volume effect			665	39 %			482	40 %
Price effect			(8)	— %			22	2 %
Exchange rate effect			(2)	— %			(5)	— %
Operating earnings	257	84	173	206 %	84	125	(41)	(33)%
Additional costs of acquired Solutia inventories	—	41	(41)		41	—	41	
Asset impairments and restructuring charges (gains), net	3	29	(26)		29	—	29	
Operating earnings excluding non-core or non-recurring items	260	154	106	69 %	154	125	29	23 %
Pro forma combined sales	$ 2,349	$ 2,254	$ 95	4 %	$ 2,254	$ 2,313	$ (59)	(3)%
Volume effect			113	5 %			(51)	(2)%
Price effect			(14)	(1)%			26	1 %
Exchange rate effect			(4)	— %			(34)	(2)%
Pro forma combined operating earnings	257	135	122	90 %	135	251	(116)	(46)%
Additional costs of acquired Solutia inventories	—	41	(41)		41	—	41	
Pro forma combined asset impairments and restructuring charges (gains), net	3	34	(31)		34	—	34	
Pro forma combined operating earnings excluding non-core or non-recurring items	260	210	50	24 %	210	251	(41)	(16)%

2013 Compared to 2012

Sales revenue in 2013 increased compared to 2012 primarily due to $588 million in sales volume in first six months 2013 from the Solutia product lines acquired in third quarter 2012. Sales revenue also increased due to higher sales volume of Eastman Tritan™ copolyester.

Pro forma combined sales revenue in 2013 increased compared to 2012 primarily due to higher sales volume for Eastman Tritan™ copolyester and interlayers products with acoustic properties.

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Operating earnings in 2013 increased compared to 2012. Operating earnings in 2012 included asset impairments and restructuring charges of $29 million including $24 million for the termination of an operating agreement at the acquired Solutia manufacturing facility in San Jose Dos Campos, Brazil and related manufacturing facility closure costs. Operating earnings in 2012 also included $41 million of additional costs of acquired Solutia inventories. Excluding non-core or non-recurring items, operating earnings increased primarily due to operating earnings of $63 million in first six months 2013 from the acquired Solutia product lines. Operating earnings also increased primarily due to higher sales volume and increased sales of higher margin products, including Eastman Tritan™ copolyester and V-Kool® brand window films, and higher capacity utilization which led to lower unit costs, attributed to increased demand for specialty plastics products, especially for Eastman Tritan™ copolyester.

Pro forma combined operating earnings in 2013 increased compared to 2012. Asset impairments and restructuring charges of $29 million in 2012 including $24 million for the termination of an operating agreement at the acquired Solutia manufacturing facility in San Jose Dos Campos, Brazil and related manufacturing facility closure costs and $5 million related to Solutia's Southwall acquisition. Operating earnings in 2012 also included $41 million of additional costs of acquired Solutia inventories. Excluding non-core or non-recurring items, operating earnings increased primarily due to $67 million for higher sales volume and increased sales of higher margin products, including Eastman Tritan™ copolyester and V-Kool® brand window films, and higher capacity utilization which led to lower unit costs, attributed to increased demand for specialty plastics products, especially for Eastman Tritan™ copolyester. This increase was partially offset by $7 million higher costs of growth initiatives for existing product lines and the related supporting functions.

2012 Compared to 2011

Sales revenue in 2012 compared to 2011 increased primarily due to $532 million in sales volume from Solutia interlayers and performance films product lines acquired in third quarter 2012, partially offset by lower sales volume in the specialty materials product lines, particularly for copolyester products in the United States attributed to economic uncertainty and weakened demand.

Pro forma combined sales revenue decreased in 2012 compared to 2011 primarily due to lower sales volume primarily in the interlayers product line end markets, particularly the transportation market in Europe, and in the specialty materials product lines, primarily as a result of lower demand in specialty copolyester end markets, particularly consumables and retail.

Operating earnings decreased in 2012 compared to 2011. Operating earnings in 2012 included asset impairments and restructuring charges of $29 million including $24 million for the termination of an operating agreement at the acquired Solutia manufacturing facility in San Jose Dos Campos, Brazil and related manufacturing facility closure costs and $4 million due to a change in approach to address recently finalized boiler air emissions regulations. Operating earnings of $2 million from the acquired Solutia interlayers and performance films product lines included $41 million of additional costs of acquired Solutia inventories. Excluding non-core or non-recurring items, operating earnings increased primarily due to $43 million from the acquired product lines and lower raw materials and energy costs of $16 million, partially offset by lower capacity utilization rates resulting in costs of $22 million attributed to weakened end market demand and efforts to reduce inventory for specialty materials, and additional costs related to capacity expansions of $9 million.

Pro forma combined operating earnings included $41 million of additional costs of acquired Solutia inventories, asset impairments and restructuring charges of $34 million including the $29 million of asset impairments and restructuring charges described above and $5 million of restructuring charges related to Solutia's Southwall acquisition in 2012. Excluding these items, operating earnings decreased in 2012 compared to 2011, primarily due to $25 million of costs resulting from lower capacity utilization primarily attributed to weakened demand in interlayers and specialty materials product line end markets and efforts to reduce inventory in specialty materials and interlayers product lines, and $13 million of additional costs related to capacity expansions.

Growth Initiatives

In 2013, the Company began the expansion of Eastman Tritan™ copolyester capacity at its Kingsport, Tennessee manufacturing facility. This expansion is expected to be operational in the second half of 2014.

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The Company is also progressing on enhancements and innovations to improve its cost position in its polyvinyl butyral ("PVB") resin technology supporting growth in the transportation and building and construction markets in the Asia Pacific region. In the first half of 2014, management plans to complete evaluation of the timing of a capacity expansion at the Kuantan, Malaysia PVB manufacturing facility.

Fibers Segment

	2013 Compared to 2012				2012 Compared to 2011			
			Change				Change	
(Dollars in millions)	2013	2012	$	%	2012	2011	$	%
Sales	$ 1,441	$ 1,315	$ 126	10 %	$ 1,315	$ 1,279	$ 36	3 %
Volume effect			49	4 %			(21)	(2)%
Price effect			78	6 %			61	5 %
Exchange rate effect			(1)	— %			(4)	— %
Operating earnings	462	385	77	20 %	385	365	20	5 %
Asset impairments and restructuring charges (gains), net	—	3	(3)		3	—	3	
Operating earnings excluding non-core or non-recurring items	462	388	74	19 %	388	365	23	6 %

2013 Compared to 2012

Sales revenue in 2013 increased compared to 2012 due to higher selling prices and higher sales volume. Higher selling prices were in response to higher raw material and energy costs, particularly for wood pulp. Higher sales volume was primarily due to acetate flake sales to the new China acetate tow joint venture in 2013 and higher acetate yarn sales volume.

Operating earnings in 2013 increased compared to 2012 primarily due to higher selling prices more than offsetting higher raw material and energy costs.

2012 Compared to 2011

Sales revenue increased in 2012 compared to 2011 primarily due to higher selling prices partially offset by lower sales volume. The higher selling prices were in response to higher raw material and energy costs, particularly for wood pulp. The lower sales volume was due to lower sales volume of acetate yarn attributed to weakened demand in the apparel market.

Operating earnings increased in 2012 compared to 2011 primarily due to higher selling prices more than offsetting higher raw material and energy costs by $30 million partially offset by higher operating costs, including labor and maintenance costs of $13 million. Operating earnings in 2012 included asset impairments of $3 million due to a change in approach to address recently finalized boiler air emissions regulations.

Growth Initiatives

In third quarter 2013, the Company completed construction of a 30,000 metric ton acetate tow manufacturing facility in Hefei, China, in a joint venture with China National Tobacco Corporation in which the Company has 45 percent ownership. The Company supplies 100 percent of the acetate flake raw material to the joint venture from the Company's manufacturing facility in Kingsport. The Company expects to begin to recognize earnings through its equity investment, reported in "Other (income) charges, net" in the Consolidated Statement of Earnings, in the joint venture in 2014.

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Specialty Fluids & Intermediates Segment

	2013 Compared to 2012				2012 Compared to 2011			
			Change				Change	
(Dollars in millions)	2013	2012	$	%	2012	2011	$	%
Sales	$ 2,497	$ 2,318	$ 179	8 %	$ 2,318	$ 2,256	$ 62	3 %
Volume effect			197	9 %			166	7 %
Price effect			(16)	(1)%			(96)	(4)%
Exchange rate effect			(2)	— %			(8)	— %
Operating earnings	363	288	75	26 %	288	204	84	41 %
Additional costs of acquired Solutia inventories	—	17	(17)		17	—	17	
Asset impairments and restructuring charges (gains), net	1	9	(8)		9	7	2	
Operating earnings excluding non-core or non-recurring items	364	314	50	16 %	314	211	103	49 %
Pro forma combined sales	$ 2,497	$ 2,473	$ 24	1 %	$ 2,473	$ 2,548	$ (75)	(3)%
Volume effect			39	2 %			9	— %
Price effect			(14)	(1)%			(72)	(3)%
Exchange rate effect			(1)	— %			(12)	— %
Pro forma combined operating earnings	363	333	30	9 %	333	271	62	23 %
Additional costs of acquired Solutia inventories	—	17	(17)		17	—	17	
Pro forma combined asset impairments and restructuring charges (gains), net	1	9	(8)		9	7	2	
Pro forma combined operating earnings excluding non-core or non-recurring items	364	359	5	1 %	359	278	81	29 %

2013 Compared to 2012

Sales revenue in 2013 increased compared to 2012 primarily due to higher sales volume. Higher sales volume included $174 million in sales volume in first six months 2013 from the Solutia product lines acquired in third quarter

2012. Excluding these sales volumes from Solutia product lines, sales volume primarily increased due to increased olefin-based intermediates products sales particularly in the Asia Pacific region.

Pro forma combined sales revenue in 2013 was relatively unchanged compared to 2012. Sales revenue increased slightly as higher sales volume of olefin-based intermediates products sold primarily into Asia Pacific and higher selling prices for specialty fluids products more than offset lower selling prices for olefin-based intermediates products and lower volume of specialty fluids products due to timing of customer project completions.

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Operating earnings in 2013 increased compared to 2012. Operating earnings included $39 million of operating earnings from the acquired Solutia product lines in first six months 2013 and higher sales volume of $17 million. Operating earnings in 2013 also included lower selling prices more than offsetting lower raw material and energy costs, particularly for propane, by $11 million. Operating earnings in 2012 included $17 million of additional costs of acquired Solutia inventories.

Pro forma combined operating earnings in 2013 increased compared to 2012. Operating earnings in 2012 included $17 million of additional costs of acquired Solutia inventories. Excluding non-core or non-recurring items in both periods, pro forma combined operating earnings increased slightly in 2013 compared to 2012. The increase was primarily due to higher sales volume of olefin-based intermediates products of $20 million. This increase was partially offset by lower selling prices more than offsetting lower raw material and energy costs, particularly for propane, by $9 million and lower specialty fluids volume of $8 million due to timing of customer project completions.

2012 Compared to 2011

Sales revenue in 2012 compared to 2011 increased primarily due to higher sales volume partially offset by lower selling prices. The higher sales volume was primarily due to $163 million in sales volume from the acquired Solutia specialty fluids product lines. Lower selling prices were primarily in the intermediates product lines due to lower raw material and energy costs, particularly for propane.

Pro forma combined sales revenue decreased in 2012 compared to 2011 primarily due to lower selling prices in intermediates product lines due to lower raw material and energy costs, particularly for propane.

Operating earnings increased in 2012 compared to 2011. The increase was primarily due to lower raw material and energy costs more than offsetting lower selling prices by $90 million. Raw material and energy cost decreases were supported by the increased benefits from the Company cracking olefins to produce low-cost propylene and ethylene. Operating earnings in 2012 included $25 million of operating earnings from the acquired Solutia specialty fluids product lines, which included $17 million in additional costs of acquired Solutia inventories. Operating earnings were partially offset by $30 million of higher operating costs including increased maintenance for cracking unit assets. Operating earnings in 2012 also included asset impairments and restructuring charges of $9 million consisting of $3 million for the termination of an operating agreement at the acquired Solutia manufacturing facility in San Jose Dos Campos, Brazil and related manufacturing facility closure costs, and $6 million due to a change in approach to address recently finalized boiler air emissions regulations. Operating earnings in 2011 included income from an acetyl technology license offset by costs from the unplanned outage of an olefin cracking unit, and $7 million in restructuring charges, primarily for severance associated with the acquisition and integration of Sterling.

Pro forma combined operating earnings increased in 2012 compared to 2011. The increase was primarily due to lower raw material and energy costs more than offsetting lower selling prices of $108 million. Raw material and energy cost decreases were supported by the increased benefits from cracking olefins to produce low-cost propylene and ethylene. Operating earnings were also partially offset by $32 million of higher operating costs, including labor and maintenance costs. Operating earnings in 2012 included $17 million of additional costs of acquired Solutia inventories. Operating earnings in 2012 also included asset impairments and restructuring charges of $9 million described above. Operating earnings in 2011 also included income from an acetyl technology license offset by costs from the unplanned outage of an olefin cracking unit, and $7 million in restructuring charges, primarily for severance associated with the acquisition and integration of Sterling.

Growth Initiatives

The Company debottlenecked its largest olefins cracking unit in Longview, Texas in first quarter 2013, primarily to produce more ethylene to improve Eastman's olefin cost position. Additionally, the Company began a Therminol® heat transfer fluid capacity expansion in Newport, Wales, which is expected to be operational in the second half of 2014 to support expected demand in the industrial chemicals and processing market. During second quarter 2012, the Company entered into an agreement with Enterprise Products Partners L.P. to purchase propylene from a planned propane dehydrogenation plant expected to be operational in 2015, expected to further improve the Company's competitive cost position compared to purchasing olefins in the North American market. Prior to completion of the plant, the Company expects to continue to benefit from a propylene market contract improving its cost position for purchased propylene beginning in 2013.

The Company continues to actively pursue options with third parties for monetizing the Company's excess ethylene capacity. The Company intends to retain its cost-advantaged integrated position to propylene.

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The Company is also actively pursuing licensing opportunities for acetyls, oxo derivatives, and mono ethylene glycol, including the announcement in fourth quarter 2013 of the development, in conjunction with a third party, of advanced proprietary technology for the production of ethylene glycol from synthesis gas-based feedstocks.

In January 2014, the Company entered into a definitive agreement to acquire the assets of BP plc's global aviation turbine engine oil business, which had 2013 annual revenues of approximately $100 million. When added to the segment's Skydrol® aviation fluids, the acquired product portfolio is expected to enable Eastman to better meet the global aviation industry's needs. The acquisition is expected to be completed in the second quarter of 2014.

Other (Dollars in millions)	2013	2012	2011
Sales	$ 18	$ 11	$—
Operating loss			
Growth initiatives and businesses not allocated to segments	$ (132)	$ (132)	$ (49)
Pension and other postretirement benefit income (expense) and gain (loss) not allocated to operating segments	394	(294)	(173)
Transaction, integration, and restructuring costs related to the acquisition of Solutia	(59)	(76)	—
Operating loss before exclusions	203	(502)	(222)
Transaction and integration costs related to the acquisition of Solutia	36	44	—
Mark-to-market pension and other postretirement benefit plans (gain) loss	(383)	276	144
Asset impairments and restructuring charges, net	70	59	(15)
Operating loss excluding non-core or non-recurring items	$ (74)	$ (123)	$ (93)
Pro forma combined sales		$ 33	$ 77
Pro forma combined operating loss			
Growth initiatives and businesses not allocated to segments		$ (135)	$ (29)
Pension and other postretirement benefit plans income (expense) and gain (loss) not allocated to operating segments		(294)	(236)
Transaction, integration, and restructuring costs related to the acquisition of Solutia		(101)	—
Pro forma combined operating loss before exclusions		(530)	(265)
Transaction and integration costs related to the acquisition of Solutia		69	—
Mark-to-market pension and other postretirement benefits (gain) loss		276	209
Pro forma combined asset impairments and restructuring charges, net		59	4
Other operating (income)		—	(29)
Pro forma combined operating loss excluding non-core or non-recurring items		$ (126)	$ (81)

Sales revenue and R&D, certain components of pension and other postretirement benefits, and other expenses and income not identifiable to an operating segment are not included in segment operating results for any of the periods presented and are shown as "other" sales revenue and "other" operating earnings (loss) when applicable, including sales revenue of $18 million and $9 million in 2013 and 2012, respectively, for the Photovoltaics product line acquired from Solutia. For more information, see Note 21, "Segment Information", to the Company's audited consolidated financial statements in Part II, Item 8 of this Annual Report.

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Included in 2013 "other" segment operating loss were integration costs of $36 million, and restructuring charges primarily for severance of $23 million related to the acquisition and integration of Solutia. Included in 2012 "other" segment operating loss were transaction costs of $28 million, integration costs of $16 million, and restructuring charges primarily for severance of $32 million related to the acquisition and integration of Solutia.

During 2013, there were $44 million of asset impairments and restructuring charges primarily for management's decision not to continue the Perennial Wood™ growth initiative, the shut-down of the Photovoltaics product line primarily in Germany, and $23 million of restructuring charges primarily for severance for the continued integration of Solutia.

Operating results in 2012 included $59 million for asset impairments and restructuring charges, including the severance related to Solutia. During fourth quarter 2012, management decided to cease production of certain products in its Perennial Wood™ growth initiative. As a result, a restructuring charge of $17 million was recognized in fourth quarter for inventory costs in excess of recoverable value on these certain product lines and to accrue for losses on take-or-pay contracts with third parties. An analysis was performed to determine what, if any, impairment may be required for the associated fixed assets. Based on the expected life of the assets and intended uses within the Company's continuing acetylation initiatives, there was no impairment. The Company recognized asset impairments related to land retained from the previously discontinued industrial gasification project, reducing the carrying value of the Beaumont land by $6 million. During 2012, the Company also ceased research and development activities for renewable chemicals at a site it acquired in 2011, resulting in asset impairments and restructuring charges of $4 million.

Operating results in 2011 included a $15 million gain from the sale of the previously impaired methanol and ammonia assets related to the terminated Beaumont, Texas industrial gasification project. Excluding this gain, the increased losses were primarily due to expenses for the market launch of Perennial Wood™.

Pension expense not allocated to operating segments was $394 million, $294 million, and $173 million in 2013, 2012, and 2011 respectively, and included $383 million of an MTM gain in 2013 and $276 million and $144 million of MTM losses in 2012 and 2011, respectively.

The Company continues to explore and invest in research and development initiatives at a corporate level that are aligned with macro trends in sustainability, consumerism, and energy efficiency through high performance materials, advanced cellulosics, and environmentally-friendly chemistry. One of these initiatives is Eastman™ microfiber technology.

SUMMARY BY CUSTOMER LOCATION – 2013 COMPARED WITH 2012

Sales Revenue

	Sales Revenue			Pro Forma Combined Sales Revenue		
(Dollars in millions)	2013	2012	Change	2013	2012	Change
United States and Canada	$4,290	$3,995	7 %	$4,290	$4,264	1 %
Asia Pacific	2,584	2,088	24 %	2,584	2,396	8 %
Europe, Middle East, and Africa	1,975	1,605	23 %	1,975	1,968	— %
Latin America	501	414	21 %	501	492	2 %
	$9,350	$8,102	15 %	$9,350	$9,120	3 %

Sales revenue in United States and Canada increased in 2013 compared to 2012 primarily due to $307 million of sales volume in first six months 2013 from the acquired Solutia businesses and increased sales revenue in the AFP and

Fibers segments partially offset by decreased sales revenue in the A&P segment. Pro forma combined sales revenue in the region increased primarily due to increased pro forma combined sales revenue in the SFI and AFP segments and higher sales revenue in the Fibers segment more than offsetting decreased sales revenue in the A&P segment.

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Sales revenue in Asia Pacific increased in 2013 compared to 2012 primarily due to $314 million of sales volume in first six months 2013 from the acquired Solutia businesses and higher sales revenue in all segments except the A&P segment. Pro forma combined sales revenue in the region increased primarily due to increased sales revenue in the Fibers segment and increased pro forma combined sales revenue in the AM and SFI segments. Eastman serves the Asia Pacific region with a portfolio of specialty products that benefit from both the emerging middle class and a focused shift in China to a consumer driven economy with significantly less exposure to government infrastructure spending fluctuations.

Sales revenue in Europe, Middle East, and Africa increased in 2013 compared to 2012 primarily due to $350 million of sales volume in first six months 2013 from the acquired Solutia businesses. Pro forma combined sales revenue in the region remained unchanged primarily due to increased pro forma combined sales revenue in the AFP and AM segments offset by decreased pro forma combined sales revenue in the SFI segment and "Other" sales revenue and lower sales volume in the A&P and Fibers segments.

Sales revenue in Latin America increased in 2013 compared to 2012 primarily due to $78 million of sales volume in first six months 2013 from the acquired Solutia businesses. Pro forma combined sales revenue in the region increased slightly due to increased pro forma combined sales revenue in the AM segment partially offset by decreased pro forma combined sales revenue in the A&P and AFP segments.

With a substantial portion of sales to customers outside the United States, Eastman is subject to the risks associated with operating in international markets. To mitigate its exchange rate risks, the Company frequently seeks to negotiate payment terms in U.S. dollars or euros. In addition, where it deems such actions advisable, the Company engages in foreign currency hedging transactions and requires letters of credit and prepayment for shipments where its assessment of individual customer and country risks indicates their use is appropriate. For additional information concerning these practices, see Note 10, "Derivatives", to the Company's consolidated financial statements in Part II, Item 8 of this Annual Report and Part II, Item 7A--"Quantitative and Qualitative Disclosures About Market Risk" of this Annual Report.

SUMMARY BY CUSTOMER LOCATION – 2012 COMPARED WITH 2011

Sales Revenue

	Sales Revenue			Pro Forma Combined Sales Revenue		
(Dollars in millions)	2012	2011	Change	2012	2011	Change
United States and Canada	$3,995	$3,824	4 %	$4,264	$4,364	(2)%
Asia Pacific	2,088	1,681	24 %	2,396	2,315	3 %
Europe, Middle East, and Africa	1,605	1,352	19 %	1,968	2,119	(7)%
Latin America	414	321	29 %	492	477	3 %
	$8,102	$7,178	13 %	$9,120	$9,275	(2)%

Sales revenue in United States and Canada increased in 2012 compared to 2011 primarily due to $260 million of higher sales volume from the acquired Solutia businesses. Excluding the volume from acquired Solutia businesses, reduced sales were due to lower sales volume in the AM and Fibers segments more than offsetting higher sales volume in the remainder of the segments. Lower selling prices were particularly in the SFI and AFP segments. Pro forma combined sales revenue in the region decreased due to lower pro forma combined sales revenue in the AM, SFI, and AFP segments partially offset by higher pro forma combined sales revenue in the A&P segment.

Sales revenue in Asia Pacific increased in 2012 compared to 2011 primarily due to $318 million of higher sales volume from the acquired Solutia businesses and higher sales volume in all segments. Pro forma combined sales revenue in the region increased due to increased pro forma combined sales revenue in all segments except the SFI segment.

Sales revenue in Europe, Middle East, and Africa increased in 2012 compared to 2011 primarily due to $317 million of higher sales volume from the acquired Solutia businesses partially offset by lower sales volume due to the economic uncertainty and an unfavorable shift in the euro to U.S. dollar exchange rate. Pro forma combined sales revenue in the region decreased due to decreased pro forma combined sales revenue in all segments.

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Sales revenue in Latin America increased in 2012 compared to 2011 primarily due to $74 million of higher sales volume from the acquired Solutia businesses and higher sales volume in the A&P segment particularly due to increase in sales volume in the plasticizers product line from the third quarter 2011 acquisition of Scandiflex do Brasil S.A. Indústrias Químicas. Pro forma combined sales revenue in the region increased due to higher pro forma combined sales revenue in the A&P segment partially offset by lower pro forma combined sales revenue in the SFI segment.

LIQUIDITY, CAPITAL RESOURCES, AND OTHER FINANCIAL INFORMATION

Cash Flows (Dollars in millions)	2013	2012	2011
Net cash provided by (used in):			
Operating activities	$1,297	$1,128	$625
Investing activities	(457)	(2,962)	(142)
Financing activities	(859)	1,504	(423)
Effect of exchange rate changes on cash and cash equivalents	7	2	1
Net change in cash and cash equivalents	$(12)	$(328)	$61
Cash and cash equivalents at beginning of period	249	577	516
Cash and cash equivalents at end of period	$237	$249	$577

Cash provided by operating activities increased $169 million in 2013 compared with 2012. The increase was primarily due to increased 2013 cash earnings from the Company's businesses and approximately $100 million of one-time payments in 2012 related to the acquisition of Solutia, partially offset by working capital requirements, higher income tax payments, and higher interest payments. The increase in working capital requirements was primarily due to trade receivables which increased $38 million in 2013 due to an increase in sales revenue during 2013 as compared with a $48 million decrease in 2012. Bond interest payments were $75 million higher in 2013 than 2012 due to a full year of interest payments on borrowings for the acquisition of Solutia.

Cash provided by operating activities increased $503 million in 2012 compared with 2011. The increase was primarily due to a decrease in working capital requirements, particularly inventories which remained relatively unchanged during 2012 as compared with an increase in inventories during 2011 primarily due to higher raw material and energy costs. The Company also benefited from increased cash earnings from the Company's business segments primarily due to the acquisition of Solutia and lower income tax payments in 2012 primarily due to the $110 million payment for the tax gain on the sale of the PET business completed first quarter 2011. Cash provided by operating activities in 2012 included approximately $100 million of one-time payments related to the acquisition of Solutia.

Cash used in investing activities decreased $2.5 billion in 2013 compared with 2012. The decrease was primarily due to the $2.6 billion cash portion of the purchase price for the acquisition of Solutia in 2012. Cash used for additions to properties and equipment was $483 million in 2013 and $465 million in 2012, respectively.

Cash used in investing activities increased $2.8 billion in 2012 compared with 2011. The increase was primarily due to the $2.6 billion cash portion of the purchase price for the acquisition of Solutia in 2012 and $615 million cash received from the sale of the PET business in 2011. Partially offsetting the increase in cash used in investing activities was $200 million in proceeds from the redemption of short-term time deposits in 2012 which were used to partially fund the cash portion of the Solutia acquisition. Cash used for additions to properties and equipment was $465 million and $457 million in 2012 and 2011, respectively.

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Cash used in financing activities was $859 million in 2013 and cash provided by financing activities was $1.5 billion in 2012. During 2013, the Company received $425 million in proceeds from commercial paper borrowings. The Company repaid the remaining $950 million of borrowings under the Term Loan. Proceeds from stock warrant exercises of $16 million and cash used for stock repurchases of $238 million were included in 2013. Proceeds from the issuance of debt for the Solutia acquisition were included in 2012. Proceeds from the issuance of Solutia acquisition debt are presented net of original issue discounts, issuance costs, and the monetization of interest rate swaps. The payment of dividends, which was $140 million in 2013 and $192 million in 2012, is also reflected in financing activities in all periods. The payment of the fourth quarter 2012 dividend of $45 million in December 2012 rather than January 2013 resulted in a decrease in total dividend payments in 2013.

Cash provided by financing activities was $1.5 billion in 2012 and cash used in financing activities was $423 million in 2011. The increase was primarily due to borrowings for the acquisition of Solutia and lower share repurchases partially offset by the repayment of debt and higher dividend payments. Borrowings included net proceeds of $2.3 billion from notes issued which are presented net of original issue discounts, issuance costs, and the monetization of interest rate swaps. Borrowings also included the $1.2 billion Term Loan. Financing fees for the Term Loan and related financing commitments were approximately $26 million. The payment of dividends, which was $192 million and $136 million in 2012 and 2011 respectively, increased primarily due to accelerated timing of payment of the fourth quarter 2012 dividend and some impact from increased shares outstanding due to the acquisition of Solutia and an increase of the quarterly dividend rate.

In 2014, the Company expects capital expenditures of approximately $600 million and U. S. defined benefit pension plan funding of $120 million. The priorities for uses of available cash in 2014 are expected to be funding growth initiatives and returning cash to stockholders by dividend payments and stock repurchases.

Liquidity and Capital Resources

The Company had cash and cash equivalents and short-term time deposits as follows:

(Dollars in millions)	December 31,		
	2013	2012	2011
Cash and cash equivalents	$237	$249	$577
Short-term time deposits	—	—	200
Total cash and cash equivalents and short-term time deposits	$237	$249	$777

In addition, at December 31, 2013, the Company had access to the sources of liquidity described below.

In October 2013, the Company entered into a $1 billion revolving credit agreement (the "Credit Facility") expiring October 2018. The Credit Facility amends and extends, and has terms substantially similar to, the $750 million revolving credit agreement entered into in December 2011 (the "Prior Credit Facility"). Borrowings under the Credit Facility are subject to interest at varying spreads above quoted market rates and a commitment fee is paid on the total unused commitment. At December 31, 2013 and December 31, 2012, the Company had no outstanding borrowings under the Credit Facility.

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The Credit Facility provides liquidity support for commercial paper borrowings and general corporate purposes. Accordingly, any outstanding commercial paper borrowings reduce capacity for borrowings available under the Credit Facility. Given the expiration date 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. At December 31, 2013, the Company's commercial paper borrowings were $425 million with a weighted average interest rate of 0.35 percent, and the proceeds were used to repay a portion of the Term Loan. There were no commercial paper borrowings at December 31, 2012.

The Company also has a $250 million line of credit under its accounts receivable securitization agreement (the "A/R Facility"), expiring April 2016. Borrowings under the A/R Facility are subject to interest rates based on a spread over the lender's borrowing costs, and the Company pays a fee to maintain availability of the A/R Facility. At December 31, 2013 and December 31, 2012 the Company had no outstanding borrowings under the A/R Facility. During second quarter 2013, $150 million of the available amount under the A/R Facility was borrowed and then repaid during fourth quarter 2013. The entire available amount under the A/R Facility was borrowed and then repaid during third quarter 2012, and $100 million of the available amount under the A/R Facility was borrowed and then repaid during fourth quarter 2012. This activity is presented on a net basis within the cash flows from financing activities section of the Statements of Cash Flows.

On July 2, 2012, the Company borrowed the entire $1.2 billion available under the five-year Term Loan. Proceeds from these borrowings were used to pay, in part, the cash portion of the Solutia acquisition, repay Solutia debt, and pay acquisition costs. As of December 31, 2013, the Company had repaid its $1.2 billion Term Loan using $425 million of commercial paper borrowings and $775 million in cash. At December 31, 2012, the Term Loan balance outstanding was $950 million.

The Credit Facility and the A/R Facility 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. Other than the $425 million reduction in the amount available under the Credit Facility as of December 31, 2013 as a result of commercial paper borrowing, substantially all of the amounts under the Credit Facility and A/R Facility were available for borrowings as of December 31, 2013 and December 31, 2012. The Company would not violate applicable covenants for these periods if the total available amounts of the facilities had been borrowed.

For more information regarding interest rates, see Note 9, "Borrowings", to the Company's consolidated financial statements in Part II, Item 8 of this Annual Report.

In 2013, the Company made $120 million in contributions to its U.S. defined benefit pension plans, of which approximately $70 million is the minimum required cash contribution under the Employee Retirement Income Security Act of 1974, as amended, and the Internal Revenue Code of 1986, as amended. In 2012 and 2011, the Company made $124 million and $102 million, respectively, in contributions to its U.S. defined benefit pension plans. Excess contributions are periodically made by management in order to keep the plans' funded status above 80 percent under the funding provisions of the Pension Protection Act to avoid partial benefit restrictions on accelerated forms of payment. The Company's U.S. defined benefit pension plans are not currently under any benefit restrictions. The Company expects U.S. defined benefit pension plan funding of approximately $120 million in 2014.

The Company maintains allowances for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments. An analysis of trends including the aging of accounts receivable and days sales outstanding is performed on a regular basis in order to ensure appropriate adjustments are made to the allowance for doubtful accounts in a timely manner. No significant variances were identified in the trend analysis performed for fourth quarter 2013 compared to third quarter 2013. The Company believes, based on historical results and its regular analysis, the likelihood of write-offs having a material adverse impact on financial results is remote.

Cash flows from operations, cash and cash equivalents, and the other sources of liquidity described above are expected to be available and sufficient to meet foreseeable cash flow requirements. However, the Company's cash flows from operations can be affected by numerous factors including risks associated with global operations, raw material availability and cost, demand for and pricing of Eastman's products, capacity utilization, and other factors described under "Forward-Looking Statements and Risk Factors" below. Eastman management believes maintaining a financial profile consistent with an investment grade company is important to its long-term strategic and financial flexibility.

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MANAGEMENT'S DISCUSSION AND ANALYSIS OF
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Capital Expenditures

Capital expenditures were $483 million, $465 million, and $457 million for 2013, 2012, and 2011, respectively. Capital expenditures in 2011 were primarily for organic growth initiatives, particularly in the AM, A&P and SFI segments. Capital expenditures in 2012 were primarily for organic growth initiatives, particularly in the SFI and AM segments. The expenditures in 2013 were primarily for improvements to plants, purchases of equipment, and organic growth initiatives particularly in the SFI and AM segments. The Company expects that 2014 capital spending will be approximately $600 million, including capital investment that will modernize and expand the Kingsport, Tennessee site, and a Therminol® heat transfer fluid capacity expansion in Newport, Wales.

Other Commitments

At December 31, 2013, the Company's obligations under notes and debentures and credit facilities totaled approximately $4.3 billion to be paid over a period of approximately 30 years. See Note 9, "Borrowings", to the Company's consolidated financial statements in Part II, Item 8 of this Annual Report.

The Company had various purchase obligations at December 31, 2013, totaling $2.5 billion over a period of approximately 30 years for materials, supplies and energy incident to the ordinary conduct of business. The Company also had various lease commitments for property and equipment under cancelable, noncancelable, and month-to-month operating leases totaling approximately $210 million over a period of several years. Of the total lease commitments, approximately 5 percent relate to machinery and equipment, including computer and communications equipment and production equipment; approximately 60 percent relate to real property, including office space, storage facilities, and land; and approximately 35 percent relate to railcars.

In addition, the Company had other liabilities at December 31, 2013, totaling approximately $1.9 billion related primarily to pension, retiree medical, other postretirement benefit obligations, and environmental reserves.

The obligations described above, and long-term debt repayment obligations, are summarized in the following table:

(Dollars in millions)	Payments Due for						
Period	Notes and Debentures	Facility Borrowings and Other	Interest Payable	Purchase Obligations	Operating Leases	Other Liabilities (a)	Total
2014	$—	$—	$162	$410	$44	$344	$960
2015	250	—	162	404	38	81	935
2016	—	—	154	269	35	96	554
2017	998	—	142	218	24	85	1,467
2018	171	425	130	211	15	85	1,037
2019 and beyond	2,410	—	1,012	971	54	1,229	5,676
Total	$3,829	$425	$1,762	$2,483	$210	$1,920	$10,629

(a) Amounts represent the current estimated cash payments required to be made by the Company primarily for pension and other postretirement benefits, environmental obligations and uncertain tax liabilities in the periods indicated. The amount and timing of such pension and other postretirement benefit payments is dependent upon interest rates, health care cost trends, actual returns on plan assets, retirement and attrition rates of employees, continuation or modification of the benefit plans, and other factors. Such factors can significantly impact the amount and timing of any future contributions by the Company. See Note 13, "Environmental Matters" to the Company's consolidated financial statements in Part II, Item 8 of this Annual Report for expected cash payments related to environmental obligations. Due to uncertainties in the timing of the effective settlement of tax positions with respect to taxing authorities, management is unable to determine the timing of payments related to uncertain tax liabilities, these amounts are included in the "2019 and beyond" line item.

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Off Balance Sheet and Other Financing Arrangements

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 December 31, 2013 totaled $117 million and consisted primarily of leases for railcars and Company aircraft and will expire beginning in 2016. Management believes, based on current facts and circumstances, that the likelihood of material residual guarantee payments is remote.

Guarantees and claims also arise during the ordinary course of business from relationships with joint venture partners, suppliers, customers, and other parties when the Company undertakes an obligation to guarantee the performance of others, if specified triggering events occur. Non-performance under a contract could trigger an obligation of the Company. The Company's current other guarantees include guarantees relating primarily to intellectual property, environmental matters, and other indemnifications and have arisen through the normal course of business. The ultimate effect on future financial results is not subject to reasonable estimation because considerable uncertainty exists as to the final outcome of these claims, if they were to occur. These other guarantees have terms between 1 and 15 years with maximum potential future payments of approximately $49 million in the aggregate, with none of these guarantees individually significant to the Company's operating results, financial position, or liquidity. The Company's current expectation is that future payment or performance related to non-performance under other guarantees is considered remote.

The Company did not have any material relationships with unconsolidated entities or financial partnerships, including special purpose entities, for the purpose of facilitating off-balance sheet arrangements with contractually narrow or limited purposes. Thus, Eastman is not materially exposed to any financing, liquidity, market, or credit risk related to any such relationships.

Treasury Stock

In August 2010, the Company's Board of Directors authorized $300 million for the repurchase of the Company's outstanding common stock. The Company completed purchases under the $300 million authorization in June 2011, acquiring a total of 7,110,524 shares.

In February 2011, the Company's Board of Directors authorized the repurchase of up to $300 million of the Company's outstanding common stock. The Company completed purchases under this $300 million repurchase authorization in August 2013, acquiring a total of 6,141,999 shares.

In May 2013, the Company's Board of Directors authorized an additional repurchase of up to $300 million of the Company's outstanding common stock at such times, in such amounts, and on such terms, as determined to be in the best interests of the Company. As of December 31, 2013, a total of 1,828,526 shares of common stock have been repurchased under this authorization for a total amount of $140 million.

In February 2014, the Company's Board of Directors authorized repurchase of up to an additional $1 billion of the Company's outstanding common stock at such times, in such amounts, and on such terms, as determined to be in the best interests of the Company.

During 2013, the Company repurchased 3,212,886 shares of common stock for a cost of approximately $238 million. The Company did not repurchase any shares of common stock during 2012.

Dividends

The Company's Board of Directors declared quarterly cash dividends of $0.30 per share in first, second, and third quarters and $0.35 per share in fourth quarter 2013 for a total of $1.25 per share in 2013. The Company's Board of Directors declared quarterly cash dividends of $0.26 per share in first, second, and third quarters and $0.30 per share in fourth quarter 2012 for a total of $1.08 per share in 2012. The Board of Directors declared quarterly cash dividends of $0.235 per share in first and second quarters and $0.26 per share in third and fourth quarters 2011 for a total of $0.99 per share in 2011. The Board of Directors has declared a cash dividend of $0.35 per share during the first quarter of 2014, payable on April 1, 2014 to stockholders of record on March 14, 2014.

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ENVIRONMENTAL

Certain Eastman manufacturing sites generate hazardous and nonhazardous wastes of which the treatment, storage, transportation, and disposal 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 as described in Note 1, "Significant Accounting Policies", to the Company's consolidated financial statements in Part II, Item 8 of this Annual Report. Although the resolution of uncertainties related to these environmental matters may have a material adverse effect on the Company's consolidated results of operations in the period recognized, because of 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 or cash flows. The Company's total reserve for environmental contingencies was $368 million and $394 million at December 31, 2013 and December 31, 2012, respectively. At December 31, 2013 and December 31, 2012, this reserve included $9 million and $8 million respectively related to previously closed and impaired sites, as well as sites that have been divested but for which the Company retains the environmental liability.

The Company accrues environmental remediation costs when it is probable that the Company has incurred a liability at a contaminated site and the amount can be reasonably estimated. When a single amount cannot be reasonably estimated but the cost can be estimated within a range, the Company accrues the minimum amount. This undiscounted accrued amount reflects liabilities expected to be paid out within 30 years and the Company's assumptions about remediation requirements at the contaminated site, the nature of the remedy, the outcome of discussions with regulatory agencies and other potentially responsible parties at multi-party sites, and the number and financial viability of other potentially responsible parties. Changes in the estimates on which the accruals are based, unanticipated government enforcement action, or changes in health, safety, environmental, and chemical control regulations and testing requirements could result in higher or lower costs. Estimated future environmental expenditures for remediation costs ranged from the minimum or best estimate of $341 million to the maximum of $581 million at December 31, 2013. The maximum estimated future costs are considered to be only reasonably possible and include the amounts accrued at December 31, 2013.

Reserves for environmental remediation that management believes to be probable and estimable are recorded appropriately as current and long-term liabilities in the Consolidated Statements of Financial Position. The amounts charged to pre-tax earnings for environmental remediation and related charges are included in cost of goods sold and other charges (income), net, and are summarized below:

(Dollars in millions)	Environmental Remediation Liabilities
Balance at December 31, 2012	$365
Changes in estimates recorded to earnings and other	7
Cash reductions	(31)
Balance at December 31, 2013	$341

Costs of certain remediation projects included in the environmental reserve are subject to a cost-sharing arrangement with Monsanto Company ("Monsanto") under the provisions of the Amended and Restated Settlement Agreement effective February 28, 2008 (the "Effective Date"), into which Solutia entered with Monsanto upon its emergence from bankruptcy (the "Monsanto Settlement Agreement"). Under the provisions of the Monsanto Settlement Agreement, the Company shares responsibility with Monsanto for remediation at certain locations outside of the boundaries of plant sites in Anniston, Alabama and Sauget, Illinois (the "Shared Sites"). The Company is responsible for the funding of environmental liabilities at the Shared Sites up to a total of $325 million from the Effective Date. If remediation costs for the Shared Sites exceed this amount, such costs will thereafter be shared equally between the Company and Monsanto. Including payments by Solutia prior to its acquisition by Eastman, $56 million had been paid for costs at the Shared Sites as of December 31, 2013. As of December 31, 2013, an additional $215 million has been accrued for estimated future remediation costs at the Shared Sites, over a period of thirty years.

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In addition to remediation activities, the Company establishes reserves for closure and postclosure costs associated with the environmental assets it maintains. Environmental assets include but are not limited to waste management units, such as landfills, water treatment facilities, and ash ponds. When these types of assets are constructed or installed, a reserve is established for the anticipated future costs associated with the closure of the asset based on its expected life and the applicable regulatory closure requirements. These future costs are charged into earnings over the estimated useful life of the assets. The best estimate accrued to date over the facilities' estimated useful lives for environmental asset retirement obligation costs was $27 million and $29 million at December 31, 2013 and December 31, 2012, respectively.

The Company's total environmental reserve for environmental contingencies, including remediation costs and asset retirement obligations, is recorded in the Consolidated Statements of Financial Position as follows:

	December 31,	
(Dollars in millions)	2013	2012
Environmental contingent liabilities, current	$40	$35
Environmental contingent liabilities, long-term	328	359
Total	$368	$394

GAAP requires an entity to recognize a liability for a conditional asset retirement obligation ("CARO") when incurred if the liability can be reasonably estimated. The Company has performed an examination of various asset categories as of December 31, 2013. Although it may have CAROs at certain of its facilities, including, but not limited to, the potential for asbestos abatement activities, the Company is unable to determine potential settlement dates to be used in fair value calculations for estimating these obligations as a result of an absence of plans or expectations to undertake a major renovation or demolition project that would require the removal of asbestos. The Company continues to monitor these conditional obligations, as well as any new ones that may develop, and will recognize contingent liabilities associated with them when and to the extent that more detailed information becomes available concerning applicable retirement costs. The accrued obligations do not have a material impact on the Company's consolidated financial position, results of operations and cash flows.

Reserves related to environmental asset retirement obligations accounted for less than 10 percent of the total environmental reserve at December 31, 2013. Currently, the Company's environmental assets are expected to reach the end of their useful lives at different times over the next 50 years. If the Company was to invest in numerous new environmental assets, or these assets were to require closure a significant number of years before the Company anticipated they would, the amortization on them would increase, and could have a material negative impact on the Company's financial condition and results of operations. The Company views the likelihood of this occurrence to be remote, and does not anticipate, based on its past experience with this type of planned remediation, that an additional accrual related to environmental assets will be necessary.

The Company's cash expenditures related to environmental protection and improvement were $285 million, $262 million, and $219 million in 2013, 2012, and 2011, respectively. These amounts were primarily for operating costs associated with environmental protection equipment and facilities, but also included $53 million and $34 million in expenditures for engineering and construction in 2013 and 2012, respectively. Expenditures in 2012 also included costs and expenditures in the second half of the year for sites acquired in the acquisition of Solutia. Management anticipates that capital expenditures associated with the Company's approach to addressing boiler air emissions regulations will modestly increase average annual environmental capital expenditures over the next four to five years compared to recent historical levels. However, the Company has decided to convert 50 percent of its steam and electric generation capacity at the Kingsport, Tennessee facility to natural gas over that period, which management believes is a more cost-efficient approach to compliance with air emissions regulations. Management does not believe that these expenditures will have a material adverse effect on the Company's consolidated financial position or cash flows. Other than these planned capital expenditures at the Company's Kingsport, Tennessee facility, the Company does not currently expect future environmental capital expenditures arising from requirements of recently promulgated environmental laws and regulations to materially increase the Company's planned level of annual capital expenditures for environmental control facilities.

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INFLATION

In recent years, general economic inflation has not had a material adverse impact on Eastman's costs. The cost of raw materials is generally based on market prices, although derivative financial instruments are utilized, as appropriate, to mitigate short-term market price fluctuations. Management expects the volatility of raw material and energy costs to continue and the Company will continue to pursue pricing and hedging strategies and ongoing cost control initiatives to offset the effects. For additional information see Note 10, "Derivatives", to the Company's consolidated financial statements in Part II, Item 8 of this Annual Report.

RECENTLY ISSUED ACCOUNTING STANDARDS

For information regarding the impact of recently issued accounting standards, see Note 24 "Recently Issued Accounting Standards", to the Company's consolidated financial statements in Part II, Item 8 of this Annual Report.

OUTLOOK

Eastman is focused on achieving consistent earnings growth through a market-driven approach that takes advantage of the Company's existing technology platforms, global marketing and manufacturing presence, and leading positions in end markets. This focus is supported by the Company's geographic and end-market diversity as it serves global markets, including emerging economies with above average growth rates, and offers both original equipment manufacturing and after-market products in a variety of end markets, such as transportation, building and construction, and consumables.

The Company expects global growth in 2014 to be slightly above two percent, with the U.S. approximately three percent, Europe approximately one percent, and China near seven and a half percent.

The Company expects that market prices for commodity products and raw material and energy costs will continue to be volatile, and the Company will continue to use pricing and hedging strategies to mitigate this volatility.

For 2014, in addition to the benefit of capacity expansions, improved product mix, and licensing, the Company expects:

- cash generated by operating activities of approximately $1.4 billion;
- capital spending to be approximately $600 million; and
- its full year tax rate on reported earnings from continuing operations before income tax to be approximately 29 percent.

Based upon the foregoing expectations, and given the strength of its differentiated portfolio of businesses, the Company currently expects 2014 earnings per share to be between $6.70 and $7.00. Any non-core and non-recurring items are excluded from the earnings per share projection.

See "Forward-Looking Statements and Risk Factors" below.

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

FORWARD-LOOKING STATEMENTS AND RISK FACTORS

Certain statements made in this Quarterly Report are "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act, Section 27A of the Securities Act of 1933, as amended and Section 21E of the Securities and Exchange Act of 1934, as amended. Forward-looking statements are all statements, other than statements of historical fact, that may be made by us from time to time. In some cases, you can identify forward-looking statements by terminology such as "anticipates," "believes," "estimates," "expects," "intends," "may," "plans," "projects," "will," "would," and similar expressions or expressions of the negative of these terms. Forward-looking statements may relate to, among other things, such matters as planned and expected capacity increases and utilization; anticipated capital spending; expected depreciation and amortization; environmental matters; pending and future legal proceedings; exposure to, and effects of hedging of, raw material and energy costs, foreign currencies and interest rates; global and regional economic, political, and business conditions; competition; growth opportunities; supply and demand, volume, price, cost, margin and sales; earnings, cash flow, dividends and other expected financial results and conditions; expectations, strategies, and plans for individual assets and products, businesses, and segments as well as for the whole of Eastman; cash requirements and uses of available cash; financing plans and activities; pension expenses and funding; credit ratings; anticipated and other future restructuring, acquisition, divestiture, and consolidation activities; cost reduction and control efforts and targets; the timing and costs of, and benefits from, the integration of, and expected business and financial performance of, acquired businesses; strategic initiatives and development, production, commercialization and acceptance of new products, services and technologies and related costs; asset, business and product portfolio changes; and expected tax rates and net interest costs.
Forward-looking statements are based upon certain underlying assumptions as of the date such statements were made. Such assumptions are based upon internal estimates and other analyses of current market conditions and trends, management expectations, plans, and strategies, economic conditions, and other factors. Forward-looking statements and the assumptions underlying them are necessarily subject to risks and uncertainties inherent in projecting future conditions and results. Actual results could differ materially from expectations expressed in the forward-looking statements if one or more of the underlying assumptions and expectations proves to be inaccurate or is unrealized. In addition to the factors described elsewhere in this Quarterly Report, the following are the most significant known factors, risks, and uncertainties that could cause actual results to differ materially from those in the forward-looking statements.
The Company cautions you not to place undue reliance on forward-looking statements, which speak only as of the date of this Quarterly Report. Additional factors not presently known to the Company, or that the Company does not currently believe to be material, may also cause actual results to differ materially from expectations. Except as may be required by law, the Company undertakes no obligation to update or alter these forward-looking statements, whether as a result of new information, future events, or otherwise.

Continued uncertain conditions in the global economy and the financial markets could negatively impact the Company.

While economic and financial market conditions have improved from those in 2008 and 2009, continued uncertain conditions in the global economy and global capital markets and uncertainty about the length and stability of economic recovery may adversely affect the Company's results of operations, financial condition, and cash flows. The Company's business and operating results were affected by the impact of the most recent global recession, including the credit market crisis, declining consumer and business confidence, fluctuating commodity prices, volatile exchange rates, and other challenges that affected the global economy. If the global economy or financial markets again deteriorate or experience significant new disruptions, the Company's results of operations, financial condition, and cash flows could be materially adversely affected; in addition the Company's ability to access the credit and capital markets under attractive rates and terms could be constrained, which may negatively impact the Company's liquidity or ability to pursue certain growth initiatives.

Volatility in costs for strategic raw material and energy commodities or disruption in the supply of these commodities could adversely affect our financial results.

The Company is reliant on certain strategic raw material and energy commodities for its operations and utilizes risk management tools, including hedging, as appropriate, to mitigate short-term market fluctuations in raw material and energy costs. These risk mitigation measures cannot eliminate all exposure to market fluctuations. In addition, natural disasters, plant interruptions, changes in laws or regulations, war or other outbreak of hostilities or terrorism, and breakdown or degradation of transportation infrastructure used for delivery of strategic raw material and energy commodities, could adversely impact both the cost and availability of these commodities.

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

The Company's business is subject to operating risks common to chemical manufacturing businesses, any of which could disrupt manufacturing operations or related infrastructure and adversely affect results of operations.

As a global specialty chemicals manufacturing company, our business is subject to operating risks common to chemical manufacturing, storage, handling, and transportation. Significant limitation on the Company's ability to manufacture products due to disruption of manufacturing operations or related infrastructure could have a material adverse effect on the Company's sales revenue, costs, results of operations, and financial condition. Disruptions could occur due to internal factors such as computer or equipment malfunction (accidental or intentional), operator error, or process failures; or external factors such as computer or equipment malfunction at third-party service providers, natural disasters, pandemic illness, changes in laws or regulations, war or other outbreak of hostilities or terrorism, cyber attacks, or breakdown or degradation of transportation infrastructure used for delivery of supplies to the Company or for delivery of products to customers. The Company has in the past experienced cyber attacks and breaches of its computer information systems, and although none of these has had a material adverse effect on the Company's operations, no assurances can be provided against the impact of any future disruptions due to these, or other, circumstances. Such disruptions could result in an unplanned event that could be significant in scale and could negatively impact operations, neighbors, and the environment, and could have a negative impact on the Company's results of operations.

Loss or financial weakness of any of the Company's largest customers could adversely affect our financial results.

The Company has an extensive customer base; however, loss of, or material financial weakness of, certain of our largest customers could adversely affect the Company's financial condition and results of operations until such business is replaced and no assurances can be made that the Company would be able to regain or replace any lost customers.

Growth initiatives may not achieve desired business or financial objectives and may require a significant use of resources in excess of those estimated or budgeted for such initiatives.

The Company continues to identify and pursue growth opportunities through both internal (or "organic") development and acquisitions and joint ventures to diversify and extend the portfolio of our businesses. These growth opportunities include development and commercialization or licensing of innovative new products and technologies and related employee leadership, expertise, and skill development and retention, expansion into new markets and geographic regions, and alliances, ventures, and acquisitions that complement and extend the Company's portfolio of businesses and capabilities. There can be no assurance that such innovation, development and commercialization or licensing efforts, investments, or acquisitions and alliances (including integration of acquired businesses) will result in financially successful commercialization of products, or acceptance by existing or new customers, or successful entry into new markets or otherwise achieve their underlying strategic business objectives or that they will be beneficial to the Company's results of operations. There also can be no assurance regarding the timing of completion of proposed acquisitions or licensing, expected benefits of proposed acquisitions or licensing, completion of integration plans, and synergies therefrom. There also can be no assurance that capital projects for growth efforts can be completed within the time or at the costs projected due, among other things, to demand for and availability of construction materials and labor and obtaining regulatory approvals and operating permits and reaching agreement on terms of key agreements and arrangements with potential suppliers and customers. Any such delays or cost overruns or the inability to obtain such approvals or to reach such agreements on acceptable terms could negatively affect the returns from any proposed or current investments and projects.

Significant acquisitions expose the Company to risks and uncertainties, the occurrence of any of which could materially adversely affect the Company's business, financial condition, and results of operations.

While acquisitions are a part of the Company's growth strategy, acquisition of large companies subjects the Company to a number of risks and uncertainties, the occurrence of any of which could have a material adverse effect on Eastman. These include, but are not limited to that the financial performance of the acquired business may be significantly worse than expected; that significant additional indebtedness may constrain the Company's ability to access the credit and capital markets at attractive interest rates and favorable terms, which may negatively impact the Company's liquidity or ability to pursue certain growth initiatives; that the Company may not be able to achieve the cost, revenue, tax, or other "synergies" expected from any acquisition, or that there may be delays in achieving any such synergies; and that the Company may be required to expend significant additional resources in order to integrate any acquired business into Eastman or that the integration efforts will not achieve the expected benefits.

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

Legislative or regulatory actions could increase the Company's future compliance costs.

The Company and its facilities and businesses are subject to complex tax, health, safety and environmental laws and regulations, which require and will continue to require significant expenditures to remain in compliance with such laws and regulations. The Company's accruals for such costs and associated liabilities are subject to changes in estimates on which the accruals are based. For example, any amount accrued for environmental matters reflects the Company's assumptions about remediation requirements at the contaminated site, the nature of the remedy, the outcome of discussions with regulatory agencies and other potentially responsible parties at multi-party sites, and the number and financial viability of other potentially responsible parties. Changes in the estimates on which the accruals are based, unanticipated government enforcement action, or changes in health, safety, environmental, chemical control regulations, and testing requirements could result in higher costs. Specifically, pending and proposed U.S. Federal legislation and regulation increase the likelihood that the Company's manufacturing sites will in the future be impacted by regulation of greenhouse gas emissions and energy policy, which legislation and regulation, if enacted, may result in capital expenditures, increases in costs for raw materials and energy, limitations on raw material and energy source and supply choices, and other direct compliance costs.

In addition to the foregoing most significant known risk factors to the Company, there may be other factors, not currently known to the Company, which could, in the future, materially adversely affect the Company, its business, financial condition, or results of operations. The foregoing discussion of the most significant risk factors to the Company does not necessarily present them in order of importance. This disclosure, including that under "Outlook" and other forward-looking statements and related disclosures made by the Company in this Annual Report and elsewhere from time to time, represents management's best judgment as of the date the information is given. The Company does not undertake responsibility for updating any of such information, whether as a result of new information, future events, or otherwise, except as required by law. Investors are advised, however, to consult any further public Company disclosures (such as in filings with the Securities and Exchange Commission or in Company press releases) on related subjects.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market risk is the potential negative impact of adverse changes in prices or rates on a firm’s net income. Eastman Chemical Company ("Eastman" or the "Company") has exposure to various market risks from changes in the prices of various commodities, interest rates, and foreign currency exchange rates. In an effort to manage these risks, the Company enters into derivative contracts which are governed by policies, procedures, and internal processes set forth by its Board.

The Company determines its exposures to market risk by utilizing sensitivity analyses, which measure the potential losses in fair value resulting from one or more selected hypothetical changes in interest rates, foreign currency exchange rates, or commodity prices.

The Company is exposed to interest rate risks primarily as a result of its borrowing and investing activities, which include long-term borrowings used to maintain liquidity and to fund its business operations and capital requirements. From time to time, to manage the Company's mix of fixed and variable rate debt effectively, the Company enters into interest rate swaps. At December 31, 2013 and 2012, these borrowings, investments, and swaps were predominately U.S. dollar denominated. The nature and amount of the Company's long-term and short-term debt may vary from time to time as a result of business requirements, market conditions, and other factors. For purposes of calculating the market risks associated with the fair value of interest-rate-sensitive instruments, the Company uses a one hundred basis point shift in interest rates. At December 31, 2013 and December 31, 2012, the market risk associated with the fair value of interest-rate-sensitive instruments, assuming a one hundred basis point change in interest rates was approximately $274 million and $340 million, respectively. This exposure is primarily related to long-term debt with fixed interest rates.

Due to the Company's operating cash flows and borrowings denominated in foreign currencies, the Company is exposed to market risk from changes in foreign currency exchange rates. The Company continually evaluates its foreign currency exposure based on current market conditions and the locations in which the Company conducts business. The Company manages most foreign currency exposures on a consolidated basis, which allows it to net certain exposures and take advantage of natural offsets. In order to mitigate foreign currency risk, the Company from time to time enters into derivative transactions to hedge the cash flows related to certain sales and purchase transactions expected within no more than five years and denominated in foreign currencies, and enters into forward exchange contracts to hedge certain firm commitments denominated in foreign currencies. The gains and losses on these contracts offset changes in the value of related exposures. It is the Company's policy to enter into foreign currency derivative financial instruments only to the extent considered necessary to meet its objectives as stated above. The Company does not enter into foreign currency derivative financial instruments for speculative purposes. At December 31, 2013, the market risk associated with certain cash flows denominated in certain foreign currencies assuming a 10 percent adverse move in the U.S. dollar relative to these foreign currencies was approximately $137 million, with an additional $14 million exposure for each additional one percentage point adverse change in those foreign currency rates. At December 31, 2012, the market risk associated with cash flows denominated in certain foreign currencies assuming a 10 percent adverse move in the U.S. dollar relative to those currencies was approximately $66 million, with an additional $7 million exposure for each additional one percentage point adverse change in those exchange rates. Since the Company utilizes currency-sensitive derivative instruments for hedging anticipated foreign currency transactions, a loss in fair value from those instruments is generally offset by an increase in the value of the underlying anticipated transactions. The increase in market risk in 2013 compared to 2012 was due to a significantly larger foreign currency derivative portfolio at December 31, 2013.

The Company is exposed to fluctuations in market prices for certain of its major raw materials and energy. To mitigate short-term fluctuations in market prices for certain commodities, principally propane, natural gas, ethane, ethylene, and paraxylene, the Company from time and time enters into derivative transactions. At December 31, 2013, the market risk associated with these derivative contracts, assuming an instantaneous parallel shift in the underlying commodity price of 10 percent, was $30 million with less than an additional $3 million exposure for each one percentage point move in closing price thereafter. At December 31, 2012, the market risk associated with these derivative contracts for feedstocks and natural gas, assuming an instantaneous parallel shift in the underlying commodity price of 10 percent, was $3 million, with less than an additional $0.5 million exposure for each one percentage point move in closing price thereafter. The increase in market risk in 2013 compared to 2012 was due to a significantly larger commodity derivative portfolio at December 31, 2013.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL STATEMENTS

Management is responsible for the preparation and integrity of the accompanying consolidated financial statements of Eastman Chemical Company ("Eastman" or the "Company") appearing on pages 78 through 132. Eastman has prepared these consolidated financial statements in accordance with accounting principles generally accepted in the United States, and the statements of necessity include some amounts that are based on management's best estimates and judgments.

Eastman's accounting systems include extensive internal controls designed to provide reasonable assurance of the reliability of its financial records and the proper safeguarding and use of its assets. Such controls are based on established policies and procedures, are implemented by trained, skilled personnel with an appropriate segregation of duties, and are monitored through a comprehensive internal audit program. The Company's policies and procedures prescribe that the Company and all employees are to maintain the highest ethical standards and that its business practices throughout the world are to be conducted in a manner that is above reproach.

The accompanying consolidated financial statements have been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, who were responsible for conducting their audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Their report is included herein.

The Board of Directors exercises its responsibility for these financial statements through its Audit Committee, which consists entirely of non-management Board members. The independent registered public accounting firm and internal auditors have full and free access to the Audit Committee. The Audit Committee meets periodically with PricewaterhouseCoopers LLP and Eastman's director of internal auditing, both privately and with management present, to discuss accounting, auditing, policies and procedures, internal controls, and financial reporting matters.

/s/ Mark J. Costa
Mark J. Costa
Chief Executive Officer

/s/ Curtis E. Espeland
Curtis E. Espeland
Executive Vice President and
Chief Financial Officer

February 28, 2014

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders of
Eastman Chemical Company

In our opinion, the consolidated financial statements listed in the index appearing under Item 15(a)(1) present fairly, in all material respects, the financial position of Eastman Chemical Company (the "Company") and its subsidiaries at December 31, 2013 and 2012, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2013 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2013, based on criteria established in Internal Control-Integrated Framework (1992) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in Management's Report on Internal Control over Financial Reporting appearing under Item 9A. Our responsibility is to express opinions on these financial statements and on the Company's internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/PricewaterhouseCoopers LLP
Philadelphia, PA
February 28, 2014

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CONSOLIDATED STATEMENTS OF EARNINGS,
COMPREHENSIVE INCOME AND RETAINED EARNINGS

	For years ended December 31,		
(Dollars in millions, except per share amounts)	2013	2012	2011
Sales	$9,350	$8,102	$7,178
Cost of sales	6,574	6,340	5,609
Gross profit	2,776	1,762	1,569
Selling, general and administrative expenses	645	644	481
Research and development expenses	193	198	159
Asset impairments and restructuring charges (gains), net	76	120	(8)
Operating earnings	1,862	800	937
Net interest expense	180	143	76
Other charges (income), net	3	8	(20)
Earnings from continuing operations before income taxes	1,679	649	881
Provision for income taxes from continuing operations	507	206	274
Earnings from continuing operations	1,172	443	607
Earnings from discontinued operations, net of tax	—	—	9
Gain from disposal of discontinued operations, net of tax	—	1	31
Net earnings	1,172	444	647
Less: Net earnings attributable to noncontrolling interest	7	7	1
Net earnings attributable to Eastman	$1,165	$437	$646
Amounts attributable to Eastman stockholders			
Earnings from continuing operations, net of tax	$1,165	$436	$606
Earnings from discontinued operations, net of tax	—	1	40
Net earnings attributable to Eastman stockholders	$1,165	$437	$646
Basic earnings per share attributable to Eastman			
Earnings from continuing operations	$7.57	$2.99	$4.34
Earnings from discontinued operations	—	0.01	0.29
Basic earnings per share attributable to Eastman	$7.57	$3.00	$4.63
Diluted earnings per share attributable to Eastman			
Earnings from continuing operations	$7.44	$2.92	$4.24
Earnings from discontinued operations	—	0.01	0.28
Diluted earnings per share attributable to Eastman	$7.44	$2.93	$4.52

CONSOLIDATED STATEMENTS OF EARNINGS,
COMPREHENSIVE INCOME AND RETAINED EARNINGS (continued)

	For years ended December 31,		
(Dollars in millions, except per share amounts)	2013	2012	2011
Comprehensive Income			
Net earnings including noncontrolling interest	$1,172	$444	$647
Other comprehensive income (loss), net of tax			
Change in cumulative translation adjustment	28	41	(15)
Defined benefit pension and other postretirement benefit plans:			
Prior service credit arising during the period	29	2	1
Amortization of unrecognized prior service credits included in net periodic costs	(16)	(15)	(22)
Derivatives and hedging:			
Unrealized (loss) gain during period	6	(36)	(20)
Reclassification adjustment for gains (losses) included in net income	1	(7)	—
Total other comprehensive income (loss), net of tax	48	(15)	(56)
Comprehensive income including noncontrolling interest	$1,220	$429	$591
Comprehensive income attributable to noncontrolling interest	7	7	1
Comprehensive income attributable to Eastman	$1,213	$422	$590
Retained Earnings			
Retained earnings at beginning of period	$3,038	$2,760	$2,253
Net earnings attributable to Eastman	1,165	437	646
Cash dividends declared	(191)	(159)	(139)
Retained earnings at end of period	$4,012	$3,038	$2,760

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

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CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

(Dollars in millions, except per share amounts)	December 31, 2013	December 31, 2012
Assets		
Current assets		
Cash and cash equivalents	$237	$249
Trade receivables, net	880	846
Miscellaneous receivables	208	151
Inventories	1,264	1,260
Other current assets	251	193
Total current assets	2,840	2,699
Properties		
Properties and equipment at cost	9,958	9,681
Less: Accumulated depreciation	5,668	5,500
Net properties	4,290	4,181
Goodwill	2,637	2,644
Intangible assets, net of accumulated amortization	1,761	1,849
Other noncurrent assets	317	337
Total assets	$11,845	$11,710
Liabilities and Stockholders' Equity		
Current liabilities		
Payables and other current liabilities	$1,470	$1,360
Borrowings due within one year	—	4
Total current liabilities	1,470	1,364
Long-term borrowings	4,254	4,779
Deferred income tax liabilities	496	182
Post-employment obligations	1,297	1,856
Other long-term liabilities	453	501
Total liabilities	7,970	8,682
Commitments and contingencies (Note 12)		
Stockholders' equity		
Common stock ($0.01 par value per share – 350,000,000 shares authorized; shares issued – 215,131,237 and 213,406,523 for 2013 and 2012, respectively)	2	2
Additional paid-in capital	1,778	1,709
Retained earnings	4,012	3,038
Accumulated other comprehensive income	171	123
	5,963	4,872
Less: Treasury stock at cost (62,714,861 shares for 2013 and 59,511,662 shares for 2012)	2,167	1,929
Total Eastman stockholders' equity	3,796	2,943
Noncontrolling interest	79	85
Total equity	$3,875	$3,028
Total liabilities and stockholders' equity	$11,845	$11,710

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in millions)	For years ended December 31, 2013	2012	2011
Cash flows from operating activities			
Net earnings including noncontrolling interest	$1,172	$444	$647
Adjustments to reconcile net earnings to net cash provided by operating activities:			
Depreciation and amortization	433	360	273
Asset impairment charges	28	46	—
Gains on sale of assets	—	—	(70)
Provision (benefit) for deferred income taxes	331	48	(22)
Mark-to-market (gain) loss on pension and other postretirement benefit plans	(383)	247	147
Changes in operating assets and liabilities, net of effect of acquisitions and divestitures:			
(Increase) decrease in trade receivables	(38)	48	(73)
(Increase) decrease in inventories	(6)	38	(156)
Increase (decrease) in trade payables	(2)	10	(51)
Pension and other postretirement contributions (in excess of) less than expenses	(149)	(97)	(103)
Variable compensation (in excess of) less than expenses	82	26	15
Other items, net	(171)	(42)	18
Net cash provided by operating activities	1,297	1,128	625
Cash flows from investing activities			
Additions to properties and equipment	(483)	(465)	(457)
Proceeds from redemption of short-term time deposits	—	200	—
Proceeds from sale of assets and investments	31	7	651
Acquisitions and investments in joint ventures, net of cash acquired	—	(2,669)	(156)
Additions to short-term time deposits	—	—	(200)
Additions to capitalized software	(5)	(5)	(9)
Other items, net	—	(30)	29
Net cash used in investing activities	(457)	(2,962)	(142)
Cash flows from financing activities			
Net increase (decrease) in commercial paper, credit facility, and other borrowings	425	(1)	1
Proceeds from borrowings	150	3,511	(36)
Repayment of borrowings	(1,105)	(1,866)	(2)
Dividends paid to stockholders	(140)	(192)	(136)
Treasury stock purchases	(238)	—	(316)
Dividends paid to noncontrolling interests	(10)	(4)	(3)
Proceeds from stock option exercises and other items, net	59	56	69
Net cash provided by (used in) financing activities	(859)	1,504	(423)
Effect of exchange rate changes on cash and cash equivalents	7	2	1
Net change in cash and cash equivalents	(12)	(328)	61
Cash and cash equivalents at beginning of period	249	577	516
Cash and cash equivalents at end of period	$237	$249	$577

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

NOTES TO THE AUDITED CONSOLIDATED FINANCIAL STATEMENTS

1. SIGNIFICANT ACCOUNTING POLICIES

Financial Statement Presentation

The consolidated financial statements of Eastman and subsidiaries are prepared in conformity with accounting principles generally accepted ("GAAP") in the United States and of necessity include some amounts that are based upon management estimates and judgments. Future actual results could differ from such current estimates. The consolidated financial statements include assets, liabilities, sales revenue, and expenses of all majority-owned subsidiaries and joint ventures in which a controlling interest is maintained. Eastman accounts for other joint ventures and investments in minority-owned companies where it exercises significant influence on the equity basis. Intercompany transactions and balances are eliminated in consolidation. Certain prior period data has been reclassified in the Consolidated Financial Statements and accompanying footnotes to conform to current period presentation.

Information related to the Solutia Inc. ("Solutia") acquisition completed July 2, 2012 is in Note 2, "Acquisitions and Investments in Joint Ventures". As of the date of acquisition, results of the acquired Solutia businesses are included in Eastman results.

Cash and Cash Equivalents

Cash and cash equivalents include cash, time deposits, and readily marketable securities with original maturities of three months or less.

Fair Value Measurements

The Company records recurring and non-recurring financial assets and liabilities as well as all non-financial assets and liabilities subject to 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. 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.

Accounts Receivable and Allowance for Doubtful Accounts

Trade accounts receivable are recorded at the invoiced amount and do not bear interest. The Company maintains allowances for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments. The allowances are based on the number of days an individual receivable is delinquent and management's regular assessment of the financial condition of the Company's customers. The Company considers a receivable delinquent if it is unpaid after the terms of the related invoice have expired. The Company evaluates the allowance based on a monthly assessment of the aged receivables. Write-offs are recorded at the time a customer receivable is deemed uncollectible. Allowance for doubtful accounts was $12 million and $8 million at December 31, 2013 and 2012, respectively. The Company does not enter into receivables of a long-term nature, also known as financing receivables, in the normal course of business.

Inventories

Inventories are valued at the lower of cost or market. The Company determines the cost of most raw materials, work in process, and finished goods inventories in the United States by the last-in, first-out ("LIFO") method. The cost of all other inventories, including inventories outside the United States, is determined by the average cost method, which approximates the first-in, first-out ("FIFO") method. The Company writes-down its inventories for estimated obsolescence or unmarketable inventory equal to the difference between the carrying value of inventory and the estimated market value based upon assumptions about future demand and market conditions.

NOTES TO THE AUDITED CONSOLIDATED FINANCIAL STATEMENTS

Properties

The Company records properties at cost. Maintenance and repairs are charged to earnings; replacements and betterments are capitalized. When Eastman retires or otherwise disposes of assets, it removes the cost of such assets and related accumulated depreciation from the accounts. The Company records any profit or loss on retirement or other disposition into earnings. Asset impairments are reflected as increases in accumulated depreciation for properties that have been placed in service. In instances when an asset has not been placed in service and is impaired, the associated costs are removed from the appropriate property accounts.

Depreciation and Amortization

Depreciation expense is calculated based on historical cost and the estimated useful lives of the assets, generally using the straight-line method. Estimated useful lives for buildings and building equipment generally range from 20 to 50 years. Estimated useful lives generally ranging from 3 to 33 years are applied to machinery and equipment in the following categories: computer software (3 to 5 years); office furniture and fixtures and computer equipment (5 to 10 years); vehicles, railcars, and general machinery and equipment (5 to 20 years); and manufacturing-related improvements (20 to 33 years). Accelerated depreciation is reported when the estimated useful life is shortened and continues to be reported in Cost of Sales.

Amortization expense for definite-lived intangible assets is generally determined using a straight-line method over the estimated useful life of the asset. For additional information, see Note 5, "Goodwill and Other Intangible Assets".

Computer Software Costs

Capitalized software costs are amortized primarily on a straight-line basis over three years, the expected useful life of such assets, beginning when the software project is substantially complete and placed in service. Capitalized software in 2013, 2012, and 2011 was approximately $5 million, $5 million, and $9 million, respectively, and consisted of costs to internally develop computer software used by the Company. During each of those same periods, approximately $7 million of previously capitalized costs were amortized. At December 31, 2013 and 2012, the unamortized capitalized software costs were $14 million and $17 million, respectively. Capitalized software costs are reflected in other noncurrent assets.

Impairment of Long-Lived Assets

Definite-lived Assets

Properties and equipment and definite-lived intangible assets to be held and used by the Company are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. The review of these long-lived assets is performed at the asset group level, which is the lowest level for which identifiable cash flows are largely independent of the cash flows of other assets and liabilities. If the carrying amount is not considered to be recoverable, an analysis of fair value is triggered. An impairment is recorded for the excess of the carrying amount of the asset over the fair value. Fair value is either salvage value determined through market analysis or alternative future use.

As the Company's assumptions related to long-lived assets are subject to change, write-downs may be required in the future. If estimates of fair value less costs to sell are revised, the carrying amount of the related asset is adjusted, resulting in a charge to earnings.

Goodwill

The Company conducts testing of goodwill annually in third quarter of each year or when impairment indicators arise, whichever comes first. The testing of goodwill is performed at the reporting unit level which the Company has determined to be its components. The Company aggregates certain components into reporting units based on economic similarities. During 2013 testing, the Company did not evaluate the acquired Solutia components for aggregation, instead testing each component as a separate reporting unit. However, management will continue to review further aggregation as those components become integrated with Eastman.

NOTES TO THE AUDITED CONSOLIDATED FINANCIAL STATEMENTS

The Company uses an income approach and applies a fair value methodology based on discounted cash flows in testing the carrying value of goodwill for each reporting unit. The key assumptions and estimates used in the Company’s 2013 goodwill impairment testing included a long-term projection of revenues, expenses, and cash flows, the estimated discount rate, and the estimated tax rate. If the estimated fair value of a reporting unit is determined to be less than the carrying value of the net assets of the reporting unit including goodwill, additional steps, including an allocation of the estimated fair value to the assets and liabilities of the reporting unit, would be necessary to determine the amount, if any, of goodwill impairment. As a result of the tests performed during 2013, there was no impairment of the Company's goodwill.

Indefinite-lived Intangible Assets

The Company conducts testing of indefinite-lived intangible assets annually in third quarter of each year or when impairment indicators arise, whichever comes first. The carrying value of indefinite-lived intangible assets is considered to be impaired when the fair value, as established by appraisal or based on discounted future cash flows of certain related products, is less than their respective carrying values.

Indefinite-lived intangible assets, consisting of various trademarks, are tested for potential impairment by comparing the estimated fair value to the carrying amount. The Company uses an income approach, specifically the relief from royalty method, to test indefinite-lived intangible assets. The carrying value of indefinite-lived intangible assets is considered to be impaired when the estimated fair value is less than the carrying value of the trademarks. There was no impairment of the Company's indefinite-lived intangible assets as a result of the tests performed during third quarter 2013.

Investments

The Company held $200 million of short-term time deposits as of December 31, 2011. These investments had staggered maturities between three and ten months at the investment date, which exceeded the three month original maturity threshold for classification as cash or cash equivalents. These short-term time deposits were redeemed in 2012.

The consolidated financial statements include the accounts of the Company and all its subsidiaries and entities/joint ventures in which a controlling interest is maintained.

Investments in affiliates over which the Company has significant influence but not a controlling interest are carried on the equity basis. Under the equity method of accounting, these investments are included in other noncurrent assets. The Company includes its share of earnings and losses of such investments in other charges (income), net, and its share of other comprehensive income (loss) in the appropriate component of other accumulated comprehensive income (loss) in stockholders' equity.

Pension and Other Postretirement Benefits

The Company maintains defined benefit pension plans that provide eligible employees with retirement benefits. Additionally, Eastman provides a subsidy toward life insurance, health care, and dental benefits for eligible retirees and a subsidy toward health care and dental benefits for retirees' eligible survivors. The costs and obligations related to these benefits reflect the Company's assumptions related to general economic conditions (particularly interest rates), expected return on plan assets, rate of compensation increase or decrease for employees, and health care cost trends. The cost of providing plan benefits depends on demographic assumptions including retirements, mortality, turnover, and plan participation.

Eastman's pension and other postretirement benefit plans costs consist of two elements: 1) ongoing costs recognized quarterly, which are comprised of service and interest costs, expected returns on plan assets, and amortization of prior service credits; and 2) mark-to-market ("MTM") gains and losses recognized annually, in the fourth quarter of each year, resulting from changes in actuarial assumptions for discount rates and the differences between actual and expected returns on plan assets. Any interim remeasurements triggered by a curtailment, settlement, or significant plan changes are recognized as an MTM adjustment in the quarter in which such remeasurement event occurs.

For additional information, see Note 11, "Retirement Plans".

NOTES TO THE AUDITED CONSOLIDATED FINANCIAL STATEMENTS

Environmental Costs

The Company accrues environmental remediation costs when it is probable that the Company has incurred a liability at a contaminated site and the amount can be reasonably estimated. When a single amount cannot be reasonably estimated but the cost can be estimated within a range, the Company accrues the minimum amount. This undiscounted accrued amount reflects liabilities expected to be paid out within 30 years and the Company's assumptions about remediation requirements at the contaminated site, the nature of the remedy, the outcome of discussions with regulatory agencies and other potentially responsible parties at multi-party sites, and the number and financial viability of other potentially responsible parties. Changes in the estimates on which the accruals are based, unanticipated government enforcement action, or changes in health, safety, environmental, and chemical control regulations and testing requirements could result in higher or lower costs.

The Company also establishes reserves for closure/postclosure costs associated with the environmental and other assets it maintains. Environmental assets include but are not limited to waste management units, such as landfills, water treatment facilities, and ash ponds. When these types of assets are constructed or installed, a reserve is established for the future costs anticipated to be associated with the closure of the site based on an expected life of the environmental assets and the applicable regulatory closure requirements. These expenses are charged into earnings over the estimated useful life of the assets. Currently, the Company estimates the useful life of each individual asset up to 50 years. If the Company changes its estimate of the environmental asset retirement obligation costs or its estimate of the useful lives of these assets, the expenses charged into earnings could increase or decrease. The Company also monitors conditional obligations and recognizes contingent liabilities associated with them when and to the extent that more detailed information becomes available concerning applicable retirement costs.

The current portion of accruals for environmental liabilities is included in payables and other current liabilities with the long-term portion included in other long-term liabilities. These accruals exclude claims for recoveries from insurance companies or other third parties. Environmental costs are capitalized if they extend the life of the related property, increase its capacity, and/or mitigate or prevent future contamination. The cost of operating and maintaining environmental control facilities is charged to expense.

For additional information see Note 13, "Environmental Matters".

Derivative Financial Instruments

Derivative financial instruments are used by the Company when appropriate to manage its exposures to fluctuations in foreign currency exchange rates, certain contract sales prices, raw material and energy costs, and interest rates. Such instruments are used to mitigate the risk that changes in exchange rates, sales prices, raw material and energy costs, or interest rates will adversely affect the eventual dollar cash flows resulting from the hedged transactions.

The Company from time to time enters into currency option and forward contracts to hedge anticipated, but not yet committed, export sales and purchase transactions expected within no more than five years and denominated in foreign currencies (principally the euro and the Japanese yen); and forward exchange contracts to hedge certain firm commitments denominated in foreign currencies. To mitigate fluctuations in market prices expected within no more than three years for propane, ethane, paraxylene, and natural gas (major raw material and energy used in the manufacturing process) and selling prices for ethylene, the Company from time to time enters into option and forward contracts. From time to time, the Company also utilizes interest rate derivative instruments, primarily swaps, to hedge the Company's exposure to movements in interest rates.

The Company's qualifying option and forward contracts are accounted for as hedges because the derivative instruments are designated and effective as hedges and reduce the Company's exposure to identified risks. Gains and losses resulting from effective hedges of existing liabilities, firm commitments, or anticipated transactions are deferred and recognized when the offsetting gains and losses are recognized on the related hedged items and are reported as a component of operating earnings. Derivative assets and liabilities are recorded at fair value.

The gains or losses on nonqualifying derivatives or derivatives that are not designated as hedges are marked to market and immediately recorded into earnings from continuing operations.

NOTES TO THE AUDITED CONSOLIDATED FINANCIAL STATEMENTS

Deferred option premiums are included in the fair market value of the hedges. The related obligation for payment is generally included in other liabilities and is paid in the period in which the options are exercised or expire.

For additional information see Note 10, "Derivatives".

Litigation and Contingent Liabilities

The Company and its operations from time to time are, and in the future may be, 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 handled and defended in the ordinary course of business. The Company accrues a liability for such matters when it is probable that a liability has been incurred and the amount can be reasonably estimated. When a single amount cannot be reasonably estimated but the cost can be estimated within a range, the Company accrues the minimum amount. The Company expenses legal costs, including those expected to be incurred in connection with a loss contingency, as incurred.

Revenue Recognition and Customer Incentives

The Company recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, the price to the customer is fixed or determinable, and collectability is reasonably assured. Revenue for products is recognized when title and risk of loss transfer to the customer.

The Company records estimated obligations for customer programs and incentive offerings, which consist primarily of revenue or volume-based amounts that a customer must achieve over a specified period of time, as a reduction of revenue from each underlying revenue transaction as the customer progresses toward goals specified in incentive agreements. These estimates are based on a combination of forecasts of customer sales and actual sales volume and revenues against established goals, the customer's current level of purchases, Eastman's knowledge of customer purchasing habits, and industry pricing practice. The incentive payment rate may be variable, based upon the customer reaching higher sales volume or revenue levels over a specified period of time in order to receive an agreed upon incentive payment.

Shipping and Handling Fees and Costs

Shipping and handling fees related to sales transactions are billed to customers and are recorded as sales revenue. Shipping and handling costs incurred are recorded in cost of sales.

Restructuring of Operations

The Company records restructuring charges incurred in connection with consolidation of operations, exited business or product lines, or shutdowns of specific sites that are expected to be substantially completed within twelve months. These restructuring charges are recorded as incurred, and are associated with site closures, legal and environmental matters, demolition, contract terminations, obsolete inventory, or other costs directly related to the restructuring. The Company records severance charges for employee separations when the separation is probable and reasonably estimable. In the event employees are required to perform future service, the Company records severance charges ratably over the remaining service period of those employees.

Share-based Compensation

The Company recognizes compensation expense in the financial statements for stock options and other share-based compensation awards based upon the grant-date fair value over the substantive vesting period. For additional information, see Note 18, "Share-Based Compensation Plans and Awards".

Research and Development

All costs identified as research and development ("R&D") costs are charged to expense when incurred with the exception of third-party reimbursed and government-funded research and development. Expenses for third-party reimbursed and government-funded research and development are deferred until reimbursement is received to ensure appropriate matching of revenue and expense, provided specific criteria are met.

NOTES TO THE AUDITED CONSOLIDATED FINANCIAL STATEMENTS

Income Taxes

The provision for income taxes has been determined using the asset and liability approach of accounting for income taxes. Under this approach, deferred taxes represent the future tax consequences expected to occur when the reported amounts of assets and liabilities are recovered or paid. The provision for income taxes represents income taxes paid or payable for the current year plus the change in deferred taxes during the year. Deferred taxes result from differences between the financial and tax bases of the Company's assets and liabilities and are adjusted for changes in tax rates and tax laws when changes are enacted. Valuation allowances are recorded to reduce deferred tax assets when it is more likely than not that a tax benefit will not be realized. Provision has been made for income taxes on unremitted earnings of subsidiaries and affiliates, except for subsidiaries in which earnings are deemed to be permanently reinvested.

The Company recognizes income tax positions that meet the more likely than not threshold and accrues interest related to unrecognized income tax positions which is recorded as a component of the income tax provision.

Purchase Accounting

In general, the acquisition method of accounting requires companies to record assets acquired and liabilities assumed at their respective fair values at the date of acquisition. The Company estimates fair value using the exit price approach which is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly market. An exit price is determined from the viewpoint of unrelated market participants as a whole, in the principal or most advantageous market, and may result in the Company valuing assets or liabilities at a fair value that is not reflective of the Company's intended use of the assets or liabilities. Any amount of the purchase price paid that is in excess of the estimated fair values of net assets acquired or liabilities assumed is recorded in the line item goodwill on the Company's consolidated balance sheets. Management's judgment is used to determine the estimated fair values assigned to assets acquired and liabilities assumed, as well as asset lives for property, plant and equipment and amortization periods for intangible assets, and can materially affect the Company's results of operations.

2. ACQUISITIONS AND INVESTMENTS IN JOINT VENTURES

Solutia Inc.

On July 2, 2012, the Company completed its acquisition of Solutia, a global leader in performance materials and specialty chemicals. In the acquisition, each outstanding share of Solutia common stock was cancelled and converted automatically into the right to receive $22.00 in cash and 0.12 shares of Eastman common stock. In total, 14.7 million shares of Eastman common stock were issued in the transaction. The fair value of total consideration transferred was $4.8 billion, consisting of cash of $2.6 billion, net of cash acquired; equity in the form of Eastman stock of approximately $700 million; and the assumption and subsequent repayment of Solutia's debt at fair value of $1.5 billion.

The funding of the cash portion of the purchase price, repayment of Solutia's debt, and acquisition costs was provided primarily from borrowings, including the $2.3 billion net proceeds from the public offering of notes on June 5, 2012 and borrowings of $1.2 billion on July 2, 2012 under a five-year term loan agreement (the "Term Loan"). See Note 9, "Borrowings".

NOTES TO THE AUDITED CONSOLIDATED FINANCIAL STATEMENTS

The purchase price allocation for the July 2, 2012 Solutia acquisition was finalized as of June 30, 2013. Updates to the December 31, 2012 preliminary purchase price allocation of the Solutia acquisition during second quarter 2013 for finalization of current and deferred income taxes were reflected in the Company's Consolidated Statements of Financial Position as of June 30, 2013 and are summarized in the table below. These adjustments were primarily for finalization of valuation allowances against Federal and state deferred tax assets in connection with the filing of the final Solutia consolidated federal tax return. These updates were not material to the Company's financial position or results of operations for 2012 or 2013.

Assets acquired and liabilities assumed on July 2, 2012

(Dollars in millions)	Initial Evaluation	2012 Net Adjustments to Fair Value	December 31, 2012	2013 Net Adjustments to Fair Value	June 30, 2013
Current assets	$901	$19	$920	$2	$922
Properties and equipment	940	7	947	—	947
Intangible assets	1,807	(16)	1,791	—	1,791
Other noncurrent assets	612	2	614	67	681
Goodwill	1,965	265	2,230	(22)	2,208
Current liabilities	(461)	(1)	(462)	—	(462)
Long-term liabilities	(2,389)	(276)	(2,665)	(47)	(2,712)
Equity and cash consideration, net of $88 million cash acquired	$3,375	$—	$3,375	$—	$3,375

The Company used the income, market, or cost approach (or a combination thereof) for the valuation as appropriate, and used valuation inputs in these models and analyses that were based on market participant assumptions. Market participants are considered to be buyers and sellers unrelated to Eastman in the principal or most advantageous market for the asset or liability. For certain items, the carrying value was determined to be a reasonable approximation of fair value based on information available to Eastman management. The fair value of receivables acquired from Solutia on July 2, 2012 was $350 million, with gross contractual amounts receivable of $366 million. Acquired intangible assets were primarily customer relationships, trade names, and developed technologies. Long-term liabilities were primarily Solutia's debt, which was repaid by Eastman at closing, deferred tax liabilities, environmental liabilities, and pension and other postretirement welfare plan obligations. The Company finalized the acquisition accounting related to the transaction during fourth quarter 2012 with the exception of income taxes which were completed during the second quarter 2013 and did not have a material impact on the Company's financial position or results of operations.

The acquisition of Solutia broadened Eastman's global presence, facilitated growth opportunities through enhanced access to markets such as the automotive and architectural industries, and expanded Eastman's portfolio of sustainable products. In connection with the purchase, the Company recorded goodwill, which represents the excess of the purchase price over the estimated fair value of tangible and intangible assets acquired, net of liabilities assumed. The goodwill is attributed primarily to Solutia as a going concern and the fair value of expected cost synergies and revenues growth from combining the Eastman and Solutia businesses. The going concern element represents the ability to earn a higher return on the combined assembled collection of assets and businesses of Solutia than if those assets and businesses were to be acquired and managed separately. Other relevant elements of goodwill are the benefits of access to certain markets and work force. Goodwill from the Solutia acquisition has been allocated to certain of the Company's reportable segments. None of the goodwill is deducted for tax purposes.

Goodwill from July 2, 2012 Acquisition Goodwill by Segment

(Dollars in millions)	
Additives & Functional Products	$745
Advanced Materials	1,004
Specialty Fluids & Intermediates	459
Total	$2,208

NOTES TO THE AUDITED CONSOLIDATED FINANCIAL STATEMENTS

Properties acquired included a number of manufacturing, sales, and distribution sites and related facilities, land and leased sites that include leasehold improvements, and machinery and equipment for use in manufacturing operations. Management valued properties using the cost approach supported where available by observable market data which includes consideration of obsolescence.

Intangible assets acquired included a number of trade names and trademarks that are both business-to-business and business-to-consumer in nature, including Crystex®, Saflex®, and Llumar®. Also acquired was technology related to products protected by a number of existing patents, patent applications, and trade secrets. In addition to these intangible assets, the Company acquired a number of customer relationships in industries such as automotive tires and aviation. Management valued intangible assets using the relief from royalty and multi-period excess earnings methods, both forms of the income approach supported by observable market data for peer chemical companies.

Intangible Assets acquired on July 2, 2012

(Dollars in millions)	Fair Value	Weighted-Average Amortization Period (Years)
Amortizable intangible assets		
Customer relationships	$809	22
Developed technologies	440	13
Indefinite-lived intangible assets		
Trade names	542	
Total	$1,791	

Management estimated the fair market value of fixed-rate debt based on the viewpoint that the exit price approximated the entry price given the lack of observable market prices. Additionally, acquired interest rate swaps and foreign exchange contracts were terminated and settled immediately following the acquisition. Because these derivatives were recorded at fair value in the opening balance sheet, there were no gains or losses associated with these settlements.

Management also evaluated probable loss contingencies, including those for legal and environmental matters, as prescribed under applicable GAAP. Due to the lack of observable market inputs, assumed liabilities for environmental loss contingencies that were both probable and estimable were recorded based upon estimates of future cash outflows for such contingencies as of the acquisition date. See Note 13, "Environmental Matters", for more information.

In 2013, the Company recognized $36 million in integration costs related to the acquisition. In 2012, the Company recognized $28 million in transaction costs, $16 million in integration costs, and $32 million in financing costs related to the acquisition. Transaction costs and integration costs were expensed as incurred and are included in the "Selling, general and administrative expenses" line item and financing costs are included in the "Other charges (income), net" and "Net interest expense" line items in the Consolidated Statements of Earnings, Comprehensive Income, and Retained Earnings. In 2012, there were $32 million in restructuring charges primarily for severance associated with the acquisition and integration of Solutia. As required by purchase accounting, the acquired inventories were marked to fair value. These inventories were sold in 2012 resulting in a $79 million increase in cost of sales, net of the LIFO impact of these inventories, primarily in third quarter 2012.

Beginning third quarter 2012, the Company's consolidated results of operations included the results of the acquired Solutia businesses. Sales revenue of $969 million and an operating loss of $25 million from the acquired Solutia businesses were included in the Company's consolidated results of operations for 2012.

The unaudited pro forma financial results for the years ended December 31, 2012 and 2011 combine the consolidated results of Eastman and Solutia giving effect to the acquisition of Solutia as if it had been completed on January 1, 2011, the beginning of the comparable annual reporting period prior to the year of acquisition. The unaudited pro forma financial results presented below do not include any anticipated synergies or other expected benefits of the acquisition. This unaudited pro forma financial information is presented for informational purposes only and is not indicative of future operations or results had the acquisition been completed as of January 1, 2011.

The unaudited pro forma financial results include certain adjustments for additional depreciation and amortization expense based upon the fair value step-up and estimated useful lives of Solutia depreciable fixed assets and definite-life amortizable assets acquired in the transaction. The unaudited pro forma results also include adjustments to net interest expense and elimination of early debt extinguishment costs historically recorded by Solutia based upon the retirement of Solutia's debt and issuance of additional debt related to the transaction. The provision for income taxes from continuing operations has also been adjusted for all periods, based upon the foregoing adjustments to historical results, as well as the elimination of historical net changes in valuation allowances against certain deferred tax assets of Solutia.

Additionally, in the preparation of unaudited pro forma sales and earnings from continuing operations including noncontrolling interest, Solutia's historical consolidated results have been retrospectively adjusted for the change in accounting methodology for pension and other postretirement benefit plans actuarial gains and losses adopted by Eastman during first quarter 2012.

(Unaudited, dollars in millions)	2012	2011
Pro forma sales	$9,120	$9,275
Pro forma earnings from continuing operations including noncontrolling interest	649	590

Non-recurring costs directly attributable to the acquisition, which will not have an ongoing impact, are excluded from unaudited pro forma earnings from continuing operations including noncontrolling interest in 2012. These items include transaction, integration, financing, and restructuring costs incurred by Eastman during 2012, as well as transaction costs of $45 million and expenses of $19 million for the accelerated vesting of stock-based compensation awards incurred by Solutia prior to its acquisition by Eastman. Additionally, the non-recurring costs of acquired inventories have been eliminated from unaudited pro forma earnings from continuing operations for 2012.

Sterling Chemicals, Inc. and Scandiflex do Brasil S.A. Indústrias Químicas

During third quarter 2011, the Company completed the acquisitions of Sterling Chemicals, Inc. ("Sterling") and Scandiflex do Brasil S.A. Indústrias Químicas ("Scandiflex"). On August 9, 2011, Eastman acquired Sterling, a single site North American petrochemical producer, to produce non-phthalate plasticizers in the Adhesives & Plasticizers segment, including Eastman 168™ non-phthalate plasticizers, and acetic acid in the Specialty Fluids & Intermediates segment. On September 1, 2011, in the Adhesives & Plasticizers segment, Eastman acquired Scandiflex, a manufacturer of plasticizers located in São Paulo, Brazil. The acquisition of Scandiflex provided the Company additional access to Brazilian plasticizer markets. The total purchase price for both acquisitions was $133 million, including a post-closing payment of $10 million to the previous shareholders of Scandiflex. Transaction costs of $4 million associated with these acquisitions were expensed as incurred and are included in the "Selling, general and administrative expenses" line item in the Consolidated Statements of Earnings, Comprehensive Income and Retained Earnings. The table below shows the final fair value purchase price allocation for these acquisitions:

(Dollars in millions)	
Current assets	$33
Properties and equipment	129
Intangible assets	11
Other noncurrent assets	20
Goodwill	33
Current liabilities	(23)
Long-term liabilities	(70)

Total purchase price	$133

In connection with the purchase transactions, the Company recorded goodwill, which represents the excess of the purchase price over the estimated fair value of net tangible and intangible assets acquired and liabilities assumed. Acquired intangible assets primarily relate to perpetual air emission credits to which management has assigned indefinite lives. Long-term liabilities primarily include Sterling pension and other postretirement benefit plan obligations, as well as Scandiflex contingent liabilities for environmental and other contingencies. In connection with the Sterling acquisition, Sterling's debt was repaid at closing and therefore not included in the above purchase price allocation.

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Other 2011 Acquisitions and Investments in Joint Ventures

On July 1, 2011, the Company acquired Dynaloy, LLC ("Dynaloy"), a producer of formulated solvents. The acquisition was accounted for as a business combination and is reported in the Additives & Functional Products segment. Dynaloy adds materials science capabilities that are expected to complement growth of the Additives & Functional Products segment's electronic materials product line. Also in 2011, the Company entered into a joint venture for a 30,000 metric ton acetate tow manufacturing facility in China that became operational in third quarter 2013.

3. INVENTORIES

	December 31,	
(Dollars in millions)	2013	2012
At FIFO or average cost (approximates current cost)		
Finished goods	$976	$941
Work in process	300	288
Raw materials and supplies	494	536
Total inventories	1,770	1,765
LIFO Reserve	(506)	(505)
Total inventories	$1,264	$1,260

Inventories valued on the LIFO method were approximately 60 percent of total inventories as of December 31, 2013 and 2012.

4. PROPERTIES AND ACCUMULATED DEPRECIATION

	December 31,	
(Dollars in millions)	2013	2012 (1)
Properties		
Land	$147	$173
Buildings and building equipment	1,057	991
Machinery and equipment	8,389	8,193
Construction in progress	365	324
Properties and equipment at cost	$9,958	$9,681
Less: Accumulated depreciation	5,668	5,500
Net properties	$4,290	$4,181

(1) Reflects a revision within the 2012 property categories as amounts were miscategorized within the property classes. There was no impact on Net Properties as reported in the Company's 2012 Annual Report on Form 10-K.

Cumulative construction-period interest of $155 million and $152 million, reduced by accumulated depreciation of $97 million and $91 million, is included in net properties at December 31, 2013 and 2012, respectively.

Interest capitalized during 2013, 2012, and 2011 was $4 million, $4 million, and $9 million, respectively.

Depreciation expense was $345 million, $309 million, and $261 million for 2013, 2012, and 2011, respectively.

NOTES TO THE AUDITED CONSOLIDATED FINANCIAL STATEMENTS

5. GOODWILL AND OTHER INTANGIBLE ASSETS

Changes in the carrying amount of goodwill follow:

(Dollars in millions)	Additives & Functional Products	Adhesives & Plasticizers	Advanced Materials	Specialty Fluids & Intermediates	Other Segments	Total
Reported balance at December 31, 2011	$211	$134	$1	$56	$4	$406
Additions	740	—	1,027	463	—	2,230
Impairments	—	—	—	—	(1)	(1)
Currency translation adjustments	(6)	(1)	16	—	—	9
Reported balance at December 31, 2012	945	133	1,044	519	3	2,644
Adjustments resulting from subsequent recognition of deferred tax assets	5	—	(23)	(4)	—	(22)
Currency translation adjustments	(2)	(1)	19	(1)	—	15
Reported balance at December 31, 2013	$948	$132	$1,040	$514	$3	$2,637

As a result of the purchase of Solutia during third quarter 2012, the Company recorded goodwill of $2,208 million.

Included in the reported balance for goodwill are accumulated impairment losses of $46 million at December 31, 2013, $46 million at December 31, 2012, and $45 million at December 31, 2011.

		December 31, 2013			December 31, 2012		
(Dollars in millions)	Estimated Useful Life in Years	Gross Carrying Value	Accumulated Amortization	Net Carrying Value	Gross Carrying Value	Accumulated Amortization	Net Carrying Value
Amortizable intangible assets:							
Customer relationships	15-25	$863	$71	$792	$869	$29	$840
Technology	7-17	455	58	397	454	21	433
Other	5-20	4	—	4	4	—	4
Indefinite-lived intangible assets:							
Trade names		568	—	568	572	—	572
Total identified intangible assets		$1,890	$129	$1,761	$1,899	$50	$1,849

As a result of the purchase of Solutia during third quarter 2012, the Company recorded intangible assets of $1,791 million, primarily for customer relationships, trade names, and developed technology.

Amortization expense of definite-lived intangible assets related to continuing operations was $80 million, $42 million, and $4 million for 2013, 2012, and 2011, respectively. Estimated amortization expense for future periods is $79 million in each year for 2014 through 2018.

See Note 2, "Acquisitions and Investments in Joint Ventures", for further details regarding the acquisition of Solutia.

NOTES TO THE AUDITED CONSOLIDATED FINANCIAL STATEMENTS

6. EQUITY INVESTMENTS

Eastman has a 50 percent interest in and serves as the operating partner in Primester, a joint venture which manufactures cellulose acetate at Eastman's Kingsport, Tennessee plant. This investment is accounted for under the equity method. Eastman's net investment in the joint venture at December 31, 2013 and 2012 was approximately $21 million and $23 million, respectively, which was comprised of the recognized portion of the venture's accumulated deficits, long-term amounts owed to Primester, and a long-term notes receivable from Primester to Eastman. Such amounts are included in other noncurrent assets.

Eastman owns 50 percent or less interest in other joint ventures which are accounted for under the equity method and included in other noncurrent assets. These include a 50 percent interest in a joint venture that has a manufacturing facility in Nanjing, China. The Nanjing facility produces Eastotac™ hydrocarbon tackifying resins for pressure-sensitive adhesives, caulks, and sealants. These also include a joint venture with a 50 percent interest for the manufacture of compounded cellulose diacetate ("CDA") in Shenzhen, China. CDA is a bio-derived material, which is used in various injection molded applications, including but not limited to ophthalmic frames, tool handles and other end use products. In third quarter 2013, the Company completed construction of a 30,000 metric ton acetate tow manufacturing facility in Hefei, China, in a joint venture with China National Tobacco Corporation in which the Company has 45 percent ownership. The Company began supplying 100 percent of the acetate flake raw material to the joint venture in third quarter 2013 from the Company's manufacturing facility in Kingsport. In 2012, the Company entered into an agreement to form a joint venture to build a 50,000 metric ton hydrogenated hydrocarbon resin plant in Nanjing, China. The venture will be equally owned by Eastman and Sinopec Yangzi Petrochemical Company Limited and is expected to be operational in late 2015. At December 31, 2013 and 2012, the Company's investment in these joint ventures was approximately $70 million and $65 million, respectively.

7. PAYABLES AND OTHER CURRENT LIABILITIES

	December 31,	
(Dollars in millions)	2013	2012
Trade creditors	$762	$723
Accrued payrolls, vacation, and variable-incentive compensation	205	171
Accrued taxes	80	76
Post-employment obligations	59	62
Interest payable	46	59
Environmental contingent liabilities, current portion	40	35
Other	278	234
Total payables and other current liabilities	$1,470	$1,360

The current portion of post-employment obligations at December 31, 2013 is an estimate of 2014 payments. Included in "Other" above are certain accruals for payroll deductions and employee benefits, dividends payable, the current portion of hedging liabilities, divestitures, and other payables and accruals.

NOTES TO THE AUDITED CONSOLIDATED FINANCIAL STATEMENTS

8. PROVISION FOR INCOME TAXES

Components of earnings from continuing operations before income taxes and the provision (benefit) for U.S. and other income taxes from continuing operations follow:

	For years ended December 31,		
(Dollars in millions)	2013	2012	2011
Earnings from continuing operations before income taxes			
United States	$1,437	$651	$717
Outside the United States	242	(2)	164
Total	$1,679	$649	$881
Provision (benefit) for income taxes on earnings from continuing operations			
United States			
Current	$143	$123	$165
Deferred	300	95	66
Outside the United States			
Current	3	27	20
Deferred	15	(51)	16
State and other			
Current	30	14	16
Deferred	16	(2)	(9)
Total	$507	$206	$274

The following represents the deferred tax charge (benefit) recorded as a component of accumulated other comprehensive income in stockholders' equity.

	For years ended December 31,		
(Dollars in millions)	2013	2012	2011
Unrecognized losses and prior service credits for benefit plans	$(8)	$(7)	$(16)
Cumulative translation adjustment	1	1	—
Unrealized gains (losses) on cash flow hedges	(5)	(27)	(11)
Total	$(12)	$(33)	$(27)

Total income tax expense (benefit) included in the consolidated financial statements was composed of the following:

	For years ended December 31,		
(Dollars in millions)	2013	2012	2011
Continuing operations	$507	$206	$274
Discontinued operations	—	—	27
Other comprehensive income	(12)	(33)	(27)
Total	$495	$173	$274

NOTES TO THE AUDITED CONSOLIDATED FINANCIAL STATEMENTS

Differences between the provision for income taxes on earnings from continuing operations and income taxes computed using the U.S. federal statutory income tax rate follow:

	For years ended December 31,		
(Dollars in millions)	2013	2012	2011
Amount computed using the statutory rate	$587	$226	$308
State income taxes, net	30	8	2
Foreign rate variance	(55)	(12)	(21)
Domestic manufacturing deduction	(17)	(12)	(17)
Change in reserves for tax contingencies	(16)	(12)	—
General business credits	(6)	—	(5)
Other	(16)	8	7
Provision for income taxes	$507	$206	$274

The 2013 effective tax rate of 30 percent reflects the positive impacts of integrating the Eastman and Solutia tax structures, a $14 million tax benefit primarily due to adjustments to the tax provision to reflect the finalization of the 2012 consolidated U.S. federal income tax return, a $14 million benefit for the finalization of foreign tax audits, and the enactment of the American Taxpayer Relief Act of 2012 in January 2013 which resulted in a $10 million benefit primarily related to an R&D tax credit.

The 2012 effective tax rate of 32 percent reflected a $12 million tax benefit for favorable audit settlements and the expiration of the relevant statute of limitations, a $9 million tax benefit for additional state tax credits, and a $5 million tax charge for nondeductible transaction costs.

The 2011 effective tax rate of 31 percent reflected an $8 million tax benefit recognized due to an increased level of capital investment which qualified for additional state tax credits.

NOTES TO THE AUDITED CONSOLIDATED FINANCIAL STATEMENTS

The significant components of deferred tax assets and liabilities follow:

	December 31,	
(Dollars in millions)	2013	2012 [(2)]
Deferred tax assets		
Post-employment obligations	$502	$715
Net operating loss carryforwards	573	630
Tax credit carryforwards	224	230
Environmental reserves	133	145
Other	210	182
Total deferred tax assets	1,642	1,902
Less valuation allowance	(204)	(215)
Deferred tax assets less valuation allowance	$1,438	$1,687
Deferred tax liabilities		
Depreciation	$(992)	$(951)
Amortization [(1)]	(631)	(666)
Other	(110)	(100)
Total deferred tax liabilities	$(1,733)	$(1,717)
Net deferred tax liabilities	$(295)	$(30)
As recorded in the Consolidated Statements of Financial Position:		
Other current assets	$196	$139
Other noncurrent assets	7	16
Payables and other current liabilities	(2)	(3)
Deferred income tax liabilities	(496)	(182)
Net deferred tax liabilities	$(295)	$(30)

[(1)] Reflects a revision of a 2012 deferred tax liability. The line item "Amortization" was mischaracterized as "Inventory Reserves" in the Company's 2012 Annual Report on Form 10-K. There was no impact on net deferred tax liability reported in the Company's 2012 Annual Report on Form 10-K.
[(2)] Reflects a revision from the Company's 2012 Annual Report on Form 10-K to correctly classify certain deferred tax assets and deferred tax liabilities. In connection with this, approximately $105 million of net operating loss deferred tax assets have been reclassified to current assets rather than as a reduction of noncurrent liabilities in 2012.

Unremitted earnings of subsidiaries outside the United States, considered to be reinvested indefinitely, totaled $835 million at December 31, 2013. It is not practicable to determine the deferred tax liability for temporary differences related to those unremitted earnings.

For certain consolidated foreign subsidiaries, income and losses directly flow through to taxable income in the United States. These entities are also subject to taxation in the foreign tax jurisdictions. Net operating loss carryforwards exist to offset future taxable income in foreign tax jurisdictions and valuation allowances are provided to reduce deferred related tax assets if it is more likely than not that this benefit will not be realized. Changes in the estimated realizable amount of deferred tax assets associated with net operating losses for these entities could result in changes in the deferred tax asset valuation allowance in the foreign tax jurisdiction. At the same time, because these entities are also subject to tax in the United States, a deferred tax liability for the expected future taxable income will be established concurrently. Therefore, the impact of any reversal of valuation allowances on consolidated income tax expense will only be to the extent that there are differences between the United States statutory tax rate and the tax rate in the foreign jurisdiction. A valuation allowance of $29 million at December 31, 2013 has been provided against the deferred tax asset resulting from these operating loss carryforwards.

December 31, 2013 foreign net operating loss carryforwards totaled $493 million. Of this total, $129 million will expire in 3 to 20 years; and $364 million have no expiration date.

At December 31, 2013, federal net operating loss carryforwards of approximately $1,007 million were available to offset future taxable income, which expire from 2023 to 2029. At December 31, 2013, foreign tax credit carryforwards of $180 million were available to reduce possible future U.S. income taxes and which expire from 2018 to 2021.

NOTES TO THE AUDITED CONSOLIDATED FINANCIAL STATEMENTS

A full valuation allowance of $50 million has been provided against the U.S. deferred tax assets for the capital loss carryforward and a partial valuation allowance of $59 million for Solutia's state net operating loss carryforwards. The valuation allowance will be retained until there is sufficient positive evidence to conclude that it is more likely than not that the deferred tax assets will be realized or the related statute expires.

As a result of the Solutia acquisition transaction, Solutia realized a change of ownership for purposes of Section 382 of the Internal Revenue Code. Management does not currently expect this change to significantly limit the Company's ability to utilize Solutia's U.S. net operating loss or foreign tax credit carryforwards estimated to be approximately $971 million and $180 million, respectively, at December 31, 2013.

Amounts due to and from tax authorities as recorded in the Consolidated Statements of Financial Position:

	December 31,	
(Dollars in millions)	2013	2012
Miscellaneous receivables	$46	$38
Payables and other current liabilities	$35	$44
Other long-term liabilities	53	68
Total income taxes payable	$88	$112

A reconciliation of the beginning and ending amounts of unrecognized tax benefits is as follows:

(Dollars in millions)	2013	2012	2011
Balance at January 1	$65	$10	$9
Additions based on tax positions related to current year	—	—	1
Additions based on Solutia acquisition	—	67	—
Lapse of statute of limitations	—	(5)	—
Settlements	(14)	(7)	—
Balance at December 31	$51	$65	$10

As of December 31, 2013, 2012, and 2011, $51 million, $65 million, and $10 million, respectively, of unrecognized tax benefits would, if recognized, impact the Company's effective tax rate.

Interest, net of tax, related to unrecognized tax benefits is recorded as a component of income tax expense. As of January 1, 2013, the Company had accrued a liability of approximately $5 million for interest, net of tax and had $3 million for tax penalties, net of tax benefit. During 2013, the Company recognized $1 million of expense for interest, net of tax and no penalties associated with unrecognized tax benefits, offset by $2 million of income for interest, net of tax, associated with favorable audit settlements. At December 31, 2013, the Company had accrued balances of $4 million for interest, net of tax benefit and $3 million for penalties, net of tax benefit.

As of January 1, 2012 the Company had accrued a liability of approximately $1 million for interest, net of tax and had no accrual for tax penalties. During 2012, the Company's acquisition of Solutia resulted in an addition of $4 million in accrued interest, net of tax, and an addition of $3 million in accrued penalties, net of tax. The Company recognized $1 million of expense for interest, net of tax and no penalties associated with unrecognized tax benefits, offset by $1 million of income for interest, net of tax, associated with favorable audit settlements. At December 31, 2012, the Company had accrued balances of $5 million for interest, net of tax benefit and $3 million for penalties, net of tax benefit.

The Company files income tax returns in the United States and various state and foreign jurisdictions. The Company is no longer subject to U.S. federal income tax examinations by tax authorities for years before 2010 and 2002 for the Eastman and Solutia group, respectively. The Eastman group is no longer subject to state and local income tax examinations by tax authorities for years before 2008. Solutia, Inc. and related subsidiaries are no longer subject to state and local income tax examinations for years before 2002. With few exceptions, the Company is no longer subject to foreign income tax examinations by tax authorities for tax years before 2006.

NOTES TO THE AUDITED CONSOLIDATED FINANCIAL STATEMENTS

It is reasonably possible that within the next twelve months, as a result of the resolution of federal, state, and foreign examinations and appeals, and the expiration of various statutes of limitation, the unrecognized tax benefits that would affect the effective tax rate will decrease by a range of $0 to $13 million. There are no unrecognized tax benefits that would not affect the effective tax rate.

9. BORROWINGS

	December 31,	
(Dollars in millions)	2013	2012
Borrowings consisted of:		
3% notes due 2015	$250	$250
2.4% notes due 2017	998	997
6.30% notes due 2018	171	174
5.5% notes due 2019	250	250
4.5% notes due 2021	250	250
3.6% notes due 2022	894	893
7 1/4% debentures due 2024	243	243
7 5/8% debentures due 2024	54	54
7.60% debentures due 2027	222	222
4.8% notes due 2042	497	496
Credit facility borrowings	425	950
Other	—	4
Total borrowings	4,254	4,783
Borrowings due within one year	—	4
Long-term borrowings	$4,254	$4,779

On June 5, 2012, the Company issued 2.4% notes due 2017 in the principal amount of $1.0 billion, 3.6% notes due 2022 in the principal amount of $900 million, and 4.8% notes due 2042 in the principal amount of $500 million. Proceeds from the sale of the notes, net of original issue discounts, issuance costs, and the monetization of interest rate swaps, were $2.3 billion. Proceeds from these borrowings were used to pay, in part, the cash portion of the Solutia acquisition, repay Solutia debt, and pay acquisition costs.

Credit Facility and Commercial Paper Borrowings

In addition, on July 2, 2012, the Company also borrowed the entire $1.2 billion available under the five-year Term Loan. Proceeds from these borrowings were used to pay, in part, the cash portion of the Solutia acquisition, repay Solutia debt, and pay acquisition costs. As of December 31, 2013, the Company had repaid its $1.2 billion Term Loan using $425 million of commercial paper borrowings and $775 million in cash. At December 31, 2012, the Term Loan balance outstanding was $950 million.

In October 2013, the Company entered into a $1 billion revolving credit agreement (the "Credit Facility") expiring October 2018. The Credit Facility amends and extends, and has terms substantially similar to, the $750 million revolving credit agreement entered into in December 2011 (the "Prior Credit Facility"). Borrowings under the Credit Facility are subject to interest at varying spreads above quoted market rates and a commitment fee is paid on the total unused commitment. At December 31, 2013 and December 31, 2012, the Company had no outstanding borrowings under the Credit Facility.

The Credit Facility provides liquidity support for commercial paper borrowings and general corporate purposes. Accordingly, any outstanding commercial paper borrowings reduce capacity for borrowings available under the Credit Facility. Given the expiration date 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. At December 31, 2013 the Company's commercial paper borrowings were $425 million with a weighted average interest rate of 0.35 percent, and the proceeds were used to repay a portion of the Term Loan. There were no commercial paper borrowings at December 31, 2012.

NOTES TO THE AUDITED CONSOLIDATED FINANCIAL STATEMENTS

The Company also has a $250 million line of credit under its accounts receivable securitization agreement (the "A/R Facility"), expiring April 2016. Borrowings under the A/R Facility are subject to interest rates based on a spread over the lender's borrowing costs, and the Company pays a fee to maintain availability of the A/R Facility. At December 31, 2013 and December 31, 2012 the Company had no outstanding borrowings under the A/R Facility. During second quarter 2013, $150 million of the available amount under the A/R Facility was borrowed and then repaid during fourth quarter 2013. The entire available amount under the A/R Facility was borrowed and then repaid during third quarter 2012, and $100 million of the available amount under the A/R Facility was borrowed and then repaid during fourth quarter 2012. This activity is presented on a net basis within the cash flows from financing activities section of the Statements of Cash Flows.

The Term Loan, Credit Facility, and the A/R Facility 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. Other than the $425 million reduction in the amount available under the Credit Facility as of December 31, 2013 as a result of commercial paper borrowings, substantially all of the amounts under the Credit Facility and A/R Facility were available for borrowings as of December 31, 2013 and December 31, 2012. The Company would not violate applicable covenants for these periods if the total available amounts of the facilities had been borrowed.

Fair Value of Borrowings

The Company has classified its long-term borrowings at December 31, 2013 and December 31, 2012 under the fair value hierarchy as defined in the accounting policies in Note 1, "Significant Accounting Policies". The fair value for fixed-rate borrowings is based on current market prices and is classified in Level 1. The fair value for the Company's floating-rate borrowings, which relate to the Term Loan, the A/R Facility, and commercial paper, equals the carrying value and is classified within Level 2.

		Fair Value Measurements at December 31, 2013			
(Dollars in millions)	Recorded Amount December 31, 2013	Total Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Long-term borrowings	$4,254	$4,366	$3,941	$425	$—

		Fair Value Measurements at December 31, 2012			
(Dollars in millions)	Recorded Amount December 31, 2012	Total Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Long-term borrowings	$4,779	$5,165	$4,215	$950	$—

10. DERIVATIVES

Hedging Programs

The Company is exposed to market risk, such as changes in currency exchange rates, commodity prices, and interest rates. The Company uses various derivative financial instruments when appropriate 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.

NOTES TO THE AUDITED CONSOLIDATED FINANCIAL STATEMENTS

Currency Rate Hedging

The Company manufactures and sells its products in a number of countries throughout the world and, as a result, is exposed to changes in foreign currency exchange rates. To manage the volatility relating to these exposures, the Company nets the exposures on a consolidated basis to take advantage of natural offsets. To manage the remaining exposure, the Company enters into currency options and forwards from time to time to hedge probable anticipated, but not yet committed, export sales and purchase transactions expected within no more than five years and denominated in foreign currencies (principally the euro and Japanese yen) and forward exchange contracts to hedge certain firm commitments denominated in foreign currencies. These contracts are designated as cash flow hedges. The MTM gains or losses on qualifying hedges are included in accumulated other comprehensive income (loss) to the extent effective, and reclassified into sales in the period during which the hedged transaction affects earnings.

Commodity Hedging

Raw material and energy sources used by the Company and sales of certain commodity products by the Company are subject to price volatility caused by weather, supply conditions, economic variables and other unpredictable factors. To mitigate expected fluctuations in market prices within no more than three years for propane, ethane, paraxylene, and natural gas (major raw material and energy used in the manufacturing process) and selling prices for ethylene, the Company from time to time enters into option and forward contracts. These contracts are designated as cash flow hedges. The MTM gains or losses on qualifying hedges are included in accumulated other comprehensive income (loss) to the extent effective, and reclassified into cost of sales (for commodity purchases) and sales (for commodity sales) in the period during which the hedged transaction affects earnings.

Interest Rate Hedging

The Company's policy is to manage interest expense using a mix of fixed and variable rate debt. To manage this mix effectively, the Company from time to time enters into interest rate swaps in which the Company agrees to exchange the difference between fixed and variable interest amounts calculated by reference to an agreed upon notional principal amount. These swaps are designated as hedges of the fair value of the underlying debt obligations and the interest rate differential is reflected as an adjustment to interest expense over the life of the swaps. As these instruments are 100 percent effective, there is no impact on earnings due to hedge ineffectiveness.

From time to time, the Company also utilizes interest rate derivative instruments, primarily forwards, to hedge the Company's exposure to movements in interest rates prior to anticipated debt offerings. These instruments are designated as cash flow hedges and are typically 100 percent effective. As a result, there is no current impact on earnings due to hedge ineffectiveness.

The MTM gains or losses on these hedges are included in accumulated other comprehensive income (loss) to the extent effective, and are reclassified into interest expense over the term of the related debt instruments.

Fair Value Hedges

Fair value hedges are defined as derivative or non-derivative instruments designated as and used to hedge the exposure to changes in the fair value of an asset or a liability or an identified portion thereof that is attributable to a particular risk. For derivative instruments that are designated and qualify as 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 December 31, 2013 and December 31, 2012, the Company had no fair value hedges.

Cash Flow Hedges

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

NOTES TO THE AUDITED CONSOLIDATED FINANCIAL STATEMENTS

As of December 31, 2013, the total notional amounts of the Company's foreign exchange forward and option contracts were €954 million (approximately $1,320 million equivalent) and ¥8.3 billion (approximately $80 million equivalent), respectively, and the total notional volume hedged for feedstock was approximately 8 million barrels. The Company had no hedges for energy, contract ethylene sales, or interest rate swaps for the future issuance of debt ("forward starting interest rate swaps") at December 31, 2013.

As of December 31, 2012, the total notional amounts of the Company's foreign exchange forward and option contracts were €480 million (approximately $635 million equivalent) and ¥3.2 billion (approximately $35 million equivalent), respectively, the total notional volume for contract ethylene sales was approximately 49 thousand metric tons, and the total notional volume hedged for feedstock was approximately 3 million barrels. The Company had no outstanding hedges for energy or interest rate swaps.

Fair Value Measurements

For additional information on fair value measurement, see Note 1, "Significant Accounting Policies".

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

(Dollars in millions)		Fair Value Measurements at December 31, 2013		
Description	December 31, 2013	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Derivative Assets	$58	$—	$58	$—
Derivative Liabilities	(46)	—	(46)	—
	$12	$—	$12	$—

(Dollars in millions)		Fair Value Measurements at December 31, 2012		
Description	December 31, 2012	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Derivative Assets	$28	$—	$28	$—
Derivative Liabilities	(24)	—	(19)	(5)
	$4	$—	$9	$(5)

The majority of the Company's derivative assets are classified as Level 2. Level 2 fair value is based on estimates using standard pricing models. These standard pricing models use inputs which are derived from or corroborated by observable market data such as interest rate yield curves and currency spot and forward rates. The fair value of commodity contracts is derived using forward curves supplied by an industry recognized and unrelated third party. In addition, on an ongoing basis, the Company tests a subset of its valuations against valuations received from the transaction's counterparty to validate the accuracy of its standard pricing models. Counterparties to these derivative contracts are highly rated financial institutions which the Company believes carry only a minimal risk of nonperformance.

From time to time, the Company holds Level 3 assets for commodity hedges. The fair values of Level 3 instruments are determined using pricing data similar to that used in Level 2 financial instruments described above, and reflect adjustments for less liquid markets or longer contractual terms. Level 3 hedges typically will mature within one year or less. The Company determines the fair value of Level 3 commodity forward contracts based on related inputs that are either readily available in public markets or can be derived from information available in publicly quoted markets, and which influence the actual forward price of the commodity. Due to the fact that the forward price of the commodity itself is considered unobservable, the Company has categorized these forward contracts as Level 3. The Company determines the fair value of ethylene derivative forward contracts using an average of unadjusted forward ethylene prices provided by industry recognized experts to value its ethylene positions.

NOTES TO THE AUDITED CONSOLIDATED FINANCIAL STATEMENTS

The table below presents a rollforward of activity for these assets for the period ended December 31, 2013 and December 31, 2012:

Fair Value Measurements Using Level 3 Inputs

Commodity Contracts	December 31,	
(Dollars in millions)	2013	2012
Beginning balance at January 1	$(5)	$—
Realized gain (loss) in sales revenue	(14)	(4)
Change in unrealized gain (loss) in Other Comprehensive Income	5	(5)
Purchases, sales and settlements	14	4
Transfers (out) in of Level 3	—	—
Ending balance at December 31	$—	$(5)

The following chart shows the financial assets and liabilities valued on a recurring basis and their location in the Consolidated Statements of Financial Position. The Company had no nonqualifying derivatives or derivatives that are not designated as hedges as of December 31, 2013 and December 31, 2012. All of the Company's derivative contracts are subject to master netting arrangements, or similar agreements, which provide for the option to settle contracts on a net basis when they settle on the same day and in the same currency. In addition, these arrangements provide for a net settlement of all contracts with a given counterparty in the event that the arrangement is terminated due to the occurrence of default or a termination event. The Company has elected to present the derivative contracts on a gross basis in the Consolidated Statements of Financial Position. Had it chosen to present the derivatives contracts on a net basis, it would have a derivative in a net asset position of $35 million and a derivative in a net liability position of $23 million as of December 31, 2013. The Company does not have any cash collateral due under such agreements.

Fair Value of Derivatives Designated as Hedging Instruments

(Dollars in millions)		Fair Value Measurements Significant Other Observable Inputs	
Derivative Assets	Statement of Financial Position Location	December 31, 2013	December 31, 2012
Cash Flow Hedges			
Commodity contracts	Other current assets	$20	$7
Commodity contracts	Other noncurrent assets	7	—
Foreign exchange contracts	Other current assets	17	8
Foreign exchange contracts	Other noncurrent assets	14	13
		$58	$28

(Dollars in millions)		Fair Value Measurements Significant Other Observable Inputs	
Derivative Liabilities	Statement of Financial Position Location	December 31, 2013	December 31, 2012
Cash Flow Hedges			
Commodity contracts	Payables and other current liabilities	$—	$13
Foreign exchange contracts	Payables and other current liabilities	21	8

Foreign exchange contracts	Other long-term liabilities	25	3
		$46	$24

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NOTES TO THE AUDITED CONSOLIDATED FINANCIAL STATEMENTS

Derivatives' Hedging Relationships

(Dollars in millions)	Amount of after tax of gain/(loss) recognized in Other Comprehensive Income on Derivatives (effective portion)		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)	
Derivatives' Cash Flow Hedging Relationships	December 31, 2013	December 31, 2012		December 31, 2013	December 31, 2012
Commodity contracts	$20	$—	Sales	$(14)	$—
			Cost of sales	14	(22)
Foreign exchange contracts	(18)	(15)	Sales	6	38
Forward starting interest rate swap contracts	5	(28)	Interest Expense	(8)	(5)
	$7	$(43)		$(2)	$11

Hedging Summary

At December 31, 2013 and 2012, pre-tax monetized positions and MTM gains and losses from raw materials and energy, currency, and certain interest rate hedges that were included in accumulated other comprehensive income totaled approximately $62 million in losses and $75 million in losses, respectively. Included in 2013 and 2012 were losses on settlement of forward starting interest rate swaps related to the issuance of debt for the Solutia acquisition. If realized, approximately $8 million in pre-tax gains will be reclassified into earnings during the next 12 months. Ineffective portions of hedges are immediately recognized in cost of sales or other charges (income), net. There were no material gains or losses related to the ineffective portion of hedges recognized in 2013. For 2012, the ineffective portion of the Company's qualifying hedges was $2 million.

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 Consolidated Statements of Earnings, and, in all periods presented, represent foreign exchange derivatives denominated in multiple currencies and are transacted and settled in the same quarter. The Company recognized approximately $4 million and $5 million net gain on nonqualifying derivatives during 2013 and 2012, respectively.

11. RETIREMENT PLANS

As described in more detail below, Eastman offers various postretirement benefits to its employees.

Defined Contribution Plans

The Company sponsors a defined contribution employee stock ownership plan (the "ESOP"), which is a component of the Eastman Investment Plan and Employee Stock Ownership Plan ("EIP/ESOP"), a plan under Section 401(a) of the Internal Revenue Code. Eastman made a contribution in February 2014 to the EIP/ESOP for substantially all U.S. employees equal to 5 percent of their eligible compensation for the 2013 plan year. Employees may allocate contributions to other investment funds within the EIP from the ESOP at any time without restrictions. Allocated shares in the ESOP totaled 2,289,618; 2,410,806; and 2,525,114 shares as of December 31, 2013, 2012, and 2011, respectively. Dividends on shares held by the EIP/ESOP are charged to retained earnings. All shares held by the

EIP/ESOP are treated as outstanding in computing earnings per share.

In 2006, the Company amended its EIP/ESOP to provide a Company match of 50 percent of the first 7 percent of an employee's compensation contributed to the plan for employees who are hired on or after January 1, 2007. Employees who are hired on or after January 1, 2007, are also eligible for the contribution to the ESOP as described above.

Charges for domestic contributions to the EIP/ESOP were $43 million, $40 million, and $38 million for 2013, 2012, and 2011, respectively.

Defined Benefit Pension Plans and Other Postretirement Benefit Plans

Pension Plans

Eastman maintains defined benefit pension plans that provide eligible employees with retirement benefits.

Effective January 1, 2000, the Company's Eastman Retirement Assistance Plan, a U.S. defined benefit pension plan, was amended. Employees' accrued pension benefits earned prior to January 1, 2000 are calculated based on previous plan provisions using the employee's age, years of service, and final average compensation as defined in the plans. The amended plan uses a pension equity formula to calculate an employee's retirement benefits from January 1, 2000 forward. Benefits payable will be the combined pre-2000 and post-1999 benefits. Employees hired on or after January 1, 2007 are not eligible to participate in Eastman's U.S. defined benefit pension plans.

In July 2012, as part of its acquisition of Solutia, the Company assumed Solutia's U.S. and non-U.S. defined benefit pension plans. Prior to the acquisition, the U.S. plans had been closed to new participants and were no longer accruing additional benefits. In August 2011, as part of its acquisition of Sterling, the Company assumed Sterling's U.S. defined benefit pension plan. Prior to the acquisition, the plan had been closed to new participants and was no longer accruing additional benefits. For more information on these acquisitions, see Note 2, "Acquisitions and Investments in Joint Ventures".

Benefits are paid to employees from trust funds. Contributions to the trust funds are made as permitted by laws and regulations. The pension trust funds do not directly own any of the Company's common stock.

Pension coverage for employees of Eastman's non-U.S. operations is provided, to the extent deemed appropriate, through separate plans. The Company systematically provides for obligations under such plans by depositing funds with trustees, under insurance policies, or by book reserves.

Other Postretirement Benefit Plans

Under its other postretirement benefit plans, Eastman provides a subsidy for life insurance, health care, and dental benefits to eligible retirees hired prior to January 1, 2007, and a subsidy for health care and dental benefits to 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 ammunition plant.

Eligible employees hired on or after January 1, 2007 have access to postretirement health care benefits, but Eastman does not provide a subsidy for the premium cost of postretirement 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.
In July 2012, as part of its acquisition of Solutia, the Company assumed Solutia's postretirement benefit plans which included a voluntary employees' beneficiary association ("VEBA") retiree trust. In August 2011, as part of its acquisition of Sterling, the Company assumed Sterling's postretirement benefit plan. For more information on these acquisitions, see Note 2, "Acquisitions and Investments in Joint Ventures".

NOTES TO THE AUDITED CONSOLIDATED FINANCIAL STATEMENTS

Below is a summary balance sheet of the change in plan assets during 2013 and 2012, the funded status of the plans, amounts recognized in the Consolidated Statements of Financial Position, and a summary of amounts recognized in accumulated other comprehensive income.

Summary of Changes

	Pension Plans				Postretirement Benefit Plans	
	2013		2012		2013	2012
(Dollars in millions)	U.S.	Non-U.S.	U.S.	Non-U.S.		
Change in projected benefit obligation:						
Benefit obligation, beginning of year	$2,466	$672	$1,531	$257	$1,140	$881
Service cost	43	14	40	8	11	10
Interest cost	89	27	86	19	44	45
Actuarial (gain) loss	(184)	22	196	88	(123)	93
Curtailment gain	—	(1)	—	—	—	—
Acquisitions	—	—	727	291	—	167
Plan amendments and other	—	—	—	—	(47)	(3)
Plan participants' contributions	—	2	—	1	20	16
Effect of currency exchange	—	20	—	21	(1)	—
Federal subsidy on benefits paid	—	—	—	—	1	2
Benefits paid	(178)	(20)	(114)	(13)	(83)	(71)
Benefit obligation, end of year	$2,236	$736	$2,466	$672	$962	$1,140
Change in plan assets:						
Fair value of plan assets, beginning of year	$1,702	$596	$1,003	$276	$210	$55
Actual return on plan assets	239	39	171	54	7	13
Effect of currency exchange	—	17	—	17	—	—
Company contributions	124	24	128	21	40	38
Reserve for third party contributions	—	—	—	—	(16)	(5)
Plan participants' contributions	—	2	—	1	20	16
Benefits paid	(178)	(20)	(114)	(13)	(83)	(71)
Federal subsidy on benefits paid	—	—	—	—	1	2
Acquisitions	—	—	514	240	—	162
Fair value of plan assets, end of year	$1,887	$658	$1,702	$596	$179	$210
Funded status at end of year	$(349)	$(78)	$(764)	$(76)	$(783)	$(930)
Amounts recognized in the Consolidated Statements of Financial Position consist of:						
Other noncurrent assets	$—	$7	$—	$11	$3	$7
Current liabilities	(3)	(1)	(3)	(1)	(41)	(42)
Post-employment obligations	(346)	(84)	(761)	(86)	(745)	(895)
Net amount recognized, end of year	$(349)	$(78)	$(764)	$(76)	$(783)	$(930)
Accumulated benefit obligation	$2,123	$678	$2,387	$603		
Amounts recognized in accumulated other comprehensive income consist of:						
Prior service credit	$(18)	$—	$(22)	$—	$(108)	$(83)

The change in projected benefit obligation and change in net assets in 2012 reflect the impact of the defined benefit pension plans and the other postretirement benefit plans of the Solutia acquisition, described in Note 2, "Acquisitions and Investments in Joint Ventures".

NOTES TO THE AUDITED CONSOLIDATED FINANCIAL STATEMENTS

Information for pension plans with projected benefit obligation in excess of plan assets:

(Dollars in millions)	2013		2012	
	U.S.	Non-U.S.	U.S.	Non-U.S.
Projected benefit obligation	$2,236	$618	$2,466	$547
Fair value of plan assets	1,887	533	1,702	460

Information for pension plans with accumulated benefit obligation in excess of plan assets:

(Dollars in millions)	2013		2012	
	U.S.	Non-U.S.	U.S.	Non-U.S.
Projected benefit obligation	$2,236	$398	$2,466	$345
Accumulated benefit obligation	2,123	373	2,387	317
Fair value of plan assets	1,887	324	1,702	276

Components of net periodic benefit cost were as follows:

Summary of Benefit Costs and Other Amounts Recognized in Other Comprehensive Income

	Pension Plans						Postretirement Benefit Plans		
	2013		2012		2011		2013	2012	2011
(Dollars in millions)	U.S.	Non-U.S.	U.S.	Non-U.S.	U.S.	Non-U.S.			
Components of net periodic benefit cost:									
Service cost	$43	$ 14	$40	$ 8	$39	$ 6	$11	$10	$9
Interest cost	89	27	86	19	71	16	44	45	44
Expected return on assets	(129)	(35)	(103)	(24)	(82)	(18)	(7)	(5)	(2)
Curtailment gain (1)	—	(1)	—	—	—	—	—	—	(7)
Amortization of:									
Prior service cost (credit)	(4)	—	(4)	—	(14)	1	(22)	(19)	(21)
Mark-to-market pension and other postretirement benefits (gains) loss	(294)	18	128	58	128	(14)	(107)	90	33
Net periodic benefit cost	$(295)	$ 23	$147	$ 61	$142	$ (9)	$(81)	$121	$56
Other changes in plan assets and benefit obligations recognized in other comprehensive income:									
Curtailment gain (2)	$—	$ —	$—	$ —	$—	$ —	$—	$—	$(5)
Current year prior service credit	—	—	—	—	—	2	47	3	—
Amortization of:									
Prior service cost (credit)	(4)	—	(4)	—	(14)	1	(22)	(19)	(21)
Total	$(4)	$ —	$(4)	$ —	$(14)	$ 3	$25	$(16)	$(26)

(1) Gain of $1 million in 2013 from the shut-down of the Photovoltaics product line in Germany. Gain of $7 million in 2011 for the Performance Polymers segment that was sold January 31, 2011 and included in discontinued operations. For more information, see Note 20, "Discontinued Operations".

(2)

For the Performance Polymers segment that was sold January 31, 2011 and included in discontinued operations. For more information, see Note 20, "Discontinued Operations".

NOTES TO THE AUDITED CONSOLIDATED FINANCIAL STATEMENTS

Net periodic benefit cost in 2012 and 2011 reflect the impact on the defined benefit pension plans and the other postretirement benefit plans of the Solutia and Sterling acquisitions, respectively, described in Note 2, "Acquisitions and Investments in Joint Ventures".

In third quarter 2013, the Company changed life insurance benefits provided to future retirees by the Eastman other postretirement benefit plan which triggered an interim remeasurement of this other postretirement benefit plan obligation. The remeasurement resulted in a reduction in the accumulated postretirement benefit obligation of approximately $47 million which will be amortized as a prior service credit from Accumulated Other Comprehensive Income over 8 years. The remeasurement of the plan also resulted in a mark-to-market actuarial gain of $86 million in third quarter 2013. The actuarial gain was primarily due to a higher assumed discount rate of 4.72 percent in third quarter 2013 compared to 4.01 percent at December 31, 2012. The higher assumed discount rate is reflective of changes in global market conditions and interest rates on high-grade corporate bonds.

The estimated prior service credit for the U.S. pension and other postretirement benefit plans that will be amortized from Accumulated Other Comprehensive Income into net periodic cost in 2014 is $4 million and $25 million, respectively.

The assumptions used to develop the projected benefit obligation for the Company's significant U.S. and non-U.S. defined benefit pension plans and U.S. postretirement benefit plans are provided in the following tables.

	Pension Plans						Postretirement Benefit Plans		
Weighted-average assumptions used to determine benefit obligations for years ended December 31:	2013		2012		2011		2013	2012	2011
	U.S.	Non-U.S.	U.S.	Non-U.S.	U.S.	Non-U.S.			
Discount rate	4.59 %	4.18 %	3.72 %	4.16 %	4.88 %	5.48 %	4.75 %	3.91 %	4.96 %
Rate of compensation increase	3.50 %	3.49 %	3.50 %	3.49 %	3.50 %	3.82 %	3.50 %	3.50 %	3.50 %
Health care cost trend									
Initial							8.00 %	8.00 %	8.00 %
Decreasing to ultimate trend of							5.00 %	5.00 %	5.00 %
in year							2020	2019	2018
Weighted-average assumptions used to determine net periodic cost for years ended December 31:	2013		2012		2011		2013	2012	2011
	U.S.	Non-U.S.	U.S.	Non-U.S.	U.S.	Non-U.S.			
Discount rate	3.72 %	4.16 %	4.50 %	5.06 %	5.21 %	5.71 %	3.91 %	4.73 %	5.33 %
Expected return on assets	7.98 %	5.90 %	8.12 %	6.17 %	8.45 %	6.40 %	3.75 %	3.75 %	— %
Rate of compensation increase	3.50 %	3.49 %	3.50 %	3.65 %	3.50 %	4.15 %	3.50 %	3.50 %	3.50 %
Health care cost trend									
Initial							8.00 %	8.00 %	8.00 %
Decreasing to ultimate trend of							5.00 %	5.00 %	5.00 %
in year							2019	2018	2017

An eight percent rate of increase in per capita cost of covered health care benefits is assumed for 2014. The rate is assumed to decrease gradually to five percent in 2020 and remain at that level thereafter. A one percent increase or decrease in health care cost trend would have had no material impact on the 2013 service and interest costs or the 2013 benefit obligation, because the Company's contributions for benefits are fixed.

NOTES TO THE AUDITED CONSOLIDATED FINANCIAL STATEMENTS

The fair value of plan assets for the U.S. pension plans at December 31, 2013 and 2012 was $1.9 billion and $1.7 billion, respectively, while the fair value of plan assets at December 31, 2013 and 2012 for non-U.S. pension plans was $658 million and $596 million, respectively. At December 31, 2013 and 2012, the expected weighted-average long-term rate of return on U.S pension plan assets was 7.83 percent and 7.98 percent, respectively. The expected weighted-average long-term rate of return on non-U.S. pension plans assets was 5.78 percent and 5.90 percent at December 31, 2013 and 2012, respectively.

The following charts reflect the fair value of the defined pension plans assets as of December 31, 2013 and 2012.

(Dollars in millions)			Fair Value Measurements at December 31, 2013					
Description	December 31, 2013		Quoted Prices in Active Markets for Identical Assets (Level 1)		Significant Other Observable Inputs (Level 2)		Significant Unobservable Inputs (Level 3)	
Pension Assets:	U.S.	Non-U.S.	U.S.	Non-U.S.	U.S.	Non-U.S.	U.S.	Non-U.S.
Cash & Cash Equivalents [1]	$36	$9	$36	$9	$—	$—	$—	$—
Debt [2]:								
Fixed Income (U.S.)	485	4	47	—	438	4	—	—
Fixed Income (Non-U.S.)	—	299	—	—	—	299	—	—
Fixed Income (Global)	—	13	—	—	—	13	—	—
U.S. Treasury Securities	36	—	—	—	36	—	—	—
Public Equity Funds [3]:								
United States	702	48	54	—	648	48	—	—
Non-U.S.	266	93	19	—	247	93	—	—
Non-U.S. Commodities Funds	—	2	—	—	—	2	—	—
Global	—	91	—	—	—	91	—	—
Other [4]:								
Private Equity, Real Estate Funds, and Other Alternative Investments	362	51	—	—	—	24	362	27
Multi-Asset Common Collective Trusts	—	48	—	—	—	48	—	—
Total	$1,887	$658	$156	$9	$1,369	$622	$362	$27

(1) Cash & Cash Equivalents: The carrying amounts of cash and cash equivalents are valued at $1 per unit, which approximates fair value. Amounts are generally invested in actively managed common trust funds or interest bearing accounts.

(2) Debt: The underlying fixed income investments in this category are generally held in common trust funds, which are either actively or passively managed investment vehicles, that are valued at the net asset value per unit/share multiplied by the number of units/shares held as of the measurement date.

(3) Public Equity: The underlying equity investments in this category are generally held in common trust funds, which are either actively or passively managed investment vehicles, that are valued at the net asset value per unit/share multiplied by the number of units/shares held as of the measurement date.

(4) Other: The underlying investments in this category are held in private investment funds. These investments are valued based on the net asset value provided by the management of each private investment fund, adjusted as appropriate, for any lag between the date of the financial reports and the measurement date.

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NOTES TO THE AUDITED CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in millions)			Fair Value Measurements at December 31, 2012					
Description	December 31, 2012		Quoted Prices in Active Markets for Identical Assets (Level 1)		Significant Other Observable Inputs (Level 2)		Significant Unobservable Inputs (Level 3)	
Pension Assets:	U.S.	Non-U.S.	U.S.	Non-U.S.	U.S.	Non-U.S.	U.S.	Non-U.S.
Cash & Cash Equivalents [1]	$45	$12	$45	$12	$—	$—	$—	$—
Debt [2]:								
Fixed Income (U.S.)	355	1	56	—	299	1	—	—
Fixed Income (Non-U.S.)	—	281	—	—	—	281	—	—
Fixed Income (Global)	—	13	—	—	—	13	—	—
U.S. Treasury Securities	39	—	—	—	39	—	—	—
Public Equity Funds [3]:								
United States	640	31	39	—	601	31	—	—
Non-U.S.	244	80	16	—	228	80	—	—
Non-U.S. Commodities Funds	—	9	—	7	—	2	—	—
Global	—	88	—	—	—	88	—	—
Other [4]:								
Private Equity, Real Estate Funds, and Other Alternative Investments	379	52	—	—	—	25	379	27
Multi-Asset Common Collective Trusts	—	29	—	—	—	29	—	—
Total	$1,702	$596	$156	$19	$1,167	$550	$379	$27

(1) Cash & Cash Equivalents: The carrying amounts of cash and cash equivalents are valued at $1 per unit, which approximates fair value. Amounts are generally invested in actively managed common trust funds or interest bearing accounts.

(2) Debt: The underlying fixed income investments in this category are generally held in common trust funds, which are either actively or passively managed investment vehicles, that are valued at the net asset value per unit/share multiplied by the number of units/shares held as of the measurement date.

(3) Public Equity: The underlying equity investments in this category are generally held in common trust funds, which are either actively or passively managed investment vehicles, that are valued at the net asset value per unit/share multiplied by the number of units/shares held as of the measurement date.

(4) Other: The underlying investments in this category are held in private investment funds. These investments are valued based on the net asset value provided by the management of each private investment fund, adjusted as appropriate, for any lag between the date of the financial reports and the measurement date.

NOTES TO THE AUDITED CONSOLIDATED FINANCIAL STATEMENTS

The following charts reflect the fair value of the postretirement benefit plan assets as of December 31, 2013 and 2012. The postretirement benefit plan is for the VEBA trust the Company assumed as part of the Solutia acquisition.

(Dollars in millions)		Fair Value Measurements at December 31, 2013		
Description	December 31, 2013	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Postretirement Benefit Plan Assets:				
Cash & Cash Equivalents [(1)]	$12	$12	$—	$—
Debt [(2)]:				
Fixed Income (U.S.)	120	—	120	—
Fixed Income (Non-U.S.)	1	—	1	—
U.S. Treasury Securities	1	—	1	—
Total	$134	$12	$122	$—

(Dollars in millions)		Fair Value Measurements at December 31, 2012		
Description	December 31, 2012	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Postretirement Benefit Plan Assets:				
Cash & Cash Equivalents [(1)]	$10	$10	$—	$—
Debt [(2)]:				
Fixed Income (U.S.)	143	—	143	—
Fixed Income (Non-U.S.)	3	—	3	—
U.S. Treasury Securities	1	—	1	—
Total	$157	$10	$147	$—

(1) Cash & Cash Equivalents: The carrying amounts of cash and cash equivalents are valued at $1 per unit, which approximates fair value. Amounts are generally invested in actively managed common trust funds or interest bearing accounts.

(2) Debt: The underlying fixed income investments in this category are generally held in common trust funds, which are either actively or passively managed investment vehicles, that are valued at the net asset value per unit/share multiplied by the number of units/shares held as of the measurement date.

The Company valued assets with unobservable inputs (Level 3), specifically its alternative investments, investments in private equity and investments in real estate and other funds under the practical expedient method. The practical expedient method allows reporting entities to use the most recently reported net asset value ("NAV") of qualifying investment companies provided it is not probable that the investment will be sold by the reporting entity at an amount different from the most recently reported NAV.

NOTES TO THE AUDITED CONSOLIDATED FINANCIAL STATEMENTS

	Fair Value Measurements Using Significant Unobservable Inputs (Level 3)						
	U.S. Pension Plans				Non-U.S. Pension Plans		
(Dollars in millions)	Private Equity	Real Estate	Other Alternative Investments(1)	Total	Real Estate	Other Alternative Investments(1)	Total
Balance at December 31, 2011	$150	$113	$93	$356	$5	$15	$20
Distributions	(32)	(12)	(24)	(68)	—	—	—
Unrealized gains (losses)	20	8	11	39	—	7	7
Purchases, contributions, and other	32	10	10	52	—	—	—
Balance at December 31, 2012	170	119	90	379	5	22	27
Distributions	(31)	(27)	(21)	(79)	—	—	—
Unrealized gains (losses)	20	5	6	31	—	2	2
Purchases, contributions, and other	18	4	9	31	(3)	1	(2)
Balance at December 31, 2013	$177	$101	$84	$362	$2	$25	$27

(1) U.S. primarily consists of natural resource and energy related limited partnership investments. Non-U.S. primarily consists of an annuity contract.

The following chart reflects the target allocation for the Company's U.S. and non-U.S. pension and postretirement benefit plans for 2014 and the asset allocation at December 31, 2013 and 2012, by asset category. The postretirement benefit plan is for the VEBA trust the Company assumed as part of the Solutia acquisition.

	U.S. Pension Plans			Non-U.S. Pension Plans			Postretirement Benefit Plan		
	Target Allocation	Plan Assets at December 31, 2013	Plan Assets at December 31, 2012	Target Allocation	Plan Assets at December 31, 2013	Plan Assets at December 31, 2012	Target Allocation	Plan Assets at December 31, 2013	Plan Assets at December 31, 2012
Asset category									
Equity securities	50%	51%	52%	33%	36%	35%	—%	—%	—%
Debt securities	32%	30%	26%	51%	49%	51%	100%	100%	100%
Real estate	4%	5%	7%	2%	2%	3%	—%	—%	—%
Other investments (1)	14%	14%	15%	14%	13%	11%	—%	—%	—%
Total	100%	100%	100%	100%	100%	100%	100%	100%	100%

(1) U.S. primarily consists of private equity and natural resource and energy related limited partnership investments. Non-U.S. primarily consists of an annuity contract and alternative investments.

The Company's investment strategy for its defined benefit pension plans is to maximize the long-term rate of return on plan assets within an acceptable level of risk in order to meet or exceed the plan's actuarially assumed long-term rate of return and to minimize the cost of providing pension benefits. A periodic asset/liability study is conducted in order to assist in the determination and, if necessary, modification of the appropriate long-term investment policy for the plan. The investment policy establishes a target allocation range for each asset class and the fund is managed within those ranges. The plans use a number of investment approaches including investments in equity, real estate, and fixed income funds in which the underlying securities are marketable in order to achieve this target allocation. The plans also invest in private equity and other funds. Diversification is created through investment across various asset classes, geographies, fund managers, and individual securities. This investment process provides for a well-diversified portfolio with no significant concentration of risk. The investment process is monitored by an investment committee comprised of various senior executives from within Eastman.

NOTES TO THE AUDITED CONSOLIDATED FINANCIAL STATEMENTS

In July 2012, as part of its acquisition of Solutia, the Company assumed Solutia's defined benefit pension and other postretirement benefit plans and in August 2011, as part of its acquisition of Sterling, the Company assumed Sterling's defined benefit pension plan. Both the Solutia and Sterling defined benefit pension plans adhere to the Company's defined benefit plan investment strategy. The Solutia defined benefit pension plans also utilize a dynamic de-risking strategy to shift from growth assets to liability matching assets as the plan's funded status improves. The investment strategy with respect to Solutia's other postretirement benefits plan is to invest in a short-term, well diversified, high quality investment instruments, with a primary objective of capital preservation.

The expected rate of return for all plans was determined primarily by modeling the expected long-term rates of return for the categories of investments held by the plans and the targeted allocation percentage against various potential economic scenarios.

The Company funded its U.S. defined benefit pension plans in the amount of $120 million in 2013 and $124 million in 2012. The minimum required cash contribution for the U.S. defined benefit pension plans under the Employee Retirement Income Security Act of 1974, as amended, and the Internal Revenue Code of 1986, as amended for 2014 is approximately $90 million.

Benefits expected to be paid from pension plans and benefits, net of participant contributions, expected to be paid for postretirement benefit obligations are as follows:

	Pension Plans		Postretirement Benefit Plans
(Dollars in millions)	U.S.	Non-U.S.	
2014	$213	$21	$63
2015	215	21	64
2016	209	21	64
2017	211	22	63
2018	202	23	64
2019-2023	889	133	324

12. COMMITMENTS

Purchase Obligations and Lease Commitments

The Company had various purchase obligations at December 31, 2013 totaling $2.5 billion over a period of approximately 30 years for materials, supplies, and energy incident to the ordinary conduct of business. The Company also had various lease commitments for property and equipment under cancelable, noncancelable, and month-to-month operating leases totaling approximately $210 million over a period of several years. Of the total lease commitments, approximately 5 percent relate to machinery and equipment, including computer and communications equipment and production equipment; approximately 60 percent relate to real property, including office space, storage facilities, and land; and approximately 35 percent relate to railcars. Rental expense, net of sublease income, was $73 million, $61 million, and $48 million in 2013, 2012, and 2011, respectively.
The obligations described above, and long-term debt repayment obligations, are summarized in the following table:

(Dollars in millions)	Payments Due For					
Period	Notes and Debentures	Facility Borrowings and Other	Interest Payable	Purchase Obligations	Operating Leases	Total

2014	$—	$—	$162	$410	$44	$616
2015	250	—	162	404	38	854
2016	—	—	154	269	35	458
2017	998	—	142	218	24	1,382
2018	171	425	130	211	15	952
2019 and beyond	2,410	—	1,012	971	54	4,447
Total	$3,829	$425	$1,762	$2,483	$210	$8,709

NOTES TO THE AUDITED CONSOLIDATED FINANCIAL STATEMENTS

Guarantees

The Company has operating leases with terms that require the Company to guarantee a portion of the residual value of the leased assets upon termination of the lease as well as other guarantees. Disclosures about each group of similar guarantees are provided below.

Residual Value Guarantees

The Company has operating leases with terms that require the Company to guarantee a portion of the residual value of the leased assets upon termination of the lease. These residual value guarantees at December 31, 2013 totaled $117 million and consisted primarily of leases for railcars and Company aircraft and will expire beginning in 2016. Management believes, based on current facts and circumstances, that the likelihood of material residual guarantee payments is remote.

Other Guarantees

Guarantees and claims also arise during the ordinary course of business from relationships with joint venture partners, suppliers, customers, and other parties when the Company undertakes an obligation to guarantee the performance of others, if specified triggering events occur. Non-performance under a contract could trigger an obligation of the Company. The Company's current other guarantees include guarantees relating primarily to intellectual property, environmental matters, and other indemnifications and have arisen through the normal course of business. The ultimate effect on future financial results is not subject to reasonable estimation because considerable uncertainty exists as to the final outcome of these claims, if they were to occur. These other guarantees have terms between 1 and 15 years with maximum potential future payments of approximately $49 million in the aggregate, with none of these guarantees individually significant to the Company's operating results, financial position, or liquidity. The Company's current expectation is that future payment or performance related to non-performance under other guarantees is considered remote.

13. 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". The Company's total reserve for environmental contingencies was $368 million and $394 million at December 31, 2013 and 2012, respectively. At December 31, 2013 and 2012, this reserve included $9 million and $8 million, respectively, related to sites previously closed and impaired by Eastman, as well as sites that have been divested by Eastman but for which the Company retains the environmental liability. Amounts at December 31, 2013 and 2012 included environmental contingencies assumed in the acquisition of Solutia on July 2, 2012. See Note 2, "Acquisitions and Investments in Joint Ventures".

Estimated future environmental expenditures for remediation costs ranged from the minimum or best estimate of $341 million to the maximum of $581 million and from the minimum or best estimate of $365 million to the maximum of $623 million at December 31, 2013 and 2012, respectively. The maximum estimated future costs are considered to be reasonably possible and include the amounts accrued at both December 31, 2013 and 2012. Although the resolution of uncertainties related to these environmental matters may have a material adverse effect on the Company's consolidated results of operations in the period recognized, because of 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 or cash flows.

For facilities that have environmental asset retirement obligations, the best estimate accrued to date over the facilities' estimated useful lives for these asset retirement obligation costs were $27 million and $29 million at December 31, 2013 and 2012, respectively.

Reserves for environmental remediation that management believes to be probable and estimable are recorded as current and long-term liabilities in the Consolidated Statements of Financial Position. These reserves include liabilities expected to be paid out within 30 years. The amounts charged to pre-tax earnings for environmental remediation and related charges are included in cost of sales and other charges (income), net, and are summarized below:

(Dollars in millions)		
Balance at December 31, 2012	$365	
Changes in estimates recorded to earnings and other	7	
Cash reductions	(31	)
Balance at December 31, 2013	$341	

The Company's total environmental reserve for environmental contingencies, including remediation costs and asset retirement obligations, is recorded in the Consolidated Statements of Financial Position as follows:

	December 31,	
(Dollars in millions)	2013	2012
Environmental contingent liabilities, current	$40	$35
Environmental contingent liabilities, long-term	328	359
Total	$368	$394

Additionally, costs of certain remediation projects included in the assumed environmental reserve are subject to a cost-sharing arrangement with Monsanto Company ("Monsanto") under the provisions of the Amended and Restated Settlement Agreement effective February 28, 2008 (the "Effective Date"), into which Solutia entered with Monsanto upon its emergence from bankruptcy (the "Monsanto Settlement Agreement"). Under the provisions of the Monsanto Settlement Agreement, the Company shares responsibility with Monsanto for remediation at certain locations outside of the boundaries of plant sites in Anniston, Alabama and Sauget, Illinois (the "Shared Sites"). The Company is responsible for the funding of environmental liabilities at the Shared Sites up to a total of $325 million from the Effective Date. If remediation costs for the Shared Sites exceed this amount, such costs will thereafter be shared equally between the Company and Monsanto. Including payments by Solutia prior to its acquisition by Eastman, $56 million had been paid for costs at the Shared Sites as of December 31, 2013. As of December 31, 2013, an additional $215 million has been accrued for estimated future remediation costs at the Shared Sites, over a period of thirty years.

Environmental costs are capitalized if they extend the life of the related property, increase its capacity, and/or mitigate or prevent future contamination. The cost of operating and maintaining environmental control facilities is charged to expense. The Company's cash expenditures related to environmental protection and improvement were $285 million, $262 million, and $219 million in 2013, 2012, and 2011, respectively. These amounts were primarily for operating costs associated with environmental protection equipment and facilities, but also included $53 million and $34 million in expenditures for engineering and construction in 2013 and 2012, respectively.

In fourth quarter 2012, the Company recognized asset impairments of $17 million due to a change in approach to address recently finalized boiler air emissions regulations. See Note 16, "Asset Impairments and Restructuring Charges (Gains), Net" for additional information.

14. 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 will have a material adverse effect on its overall financial condition, results of operations, or cash flows.

NOTES TO THE AUDITED CONSOLIDATED FINANCIAL STATEMENTS

15. STOCKHOLDERS' EQUITY

A reconciliation of the changes in stockholders' equity for 2013, 2012, and 2011 is provided below:

(Dollars in millions)	Common Stock at Par Value $	Paid-in Capital $	Retained Earnings $	Accumulated Other Comprehensive Income (Loss) $	Treasury Stock at Cost $	Total Stockholders' Equity Attributed to Eastman $	Noncontrolling Interest $	Total Stockholders' Equity $
Balance at December 31, 2010	2	793	2,253	194	(1,615)	1,627	32	1,659
Net Earnings	—	—	646	—	—	646	1	647
Cash Dividends (1)	—	—	(139)	—	—	(139)	—	(139)
Other Comprehensive Income	—	—	—	(56)	—	(56)	—	(56)
Share-Based Compensation Expense (2)	—	39	—	—	—	39	—	39
Stock Option Exercises	—	59	—	—	—	59	—	59
Other (3)	—	9	—	—	1	10	—	10
Share Repurchase	—	—	—	—	(316)	(316)	—	(316)
Distributions to noncontrolling interest	—	—	—	—	—	—	(2)	(2)
Balance at December 31, 2011	2	900	2,760	138	(1,930)	1,870	31	1,901
Net Earnings	—	—	437	—	—	437	7	444
Cash Dividends (1)	—	—	(159)	—	—	(159)	—	(159)
Other Comprehensive Income	—	—	—	(15)	—	(15)	—	(15)
Share-Based Compensation Expense (2)	—	25	—	—	—	25	—	25
Stock Option Exercises	—	40	—	—	—	40	—	40
Shares Issued for Business Combination	—	730	—	—	—	730	—	730
Other (3)	—	14	—	—	1	15	—	15
Share Repurchase	—	—	—	—	—	—	50	50
Distributions to noncontrolling interest	—	—	—	—	—	—	(3)	(3)

Balance at December 31, 2012	2	1,709	3,038	123	(1,929)	2,943	85	3,028
Net Earnings	—	—	1,165	—	—	1,165	7	1,172
Cash Dividends [1]	—	—	(191)	—	—	(191)	—	(191)
Other Comprehensive Income	—	—	—	48	—	48	—	48
Share-Based Compensation Expense [2]	—	39	—	—	—	39	—	39
Stock Option Exercises	—	12	—	—	—	12	—	12
Shares Issued for Business Combination	—	16	—	—	—	16	—	16
Other [3]	—	2	—	—	—	2		2
Share Repurchase	—	—	—	—	(238)	(238)	—	(238)
Noncontrolling interests associated with acquisition	—	—	—	—	—	—	—	—
Distributions to noncontrolling interest	—	—	—	—	—	—	(13)	(13)
Balance at December 31, 2013	2	1,778	4,012	171	(2,167)	3,796	79	3,875

(1) Includes cash dividends paid and dividends declared, but unpaid.

(2) Includes the fair value of equity share-based awards recognized for share-based compensation.

(3) Paid in capital includes tax benefits/charges relating to the difference between the amounts deductible for federal income taxes over the amounts charged to income for book value purposes have been adjusted to paid-in capital and other items. Equity attributable to noncontrolling interest includes adjustments for currency revaluation.

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NOTES TO THE AUDITED CONSOLIDATED FINANCIAL STATEMENTS

The Company is authorized to issue 400 million shares of all classes of stock, of which 50 million may be preferred stock, par value $0.01 per share, and 350 million may be common stock, par value $0.01 per share. The Company declared dividends per share of $1.25 in 2013, $1.08 in 2012, and $0.99 in 2011.

On July 2, 2012, as part of the Company's acquisition of Solutia, the Company issued 14.7 million shares of Eastman common stock and 4,481,250 warrants to purchase 0.12 shares of Eastman common stock and $22.00 cash per warrant upon payment of the warrant exercise price of $29.70. The warrants expired on February 27, 2013. For more information, see Note 2, "Acquisitions and Investments in Joint Ventures". There were no warrants outstanding as of December 31, 2013.

The Company established a benefit security trust in 1997 to provide a degree of financial security for unfunded obligations under certain unfunded plans and contributed to the trust a warrant to purchase up to 6 million shares of common stock of the Company for par value. The warrant, which remains outstanding, is exercisable by the trustee if the Company does not meet certain funding obligations, which obligations would be triggered by certain occurrences, including a change in control or potential change in control, as defined, or failure by the Company to meet its payment obligations under certain covered unfunded plans. Such warrant is excluded from the computation of diluted earnings per share because the conditions upon which the warrant becomes exercisable have not been met.

The additions to paid-in capital for 2013 are primarily for compensation expense of equity awards and employee stock option exercises. The additions in 2012 are primarily for shares issued as part of the acquisition of Solutia and employee stock option exercises and compensation expense of equity awards. The additions in 2011 are primarily the result of employee stock option exercises and compensation expense of equity awards.

In August 2010, the Company's Board of Directors authorized $300 million for repurchase of the Company's outstanding common stock. The Company completed all repurchases under the $300 million repurchase authorization in June 2011, acquiring a total of 7,110,524 shares. In February 2011, the Company's Board of Directors authorized an additional repurchase of up to $300 million of the Company's outstanding common stock. The Company completed the $300 million repurchase authorization in August 2013, acquiring a total of 6,141,999 shares. In May 2013, the Company's Board of Directors authorized an additional repurchase of up to $300 million of the Company's outstanding common stock at such times, in such amounts, and on such terms, as determined to be in the best interests of the Company. As of December 31, 2013, a total of 1,828,526 shares have been repurchased under this authorization for a total of approximately $140 million. In February 2014, the Company's Board of Directors authorized repurchase of up to an additional $1 billion of the Company's outstanding common stock at such times, in such amounts, and on such terms, as determined to be in the best interests of the Company. During 2013, the Company repurchased 3,212,886 shares of common stock for a cost of approximately $238 million. The Company did not repurchase any shares of common stock during 2012.

The Company's charitable foundation held 50,798 shares of the Company's common stock at December 31, 2013, 60,485 shares at December 31, 2012, and 88,456 shares at December 31, 2011 which are included in treasury stock.

NOTES TO THE AUDITED CONSOLIDATED FINANCIAL STATEMENTS

The following table sets forth the computation of basic and diluted earnings per share ("EPS") for continuing operations:

	For years ended December 31,		
(In millions, except per share amounts)	2013	2012	2011
Numerator			
Earnings attributable to Eastman stockholders:			
Earnings from continuing operations, net of tax	$1,165	$436	$606
Denominator			
Weighted average shares used for basic EPS	154.0	145.5	139.7
Dilutive effect of stock options and other award plans	2.5	3.6	3.4
Weighted average shares used for diluted EPS	156.5	149.1	143.1
EPS from continuing operations [1]			
Basic	$7.57	$2.99	$4.34
Diluted	$7.44	$2.92	$4.24

[1] Earnings per share are calculated using whole dollars and shares.

There were no stock options excluded from the 2013 calculation of diluted earnings per share. For 2012, the only shares excluded from the computation of diluted earnings per share were 536,803 shares then issuable upon exercise of the warrants issued in the Solutia acquisition. Stock options excluded from the 2011 calculation of diluted earnings per share were 408,850 because the total market value of option exercises for these awards was less than the total cash proceeds that would be received from these exercises.

	For years ended December 31,		
Shares of common stock issued [1]	2013	2012	2011
Balance at beginning of year	213,406,523	196,455,131	193,688,890
Issued for employee compensation and benefit plans	1,455,030	2,263,783	2,766,241
Issued for Solutia acquisition and related warrants	269,684	14,687,609	0
Balance at end of year	215,131,237	213,406,523	196,455,131

[1] Includes shares held in treasury.

ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS), NET OF TAX

(Dollars in millions)	Cumulative Translation Adjustment $	Benefit Plans Unrecognized Prior Service Credits $	Unrealized Gains (Losses) on Cash Flow Hedges $	Unrealized Losses on Investments $	Accumulated Other Comprehensive Income (Loss) $
Balance at December 31, 2011	64	78	(3)	(1)	138
Period change	41	(13)	(43)	—	(15)
Balance at December 31, 2012	105	65	(46)	(1)	123
Period change	28	13	7	—	48
Balance at December 31, 2013	133	78	(39)	(1)	171

NOTES TO THE AUDITED CONSOLIDATED FINANCIAL STATEMENTS

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.

Components of other comprehensive income recorded in the Consolidated Statements of Earnings, Comprehensive Income and Retained Earnings are presented below, before tax and net of tax effects:

	For years ended December 31,					
	2013		2012		2011	
(Dollars in millions)	Before Tax	Net of Tax	Before Tax	Net of Tax	Before Tax	Net of Tax
Other comprehensive income (loss)						
Change in cumulative translation adjustment	$29	$28	$42	$41	$(15)	$(15)
Defined benefit pension and other postretirement benefit plans:						
Prior service credit arising during the period	47	29	3	2	2	1
Amortization of unrecognized prior service credits included in net periodic costs	(26)	(16)	(23)	(15)	(39)	(22)
Change in defined benefit pension and other postretirement benefit plans	21	13	(20)	(13)	(37)	(21)
Derivatives and hedging:						
Unrealized (loss) gain	10	6	(59)	(36)	(31)	(20)
Reclassification adjustment for gains included in net income	2	1	(11)	(7)	—	—
Change in derivatives and hedging	12	7	(70)	(43)	(31)	(20)
Total other comprehensive income (loss)	$62	$48	$(48)	$(15)	$(83)	$(56)

For additional information regarding the impact of reclassifications into earnings, refer to Note 10, "Derivatives".

16. ASSET IMPAIRMENTS AND RESTRUCTURING CHARGES (GAINS), NET

Components of asset impairments and restructuring charges (gains), net, are presented below:

	For years ended December 31,		
(Dollars in millions)	2013	2012	2011
Fixed asset impairments	$28	$41	$—
Gain on sale	—	—	(15)
Intangible asset and goodwill impairments	—	5	—
Severance charges	27	33	7
Site closure and restructuring charges	21	41	—
Total	$76	$120	$(8)

2013

In 2013, there were $76 million in asset impairments and restructuring charges and gains, net, including $23 million of restructuring charges primarily for severance associated with the continued integration of Solutia. For additional information related to the acquisition of Solutia, see Note 2, "Acquisitions and Investments in Joint Ventures".

NOTES TO THE AUDITED CONSOLIDATED FINANCIAL STATEMENTS

During fourth quarter 2013, management decided not to continue its Perennial Wood™ growth initiative. This resulted in asset impairment charges of $16 million and restructuring charges of $14 million primarily for inventory and contract termination costs. Also during fourth quarter 2013, management decided to terminate efforts to develop a continuous resin process in Kuantan, Malaysia and Antwerp, Belgium. This resulted in asset impairment charges of $4 million.

During 2013, management decided to shut-down the Photovoltaics product line, including the primary production facility in Germany. This resulted in the Company recognizing asset impairments of $8 million and restructuring charges of $6 million including charges for severance.

During 2013, management also approved and recorded severance charges of $6 million primarily for a voluntary separation plan for certain employees.

In addition, during 2013, a change in estimate for certain costs for the fourth quarter 2012 termination of the operating agreement for the Sao Jose dos Campos, Brazil site resulted in a reduction of $4 million to previously recorded asset impairments and restructuring charges. Analysis of total site shutdown costs is ongoing and is subject to the finalization of certain aspects of the operating agreement termination.

2012

In 2012, there were $120 million in asset impairments and restructuring charges and gains, net.

During 2012, the Company terminated an operating agreement at the acquired Solutia facility in Sao Jose dos Campos, Brazil. This resulted in asset impairments and restructuring charges of $35 million. Restructuring charges for the shutdown of manufacturing activities at this site included contract terminations costs for severance and other required costs under the operating agreement. Additionally, the Company recorded asset impairments for long-lived assets at the site, based on fair value indicators.

During 2012, management approved the closure of a production facility in China. Based on business analysis completed in fourth quarter, the Company concluded the production of the related product lines would be most efficiently performed in its Kingsport, Tennessee facility. This resulted in the Company recognizing asset impairment and restructuring charges of $6 million.

During 2012, acquisition related restructuring charges of $32 million were recorded primarily for severance costs associated with the acquisition and integration of Solutia.

During 2012, the Company ceased research and development activities for renewable chemicals at a site it acquired in 2011, resulting in asset impairments and restructuring charges of $4 million.

During 2012, the Company recognized asset impairments of $17 million due to a change in approach to address recently finalized boiler air emissions regulations. The Company had incurred engineering costs associated with required modifications for its existing steam and electric generation capacity. However, based on the then current availability of natural gas and the lower cost of operation, management determined that conversion to natural gas fueled boilers was more cost efficient. The Company entered into long-term natural gas supply agreements with a third party in fourth quarter 2012, triggering the impairment of the project.

During 2012, management decided to cease production of certain products in its Perennial Wood™ growth initiative. As a result, a restructuring charge of $17 million was recognized for inventory costs in excess of recoverable value on these certain product lines and to accrue for losses on take-or-pay contracts with third parties. An analysis was performed to determine what, if any, impairment may be required for the associated fixed assets. Based on the expected life of the assets and intended uses within the Company's continuing acetylation initiatives, there was no impairment.

The Company also recognized asset impairments related to land retained from the previously discontinued industrial gasification project. Based on fair value indicators, the carrying value of the Beaumont land was reduced by $6 million.

NOTES TO THE AUDITED CONSOLIDATED FINANCIAL STATEMENTS

2011

In 2011, the Company recorded $8 million net gain in asset impairments and restructuring charges (gains), net. A gain of $15 million was recognized from the sale of the previously impaired methanol and ammonia assets related to the discontinued industrial gasification project and restructuring charges of $7 million primarily for severance associated with the acquisition and integration of Sterling.

The following table summarizes the changes in estimates described above, other asset impairments and restructuring charges and gains, the non-cash reductions attributable to asset impairments, and the cash reductions in shutdown reserves for severance costs and site closure costs paid:

	Balance at January 1, 2011	Provision/ Adjustments	Non-cash Reductions	Cash Reductions	Balance at December 31, 2011
Noncash charges	$—	$(15)	$15	$—	$—
Severance costs	15	7	—	(20)	2
Total	$15	$(8)	$15	$(20)	$2
	Balance at January 1, 2012	Provision/ Adjustments	Non-cash Reductions	Cash Reductions	Balance at December 31, 2012
Noncash charges	$—	$43	$(43)	$—	$—
Severance costs	2	34	—	(32)	4
Site closure & restructuring costs	—	43	(20)	(2)	21
Total	$2	$120	$(63)	$(34)	$25
	Balance at January 1, 2013	Provision/ Adjustments	Non-cash Reductions	Cash Reductions	Balance at December 31, 2013
Noncash charges	$—	$28	$(28)	$—	$—
Severance costs	4	27	2	(11)	22
Site closure & restructuring costs	21	21	(16)	(12)	14
Total	$25	$76	$(42)	$(23)	$36

During 2013 and 2012, the Company accrued for employee separations associated with the acquisition and integration of Solutia. During 2011, the Company accrued for employee separations associated with the acquisition and integration of Sterling. Substantially all separation payments for the 2013 accruals will be completed by December 31, 2014, and all 2012 and 2011 accruals were completed by December 2013.

17. OTHER CHARGES (INCOME), NET

	For years ended December 31,		
(Dollars in millions)	2013	2012	2011
Foreign exchange transactions (gains) losses, net	$7	$(4)	$(2)
Solutia financing costs	—	23	—
Investments (gains) losses, net	(5)	(9)	(16)
Other, net	1	(2)	(2)
Other charges (income), net	$3	$8	$(20)

Included in other charges (income), net are gains or losses on foreign exchange transactions, results from equity investments, gains or losses on business venture investments, gains from the sale of non-operating assets, certain litigation costs, fees on securitized receivables, other non-operating income, and other miscellaneous items. Financing costs recorded in "Other Charges (Income), Net" in 2012 were primarily fees for Solutia acquisition borrowings. Investment gains in 2011 included sales of business venture investments.

NOTES TO THE AUDITED CONSOLIDATED FINANCIAL STATEMENTS

18. SHARE-BASED COMPENSATION PLANS AND AWARDS

2012 Omnibus Stock Compensation Plan

Eastman's 2012 Omnibus Stock Compensation Plan ("2012 Omnibus Plan") was approved by stockholders at the May 3, 2012 Annual Meeting of Stockholders and shall remain in effect until its fifth anniversary. The 2012 Omnibus Plan authorizes the Compensation and Management Development Committee of the Board of Directors to: grant awards, designate participants, determine the types and numbers of awards, determine the terms and conditions of awards and determine the form of award settlement. Under the 2012 Omnibus Plan, the aggregate number of shares reserved and available for issuance is 10 million, which will consist of a number of shares not previously authorized for issuance under any other plan. The number of shares covered by an award is counted against this share reserve as of the grant date of the award. Shares covered by full value awards (e.g. performance shares and restricted stock awards) are counted against the total number of shares available for issuance or delivery under the plan as 2.5 shares for every one share covered by the award. Any stock distributed pursuant to an award may consist of, in whole or in part, authorized and unissued stock, treasury stock, or stock purchased on the open market. Under the 2012 Omnibus Plan and previous plans, the forms of awards have included: restricted stock and restricted stock units, stock options, stock appreciation rights ("SARs"), and performance shares. The 2012 Omnibus Plan is flexible as to the number of specific forms of awards, but provides that stock options and SARs are to be granted at an exercise price not less than 100 percent of the per share fair market value on the date of the grant.

Director Stock Compensation Subplan

Eastman's Director Stock Compensation Subplan ("Directors' Subplan"), a component of the 2012 Omnibus Plan, remains in effect until terminated by the Board of Directors or the earlier termination of the 2012 Omnibus Plan. The Directors' Subplan provides for structured awards of restricted shares to non-employee members of the Board of Directors. Restricted shares awarded under the Directors' Subplan are subject to the same terms and conditions of the 2012 Omnibus Plan. The Directors' Subplan does not constitute a separate source of shares for grant of equity awards and all shares awarded are part of the 10 million shares authorized under the 2012 Omnibus Plan. Shares of restricted stock are granted on the first day of a non-employee director's initial term of service and shares of restricted stock are granted each year to each non-employee director on the date of the annual meeting of stockholders.

The Company is authorized by the Board of Directors under the 2012 Omnibus Plan to provide grants to employees and non-employee members of the Board of Directors. It has been the Company's practice to issue new shares rather than treasury shares for equity awards that require settlement by the issuance of common stock and to withhold or accept back shares awarded to cover the related income tax obligations of employee participants. Shares of non-employee directors are not withheld or acquired to satisfy the withholding obligation related to their income taxes. Shares of unrestricted common stock owned by specified senior management level employees are accepted by the Company to pay the exercise price of stock options in accordance with the terms and conditions of their awards.

For 2013, 2012, and 2011, total share-based compensation expense (before tax) of approximately $40 million, $28 million, and $39 million, respectively, was recognized in selling, general and administrative expense in the Consolidated Statements of Earnings for all share-based awards of which approximately $5 million, $2 million, and $4 million, respectively, related to stock options. The compensation expense is recognized over the substantive vesting period, which may be a shorter time period than the stated vesting period for qualifying termination eligible employees as defined in the forms of award notice. For both 2013 and 2011, approximately $3 million of stock option compensation expense was recognized due to qualifying termination eligibility preceding the requisite vesting period.

Stock Option Awards

Options have been granted on an annual basis to non-employee directors under the Directors' Subplan and predecessor plans and by the Compensation and Management Development Committee of the Board of Directors under the 2012 Omnibus Plan and predecessor plans to employees. Option awards have an exercise price equal to the closing price of the Company's stock on the date of grant. The term of options is ten years with vesting periods that vary up to three years. Vesting usually occurs ratably over the vesting period or at the end of the vesting period. The Company utilizes the Black Scholes Merton option valuation model which relies on certain assumptions to estimate an option's fair value.

NOTES TO THE AUDITED CONSOLIDATED FINANCIAL STATEMENTS

The weighted average assumptions used in the determination of fair value for stock options awarded in 2013 and 2011 are provided in the table below. There were no stock options granted in 2012.

Assumptions	2013	2011
Expected volatility rate	34.90%	33.00%
Expected dividend yield	1.97%	2.23%
Average risk-free interest rate	0.77%	0.95%
Expected forfeiture rate	0.75%	0.75%
Expected term years	5.00	5.20

The volatility rate of grants is derived from historical Company common stock price volatility over the same time period as the expected term of each stock option award. The volatility rate is derived by mathematical formula utilizing the weekly high closing stock price data over the expected term.

The expected dividend yield is calculated using the Company's average of the last four quarterly dividend yields.

The average risk-free interest rate is derived from United States Department of Treasury published interest rates of daily yield curves for the same time period as the expected term.

GAAP specifies only share-based awards expected to vest be included in share-based compensation expense. Estimated forfeiture rates are determined using historical forfeiture experience for each type of award and are excluded from the quantity of awards included in share-based compensation expense.

The weighted average expected term reflects the analysis of historical share-based award transactions and includes option swap and reload grants which may have much shorter remaining expected terms than new option grants.

A summary of the activity of the Company's stock option awards for 2013, 2012, and 2011 is presented below:

	2013		2012		2011	
	Options	Weighted-Average Exercise Price	Options	Weighted-Average Exercise Price	Options	Weighted-Average Exercise Price
Outstanding at beginning of year	2,480,100	$ 33	3,974,400	$ 30	5,505,800	$ 29
Granted	317,900	70	—	—	537,500	38
Exercised	(436,500)	28	(1,486,300)	27	(2,059,900)	29
Cancelled, forfeited, or expired	(2,400)	15	(8,000)	19	(9,000)	25
Outstanding at end of year	2,359,100	$ 39	2,480,100	$ 33	3,974,400	$ 30
Options exercisable at year-end	1,862,000		1,912,400		2,796,400	
Available for grant at end of year	8,454,854		9,808,610		1,475,922	

NOTES TO THE AUDITED CONSOLIDATED FINANCIAL STATEMENTS

The following table provides the remaining contractual term and weighted average exercise prices of stock options outstanding and exercisable at December 31, 2013:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number Outstanding at December 31, 2013	Weighted-Average Remaining Contractual Life (Years)	Weighted-Average Exercise Price	Number Exercisable at December 31, 2013	Weighted-Average Exercise Price
$15-$24	51,200	2.1	$21	51,200	$21
$25-$29	576,300	4.6	28	576,300	28
$30-$32	263,000	3.0	31	263,000	31
$33-$34	189,700	3.8	33	189,700	33
$35-$40	961,000	7.2	39	781,800	39
$41-$70	317,900	9.2	70	—	—
	2,359,100	6.0	$39	1,862,000	$33

The range of exercise prices of options outstanding at December 31, 2013 is approximately $15 to $70 per share. The aggregate intrinsic value of total options outstanding and total options exercisable at December 31, 2013 is $99 million and $88 million, respectively. Intrinsic value is the amount by which the closing market price of the stock at December 31, 2013 exceeds the exercise price of the option grants.

The weighted average remaining contractual life of all exercisable options at December 31, 2013 is 5.3 years.

The weighted average fair value of options granted during 2013 and 2011 was $17.92 and $9.27, respectively. There were no options granted in 2012. The total intrinsic value of options exercised during the years ended December 31, 2013, 2012, and 2011, was $21 million, $43 million, and $37 million, respectively. Cash proceeds received by the Company from option exercises and the related tax benefit totals $12 million and $6 million, respectively, for 2013, $40 million and $14 million, respectively, for 2012, and $59 million and $10 million, respectively, for 2011. The total fair value of shares vested during the years ended December 31, 2013, 2012, and 2011 was $3 million, $5 million, and $4 million, respectively.

A summary of the status of the Company's nonvested options as of December 31, 2013 and changes during the year then ended is presented below:

Nonvested Options	Number of Options	Weighted-Average Grant Date Fair Value
Nonvested at January 1, 2013	567,700	$9.02
Granted	317,900	17.92
Vested	(388,500)	8.91
Forfeited	—	—
Nonvested Options at December 31, 2013	497,100	$14.80

For options unvested at December 31, 2013, approximately $2 million in compensation expense will be recognized over the next two years.

NOTES TO THE AUDITED CONSOLIDATED FINANCIAL STATEMENTS

Other Share-Based Compensation Awards

In addition to stock option awards, the Company has awarded long-term performance share awards, restricted stock awards, and stock appreciation rights. The long-term performance awards are based upon actual return on capital compared to a target return on capital and total stockholder return compared to a peer group ranking by total stockholder return over a three year performance period. The awards are valued using a Monte Carlo Simulation based model and vest pro-ratably over the three year performance period. The number of long-term performance award target shares granted for the 2013-2015, 2012-2014, and 2011-2013 periods were 270 thousand, 338 thousand, and 443 thousand, respectively. The target shares granted are assumed to be 100 percent. At the end of the three-year performance period, the actual number of shares awarded can range from zero percent to 250 percent of the target shares granted based on the award notice. The number of restricted stock awards granted during 2013, 2012, and 2011 were 146 thousand, 84 thousand, and 157 thousand, respectively. The fair value of a restricted stock award is equal to the closing stock price of the Company's stock on the date of grant and normally vests over a period of three years. The recognized compensation cost before tax for these other share-based awards in the years ended December 31, 2013, 2012, and 2011 was approximately $35 million, $26 million, and $35 million, respectively. The unrecognized compensation expense before tax for these same type awards at December 31, 2013 was approximately $30 million and will be recognized primarily over a period of two years.

19. SUPPLEMENTAL CASH FLOW INFORMATION

Included in the line item "Other items, net" of the "Cash flows from operating activities" section of the Consolidated Statements of Cash Flows are specific changes to certain balance sheet accounts as follows:

	For years ended December 31,		
(Dollars in millions)	2013	2012	2011
Current assets	$(56)	$(23)	$15
Other assets	102	53	16
Current liabilities	(26)	(1)	37
Long-term liabilities and equity	(191)	(71)	(50)
Total	$(171)	$(42)	$18

The above changes included transactions such as accrued taxes, deferred taxes, environmental liabilities, monetized positions from raw material and energy, currency, and certain interest rate hedges, prepaid insurance, miscellaneous deferrals, value-added taxes, and other miscellaneous accruals.

Cash flows from derivative financial instruments accounted for as hedges are classified in the same category as the item being hedged.

	For years ended December 31,		
(Dollars in millions)	2013	2012	2011
Cash paid for interest and income taxes is as follows:			
Interest, net of amounts capitalized	$186	$125	$78
Income taxes	224	137	261
Non-cash investing and financing activities:			
Increase (decrease) in trade payables related to capital expenditures	28	—	(11)
(Gain) loss from equity investments	(4)	(8)	9

20. DISCONTINUED OPERATIONS

On January 31, 2011, the Company completed the sale of the polyethylene terephthalate ("PET") business, related assets at the Columbia, South Carolina site, and technology of its Performance Polymers segment for $615 million and recognized a gain of approximately $30 million, net of tax. The Company contracted with the buyer for transition services to supply certain raw materials and services for a period of less than one year. Transition supply agreement revenues of approximately $220 million, relating to raw materials, were more than offset by costs and reported net in cost of sales. The PET business, assets, and technology sold were substantially all of the Performance Polymers segment and therefore the segment operating results are presented as discontinued operations for all periods presented and are not included in results from continuing operations.

NOTES TO THE AUDITED CONSOLIDATED FINANCIAL STATEMENTS

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

	For years ended December 31,	
(Dollars in millions)	2012	2011
Sales	$—	$ 105
Earnings before income taxes	—	17
Earnings from discontinued operations, net of tax	—	9
Gain from disposal of discontinued operations, net of tax	1	31

21. SEGMENT INFORMATION

The Company's products and operations are currently managed and reported in five reporting segments: Additives & Functional Products ("AFP"), Adhesives & Plasticizers ("A&P"), Advanced Materials ("AM"), Fibers, and Specialty Fluids & Intermediates ("SFI").

In the AFP segment, the Company manufactures chemicals for products in the coatings and tire industries in transportation, building and construction, durable goods, and consumables markets. The products Eastman manufactures for the coatings industry can be broadly classified as solvents, which include specialty coalescents and ketones and esters, glycol ethers, and alcohol solvents; and polymers, which include cellulose and polyester-based specialty polymers and paint additives. Products for the tires industry are classified into three main product groups: insoluble sulfur products, which are vulcanizing agents principally marketed under the Crystex® brand; antidegradants, principally marketed under the Santoflex® brand; and hydrocarbon resins. Coatings industry sales accounted for 48 percent, 59 percent, and 73 percent of the AFP segment's total sales for 2013, 2012, and 2011 respectively. Tires industry sales accounted for 34 percent and 20 percent of the AFP segment's total sales for 2013 and 2012, respectively, with no sales revenue in 2011 prior to the acquisition of Solutia. The remainder of sales were from other industries.

In the A&P segment, the Company manufactures adhesives resins and plasticizers which are used in the manufacture of products sold into the consumables, building and construction, health and wellness, industrial chemicals and processing, and durable goods markets. The adhesives resins product line consists of hydrocarbon resins such as Regalite™ and Eastotac™; non-hydrogenated hydrocarbons resins such as Piccotac™; and rosins such as Eastoflex™. The plasticizers product line consists of a unique set of primary non-phthalate plasticizers such as Eastman 168™, and a range of niche non-phthalate plasticizers such as Benzoflex™ and Eastman TXIB™. Adhesives resins accounted for 52 percent, 55 percent, and 56 percent of the A&P segment's total sales for 2013, 2012, and 2011, respectively. Plasticizers accounted for 48 percent, 45 percent, and 44 percent of the A&P segment's total sales for 2013, 2012, and 2011, respectively.

In the AM segment, the Company produces and markets specialty copolyesters, cellulose esters, interlayers, and aftermarket window film products that possess differentiated performance properties for value-added end uses in transportation, consumables, building and construction, durable goods, and health and wellness. The specialty plastics product line consists of two primary products: specialty copolyesters and cellulose esters. The interlayers product line includes specialty intermediate polyvinyl butyral ("PVB") sheet and resins. PVB is a specialty resin used in the production of laminated safety glass sheet used in automotive and architectural applications. The performance films product line primarily consists of window film products, which are aftermarket applied films to enhance the characteristics and functional performance of automotive and architectural glass. Eastman's specialty plastics product line accounted for 53 percent of the AM segment's total sales for 2013, and 69 percent and 100 percent for 2012 and 2011, respectively, prior to the acquisition of Solutia. The interlayers product line accounted for 34 percent and 23 percent of the AM segment's total sales for 2013 and 2012, respectively, with no sales revenue in 2011 prior to the acquisition of Solutia. The performance films product line accounted for 13 percent and 8 percent of the AM segment's total sales for 2013 and 2012, respectively, with no sales revenue in 2011 prior to the acquisition of Solutia.

In the Fibers segment, the Company manufactures Estron™ acetate tow and Estrobond™ triacetin plasticizers which are used primarily in cigarette filters; Estron™ natural (undyed) and Chromspun™ solution-dyed acetate yarns for use in apparel, home furnishings, and industrial fabrics; and cellulose acetate flake and acetyl raw materials for other acetate fiber producers. Acetate tow accounted for 83 percent, 86 percent, and 82 percent of the Fibers segment total sales revenue in 2013, 2012, and 2011, respectively, with the remainder of sales from other product lines, including acetate yarn and acetyl chemical products.

NOTES TO THE AUDITED CONSOLIDATED FINANCIAL STATEMENTS

In the SFI segment, the Company manufactures diversified products that are sold externally for use in markets such as industrial chemicals and processing; building and construction; health and wellness; and agriculture, as well as used internally by other segments of the Company. In the specialty fluids product line, the Company produces Therminol® heat transfer fluids and Skydrol® brand aviation hydraulic fluids. In the chemical intermediates product line, the Company produces acetic anhydride, acetic acid and derivatives, and oxo alcohols and derivatives. Other intermediate products include olefin, chemical intermediates, and polymer intermediates. Specialty fluids accounted for 13 percent and 7 percent of the SFI segment's total sales for 2013 and 2012, respectively, with no sales revenue in 2011 prior to the acquisition of Solutia. Chemical intermediates accounted for 48 percent, 51 percent, and 54 percent of the SFI segment's total sales for 2013, 2012, and 2011, respectively. Sales for other products accounted for 39 percent, 42 percent, and 46 percent of the SFI segment's total sales for 2013, 2012, and 2011, respectively.

Sales revenue and expense for the Photovoltaics product line and the Perennial Wood™ growth initiative are shown in the tables below as "other" sales revenue and operating loss. R&D, pension and other postretirement benefits, and other expenses and income not identifiable to an operating segment are shown in the tables below as "other" operating earnings (loss).

The Company continues to explore and invest in R&D initiatives that are aligned with macro trends in sustainability, consumerism, and energy efficiency such as high performance materials, advanced cellulosics, and environmentally-friendly chemistry. An example of such an initiative is Eastman™ microfiber technology which leverages the Company's core competency in polymers chemistry, spinning capability, and in-house application expertise, for use in high purity air filtration, liquid filtration, and energy storage media, and with opportunities for future growth in nonwoven and textile applications. Cerfis™ technology for the building and construction market was previously included in Corporate Initiatives and is now reported in the AM segment.

Included in 2013 "other" operating loss were integration costs of $36 million and $23 million in restructuring charges, primarily for severance associated with the acquisition and integration of Solutia.

	For years ended December 31,		
(Dollars in millions)	2013	2012	2011
Sales by Segment			
Additives & Functional Products	$1,719	$1,332	$1,067
Adhesives & Plasticizers	1,326	1,432	1,381
Advanced Materials	2,349	1,694	1,195
Fibers	1,441	1,315	1,279
Specialty Fluids & Intermediates	2,497	2,318	2,256
Total Sales by Segment	$9,332	$8,091	$7,178
Other	18	11	—
Total Sales	$9,350	$8,102	$7,178

NOTES TO THE AUDITED CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in millions)	For years ended December 31, 2013	2012	2011
Operating Earnings (Loss)			
Additives & Functional Products[1][2][3][4][5][6]	$405	$285	$215
Adhesives & Plasticizers[2][4]	172	260	250
Advanced Materials[1][2][3][4][5][7]	257	84	125
Fibers[4]	462	385	365
Specialty Fluids & Intermediates[1][2][4][5][8]	363	288	204
Total Operating Earnings by Segment	1,659	1,302	1,159
Other[9]			
Growth initiatives and businesses not allocated to segments[2][10][11][12][13][14]	(132)	(132)	(49)
Pension and other postretirement benefit costs not allocated to operating segments[15]	394	(294)	(173)
Transaction, integration, and restructuring costs related to the acquisition of Solutia[16]	(59)	(76)	—
Total Operating Earnings	$1,862	$800	$937

(1) Included in 2012 earnings are additional costs of $21 million, $41 million, and $17 million in the AFP, AM, and SFI segments, respectively, of acquired Solutia inventories. See Note 2, "Acquisitions and Investments in Joint Ventures".

(2) Included in 2013 earnings are restructuring charges of $2 million, $1 million, $2 million, and $1 million in the AFP, A&P, AM, and SFI segments, respectively, and $3 million in "Other", in each case primarily for severance.

(3) Included in 2013 earnings is a reduction in previous charges for the fourth quarter 2012 termination of the operating agreement for the Sao Jose dos Campos, Brazil site, which is reported as reductions of $1 million and $3 million in the AFP and AM segments, respectively.

(4) Included in 2012 were asset impairments and restructuring charges of $3 million, $3 million, $5 million, $3 million, and $6 million in the AFP, A&P, AM, Fibers and SFI segments, respectively, primarily related to discontinuance of a project to modify existing utility assets in order to meet requirements of recently enacted environmental regulations controlling air emissions from boilers.

(5) Included in 2012 were asset impairments and restructuring charges of $8 million, $24 million, and $3 million in the AFP, AM, and SFI segments, respectively, for the fourth quarter termination of an operating agreement at the acquired Solutia manufacturing facility in Sao Jose Dos Campos, Brazil and related manufacturing facility closure costs.

(6) Included in 2012 earnings are asset impairments and restructuring charges of $6 million in the AFP segment related to the closure of a production facility in China.

(7) Included in 2013 are asset impairments of $4 million in the AM segment for the fourth quarter decision to terminate efforts to develop a continuous resin process in Kuantan, Malaysia and Antwerp, Belgium.

(8) Included in 2011 earnings are restructuring charges of $7 million in the SFI segment related to severance.

(9) Research and development, pension and other postretirement benefits, and other expenses not identifiable to an operating segment are not included in segment operating results for any of the periods presented and are shown as "other" operating earnings (loss).

(10) Businesses not allocated to segments include the Perennial Wood™ growth initiative and Photovoltaics product line. See Note 11 below.

(11) Included in 2013 are asset impairment and restructuring charges of $30 million for management's decision not to continue its Perennial Wood™ growth initiative. Operating earnings in 2012 included restructuring charges of $17

million for inventory costs in excess of recoverable value of certain Perennial Wood™ product lines and to accrue for losses on take-or-pay contracts with third parties.

(12) Included in 2013 earnings are asset impairments and restructuring charges of $14 million for the shut-down of the Photovoltaics product line primarily in Germany.

(13) Included in 2012 were asset impairments and restructuring charges of $4 million for termination of the research and development activities of a site acquired in 2011 and a charge of $6 million for the impairment of land retained from the terminated Beaumont, Texas industrial gasification project.

(14) Included in 2011 earnings is a $15 million gain from the sale of the previously impaired methanol and ammonia assets related to the discontinued industrial gasification project.

(15) Included in 2013 earnings are MTM pension and other postretirement benefit plans gains of $297 million and an MTM other postretirement benefit plan gain of $86 million for a change in benefits. Included in 2012 and 2011 earnings are MTM pension and other postretirement benefit plans losses of $276 million and $144 million, respectively. See Note 11, "Retirement Plans."

(16) Included in 2013 earnings are restructuring charges of $23 million primarily for severance associated with the continued integration of Solutia. Operating earnings in 2012 included restructuring charges $32 million primarily for severance related to the acquisition and integration of Solutia.

NOTES TO THE AUDITED CONSOLIDATED FINANCIAL STATEMENTS

For more information about asset impairments and restructuring charges included in operating earnings, see Note 16, "Asset Impairments and Restructuring Charges (Gains), Net".

	December 31,	
(Dollars in millions)	2013	2012
Assets by Segment [(1)]		
Additives & Functional Products	$2,940	$2,892
Adhesives & Plasticizers	996	1,088
Advanced Materials	3,807	3,744
Fibers	974	937
Specialty Fluids & Intermediates	2,054	1,987
Total Assets by Segment	10,771	10,648
Corporate Assets	1,075	1,062
Total Assets	$11,845	$11,710

(1) The chief operating decision maker holds segment management accountable for accounts receivable, inventory, fixed assets, goodwill, and intangible assets.

	For years ended December 31,		
(Dollars in millions)	2013	2012	2011
Depreciation and Amortization Expense by Segment			
Additives & Functional Products	$95	$63	$33
Adhesives & Plasticizers	45	46	44
Advanced Materials	144	109	64
Fibers	65	66	68
Specialty Fluids & Intermediates	80	72	60
Total Depreciation and Amortization Expense by Segment	429	356	269
Other	4	4	4
Total Depreciation and Amortization Expense	$433	$360	$273

	For years ended December 31,		
(Dollars in millions)	2013	2012	2011
Capital Expenditures by Segment			
Additives & Functional Products	$74	$70	$44
Adhesives & Plasticizers	56	51	58
Advanced Materials	170	153	193
Fibers	65	52	51
Specialty Fluids & Intermediates	113	128	79
Total Capital Expenditures by Segment	478	454	425
Other	5	11	32
Total Capital Expenditures	$483	$465	$457

Sales are attributed to geographic areas based on customer location; long-lived assets are attributed to geographic areas based on asset location.

NOTES TO THE AUDITED CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in millions)	For years ended December 31,		
Geographic Information	2013	2012	2011
Sales			
United States	$4,140	$3,831	$3,662
All foreign countries	5,210	4,271	3,516
Total	$9,350	$8,102	$7,178

	December 31,		
	2013	2012	2011
Long-Lived Assets, Net			
United States	$3,247	$3,172	$2,687
All foreign countries	1,043	1,009	420
Total	$4,290	$4,181	$3,107

22. QUARTERLY SALES AND EARNINGS DATA – UNAUDITED

(Dollars in millions, except per share amounts)	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
2013				
Sales	$2,307	$2,440	$2,338	$2,265
Gross profit	616	677	689	794
Asset impairments and restructuring charges, net	3	18	3	52
Net earnings (loss) attributable to Eastman	247	264	308	346
Net earnings (loss) per share attributable to Eastman(1)				
Basic	$1.60	$1.71	$2.00	$2.26
Diluted	1.57	1.69	1.97	2.22

(1) Each quarter is calculated as a discrete period; the sum of the four quarters may not equal the calculated full year amount.

NOTES TO THE AUDITED CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in millions, except per share amounts)	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
2012				
Sales	$1,821	$1,853	$2,259	$2,169
Gross profit	431	481	525	325
Asset impairments and restructuring charges (gains), net	—	—	37	83
Earnings from continuing operations attributable to Eastman	159	177	154	(54)
Gain from disposal of discontinued operations, net of tax	(1)	2	—	—
Net earnings attributable to Eastman	158	179	154	(54)
Earnings from continuing operations per share attributable to Eastman[1]				
Basic	$1.15	$1.28	$1.01	$(0.35)
Diluted	1.13	1.26	0.99	(0.35)
Earnings from discontinued operations per share attributable to Eastman[1]				
Basic	$—	$0.02	$—	$—
Diluted	(0.01)	0.01	—	—
Net earnings per share attributable to Eastman[1]				
Basic	$1.15	$1.30	$1.01	$(0.35)
Diluted	1.12	1.27	0.99	(0.35)

(1) Each quarter is calculated as a discrete period; the sum of the four quarters may not equal the calculated full year amount.

23. RESERVE ROLLFORWARDS

Valuation and Qualifying Accounts
(Dollars in millions)

		Additions (Deductions)			
	Balance at January 1, 2011	Charged to Cost and Expense	Charged to Other Accounts	Deductions	Balance at December 31, 2011
Reserve for:					
Doubtful accounts and returns	$5	$4	$—	$1	$8
LIFO inventory	490	100	—	—	590
Environmental contingencies	40	2	3	6	39
Deferred tax valuation allowance	48	—	—	6	42
	$583	$106	$3	$13	$679

		Additions (Deductions)			
	Balance at January 1, 2012	Charged to Cost and Expense	Charged to Other Accounts	Deductions	Balance at December 31, 2012
Reserve for:					
Doubtful accounts and returns	$8	$2	$—	$2	$8
LIFO inventory	590	(85)	—	—	505
Environmental contingencies	39	2	370	17	394

Deferred tax valuation allowance	42	—	173	—	215
	$679	$(81)	$543	$19	$1,122

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NOTES TO THE AUDITED CONSOLIDATED FINANCIAL STATEMENTS

		Additions (Deductions)			
	Balance at January 1, 2013	Charged to Cost and Expense	Charged to Other Accounts	Deductions	Balance at December 31, 2013
Reserve for:					
Doubtful accounts and returns	$8	$5	$—	$1	$12
LIFO inventory	505	1	—	—	506
Environmental contingencies	394	4	1	31	368
Deferred tax valuation allowance	215	—	—	11	204
	$1,122	$10	$1	$43	$1,090

24. RECENTLY ISSUED ACCOUNTING STANDARDS

In February 2013, the Financial Accounting Standards Board issued accounting guidance, given divergence in practice, covering loss contingencies that are joint and several liability arrangements for which the settlement amount is fixed and is not covered by other GAAP. Under the new requirements, an entity is to measure the obligation as the amount the entity agreed to pay on the basis of its arrangement among its co-obligors and any additional amount the entity expects to pay on behalf of it co-obligors. This guidance is effective for reporting periods beginning after December 15, 2013. The Company has concluded that this new guidance will not have a material impact on the Company's financial position or results of operations.

In March 2013, the Financial Accounting Standards Board issued amended accounting guidance to address the release of cumulative translation adjustments into net income when a reporting entity (parent) ceases to have a controlling financial interest in a subsidiary or group of assets that is a business (other than an in-substance real estate sale or oil/gas mineral rights) within a foreign entity. The cumulative translation adjustments should be released into net income only if the sale or transfer results in the complete or substantially complete liquidation of the foreign entity in which the subsidiary or group of assets had resided. Additionally, in the event of a step acquisition when the acquirer obtains control of an acquiree in which it held an equity interest immediately prior to the acquisition, the cumulative translation adjustments would be released into net income. This guidance is effective prospectively for reporting periods beginning after December 15, 2013. The Company has concluded that this new guidance will not have a material impact on the Company's financial position or results of operations.

In April 2013, the Financial Accounting Standards Board issued clarifying guidance that requires financial statements to be prepared using the liquidation basis of accounting to present relevant information about an entity's expected resources in liquidation by measuring and presenting assets at the amount of the expected cash proceeds from liquidation when liquidation is imminent. Liquidation is considered imminent when the likelihood is remote that the entity will return from liquidation and either (a) a plan for liquidation is approved and the likelihood is remote that the execution of the plan will be blocked by other parties or (b) a plan for liquidation is being imposed by other forces (i.e. involuntary bankruptcy). This guidance is effective for entities that determine liquidation is imminent during annual reporting periods beginning after December 15, 2013. The Company has concluded that this new guidance will have no impact on the Company's financial position or results of operations.

In July 2013, the Financial Accounting Standards Board issued amended accounting guidance to permit the use of the Fed Funds Effective Swap Rate as a U.S. benchmark interest rate for hedge accounting purposes. In addition, the update also removes the restriction on using different benchmark rates for similar hedges. This guidance is effective prospectively for qualifying new or redesignated hedging relationships entered into on or after July 17, 2013. The

Company has concluded that this new guidance will not have a material impact on the Company's financial position or results of operations.

In July 2013, the Financial Accounting Standards Board issued amended accounting guidance, given divergence in practice, that addresses the financial statement presentation of tax items eligible for netting. An unrecognized tax benefit, or a portion of an unrecognized tax benefit, should be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward. This guidance is effective prospectively for reporting periods beginning after December 15, 2013. Retrospective application and early adoption is permitted. The Company has concluded that this new guidance will not have a material impact on the Company's financial position or results of operations.

NOTES TO THE AUDITED CONSOLIDATED FINANCIAL STATEMENTS

25. SUBSEQUENT EVENT

In January 2014, the Company entered into a definitive agreement to acquire the assets of BP plc's global aviation turbine engine oil business. The business had 2013 annual revenues of approximately $100 million. When added to the segment's Skydrol® aviation fluids, the acquired product portfolio is expected to enable Eastman to better meet the global aviation industry's needs. The acquisition is expected to be completed in the second quarter of 2014, and the acquired business will become a part of the SFI segment.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures
Eastman Chemical Company (the "Company") maintains a set of disclosure controls and procedures designed to ensure that information required to be disclosed by the Company in reports that it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized, and reported within the time periods specified in Securities and Exchange Commission rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to provide reasonable assurance that information required to be disclosed by the Company in the reports that it files or submits under the Securities Exchange Act of 1934 is accumulated and communicated to the Company's management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. An evaluation was carried out under the supervision and with the participation of the Company's management, including the Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"), of the effectiveness of the Company's disclosure controls and procedures. Based on that evaluation, the CEO and CFO have concluded that as of December 31, 2013, the Company's disclosure controls and procedures were effective to provide reasonable assurance that information required to be disclosed was accumulated and communicated to management as appropriate to allow timely decisions regarding required disclosure.

Management necessarily applies its judgment in assessing the costs and benefits of such controls and procedures, which, by their nature, can provide only reasonable assurance regarding management's control objectives. Management, including the CEO and CFO, does not expect that the Company's disclosure controls and procedures can prevent all possible errors or fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance; judgments in decision-making can be faulty; and breakdowns can occur because of simple errors or mistakes. Additionally, controls can be circumvented by the individual acts of one or more persons. The design of any system of controls is based in part upon certain assumptions about the likelihood of future events, and while the Company's disclosure controls and procedures are designed to be effective under circumstances where they should reasonably be expected to operate effectively, there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Because of the inherent limitations in any control system, misstatements due to possible errors or fraud may occur and not be detected.

Management's Report on Internal Control Over Financial Reporting
Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting. The Company's internal control over financial reporting is a process designed under the supervision of the Company's CEO and CFO to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the Company's financial statements for external purposes in accordance with U.S. generally accepted accounting principles.

The Company's internal control over financial reporting includes policies and procedures that:

- Pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect transactions and acquisitions and dispositions of assets of the Company;

- Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S. generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and the directors of the Company; and

- Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the Company's financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management has assessed the effectiveness of its internal control over financial reporting as of December 31, 2013 based on the framework established in Internal Control – Integrated Framework (1992) issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). Based on this assessment, management has determined that the Company's internal control over financial reporting was effective as of December 31, 2013.

The effectiveness of the Company's internal control over financial reporting as of December 31, 2013 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report which appears herein.

Changes in Internal Control Over Financial Reporting

There has been no change in the Company's internal control over financial reporting that occurred during the quarter ended December 31, 2013 that has materially affected, or is reasonably likely to materially effect, the Company's internal control over financial reporting.

ITEM 9B. OTHER INFORMATION

None.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The material under the heading "Proposals to be Voted On at the Annual Meeting--Item 1--Election of Directors" to (but not including) the subheading "The Board of Directors and Corporate Governance" and under the subheading "Board Committees--Audit Committee" (except for the material under the subheading "Board Committees--Audit Committee--Audit Committee Report", which is not incorporated by reference herein), each as included and to be filed in the 2014 Proxy Statement, is incorporated by reference herein in response to this Item. Certain information concerning executive officers of the Company is set forth under the heading "Executive Officers of the Company" in Part I of this Annual Report on Form 10-K.

The Company has adopted a Code of Ethics and Business Conduct applicable to the Chief Executive Officer, the Chief Financial Officer, and the Controller of the Company. The Company has posted such Code of Ethics and Business Conduct on its Internet website (www.eastman.com) in the "Investors -- Corporate Governance" section.

ITEM 11. EXECUTIVE COMPENSATION

The material under the heading "Proposals to be Voted On at the Annual Meeting--Item 1--Election of Directors—Board Committees – Compensation and Management Development Committee – Compensation Committee Report", under the subheading "Director Compensation", and under the heading "Executive Compensation", each as included and to be filed in the 2014 Proxy Statement, is incorporated by reference herein in response to this Item.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The material under the headings "Stock Ownership of Directors and Executive Officers--Common Stock" and "Principal Stockholders" as included and to be filed in the 2014 Proxy Statement is incorporated by reference herein in response to this Item.

SECURITIES AUTHORIZED FOR ISSUANCE UNDER EQUITY COMPENSATION PLANS

Equity Compensation Plans Approved by Stockholders

Stockholders approved the Company's 2002 and 2007 Omnibus Long-Term Compensation Plans, the 2012 Omnibus Stock Compensation Plan, and the 2002 Director Long-Term Compensation Plans. Although stock and stock-based awards are still outstanding under the 2002 and 2007 Omnibus Long-Term Compensation Plans, the 2002 Director Long-Term Compensation Plan, and both the 2007 and 2008 Director Long-Term Compensation Subplans, components of the 2007 Omnibus Long-Term Compensation Plan, no new shares are available under these plans for future awards. All future share-based awards will be made from the 2012 Omnibus Stock Compensation Plan and the 2013 Director Stock Compensation Subplan, a component of the 2012 Omnibus Stock Compensation Plan.

Equity Compensation Plans Not Approved by Stockholders

Stockholders have approved all compensation plans under which shares of Eastman common stock are authorized for issuance.

Summary Equity Compensation Plan Information Table

The following table sets forth certain information as of December 31, 2013 with respect to compensation plans under which shares of Eastman common stock may be issued.

Plan Category	Number of Securities to be Issued upon Exercise of Outstanding Options (a)		Weighted-Average Exercise Price of Outstanding Options (b)	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities reflected in Column (a)) (c)	
Equity compensation plans approved by stockholders	2,359,100	(1)	$39	8,454,854	(2)
Equity compensation plans not approved by stockholders	—		—	—	
TOTAL	2,359,100		$39	8,454,854	

(1) Represents shares of common stock issuable upon exercise of outstanding options granted under Eastman Chemical Company's 2002 and 2007 Omnibus Long-Term Compensation Plans; the 2002 Director Long-Term Compensation Plan; and both the 2007 and 2008 Director Long-Term Compensation Subplans, components of the 2007 Omnibus Long-Term Compensation Plan.

(2) Shares of common stock available for future awards under the Company's 2012 Omnibus Stock Compensation Plan, including the 2013 Director Stock Compensation Subplan, a component of the 2012 Omnibus Stock Compensation Plan.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The material under the heading "Proposals to be Voted On at the Annual Meeting--Item 1--Election of Directors", subheadings "Director Independence" and "Transactions with Directors, Executive Officers, and Related Persons", each as included and to be filed in the 2014 Proxy Statement, is incorporated by reference herein in response to this Item.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information concerning amounts billed for professional services rendered by the principal accountant and pre-approval of such services by the Audit Committee of the Company's Board of Directors under the heading "Item 3 - Ratification of Appointment of Independent Auditors" as included and to be filed in the 2014 Proxy Statement is incorporated by reference herein in response to this Item.

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

	Eastman Chemical Company
By:	/s/ Mark J. Costa Mark J. Costa Chief Executive Officer and Director

Date: February 28, 2014

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

SIGNATURE	TITLE	DATE
PRINCIPAL EXECUTIVE OFFICER AND DIRECTOR:		
/s/ Mark J. Costa Mark J. Costa	Chief Executive Officer and Director	February 28, 2014
PRINCIPAL FINANCIAL OFFICER:		
/s/ Curtis E. Espeland Curtis E. Espeland	Executive Vice President and Chief Financial Officer	February 28, 2014
PRINCIPAL ACCOUNTING OFFICER:		
/s/ Scott V. King Scott V. King	Vice President, Controller and Chief Accounting Officer	February 28, 2014

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SIGNATURE	TITLE	DATE
DIRECTORS (other than Mark J. Costa, who also signed as Principal Executive Officer):		
/s/ Humberto P. Alfonso Humberto P. Alfonso	Director	February 28, 2014
/s/ Gary E. Anderson Gary E. Anderson	Director	February 28, 2014
/s/ Brett D. Begemann Brett D. Begemann	Director	February 28, 2014
/s/ Michael P. Connors Michael P. Connors	Director	February 28, 2014
/s/ Stephen R. Demeritt Stephen R. Demeritt	Director	February 28, 2014
/s/ Robert M. Hernandez Robert M. Hernandez	Director	February 28, 2014
/s/ Julie F. Holder Julie F. Holder	Director	February 28, 2014
/s/ Renée J. Hornbaker Renée J. Hornbaker	Director	February 28, 2014
/s/ Lewis M. Kling Lewis M. Kling	Director	February 28, 2014
/s/ Howard L. Lance Howard L. Lance	Director	February 28, 2014
/s/ David W. Raisbeck David W. Raisbeck	Director	February 28, 2014
/s/ James P. Rogers James P. Rogers	Executive Chairman of the Board	February 28, 2014

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EXHIBIT INDEX

Exhibit Number	Description	Sequential Page Number
3.01	Amended and Restated Certificate of Incorporation of Eastman Chemical Company (incorporated herein by reference to Exhibit 3.01 to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2012)	
3.02	Amended and Restated Bylaws of Eastman Chemical Company	144 - 153
4.01	Form of Eastman Chemical Company common stock certificate as amended February 1, 2001 (incorporated herein by reference to Exhibit 4.01 to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2001)	
4.02	Indenture, dated as of January 10, 1994, between Eastman Chemical Company and The Bank of New York, as Trustee (the "Indenture") (incorporated herein by reference to Exhibit 4(a) to the Company's Current Report on Form 8-K dated January 10, 1994)	
4.03	Indenture, dated as of June 5, 2012, between Eastman Chemical Company and Wells Fargo Bank, as Trustee (incorporated herein by reference to Exhibit 4.1 to the Company's Current Report on Form 8-K dated June 5, 2012)	
4.04	Form of 7 1/4% Debentures due January 15, 2024 (incorporated herein by reference to Exhibit 4(d) to the Company's Current Report on Form 8-K dated January 10, 1994)	
4.05	Officers' Certificate pursuant to Sections 201 and 301 of the Indenture related to 7 5/8% Debentures due 2024 (incorporated herein by reference to Exhibit 4(a) to the Company's Current Report on Form 8-K dated June 8, 1994)	
4.06	Form of 7 5/8% Debentures due June 15, 2024 (incorporated herein by reference to Exhibit 4(b) to the Company's Current Report on Form 8-K dated June 8, 1994)	
4.07	Form of 7.60% Debentures due February 1, 2027 (incorporated herein by reference to Exhibit 4.08 to the Company's Annual Report on Form 10-K for the year ended December 31, 1996)	
4.08	Officer's Certificate pursuant to Sections 201 and 301 of the Indenture related to 7.60% Debentures due February 1, 2027 (incorporated herein by reference to Exhibit 4.09 to the Company's Annual Report on Form 10-K for the year ended December 31, 2006)	
4.09	Form of 5.500% Note due 2019 (incorporated herein by reference to Exhibit 4.1 to the Company's Current Report on Form 8-K dated November 2, 2009)	
4.10	Form of 6.30% Note due 2018 (incorporated herein by reference to Exhibit 4.14 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2003)	

4.11	Form of 3% Note due 2015 (incorporated herein by reference to Exhibit 4.1 to the Company's Current Report on Form 8-K dated December 10, 2010)
4.12	Form of 4.5% Note due 2021 (incorporated herein by reference to Exhibit 4.2 to the Company's Current Report on Form 8-K dated December 10, 2010)
4.13	Form of 2.4% Note due 2017 (incorporated herein by reference to Exhibit 4.2 to the Company's Current Report on Form 8-K dated June 5, 2012)
4.14	Form of 3.6% Note due 2022 (incorporated herein by reference to Exhibit 4.3 to the Company's Current Report on Form 8-K dated June 5, 2012)
4.15	Form of 4.8% Note due 2042 (incorporated herein by reference to Exhibit 4.4 to the Company's Current Report on Form 8-K dated June 5, 2012)
10.01	Accounts Receivable Securitization Agreement dated July 9, 2008 (amended February 18, 2009, July 9, 2009, July 7, 2010, January 31, 2011, July 6, 2011, April 30, 2012, and August 1, 2013), between the Company and The Bank of Tokyo-Mitsubishi UFJ, Ltd., as agent (incorporated herein by reference to Exhibit 4.09 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2009, Exhibit 4.10 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2010, Exhibit 4.10 to the Company's Annual Report on Form 10-K for the year ended December 31, 2010, Exhibit 4.10 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2011, Exhibit 10.01 to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2012, and Exhibit 10.01 to the Company's Quarterly Report on Form 10-Q/A for the quarter ended June 30, 2013)

EXHIBIT INDEX

Exhibit Number	Description	Sequential Page Number
10.02**	Eastman Excess Retirement Income Plan (incorporated herein by reference to Exhibit 10.02 to the Company's Annual Report on Form 10-K for the year ended December 31, 2008)	
10.03**	Form of Executive Change in Control Severance Agreements (incorporated herein by reference to Exhibit 10.02 to the Company's Annual Report on Form 10-K for the year ended December 31, 2010)	
10.04**	Eastman Unfunded Retirement Income Plan (incorporated herein by reference to Exhibit 10.04 to the Company's Annual Report on Form 10-K for the year ended December 31, 2008)	
10.05**	2002 Omnibus Long-Term Compensation Plan, as amended (incorporated herein by reference to Exhibit 10.02 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2007)	
10.06**	2002 Director Long-Term Compensation Plan, as amended (incorporated herein by reference to Appendix B to Eastman Chemical Company's 2002 Annual Meeting Proxy Statement)	
10.07**	Eastman Chemical Company Benefit Security Trust dated December 24, 1997, as amended May 1, 1998 and February 1, 2001 and Amendment Number Three to the Eastman Chemical Company Benefit Security Trust dated January 2, 2002 (incorporated herein by reference to Exhibit 10.01 to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2001 and Exhibit 10.04 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2002)	
10.08**	Amended and Restated Warrant to Purchase Shares of Common Stock of Eastman Chemical Company, dated January 2, 2002 (incorporated herein by reference to Exhibit 10.02 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2002)	
10.09**	Amended and Restated Registration Rights Agreement, dated January 2, 2002 (incorporated herein by reference to Exhibit 10.03 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2002)	
10.10**	Amended and Restated Eastman Executive Deferred Compensation Plan (incorporated herein by reference to Exhibit 10.10 to the Company's Annual Report on Form 10-K for the year ended December 31, 2012)	
10.11**	Amended and Restated Eastman Directors' Deferred Compensation Plan (incorporated herein by reference to Exhibit 10.11 to the Company's Annual Report on Form 10-K for the year ended December 31, 2012)	
10.12**	Eastman Unit Performance Plan as amended and restated effective December 5, 2012 (incorporated herein by reference to Exhibit 10.12 to the Company's Annual	

	Report on Form 10-K for the year ended December 31, 2012)	
10.13**	Form of Indemnification Agreements with Directors and Executive Officers (incorporated herein by reference to Exhibit 10.25 to the Company's Annual Report on Form 10-K for the year ended December 31, 2003)	
10.14**	Cancellation of Employment Agreement between Eastman Chemical Company and Mark J. Costa dated May 4, 2006 (Employment Agreement incorporated by reference to Exhibit 10.01 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2006 and Exhibit 10.15 to the Company's Annual Report on Form 10-K for the year ended December 31, 2009)	154 - 155
10.15**	Forms of Award Notice for Stock Options Granted to Executive Officers under the 2002 Omnibus Long-Term Compensation Plan (incorporated herein by reference to Exhibit 10.03 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2006 and Exhibits 10.01 and 10.02 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2006)	

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Exhibit Number	Description	Sequential Page Number
10.16**	Forms of Award Notices for Stock Options Granted to Executive Officers under the 2007 Omnibus Long-Term Compensation Plan (incorporated herein by reference to Exhibit 10.08 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2007, Exhibits 10.01 and 10.02 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2008, and Exhibits 10.01 and 10.02 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2010)	
10.17**	1997 Omnibus Long-Term Compensation Plan (incorporated herein by reference to Exhibit 10.03 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2007)	
10.18**	2007 Omnibus Long-Term Compensation Plan (incorporated herein by reference to Exhibit 10.01 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2007)	
10.19**	Forms of Performance Share Awards to Executive Officers (2011 – 2013 Performance Period) (incorporated herein by reference to Exhibits 10.03 and 10.04 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2010)	
10.20**	Forms of Performance Share Awards to Executive Officers (2012 – 2014 Performance Period) (incorporated herein by reference to Exhibit 10.02 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2011)	
10.21**	Forms of Performance Share Awards to Executive Officers (2013 – 2015 Performance Period) (incorporated herein by reference to Exhibit 10.35 to the Company's Annual Report on Form 10-K for the year ended December 31, 2012)	
10.22**	2007 Director Long-Term Compensation Subplan of the 2007 Omnibus Long-Term Compensation Plan (incorporated herein by reference to Exhibit 10.10 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2007)	
10.23**	2008 Director Long-Term Compensation Subplan of the 2007 Omnibus Long-Term Compensation Plan (incorporated herein by reference to Exhibit 10.05 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2008)	
10.24**	UPP performance measures and goals, specific target objectives with respect to such performance goals, the method for computing the amount of the UPP award allocated to the award pool if the performance goals are attained, and the eligibility criteria for employee participation in the UPP, for the 2013 performance year (incorporated herein by reference to the Company's Current Report on Form 8-K dated December 5, 2012)	

10.25**	Form of Award Notice for Stock Options Granted to James P. Rogers, Chief Executive Officer, on November 2, 2011 (incorporated herein by reference to Exhibit 10.05 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2011)	
10.26**	UPP performance measures and goals, specific target objectives with respect to such performance goals, the method for computing the amount of the UPP award allocated to the award pool if the performance goals are attained, and the eligibility criteria for employee participation in the UPP, for the 2014 performance year (incorporated herein by reference to the Company's Current Report on Form 8-K dated December 4, 2013)	
10.27**	2012 Omnibus Stock Compensation Plan (incorporated herein by reference to Appendix A to the Company's 2012 Annual Meeting Proxy Statement)	
10.28**	2012 Director Stock Compensation Subplan of the 2012 Omnibus Stock Compensation Plan and Form of Restricted Stock Award Notice (incorporated herein by reference to Exhibit 10.06 to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2012)	
10.29**	Forms of Award Notices for Stock Options and Stock Appreciation Rights Granted to Executive Officers under the 2012 Omnibus Stock Compensation Plan (previous forms of awards incorporated herein by reference to Exhibit 10.01 to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2013)	156 -166

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Exhibit Number	Description	Sequential Page Number
10.30	Amendment to Amended and Restated Five-Year Credit Agreement, dated as of October 31, 2013, amended December 20, 2013, among Eastman Chemical Company, the initial lenders named therein, and Citibank N.A., as administrative agent, Citigroup Global Markets Inc. and J.P. Morgan Securities LLC, as joint lead arrangers (Agreement incorporated herein by reference to Exhibit 10.01 to the Company's Current Report on Form 8-K dated October 31, 2013)	167
10.31**	2013 Director Stock Compensation Subplan of the 2012 Omnibus Stock Compensation Plan and Form of Restricted Stock Award Notice (incorporated herein by reference to Exhibit 10.32 to the Company's Annual Report on Form 10-K for the year ended December 31, 2012)	
10.32**	Forms of Performance Share Awards to Executive Officers (2014 - 2016 Performance Period)	168 - 186
12.01	Statement re: Computation of Ratios of Earnings (Loss) to Fixed Charges	187
21.01	Subsidiaries of the Company	188 - 192
23.01	Consent of Independent Registered Public Accounting Firm	193
31.01	Rule 13a – 14(a) Certification by Mark J. Costa, Chief Executive Officer, for the year ended December 31, 2013	194
31.02	Rule 13a – 14(a) Certification by Curtis E. Espeland, Executive Vice President and Chief Financial Officer, for the year ended December 31, 2013	195
32.01	Section 1350 Certification by Mark J. Costa, Chief Executive Officer, for the year ended December 31, 2013	196
32.02	Section 1350 Certification by Curtis E. Espeland, Executive Vice President and Chief Financial Officer, for the year ended December 31, 2013	197
99.01	2013 Databook	198
101.INS	XBRL Instance Document	
101.SCH	XBRL Taxonomy Extension Schema	
101.CAL	XBRL Taxonomy Calculation Linkbase	
101.LAB	XBRL Taxonomy Label Linkbase	
101.PRE	XBRL Definition Linkbase Document	
101.DEF	XBRL Definition Linkbase Document	

*	Schedules and exhibits have been omitted from this exhibit pursuant to Item 601(b)(2) of Regulation S-K and are not filed herewith. The Registrant agrees to furnish supplementally a copy of the omitted schedules and exhibits to the SEC upon request.
**	Management contract or compensatory plan or arrangement filed pursuant to Item 601(b) (10) (iii) of Regulation S-K.

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