EASTMAN CHEMICAL CO
Form 10-Q
October 28, 2013

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

(Mark One)	
[X]	QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
	For the quarterly period ended September 30, 2013
	OR
[ ]	TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
	For the transition period from ______________ to ______________

Commission file number 1-12626

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

Delaware	62-1539359
(State or other jurisdiction of incorporation or organization)	(I.R.S. employer identification no.)

200 South Wilcox Drive	
Kingsport, Tennessee	37662
(Address of principal executive offices)	(Zip Code)

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

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

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

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

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

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

YES [ ] NO [X]

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

Class	Number of Shares Outstanding at September 30, 2013
Common Stock, par value $0.01 per share	153,920,316

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UNAUDITED CONSOLIDATED STATEMENTS OF EARNINGS, COMPREHENSIVE INCOME AND RETAINED EARNINGS

	Third Quarter		First Nine Months	
(Dollars in millions, except per share amounts)	2013	2012	2013	2012
Sales	$2,338	$2,259	$7,085	$5,933
Cost of sales	1,649	1,734	5,103	4,496
Gross profit	689	525	1,982	1,437
Selling, general and administrative expenses	159	173	510	420
Research and development expenses	48	52	148	136
Asset impairments and restructuring charges, net	3	37	24	37
Operating earnings	479	263	1,300	844
Net interest expense	44	48	137	95
Other charges (income), net	1	(6)	2	14
Earnings from continuing operations before income taxes	434	221	1,161	735
Provision for income taxes from continuing operations	125	64	338	240
Earnings from continuing operations	309	157	823	495
Gain from disposal of discontinued operations, net of tax	—	—	—	1
Net earnings	$309	$157	$823	$496
Less: Net earnings attributable to noncontrolling interest	1	3	4	5
Net earnings attributable to Eastman	$308	$154	$819	$491
Amounts attributable to Eastman stockholders				
Earnings from continuing operations, net of tax	$308	$154	$819	$490
Gain from discontinued operations, net of tax	—	—	—	1
Net earnings attributable to Eastman stockholders	$308	$154	$819	$491
Basic earnings per share attributable to Eastman				
Earnings from continuing operations	$2.00	$1.01	$5.31	$3.43
Earnings from discontinued operations	—	—	—	0.01
Basic earnings per share attributable to Eastman	$2.00	$1.01	$5.31	$3.44
Diluted earnings per share attributable to Eastman				
Earnings from continuing operations	$1.97	$0.99	$5.23	$3.35
Earnings from discontinued operations	—	—	—	—
Diluted earnings per share attributable to Eastman	$1.97	$0.99	$5.23	$3.35

UNAUDITED CONSOLIDATED STATEMENTS OF EARNINGS,
COMPREHENSIVE INCOME AND RETAINED EARNINGS (continued)

	Third Quarter		First Nine Months	
(Dollars in millions, except per share amounts)	2013	2012	2013	2012
Comprehensive Income				
Net earnings including noncontrolling interest	$309	$157	$823	$496
Other comprehensive income (loss), net of tax				
Change in cumulative translation adjustment	45	30	10	21
Defined benefit pension and other post-employment benefit plans:				
Amortization of unrecognized prior service credits included in net periodic costs	25	(4)	18	(12)
Derivatives and hedging:				
Unrealized (loss) gain during period	(13)	(3)	(4)	(33)
Reclassification adjustment for (losses) gains included in net income	—	(4)	—	(5)
Total other comprehensive income (loss), net of tax	57	19	24	(29)
Comprehensive income including noncontrolling interest	366	176	847	467
Comprehensive income attributable to noncontrolling interest	1	3	4	5
Comprehensive income attributable to Eastman	$365	$173	$843	$462
Retained Earnings				
Retained earnings at beginning of period	$3,456	$3,024	$3,038	$2,760
Net earnings attributable to Eastman	308	154	819	491
Cash dividends declared	(46)	(39)	(139)	(112)
Retained earnings at end of period	$3,718	$3,139	$3,718	$3,139

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

UNAUDITED CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

(Dollars in millions, except per share amounts)	September 30, 2013	December 31, 2012
Assets		
Current assets		
Cash and cash equivalents	$222	$249
Trade receivables, net	967	846
Miscellaneous receivables	181	151
Inventories	1,274	1,260
Other current assets	123	88
Total current assets	2,767	2,594
Properties		
Properties and equipment at cost	9,872	9,681
Less: Accumulated depreciation	5,655	5,500
Net properties	4,217	4,181
Goodwill	2,634	2,644
Intangible assets, net of accumulated amortization	1,801	1,849
Other noncurrent assets	308	351
Total assets	$11,727	$11,619
Liabilities and Stockholders' Equity		
Current liabilities		
Payables and other current liabilities	$1,323	$1,360
Borrowings due within one year	—	4
Total current liabilities	1,323	1,364
Long-term borrowings	4,429	4,779
Deferred income tax liabilities	204	91
Post-employment obligations	1,624	1,856
Other long-term liabilities	478	501
Total liabilities	8,058	8,591
Stockholders' equity		
Common stock ($0.01 par value – 350,000,000 shares authorized; shares issued – 214,950,611 and 213,406,523 for 2013 and 2012, respectively)	2	2
Additional paid-in capital	1,763	1,709
Retained earnings	3,718	3,038
Accumulated other comprehensive income	147	123
	5,630	4,872
Less: Treasury stock at cost (61,081,093 shares for 2013 and 59,511,662 shares for 2012)	2,042	1,929
Total Eastman stockholders' equity	3,588	2,943
Noncontrolling interest	81	85
Total equity	$3,669	$3,028
Total liabilities and stockholders' equity	$11,727	$11,619

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

UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

	First Nine Months	
(Dollars in millions)	2013	2012
Cash flows from operating activities		
Net earnings including noncontrolling interest	$823	$496
Adjustments to reconcile net earnings to net cash provided by (used in) operating activities:		
Depreciation and amortization	326	252
Asset impairment charges	6	9
Provision for deferred income taxes	118	63
Mark-to-market pension and other post-employment benefits (gain) loss	(86)	—
Pension and other post-employment contributions (in excess of) less than expenses	(120)	(85)
Variable compensation (in excess of) less than expenses	30	(5)
Changes in operating assets and liabilities, net of effect of acquisitions and divestitures:		
(Increase) decrease in trade receivables	(119)	(63)
(Increase) decrease in inventories	(14)	30
Increase (decrease) in trade payables	(67)	13
Other items, net	(103)	(22)
Net cash provided by operating activities	794	688
Cash flows from investing activities		
Additions to properties and equipment	(312)	(297)
Proceeds from redemption of short-term time deposits	—	200
Proceeds from sale of assets and investments	6	7
Acquisitions and investments in joint ventures, net of cash acquired	—	(2,668)
Additions to capitalized software	(2)	(4)
Other items, net	—	(33)
Net cash used in investing activities	(308)	(2,795)
Cash flows from financing activities		
Net increase (decrease) in commercial paper, credit facility, and other borrowings	300	(1)
Proceeds from borrowings	150	3,511
Repayment of borrowings	(805)	(1,666)
Dividends paid to stockholders	(94)	(107)
Treasury stock purchases	(113)	—
Dividends paid to noncontrolling interest	(10)	(4)
Proceeds from stock option exercises and other items, net	55	32
Net cash provided by (used in) financing activities	(517)	1,765
Effect of exchange rate changes on cash and cash equivalents	4	2
Net change in cash and cash equivalents	(27)	(340)
Cash and cash equivalents at beginning of period	249	577
Cash and cash equivalents at end of period	$222	$237

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

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NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

1. BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements have been prepared by Eastman Chemical Company (the "Company" or "Eastman") in accordance and consistent with the accounting policies stated in the Company's 2012 Annual Report on Form 10-K and should be read in conjunction with the consolidated financial statements in Part II, Item 8 of the Company's 2012 Annual Report on Form 10-K. The unaudited consolidated financial statements are prepared in conformity with accounting principles generally accepted in the United States ("GAAP") and of necessity include some amounts that are based upon management estimates and judgments. Future actual results could differ from such current estimates. The unaudited consolidated financial statements include assets, liabilities, sales revenue, and expenses of all majority-owned subsidiaries and joint ventures in which a controlling interest is maintained. Eastman accounts for other joint ventures and investments where it exercises significant influence on the equity basis. Intercompany transactions and balances are eliminated in consolidation. Certain prior period data has been reclassified in the Consolidated Financial Statements and accompanying footnotes to conform to current period presentation.

Solutia acquisition
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.

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 6, "Borrowings".

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 Valuation	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

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NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

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 are primarily customer relationships, trade names, and developed technologies. Long-term liabilities are primarily Solutia's debt, which was repaid by Eastman at closing, deferred tax liabilities, environmental liabilities, and pension and other post-employment 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 second quarter 2013 and did not have a material impact on the Company's financial position or results of operations.

The acquisition of Solutia broadens Eastman's global presence, facilitates growth opportunities through enhanced access to markets such as the automotive and architectural industries, and expands 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 revenue 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 deductible for tax purposes.

Goodwill	Goodwill by Segment
(Dollars in millions)	
Additives & Functional Products	$745
Advanced Materials	1,004
Specialty Fluids & Intermediates	459
Total	$2,208

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

(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

NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

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 10, "Environmental Matters", for more information.

In third quarter and first nine months 2013 the Company recognized $9 million and $24 million, respectively, in integration costs. In third quarter and first nine months 2012, the Company recognized $15 million and $28 million, respectively, in Solutia acquisition transaction costs and $7 million and $9 million, respectively, in integration costs. In first nine months 2012, the Company recognized $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 "Net interest expense" and "Other charges (income), net" line items in the Unaudited Consolidated Statements of Earnings, Comprehensive Income, and Retained Earnings. In third quarter and first nine months 2012, there were $28 million in restructuring charges 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 third quarter 2012 resulting in a one-time $75 million increase in cost of sales, net of the LIFO impact of these inventories, in third quarter and first nine months 2012.

Beginning third quarter 2012, the Company's consolidated results of operations include the results of the acquired Solutia businesses. The unaudited pro forma financial results for three months and nine months ended September 30, 2012 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 post-employment benefit ("OPEB") plans actuarial gains and losses adopted by Eastman during first quarter 2012. For additional information, see Note 14, "Accounting Methodology Change for Pension and Other Postretirement Benefit Plans" in Part II, Item 8 of the Company's 2012 Annual Report on Form 10-K.

2012

(Dollars in millions)	Third Quarter	First Nine Months
Pro forma sales	$2,259	$6,951
Pro forma earnings from continuing operations including noncontrolling interest	241	689

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NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

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 third quarter 2012. These items include transaction, integration, and financing costs incurred by Eastman during third quarter and first nine months 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 the unaudited pro forma earnings from continuing operations in third quarter 2012 and first nine months 2012.

3. INVENTORIES

(Dollars in millions)	September 30, 2013	December 31, 2012
At FIFO or average cost (approximates current cost)		
Finished goods	$966	$941
Work in process	297	288
Raw materials and supplies	511	536
Total inventories	1,774	1,765
LIFO Reserve	(500)	(505)
Total inventories	$1,274	$1,260

Inventories valued on the LIFO method were approximately 60 percent of total inventories as of both September 30, 2013 and December 31, 2012.

4. PAYABLES AND OTHER CURRENT LIABILITIES

(Dollars in millions)	September 30, 2013	December 31, 2012
Trade creditors	$657	$723
Accrued payrolls, vacation, and variable-incentive compensation	172	171
Accrued taxes	97	76
Post-employment obligations	60	62
Interest payable	36	59
Environmental contingent liabilities, current portion	35	35
Other	266	234
Total payables and other current liabilities	$1,323	$1,360

The current portion of post-employment obligations is an estimate of current year payments. Included in "Other" above are dividends payable, certain accruals for payroll deductions and employee benefits, the current portion of hedging liabilities, and other payables and accruals.

NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

5. PROVISION FOR INCOME TAXES

	Third Quarter		First Nine Months	
(Dollars in millions)	2013	2012	2013	2012
Provision for income taxes	$125	$64	$338	$240
Effective tax rate	29 %	29 %	29 %	33 %

The third quarter 2013 effective tax rate was impacted by 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. The first nine months 2013 effective tax rate was impacted by the $14 million benefit of the adjustment and enactment of the American Taxpayer Relief Act of 2012 in January 2013 which resulted in a $10 million benefit primarily related to a research and development ("R&D") tax credit. The third quarter and first nine months 2012 effective tax rates included an $8 million benefit from the settlement of U.S. and non-U.S. income tax audits and a $5 million benefit from the reversal of tax reserves due to the expiration of the relevant statute of limitations.

The following table reflects a revision of a 2012 deferred tax liability line item reported in Note 9, "Provision for Income Taxes" to the consolidated financial statements in Part II, Item 8 of the Company's 2012 Annual Report on Form 10-K. The "Amortization" line item was mischaracterized as "Inventory reserves". There was no impact on net deferred tax liability reported in the Company's 2012 Annual Report on Form 10-K.

(Dollars in millions)	December 31, 2012
Deferred tax assets	
Post-employment obligations	$715
Net operating loss carryforwards	630
Tax credit carryforwards	230
Environmental reserves	145
Other	82
Total deferred tax assets	1,802
Less valuation allowance	(215)
Deferred tax assets less valuation allowance	$1,587
Deferred tax liabilities	
Depreciation	$(951)
Amortization	(666)
Total deferred tax liabilities	$(1,617)
Net deferred tax liabilities	$(30)
As recorded in the Consolidated Statements of Financial Position:	
Other current assets	$34
Other noncurrent assets	30
Payables and other current liabilities	(3)
Deferred income tax liabilities	(91)
Net deferred tax liabilities	$(30)

NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

6. BORROWINGS

(Dollars in millions)	September 30, 2013	December 31, 2012
Borrowings consisted of:		
3% notes due 2015	$250	$250
2.4% notes due 2017	997	997
6.30% notes due 2018	172	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 and commercial paper borrowings	600	950
Other	—	4
Total borrowings	4,429	4,783
Borrowings due within one year	—	4
Long-term borrowings	$4,429	$4,779

Credit Facility and Commercial Paper Borrowings

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. During the first nine months of 2013, the Company repaid $800 million of its Term Loan using $300 million of commercial paper borrowings, $150 million of its accounts receivable securitization facility (the "A/R Facility"), and $350 million in cash. At September 30, 2013 and December 31, 2012, the Term Loan balances outstanding were $150 million and $950 million, respectively. The interest rate on the Term Loan as of September 30, 2013 was 1.69 percent.

The Company has a $750 million revolving credit agreement (the "Revolving Credit Facility") expiring December 2016. Borrowings under the Revolving 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 September 30, 2013 and December 31, 2012, the Company had no outstanding borrowings under the Revolving Credit Facility.

The Revolving 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 Revolving Credit Facility. Given the expiration date of the Revolving Credit Facility, any commercial paper borrowings supported by the Revolving 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 September 30, 2013 the Company's commercial paper borrowings were $300 million with a weighted average interest rate of 0.33 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 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 September 30, 2013, the Company's borrowings under the A/R Facility were $150 million secured by trade receivables with an interest rate of 0.91 percent, and the proceeds

were used to repay a portion of the Term Loan. At December 31, 2012, the Company had no outstanding borrowings under the A/R Facility.

NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

The Term Loan, Revolving 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. As of September 30, 2013, as a result of the $300 million in commercial paper borrowings, the amount available under the Revolving Credit Facility was $450 million. As of September 30, 2013, as a result of the $150 million borrowings under the A/R Facility, $100 million was available under this facility. As of December 31, 2012, substantially all of the amounts under these facilities were available for borrowing. 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 September 30, 2013 and December 31, 2012 under the fair value hierarchy as defined in the accounting policies in Note 1, "Significant Accounting Policies" to the consolidated financial statements in Part II, Item 8 of the Company's 2012 Annual Report on Form 10-K. 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 September 30, 2013			
(Dollars in millions)	Recorded Amount September 30, 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	$4,429	$4,569	$3,969	$600	$—

		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	$—

7. 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. For further information, see Note 12, "Derivatives", to the consolidated financial statements in Part II, Item 8 of the Company's 2012 Annual Report on Form 10-K.

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 September 30, 2013 and December 31, 2012, the Company had no fair value hedges.

NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

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.

As of September 30, 2013, the total notional amounts of the Company's foreign exchange forward and option contracts were €867 million (approximately $1.2 billion equivalent) and ¥9.1 billion (approximately $94 million equivalent), respectively. The total notional volume hedged for contract ethylene sales was approximately 26 thousand metric tons, and the total notional volume hedged for feedstock was approximately 10 million barrels. The Company had no outstanding hedges for energy or interest rate swaps.

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 hedged 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" to the consolidated financial statements in Part II, Item 8 of the Company's 2012 Annual Report on Form 10-K.

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

(Dollars in millions)		Fair Value Measurements at September 30, 2013		
Description	September 30, 2013	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Derivative Assets	$42	$—	$42	$—
Derivative Liabilities	(46)	—	(43)	(3)
	$(4)	$—	$(1)	$(3)

(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.

NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

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. All Level 3 hedges will mature in the current year. The Company determines the fair value of paraxylene derivative 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.

The table below presents a rollforward of activity for these assets (liabilities) for the period ended September 30, 2013:

Fair Value Measurements Using Level 3 Inputs

Commodity Contracts	Third Quarter		First Nine Months	
(Dollars in millions)	2013	2012	2013	2012
Balance at beginning of period	$(7)	$(8)	$(5)	$—
Realized gain (loss) in sales revenue	(3)	—	(10)	—
Change in unrealized gain (loss)	4	4	2	(5)
Settlements	3	3	10	4
Transfers (out) in of Level 3	—	—	—	—
Ending balance at Balance at September 30	$(3)	$(1)	$(3)	$(1)

The following chart shows the financial assets and liabilities valued on a recurring basis and their location in the Unaudited Consolidated Statements of Financial Position. The Company had no nonqualifying derivatives or derivatives that are not designated as hedges as of September 30, 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 the same currency. In addition, these arrangements provide for a net settlement of all contracts with a given counterparty in the event that the arrangement is terminated due to the occurrence of default or a termination event. The Company has elected to present the derivative contracts on a gross basis in the Unaudited Consolidated Statements of Financial Position. Had it chosen to present the derivatives contracts on a net basis, it would have a derivative in a net asset position of $17 million and a derivative in a net liability position of $21 million as of September 30, 2013. The Company also 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	September 30, 2013	December 31, 2012
Cash Flow Hedges			
Commodity contracts	Other current assets	$13	$7
Commodity contracts	Other noncurrent assets	4	—
Foreign exchange contracts	Other current assets	13	8
Foreign exchange contracts	Other noncurrent assets	12	13
		$42	$28

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NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in millions)		Fair Value Measurements Significant Other Observable Inputs	
Derivative Liabilities	Statement of Financial Position Location	September 30, 2013	December 31, 2012
Cash Flow Hedges			
Commodity contracts	Payables and other current liabilities	$11	$13
Commodity contracts	Other long-term liabilities	6	—
Foreign exchange contracts	Payables and other current liabilities	14	8
Foreign exchange contracts	Other long-term liabilities	15	3
		$46	$24

Derivatives' Hedging Relationships

Third Quarter

(Dollars in millions)	Change in amount 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	September 30, 2013	September 30, 2012		September 30, 2013	September 30, 2012
Commodity contracts	$ 8	$3	Sales	$(3)	$—
			Cost of Sales	4	1
Foreign exchange contracts	(22)	(11)	Sales	2	12
Forward starting interest rate swap contracts	1	1	Net interest expense	(2)	(2)
	$ (13)	$(7)		$1	$11

First Nine Months

(Dollars in millions)	Change in amount 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	September 30, 2013	September 30, 2012		September 30, 2013	September 30, 2012
Commodity contracts	$ 4	$(1)	Sales	$	

(3) Wellington Management Company, LLP, in its capacity as an investment adviser in

accordance with Section 240.13d-1(b)(1)(ii)(E), may be deemed to beneficially own 10,138,998 shares which are held of record by clients of Wellington Management Company, LLP. Wellington Management Company, LLP has shared voting power with respect to 8,409,134 shares and has shared dispositive power with respect to 10,138,998 shares. The address for Wellington Management Company is 280 Congress Street, Boston, Massachusetts 02210.

(4) These securities may be deemed to be beneficially owned by Capital Research Global Investors, an investment adviser, in accordance with Section 240.13d-1(b)(1)(ii)(E). The address for Capital Research Global Investors is 333 South Hope Street, Los Angeles, California 90071.

(5) These securities may be deemed to be beneficially owned by Penn Capital Management, an investment adviser, in accordance with Section 240.13d-1(b)(1)(ii)(E). The address for Penn Capital Management is Navy Yard Corporate Center, Three Crescent Drive, Suite 400, Philadelphia, Pennsylvania 19112.

(6) Consists of (a) all of the shares of common stock otherwise described in footnote 2 by virtue of Dr. Rachesky s position as the managing member of each of Fund Management, Advisors, Institutional Advisors II and

Institutional Advisors III; (b) 40,200 shares of common stock issuable upon exercise of options and 6,379 shares of restricted stock, as further described in footnote 7; and (c) 9,133 shares of common stock which were previously granted as shares of restricted stock and which have vested. The address for Dr. Rachesky is 40 West 57th Street, 24th Floor, New York, New York 10019.

(7) Includes (a) shares issuable upon exercise of vested stock options, as follows: Dr. Rachesky, 40,200 shares; Mr. Harkey, 2,500 shares; Mr. Targoff, 4,500 shares; and Mr. LaPenta, 12,500 shares; (b) restricted stock awards which vest in three equal installments on May 22, 2010, 2011 and 2012, as follows: Dr. Rachesky, 2,563 shares; Mr. Harkey, 2,563 shares; Mr. Targoff, 2,563 shares; and Mr. LaPenta, 2,563 shares; (c) restricted stock awards which vest in three equal installments on November 2, 2010, 2011 and 2012, as follows: Mr. Chapple, 14,970 shares; Mr. Kramer, 14,970 shares; and Mr. Roper, 14,970 shares; (d) restricted stock awards which vest in three equal installments on May 21, 2011, 2012 and 2013, as follows: Dr. Rachesky, 6,135 shares; Mr. Harkey, 6,135 shares; Mr. Targoff, 6,135 shares; and Mr. LaPenta, 6,135 shares; (e) restricted stock awards which vest on July 14, 2011, as follows: Dr. Rachesky, 149 shares; Mr. Chapple, 149 shares; Mr. Harkey,

149 shares; Mr. Kramer,
149 shares; Mr. LaPenta,
149 shares; Mr. Roper,
149 shares; and Mr. Targoff,
299 shares; (f) restricted stock
awards which vest on
October 14, 2011, as follows:
Dr. Rachesky, 697 shares;
Mr. Chapple, 610 shares;
Mr. Harkey, 784 shares;
Mr. Kramer, 784 shares;
Mr. LaPenta, 784 shares;
Mr. Roper, 610 shares; and
Mr. Targoff, 958 shares; and
(g) restricted stock awards
which vest on January 14,
2012, as follows:
Dr. Rachesky, 589 shares;
Mr. Chapple, 295 shares;
Mr. Harkey, 295 shares;
Mr. Kramer, 295 shares;
Mr. LaPenta, 295 shares;
Mr. Roper, 295 shares; and
Mr. Targoff, 442 shares.

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(8) Includes 5,000 shares held by a corporation which is wholly owned by Mr. LaPenta. Mr. LaPenta has the power to vote and dispose of such shares by virtue of his serving as an officer and director thereof.

(9) Includes (a) restricted stock awards for 25,000 shares which vest on March 25, 2012; (b) restricted stock awards for 37,500 shares, of which 12,500 shares vest on April 14, 2012 and 25,000 shares vest on April 14, 2013; (c) restricted stock awards for 40,000 shares of which 10,000 shares vest on March 15, 2012, 10,000 shares vest on March 15, 2013 and 20,000 shares vest on March 15, 2014; and (d) restricted stock awards for 80,000 shares, of which 20,000 shares vest on March 15, 2012, 20,000 shares vest on March 15, 2013 and 40,000 shares vest on March 15, 2014, subject in each case to the achievement of certain performance-based vesting conditions. Also includes 334,986 shares issuable upon exercise of vested stock options.

(10) Includes (a) restricted stock awards for 18,750 shares, of which 6,250 shares vest on June 23, 2011 and 12,500 shares vest on June 23, 2012; (b) restricted stock awards for 20,000 shares of which 10,000 shares vest on June 23, 2011 and 10,000 shares vest on June 23, 2012; (c) restricted stock awards for 20,000 shares, of which 5,000 shares vest on March 15, 2012, 5,000 shares vest on March 15, 2013 and 10,000 shares vest on March 15, 2014; and (d) restricted stock awards for 32,000 shares, of which 8,000 shares vest on March 15, 2012, 8,000 shares vest on March 15, 2013 and 16,000 shares vest on March 15, 2014, subject to certain performance-based vesting conditions. Also includes 62,500 shares issuable upon exercise of vested stock options.

(11) Includes (a) restricted stock awards for 15,000 shares which vest on February 29, 2012; (b) restricted stock awards for 15,000 shares, of which 5,000 shares vest on August 6, 2011 and 10,000 shares vest on August 6, 2012; (c) restricted stock awards for 18,750 shares, of which 6,250 shares vest on April 14, 2012 and 12,500 shares vest on April 14, 2013; (d) restricted stock awards for 20,000 shares, of which 5,000 shares vest on March 15, 2012, 5,000 shares vest on March 15, 2013 and 10,000 shares vest on March 15, 2014; and (e) restricted stock awards for 32,000 shares, of which 8,000 shares vest on March 15, 2012, 8,000 shares vest on March 15, 2013 and 16,000 shares vest on March 15, 2014, subject to certain performance-based vesting conditions. Also includes 222,410 shares issuable upon exercise of vested stock options.

(12) Includes (a) restricted stock awards for 17,240 shares which vest on May 12, 2013, subject to certain conditions and accelerated vesting; and (b) restricted stock awards for 20,000 shares, of which 5,000 shares vest on March 15, 2012, 5,000 shares vest on March 15, 2013 and 10,000 shares vest on March 15, 2014. Also includes 11,730 shares issuable upon the exercise of vested stock options.

(13) Includes (a) restricted stock awards for 12,930 shares which vest on September 19, 2012, subject to certain conditions and accelerated vesting; (b) restricted stock awards for 3,750 shares which vest on December 22, 2011; (c) restricted stock awards for 7,500 shares which vest on February 27, 2012; (d) restricted stock awards for 7,500 shares, of which 2,500 shares vest on April 14, 2012 and 5,000 shares vest on April 14, 2013; (e) restricted stock awards for 10,000 shares, of which 2,500 shares vest on March 15, 2012, 2,500 shares vest on March 15, 2013 and 5,000 shares vest on March 15, 2014; and (f) restricted stock awards for 16,000 shares, of which 4,000 shares vest on March 15, 2012, 4,000 shares vest on March 15, 2013 and 8,000 shares vest on March 15, 2014, subject to certain performance-based vesting conditions. Also includes 20,220 shares issuable upon the exercise of vested stock options.

EQUITY COMPENSATION PLAN INFORMATION

The following table provides information as of December 31, 2010 with respect to equity compensation plans (including individual compensation arrangements) under which Leap common stock is authorized for issuance.

Plan Category	Number of Securities to be Issued Upon Exercise of Outstanding Options or Rights		Weighted-Average Exercise Price of Outstanding Options and Rights	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans
Equity compensation plans approved by security holders	4,344,670(1)(3)	$	41.67	1,165,431(4)
Equity compensation plans not approved by security holders	285,875(2)(3)	$	26.39	16,175
Total	4,630,545	$	40.73	1,181,606

(1) Represents shares reserved for issuance under the 2004 Stock Plan, adopted by the Compensation Committee of our Board of Directors on December 30, 2004 (as contemplated by our confirmed plan of reorganization) and as amended on March 8, 2007. Stock options granted prior to May 17, 2007 were granted prior to the approval of the 2004 Stock Plan by Leap stockholders. The material features of the 2004 Stock Plan are described above under Discussion of Summary Compensation and Grants of Plan-Based Awards Tables 2004 Stock Option, Restricted Stock and Deferred Stock Unit Plan.

(2) Represents shares reserved for issuance under the 2009 Inducement Plan, which was adopted in February 2009 without stockholder approval, as permitted under the rules and regulations of the NASDAQ Stock Market. The material features of the 2009 Inducement Plan are described above under Discussion of Summary Compensation and Grants of Plan-Based Awards Tables 2009 Employment Inducement Equity Incentive Plan. The 2009 Inducement Plan was amended on January 14, 2010 by our Board to increase the number of shares reserved for issuance under the 2009 Inducement Plan by 100,000 shares of Leap common stock.

(3) Excludes 2,020,605 and 97,950 shares of restricted stock issued under the 2004 Stock Plan and 2009 Inducement Plan, respectively, which are subject to release upon vesting of the shares.

(4) Consists of 368,147 shares reserved for issuance under the ESP Plan, and 797,284 shares reserved for issuance under the 2004 Stock Plan.

CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Historically, we have reviewed potential related party transactions on a case-by-case basis. On March 8, 2007 the Board approved a Related Party Transaction Policy and Procedures. Under the policy and procedures, the Audit Committee, or alternatively, those members of the Board who are disinterested, reviews the material facts of specified transactions for approval or disapproval, taking into account, among other factors that it deems appropriate, the extent of the related person s interest in the transaction and whether the transaction is fair to Leap and is in, or is not inconsistent with, the best interests of Leap and its stockholders. Transactions to be reviewed under the policy and procedures include transactions, arrangements or relationships (including any indebtedness or guarantee of indebtedness) in which (1) the aggregate amount involved will or may be expected to exceed $120,000 in any calendar year, (2) Leap or any of its subsidiaries is a participant, and (3) any (a) executive officer, director or nominee for election as a director, (b) greater-than-five-percent beneficial owner of our common stock, or (c) immediate family member, of the persons referred to in clauses (a) and (b), has or will have a direct or indirect material interest (other than solely as a result of being a director or a less-than-ten-percent beneficial owner of another entity). Terms of director and officer compensation that are disclosed in proxy statements or that are approved by the Board or Compensation Committee and are not required to be disclosed in our proxy statement, and transactions where all holders of our common stock receive the same benefit on a pro rata basis, are not subject to review under the policy and procedures.

For a description of the registration rights agreement between Leap and certain affiliates of Dr. Mark H. Rachesky, our Chairman of the Board, see Compensation Committee Interlocks and Insider Participation set forth above in this proxy statement.

STOCKHOLDER PROPOSALS

To be included in our proxy statement, proposals of stockholders that are intended to be presented at our 2012 annual meeting of stockholders must be received no later than February 29, 2012 and must satisfy the conditions established by the SEC for such proposals. However, if Leap changes the date of its 2012 annual meeting by more than thirty days from the anniversary date of the Annual Meeting, the deadline for proposals that stockholders wish to include in the proxy statement for the 2012 annual meeting of stockholders will be a reasonable time before we begin to print and mail the proxy materials for that meeting.

In order for a stockholder proposal that is not included in our proxy statement for the 2012 annual meeting to be eligible for presentation at the 2012 annual meeting of stockholders, the stockholder presenting such proposal must give timely notice of the proposal to us in writing and otherwise comply with the provisions of our Bylaws. For a proposal to be timely, Article II, Section 8 of the Bylaws provides that we must have received the stockholder s notice not less than seventy days nor more than ninety days prior to the anniversary of our annual meeting, meaning between April 29, 2012 and May 19, 2012 for the 2012 annual meeting. In the event that the 2012 annual meeting of stockholders is advanced by more than thirty days or delayed by more than seventy days from the anniversary date of the Annual Meeting, proposals that stockholders wish to present at the 2012 annual meeting must be received by Leap no earlier than the ninetieth day prior to the date of the 2012 annual meeting of stockholders, nor later than the later of the seventieth day prior to such annual meeting date, or the date which is ten days after the day on which public announcement of the date of such meeting is first made.

All proposals should be sent to Leap s Secretary at our principal executive offices, 5887 Copley Drive, San Diego, California 92111.

OTHER MATTERS

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Securities Exchange Act of 1934 requires Leap s directors and executive officers, and persons who beneficially own more than ten percent of a registered class of Leap s equity securities to file with the SEC initial reports of ownership and reports of changes in ownership of common stock and other equity securities of

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Leap. Officers, directors and greater-than-ten-percent beneficial owners are required by SEC regulations to furnish Leap with copies of all Section 16(a) forms they file.

To Leap s knowledge, based solely on a review of the copies of such reports furnished to Leap and written representations that no other reports were required, during the fiscal year ended December 31, 2010, all Section 16(a) filing requirements applicable to its officers, directors and greater-than-ten-percent beneficial owners were complied with.

Householding of Proxy Materials

The SEC has adopted rules that permit companies and intermediaries (e.g., brokers) to satisfy the delivery requirements for proxy statements, annual reports and notices of Internet availability of proxy materials with respect to two or more stockholders sharing the same address by delivering a single proxy statement, annual report or notice of Internet availability of proxy materials, as applicable, addressed to those stockholders. This process, which is commonly referred to as householding, potentially means extra convenience for stockholders and cost savings for companies. Brokers with account holders who are Leap stockholders may be householding our proxy materials. If you hold your shares in an account with one of those brokers, a single proxy statement, annual report, or notice of Internet availability of proxy materials, as applicable, may be delivered to multiple stockholders sharing an address unless contrary instructions have been received from the affected stockholders. Once you have received notice from your broker that it will be householding communications to your address, householding will continue until you are notified otherwise or until you revoke your consent. If, at any time, you no longer wish to participate in householding and would prefer to receive a separate proxy statement, annual report or notice of Internet availability of proxy materials, as applicable, please notify your broker. Householding for bank and brokerage accounts is limited to accounts within the same bank or brokerage firm. If two individuals share the same last name and address but have accounts containing our stock at two different banks or brokerage firms, your household will receive two copies of our proxy statement, annual report or notice of Internet availability of proxy materials, as applicable one from each firm. Stockholders who currently receive multiple copies of our proxy statement, annual report or notice of Internet availability of proxy materials, as applicable, from one bank or brokerage firm and would like to request householding of their communications should contact their bank or brokerage firm.

We will deliver promptly upon written or oral request a separate proxy statement, annual report or notice of Internet availability of proxy materials, as applicable, to a stockholder at a shared address to which a single copy of the documents was delivered. Please direct such requests to Leap Wireless International, Inc., Attn. Investor Relations, 5887 Copley Drive, San Diego, California 92111, or to our Investor Relations Dept. by telephone at (858) 882-9876.

Annual Report on Form 10-K

A copy of Leap s Annual Report on Form 10-K for the fiscal year ended December 31, 2010, as amended, as filed with the SEC, including the financial statements and the financial statement schedules, but excluding exhibits, may be obtained by stockholders without charge by written request addressed to Leap Wireless International, Inc., Attn: Director of Investor Relations, 5887 Copley Drive, San Diego, California 92111. The exhibits to the Annual Report on Form 10-K are available upon payment of charges that approximate our cost of reproduction.

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Other Business

The Board knows of no other matters that will be presented for consideration at the Annual Meeting, or any continuation, adjournment or postponement thereof. If any other matters are properly brought before the Annual Meeting, or any continuation, adjournment or postponement thereof, it is the intention of the persons named in the accompanying proxy to vote on such matters in accordance with their best judgment.

All stockholders are urged to complete, sign, date and return the accompanying proxy card in the enclosed envelope as promptly as possible.

By Order of the Board of Directors

S. Douglas Hutcheson
President and Chief Executive Officer

June 28, 2011

APPENDIX A

DEFINITION OF ADJUSTED OIBDA AND RECONCILIATION TO OPERATING INCOME

Adjusted OIBDA is a non-GAAP financial measure defined as operating income (loss) before depreciation and amortization, adjusted to exclude the effects of: gain/(loss) on sale/disposal of assets; impairment of assets; and share-based compensation expense. Adjusted OIBDA should not be construed as an alternative to operating income (loss) or net income as determined in accordance with GAAP, or as an alternative to cash flows from operating activities as determined in accordance with GAAP or as a measure of liquidity.

In a capital-intensive industry such as wireless telecommunications, management believes that adjusted OIBDA, and the associated percentage margin calculations, are meaningful measures of our operating performance. We use adjusted OIBDA as a supplemental performance measure because management believes it facilitates comparisons of our operating performance from period to period and comparisons of our operating performance to that of other companies by backing out potential differences caused by the age and book depreciation of fixed assets (affecting relative depreciation expenses) as well as the items described above for which additional adjustments were made. While depreciation and amortization are considered operating costs under generally accepted accounting principles, these expenses primarily represent the non-cash current period allocation of costs associated with long-lived assets acquired or constructed in prior periods. Because adjusted OIBDA facilitates internal comparisons of our historical operating performance, management also uses this metric for business planning purposes and to measure our performance relative to that of our competitors. In addition, we believe that adjusted OIBDA and similar measures are widely used by investors, financial analysts and credit rating agencies as measures of our financial performance over time and to compare our financial performance with that of other companies in our industry.

Adjusted OIBDA has limitations as an analytical tool, and should not be considered in isolation or as a substitute for analysis of our results as reported under GAAP. Some of these limitations include:

- it does not reflect capital expenditures;
- although it does not include depreciation and amortization, the assets being depreciated and amortized will often have to be replaced in the future and adjusted OIBDA does not reflect cash requirements for such replacements;
- it does not reflect costs associated with share-based awards exchanged for employee services;
- it does not reflect the interest expense necessary to service interest or principal payments on current or future indebtedness;
- it does not reflect expenses incurred for the payment of income taxes and other taxes; and
- other companies, including companies in our industry, may calculate this measure differently than we do, limiting its usefulness as a comparative measure.

Management understands these limitations and considers adjusted OIBDA as a financial performance measure that supplements but does not replace the information provided to management by our GAAP results.

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The following table reconciles adjusted OIBDA to operating income (loss), which we consider to be the most directly comparable GAAP financial measure to adjusted OIBDA (in thousands):

	Year Ended December 31, 2009	Year Ended December 31, 2010
Operating income (loss)	$ 31,124	$ (450,738)
Plus depreciation and amortization	410,697	457,035
OIBDA	$ 441,821	$ 6,297
Plus loss on sale or disposal of assets	418	5,061
Plus impairment of assets	639	477,327
Plus share-based compensation expense	42,713	36,609
Adjusted OIBDA	$ 485,591	$ 525,294

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LEAP WIRELESS INTERNATIONAL, INC.
Annual Meeting of Stockholders - July 28, 2011
THIS PROXY IS SOLICITED BY THE BOARD OF DIRECTORS OF THE COMPANY

The undersigned, revoking any proxies previously given, hereby appoints S. Douglas Hutcheson, Walter Z. Berger and Robert J. Irving, Jr., and each of them, with power to act without the other and with power of substitution, as proxies and attorneys-in-fact and hereby authorizes them to represent and vote, as directed herein, all the shares of Leap Wireless International, Inc. (the Company) Common Stock which the undersigned is entitled to vote, and, in their discretion, to vote upon such other business as may properly come before the Annual Meeting of Stockholders of the Company to be held July 28, 2011 at 8:30 a.m Eastern Daylight Time or at any continuation, adjournment or postponement thereof, with all powers which the undersigned would possess if present at the Annual Meeting.

This proxy will be voted as specified herein and, unless otherwise directed, will be voted FOR ALL the nominees for director listed in Proposal 1, FOR Proposal 2, FOR 1 year on Proposal 3, and FOR Proposals 4 and 5.

YOUR VOTE IS VERY IMPORTANT - PLEASE VOTE TODAY.

(CONTINUED AND TO BE SIGNED AND DATED ON THE REVERSE SIDE.)

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YOUR VOTE IS IMPORTANT

Please take a moment now to vote your shares of Leap Wireless International, Inc.
Common Stock for the upcoming Annual Meeting of Stockholders.

PLEASE REVIEW THE PROXY STATEMENT AND VOTE TODAY IN ONE OF THREE WAYS:

1. **Vote by Telephone** Please call toll-free in the U.S. or Canada at **1-866-825-8782,** on a touch-tone phone. If outside the U.S. or Canada, call **1-215-521-1341**. Please follow the simple instructions. You will be required to provide the unique control number printed below.

OR

2. **Vote by Internet** Please access *proxy.leapwireless.com*, and follow the simple instructions. Please note you must type an s after http. You will be required to provide the unique control number printed below.

You may vote by telephone or Internet 24 hours a day, 7 days a week. Your telephone or Internet vote authorizes the named proxies to vote your shares in the same manner as if you had marked, signed and returned a proxy card.

OR

3. **Vote by Mail** If you do not wish to vote by telephone or over the Internet, please complete, sign, date and return the proxy card in the envelope provided, or mail to: **Leap Wireless International, Inc., c/o Innisfree M&A Incorporated, FDR Station, P.O. Box 5155, New York, NY 10150-5155.**

6 **TO VOTE BY MAIL, PLEASE DETACH PROXY CARD HERE, AND SIGN, DATE AND RETURN IN THE POSTAGE-PAID ENVELOPE PROVIDED** 6

x

Please mark your vote as in this example

The Board of Directors recommends a vote FOR ALL the nominees for director listed in Proposal 1, FOR Proposal 2, FOR 1 year on Proposal 3, and FOR Proposals 4 and 5.

		FOR ALL	WITHHOLD FROM ALL	FOR ALL, WITH EXCEPTIONS
1. (01) John D. Harkey, Jr.	(05) Robert V. LaPenta	o	o	o
(02) S. Douglas Hutcheson	(06) Mark A. Leavitt			
(03) Ronald J. Kramer	(07) Mark H. Rachesky, M.D.			
(04) Paula Kruger	(08) Michael B. Targoff			

INSTRUCTIONS: To withhold authority to vote for any individual nominee(s) mark the FOR ALL, WITH EXCEPTIONS box and write the number of the excepted nominee(s) in the space below.

	FOR	AGAINST	ABSTAIN
2. Approval on an advisory basis of executive compensation.	o	o	o

	1 YEAR	2 YEARS	3 YEARS	ABSTAIN
3. Approval on an advisory basis of the frequency of conducting future advisory votes on executive compensation.	o	o	o	o

	FOR	AGAINST	ABSTAIN
4. Proposal to approve a stock option exchange program.	o	o	o
	FOR	**AGAINST**	**ABSTAIN**
5. Proposal to ratify the selection of PricewaterhouseCoopers LLP as Leap s independent registered public accounting firm for the fiscal year ending December 31, 2011.	o	o	o

Dated , 2011

Signature(s)

Signature (if held jointly)

Title(s), if any

Please sign exactly as your name(s) appear(s) hereon. When signing as attorney, executor, administrator, or other fiduciary, please give full title as such. Joint owners should each sign personally. If a corporation, please sign in full corporate name, by authorized officer. If a partnership, please sign in partnership name by authorized person.